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The Treasury

Via Email: SustainableFinanceConsultation@treasury.gov.au

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Sustainable Finance Strategy

Thank you for the opportunity to provide a submission to Sustainable Finance Strategy consultation paper.

Australian Retirement Trust (ART) is one of Australia's largest superannuation funds. 2.3 million Australians trust us to take care of over $260 billion of their retirement savings[1].

Effective management of the retirement savings of members requires that ART incorporate the financial implications of environmental, social and governance (ESG) factors into investment processes. We believe this is consistent with a focus on investment outcomes in the long term, as is pursuing appropriate opportunities that emerge from ESG considerations.

We recognise the importance of enhancing our disclosures for our members and other stakeholders and launched our Net Zero 2050 Roadmap in September 2023, which sets out our current approach towards our target of commitment to a net zero greenhouse gas emissions investment portfolio by 2050[2] .

ART welcomes the draft Sustainable Finance Strategy as an important step towards creating a sustainable finance policy architecture to address climate and other sustainability related financial risks and opportunities and to channel capital consistent with a transition to net zero and broader sustainability objectives.

We support the 'key principles' identified in the consultation paper which prioritise inter-operability; ambition; alignment with Australia's net zero commitment; sensible staging of reforms; simplicity and useability; and cross-sector collaboration and shared responsibility.

Additionally, ART supports the proposed approach to focus on climate-related reforms in the near term, while providing a platform to address other sustainability-related issues over time, in particular nature and biodiversity and First Nations' perspectives and outcomes. Whilst we recognise that a 'climate-first' approach is a necessary and pragmatic approach, we believe that nature and biodiversity and First Nations' perspectives should be incorporated as much as possible as the Sustainable Finance Strategy is developed and implemented. Adopting a 'climate-first' approach without appropriate consideration of broader sustainability issues could result in unintended adverse impacts on nature and/ or human rights.

We do note however that implementation of the Sustainable Finance Strategy is likely to require additional regulation, oversight and reporting, all of which have associated costs for the industry. We believe that there are valuable lessons to be learned from how other regions have approached the

1 As at October 2023.
[2] Scope 3 category 15 (investments) emissions. PCAF (2022). The Global GHG Accounting and Reporting Standard Part A: Financed Emissions. Second Edition

implementation of such strategies, so that the increased costs that are required to help ensure effective implementation of the Sustainable Finance Strategy, do not outweigh the benefits.

The Treasury should also consider implications of the Your Future, Your Super (YFYS) Annual Performance Test for superannuation funds. YFYS currently does not recognise sustainability consideration within its benchmarks. Obligations resulting from the Sustainable Finance Strategy, particularly around sustainability product labelling, is likely to create tension with YFYS benchmarks and the ability to meet the YFYS performance test over time. We support further consultation with the superannuation industry to improve the application of the performance test to all superannuation products, including those that are marketed as sustainable.

Another important area of consideration for superannuation funds is liquidity. Many of the required investments in sustainable finance could be within private markets. A system wide approach to managing liquidity constraints within superannuation funds to enable appropriate levels of capital to flow to towards sustainable finance could be a consideration.

The main body of our submission addresses the consultation questions raised by Treasury. ART has provided answers to the consultation questions where we feel we can add most value to Treasury's considerations. We trust this feedback will be beneficial to Treasury and would welcome the opportunity to discuss our submission in further detail.

Chris Ramsay, Senior Manager Policy and Government Relations is the primary Australian Retirement Trust contact regarding our submission and can be contacted at Christopher.Ramsay@art.com.au.

Yours sincerely,

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Sustainable Finance Strategy - Australian Retirement Trust responses

Priority 1: Establish a framework for sustainability-related financial disclosures

- What are the opportunities for Government, regulators and industry to support companies to develop the required skills, resources and capabilities to make climate disclosures under the proposed new obligations?
- How should the Government, regulators and industry prepare for global developments in sustainability-related financial disclosure frameworks and standards, including the TNFD?

ART believes that a lack of skills and capabilities is a key barrier to accelerating the Government's ambition on sustainable finance. This includes a shortage of sustainable finance professionals, as well as climate and sustainability issues not being adequately understood across businesses and government.

Therefore, ART supports the Government facilitating industry initiatives to build a supportive ecosystem for sustainable finance training and professional development, including through initiatives such as skills and capability frameworks and accreditation. Government should also support industry and regulatory bodies to publish guidance on how to meet disclosure requirements.

Priority 2: Develop a Sustainable Finance Taxonomy

- What are the most important policy priorities and use cases for an Australian sustainable finance taxonomy? What are the key insights from international experience to date?
- What are priorities for expanding taxonomy coverage after the initial focus on climate mitigation objectives in key sectors?
- What are appropriate long-term governance arrangements to ensure that the taxonomy is effectively embedded in Australia's financial and regulatory architecture?

ART supports the development of a sustainable finance taxonomy that is fit for purpose for the Australian economy. The key use case of the taxonomy should be to aid transparency for investors (coupled with climate related disclosures) on what constitutes a climate solution or climate transition activity, therefore, helping to direct the flow of capital towards more sustainable outcomes.

A key consideration for investors is having a clear understanding of how the taxonomy will complement and work alongside the other priorities outlined in the Sustainable Finance Strategy (Strategy). In addition, there is a need to ensure the correct sequencing of the various initiatives, such that they are able to be used as and when needed. As one example, the development of the sector emissions reduction pathways should complement and make use of the taxonomy.

Other considerations include:

- The importance of defining 'transition finance'. This is currently a barrier to increasing the flow of capital required to support the net zero transition
- Being based on science
- Ability to evolve over time and be dynamic as the climate transition progresses towards net zero 2050
- Leveraging taxonomies from other jurisdictions to increase inter-operability and pace of implementation

We note that while the Government is adopting a 'climate-first' approach, it has recognised the need to incorporate nature and biodiversity in the Strategy with the intention of aligning financial flows with nature positive outcomes. We support expanding the taxonomy to include nature and biodiversity.

In terms of sector coverage, we note that the initial phase of the Taxonomy Development Project covers the development of climate change mitigation criteria for three priority economic sectors:

i. Electricity and Energy;
ii. Minerals, mining and metals;
iii. Construction and the built environment.

Reflecting the urgency required to support the transition to net zero, we recommend that funding and support be provided to enable the extension of the Taxonomy Development Project to the other three priority sectors (i.e. Manufacturing, Transport and Agriculture & Land) and thereafter to the remaining sectors in the Australian economy.

Once the taxonomy has been developed, it will need to be refreshed and updated on a periodic basis, for example to reflect scientific and technological developments. We suggest that an appropriate regulatory body such as APRA be tasked with the responsibility of overseeing this review process, and that it includes input from relevant technical experts.

Priority 4: Develop a labelling system for investment products marketed as sustainable

- What should be the key considerations for the design of a sustainable investment product labelling regime?
- How can an Australian model build off existing domestic approaches and reflect key developments in other markets?

Product labels are important. Our own research suggests that members are seeking investment option names that provide a simple explanation and which avoid misinterpretation and confusion. In our view there is still a lack of consistency in the use of product labels in the superannuation industry in Australia. We believe that more could be done in this area, so as to provide greater consistency of labelling and reliability of product differentiation.

ART supports the development of a sustainability product labelling scheme to help members choose products that are consistent with their sustainability beliefs. However, we note that existing sustainability themed products cover a wide range of beliefs and approaches to sustainable investment and so the labelling system adopted should be flexible enough to cater for this.

Key considerations include:

- That it applies to all retail, superannuation and investment products (both retail and wholesale)
- The need to acknowledge the heterogeneity of the products and that labelling be flexible enough to account for different approaches to sustainability. This may require more than one category for labelling
- Labelling is focused on the end consumer, using terms that can be easily understood
- Learnings from overseas should be examined, while acknowledging labelling needs to be relevant to the Australian consumer
- Determining the requirement for certification of products labelled “sustainable”
- A review of the Your Future, Your Super annual performance test for member choice superannuation products labelled as "sustainable”.

Further consultation should consider whether labelling should apply to all products, as has occurred in overseas jurisdictions i.e. whether it should be applicable to both sustainable and non-sustainable products.

The consultation paper references international developments in product labelling for investment products that incorporate sustainable considerations. Because some of these are already in operation, there are likely to be some helpful learnings that could be applied to development of the Australian labelling system. However, there does not appear to be a consistent approach across the different regions and so we believe it is likely to be very difficult for Australia to achieve consistency with all of them. This is a complex area and further consultation would be welcomed.

Priority 5: Enhancing market supervision and enforcement

- Are Australia's existing corporations and financial services laws sufficiently flexible to address greenwashing? What are the priorities for addressing greenwashing?
- Is there a case for regulating ESG ratings as financial services?

ART considers that existing corporations and financial services laws are sufficiently flexible to address greenwashing. This view is informed by statements from ASIC, and an understanding that greenwashing is, at heart, misleading or deceptive conduct. We also note the Government's commitment to introduce mandatory climate related financial disclosure requirements in 2024 which may also provide a clear framework for how certain matters of sustainable finance are publicly disclosed.

While existing laws are sufficient to regulate and address such conduct, given the specific regulatory focus that is currently applied to greenwashing (as one type of misleading and deceptive conduct), superannuation funds would benefit from further regulatory guidance in this space.

ASIC Information Sheet 271 (INFO 271) provides useful guidance to assist with the current regulatory framework. As the Government's Sustainable Finance Strategy is implemented through further legislation and/or regulation , additional questions and clarification to complement those questions addressed in INFO 271 can only assist superannuation funds in providing clear and accurate information, helping members and potential members be confident and informed.

Further guidance will also assist superannuation funds to navigate the upcoming mandatory climate related financial disclosure regime in this context, as well as helping to ensure that disclosure requirements can remain clear and align with the proposed approach of the Sustainable Finance Strategy to place Australia as a 'sustainability leader'.

In relation to potentially regulating ESG ratings as financial services, we note that the International Organisation of Securities Commissions published a series of recommendations3 applicable to ESG ratings and data product providers in November 2021. We are supportive of initiatives in line with these recommendations to improve transparency, governance, management of conflicts of interest, and reliability of ESG ratings and data products. We have no view as to whether these initiatives would best fall within the AFS licencing regime.

[3] FR09/2021 Environmental, Social and Governance (ESG) Ratings and Data Products Providers (iosco.org

Priority 7: Addressing data and analytical challenges

- What are the priorities for ensuring that data-related initiatives already underway are tailored to meet the needs of firms and investors?
- What key sustainability data gaps or uncertainties faced by financial institutions in Australia should be prioritised by the CFR?

ART supports the proposal outlined in the consultation paper to have the Council of Financial Regulators conduct a detailed assessment to address key sustainability-related data challenges faced by financial market participants. We also support the scope of the review covering the challenges in obtaining nature-related data and making it more accessible for investors.

We note that whilst the availability of climate-related data has improved significantly, there is still a wide variety of ways that companies report their sustainability outcomes, which can make obtaining the required information difficult. A centralised repository for a set of core sustainability metrics would increase efficiency and comparability.

We would support the establishment of a formal industry group to provide advice on these issues.

Priority 8: Ensuring fit for purpose regulatory frameworks

- Do you agree that existing regulatory and governance frameworks and practices have adapted well to support better integration of sustainability-related issues in financial decision making? Are there barriers or challenges that require further consideration? This may include:
  - Corporate governance obligations, including directors' duties
  - Prudential frameworks and oversight, including in relation to banks and insurers
  - Regulation of the superannuation system and managed investment schemes
- What steps could the Government or regulators take to support effective investor stewardship?

The superannuation system

The Consultation Paper notes that the Government will continue to explore and consult on further changes that improve the sophistication of the Your Future, Your Super (YFYS) performance test. We believe that this is necessary, as the current structure of the performance test is such that it is largely a test of implementation vs. a standard market benchmark used for each asset class. This does create issues for funds that aim to incorporate sustainability considerations into their process and which results in an investible universe that is different to that used in the performance test. This could arise due to the use of exclusions (defined criteria that reflect particular ESG principles); or where there is an intention to allocate capital towards a sub-sector of the broader universe (such as investing in renewable energy infrastructure assets). We therefore support further consultation with the superannuation industry to improve the application of the performance test to all superannuation products, including those that are marketed as sustainable.

We do note however that implementation of the Strategy is likely to require additional regulation, oversight and reporting, all of which have associated costs for the industry. We believe that there are valuable lessons to be learned from how other regions have approached the implementation of such strategies, so that the increased costs that are required to help ensure effective implementation of the Strategy, do not outweigh the benefits.

Stewardship

Additional regulatory guidance to support existing frameworks would be of assistance to investors (including superannuation funds and ultimately, our members) – particularly in relation to stewardship and collaboration. Sustainable finance is an evolving area, with the identification of risks and opportunities from climate change now being accepted, and other environmental, social and governance factors giving rise to further considerations when engaging with investee companies.

In relation to steps the Government or regulators could take to support effective stewardship:

i. we suggest that updated regulatory guidance around collective investor engagement with specific examples concerning ESG-related matters, and clear specifications around what engagement practices are and are not acceptable in this space, may support effective outcomes that both adhere to existing legal requirements and facilitate the encouragement of improved practices by investee entities.
ii. we point to the current regime of director elections for listed companies, which is governed by the ASX Listing Rules. Currently, directors (excluding the Managing Director) generally serve 3-year terms. Whilst we acknowledge the benefits of board stability in this approach, this regime reduces director accountability to shareholders. By contrast, the annual election of directors could facilitate board accountability and responsiveness to shareholders and assist shareholders to exercise more effective investment stewardship,

A handful of ASX listed companies, including BHP Group and Treasury Wine Estates have introduced annual election of directors to no identifiable detriment.

Priority 9: Issuing Australian sovereign green bonds

- What are the key expectations of the market around issuance of, and reporting against, sovereign green bonds? What lessons can be learned from comparable schemes in other jurisdictions?
- What other measures can the Government take to support the continued development of green capital markets in Australia?

ART supports the development of an Australian sovereign green bond market. A well functioning market could provide potential investment opportunities for superannuation funds.

Market participants will need to have confidence in the functioning of the green bond market before investing. ART considers that this will require:

- a long term commitment to issuance of green bonds;
- an indication of the aspirational weight of green bonds within the Government bond market;
- indicative annual issuance plans (volume and maturity);
- a broad secondary market dealing panel;
- inclusion in recognised market indices (such as the MSCI Green Bond Index); and
- issuer framework and reporting consistent with recognised global guidelines (such as the ICMA guidelines).

Comparable schemes exist in many other sovereigns and some lessons could be learnt from the experience in France and Germany. In particular, it would be worthwhile the Australian Office of Financial Management considering whether green bonds should have the same or different maturity to existing bonds. Sovereign green bonds in Germany are issued to the same maturity date as traditional bonds, which may assist increase liquidity in the green bonds.

Priority 12: Position Australia as a global sustainability leader

- What are other key near-term opportunities for Australia to position itself as a global leader in sustainable finance and global climate mitigation and adaptation?
- What are some longer-term international sustainability goals for Australia where sustainable finance can play a role?
- What are the key market, regulatory and institutional barriers to increasing private sector engagement in blended financing opportunities? How can these barriers be overcome?
- What are other means to mobilise private sector finance toward sustainability solutions in the Indo-Pacific region?

ART acknowledges that superannuation funds are required to manage liquidity. Many of these investments, and those in sustainable finance generally, could be in the private market space and potentially deeply illiquid. Whilst there is a desire to increase investment in sustainable finance, and explore blended finance, liquidity constraints could prevent the substantial channelling of capital flows into this area. Consideration could be given to ideas such as centralised system of liquidity pools and liquidity window provisions to manage this constraint.