# SUSTAINABLE FINANCE SUBMISSION

IMPACT CLUB

Changing the Future

## Introduction

Impact Club Ltd is Australia's first impact investing network created specifically for sophisticated investors who are using their investment capital to make investments that create positive social and environmental impact. Impact Club Ltd is a membership-based, non-profit organisation, whose mission is to increase the investment capital deployed to create positive social and environmental impact.

As Australia's leading impact investment network for high-net-worth impact investors, family offices and foundations, our members are comprised of nearly 70 memberships and 120 associated investors. The Club is broadly in support of the Sustainable Finance Strategy and have offered insights from their unique perspective as impact investors with knowledge across multiple asset classes and finance structures.

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**PREPARED FOR**

Australian Government
Treasury Department

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**Background**

The Australian Government has identified that Australia's transition to net zero will require a significant amount of private and public investment. It is important that financial markets are well placed to finance this transition and therefore support the Government's emissions reductions target. To advance these finance initiatives, the Australian Government has proposed a Sustainable Finance Strategy with the intention of mobilising the private investment needed in coming decades. The Strategy recognises that markets are increasingly focussed on sustainability issues that extend beyond climate change but does not address these areas specifically.

To assist the Government regarding the specific questions raised in this draft of the Sustainable Finance strategy paper, and to provide some context for the broader impact landscape the Impact Club has collated a variety of responses from impact investors from within the network.

**Pillar 1: Improve transparency on climate and sustainability**

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

To assist companies in meeting these new obligations, collaboration among the government, regulators, and industry is vital. This collaboration should prioritise the swift adaptation of AI and technology for measuring impacts. Regulatory frameworks must be flexible and adaptive to keep pace with technological advancements. To address global developments in sustainability disclosure frameworks, preparation involves international cooperation by the Government, regulators, and industry. Transparent governance structures should be established to oversee the formulation and adoption of standards, potentially through industry-specific panels. To address impact finance comprehensively, a specialised department within the Treasury should adopt a systemic change approach. This proactive stance ensures readiness for evolving global standards and fosters effective collaboration among stakeholders.

*Priority 2: Develop a Sustainable Finance Taxonomy*

To determine policy priorities for an Australian sustainable finance taxonomy, it is crucial to distinguish between mere alignment and genuine sustainability. Initial focus should centre on climate resilience, clean energy, water efficiency, circular economies, aligning with Sustainable Development Goals (SDG)s and the EU Taxonomy. The taxonomy's structure should be flexible, accommodating evolving standards. Allowing for tolerances is essential when considering transitioning economies. Use cases include guiding investments, risk assessments, consumer awareness, regulatory informatics, market development, and fostering innovation. Expanding coverage post-climate focus involves social sustainability, biodiversity, ecosystem services, valuing natural capital, cross-sectoral integration, and addressing human rights. Technological advances and adaptability to disruptions are key considerations. Long-term governance requires clear leadership, cross-industry collaboration, transparency, coordination with regulatory bodies, and alignment with international standards. Compliance incentives are vital, as voluntary reporting may lack consistency. Mandatory, enforceable standards are essential for meaningful climate change mitigation.

*Priority 3: Support credible net zero transition planning*

Australia faces notable gaps in capability and practice compared to 'gold standard' approaches like the Transition Pathway Initiative (TPI). A lack of consistent bipartisan commitment to climate change hampers comprehensive strategies. Detailed, long-term roadmaps for businesses and trading partners are absent, hindering alignment with sustainable practices. Inadequate scenario analysis planning for businesses regarding climate mitigation and low-carbon transitions is another critical gap.

The Super Performance Test, as currently structured, impedes sustainable and impact investment approaches by discouraging innovation. A transformative step would be incorporating benchmarks within the Your Future, Your Super (YFYS) performance test that genuinely reflect net-zero emissions pathways.

ISSB-aligned corporate disclosure improves transparency, but current plans lack depth. In the medium term, additional transition disclosure requirements should incorporate sustainability preferences, aligning with investor expectations and directing capital toward ethical investments.

The goal should be to move beyond sustainability to embrace regenerative and circular approaches. Regenerative practices actively restore environmental well-being, while circular practices minimise waste and maximise resource lifespan. Australia should prioritise a comprehensive perspective, incorporating these principles into target setting and transition planning for a more effective and resilient relationship with nature.

*Priority 4: Develop a labelling system for investment products marketed as sustainable*
Designing a sustainable investment product labelling regime for Australia requires drawing from global leaders like the CFA Institute, Global Sustainable Investment Alliance (GSIA), and Principles for Responsible Investment (PRI) to incorporate robust practices and impact assessments. Prioritising consumer and industry education is crucial for widespread adoption and effective implementation, aligning with global sustainable finance advancements. To address greenwashing, Australia's existing laws provide a foundation, but increased flexibility is essential. Addressing this challenge requires legal and regulatory enhancements, investor education, and market-driven mechanisms to ensure adaptability and combat deceptive practices effectively. Whistleblower reform should also address proper protection to encourage internal oversight of organisation governance.

Regulating Environmental, Social, and Governance (ESG) ratings as financial services is compelling to guarantee accuracy and transparency. This proactive measure aligns ESG ratings with high standards, fostering investor confidence and contributing to financial system stability.

To respond to systemic sustainability-related risks, grassroots education and training within impact and finance sectors are crucial. Establishing a Sustainable Unit Cost Database, aligning with global reporting frameworks (see footnotes), and expanding Australian Prudential Regulation Authority (APRA)'s Climate Vulnerability Assessment beyond major banks are key initiatives to enhance market-wide understanding of sustainability risks. This will ensure a dynamic overview of financial implications associated with sustainability-related risks, contributing to a comprehensive understanding across diverse sectors and the entire economy.

**Pillar 2: Financial system capabilities**

*Priority 5: Enhancing market supervision and enforcement.*
Australia's current corporations and financial services laws, while foundational, lack the necessary flexibility and robustness to effectively combat greenwashing. Addressing this challenge requires a multifaceted strategy, involving legal enhancements, regulatory measures, investor education, and market discipline. Prioritising adaptability and effectiveness in existing laws is crucial, along with educating investors on distinguishing genuine sustainability efforts from deceptive claims. Market-driven mechanisms enforcing transparency and accountability are essential for combating greenwashing effectively, aiming to strengthen the legal and regulatory landscape and foster a vigilant investment community.

Regulating ESG ratings as financial services is imperative. ESG ratings' significant impact on financial markets necessitates regulation to ensure accuracy, transparency, and credibility. By implementing regulatory measures, Australia can proactively address growing concerns, align ESG ratings with high standards, protect investors, and contribute to overall financial system stability and credibility.

*Priority 6: Identifying and responding to potential systemic financial risks*
APRA spearheads the Council of Financial Regulators (CFR) Climate Working Group's response to climate-related financial risks. Future efforts, led by APRA, should expand on climate and sustainability risks, enhancing risk management capabilities. This includes a Climate Vulnerability Assessment focused on the household insurance sector.

***International Reporting Frameworks**
Global Reporting Initiative (GRI)
Sustainability Accounting Standards Board (SASB)
Task Force on Climate-related Financial Disclosures (TCFD)

To boost market-wide understanding of systemic sustainability risks, government and regulators can support grassroots education, especially within impact and finance sectors. Initiatives such as establishing a Sustainable Unit Cost Database, aligned with established global frameworks, can centralise cost estimates and standardise reporting practices, providing a dynamic overview of sustainability-related risks. Expanding APRA's 2022 Climate Vulnerability Assessment beyond major banks to illustrate systemic changes from climate change in Australia's economy is crucial for a comprehensive understanding across various sectors.

*Priority 7: Addressing data and analytical challenges*
Data and analytical challenges require tailoring initiatives to meet firms and investors' needs. Key priorities should include substantial investments in data collection, standardised reporting tools, and technology infrastructure for streamlined sustainability data management. Shifting reporting focus from activities to outcomes is crucial, demanding firms disclose the actual impact of sustainability efforts. Capacity building for Impact Weighted Accounting practices is essential to measure and account for social and environmental impact comprehensively, enhancing transparency in sustainability reporting.

For the CFR, addressing biodiversity data gaps is urgent, considering its complexity and challenges in incorporation into simplistic metrics. The underwhelming efficacy of biodiversity offsets necessitates a reframing, with emerging positive outcomes from intricate transformation and systems capital investment approaches. Prioritising these sophisticated strategies is crucial for comprehensive and effective sustainability data coverage in the financial sector.

*Priority 8: Ensuring fit for purpose regulatory frameworks*
The existing regulatory and governance frameworks have not adequately adapted to facilitate the seamless integration of sustainability-related issues into financial decision-making. A prime example is the conflicting requirements faced by superannuation trustee directors, mandated to prioritise members' best financial interests (MBFI) but constrained by the YFYS performance test settings, which incentivise short-term focus and investments in high-emission industries, exacerbating climate-related financial risks.

Barriers include the lack of explicit acknowledgment of climate-related financial risks in MBFI duties, hindering effective decision-making in superannuation. To address this, corporate governance obligations, including directors' duties, should align with sustainability and climate risk, ensuring resilience in the financial system.

To support effective investor stewardship, the government and regulators should focus on ESG integration, transparency in research, and data availability. Education initiatives are crucial for enhancing responsible investment practices. Robust enforcement mechanisms and accountability measures, along with encouraging participation in collaborative initiatives like the Principles for Responsible Investment (PRI), will further promote effective investor stewardship.

**Pillar 3: Australian Government leadership and engagement**

*Priority 9: Issuing Australian sovereign green bonds*
Market expectations for sovereign green bonds centre on transparency and comprehensive reporting, emphasising evolving structures covering a broad range of impact metrics, including SDGs. The market anticipates standardised reporting detailing environmental impact and ongoing project progress to ensure accountability and alignment with sustainability goals.

Lessons from comparable schemes highlight the importance of flexible frameworks, like the Green Bond Principles, fostering credibility and attracting diverse investors. Adapting to market dynamics is crucial for these principles to remain effective and relevant internationally. Success in other jurisdictions emphasises the need for effective standards transcending borders and engaging diverse stakeholders for a comprehensive market understanding.

To further develop green capital markets, the government can provide grants and subsidies for green and social incentives, establish a central outcomes fund, encourage stakeholder engagement, and support intermediaries, impact organisations, and public-private partnerships. Collaboration between philanthropic initiatives and incentivising endowment use can enhance sustainable finance. Establishing ministerial oversight and expert roundtables would shape program design and implementation effectively.

*Priority 10: Catalysing sustainable finance flows and markets*
The Clean Energy Finance Corporation (CEFC) faces barriers such as limited awareness, risk perception challenges, evolving policy frameworks, and concerns related to social and greenwashing. However, there are notable opportunities for the CEFC in supporting financing and market development with significant climate co-benefits, particularly in nature and biodiversity. These opportunities lie in emphasising whole-system benefits that extend beyond sustainability, promoting innovations and technology, exploring blended finance models through public-private partnerships, and implementing education and awareness programs. By capitalising on these opportunities, the CEFC can play a pivotal role in driving positive outcomes for both people and the planet.

*Priority 11: Promoting international alignment*
While global partners have moved forward, Australia has been slow to position itself as a global leader in sustainable finance and climate mitigation and adaptation. Despite being one of the world's largest pools of pension capital, the superannuation sector's potential remains largely untapped. Refining the YFYS performance test can redirect capital toward sectors crucial for achieving net-zero targets. Decisive action is needed to harness its potential in sustainable finance.

In contributing to longer-term international sustainability goals, Australia can use sustainable finance to invest in biodiversity conservation, regenerative agricultural practices, and circular economy initiatives. These investments align with global objectives, promoting environmental preservation, food security, and responsible resource utilisation.

To overcome barriers to private sector engagement in blended financing opportunities, Australia needs consistent strategies, clear standards, and support for intermediaries. Collaboration, long-term commitments, and the development of a common language within the sector are crucial for effective blended financing. Government must play a pivotal role in the harmonising the approach of the finance sector across industries and asset classes.

Mobilising private sector finance in the Indo-Pacific region requires government incentives, subsidies, and regulatory support. Establishing a mechanism for major institutions to contribute to climate risk insurance through impact reporting can encourage their active engagement in supporting sustainability initiatives in the region. This structured framework ties financial contributions to specific climate risk mitigation outcomes, promoting private sector involvement in sustainable solutions.

**Summary**
The government's Sustainable Finance draft strategy demonstrates a commendable commitment to aligning Australia with international standards. Emphasising flexibility for broader environmental considerations and future social/cultural metrics, coupled with ongoing industry expert engagement, will provide a forward-looking approach. The strategy should include education, regulatory frameworks, whistleblower reform and compliance measures to effectively address the risk of greenwashing. Acknowledging the pivotal role of institutional finance, including banks and superannuation, underscores the government's understanding of diverse economic levers required to support and drive sustainable finance. This holistic and adaptive approach positions the government's efforts as comprehensive in fostering a resilient and responsible financial ecosystem.

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