UNSW
Institute for Climate
Risk & Response

1 December 2023

Sustainable Finance Unit
Climate and Energy Division
Treasury
Langton Cres
Parkes ACT 2600
By email

Dear colleagues

Thank you for the opportunity to provide a submission to the Commonwealth Treasury on the government's:

Sustainable Finance Strategy

Preliminary

By way of introduction, I am an Associate Professor at UNSW Sydney in the Faculty of Law and Justice. I am also Deputy Director of the UNSW Institute for Climate Risk and Response, a multi-Faculty initiative of the university designed to promote, draw together and deliver research related to how individuals, companies, regulators and governments ought to respond to the opportunities and challenges of climate change. I am also retained on a part-time basis as an External Consultant by Herbert Smith Freehills.

Prior to entering academia in 2010, I worked for ipac (1986-1994) and Frank Russell Company (now Russell Investment Group) (1994-2009). Much of that time was spent actively involved in advising institutional investors such as superannuation funds and insurance companies, and their stakeholders, on governance and investment matters.

The views expressed in this submission are informed by my experience and research, but they are my own and ought not be taken to reflect the views of UNSW or Herbert Smith Freehills, nor any of their clients, employees or associates. I make this submission not on anyone's behalf or at anyone's instruction.

Submission

I wish to comment on the invitations in the Consultation Paper to identify:

- 'related priorities and opportunities for supporting enhanced target setting and transition planning for nature and other sustainability issues' (page 19); and
- '[steps] the Government or regulators [could take] to support effective investor stewardship' (page 30).

The trustees of Australia's superannuation funds are responsible collectively for the investment of the largest pool of patient capital in Australia. They are required by law to exercise their investment powers in the best financial interests of the members of the funds they administer. That is proper. One of the reasons that the law of trusts was chosen in 1993 as the preferred legal architecture for the Superannuation Guarantee-fuelled superannuation system was the intense focus the law of trusts requires trustees to maintain on the needs and objectives of the persons they serve. Relevantly in the current context, the trustees are also required to act carefully, skilfully and diligently and to give priority to the interests of members.[1] They are also required to formulate, review regularly and give effect to an investment strategy for the fund and for each investment option offered within that fund.[2] In complying with that latter duty they are required to have regard to an inclusive set of factors, including risk, return, diversification, liquidity, the availability of reliable valuation information, tax, costs and 'any other relevant matters'.

I recommend that the list of factors in section 52(6) of the *SIS Act* to which a superannuation trustee must have regard be amended to include expressly the 'financial impact on the entity of climate and environmental risks'.[3]

I believe that this will remove any hint of ambiguity about whether the trustees of superannuation funds ought to have regard for such matters in the formulation of their investment strategies, including any perception that attention to climate change is inconsistent either with the sole purpose test (section 62 of the *SIS Act*) or the best financial interests duty (section 52(2)(c) of the *SIS Act*). Importantly, it does so without impinging upon the longstanding practice of government in Australia of not directing the trustees of superannuation funds to invest in particular ways or in specific assets.

1 Section 52(2) of the *Superannuation Industry Supervision Act 1993* (Cth) ('*SIS Act*').
2 Section 52(6) of the *SIS Act*.
3 Superannuation funds are termed 'entities' in the *SIS Act*.

Several aspects of this recommendation deserve elaboration:

- **Salience and enforceability**. It is certainly the case that the trustees of Australian superannuation funds can have regard to the expected financial impact of climate and environmental risks on the investment portfolios they administer under the legislation as currently drafted,[4] whether because they are implicitly considered under the broader rubric of 'risk' in section 52(6)(a)(i) or as a result of the catch-all provision in section 52(6)(a)(viii). However, including items specifically on the list expressly draws attention to them.[5] As Donald Duval, one of the key architects of the *SIS Act* in 1993, has noted, much of the work that the covenants in section 52 do is to make express in statutory form what would otherwise be implicit in the law of trusts.[6] It is also the case that the introduction of the civil penalty regime in section 54B of the *SIS Act* has made these obligations more easily enforced by APRA and ASIC. I believe that the importance of ensuring that the trustees of superannuation funds consider carefully the threats posed by climate change, and be held accountable if they do not, justifies express inclusion in the list of factors in the covenant in section 52(6) of the *SIS Act*.
- **Open texture**. One of the strengths of the regulatory regime shaping the superannuation system is that it engages with the system in a nuanced way. Certain things are prohibited; others are required. The covenant in section 52(6) of the *SIS Act* regulating trustee decision-making in the investment sphere occupies a middle ground – it requires consideration of certain factors but does not mandate specific actions. This permits, indeed requires, that the trustee consider how the various factors relate to the unique circumstances of the fund for which it is responsible. It also does not dictate any particular investment approach, an 'open-textured' stance that permits trustees to implement a bespoke investment strategy tailored to their fund but also, crucially from a systemic perspective, accommodates innovation and diversity. Innovation and diversity will be, in my opinion, crucial for the efficient and resilient development of the system over coming decades.
- **Focus on risk, not opportunities**. Climate change has created, and will continue to create, opportunities for profitable investment as well as risks. There is however less need to emphasise the need for trustees to consider the opportunities because the pursuit of investment performance already provides impetus for that. That said, the inclusion of a reference to the opportunities arising from climate change would not undermine the main thrust of the covenant I am recommending.

---

4 See for instance N C Hutley and J E Mack, 'Memorandum of Opinion. Superannuation Trustee Duties and Climate Change' (16 February 2021), available at equitygenerationlawyers.com/wp/wp-content/uploads/2021/04/Hutley-SC-Mack-Superannuation-Trustee-Duties-and-Climate-Change-Memo-2021.pdf. Also M Scott Donald, 'Modern challenges to the prudence expected of pension fund trustees' (2022) 33 *Kings Law Journal* 92; Olivia Kilponen 'An Inconvenient Covenant: How Climate Risks Are Transforming Australian Superannuation Trustees' Liability under Statutory Covenants' (2021) 38 *Environmental and Planning Law Journal* 55; Sarah Barker, Mark Baker-Jones, Emilie Barton and Emma Fagan 'Climate change and the fiduciary duties of pension fund trustees–lessons from the Australian law' (2016) 6(3) *Journal of Sustainable Finance and Investment* 211.

5 As for instance with the inclusion of sub-paragraphs (iv), (vi) and (vii) in section 52(6)(a) in 2012.

6 Donald Duval, 'The Objectives of the Superannuation Supervisory Legislation' in M. Scott Donald and Lisa Butler Beatty, *The Evolving Role of Trust in Superannuation*, (Federation Press, 2017), 15.

- **International comparisons.** Governmental and regulator attention to the financial dimensions of climate risk in the occupational pensions has increased markedly over the past decade in jurisdictions across the world, including the United States (especially ERISA), United Kingdom and European Union. Australia is recognised as having one of the world's most sophisticated and well governed occupational (superannuation) systems.[7] A carefully calibrated response to the existential challenge posed by climate change, such as that recommended here, will be crucial to maintaining that global leadership.

Consistent with the guidance you have provided, I have attempted to advance this recommendation succinctly. I would be happy to elaborate further on any of the information or ideas presented here at your convenience.

Yours sincerely

M Scott Donald PhD CFA
Associate Professor, UNSW Law and Justice
Deputy Director, UNSW Institute for Climate Risk and Response
UNSW Sydney

7 Mercer CFA Institute Global Pension Index 2023, available at mercer.com/insights/investments/market-outlook-and-trends/mercer-cfa-global-pension-index/.