1 December 2023

Sent to: sustainablefinanceconsultation@treasury.gov.au

Sustainable Finance Unit
Climate and Energy Division
Treasury
Langton Crescent
PARKES ACT 2600

Thank you for the opportunity to comment on the *Sustainable Finance Strategy Consultation Paper* of November 2023.

JANA supports the objective of improving transparency and consistency across the industry. There are some additional areas we have identified for Treasury's consideration.

We would be delighted to discuss further any items covered in this consultation response.

JANA Contact Details

Any questions regarding this submission can be directed to Suzy Yoon (suzy.yoon@jana.com.au) and the Sustainability Team (sustainability@jana.com.au) at JANA Investment Advisers Pty Ltd.

About JANA Investment Advisers

JANA Investment Advisers was established in 1987 and is Australia's leading and largest investment advisory and research firm. For 35 years, we have provided advice to our clients, rooted in our depth of talent, global research, deep insight, and innovative thinking.

Today, we have grown to over 140 staff members, with $1.3tn in funds under advice. A management-owned asset consultancy, JANA advises over 80 institutional clients across superannuation funds, universities, foundations, endowments, charitable trusts, insurers, corporate clients, long-service leave funds and family offices. JANA-advised clients have a history of outperforming both their internal benchmarks and peers.

At JANA, we believe that together with our clients, we can make a meaningful positive difference to the lives of millions of everyday people directly or indirectly impacted by the advice we provide. We understand that the immense challenges to our physical and social environments are everyone’s responsibility to solve, and JANA will play its part. Together, we believe we can make a substantial and meaningful contribution to our clients, their beneficiaries, and our society.

General Comments

In the time allocated, we have prioritised our responses, but we would be happy to comment further on other areas should we be requested to or we can elaborate further on the responses below.

The Strategy has been described as 'high ambition', and we believe the following considerations will support this to be a genuinely high ambition Strategy:

- **Take a systems-level approach**: We do not believe a 'climate first' approach aligns well with a 'high ambition' approach and have seen some negative consequences from a climate-first focus. We recommend a systems-level approach is undertaken - one that incorporates broader environmental and social issues concurrently. We already see evidence of the climate-first approach negatively impacting other sustainability issues, such as communities, biodiversity and water scarcity. The proposed 'staging' of nature-related priorities over time puts Australia at risk of causing irrevocable harm in its quest for climate action.
- **Do no significant harm (DNSH)**: It is imperative to take this approach, and we believe this needs to be clearly defined. We need to ensure it is well monitored and enforced and does not lead to a situation where harm that is not ‘significant’ is acceptable.
- **Policy support**: Mobilising private sector investment in emissions reduction is clearly an essential part of the Strategy, but the Strategy itself would benefit from some context on how Government priorities and policies will complement the mobilisation of private sector investment, particularly given critical bottlenecks like poles and wire infrastructure. We believe there is ample private sector capital that can be allocated to support the transition to net zero and broader sustainable outcomes; it just requires appropriate policy support. Allocating to sustainable investments and supporting the transition requires patient capital, and we expect the Government to create an environment that supports this. It needs to be clear how all these priorities will support the flow of capital to sustainable outcomes and the achievement of other fiduciary obligations.

Pillar 1: Improve transparency on climate and sustainability

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 the priorities for expanding taxonomy coverage after the initial focus on climate mitigation objectives in key sectors?

JANA believes it is important to have a sustainable finance taxonomy that clearly defines what assets support the transition to net zero and other sustainability goals.

Asset owners committed to net zero would benefit significantly from clarity on what is considered a climate/transition solution, as many have established interim targets that include an allocation to such investments. Providing a taxonomy that supports their underlying investments will guard these asset owners from *greenwashing* allegations and support the allocation of this private capital to areas supporting Australia's mission to transition to net zero.

In developing the taxonomy, priority should be given to the areas that require further investment to support the transition to net zero ('brown to green'), and not limiting it only to 'green' investments. This focus should take a systems-level lens, which takes into consideration other environmental considerations (e.g., biodiversity and water) and social considerations (e.g., just transition and First Nations communities), ultimately supporting the efficient allocation of resources to the areas that will support the transition.

The Taxonomy is focused on climate financing, and while it does address other sustainability factors through its 'do no significant harm (DNSH)' approach (i.e., you must show you meet the criteria for sustainable activities (climate focused), *and* you must also do no harm to other aspects of sustainability), it does not avoid the limitation of defining 'sustainable activities' as only those related to climate. The taxonomy on defining natural capital and/or what supports biodiversity objectives should be considered urgently, with the 23 targets for 2030 of the Kunming-Montreal Global Biodiversity Framework given priority.

The EU Taxonomy has six environmental objectives, of which climate change mitigation is the first. It appears that the Australian taxonomy will seek to focus on this initial pillar, but there is no indication of whether other pillars will also be considered. We believe the EU Taxonomy is a robust approach given it had the six objectives (related to climate, water, biodiversity, etc.) since its creation, and companies/projects must further one objective and do no significant harm to others. We believe there are efficiencies in adopting a similar approach in Australia. The base framework should include broader environmental and social matters so that when each pillar is developed (assuming the building block approach), other pillars are also considered. Taking this broader systems-level approach from the outset is more ambitious.

However, there has been some criticism concerning the depth of detail (potentially being too prescriptive) of the EU Taxonomy and the complexity it has caused. We have seen that political views have also mired the EU experience, which has caused confusion and not necessarily led to greater clarity for investors and end users. Hence, we propose that the architects of the Taxonomy take a simpler and broader approach to allow for more straightforward and quicker implementation.

Priority 3: Support credible net zero transition planning

What are key gaps in Australian capability and practice, including relative to 'gold standard' approaches to transition planning developed through the TPT and other frameworks?

JANA supports the proposed approach to be informed by emerging international standards and practice. We suggest expediting this priority, as it will provide guidance on what should be disclosed (Priority 1). Per our previous comment, asset owners will benefit substantially from consistent definitions and disclosures concerning corporate transition plans.

In addition to disclosing information about climate-related targets, progress towards these targets and any mitigation strategies, we suggest the level of risk management required is also disclosed as part of transition plans and sustainability reporting (Priority 1).

We note the dominant focus on disclosing 'opportunities and risks', with loose wording around disclosing 'any mitigation strategies' rather than an obligation to disclose mitigation strategies for each risk disclosed. We believe that such an approach can be subject to loopholes, allowing companies to provide a general or potentially greenwashed summary of risk mitigation rather than demonstrating how each key risk will be mitigated throughout the transition period.

Again, the focus on climate-related disclosures in isolation also leaves risk on the table in terms of the impact of the transition on other factors. For example, water scarcity in Australia will have significant financial ramifications across multiple sectors. This issue could be captured by assessing physical climate risks, but it is currently absent in this Strategy or the Australian Sustainability Reporting Standards (ASRS).

To what extent will ISSB-aligned corporate disclosure requirements improve the transparency and credibility of corporate transition planning? What additional transition disclosure requirements or guidance would be most useful in the medium-term?

Building off the initial ASRS metrics, the following additional categories will help improve the transparency of transition plans:

- Renewable energy usage and plans to use/pay for renewable energy.
- Planned capex that aligns with or supports the transition plan or emissions reduction activity.
- Net zero targets.
- Assessment and quantification of potential stranded asset risk - value at risk (dollars).

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?

Should a sustainable investment product labelling regime be established, clear readability and understandability for retail investors and a clear definition of 'sustainable' will be essential. We suggest that labelling takes a broader systems lens rather than the 'climate first' approach outlined in the Strategy, aligning with the broader taxonomy to support the transition to net zero.

The learnings from the implementation of the European SFDR and the UK FCA's approach (where the focus was on the end user) should be considered when developing Australia's product labelling regime. Global interoperability will also be of benefit to the labelling regime.

Pillar 2: Financial system capabilities

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 Council of Financial Regulators (CFR)?

We believe a priority is ensuring clarification of definitions and a common language on what constitutes sustainable investment activities. A common language will help with data analytics to support effective corporate risk disclosure and inform financial decision-making. We also believe it is essential that any data initiatives encompass not just climate-related metrics but broader environmental and social metrics (where relevant and useful).

Currently, the Your Future Your Super (YFYS) regulation forces users to purchase a particular vendor's product. We caution that such an outcome be avoided in relation to sustainability data requirements. Users should be able to choose from a panel of providers, to avoid monopolistic behaviours.

Data collection is often resource (time and money) intensive and not utilised effectively, so we should be discriminating on what data is required. The CFR should prioritise actual performance against sustainability targets and managing disclosed climate or sustainability risks.

We believe estimating Scope 3 emissions is challenging and question the benefits relative to the costs of estimating and capturing the data. Australia relies heavily on commodities exports, of which fossil fuels (including liquified natural gas) are a significant component. We note that the inclusion of Scope 3 country emissions within the reporting framework for Australia as a country, could have a significant difference towards the acceptance and adoption of Australia’s export finance.

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

Given JANA's extensive work on this topic, our response to this question focuses on the YFYS Performance Test. We first deal with some of the observed related issues regarding YFYS before providing possible solutions.

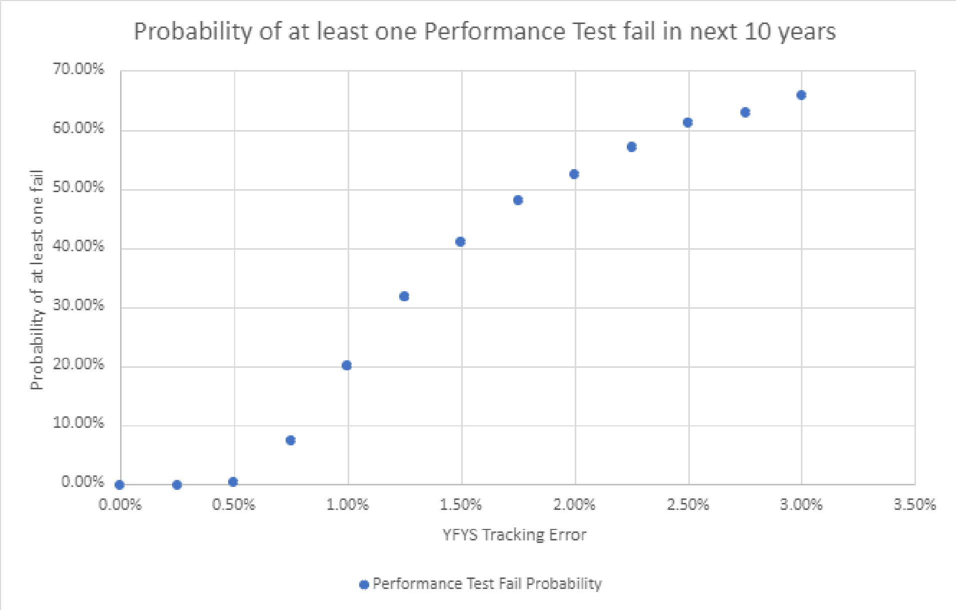
Many investors consider sustainability and climate-related risks and opportunities as part of their investment approach. Regulatory requirements and practice guidance concerning sustainability include investment governance, due diligence, analysis, active ownership and disclosure. At the same time, APRA oversees YFYS regulations that require MySuper and Trustee Directed Products strategic asset allocations to be benchmarked against Treasury-assigned asset class benchmarks that aim to reflect the investable universe and may have limited sustainability and climate considerations. Due to its annual appraisal on rolling returns, the Performance Test limits the performance variation (tracking error) superannuation Trustees may tolerate (due to the implications of failing the test). JANA's analysis, below, shows that Trustees are incentivised to maintain low tracking errors relative to Treasury-assigned YFYS benchmarks under the Performance Test.

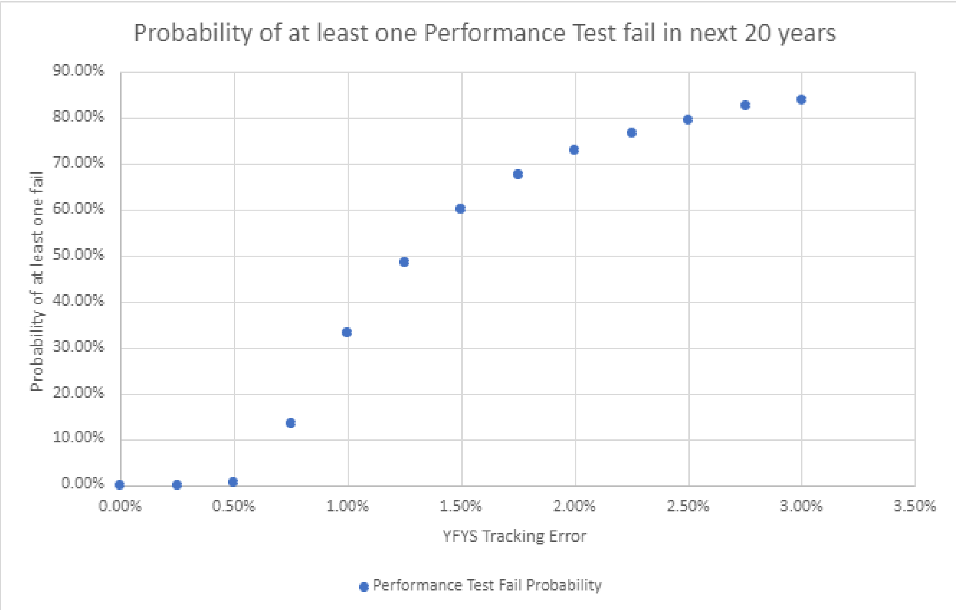
The tracking error constraint creates two unintended and related consequences for sustainable financing:

1. A focus on a shorter investment horizon due to the inability to withstand investments with a longer-term back-end payoff structure or a payoff structure that deviates too far from assigned benchmark holdings' return profile.
2. Long-term investments are currently not adequately represented in Treasury-assigned benchmarks, limiting the investability by superannuation funds due to tracking error risk.

Members invested in ESG/sustainability labelled options have made an active choice to hold these products and will have done so based on investment objectives disclosed within the Product Disclosure Statement (PDS) that may not reference the composite benchmark metric used in the Performance Test. It is reasonable to assume that such members who invest in sustainable investment options do so because of their investment beliefs and preferences regarding the benefits of this type of investment. In some cases, we can envisage that restricting the ability of new members to invest in these products based on the current format of the Performance Test creates a misalignment between member preferences and the design of the Performance Test.

The YFYS Performance Test potentially creates a disincentive for superannuation funds to support the Treasury's sustainability financing initiatives to the maximum extent (i.e., within the fee, liquidity and risk budgets) and for superannuation Trustees to meet member and stakeholder expectations on sustainability considerations and investments. An example of the disincentive is when the quantum of sustainability financing investments creates a YFYS Benchmark mismatch and increases the tracking error relative to the YFYS Performance Test beyond a level the Trustee is comfortable with (e.g., subject to a risk budget).





Solutions

We propose applying the work undertaken in Pillar 1, which focuses on developing a sustainable finance taxonomy and a labelling system for investment products, to the YFYS Performance Test. The application would permit investment options that meet the labelling definitions to be afforded a defined increase in the YFYS buffer. The increased buffer is to recognise and not penalise specific investment products that are ESG/sustainability-focused or for products that want to further increase exposure to sustainable financing opportunities without fear of YFYS failure or associated adverse consequences due to tracking error concerns.

The increased buffer could be proportional to underlying sustainable financing investments within a product and subject to an upper limit. For example, if 50% of underlying investments in a Trustee-directed product are classified as green/transition/sustainable according to the labelling/disclosure framework, then 50% x (upper limit buffer increase) would apply to the existing 0.5% buffer. Hence, if the upper limit was 1%, then (50% x 1%) + 0.5% = 1%. 1% would be the new buffer for the superannuation investment product to reflect the tracking error associated with sustainable investments versus YFYS benchmarks. Whilst this approach will add to the data collection and review by APRA and some complexity, it is likely that this data will be required to be collated for disclosure requirements anyway.

We considered adding additional sustainability/ESG benchmarks as an alternative solution. We discounted this approach as it can only apply to listed holdings-based benchmarks, while real assets such as infrastructure, property and natural capital would have no equivalent alternative sustainable benchmarks. Additionally, listed ESG/sustainability benchmarks suffer from prescribed views on sustainability that may not align with the Trustees approach, which may create further tracking error issues. For low carbon indices, many indices utilise backward-looking carbon calculations that ignore climate transition investments or future trajectories of company carbon footprints. Lastly, our proposed approach allows for the inclusion of biodiversity/natural capital investments, which, to date, the market has minimal index offerings.

We also considered the option of an express exemption from the YFYS Performance Test for all sustainability investment options. We have not explored these possibilities in detail on the understanding that they are unpalatable versus amendment to the existing YFYS Performance Test, as discussed above.

What steps could the Government or regulators take to support effective investor stewardship?

Firstly, we believe it is important to define what 'effective investor stewardship' is and establish expectations on how this will interlink with investment return outcomes. As per our comments upfront, allocating to sustainable investments and supporting the transition to net zero requires patient capital, and we expect the Government to create an environment that supports this. Clarity is needed on how the Government or regulators will facilitate the flow of private capital to sustainable investments and support the ensuing stewardship initiatives in a way that does not conflict with the achievement of other fiduciary obligations. Particularly given the transition to net zero is a long-term endeavour and may not necessarily align with shorter term investment return expectations. As discussed directly above, the YFYS tracking error constraint can create unintended consequences that may deter the flow of capital to sustainable financing, thus limiting the ability for investors to adopt effective stewardship practices that would support a sustainable transition.

It will also be beneficial if there is guidance on how the Government and regulators expect stewardship to be undertaken and disclosed. For example, supporting and encouraging collective action brought to companies, ensuring it won't be considered as collusion. We suggest that guidance is provided on how investors can demonstrate that stewardship advances the long-term interests of beneficiaries, particularly from a financial perspective.

Pillar 3: Australian Government leadership and engagement

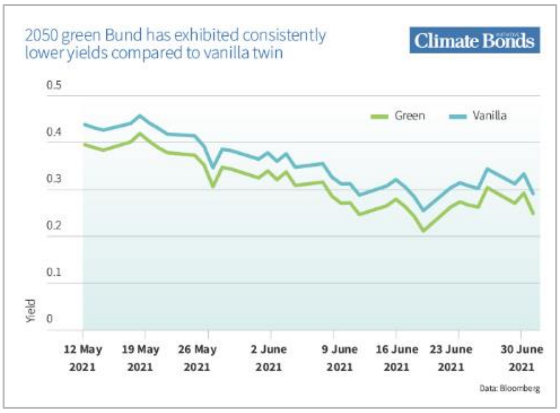
Priority 9: Issuing Australian sovereign green bonds

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?

For the Australian Government to have a successful sovereign green bond program, JANA believes it will need to consider the following points:

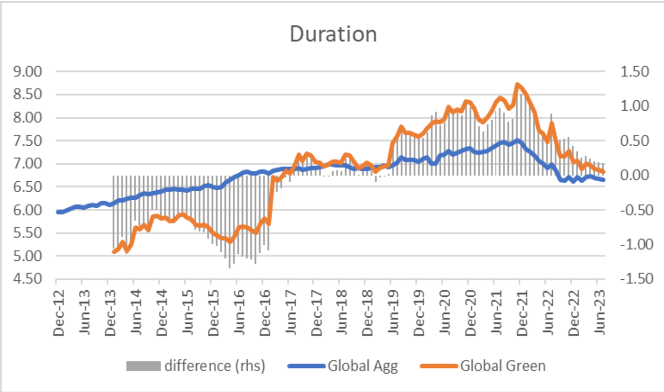
Comparability and viability against traditional sovereign bonds
Sovereign green bond issuance in other countries has typically been materially smaller than nominal bond programs. Hence, a combination of lower liquidity but high investor demand has meant that historically, green bonds have an applied "greenium" where the yield is lower and the price is higher than an equivalent nominal bond. These aspects of lower yield and lower liquidity makes it relatively unattractive for investors to buy green bonds and trade in the secondary market.

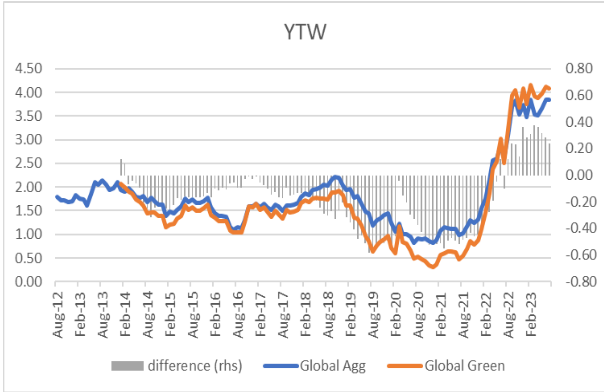


Source: [Greenium Remains Visible in Latest Pricing Study | Climate Bonds Initiative]

Hence, to resolve the liquidity constraints, a commitment to the market to regular issues, including 'tapping existing lines' (issuing extra if there is later demand) is important. New Zealand offers a good case study where its green 2034 maturity has been tapped four times since its launch, enabling the bonds to trade with similar secondary market liquidity to non-green issuance.

JANA also believes that the issuance profile for green bonds should match the profile of the traditional nominal bonds market e.g., the Ausbond Treasury 0+ currently has a duration of 5.5 years and it would be preferable for the issuance profile of the Australian Treasury Green market to eventually match the nominal treasury market. This would offer investors the same tenors as the nominal market, and result in the overall green bond market (represented by a green bond index) to have a similar interest rate profile. A matched profile would increase the viability for investors to consider allocating to green bonds as they aren't taking on materially different interest rate risk relative to the broader Government Bond benchmarks. JANA has observed that green bonds globally now have broad risk characteristics that more closely match the Global Aggregate than they used to as shown in the two charts below. This makes them a much more attractive sector for bond investors. Moving from a traditional bond allocation to a green bond allocation doesn't necessarily introduce material differences (i.e., tracking error) to the traditional (and often non-green) benchmarks against which investments are compared.





Source: *JANA*

Clarity in use of proceeds and meeting reporting expectations
The Australian Government has already made immense financial commitments in the Federal Budget to meet national sustainable targets, including Australia's Net Zero commitment. For the issuance to succeed, JANA believes that any green (or sustainability-linked) bond issuance should be used to target new, more specific sustainability-related (be it climate or social) initiatives in the country. JANA also believes that the targets need to be bold and aspirational in how proceeds will be used, improving the bond's attractiveness.

For the issuance to be successful, the use of proceeds needs to be independently verified, as this is a significant component of what makes green bonds attractive and less susceptible to greenwashing. There are various forms of green bond certification therefore, the Government needs to consider the integrity of the certification or assurance process and the provider chosen.

The Principles of Responsible Investors published a paper in November 2023[1] on climate change in sovereign debt issuance, which suggested that issuers "commit to regular, timely and detailed reporting when issuing labelled bonds". JANA agrees with this approach as it enables investors to track the use of proceeds, engage in dialogue with the issuer on projects and report to their stakeholders, thus improving the overall attractiveness of the green bond.

In relation to issuance, we note that the World Bank works with NGO's and the buyside to structure solutions that are beneficial for both sides and provides the monitoring and verification. Consideration of an agency in Australia that provides that conduit/service to enable broader access for sustainability financing will be beneficial.

[1] Considering climate change in sovereign debt | PRI (unpri.org)