Australia's Sustainable Finance Strategy

CPD submission to the Treasury

December 2023

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The Centre for Policy Development is an independent, non-partisan policy institute with staff in Sydney, Melbourne, Canberra and Jakarta, and a network of experts across the Indo-Pacific region. We confront the toughest long-term challenges facing Australia and the region, and take people on the journey of solving them.

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Published by the Centre for Policy Development

Cite this paper as: Mara Hammerle and Toby Phillips (2023) *Australia's Sustainable Finance Strategy: CPD submission to the Treasury*, CPD Submission, Centre for Policy Development.

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Executive Summary

The Centre for Policy Development (CPD) is grateful for the opportunity to contribute to the Commonwealth Treasury's consultation on its *Sustainable Finance Strategy*. Over many years, CPD has been working to align financial systems with the reality of global decarbonisation. CPD has a long history exploring the legal obligations of company directors (in both the public and private sectors) to consider the impact of climate change risks on their organisations and in recent years has made significant contributions to thinking around financial disclosures and public sector management.[1] CPD has also made contributions looking at how key economic institutions – such as the RBA and Future Fund – could more meaningfully integrate climate risks into their decision making.[2] Recently, CPD released the report *Green Gold*, which investigates how the Commonwealth Government can capitalise on Australia's competitive advantages by kickstarting key green industries.[3]

We welcome the publication of the Treasury's Sustainable Finance Strategy consultation paper. This is the culmination of many streams of work across the Treasury and financial regulators – our congratulations to everyone involved! The focus of this submission is primarily on highlighting opportunities for the Commonwealth Government to build on this strong start and truly position Australia as a sustainable finance leader across the board.

Pillar and priority	Our recommendations
Pillar 1, priority 2: Develop a sustainable finance taxonomy	Economic institutions – such as the RBA and the Future Fund – should use the taxonomy in classifying their holdings, assessing their climate-related financial risks, and proactively managing climate transition risks.
Pillar 1, priority 3: Support credible net zero transition planning **Pillar 2, priority 7**: Addressing data and analytical challenges	The government should publish at least one central scenario that entities must report against in making climate-related financial disclosures. The Government should provide key forward-looking sector-specific parameters in describing any central scenario for use in transition planning and disclosures. The Government should make significant investments into its economic modelling capabilities to better reflect the empirical realities of global carbon transition.
Pillar 2, priority 5: Enhancing market supervision and enforcement	Australian regulatory frameworks for listed companies seem appropriate for regulating greenwashing *provided there is sufficient policy support and resources for strong enforcement*.

Pillar 2, priority 6: Identifying and responding to potential systemic financial risks	The Australian Government should be a leader in providing climate-related financial disclosure and set the bar for the comprehensiveness of such disclosures. The RBA should begin issuing annual climate risk disclosure consistent with international frameworks and standards, and emerging guidance for reporting by central banks.
Pillar 3, priority 10: Catalysing sustainable finance flows and markets	While the CEFC is a valuable investment vehicle to catalyse financial flows, the Australian Government must also make direct expenditures (without expectation of commercial return) on activities earlier in the innovation process and on building social licence.
Pillar 3, priority 12: Position Australia as a global sustainability leader	Australia should position itself as a global leader in the green economy, advancing multilateral collaboration towards addressing carbon leakage and carbon pricing. Australia should consistently collaborate with partner countries and neighbours (such as Indonesia) to support regional decarbonisation efforts.

Pillar 1, priority 2: Develop a sustainable finance taxonomy

Key question: 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?

Implementation of the sustainable finance taxonomy will be transformative for the private sector. However, there are also strong opportunities for the Australian Government to lead by example in putting the taxonomy to use. CPD has published work calling for stronger environmental stewardship by both the Reserve Bank of Australia and the Future Fund.[4] Both of these institutions could make use of the taxonomy to integrate climate risk into their investment decisions and disclose their exposures to climate risks.

The RBA could use the taxonomy in the following ways:

1. The RBA, like all asset holders, faces data, methodology and other constraints in assessing the full breadth of its exposure to and impact on climate-related financial risks.[5] The taxonomy could be a useful guide to understanding whether RBA assets are "green" in disclosures of climate risk.
2. The RBA could draw upon the taxonomy to help with integrating climate-related financial risks in collateral frameworks. Existing collateral frameworks are often biased towards assets that support carbon-intensive activities by not considering climate risk in their risk assessments.[6] Instead, the RBA could use the taxonomy to ensure haircuts and collateral eligibility rules reflect the risks inherent in transition-exposed assets.
3. The RBA could use the taxonomy in encouraging further issuance of green sovereign debt from Australian issuers and other international jurisdictions. The RBA has made ongoing investments in the green bond market in Asia, including by investing in the Asian Bond Fund.[7] The RBA could use the taxonomy to classify its future investments in green sovereign debt. Similarly, the RBA could also use the taxonomy to contribute to the emergence of other debt instruments for resilience and transition activities by sovereign debt issuers.

Unlike many private institutional investors and a growing number of sovereign wealth funds, the Future Fund does not have a published climate change strategy nor does it provide regular public disclosure of its climate risks.[8] The limited public information available further obscures sight of whether and how the Future Fund considers climate-related risks in its investments. To assist with the development of a climate change strategy and providing disclosure, the taxonomy could be used in understanding the carbon intensity of the Future Fund's portfolio, setting goals for portfolio decarbonisation or green investment, and guiding divestment triggers for investments with particularly high climate risk exposure. This would be consistent with international best practice, and the Fund could be directed to do so through their investment mandate from the government.

Recommendation 1: Economic institutions – such as the RBA and the Future Fund – should use the taxonomy in classifying their holdings, assessing their climate-related financial risks, and proactively managing climate transition risks.

Pillar 1, priority 3: Support credible net zero transition planning*; and* Pillar 2, priority 7: Addressing data and analytical challenges

Key questions:

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?

What key sustainability data gaps or uncertainties faced by financial institutions in Australia should be prioritised by the CFR?

CPD has engaged with the Commonwealth Treasury on its policy to mandate the disclosure of climate-related financial risks by businesses and financial institutions.[9] We welcome the steps that have been taken by the Treasury on this policy.

To increase the usefulness of these disclosures for investors and broader market mechanisms, users of the disclosures must be able to draw comparisons between them – capital markets need to be able to compare apples to apples. To this end, the Treasury's proposal that scenario analysis (and transition plan targets) must be benchmarked to the global temperature goal in the *Climate Change Act 2022* is a valuable inclusion. But CPD recommends that the Treasury should take additional steps to ensure consistency between disclosures including through establishing common metrics.

Reporting organisations should be allowed to publish climate risk disclosure based on their own view of the future, however CPD also recommends requiring them to publish a risk assessment based on at least one central scenario published by the Australian Government. The central scenario would serve as a benchmark that all organisations must report against, even if they disagree with the outlook and base their own decisions on different expectations and assumptions (in which case, this can be made clear to investors).

The Treasury's second consultation paper notes that mandating the use of a single scenario could introduce systematic risk if the mandated scenario is wrong about the future.[10] However, the countervailing risks are that by not providing any guidance, firms cherry-pick and tailor their forward scenario to create flattering results, and investors are thus unable to compare plans between firms. To mitigate risks associated with any one scenario being incorrect about the future, firms could be allowed to disclose against other scenarios as well.

At a minimum, if the Government does not publish its own central scenario, the Treasury should recommend (if not mandate) the use of established scenarios such as the Network for Greening the Financial System (NGFS) scenarios, the IEA Net Zero scenario, or the UN PRI forecast policy scenario (FPS). If the only guidance given is that one scenario must be consistent with temperature rises "well below 2°C", then an entity's second chosen scenario should be materially different (not marginally different, e.g. not "a scenario reflecting the Government's commitment to reduce emissions by 43 per cent by 2030"). A materially different scenario could be something like a sudden disorderly transition, or a world of 3°+ average temperature rises. The New Zealand XRB requires disclosures to include a 1.5° world, a 3° world, and a third scenario of the entity's choosing.[11]

Recommendation 2: The government should publish at least one central scenario that entities must report against in making climate-related financial disclosures.

Forward-looking central scenarios for disclosures would need to include key sector-specific parameters for industries exposed to particularly significant transition and physical risks. This could include assumptions about the future with regard to: energy price trajectories, global demand for Australian fossil fuel exports, prices for key industrial inputs, geographical incidence of physical risks and disasters, and the cost of capital.

Work is being done by various Australian government departments that could be collated to assist with this task. The work by AEMO and APRA on scenario analysis and vulnerability assessment has proven to be quite valuable in the energy and banking sectors, respectively. AEMO provides an outlook of the domestic energy market for firms to use in their own modelling and planning purposes.[12] And APRA's Climate Vulnerability Assessment of Australia's five largest banks used two future climate scenarios, themselves based on the scenarios developed by the Network for Greening the Financial System.[13] Extending these approaches would be a good place for the government to start in developing a central scenario.

Modelling exercises consistently fail to effectively forecast the rate of change of the global economy, as well as the impact of policy choices. For instance, the price of renewable energy generation has consistently been overestimated, leading to higher assumptions around the cost of transition. In recent submissions to the Climate Change Authority, CPD recommended several ways that economic modelling exercises can be more closely aligned with the empirical realities of carbon transition: assuming aggressive learning rates with costs falling as a function of deployment, assuming a modest decline in the cost of capital as a function of national decarbonisation, incorporating a social cost of carbon, and more.[14]

Recommendation 3: The Government should provide key forward-looking sector-specific parameters in describing any central scenario for use in transition planning and disclosures.

Recommendation 4: The Government should make significant investments into its economic modelling capabilities to better reflect the empirical realities of global carbon transition.

Pillar 2, priority 5: Enhancing market supervision and enforcement

Key question: Are Australia's existing corporations and financial services laws sufficiently flexible to address greenwashing? What are the priorities for addressing greenwashing?

In a 2021 legal opinion commissioned by CPD, Noel Hutley SC and Sebastian Hartford Davis suggest that a company (and its directors) could be found to have breached the Corporations Act 2001 if they do not have "reasonable grounds" to support the express or implied claims in sustainability commitments.[15] That is, companies wishing to commit to net zero must have a reasonable basis now for believing that they can achieve that commitment.

Companies that do not meet this standard are effectively engaging in deceptive or misleading conduct, and should face consequences for greenwashing. The proceedings by the Australasian Centre for Corporate Sustainability (ACCR) against Santos Ltd in the Federal Court provide a concrete example of the arguments outlined in the Hutley opinion. ACCR alleges that Santos breached the Corporations Act and the Australian Consumer Law by making misleading claims about its plans to achieve net-zero emissions.

Corporate/investor greenwashing (as distinct from greenwashing statements about consumer products) needs to be treated with the same seriousness as other material disclosures to investors, e.g. financial reports. The regulatory frameworks to address greenwashing seem appropriate provided two assumptions hold:

1. The courts agree with and uphold the 2021 opinion advanced by Hutley and Hartford Davis.
2. There is sufficient policy support and resourcing to enable ASIC to regulate companies and take enforcement action.

Recommendation 5: Australian regulatory frameworks for listed companies seem appropriate for regulating greenwashing *provided there is sufficient policy support and resources for strong enforcement*.

Pillar 2, priority 6: Identifying and responding to potential systemic financial risks

Key question: Are there specific areas where the Government or regulators could further contribute to market-wide understanding of systemic sustainability related risks, including climate-related financial risks?

For many years now, CPD has stressed the case for mandating public authorities to make their own climate-related financial disclosures because they (a) represent a significant share of the economy, (b) often have responsibility for systemic economic stability and risk management, and (c) are in a position to demonstrate best practice to the private sector.[16] Given the importance of public authorities for the economy, CPD welcomes the steps taken by the Department of Finance towards mandatory disclosures of climate exposure by all Commonwealth entities, beyond those captured under the Treasury's reforms to Corporation Act entities.

The Commonwealth Government should endeavour to play a leading role in providing climate-related financial disclosures. Importantly, disclosures should include all types of emissions – scopes 1, 2, and 3. The initial approach announced from the Department of Finance does not seem to include scope 3 emissions disclosures for public authorities (except for those covered by the Treasury's framework for Corporations Act entities).

Scope 3 emissions account for around two-thirds of the emissions for which public procurement is responsible globally.[17] In its draft guidance, the AASB requires entities to consider the measurement of their scope 3 emissions.[18]

Thus, the Commonwealth Government should ensure it is including scope 3 emissions to achieve the highest possible standards and to provide an example for how the private sector might go about estimating these emissions. An important component of the Commonwealth Government's scope 3 emissions are those associated with grants to states and territories, particularly for infrastructure projects. Moreover, Commonwealth entities should also be required to clarify how much of any reduction in reported emissions is due to purchased offsets. There are legitimate concerns about whether offset projects do reduce or remove carbon, whether the projects would have occurred regardless, and how the offsets are verified – and in this context, transparency is critical.

The publication of transition plans alongside disclosure would be an important component to demonstrate how Commonwealth entities are reducing their carbon exposure and to help avoid greenwashing. Net zero transition plans should include an entity's targets to decrease greenhouse gas emissions and milestones along the way to 2050, as well as information on the actions it will take to achieve these targets.

Recommendation 6: The Australian Government should be a leader in providing climate-related financial disclosure and set the bar for the comprehensiveness of such disclosures – including scope 3 disclosures and transition plans.

In our submission to the RBA Review, CPD called for regular disclosure of climate-related financial risks by the central bank.[19] The RBA, like other central banks, has been an important voice in reinforcing the importance of widespread, credible and consistent climate risk disclosure as a key tool for financial stability. Through its work with the Council for Financial Regulators, the RBA has helped reinforce guidance from APRA and the Australian Securities and Investment Commission to regulated entities about the need for climate risk disclosure.

However, it is also important for central banks, including the RBA, to issue their own climate risk disclosures. Other central banks have already issued disclosures consistent with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations and guidance, including the Bank of England, Banco Central do Brasil and Banque de France.

The RBA should follow in these footsteps for several reasons, including that climate risk disclosure by the RBA would:

- Demonstrate good practice to the broader Australian market and reinforce the RBA's message about the importance of climate risk reporting by financial institutions.
- Bring the RBA into line with the growing practice of its international counterparts and fulfil its commitment to the NGFS.
- Help the RBA further understand climate risks to Australian financial stability, the exposure of its own portfolio, and its own impact on the nature and pace of the net zero transition by virtue of needing to increase the depth of its climate risk analysis, in line with international counterparts and reporting requirements
- More generally enhance the RBA's communication and transparency with the Australian people about climate-related issues and its own operations.

Recommendation 7: The RBA should begin issuing annual climate risk disclosure consistent with international frameworks and standards, and emerging guidance for reporting by central banks.

Pillar 3, priority 10: Catalysing sustainable finance flows and markets

Key question: What role can the CEFC play to support scaling up of sustainable investment in Australia, as part of a more comprehensive and ambitious sustainable finance agenda?

The CEFC plays an important role in Australia in providing access to finance – typically in the form of loans or equity – to support the delivery of net-zero-aligned initiatives. However, the CEFC generally focuses on later-stage, near-commercial activities that will deliver a positive return to government. Other types of investments are also required to achieve Australia's climate change commitments.

The emergence of green industries in Australia is currently held back by high costs for low-carbon industrial goods, limited demand for low-carbon products, and a lack of a level playing field (fossil fuel intensive goods benefit from a 'grey discount'). Many of the technologies required to decarbonise industrial processes are not yet fully mature – such as hydrogen electrolysers or substitutes for blast furnaces – and are often much more expensive than carbon-intensive alternatives. At the same time, there are no robust drivers of demand for low-carbon industrial outputs in the Australian market, nor widespread policy mechanisms to solve this. This creates a first-mover problem because investors cannot make investments in the capital-intensive facilities that create these outputs when they do not have guaranteed demand at the higher prices the outputs entail. Policy support is needed to help fund the costs of developing, building and deploying these technologies, so that costs can fall and the technologies can become commercially viable.

CPD's *Green Gold* report finds that significant policy support, in the range of at least $60-$100 billion and possibly more, is needed in the short term to bridge this fundamental economic gap for new industries.[20] 'Policy support' refers to spending or regulatory measures that bridge cost differences between low-carbon and emissions-intensive products. This does not include near-commercial investments (such as the bulk of investments from the CEFC, NAIF and NRF). As set out in the *Green Gold* report, necessary policies by the public sector include: contracts-for-difference to support the first movers in key industries (such as iron, alumina, aluminium, and ammonia), modest subsidies to encourage second- and third-movers to reach a critical mass in these key industries, investments in research and development, and a Net Zero Government Fund to defray costs of procuring low-carbon material (e.g. for government infrastructure). Broader policies and investments are also needed, to support the establishment of green industries (such as permitting and approvals reform) and the transition of affected communities (such as a Regional Transformation Fund).

As an immediate step, the capacities of existing Australian institutions could be expanded to enable greater investment in developing green industries. The role of the Australian Renewable Energy Agency (ARENA) could be expanded (with a significant capital boost) to support industry-led demonstration, testing and deployment projects. CEFC's Clean Energy Innovation Fund, ARENA, and Main Sequence Ventures could be given more capital to use for venture-style investments. The Commonwealth Government could further support Australian-led innovation in core sciences by increasing funding for existing programs under the CSIRO, the University Research Commercialisation Package, and Cooperative Research Centres.

Recommendation 8: While the CEFC is a valuable investment vehicle to catalyse financial flows, the Australian Government must also make direct expenditures (without expectation of commercial return) on activities earlier in the innovation process and on building social licence.

Pillar 3, priority 12: Position Australia as a global sustainability leader

Key question: 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?

Australia can play an outsized role in decarbonising the global economy. The single largest way Australia can decrease global emissions is to process exports onshore using renewable energy. CPD's *Green Gold* report found that green onshore processing of 25% of Australia's iron ore and alumina exports would avoid more than twice the amount of global emissions per year than Australia's commitment as per its Nationally Determined Contribution.[21] Recent research by the Australian National University suggests that Australia could reduce greenhouse gas emissions in the Asia Pacific by around 8.6% by replacing key commodity exports (e.g. thermal coal, LNG, and iron ore) with green alternatives.[22]

There are legitimate concerns around competitiveness and carbon leakage if Australian green industries are selling into global markets that give a significant discount to emissions-intensive production. One way to address this issue is to work with major trade partners and other producers of key commodities, such as iron, aluminium and ammonia, to build a level playing field globally. Indeed, this could be a part of the agenda of an Australian COP presidency. A coalition that brings together countries like Brazil (seeking to host COP in 2025), Canada, Japan, South Korea, EU countries, and China would include most of the world's production of iron, aluminium and ammonia. Australia's diplomatic and trade efforts should advance interventions that make green production more competitive, for example by advocating for carbon pricing or introducing an Australian carbon border adjustment mechanism.

Recommendation 9: Australia should position itself as a global leader in the green economy, advancing multilateral collaboration towards addressing carbon leakage and carbon pricing.

Australia should also engage with initiatives taken by other countries, for example in the Indo-Pacific. As the two largest coal exporters, Australia and Indonesia could make a powerful impact by collaborating on a just energy transition. Indonesia has made great strides in recent years including by designing a Comprehensive Investment and Policy Plan to support its $20 billion Just Energy Transition Partnership (JETP). JETPs are cooperative financing mechanisms, designed to help developing countries move away from coal production while addressing the associated social consequences. Australia could support steps by Indonesia, and other fossil-fuel dependent emerging economies, by making joint announcements at COP28 or the ASEAN-Australia Summit in March 2024 on ways to scale up decarbonisation.

Australia should also take steps to ensure it is seen as a consistent actor on the global stage in addressing climate change. Australia can build a reputation as a sustainable finance leader through enhancing commitments to blended finance and other forms of innovative finance in the Indo-Pacific. The AU$200 million Australia-Indonesia Climate and Infrastructure Partnership is one example of this.

More broadly, the Australian Government should continue to focus on promoting Australian business engagement with green initiatives in the Indo-Pacific.

For example, the Australian Energy Mission to Vietnam enabled Australian and Vietnamese businesses to discuss opportunities to develop markets for renewable energy technologies. Co-hosting COP31 in collaboration with Pacific partners would be another strong signal to the world that Australia is a reliable and committed player in sustainable finance.

Recommendation 10: Australia should consistently collaborate with partner countries and neighbours (such as Indonesia) to support regional decarbonisation efforts.

Endnotes

[1] See, for example: T Phillips and M Hammerle, *Mandatory climate-related financial disclosure: Response to Commonwealth Treasury consultation paper*, CPD, 2023; N Hutley and S Hartford Davis, *Climate change and directors' duties: Memorandum of opinion*, CPD and the Future Business Council, 2016.

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[3] T Phillips, *Green gold: A strategy to kickstart Australia's renewable industry future*, CPD, 2023.

[4] See endnote 2.

[5] *'BIS report notes existing gaps in climate risk data at central banks*', Moody's Analytics, 2022.

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[7] '*Reserve Bank of Australia annual report 2023, 2.5 International financial cooperation*', RBA, 2023.

[8] *Newton's second law: Sovereign wealth funds' progress on climate change*, International Forum of Sovereign Wealth Funds, 2023.

[9] See T Phillips and M Hammerle, 2023 in endnote 1.

[10] *Climate-related financial disclosure, Consultation paper, June 2023*, The Treasury, Australian Government, 2023.

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[12] '*2023-24 inputs, assumptions and scenarios*', AEMO, 2023.

[13] *Information paper: Climate Vulnerability Assessment results*, APRA, 2022.

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[15] N Hutley and S Hartford Davis, *Climate change and directors' duties: Further supplementary memorandum of opinion*, CPD, 2021.

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[17] *Green public procurement: Catalysing the net-zero economy*, World Economic Forum, 2022.

[18] *Australian Sustainability Reporting Standards – disclosure of climate-related financial information*, AASB, 2023.

[19] See endnote 2.

[20] See endnote 3.

[21] See endnote 3.

[22] PJ Burke et al., '*Contributing to regional decarbonization: Australia's potential to supply zero-carbon commodities to the Asia-Pacific*', *Energy*, 2022.

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