

April 28, 2021

Parliamentary inquiry into the prudential regulation of investment in Australia's export industries

Submission by the Responsible Investment Association Australasia

The Responsible Investment Association Australasia (RIAA) welcomes the opportunity to make a submission to the Joint Standing Committee on Trade and Investment Growth of the Federal Parliament inquiry into prudential regulation of investment in Australia's export industries.

About RIAA and our members

RIAA champions responsible investing and a sustainable financial system in Australia and New Zealand and is dedicated to ensuring capital is aligned with achieving a healthy society, environment, and economy.

With over 350 members managing more than \$9 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across Australia and New Zealand.

RIAA's membership includes superannuation funds, fund managers, banks, consultants, researchers, brokers, property managers, community trusts, foundations, faith-based groups, financial advisers, financial advisory groups, and others involved in the finance industry, across the full value chain of institutional to retail investors.

Scope of this submission

RIAA's submission to the Committee covers item 3 of the Terms of Reference being the motivations and approach of financial institutions and publicly listed companies, to their investment in Australia's export industries. RIAA's input is guided by:

- evidence assembled from temporal, primary research undertaken across Australia each year for the last 20 years comparing the financial performance of responsible investments with their equivalent benchmarks
- information collected through RIAA's member working groups drawing on the expertise of members such as asset owners and asset managers who have themselves committed to net zero by 2050
- our fiduciary members' behaviours aimed at delivering long term value creation for their beneficiaries consistent with their respective obligation set out in the SIS Act 1993
- knowledge amassed over the past 2.5 years as Secretariat to (and RIAA's CEO Co-chairing of) the [Australian Sustainable Finance Initiative](#) and its [Roadmap](#) for aligning Australia's financial system with a sustainable, resilient, and prosperous future for all Australians.

Addressing the terms of reference

According to RIAA's annual [Responsible Investment Benchmark Report 2020](#), a full \$1.1 trillion (37%) of professionally managed funds in Australia is invested consistent with responsible investing strategies, be they environmental, social and governance (ESG) integration, corporate engagement, normative, negative or positive screens, impact investment or a combination of some or all of these.

The growth in responsible investing has been for several reasons including:

1. consumers are increasingly seeking out investments aligned with their preferences and personal values, particularly around sustainability issues;
2. responsible investments have provided better risk adjusted returns over the long-term; and
3. managing ESG risks, such as climate change transition risk, is akin with prudent execution of fiduciary duties.

Consumers (and citizens) are increasingly seeking out investments aligned with their consuming tastes

Responsible investing continues to be a growth area as Australians become more aware of the environmental, social and governance issues that play out in the world around them, from climate change in the form of devastating bushfires over the 2019/20 Summer, to global pandemics and the destruction, in May 2020 of ancient Indigenous cultural sites by a legally operating, listed company.

[Our consumer research from 2020](#) revealed an overwhelming majority of Australians now *expect* their savings (87%) and superannuation (86%) to be invested responsibly and ethically. More than 2 in 3 Australians do not want their money to cause harm to the planet, such as environmental degradation, fossil fuels, or logging.

Nine in 10 Australians believe our finance sector has a role to play in generating positive social, environmental, and economic outcomes for the country highlighting the central role of responsible and ethical investing in helping the business and finance sectors better meet the needs of clients, customers, staff, and communities they are engaging with.

Responsible investments provide better risk adjusted returns over the long-term

The evidence supporting the steady growth (a rise of 17% between 2018 and 2019) in responsible investing across Australia and the globe is predicated on year-on-year outperformance of responsible investments compared with their mainstream benchmarks. According to RIAA's annual [Responsible Investment Benchmark Report 2020](#) in 2019, Australian and multi-sector responsible investment funds outperformed mainstream funds over 1-, 3-, 5- and 10-year time horizons. Further analysis shows the outperformance has continued amidst the massive market disruption brought on by the COVID-19 pandemic.

The likely causal link between outperformance and responsible investing is that businesses which look after their employees, minimise their impact on the environment, have good governance and protect human rights across supply chains are more likely to better manage their respective businesses and deliver superior financial returns to investors.

It follows that the consideration of ESG factors in investment decision making, including climate change risks, leads to better risk adjusted returns for beneficiaries of superannuation – those starting their first job today, as well as those drawing an annuity tomorrow. This also leads to the stronger longer term value creation for the universal assets (secure productive workforce, resilient healthcare system, contemporary education system, connected, reliable communications, clean and efficient transportation, secure and sustainable food and water and affordable, reliable energy supply and storage) that underpin the future productivity and competitiveness of the Australian economy.

It is upon this strong evidence base that investors today are seeing climate change as a critical ESG risk to manage to protect and enhance future investment returns and therefore outcomes for beneficiaries. Considering the evidence base around the impacts resulting from a changing climate, we now see that there

are trillions of dollars that RIAA members are looking to invest in assets and enterprises that align with achieving net zero emissions and put the Australian economy on a strong footing now and into the future.

Managing ESG risks, such as climate change transition risk is akin with prudent execution of fiduciary duties

The global transition to net zero emissions is underway, accelerating, and irreversible, and Australian entities are already exposed through the response in international capital markets and policy change in other markets. Australia is part of this global transition and its efforts are aligned with our collective goal set out in the Paris Agreement ratified by the Australian Government in October 2016.

Research and modelling from leading global institutions has unequivocally set out the level of risk involved in a changing climate sufficient that investors are now taking action to mitigate and manage those risks prudently to protect the interests of their beneficiaries. In accord, the World Economic Forum's Global Risks Perceptions Survey 2019-2020 identified climate action failure as the most impactful and second most (after related 'extreme weather') likely [global risk](#) in 2020 (see overleaf).

Modelling conducted by the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), which comprises 89 members (including the RBA and APRA) from countries responsible for 75% of global greenhouse gas emissions, found unabated climate change would result in a cumulative loss of global GDP of 25 per cent by the end of the century from physical risks (worsening extreme weather) alone.¹

Deloitte Access Economics found that runaway climate change would reduce Australian economic growth by 3.6 per cent (or \$1.1 trillion) and cost 310,000 jobs annually by 2050, rising to 6 per cent (or \$3.4 trillion) and 880,000 jobs by 2070.²

Based on modelling and research such as that above, RIAA and its members acknowledge the systemic risks and opportunities for the Australian economy from climate change; as have both domestic and global regulatory and supervisory bodies. Global and domestic regulatory bodies have expressed the financial significance of climate change in clear terms for investors, such as, for example the Bank of International Settlements, often described as the bank of central banks, which identified unaddressed climate risks as a likely cause of the next global financial crisis.³

In February 2017, a senior APRA representative stated "These risks [climate change] are material, foreseeable and actionable now. Uncertainty over long-term impacts or policy direction is not an excuse for doing nothing." APRA is now stepping up its scrutiny of climate risks as a result⁴ and has issued draft market guidance on investment and climate risk response, and alongside the RBA is undertaking climate risk vulnerability risk assessment of the largest Australian banks.⁵

According to the RBA "Climate change is exposing financial institutions and the financial system more broadly to risks that will rise over time, if not addressed." The RBA has warned that Australian financial institutions that are exposed to carbon-intensive industries face transitional risks that if change occurs "abruptly, and certain sectors or firms face large losses, there could be broader dislocation in financial markets, despite the opportunities created for some firms from these changes."⁶

¹ https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf

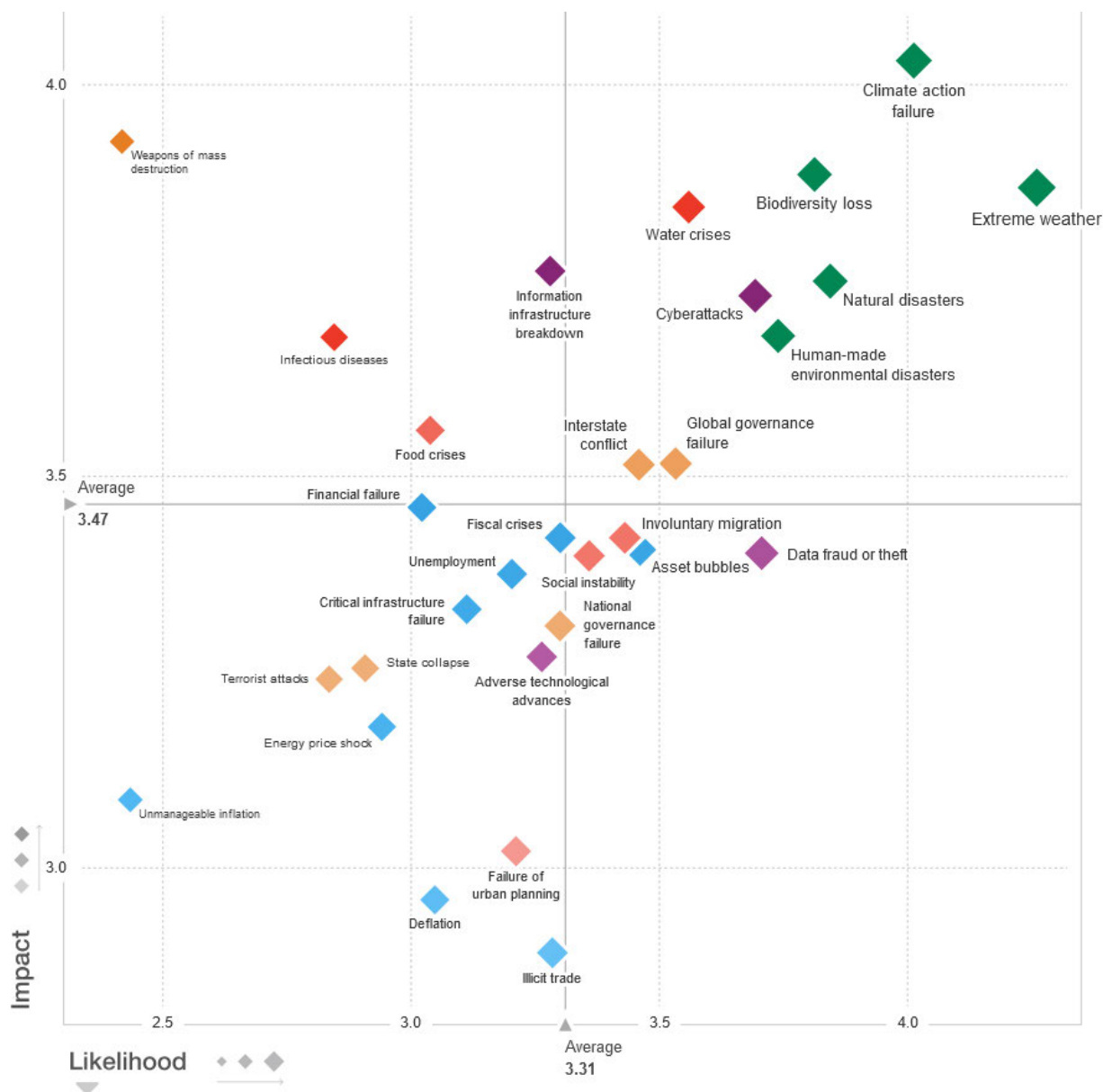
² <https://www2.deloitte.com/content/dam/Deloitte/au/Documents/Economics/deloitte-au-dae-new-choice-climate-growth-051120.pdf?nc=1>

³ <https://www.bis.org/publ/othp31.pdf>

⁴ <https://www.apra.gov.au/news-and-publications/apra-to-step-up-scrutiny-of-climate-risks-after-releasing-survey-results>

⁵ <https://www.apra.gov.au/understanding-and-managing-financial-risks-of-climate-change>

⁶ <https://www.rba.gov.au/publications/fsr/2019/oct/box-c-financial-stability-risks-from-climate-change.html>



World Economic Forum's Global Risks Perceptions Survey 2019-2020 which shows climate action failure as the most impactful and likely [global risk](#) in 2020

Upon the basis of the three drivers articulated above – consumer demand, better investment outcomes and managing ESG risks as akin to prudent execution of fiduciary duties –asset owners and managers are also making public commitments and acting to decarbonise their respective portfolio of investments such as the ‘net zero emission by 2050’ commitments by some of RIAA’s largest asset owners and managers⁷. This action is being taken in direct response to the risks posed by climate change, in the interests of managing the risk that the climate poses to their members’ current and future earnings. Now, as they have since 1993, superannuation investors, are choosing investments that align with the best financial interests of beneficiaries – accordingly they are seeking out investments that will endure the structural transition in play for the international economy.

⁷ Announcement by RIAA’s largest asset owners/managers, in 2020/21 to go ‘net zero by 2050’ include but is not limited to HESTA, Aware Super (formerly First State Super), Cbus, IFM Investors, Rest, AustralianSuper, QBE, Macquarie, and NGS Super. For a list of global investor commitments to net zero visit <https://www.netzeroassetmanagers.org/>

In meeting net-zero commitments, investors have targeted real assets, especially infrastructure and real estate, principally because of the exposure of these sectors to relatively high greenhouse gas emissions (a quarter of Australia's greenhouse gas emissions occur in buildings⁸) and the maturity of industry initiatives to enable quick wins, such as ratings programs including NABERS and the Australian Green Building Council's GreenStar.

The increased attention given to engagement with listed companies whose primary attention is on the exploration and extraction of hydrocarbons (e.g., Climate Action 100+) is in response to a considered assessment of the inherent risks embodied in these assets given the current transition of the global economy. Institutional investors, insurers and banks are acting to manage the downside risk arising from the policies and actions of Australia's export nations⁹ and the likelihood of holding stranded assets in investment portfolios; assets that run at a loss and/or need to be written as a bad debt/investment and ultimately negatively impacting member benefits.

The reason for a large uptake in shareholder engagement with listed companies highly exposed to this risk, is a genuine intent by investors to assist these companies to keep pace with their business planning and risk management systems to remain competitive, productive investments, now and into the future. Engagement, not divestment, is the preferred approach for most institutional investors including superannuation funds and fund managers.

Summary

Overall, the motivations of investors and business to address climate change risks is prudent and commercially focussed. Done well and at pace, these decisions should support an efficient, effective, and equitable transition of our economy and its communities to one that is in step with key trading partners and within the safe limits of the physical changes to the climate and environment on which Australian communities depend. These actions shall assist in an orderly transition, and support Australian job creation and protection, trade competitiveness, and prosperity now and into the future for all Australians.

We wish you success with this inquiry.

Yours sincerely,



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⁸ https://www.researchgate.net/publication/318754386_From_leaders_to_majority_a_frontrunner_paradox_in_built-environment_climate_governance_experimentation

⁹ 70% of Australia's two-way trade is currently with countries that have commitments to reaching net zero emissions by or near mid-century. 68 % of the world's GDP is covered by net zero commitments at or near mid-century, as are companies with \$US14 trillion in annual sales. https://ca1-eci.edcdn.com/reports/ECIU-Oxford_Taking_Stock.pdf?mtime=20210323005817&focal=none