PRI RESPONSE

TREASURY'S CONSULTATION ON AUSTRALIA'S SUSTAINABLE FINANCE STRATEGY

1 December 2023

To inform this briefing, the following investor group has been consulted: PRI Regional Policy Reference Group for Australia. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.

PRI Association

Registered office: 25 Camperdown Street
London, UK, E1 8DZ Company no. 7207947
T: +44 (0) 20 3714 3220 W: www.unpri.org E:info@unpri.org

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI welcomes the opportunity to respond to the Australian Government Treasury's request for feedback and comments on Australia's Sustainable Finance Strategy.

ABOUT THIS CONSULTATION

On 2 November 2023, the Australian Government Treasury published Australia's Sustainable Finance Strategy (Strategy) for feedback and comments. The Strategy aims to support Australia's pathway to net zero, by providing an ambitious and comprehensive framework for reducing barriers to investment into sustainable activities. The strategy's policy priorities are structured in 3 key pillars: Pillar 1: Improve transparency on climate and sustainability; Pillar 2: Financial system capabilities; Pillar 3: Australian Government leadership and engagement.

The government seeks feedback on this strategy, the proposed tools and policies, and the specific questions raised in the paper.

For more information, contact:

Daniel Wiseman	Kazuma Osaki
Head of APAC Policy	Policy Specialist
daniel.wiseman@unpri.org	kazuma.osaki@unpri.org

KEY RECOMMENDATIONS

The PRI welcomes the Australian Government's publication of the Australian Sustainable Finance Strategy. The collection of measures identified within the Strategy represent an important step forward in providing the frameworks, information and tools needed by investors to better integrate sustainability-related risks and impacts into their activities, and to contribute to Australia's net zero transition.

The PRI supports the overarching objectives and key principles set out in the Strategy. In particular, the intention to take a high ambition approach, and to ensure that the Strategy supports Australia's emission reduction plan and transition pathway are welcome. Swift and effective implementation of the measures described in the Strategy and a clear roadmap for next steps will be necessary to ensure that aspirations of high ambition are met and to ensure that Australia keeps pace with rapid global developments in sustainable finance policy and practice.

While we welcome these proposals, we also note growing recognition globally that, albeit important, sustainable finance policy reforms are just one component of the broader whole of government approach needed to enable the economic transition.[1] Real economy targets, policies and incentives must be aligned with global climate and sustainability goals and well-coordinated with sustainable finance tools and frameworks in order facilitate the efficient flow of capital to support the transition.

Alongside overarching policy settings, broader market-related regulatory frameworks, especially in relation to consumer and competition law should also be reviewed to ensure that they are not inadvertently undermining legitimate private sector ambition and collaboration on sustainability goals.[2]

As the Government moves forward with the implementation of the Strategy and the development of its Sustainable Finance Roadmap, we would encourage continued and close engagement with the responsible investment industry to ensure that practical barriers and disincentives limiting the ability of investors and financial institutions to support the economic transition can be identified and addressed and to ensure international alignment, where possible.

Key recommendations

- The Government should support and work with regulators and existing industry and professional bodies to enhance and accelerate training and resourcing for sustainability-related disclosures, assurance, and supervision (*Draft Strategy - Priority 1*).
- In advance of the adoption of mandatory sustainability disclosure standards beyond climate change, ASIC and APRA should provide guidance to firms on the appropriate usage of voluntary frameworks to assist them in meeting their existing legal obligations in relation to material sustainability risks and impacts (*Draft Strategy - Priority 1*).
- Ultimately, to be an effective tool and to achieve its objectives, the sustainable finance taxonomy currently under development, will need to be embedded in the overall regulatory architecture, starting with disclosure requirements for businesses. (*Draft Strategy - Priority 2*).

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[1] See, PRI, 'Investing for the Economic Transition: The case for whole of Government Policy Reform: Policy White Paper' (2023)

[2] See, International Chamber of Commerce, 'How competition policy acts as a barrier to climate action' , (2023)

- Government should work with industry and existing initiatives to develop and publish best practice regulatory guidance and minimum requirements for transition plan disclosure in Australia (*Draft Strategy – Priority 3*).
- Any product labelling and disclosure regime for sustainable investment products should be designed to support the achievement of sustainability objectives, take into account investor stewardship activities, and be interoperable with global developments (*Draft Strategy - Priority 4*).
- In carrying out regulatory activities in relation to greenwashing, regulators should ensure an appropriate balance is met between supporting market integrity and supporting the effective development of emerging sustainable finance practices in Australia (*Draft Strategy - Priority 5*).
- Proportionate regulatory action to enhance the functioning of the market for ESG ratings and data products is welcome, particularly in relation to the transparency of methodologies, rating processes, pricing policies, and the appropriateness of governance arrangements (*Draft Strategy - Priority 5*).
- Further clarification and guidance from Government and regulators is needed regarding the consideration of system-level risks, beneficiary and client sustainability preferences and the pursuit of sustainability outcomes (*Draft Strategy - Priority 8*).
- Treasury and APRA should evaluate how the heatmaps and the YFYS performance tests may be inadvertently undermining investors' ability to take into account sustainability risks and opportunities, and beneficiaries sustainability preferences (*Draft Strategy - Priority 8*).
- Government and regulators should clarify regulatory expectations for effective stewardship through addressing investor rights, duties and implementation mechanisms and introducing a stewardship code that builds on international best practice (*Draft Strategy - Priority 8*).
- Government and regulators should review acting in concert rules to ensure investors legitimate use of collaborative stewardship measures intended to reduce the emissions or otherwise improve the climate and sustainability performance of investee companies and assets is not discouraged (*Draft Strategy - Priority 8*).
- In designing its Green Bonds Scheme, Government should ensure that the use of proceeds selected are consistent with, support and are connected to a clear country decarbonisation strategy, sustainability plan, emission targets and goals (*Draft Strategy - Priority 9*).
- Australian government investment funds, such as the CEFC would benefit from greater engagement with leading international investor networks, such as the PRI, to keep pace with global progression in sustainable finance (*Draft Strategy - Priority 10*).

DETAILED RESPONSE

PILLAR 1: IMPROVE TRANSPARENCY ON CLIMATE AND SUSTAINABILITY

PRIORITY 1: ESTABLISH A FRAMEWORK FOR SUSTAINABILITY-RELATED FINANCIAL DISCLOSURES

What are the opportunities for Government, regulators and industry to support companies to develop the required skills, resources and capabilities to make climate disclosures under the proposed new obligations?

The PRI supports the Australian Government's commitment to introducing mandatory ISSB-aligned climate disclosure standards as a key pillar of its sustainable finance agenda. Our submission to Treasury's second consultation earlier this year is available here.

Many of the PRI's signatories are both users and preparers of climate change and other sustainability-related information. If implemented effectively, mandatory and standardised disclosure of decision-useful information on climate change-related risks, opportunities, impacts and dependencies will improve market transparency, assist both companies and investors to navigate the transition and help facilitate two-way global investment flows into Australia.

To ensure that disclosed information is high quality and provides a trustworthy basis for investment decisions, it must ultimately be subject to the same legal and regulatory accountability mechanisms as existing financial disclosures. It should also be subject to third party verification and assurance, at least at the corporate entity level of disclosure – if not for specific datapoints, like emissions. This will require a rapid development in expertise and capacity internally within disclosing firms, as well as from advisory service and assurance providers.

The PRI agrees that there will be an Important role for Government in helping to support the development of skills and capabilities to meet these requirements. The PRI recommends the Government support and work with regulators and existing industry and professional bodies to enhance and accelerate training and resourcing in this area, including in relation to the assurance, supervision and enforcement of disclosed information. As has been done in other markets,[3] the government and regulators could also consider carrying out a survey and review of the current skills gaps within industry.

How should the Government, regulators and industry prepare for global developments in sustainability-related financial disclosure frameworks and standards, including the TNFD?

The PRI supports the Strategy's proposed approach of adopting global sustainability standards as they are developed by the ISSB. However, we note that there is now widespread recognition that the risks and impacts of a variety of sustainability issues beyond climate change (including biodiversity loss, environmental degradation, human capital and human rights management) are highly material to investment decision-making. In this respect, many entities currently do and will need to continue

[3] See, eg, Japan FSA Expert Panel on Sustainable Finance, 'Third Report: Enhancing sustainable Finance' (2023)

reporting material information in relation to these broader sustainability risks and impacts to satisfy their existing legal obligations. In doing so, it is appropriate that they use the most widely accepted industry-developed standards, such as the TNFD, for doing so.

The PRI welcomes and supports the TNFD recommendations,[4] which will significantly increase the availability of meaningful nature-related information for investors and other relevant stakeholders to integrate in their decision-making and contribute to the goals and targets of the Kunming-Montreal Global Biodiversity Framework.

To ensure that these broader material sustainability risks and impacts are disclosed consistently and is decision-useful, PRI recommends that Australia adopts the entirety of IFRS S1 Standard for General Sustainability Reporting as soon as practicable, and ideally alongside IFRS S2. We note that the AASB's exposure draft standards for climate disclosures only adopt IFRS S1 to the extent required to support the introduction of climate related disclosure (based on IFRS S2) in Australia. Adoption of the entirety of S1 would help to provide clarity around the approach to disclosure that will be expected going forward and help market participants prepare for further developments.

In advance of the adoption of further issue specific sustainability standards, ASIC and APRA should provide guidance to firms on the appropriate usage of voluntary frameworks to assist them in meeting their existing legal obligations, as they have already done so in relation to climate change. This will also assist Australian firms to keep pace with other key markets, such as the EU, that are moving ahead rapidly with the introduction of a broad suite of sustainability reporting standards beyond climate change.

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?

The PRI strongly welcomes the Government's support of the industry-led taxonomy being developed by ASFI, with an initial focus on climate mitigation objectives. By providing consistent, widely recognised standards, taxonomies are a critical policy tool to ensure the credibility of sustainable investment products and strategies. A well-designed, effectively implemented sustainable finance taxonomy can:

- Provide clarity on what is a sustainable economic activity, and under which criteria. This clarity can reduce the risk of greenwashing.
- Go beyond identifying sustainable economic activities and include, for instance, economic activities that are needed to enable a transition towards achieving social or environmental goals or economic activities that are inherently harmful (henceforth 'extended taxonomy'). Extended taxonomies should always make clear that they are not only identifying sustainable economic activities, and maintain a clear distinction between the different types of economic activities (i.e. sustainable, transition, harmful) so that investors can clearly distinguish the degree to which their investments are or are not contributing to the objectives defined by the taxonomy.

[4] Taskforce on Nature-related Financial Disclosures (TNFD), 'Recommendations of the TNFD' (2023)

- Help measure the degree of sustainability of an investment and of companies' activities through, for example, identifying the proportion of revenues or expenditures which are green or transition-aligned and which are not.
- Help investors and companies to plan and report on a transition towards sustainability by setting the objectives and the direction of travel for different economic activities.
- Help policy makers make informed decisions and develop policies that are consistent with relevant long-term objectives such as those of the Paris Agreement.
- Provide a shared reference point and encourage collaboration between policy makers, investors and companies.

We understand the Government's current intention that during the initial regulatory phase, the taxonomy will have no formal regulatory status. However, ultimately, in order to be an effective tool and to achieve its objectives, it will need to be embedded in the overall regulatory architecture and disclosure requirements.

In particular, for financial institutions to be able to use the taxonomy in their own activities and products they will first need data about the underlying alignment of business activities of individual firms within their portfolios and loan books. For investors to have sufficient confidence in this information as a basis for investment decisions and communications, as a first step, disclosure from businesses will need to be mandated or otherwise incentivised and subject to appropriate regulatory oversight.

It should finally be understood that while a taxonomy is a cornerstone of a robust sustainable finance strategy, it will not enable the transition to a sustainable economy by itself. It should therefore be developed in parallel to other instruments (i.e. sector roadmaps and corporate transition plans) to ensure a coordinated and effective approach, as well as interact with other policy instruments such as stewardship and broader disclosure requirements.

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

We recommend that ultimately the Australian Taxonomy's objectives should align with the EU's six environmental objectives: (1) climate change mitigation; (2) climate change adaptation; (3) the sustainable use and protection of water and marine resources; (4) the transition to a circular economy; (5) pollution prevention and control; and (6) the protection and restoration of biodiversity and ecosystems. Having similar objectives as the EU taxonomy (with some adaptation to national contexts) will facilitate and enable interoperability. We support the inclusion of additional social objectives and recommend that these include objectives and/or criteria relevant to First Nations rights, reconciliation and perspectives.

What are appropriate long-term governance arrangements to ensure that the taxonomy is effectively embedded in Australia's financial and regulatory architecture?

No response.

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?

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?

The PRI strongly welcomes the Government's intention to support firm level transition planning. Investors expect to understand companies' time-bound action plans to pivot their existing assets, operations, and entire business model to align with a 1.5-degree trajectory. In September 2022, more than 500 institutional investors from around the world issued a public statement to urge governments to step up climate policy ambition, including by requiring the public disclosure of 1.5°C pathway aligned, science-based, independently verifiable climate transition plans for listed and large non-listed companies, asset managers and regulated asset owners.[5]

While some Australian companies are beginning to produce standalone transition plans or incorporate relevant elements in their reporting, a lack of standardisation and regulatory guidance means much of this disclosure is incomplete or inadequate for investor needs. For example, recent analysis of 183 Australian companies reporting to CDP in 2022, shows that none of them met all 21 key indicators of a credible transition plan. Only 24 of the Australian companies assessed disclosed information on between 14 to 20 of the key indicators.[6]

A clear framework for developing and disclosing an entity's climate transition plan (transition plan) is critical to meet investor needs and promote ongoing investment in Australian companies. Transition plans will support Australia's whole of economy transition.

As noted in a recent joint investor statement from PRI, CDP and IGCC,[7] while Australian companies are beginning to publish transition plans, a lack of standardisation and regulatory guidance means much of this disclosure is incomplete or inadequate for investor needs. Adopting the International Sustainability Standards Board (ISSB) Standard IFRS S2 Climate-related Disclosures (ISSB Climate Standard) baseline requirements for the disclosure of transition plans[8] is a valuable starting point.

While adoption of the ISSB-aligned disclosure requirements is an important starting point, further steps are needed to support Australian entities to produce credible transition plans which contribute to and are consistent with Australia's climate commitments and the goals of the Paris Agreement. Accordingly, we recommend that the Federal Government establish a clear framework for developing and disclosing transition plans which supports a whole of economy just transition aligned with limiting global temperatures to 1.5°C.

This would include introducing best practice regulatory guidance and minimum requirements for transition plan disclosure in Australia. This should build on the ISSB Climate Standard, draw on international examples, and involve close consultation with finance sector representatives, industry experts and the wider community. While guidance should support all entities with transition planning, there is an urgent need to promote transparency and insight into how Australia's highest emitting and risk-exposed companies are pivoting their existing assets, operations, and business model to align with a 2050 net-zero trajectory. Strong emphasis should be placed on short- and medium-term actions that an entity plans to take to achieve its strategic ambition, alongside details on how these steps will be financed.

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[5] The Investor Agenda (2022), 2022 Global Investor Statement to Governments on the Climate Crisis.
[6] CDP, Are Companies Developing Credible Climate Transition Plans (February 2023) .
[7] CDP, IGCC. PRI, '*Joint Investor Statement: Corporate climate transition plans are an essential building block on global reporting baseline*' (2023).
[8] See IFRS S2 Climate-related Disclosures, Paragraph 13.

Alongside transition plans, ultimately it would be beneficial to provide guidance to companies on how they may also consider physical risks through an "adaptation plan" or a comprehensive "Climate Action Plan", particularly as information on how companies should adapt to climate change is increasingly important to investors. Enhancing physical risks disclosures can contribute to risk reduction and contribute to building resilience in the real economy.

In considering possible approaches to providing guidance on these issues, we recommend that the Government have regard to broader frameworks being developed, including the CA 100+ Company Benchmark,[9] the GFANZ Guidance on Net Zero Transition Plans for Financial Institutions and the Investor Agenda's Climate Action Plan Framework.[10] The Climate Bonds Initiative has also recently published helpful mapping of existing transition frameworks.[11]

It should finally be understood that while corporate transition plans are a key building block of a robust sustainable finance strategy, they will not enable the transition to a sustainable economy by itself. They should therefore be developed in parallel to other instruments (i.e. sector roadmaps and taxonomy) to ensure a coordinated and effective approach, as well as interact with other policy instruments such as stewardship and broader disclosure requirements.

Are there related priorities and opportunities for supporting enhanced target setting and transition planning for nature and other sustainability issues?

We note that UNEP FI has recently published the Principles for Responsible Banking Nature Target Setting Guidance[13] and the Finance for Biodiversity Foundation has released its Guidance on the Nature Target Setting Framework for Asset Managers and Asset Owners[14]. These industry-first guidance documents aim to help banks and investors integrate nature considerations into their core practices and processes to shift away from harmful activities while mobilizing financial resources to bridge the annual $700 billion biodiversity finance gap.

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?

How can an Australian model build off existing domestic approaches and reflect key developments in other markets?

PRI welcomes the proposals to introduce a sustainable investment product labelling and disclosure regime for Australia. Such an approach would be beneficial in providing investors and market participants with clearer and more consistent information about if and how a particular investment product considers sustainability-related risks, opportunities, impacts and dependencies.

If implemented appropriately this could help financial product customers, including retail and institutional investors, better identify products that align with their sustainability-related objectives and convictions. Ultimately the design of and labelling or disclosure regime should also take into account and be designed in a way that supports the Sustainable Finance Strategy's overarching objective of supporting Australia's emission reduction plan and transition pathway.

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[9] See Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf
[10] See Investor Climate Action Plans | The Investor Agenda
[11] See Transition Mapping - Climate Bonds - 6 Nov 2023.pdf

In designing a product labelling and disclosure regime for sustainable investment products, key considerations should include: ensuring that the mechanisms introduced are fit for purpose, adequately take into account investor stewardship activities and other investment activities, and are designed to be interoperable with developments in key global markets.

Ensuring that mechanisms are fit-for-purpose

A "sustainable investment product labelling regime" is a policy tool that likens itself to product naming rules, certification schemes, and product-level disclosure requirements. Each of these approaches generally aim to address concerns in the market related to greenwashing, where sustainability-related products or product features are misrepresented. However, they may also serve other purposes, such as improving capital flow toward pre-defined "green" or "sustainable" economic activities to respond to growing demand from retail investors for sustainable investment opportunities. It is important to clarify the objectives of any such intervention and carry out the design of the scheme accordingly.

Scheme design should also take into account existing market realities, naming and disclosure requirements, and certification schemes currently in use. Consumer market research and testing will need to be carried out on label names and categories to assess market fit. To ensure consistency in usage across the market, introducing equivalent requirements for wholesale as well as retail funds should also be considered. Finally, scheme design should take into account and avoid any undue burden on the development and marketing of sustainable investment products, that might inadvertently create a disincentive for their use and create a market distortion.

Differentiate categories based on the product's objective, not investment process and practice

In practice, most existing financial products combine different strategies. Therefore, designing any categories based on investment practices and processes may be inappropriate. The categories should allow for a variety of responsible investment strategies (positive/negative screening, thematic, impact investing, etc.) and investor levers (capital allocation, divestment, stewardship) to be used in combination to achieve the product's objectives.

To ensure clarity and consistency for end-investors, the PRI believes that a **product's objective** (what it aims to achieve) should be the key element to differentiate between product categories. Investors should then be able to demonstrate in the disclosures how different strategies and practices are used to achieve the objective over the life of the product. An additional layer could be added to the categories to reflect the specific sustainability issues targeted by the product (e.g. climate, biodiversity, workers' rights, human rights).

Take into account stewardship activities

Stewardship, also referred to as active ownership, is the use of influence by institutional investors to maximise overall long-term value, including the value of common economic, social, and environmental assets, on which returns, and clients' and beneficiaries' interests, depend. Increasingly, investors are undertaking effective stewardship with the explicit objective of achieving positive sustainability outcomes that deliver real benefits for investors and society as a whole.

Such an approach is now widely seen as necessary to help mitigate system-level risks (such as those derived from climate change, biodiversity loss, rising social inequality and human rights violations) that threaten the health and stability of economies and investors long term returns. Many beneficiaries and clients are now demanding that those investing on their behalf take effective action on these issues.

Stewardship is already a key approach by which investors and investment products deliver on their sustainability-related claims. Policymakers around the world are also implementing various policy measures, such as stewardship codes, to support and guide investors on best practices – including through explicit mention of the integral role that sustainability-related system-level risks can play in stewardship activities. Any product labelling regime to be considered would require careful consideration of what the expectations and/or rules are regarding stewardship practices. In this respect, the 'sustainable improver' category being introduced by the FCA in the UK provides a relevant example to be considered.

Ensure interoperability with global market developments

Global developments surrounding ESG-related disclosures for investors are evolving rapidly, and numerous regulatory efforts have emerged to address market fragmentation in the use of ESG names and standards in various jurisdictions and regions.[12] The Australian Government and regulatory agencies should proactively work with counterparts in other jurisdictions and multilateral organisations to minimise risks of increasing fragmentation. As much as possible, any Australian policy reforms should contribute to the global alignment of investment and finance regulations to support the economic transition to net-zero. With this objective in mind, in designing any Australia-specific scheme the following international initiatives should be considered:

In their report Recommendations on Sustainability Related Practices, Policies, Procedures and Disclosure in Asset Management, the International Organisation of Securities Commissions (IOSCO) provides useful suggestions on how regulatory bodies can better address issues related to greenwashing. Their report provides a general and global view of best practices in this area that can facilitate the government's consideration of practices that are internationally aligned with existing policies.

Currently, there is a growing number of jurisdiction-specific rules governing ESG-related disclosures for investors that create a complex and fragmented environment for market participants to navigate. In designing any Australia-specific regime, consideration must be given to developments in other markets and coordination efforts currently being led by global regulators and initiatives, such as:

- The PRI, CFA, and GSIA definitions for responsible investment approaches[13]
- the International Organisation of Securities Commissions (IOSCO) report on Recommendations on Sustainability Related Practices, Policies, Procedures and Disclosure in Asset Management[14]
- The IOSCO call for voluntary standard setting bodies and industry associations operating in financial markets to promote good practices among their members to counter the risk of greenwashing.[15]
- The IIF Sustainable Finance Working Group (SFWG) Report, which highlights sources of confusion in sustainable investment terminologies that may prevent the development of sustainability-related investment products[16]

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[12] See, Review of trends in ESG reporting requirements for investors | Policy report | PRI (unpri.org)

[13] Definitions for responsible investment approaches | Technical guide | PRI (unpri.org)

[14] FR08/2021 Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management (iosco.org)

[15] The International Organisation of Securities Commissions (November 2022), IOSCO Good Sustainable Finance Practices for Financial Markets Voluntary Standard Setting Bodies and Industry Associations: Call for Action

[16] The IIF Sustainable Finance Working Group (October 2019), The Case for Simplifying Sustainable Investment Terminology

- The Chartered Financial Analyst (CFA) Institute Global ESG Disclosures Standards for Investment Products whose goal is to provide greater transparency and consistency in ESG-related disclosures, to enhance clarity with respect to the ESG-related features of investment products.[17]

Alongside international initiatives, it would also be beneficial to take into account approaches taken by regulators in other jurisdictions, including:

- The European Securities and Markets Authority (ESMA) published a supervisory briefing on sustainability risks and disclosures that, alongside the Sustainable Finance Disclosure Regulation (SFDR), aim to better regulate investment products with sustainability-related claims.[18]
- The UK's Financial Conduct Authority (FCA) has published its final Sustainability Disclosure Requirements (SDR) and investment labels regime. The FCA has set out a comprehensive approach to sustainable investment labels, disclosure requirements, anti-greenwashing rules, and restrictions on sustainability-related terms in product naming and marketing. The rules set clear regulatory standards to support investor disclosure on sustainability claims.[19]
- The US Securities and Exchange Commission (SEC) held a public consultation regarding a new proposed rule on fund names that are likely to mislead investors, which includes a dedicated component on ESG terminology.[20]
- The Japan Financial Services Agency (FSA) published the Revised Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc., which provides supervisory guidelines for disclosures and practices related to retail funds with ESG-related claims.[21]

PILLAR 2: FINANCIAL SYSTEM CAPABILITIES

PRIORITY 5: ENHANCING MARKET SUPERVISION AND ENFORCEMENT

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

The PRI welcomes recent clarity being provided by ASIC and other regulators on their intentions in relation to the supervision, monitoring and enforcement of greenwashing. In carrying out regulatory activities in relation to greenwashing, consideration should be given to the need to ensure an appropriate balance is met between supporting market integrity while not hindering the effective development of emerging sustainable finance practices in Australia. Further guidance from ASIC and APRA in relation to their expectations for sustainable finance practices could assist market participants in relation to these matters.

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[17] The Chartered Financial Analyst Institute (May 2021), Global ESG Disclosures Standards for Investment Products
[18] European Securities and Markets Authority (May 2022), Supervisory briefing – Sustainability risks and disclosures in the area of investment management

[19] The Financial Conduct Authority (November 2023) Sustainability Disclosure Requirements (SDR) and investment labels – Policy Statement

[20] The US Securities and Exchange Commission (May 2022), File No. S7-16-22
[21] The Japan Financial Services Agency (March 2023), Revised Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.

Is there a case for regulating ESG ratings as financial services?

The PRI is supportive of effective and proportionate regulatory action to enhance the functioning of the market for ESG ratings and data products, particularly in relation to the transparency of methodologies, rating processes, pricing policies, and the appropriateness of governance arrangements.

Demand for these products and services is likely to keep growing in the future, given investors' accelerating interest in ESG and sustainable investing and as they increasingly face mandatory ESG disclosure requirements. Although large investors are increasingly developing in-house metrics to better capture ESG risks and opportunities and sustainability performance within their investment processes, third-party providers of ESG ratings and data will continue to play an important role by providing more tailored services, such as data modelling and analytics, and bespoke data feeds.

As intermediaries between corporates and investors, they are an essential component of the investment chain. Given the substantial and growing impact that ESG evaluations have on investment allocations, the integrity of these evaluations is paramount. A recent report by IOSCO provides a general guidance on best practices at the policy-level to address market integrity issues related to ESG ratings and data providers. Examples from Japan and the UK that respond to the IOSCO report have seen policymakers implement voluntary codes of conducts that aim to provide a proportionate response that does not amount to full regulation financial services regulation.

PRIORITY 6: IDENTIFYING AND RESPONDING TO POTENTIAL SYSTEMIC FINANCIAL RISKS

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?

Beyond climate change, there is now widespread recognition of a wide variety of systemic sustainability-related risks about which investors and other market participants need increasingly granular and reliable data. Most notable this includes risks related to nature and biodiversity, as well as social and governance risks, including human rights, decent work and inequality.

Nature and biodiversity-related risks

The nature-related risks to the financial system and economy are well-documented now by initiatives and bodies such as the TNFD, Network for Greening the Financial System, and the World Economic Forum. The Kunming-Montreal Global Biodiversity Framework also have material implications for responsible investors.[22]

While we acknowledge that the Government has decided to adopt a "climate first" approach, the climate and nature crises are deeply interconnected: we cannot reach net zero without halting and reversing biodiversity loss, and we cannot tackle biodiversity loss without addressing climate change. As much as possible, the Government should take coordinated action with a holistic view across the climate and nature agendas to capture co-benefits and synergies, and to carefully manage trade-offs.

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22 https://www.unpri.org/biodiversity/stepping-up-on-biodiversity-what-the-kunmingmontreal-global-biodiversity-framework-means-for-responsible-investors/11366.article#:~:text=Investors%20should%20invest%20in%20innovative,Global%20Biodiversity%20Framework%20(GBF).

Social and governance-related risks

While metrics around environmental (E) and governance (G) aspects are currently more evolved, there is a movement towards the development of disclosure metrics and standards on social issues. Policymakers and standards setters are increasingly active in this area, mirroring the strategies employed on climate and environmental issues. This is exemplified by the European Sustainability Reporting Standards (ESRS) and the proposed expansion of the International Sustainability Standards Board's (ISSB) work to encompass human rights and social issues.

Access to a set of consistent and standardised corporate disclosures will assist investors in meeting their sustainability targets. It will enable them to manage the impacts on individuals that arise, or could arise from their business activities and investee companies, while at the same time reducing financial and reputational risks by providing comprehensive information about their investments. To conduct this analysis, investors need different types of data throughout the investment process. However, there are gaps in terms of available information and reliable sources, and even when this information is accessible, it can be difficult to access and process at scale.

As set out in PRI's recent discussion paper on 'Adopting a strategic approach to Human rights and social issues policy',[23] policymakers will ultimately need to introduce mandatory disclosure regimes that:

- Make social and governance data available by:
  - aligning required disclosures with international human rights standards; o
  - expanding the availability of contextual data to provide more granular information on companies' value chains;
  - o focusing disclosures on companies' leadership and governance characteristics, business risks, and human rights due diligence;
  - o requiring quantitative information on positive human rights impacts.
- Make social and governance data accessible through data tagging, digital taxonomies, and digital corporate reporting.

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?

To ensure the provision of decision-useful[24] corporate sustainability information to investors, existing data-related initiative should look to align with and support the adoption of the current ISSB Standards and look to input into future ISSB Standards. The PRI supports the ISSB in its mission to deliver a high-quality global baseline of sustainability-related financial disclosures.

[23] PRI, 'Adopting a strategic approach to Human rights and social issues policy' (2023)

[24] As set out in the PRI's Investor Data Needs framework, to be decision-useful, sustainability information must be available, accessible, verifiable, comparable across multiple dimensions, a faithful representation and relevant to investors.

The PRI's measure of good practice is ultimately rooted in whether corporate sustainability data will be decision-useful for responsible investors. The PRI's Investor Data Needs framework summarises the set of requirements for these mechanisms to meet this expectation.

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

No response.

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**

PRI agrees that to be fit for the long-term, the legal and regulatory frameworks that govern the decision-making and mandates of companies, financial institutions and regulators must enable and ensure proper consideration of climate change and other sustainability-related issues.

Currently, the regulatory and governance frameworks do provide an effective principles-based approach to support financial institutions and companies to disclose and manage near term and immediate sustainability-related risks. However, they may not be well adapted enabling firms to adequately disclose or manage broader and longer-term system-level (market-wide) risks, to take into account or address their sustainability-related impacts, or to proactively support Australia's achievement of its net zero transition and other sustainability objectives. In this respect, there are a number of areas that could be considered for improvement.

Review corporate director's duties to ensure alignment with sustainable finance strategy

As a result of investor engagement, customer demand and broader market pressures many companies have been improving their integration of sustainability-related considerations. However, the current formulation of directors' duties in Australia could potentially be improved to help support alignment with sustainable finance and broader economic and sustainability goals. The PRI would welcome a review to assess whether there should be a more directed approach, for example that directors be required to take certain sustainability matters into account (rather than the current articulation, under which directors are permitted to take them into account. An example of this approach can be found in the UK's Companies Act (s172).

Guidance on managing system-level risks, beneficiary preferences and sustainability outcomes

As set out in PRI's recent report, *A legal Framework for Impact: Australia – Integrating Sustainability Goals Across the Investment Industry*,[25] for large institutional investors, whose highly diversified

[25] PRI, A legal Framework for Impact: Australia – Integrating Sustainability Goals Across the Investment Industry (2022)

portfolios effectively represent a slice of the overall market, investment returns depend not only on decisions as to what to invest in, but on the health and stability of the wider economy.

To maintain and improve long-term financial performance in the best interests of clients and beneficiaries, institutional investors have a responsibility to consider whether key whether market-wide sustainability risks such as the broader impacts of climate change or biodiversity loss have a bearing on their ability to meet their legal obligations and, if so, how they can mitigate those risks.[26] This may require them to consider how their individual and collective actions can shape sustainability outcomes, contributing to what can be called "better beta" – or reduced system-level risks – which could improve financial outcomes over the long term.[27] Many institutional investors Institutional investors are also facing growing pressure from clients and beneficiaries on these issues.

While the need for action to address such system-level sustainability risks and also beneficiaries sustainability preferences is now widely recognised, there remains a lack of clarity and guidance in current regulatory frameworks about the extent to which different types of institutional investors are permitted to integrate these issues into their decision making. Further clarification and guidance from the government and regulators would be of benefit to better align with emerging market practice, to support investors to discharge their duties and meet their beneficiaries and clients expectations.

Your Future Your Super

It is our understanding that under the existing framework, the Your Future Your Super test in its current form may be inadvertently undermining investors ability to take into account system level sustainability risks, and beneficiaries sustainability preferences. Treasury and APRA should ensure that the product heatmaps and the YFYS performance tests fully enable RSE licensees to address sustainability-related system-level risks while being consistent with other guidance provided by APRA.

Treasury and APRA should evaluate how the heatmaps and the YFYS performance tests are affecting or could affect RSE licensees' decisions to set sustainability goals, monitor their investments' impact on sustainability-related system-level risks and undertake stewardship or policy engagement in order to mitigate those risks. Treasury and APRA should also establish how the assessments of RSE licensees' fees and costs in the heatmaps and in the YFYS performance tests influence their decisions to take into account system-level risks that may not manifest in the short term.

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

Stewardship, also referred to as active ownership, is the use of influence by institutional investors to maximise overall long-term value, including the value of common economic, social, and environmental assets on which returns, and client's and beneficiaries' interests, depend. In signing up to the PRI, signatories commit to be active owners and incorporate ESG issues into their ownership policies and practices.

Stewardship is a healthy part of corporate governance and an integral component of investors' fiduciary duties and risk management. When used well, stewardship can help mitigate both idiosyncratic and system-level risks investors face by encouraging appropriate corporate governance that minimises the risky behaviour of an investee company or other assets and their impacts on

[26] Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (p.154-p.192)
[27] See Hawley, J., Lukomnik, J. (2019), Modernising modern portfolio theory.

environmental and social factors. Australian investors have been undertaking stewardship activities on ESG issues for over two decades – through activities including corporate and policy engagement, collaborative initiatives, filing shareholder resolutions and proxy voting among other activities. In 2022, approximately 85% of Australian institutional investors had published a stewardship policy.

Effective stewardship can complement national climate policies

Increasingly, leading investors are undertaking effective stewardship activities to pursue real world, sustainability outcomes that deliver both benefits for society and long-term returns for clients and beneficiaries. Effective stewardship can deliver these benefits through prioritising outcomes at the economy- and society-wide scales that reflect common goals for investors and governments. In conjunction with ambitious national policies, investor stewardship plays an important role in transitioning the Australian economy to meet the objectives of global sustainability agreements (such as the Paris Agreement and Global Biodiversity Framework)

Australia's policy framework should encourage and scale up effective stewardship

Despite the overall importance of stewardship, several barriers exist within Australia's legal and regulatory framework that impinge on investors' ability to effectively steward their investments. To encourage and scale up stewardship to mitigate sustainability-related system-level risks and pursue collective societal and policy goals, we recommend the Australian Government and financial regulators:

- Review and update the network of legislation and regulatory guidance with a view to streamline the stewardship policy framework, enhance effectiveness and accountability of investor stewardship, and guide stewardship practice towards sustainability outcomes.
- Clarify regulatory expectations for effective stewardship through addressing investor rights, duties and implementation mechanisms and introducing a stewardship code that builds on international best practice.
- Revise acting in concert rules to clarify permissions or carve out exceptions for investors to use collaborative stewardship measures intended to reduce the emissions or otherwise improve the climate and sustainability performance of investee companies and assets.
- Investigate and take measures to simplify and enhance the shareholder resolution process by:
    - addressing lodging challenges from custody chains and complexity with shareholder registries,
    - allowing non-binding shareholder resolutions, and
    - incentivising content-focused disclosure of voting policies and records.
- Establish clear reporting requirements for stewardship and integrate such disclosure requirements in investor/product sustainability disclosure framework. This enables institutional investors to demonstrate and articulate actions taken to obtain sustainability characteristics or objectives and progress/outcomes have been achieved against any sustainability objectives. It supports the regulatory objective of tackling greenwashing because stewardship reporting enables both clients and regulators to hold investors to account for their sustainability related pledges or targets. In addition, it also provides necessary information for the market to

differentiate financial products or entities that invest for sustainability impacts from those who don't.[28]

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?

The PRI welcomes the Government's proposal to move ahead with a green bond issuance program. Based on previous consultations with selected signatories, key considerations for the design of the scheme should include the following matters.

The use of proceeds selected must be consistent, support and connected to a clear country decarbonisation strategy, sustainability plan, emission targets and goals.

Australia's economic structure is an outlier amongst developed market sovereign issuers of green bonds given the centrality of the fossil fuel sector and commodity exports. Whilst many sovereigns issuing green bonds have focused heavily on the transport sector, Australia's first green bond issuance could more appropriately be tailored to the specific needs of the Australian market and support to the domestic transition.

In this respect, the use of proceeds should be targeted at addressing the areas of greatest systemic importance to the Australian economy. Whilst we recognise measures are underway regarding the disclosure of systemic climate risks to Australia's sovereign creditworthiness, the green bond issuance offers a key opportunity to demonstrate measures taken to mitigate these risks.

Examples include risks to existing commodity exports from tightening climate policies in key Asia-Pacific markets (for example, 60% of trade in iron ore, coal and gas is concentrated in China, Japan and Korea), persistent challenges with regard to grid infrastructure modernisation and connectivity of renewables and rising damages and insurability challenges relating to the physical impacts of climate change on assets.

Another area of focus should be maximising comparative advantage and international opportunities from the transition to net zero. Here again there are relatively unique opportunities for Australia, with cleaner mining and processing of critical minerals and development of the green hydrogen value chain natural areas of focus given a sufficiently long-term view of projects and their potential contribution to the Australian economy.

Clear accountability, assurance and rationale for project selection and reporting is critical, particularly where these relate to transition in emissions-intensive sectors.

Whilst ultimately the issuance should be linked to a credible sustainable finance taxonomy for Australia, we recognise that timescales for the development of the taxonomy will not align with the

[28] The UK, US, and EU have all included or propose to include indicators for stewardship activities, strategies and outcomes in investor disclosure requirements.

initial issuance. In the interim the ICMA Green Bond Principles provide a generally supported baseline and additional certification may be needed to add credibility to the framework, including seeking formal Climate Bonds Initiative (CBI) certification for issued debt products. The Climate Bond Initiative's Green Bond Methodology may be particularly useful given the detailed criteria for important activities such as hydrogen, bioenergy, electricity distribution, land use and transport. We also note the wide use of the EU Taxonomy amongst European investors as an impact framework, which could influence overseas demand.

Given the carbon intensive nature of the Australian economy, a "pure" green issuance alone may be unlikely to support the breadth of transition activities the Australian Government may need to fund. Consideration should therefore be given to additional labelled products going forward, including transition bonds and resilience bonds. Such an approach could be adopted for a second round of issuance, given the need for capacity building required in the issuer/department, which the initial green issuance will help with.

What other measures can the Government take to support the continued development of green capital markets in Australia?

No response.

PRIORITY 10: CATALYSING SUSTAINABLE FINANCE FLOWS AND MARKETS

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

PRI welcomes the stated intent for the CEFC to support the development of clear standards and frameworks for sustainable finance markets, and to position Australia as a global sustainability leader. To demonstrate leadership, it will be also important for Australian government investment funds to engage with leading international investors to keep pace with global progression in sustainable finance; and actively participate in the development of leading investor practices on sustainable markets. This means collaborating with other leaders in the global responsible investment community on policy and practice development, including through international bodies such as the PRI which provides a global collaboration platform and opportunities for signatories to inform and develop leading investor practices.

Currently, Australian Federal Government investment funds do not engage actively with organisations like the PRI which plays a vital role in connecting and coordinating global investment bodies with standard setters on sustainable finance objectives and practices. This contrasts with other markets like EU nations (eg. AP funds, Fonds de réserve pour les retraites, NBIM, NGPF), Canada (CPPIB, CDPQ) and Asia (Khazanah, KWAP, KIC), and even Australian state and territory funds like VFMC, QIC and Funds SA who are all PRI signatories. The PRI stands ready to work with Australian Federal Government investment funds and to support their engagement with global developments and networks.

What are the key barriers and opportunities for the CEFC to support financing and market development in areas with significant climate co-benefits, including nature and biodiversity?

No response.

PRIORITY 11: PROMOTING INTERNATIONAL ALIGNMENT

What are the key priorities for Australia when considering international alignment in sustainable finance?

Global policy alignment is essential in enabling the transition to net zero. We urge the Australian government to work with peer governments around the world and multilateral organizations to develop common principles and standards for key policies and regulatory tools including reporting, taxonomies and transition plans.

PRIORITY 12: POSITION AUSTRALIA AS A GLOBAL SUSTAINABILITY LEADER

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?

What are some longer-term international sustainability goals for Australia where sustainable finance can play a role?

What are the key market, regulatory and institutional barriers to increasing private sector engagement in blended financing opportunities? How can these barriers be overcome?

What are other means to mobilise private sector finance toward sustainability solutions in the Indo-Pacific region?

The PRI welcomes the Government's ambition for Australia to be a global leader on sustainable finance, Australia's transition to a clean energy economy will require an immense investment of capital to meet climate targets but also ensure that the transition is just for all. It will be fundamental for Australia to attract overseas financing.

In order to achieve these objectives, real economy targets, policies and incentives must be aligned with global climate and sustainability goals and well-coordinated with sustainable finance tools and frameworks in order facilitate the efficient flow of capital to support the transition. Alongside overarching policy settings, broader market-related regulatory frameworks, especially in relation to consumer and competition law should also be reviewed to ensure that they are not inadvertently undermining legitimate private sector ambition and collaboration on sustainability goals.[29]

As the Government moves forward with the implementation of the Strategy and the development of its Sustainable Finance Roadmap, we would encourage continued and close engagement with the responsible investment industry to ensure that practical barriers and disincentives limiting the ability of investors and financial institutions to support the economic transition can be identified and addressed and to ensure international alignment, where possible.

There are enormous opportunities for Australia to turn the risks of the transition into an opportunity for global and regional leadership. A strong framework to support sustainable finance will be critical to success.

[29] See, International Chamber of Commerce, '[How competition policy acts as a barrier to climate action](#)' , (2023)

Please send any questions or comments to policy@unpri.org.

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