SUBMISSION

Submission to the Australian Sustainable Finance Institute – Australian Sustainable Finance Taxonomy V0.1

28 June 2024

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Dear Sir/Madam

Australian Sustainable Finance Taxonomy V0.1

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Australian Sustainable Finance Institute's consultation on the Australian Sustainable Finance Taxonomy V0.1.

About ASFA

ASFA has been operating since 1962 as the peak policy, research and advocacy body for Australia's superannuation industry. ASFA represents the APRA regulated superannuation industry with over 100 organisations as members from corporate, industry, retail and public sector funds, and service providers.

We develop policy positions through collaboration with our diverse membership base and use our deep technical expertise and research capabilities to assist in advancing outcomes for Australians.

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If you have any queries or comments in relation to the content of our submission, please contact Andrew Craston on 0401 016 587 or by email: acraston@superannuation.asn.au.

Yours sincerely

James Koval

Head of Policy and Advocacy

General comments

ASFA broadly supports the proposed approach to develop an Australian sustainable finance taxonomy. ASFA's comments on the Consultation Paper relate to the high-level approach and objectives/ambitions.

APRA-regulated superannuation funds – collectively institutional superannuation – will play an important role in the shared challenge of the orderly transition of the Australian economy to net zero emissions. Institutional superannuation is part of the broader financial sector that intermediates the savings of households with the funding needs of the real economy. Total financial investments of institutional superannuation – which stand at $2.7 trillion – are projected to reach around $10 trillion by 2050 (future dollars). The more orderly the transition to net zero (by Australia and globally), the better able superannuation funds will be to protect and preserve the value of investments on behalf of their members.

Scope of taxonomy objectives and ambitions

ASFA broadly supports the proposed headline objectives and ambitions for the Australian sustainable finance taxonomy, as set out in page 21 of the Consultation Paper. ASFA acknowledges that the proposed taxonomy framework is being designed to achieve six interrelated environmental objectives.

- The proposed headline objectives and ambitions recognise the interdependence between climate change and the degradation of natural systems, and thus highlights the need for complementary reforms with the objective of preserving natural capital and biodiversity.
- This includes the notion of the circular economy. That is, to seek to reduce markedly human-produced waste (and the impact on the natural world) and to circulate materials within production processes for as long as possible – and thus facilitate the regeneration of human-induced impacts on the natural world.

ASFA agrees that the taxonomy framework should be developed in a way that its coverage can be extended (over time) to encompass the universe of sustainability-related objectives – including Government policy priorities and ambitions that are yet to be fully developed.

- As set out in Table 4, this would encompass climate mitigation across all sectors of the economy, but also climate adaptation, as well as activities that contribute to the preservation of natural resources, natural capital and biodiversity.
- Sustainability objectives more broadly – including social objectives.

While such an approach is likely to present challenges in framework design, ultimately it would generate efficiencies for industry, government and regulators, and lead to better outcomes for superannuation fund members and for the wellbeing of Australians. Particular sources of efficiencies would be likely to include: for industry, lower costs of compliance; for government, efficiencies in consultation and policy development; and for regulators, efficiencies in the provision of guidance.

In this regard, the current process provides an opportunity for Australia to build on the lessons learned from other relevant jurisdictions, where a climate-first approach has not taken adequate account of broader sustainability in framework design.

Beyond the headline ambitions, the Consultation Paper also makes use of other purpose-related concepts, including 'core principles' (page 6), 'primary objectives' (page 10). However, the relationship between these, and the headline ambitions, is not clear. This could lead to confusion among taxonomy users (including institutional investors) and lead to difficulties in implementation where the taxonomy is seeking to deliver on potentially competing objectives. In this regard, the taxonomy would benefit from setting out how the headline ambitions relate to the core principles and primary objectives.

Interoperability

ASFA agrees that it is crucial that the Australian taxonomy should be broadly compatible with international standards and other jurisdictions' sustainable finance taxonomies (while taking account of the Australian context). This will help ensure that global investors can meet their obligations globally with respect to investments in Australia, by complying with the Australian taxonomy, and that Australia retains access to cost-competitive international capital that will be required for Australia's net-zero transition.

Globally, myriad frameworks are evolving to evaluate whether economic activities are aligned with, or contribute to the net zero transition, and sustainability objectives more broadly.

For institutional investors, the greater the degree of alignment between taxonomies, the easier it is to compare investment opportunities across different countries. This is particularly relevant for superannuation funds – whose total allocation to offshore assets is almost 50 per cent. It will also mean that Australia, as a destination for foreign financial capital, will not be disadvantaged.

A taxonomy landscape comprising inconsistent or even conflicting information is likely to create confusion among investors, increase the complexity of investment decisions, increase regulatory burden on institutions, and raise the cost of investing – which ultimately will impede the allocation of financial capital. For superannuation funds, in the context of global net zero transition, this suggests the risk of a lower quantum of funding from superannuation than otherwise would be the case, as well as a less efficient allocation of that funding in respect of net zero outcomes.

Thus, it is crucial that the Australian taxonomy is developed in concert with equivalent taxonomies in other jurisdictions, such that the Australian taxonomy is (and remains) internationally credible and operable – noting that taxonomy will be most effective as a 'living document'. In particular, the development (and refinement over time) of the Australian taxonomy should draw on taxonomies in equivalent jurisdictions, which are key sources of financial capital for Australia. ASFA recognises that development of the Australian taxonomy will need to take account of Australia's particular circumstances that relate to the structure of Australia's economy, and to our required transition pathway.

In this regard, ASFA acknowledges that the proposed headline ambitions reflect relevant international developments (e.g. EU and the UK), while accounting for the Australian context. Likewise, the proposed 'activity qualification' criteria (technical screening criteria for significant contribution activities, do no significant harm, and minimum safeguards) also reflect leading international approaches. Rightly, with respect to specific industry sectors, Australia's focus reflects the relative importance of those sectors in the Australian economy (e.g. the minerals, mining, and metals sector).

Once finalised, the taxonomy should include explanations for users on how it has been designed to be interoperable with other (international) taxonomies.

Additional comments

Integration into regulatory architecture

At this time, ASFA considers that is too early to specify the particular form of integration into regulatory architecture (by legislation or otherwise). Ultimately, this will depend on the final shape of the taxonomy – and in particular whether it is widely regarded as credible and legitimate, is widely adopted, and is considered by market participants as materially supporting Australia's transition to net zero. It is crucial to avoid a binding taxonomy that is not widely considered by investors as useful and effective.

Regardless, it is crucial that the taxonomy has interoperability with the multiple other areas of legislation affecting climate or sustainability reporting, which includes the recently developed regime for mandatory climate-related financial disclosures and product labelling regimes. This will help support the credibility and useability of the regime.

ASFA recognises that there are challenges in this regard – sustainability-related financial disclosures tend to be based on financial materiality threshold, while sustainable finance taxonomy tends to also incorporate impact assessment (e.g. no significant harm provisions).

Design to achieve sustainability outcomes

As stated in the Consultation Paper, the core purpose of the taxonomy is to facilitate investment decisions, and flow of financial capital, into sustainable activities and ensure market integrity, transparency, and fairness, and to address greenwashing.

A key risk in taxonomy design is that the criteria by which to determine whether funding decisions align with sustainability objectives ultimately discourage investment that otherwise would be consistent with objectives (and so would be at odds with the purpose of the taxonomy). There is an inter-temporal element to this risk: the more restrictive the criteria, the greater the risk that (over time) activities and investments that might have been considered sustainable (in accordance with the taxonomy) at a particular point in time, might not be considered sustainable at a later point in time.

While this risk can be reduced through taxonomy design, it cannot be eliminated. In this regard, it would be appropriate to incorporate a grandfathering mechanism, coupled with an obligation to disclose that an investment is no longer consistent with a sustainability criterion. Not only would this avoid penalising funds for making decisions that were, at one time, consistent with sustainability criteria, it also would avoid disorderly disinvestment from such assets (which would be at odds with the broader ambition for an orderly economy-wide transition to net zero).