Centre for Business and Social Innovation

Institute for Sustainable Futures

Unlocking Australia's Sustainable Finance Potential

Introduction

Global financial markets are gaining momentum on developing financial systems aligned to deliver climate and sustainability objectives. Many countries have committed to or are already in the process of creating and coordinating the implementation of road maps and action plans for a sustainable financial system. Financial institutions can see the challenge and opportunities in raising and directing trillions of dollars of finance required to deliver on the UN Sustainable Development Goals (SDGs). Developing new green infrastructure presents an estimated $100 trillion investment opportunity over the next 15 years to meet the Paris Agreement on Climate Change, and to mitigate risks posed to extant portfolios.

The World Economic Forum annual Global Risks Report shows a consistent trend for environment or human-made environmental risks to be of top concern, with the latest report attributing five of the top ten risks to such causes and dominating the top three positions. Sustainable finance is concerned with taking such environmental risks and turning them into opportunities. Collectively sustainable finance refers to any form of financial service including investment, insurance, banking, accounting, trading and financial reporting that goes beyond integrating environmental, social and governance (ESG) criteria into business or investment decisions. As an integral part of the economy, the financial system can reduce short term systemic risks and direct investment toward long term sustainability targets.

The Paris agreement requires nations to take action to limit their greenhouse-gas emissions and prevent global temperatures from rising 2 degrees Celsius above pre-industrial levels. The European Union (EU), sought first mover advantage to obtain these goals by requesting advice from a High-Level Expert Group (HLEG), comprised of 20 industry experts. The HLEG considered how to enable coordinated action, mechanisms to steer capital towards sustainable investments and protect the financial system from environmental risks. The HLEG released its final report in January 2018 and its recommendations now form the basis of the EU's Action Plan on Sustainable Finance adopted by the European Commission (EC) in March 2018.

High-Level Findings

This report reviews the EU Action Plan, comparing each of its ten action points to the current state of play in Australia. Analysis of opportunities for unlocking Australia's sustainable finance potential are considered in relation to the unique landscape of the Australian financial sector and the opinions of a wide range of financial sector experts.

The EU is recognised as an emerging global benchmark with the development of its Action Plan. Australian experts agree that there is opportunity to learn from the recommendations of the EU Action Plan, although there is considerable disagreement on some elements such as the adoption of a taxonomy, mandated standards, labels and disclosures (see Table 1 below). Adopting such a comprehensive and coordinated sustainable finance action plan in this country would mean overcoming some serious and endemic hurdles as well as grasping the available opportunities. These include:

Coordination and consistency: Most stakeholders indicated that a major impediment to the emergence of sustainable finance was a politicised agenda regarding climate policy, that was disconnected from the operationalisation of a progressive policy agenda and even further disconnected from thriving voluntary sustainable finance initiatives. Most stakeholders agreed a sustainable finance system would focus on long term horizons yet moving away from a short-term focus would require a series of changes across the finance system simultaneously undertaken by different stakeholders. In relation to listed companies: investors need to accept long-term returns as fund performance indicators: asset managers need to see long-term performance as optimal return; and boards have to change incentive structures for executives. This must be underpinned by trust and collaboration between these interdependent stakeholders.

Regulatory opportunity: The EU action plan items are already progressing towards adoption as three pieces of legislation have been proposed to the EC, together with several non-legislative and investigative actions. By comparison to this trajectory, Australia's adoption of sustainable finance initiatives is mixed. On the positive side, there is a patchwork of initiatives across a spectrum of regulatory to voluntary, that could support uptake of sustainable finance in the Australian context. However, Australia lacks key initiatives that have underpinned action in the EU, such as mandatory disclosures and an emissions trading scheme. Experts highlighted that some elements of sustainable finance are yet to become a topic of serious discussion in the Australian financial sector, or there may be a sense of misplaced optimism whereby people perceive action is further advanced than is actually the case.

Overcoming inertia: Stakeholders in the Australian financial landscape have different roles and responsibilities than in the EU. Views differed regarding how to, and who is responsible for overcoming the embedded status quo, with most stakeholders alluding to initiatives others should undertake prior to their own action. This is categorised as a general malaise around how participants' perceive their own agency to affect adoption of sustainable finance in the Australian financial system. This appears to be an endemic and systemic impediment to the adoption of sustainable finance.

Education and awareness: Participants described a lack of understanding and engagement concerning the opportunities of sustainable finance and a tendency to carry on with business as usual. While respondents highlighted there was a proactive sentiment within the sustainable or responsible finance networks, they were met with a general resistance or despondency, that some attributed more strongly to a form of willful ignorance.

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Australian sentiment with regard to EU Action Plan items		
EU Action Plan		Summary of interview responses
0	Overall plan	General agreement
1	Establishing an EU classification system (taxonomy) for sustainable products.	Mixed views
2	Creating standards and labels for green financial products	Mixed views
3	Fostering investment in sustainable products	General agreement
4	Incorporating sustainability when providing investment advice	General agreement
5	Developing sustainability/carbon benchmarks	General agreement
6	Better integrating sustainability in ratings and research	General agreement
7	Clarifying institutional investors and asset managers duties	General agreement
8	Incorporating sustainability in prudential requirements	Further research required
9	Strengthening sustainability disclosure and accounting rule-making.	Mixed views
10	Fostering sustainable corporate governance and attenuating short-termism in capital markets.	General agreement

NEXT STEPS: Building on the recommendations of the Banking Royal Commission

Simple, principle-based law rather than precise rules
Strengthening connections between particular rules and norms of conduct e.g. fiduciary duties and disclosure
Breach of duties of super fund trustees may become subject to civil penalties
Supporting industry codes through increased enforceability e.g. governance and stewardship codes
Culture and corporate governance must focus on non-financial risk as well as financial risk
Remuneration systems and incentives must encourage sound management of non-financial risks

PROJECT SPONSORS

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