Safeguard Mechanism Reforms consultation - September 2022

HESTA welcomes the opportunity to make a brief submission to Department of Climate Change, Energy, the Environment and Water's *Safeguard Mechanism Reforms Consultation paper.*

Climate change impacts outcomes for HESTA members

HESTA is a super fund that invests around $68 billion of assets on behalf of more than 950,000 members who work in caring industries, primarily in the health and community services sectors. Eighty per cent of our members are women, and most are on low-to-middle incomes. Our members rely on us to ensure that their experiences are considered in complex policy deliberations that impact their financial security in retirement.

Climate change is a systemic risk that impacts the performance of our assets and therefore our members' financial wellbeing. As universal owners across the Australian and global economies, we cannot avoid this risk. Investment outcomes are being impacted by how the global economy transitions to a low carbon future, and it is in the best financial interests of our members to manage climate risk in our portfolio.

The need for a robust Mechanism

HESTA supports the Government's intention of promoting policy certainty and stability in pursuit of Australia's commitment to reduce national emissions to 43 percent below 2005 levels by 2030, and achieve net zero emissions by 2050.

To achieve this stability all relevant legislative and regulatory instruments need to formally consider how they enable the targets. We therefore welcome the opportunity that this consultation presents to ensure that the Safeguard Mechanism is driving genuine reductions in industrial sector emissions.

The best financial interests of members are served through a timely, equitable and orderly transition to a low carbon economy. A transition that is managed in this way reduces the likelihood of economic volatility, reduces the risk of stranded assets, and provides opportunity for investment in the new energy economy.

Enabling portfolio emissions reduction

The Safeguard Mechanism should operate in such a way that it provides a clear framework for investors as they undertake the crucial task of portfolio decarbonisation.

To support a well-managed transition, HESTA recently announced a new target to halve normalised emissions across our portfolio by 2030, lifting an interim target we set in 2020 to achieve a 33% reduction in normalised emissions by 2030 (against a 2020 baseline). As part of this target HESTA has committed to by 2030 investing 10% of our portfolio in climate solutions, such as renewable energy and sustainable property.

HESTA is committed to using active ownership with emissions-intensive companies to help drive down emissions in the portfolio and manage climate risk. HESTA has been engaging with emissions-intensive companies through both direct and collaborative programs for a number of years.

In 2021, we introduced our engagement escalation framework. In July this year, HESTA conducted an annual assessment of the climate change transition progress of companies that are key contributors to portfolio emissions. The assessment identified that four Australian listed companies face significant decarbonisation challenges, requiring a major shift in their strategies to meet a 1.5˚C transition pathway. These companies have now been moved to a watchlist position according to the framework.

Watchlist companies are subject to closer engagement and monitoring with additional escalation possibilities. We are requesting these companies review, among other things, their exploration activities and new projects against the imperative of achieving climate targets.

Ensuring the Mechanism drives emissions reduction

In order to fulfill its objective of delivering on the Government’s climate target and reducing the systemic risk that climate change presents for investors, it is imperative that the Mechanism is designed to deliver on the objective of driving an absolute reduction in emissions. In our engagement, HESTA has been agnostic about how companies achieve emissions reduction, as long as targets are structured to maximise the absolute reduction of emissions in line with a 1.5˚C outcome.

To achieve this:

- Baselines should be transparent, deliver the national emissions reduction target, and align with technology and emissions pathways designed to limit warming to 1.5°C

- Industry average benchmarks are a reasonable approach, however there is a need to ensure baselines drive reductions for all industry participants
- Company reporting should align with baselines, providing investors with a clear picture of how a company is tracking against baseline requirements
- Credits should be structured so that offsetting only occurs after genuine reduction has been maximised, with clear reporting to investors on how the use of credits supports the facility's emissions reduction pathway
- The approach should incentivise companies to reduce emissions as quickly as possible, while those with limited near-term abatement opportunities should be incentivised to undertake R&D and develop alternative transition approaches
- Importantly, any support for trade-exposed facilities must not slow emissions reduction or restrict necessary industry transition, and must be accompanied by transparent justification and reporting

A robust Mechanism with transparent reporting will provide the certainty and consistency investors need to manage climate risk in portfolios in line with emissions reduction targets. HESTA encourages the Government to ensure all relevant legislative and regulatory settings are aligned to deliver this outcome, supporting crucial decarbonisation efforts across the economy.