SETTING, TRACKING AND ACHIEVING AUSTRALIA'S CLIMATE TARGETS

HESTA submission – June 2023

HESTA welcomes the opportunity to provide a submission to the Climate Change Authority's consultation on Setting, Tracking and Achieving Australia's Climate Targets.

HESTA members and climate change

HESTA invests more than $72 billion on behalf of more than 1 million members who work in caring industries, primarily in the health and community services sectors. Almost eighty per cent of our members are women and most are on low-to-middle incomes. Climate, environment and social factors can impact the performance of our assets and therefore our members' investment outcomes. As large and diversified owners across the Australian and global economies, we cannot avoid the financial risks presented by climate change, environmental degradation and social inequality. Our members' investment outcomes are impacted by how we manage climate risk in our portfolio, and how the global economy transitions to a low carbon future.

Our approach to managing climate-related risks is carefully considered and informed by a wide breadth of investment expertise and research that prioritises members best financial interests.

HESTA is pleased to have achieved its interim portfolio emissions reduction target of 33% in normalised portfolio emissions[1] eight years ahead of its original 2030 target. In achieving this target, we have considered the Australian Government's increased commitment as well as the updated scientific research and strengthened our 2030 interim target from 33% to 50% reduction in normalised (intensity based) portfolio emissions, measured against the same 2020 baseline.

HESTA has also committed to investing 10% of our investment portfolio in climate solutions, such as renewable energy and sustainable property, by 2030[2]. As a large and

[1] Normalised carbon emissions scope 1 and 2 (tonnes CO2e / $m invested) below the 2020 baseline. We've chosen normalised carbon emission as it represents HESTA's share (based on Enterprise Value) of real-world emissions. As at 30 June 2022.
[2] Identification of opportunities has been based upon the Sustainable Development Investment Asset Owner Platform (SDI AOP) Taxonomy. Investments that are aligned to SDG 7, 11.1 and 13 have been included in the baseline.

diversified asset owner, we support a stable, cohesive, internationally-aligned framework that supports active ownership approaches and investment innovation to allow us to undertake the crucial task of portfolio decarbonisation while investing in Australia. This will help to ensure that Australia remains competitive in global markets, enabling sufficient provision of capital to meet the enormous challenge of the transition, while facilitating equitable sharing of the opportunities presented by the transition to a low carbon economy.

HESTA's recommendations focus on key areas of the Authority's consultation paper that are material to investment outcomes for our members.

Stable, cohesive, Paris-aligned policy settings needed to facilitate investment

Moving towards stable, cohesive, Paris-aligned policy settings would support Australia in attracting the investment that is needed to transition our economy to a low carbon future. Stability is particularly important for patient superannuation fund capital, which is well suited to long-term investments in energy infrastructure, renewables, and low emissions technology, provided the policy settings deliver the right conditions.

To address climate risk and foster the conditions necessary for scaling of institutional investment and portfolio decarbonisation, Australia's climate targets should move towards Paris-alignment and all relevant legislative and regulatory instruments should be consistent with and supportive of the achievement of these climate targets. A cohesive, internationally-aligned policy approach will support investment innovation and enable greater capital allocation to climate solutions and maximisation of opportunities arising from the transition.

HESTA supports the Authority's proposed stocktake of Commonwealth, state and territory emissions reduction and adaption policies. This stocktake should be as broad as possible, taking into account all transition-enabling policy settings, including considering work that is in development and consultation such as the Sustainable Finance Strategy, National Climate Risk Assessment and the Capacity Investment Scheme. The policy framework should also be based on an assessment of the barriers to achieving sector pathways and targets (see below).

Both the national interest, and the best financial interests of superannuation fund members are served through a cohesive legislative and policy framework that delivers a timely, equitable and orderly transition to a low carbon economy. A transition that is managed in this way is likely to reduce economic volatility associated with an abrupt or

disorderly transition, reduces the risk of stranded assets, reduces physical risks and provides opportunity for equitable distribution of the benefits of investment in the new energy economy.

Recommendation 1: *Ensure recommendations support an internationally consistent, stable, cohesive policy framework, based on the broadest possible policy stocktake and that all legislative, financing and policy settings are focussed on delivering Paris-aligned climate targets.*

Focus on physical risk

Alongside transition risks, investors are particularly focussed on physical climate-related portfolio risks, which are expected to be the most financially significant area of climate risk over the longer term. Financial implications of natural disasters, rising sea levels and major weather events may include direct damage to assets, as well as business disruption and indirect costs from supply chain disruption and insurance costs.

HESTA has commissioned analysis to understand and rate the exposure to acute and chronic physical impacts of climate in our infrastructure and property portfolios. The analysis supports an ongoing strategy of engagement with asset managers and portfolio companies to focus on capital expenditure and maintenance programs as part of a broader adaption strategy to climate risk and follows on from a physical risk assessment that was undertaken previously.

An accessible, comprehensive, internationally-aligned Government response to assessing and managing physical climate risk is centrally important to providing the conditions needed for long-term investment. To support this, consideration of physical risk, with input from industry and technical experts, should be incorporated into all climate-related risk modelling and assessment, with physical risk benchmarks included in the Authority's progress and strategic frameworks. This should be coordinated with the development of the National Climate Risk Assessment.

Recommendation 2: *Embed consistent consideration of physical risk throughout relevant policy settings, frameworks and modelling, ensuring benchmarks are internationally-aligned and closely informed by technical and industry expertise.*

Indicators of progress must consider social license and those most at risk

To ensure a just and equitable transition that maximises Australia's strategic advantage and reduces barriers to deploying capital, measures of progress toward net zero should consider diversity and human rights experiences and outcomes, as well as ensuring that transition planning takes a broad view of economic and social outcomes for communities that are impacted by the transition. International examples demonstrate that in an energy transition that fails to take account of social equity risks, those who can least afford energy bear a disproportionate burden.

Maintaining community support is crucial to enabling transition activity. Consideration of factors related to level of community support should be embedded throughout transition-enabling frameworks and progress evaluation.

HESTA supports the focus on priority groups outlined in section 2.2 of the issues paper, including First Nations peoples (who are strongly represented in all other priority groups including those below), regional, remote and very remote communities, and low income earners. We encourage the Authority to expand this to include specific consideration of women and carers, health and community sector workers, and human rights in supply chains.

The gender impacts of climate change

Any assessment of wellbeing should include a gender lens to understand the particular impacts of climate change on people of different genders, including how the particular adverse impacts of climate change affect these groups, including ensuring they can equitably access new opportunities presented by the transition.

The majority of HESTA members are women, a significant 44% of HESTA members live outside capital cities and almost 5% live in communities that will be directly impacted by the transition in the short-term. While they are less likely to work in directly impacted jobs, and therefore are at risk of being overlooked when programs to support impacted industries are being developed, they work in largely lower paid roles in services that are closely integrated with impacted communities. Many of our members work part-time in these roles while they also provide unpaid care work in these communities.

The health impacts of climate change

Assessment of wellbeing should include consideration of the impact of climate change on health outcomes, including for those with existing health concerns, and the impact of

climate change on the wellbeing of health and community services sector workers who are likely to experience increased demand for services due to health effects of climate change.

These impacts include heatwave-related deaths, the spread of infectious diseases, the potential social dislocation of climate refugees, and the consequences of extreme weather events. The Victorian Council of Social Service found that smoke from the 2019-2020 Black Summer bushfires has been responsible for 120 deaths and around 1,300 hospital admissions for cardiovascular illness, respiratory disease, and asthma[3], and it is expected that climate change will continue to lead to more frequent and severe bushfires.[4]

The human rights impacts of climate change

Measures of progress to net zero must also consider protection of human rights throughout the supply chains that will be called on to deliver renewables and emerging technologies – meeting the challenge to transition our economy should not be predicated on the use of modern slavery, including forced labour. Concerns include alleged labour rights abuses in production of polysilicon in particular regions for use in solar panels and the mining of critical minerals including cobalt for use in batteries, and labour rights, environmental and indigenous land rights issues around the sourcing of balsa wood for use in wind turbines.[5] These modern slavery supply chain issues create a barrier to investment in renewable technology. They also present opportunities for the development of new industries and supply chains that build on Australia's strategic advantage, particularly in the area of critical minerals.

Recommendation 3: *Indicators of progress towards net zero emissions and adaptation to climate change should take into account community support and human rights outcomes, including the impact of climate change on:*

- *Health outcomes and health and community sector employees*
- *Women and carers*
- *Those vulnerable to modern slavery, particularly in renewable supply chains*

Risks and opportunities for investors

HESTA uses both active ownership[6] and the integration of climate change into decision-making and capital allocation as strategies to seek to drive a reduction in emissions in our

[3] VCOSS, Submission to the Inquiry into Health Impacts of Air Pollution in Victoria, April 2021.
[4] Climate Council, The Facts about Bushfires and Climate Change.
[5] Clean Energy Council, Addressing Modern Slavery in the Clean Energy Sector, November 2022.
[6] Principles for Responsible Investment, Acting Ownership 2.0.

portfolio. This requires working with portfolio companies who are taking action to reduce emissions, as well as looking for opportunities to deploy capital in the new energy economy in both Australia and internationally that provide appropriate risk adjusted returns for our members. We see a role for the Commonwealth Government in removing the barriers to scaling capital allocation and creating the conditions for effective stewardship that enables transition activity, including through setting climate targets, introducing mandatory climate-related disclosures and a sustainable finance taxonomy.

Corporate action

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

By focusing on engagement over divestment, we include within our investible universe those companies that may have high emissions today but are able to transition. We note that many major emitters are already moving to set their own 'net zero' commitments and reduce emissions.

We can use active ownership, or corporate stewardship, to engage with companies in which we invest to influence a shift in their strategy to move towards alignment with a low carbon future. We seek to use collaborative approaches through engagement, voting and advocacy, working with other asset owners and managers to strengthen our voice.

While we do apply selective divestment (particularly for business with very limited ability to transition and where we have formed the view that further engagement is unlikely to achieve alignment with our objectives and ensure any divestment decision is in members' best financial interests), we believe that active ownership is more effective in supporting a timely, orderly and just transition than divestment alone. Without ownership, responsible investors have little ability to influence high emitting companies. We believe active ownership, using the tools of company engagement, share voting and advocacy, is more effective than divestment. Simply selling shares in high emitting companies, without first attempting to change company behaviour, does little to mitigate the broader systemic risks of climate change. Our members' investments held across the globe are still exposed to these long-term climate-related risks and divestment effectively moves the problem to the next buyer of these shares.

Recommendation 4: *Policy settings should seek to provide certainty to investors to enable their continued engagement with companies to set and achieve corporate transition plans.*

The global search for new energy investment opportunities

To meet our target of investing 10% of the portfolio in climate solutions by 2030, we continue to look for opportunities to invest in the development of renewable energy, and innovative technologies and businesses that are at the forefront of the shift to a low carbon future.

Australia's natural assets and track record in large-scale energy industries gives us the potential to become a global leader in exports such as green hydrogen and renewable energy. Australia also has significant opportunity arising from the reserves of critical minerals required for low emissions technologies.[7] Seizing these opportunities is crucial to supporting economic growth, driving long-term value for super fund members, and supporting a just and equitable transition.

While opportunities with strong potential to meet investor risk and return expectations are present in Australia, opportunities in other jurisdictions are increasingly attractive as global competition for clean energy capital drives significant increases in public expenditure[8]. Despite some positive developments in the 2023-24 Federal Budget, Australia risks lagging over time without a substantial and coordinated response from Government that addresses financing gaps to enable decarbonization pathways.

Investors are looking for opportunities to invest in the transition through a variety of approaches. Government support should be coordinated based on an assessment of investment barriers across transition pathways, and delivered to facilitate innovation, and support both debt and equity exposure.

For example, HESTA regularly explores emerging technologies and monitors the market with a view to investing in these as they become more scalable and their risk/return parameters become suitable. To meet the risk-return profile that institutional investors

[7] ASFI, Designing Australia's sustainable finance taxonomy, December 2022.
[8] For example, the US Inflation Reduction Act.

require, technologies must reach a certain stage of development and be able to demonstrate their underlying investment thesis.

HESTA has recently signed a platform agreement for investment in proposed Australian green hydrogen projects with ReNu Energy through its subsidiary Countrywide Hydrogen. Countrywide Hydrogen originates and develops green hydrogen projects with a view to developing them alongside project partners and governments. Projects initially target domestic market demand with a view to expanding the projects to meet future export demand where viable.

There is an opportunity for Government to accelerate the development of opportunities such as these with measures that improve certainty of offtake, as well as by providing early stage funding with a high risk appetite to new or emerging technologies. This could de-risk the technology, accelerating the ability for institutional investors to deploy capital to scale the technology.

> ***Recommendation 5:*** *Expanded, coordinated, predictable, targeted financing models that provide a range of ways for investors to access opportunities is needed to facilitate investment in the transition and to enable Australia to remain competitive globally. The Government should also consider measures such as increasing certainty of offtake that improve the risk/return profile for investment.*

The need for a move towards a Paris-aligned 2035 target

HESTA supports the Government's intention of establishing Australia as a climate leader. Investment outcomes are stronger in an orderly transition, which in turn moves towards alignment with the goals of the Paris Agreement to pursue efforts to limit warming to a 1.5°C pathway[9]. Australia's 2035 target should seek to align with this objective, providing the stability investors need in the form of increased policy certainty delivered by clear national climate targets and the frameworks that enable them.

Moving towards alignment with the Paris Agreement is crucial to limiting physical impacts and transitioning Australia's traditionally emissions-intensive economy, avoiding increasing costs of capital[10] and maximising opportunities arising from the transition. A

[9] A path of emissions reduction for a country, sector or company that aligns with or is moving toward alignment with the goals of the Paris Agreement to limit warming to well below 2°C and pursuing efforts to limit it to 1.5°C.

[10] Treasury estimated that the capital risk premium associated with poor Australian transition policies could range from 100 to 300 basis points by 2050: Australian Government, Australia's Long-term Emissions Reduction Plan: Modelling and Analysis.

coordinated effort from investors and the private sector based on ambitious Government leadership will be needed if we are to be successful in meeting the challenge of transition.

Recommendation 6: *Set a Paris-aligned 2035 emissions target intended to limit global warming to well below 2°C and pursue efforts to limit the temperature increase to 1.5°C to improve policy certainty and support an orderly transition.*

Sector transition pathways are the basis for scaling capital

To deliver absolute decarbonisation outcomes in the real economy, climate targets must be supported by Paris-aligned emissions pathways for emissions-intensive sectors of Australia's economy. Sector transition pathways should provide a basis for policy setting that identifies and removes barriers to achieving the required sector outcomes. Pathways are crucial to providing certainty and inform decision making for companies and investors, supporting the allocation of capital to transition activity. HESTA welcomes the Government's intention to deliver sector plans along with a Net Zero Australia Plan.

Pathways should include sector-specific targets that support national targets, and align with global transition pathways and analysis while adapting to the Australian context. They should include sufficient detail to provide certainty for the development of corporate transition plans, while not being overly prescriptive, and be subject to ongoing progress monitoring and review. Sector pathways build on the substantive body of work that has already been completed, including that done by the Australian Industry Energy Transitions Initiative[11], and should be subject to consultation with industry and climate experts.

HESTA supports the Authority's intention to focus initially on sectors as they are set out in Australia's National Greenhouse Gas Inventory (electricity, stationary energy, transport, fugitive emissions, industrial processes and product use, agriculture, waste, and land use, land use change and forestry) and the key greenhouse gas emitting activities within these sectors.

[11] Australian Industry Energy Transitions Initiative.

Importantly, analysis of barriers to delivering sector pathways should form the basis of a cohesive policy response aimed at scaling capital to deliver the transition.

Recommendation 7: *Develop Paris-aligned sector transition pathways to provide a clear roadmap for policy makers, investors and companies own transition plans as they manage the risks and opportunities associated with the transition.*

Carbon credits

We support corporate decarbonisation plans that follow a robust mitigation hierarchy, prioritising absolute reduction in emissions before using offsets. Where offsets are used these should result in genuine emissions reduction from removal rather than avoidance. The Climate Active integrity principles provide a framework to ensure that any offsets used are genuine and credible.

Improvements in the functioning of carbon markets, and the transparency of ACCUs can provide investors with greater confidence to enter carbon markets and build market depth and trading liquidity. We support the commitment to implement the recommendations of the Chubb Review, in particular measures to enhance integrity and improve disclosure and transparency. We also welcome the development of the Australian Carbon Exchange as a mechanism to encourage greater institutional investment in carbon markets.

However, we recognise that the growth and operation of the carbon market should be balanced against the purpose of the carbon market, to support and fund real-world decarbonisation and facilitate emissions removal for hard-to-abate sectors, either through nature-based or technological means. Integrity buffers should ensure that this purpose is given the highest priority in scheme design.

Recommendation 8: *Integrity buffers should give highest priority to the purpose of carbon markets: to support real-world decarbonisation and facilitate emissions removal for hard-to-abate sectors, either through nature-based or technological means.*