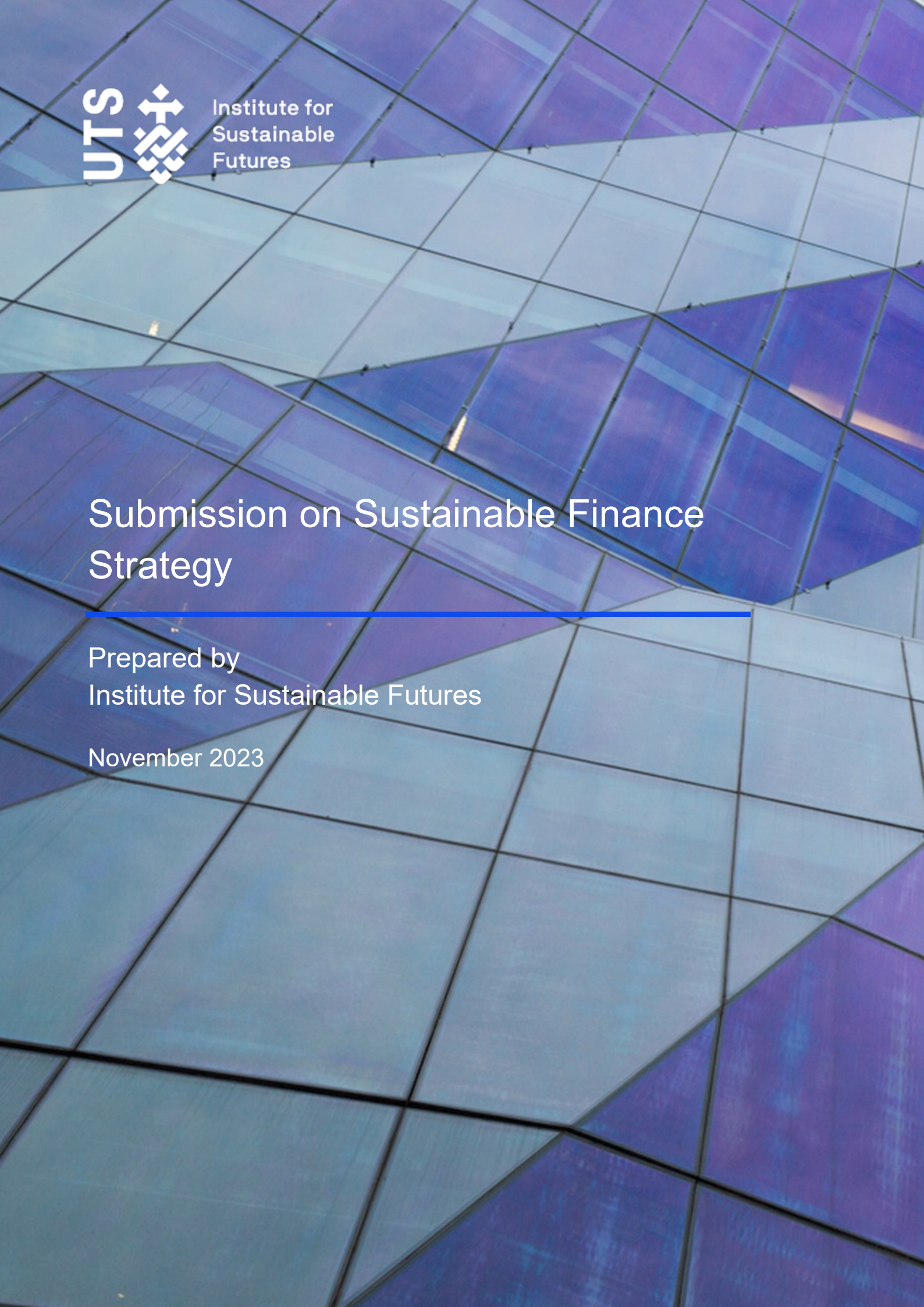

UTS Institute for Sustainable Futures

Submission on Sustainable Finance Strategy

Prepared by
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About the Institute for Sustainable Futures

The Institute for Sustainable Futures (ISF) is an interdisciplinary research and consulting organisation at the University of Technology Sydney with over 100 research staff and students. ISF has been working collaboratively since 1997 with governments, businesses, organisations and communities to create change towards sustainable futures. Our work in Australia and around the world aims to protect and enhance the environment, human well-being and social equity. We work with financial system participants to advance sustainability, prosperity and well-being through sustainable finance and investment. We deliver bespoke research and capacity building services with a focus on partnering to establish a sustainable finance learning ecosystem.

Summary

Thank you for the opportunity to make a submission on the Australian Government's Sustainable Finance Strategy which proposes a range of measures to support Australia's transition to net zero emissions.

UTS Institute for Sustainable Futures (ISF) broadly supports the Strategy. We believe that the Government's actions will establish foundations that will support the mobilisation of capital needed to finance the transition to net zero.

Our submission provides a detailed response aligned to the Strategy's three pillars. We highlight areas where engagement by the Australian Government can support Australia's net zero transition.

A critical issue we highlight is the importance of sustainable finance skills and competencies. We are concerned that the lack of depth and quality of sustainable finance skills may be an impediment to Australia's net zero transition. Our submission proposes practical measures for the Australian Government to support that would build the depth and quality of sustainable finance skills across Australia's financial system.

We note the Strategy's approach focuses on the need for actions to be carefully staged and sequenced. One of the challenges with a sequenced approach is that some issues are fundamentally connected. We cite nature risks that are fundamentally linked to climate risks, as well as the transition to a more circular economy as a cross-cutting de-risking strategy. Given the scale and urgency of the multiple environmental crises we face nationally and internationally, we believe a more urgent and holistic response is required on these issues. We believe there is a need for the Australian Government to establish supportive cross-cutting institutional structures to implement the response.

We make the following additional recommendations to the Sustainable Finance Strategy, aligned with the strategic priorities:

Pillar 1: Improve transparency on climate and sustainability

Priority 1: Establish a framework for sustainability-related financial disclosures

Strategic actions to support sustainable finance skills and competency

The Australian Government should establish an annual Australian Sustainable Finance Employment Report that identifies and monitors sustainable finance skills and competency across the financial system.

There is a need for regulators to develop a consistent approach to assessing the sustainable finance competency of a financial institution. We propose that the Council of Financial Regulators consult on disclosure of *Sustainable Finance Continuing Professional Development.* An organization's systems and processes should enable employees to register sustainable finance CPD. Regulators should request financial institutions to disclose *Sustainable Finance Registers* to enable the quality, appropriateness, and frequency of sustainable finance learning to be reviewed.

Treasury should issue a discussion paper for consultation on sustainable finance competency standards that examines international practices and considers options for the Australian financial system.

There is a need for institutional structures that build understanding of the levels of competency and emergence of skills gaps. We propose that the Australian Government should establish a transdisciplinary Green Finance Skills Centre that would support the development of skills and competencies, identifying and addressing market gaps through interventions including delivery of an annual Australian Sustainable Finance Employment Report.

Priority 2: Develop a Sustainable Finance Taxonomy

According to the Australian Sustainable Finance Institute (ASFI), the Australian sustainable finance taxonomy is intended to be used to guide capital to achieve Australia's climate, environmental and social objectives. We recommend that the sustainable finance taxonomy objectives should therefore be informed by the key climate, environmental and social policy priorities, ambitions and commitments of the Australian Government, while also incorporating international best practice (where this is relevant to Australia) and

scientifically determined benchmarks. This includes Government climate and environmental priority areas that are still under development, such as climate/net zero planning, nature positive and initiatives to support the transition to a more circular economy. The taxonomy should also consider incorporating social objectives in future. Incorporating Australia's international commitments to the Paris Agreement, Kunming-Montreal Global Biodiversity Framework as well as the UN Sustainable Development Goals (SDGs) is also important.

We support the concept that the taxonomy is embedded in Australia's financial regulatory structure. We suggest that potential use cases can go beyond corporate and financial sustainability disclosure and product labelling standards, to include i) setting the foundation for sustainable finance skills development, ii) form the basis for corporate sustainability due diligence undertaken by banks and investors in financial decision-making, and iii) provide a foundation for Green, Social, Sustainability and Sustainability-Linked (GSSS) bonds, loans and securitisation markets.

We propose that the Council of Financial Regulators (CFR) establish a Climate Financial Risk Governance Board to provide a mechanism for Australia's financial system regulators to work with Australian financial system participants, including businesses, banks, investors, insurers and research institutions. Such a body would be consistent with collaborative structures that have been used across the financial system.

Priority 3: Support credible net zero transition planning

We recognise that transition plans are still under development, but their quality needs to rapidly improve to provide adequate, high integrity information, and we support the issuance by ASIC of guidance on transition plans. Without the issuance of regulatory guidance, we are concerned that differences in transition plan practices will emerge, resulting in fragmentation that would make it difficult for consumers to make informed decisions on the integrity of organisation's net zero transition plans.

We suggest that high integrity plans should at a minimum include: i) scope and coverage of short to long-term decarbonisation targets; ii) alignment of targets to scientifically robust target setting methodologies; iii) sufficient quantification of measures to achieve targets and allocation of capital; and iv) consistent and transparent progress reporting against targets.

It is also important to acknowledge that climate and nature are fundamentally interlinked, and that nature and climate risk must be integrated. We recommend the timely incorporation of nature into the Sustainable Finance Strategy to avoid potential severe consequences of delay.

Priority 4: Develop a labelling system for sustainable investment products

We support the issuance of guidance on labelling sustainable investment products, in line with Australia's principles based regulatory framework. A key issue is to ensure that the cost of operating certification schemes does not become prohibitive. Alignment of labelling standards with the taxonomy needs to be considered, and we suggest that regulators issue a discussion paper on potential pathways.

Pillar 2: Financial system capabilities

Priority 5: Enhancing market supervision and enforcement

We recommend that a priority for addressing greenwashing is to develop robust guidance on transition planning, drawing on gold standard transition planning frameworks.

We believe that there is no clear purpose of regulating ESG ratings separately to other investment research, particularly given the evolution of investor practices focused on disaggregated data. While ESG ratings may (or may not) be demanded by investors in future, ESG data will be. We suggest that a next step should be to conduct research to understand how investors are using ESG ratings and ESG data.

Priority 6: Identifying and responding to potential systemic financial risks

A key issue we identify is the lack of broad knowledge across Australia's financial system of systemic sustainability risks posed by breaching planetary boundaries. The dangers of extreme heat are an example, where it is important for investors to understand the impacts on climate scenarios and on investment portfolios.

Nature should also be seen as a systemic sustainability risk, as more than half of global GDP is dependent on biodiversity and ecosystem services. With Australia facing a nature crisis, as outlined in the recent Australian Government State of the Environment Report, and with current policy priorities including nature positive planning, updating the EPBC Act and developing a nature repair market, it is positive to see that nature and biodiversity is intended to be incorporated into the Sustainable Finance Strategy. Institutional structures (such as the Green Finance Skills Centre mentioned above), can be used to leverage the existing expertise in Australia's university sector on systemic sustainability risks within the financial system.

An emerging area of systemic risk is linear risk, which is a result of the way we produce and consume products and food – the current "take-make-use-waste" linear economic model. This linear economic model is unsustainable, with growing levels of production and consumption impacting on earth systems, including driving the multiple planetary crises of climate change, biodiversity loss and pollution.

The transition to a more circular economy is increasingly recognised as a systems solution that is key to addressing sustainability risks such as climate change, biodiversity loss, pollution, water as well as linear risk. We therefore recommend that the transition to a more circular economy should be incorporated into the Sustainable Finance Strategy as a cross-cutting de-risking strategy.

Priority 7: Addressing data and analytical challenges

The Australian Government should work with key data holders to ensure that there are no structural impediments that prevent data from being efficiently accessed, including consideration of how to make existing databases more accessible and useful.

Priority 8: Ensuring fit for purpose regulatory frameworks

Skills and competencies need to be developed in sustainability risk assessment across the financial system, including nature risk and linear risk.

We urge the Government to undertake a systemic review of barriers and solutions to superfund allocation of capital to the net zero transition. This is not an issue that can wait because the urgency of transition requires a rapid response to overcome systemic barriers to release allocation of Australia's most substantial capital funds. Potential solutions could include measures to address the liquidity challenges and absence of YFYS benchmarks of early-stage companies.

There are clear benefits to creating a bridge between Australia's science community and Australia's superannuation system. This can be facilitated through a partnership with the Federal Government. 'Science meet finance' skills and competency programs can also support superannuation funds to build science capabilities that are needed for key investment opportunities.

Pillar 3: Australian Government leadership and engagement

Priority 9: Issuing Australian sovereign green bonds

The issuance of Australian Government green bonds should be seen from a strategic perspective. As the Australian Government approaches issuance of green bonds, a key consideration should be how its activities support creation of the market not only of green bonds, but of green lending. Opportunities from building the depth of Australia's green bond market include:

- Finance for new and existing projects that offer climate change and environmental benefits, such as renewable energy, pollution prevention, sustainable agriculture, clean transportation, circular economy products and green buildings.
- State and local governments, including water businesses issuing bonds for nature-related and circular economy initiatives.
- Banks providing green loans to customers for a range of purposes including energy retrofits as well as nature-related and circular economy initiatives.
- Local governments in partnership with State Governments issuing green bonds to redevelop community infrastructure.
- Government providing credit enhancement for bonds and loans that focus on circular and nature-related investments.

Priority 10: Catalysing sustainable finance flows and markets

The CEFC should consider additional ways to support circular business model SMEs and start-ups, small-scale distributed energy and deployment of storage technology.

The Australian Government should encourage the Future Fund to establish a net zero transition plan.

Priority 11: Promoting international alignment

A key priority for the Australian Government should be to support financial system capacity building aligned to the G20 Sustainable Finance Working Group.

Priority 12: Position Australia as a global sustainability leader

Australia has the opportunity to become a regional sustainable finance hub. Key to this opportunity is the strength of Australia's university sector engagement with our region. Sustainable finance skills and competencies should be seen as a mechanism through which Australia can provide education and learning services to our region.

Blended finance approaches should be adapted to suit local circumstances with opportunities to establish businesses listed on local stock exchanges in Pacific Island Countries that focus on distributed energy opportunities suitable for the region's 25,000 islands.

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 Australian Government should develop a strategic approach to the development of green and sustainable finance skills and competencies to prevent momentum stalling as Australia's financial system (including businesses, banks, investors, insurers and regulators) implement the Government's finalised Sustainable Finance Strategy.

All participants across Australia's financial system will need to be involved in Australia's net zero transition. From an employment perspective, a broad range of skills and occupations will be involved in supporting net zero transition. Accountants, risk managers, chief financial officers, investment analysts and bankers are just some of the professions that will be involved.

If Australia's financial system participants do not have the requisite skills and competencies to implement the Government's Sustainable Finance Strategy then, given the importance of appropriate asset allocation by the finance system, there is a risk that Australia's momentum towards net zero will slow. Should momentum stall, it would be difficult to recover in time to meet net zero goals. It is also important that the Australian financial system has the appropriate skills to determine which sustainable activities are to be considered to guide capital to achieving Australia's climate, environmental and social objectives (refer also Priority 2 re: taxonomy below).

Sustainable finance requires both specialist expertise and technical knowledge as well as a broad understanding from all financial participants including consumers and small businesses. The development of sustainability-related financial disclosure frameworks is increasing the need for technical competence across Australia's financial system. As sustainable finance mainstreams, which will initially be driven by requirements of businesses, institutional investors and banks to report climate-related financial disclosures, we can expect that there will be a need to not only build the technical competence of existing sustainable finance employees, but to build sustainable finance literacy across the whole of the financial system. Our comments in this section relate not only to skills and competencies required for sustainability-related financial disclosures, but to sustainable finance more broadly.

ISF- CSIRO Sustainable Finance Skills Survey

ISF began focusing on the issue of sustainable finance skills in 2022 when, in partnership with CSIRO Climate Science Centre, we released the report *Advancing climate skills in the Australian financial system* [1] which detailed the results of our national 'Climate Skills Survey' of finance professionals to understand the level of climate-related skills across Australia's financial system.

Survey respondents were people working in Australian financial institutions or financial system related roles, including government or academia, who self-identified that they have some responsibility for sustainable finance-related matters in their role.

More than three quarters of survey respondents indicated that climate skills were in moderate to high demand in their organisation. Demand for climate skills was greater than supply, with 67% in total saying there is less supply than demand and nearly 40% of respondents saying there is much less supply than demand.

Given survey respondents were sustainable finance professionals there would be an expectation that this cohort already had significant skills. However, 63% of respondents indicated that they felt that they needed to upskill on their own climate skills, a reflection on the rapid development of new tools and frameworks globally.

[1] https://www.uts.edu.au/isf/explore-research/projects/advancing-climate-skills-australian-financial-system

The report argued that there is a climate skills gap and that this gap is likely to grow unless urgent action is taken. Whilst the survey was conducted in 2022 from anecdotal conversations the demand for climate-related financial skills has increased in 2023.

The report also examined how climate and sustainable finance skills are being integrated into financial system regulatory practices and financial centre initiatives.

An example of an international initiative is the Climate Training Alliance (CTA), a collaboration between the Bank of International Settlements, the International Association of Insurance Supervisors, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), and the UN-convened Sustainable Insurance Forum that was established in July 2021 as an open collaborative learning platform for financial system regulators to share knowledge and promulgate best practices in managing climate risk.

Nations are also developing sustainable finance skill initiatives:

- The Monetary Authority of Singapore and the Institute of Banking and Finance Singapore (IBF) have launched the Sustainable Finance Technical Skills and Competencies (TSCs) framework to provide robust, common level of sustainable finance proficiency, knowledge and abilities needed for individuals to perform various roles in sustainable finance.
- The United Kingdom's Green Finance Institute hosts the Green Finance Education Charter 16 which is designed to build the capacity and capability of the green finance sector by ensuring all financial services practitioners have the skills necessary to accurately assess climate and nature-related risk and opportunities.
- In Ireland, Sustainable Finance Skillnet works to upskill those employed within both the financial services sector and corporate Ireland to be leaders in the area of sustainable finance and where Environmental, Social and Governance (ESG) skills are an imperative.
- Japan's Financial Services Agency Second Report of the FSA Expert Panel on Sustainable Finance focuses on skills and competency. The report outlines the importance of skills maps, understanding scientific knowledge and integrating sustainable finance into finance-related courses at universities.
- The UK's Financial Conduct Authority issued a Discussion Paper DP23/1[2], *Finance for positive sustainable change: governance, incentives and competence in regulated firms,* which recognised the need for genuine capability-building across the financial sector, including staff training on climate change and net zero, and sustainability more broadly. The discussion paper argued that "collective knowledge and ongoing training can help create a work environment where different expert views are shared. Knowledge gaps, including a failure to identify interdependencies between sustainability issues, may hinder a firm's ability to make informed decisions".
- The Hong Kong Monetary Authority has supported the establishment of the Centre for Green and Sustainable Finance (GSF Centre) to "build capacity and enhance talent and data resources for the financial industry". The Hong Kong Monetary Authority released Core Level of the Enhanced Competency Framework on Green and Sustainable Finance[3] a framework to facilitate banking practitioners to acquire green and sustainable finance (GSF) knowledge and develop professional competencies in the GSF-related area more effectively.
- The 2023 G20 Sustainable Finance Report[4] recommended that financial market participants should consider enhancing internal capacity to increase investments in the climate transition and SDGs. They should also consider developing sustainable finance competency frameworks to help measure and align relevant governance processes with the gaps identified in employee skills, knowledge, and attributes with relevant climate- and sustainability-aligned plans.
- The Sustainable Stock Exchanges Initiative announced[5] that with support from the IFC and the IFRS Foundation, stock exchanges will be providing training and guidance on the latest standards for climate and sustainability disclosures published by the IFRS Foundation's International Sustainability Standards Board.

[2] https://www.fca.org.uk/publication/discussion/dp23-1_updated.pdf
[3] https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2023/20230728e2.pdf
[4] https://g20sfwg.org/wp-content/uploads/2023/10/Volume-I-G20-India-Final-VF.pdf
[5] https://sseinitiative.org/all-news/stock-exchanges-preparing-markets-for-new-climate-disclosure-standards/

Concerningly, LinkedIn's recent Green Skills Report[6] found that "While the median green talent concentration across all industries is 12.3% (meaning that one in eight workers has green skills), it's only 6.8% for the finance industry (meaning that one in 15 has green skills). This places finance behind industries ranging from energy and mining to agriculture, healthcare, and manufacturing, when it comes to green talent." The LinkedIn Green Skills Report reveals that Australia ranks 30th on share of green talent for finance.

Strategic Actions to Support Sustainable Finance Skills and Competency

The development of sustainable finance skills and competencies cannot be left to the market alone.

The challenge with a market approach to the development of sustainable finance skills and competencies is the time it will take to develop a skilled workforce across the whole of Australia's financial system (including businesses, banks, investors, insurers and regulators).

In the short term a sustainable finance skills deficit will lead organisations that are seeking to build expertise to actively recruit from the market. The result will be increasing salaries for employees with skills that are in demand. Anecdotal evidence is that this is already occurring.

A market approach to sustainable finance skills and competencies will ultimately result in disruption as employees seek better paid roles. Organisations that lose employees will in turn be forced to recruit from a shrinking pool of candidates as supply is not keeping pace with demand. The challenge is that the disruption caused by market forces will inevitably impact the quality of efforts to implement the Government's Sustainable Finance Strategy.

Through a strategic approach to the development of sustainable finance skills and competencies the Government can support Australia's financial system to build the skills and competencies that will ultimately support transition and will also help to address greenwashing, which is becoming an increasing issue in the Australian financial sector. We propose a number of initiatives:

Australian Sustainable Finance Employment Report

Positive measures are being put in place to build skills and competencies a[1]cross industries that will be responsible for implementing investments aligned to Australia's net zero transition. In particular, the Australian Energy Employment Report (AEER), which is Australia's first national energy workforce survey, will assist with understanding the skills development and training opportunities in the energy sector that relate to net zero transition.

The Australian Government should establish an annual Australian Sustainable Finance Employment Report that identifies and monitors sustainable finance skills and competency across the financial system. The report would provide valuable data on skills needs and gaps relating to achievement of climate and other sustainability goals. One of the core purposes of the report would be to provide students with intelligence on market needs which then informs their studies.

Sustainable Finance Competency Assessment

Competency is a foundation of professionalism. Transition to net zero emissions and SDG impact requires financial system participants, including corporates, banks, investors, insurers, regulators to build skills and competencies around sustainability. Without adequate and credible competency, the progress of transition may be impeded. A key benefit to financial institutions of building sustainable finance competency is to protect from allegations of greenwashing and to reduce the risk of inadvertent greenwashing.

The importance of sustainable finance skills and competency is recognised through APRA's Prudential Practice Guide CPG 229 (Climate Change Financial Risks) which outlines that a financial institution's management is responsible for ensuring that adequate resources, skills and expertise are allocated to the management of climate risks, including thorough training and capacity building amongst relevant staff. From engagement with financial institutions, we are aware that regulators are questioning financial institutions

[6] https://economicgraph.linkedin.com/research/global-green-skills-report

around their approach to climate related skills. As regulators implement the Government's sustainable finance program it will be increasingly important to be able to assess the competency of an institution.

A foundation of professional development is continuing professional development (CPD). Given the importance of climate change and delivering on the SDGs, it is considered that the equivalent of one week's employment of continuing professional development (CPD) per year is an appropriate standard for a full-time sustainable finance professional. This is consistent with other professions. For sustainability professionals where sustainability is a component of a role, the hours of sustainability focused CPD should be allocated on a pro-rata basis depending on the number of hours dedicated to sustainability functions. A benefit of aligning sustainable finance skills training with CPD is that it is recognised within existing CPD requirements rather than becoming a time burden. Demonstration of competence provides some defence from allegations of greenwashing.

Sustainable finance professionals should be provided with learning relevant to the employee's function. Sustainable finance CPD should:

- be relevant to the employee's current role and any anticipated changes to that role
- maintain the employee's knowledge by reference to current qualification standards relevant to the role
- contribute to the employee's professional skill, knowledge and subject matter expertise
- address any identified gaps and emerging requirements in the employee's technical knowledge
- have written learning objectives based on learning needs and a documented learning outcome
- be measurable and capable of being independently verified by an accredited body

A significant challenge facing for profit and not-for-profit boards is the need for appropriate qualifications and skills to manage the risks from nature loss and or climate change impacts. We note comments from AICD that "it will be critical for directors to ensure that any decision in relation to strategy, risk oversight or disclosure in relation to biodiversity-related issues is made on the basis of contemporary knowledge in what is a highly-dynamic area. Depending on the company context, specific capacity-building on biodiversity may be warranted."[7] There is an opportunity to integrate nature-related risks into sustainable finance competency assessments.

There is a need for regulators to develop a consistent approach to assessing the sustainable finance competency of a financial institution. We propose that the Council of Financial Regulators consult on disclosure of *Sustainable Finance Continuing Professional Development.* An organization's systems and processes should enable employees to register that sustainable finance CPD that employees receive. Regulators should request financial institutions to disclose *Sustainable Finance Registers* to enable the quality, appropriateness, and frequency of sustainable finance learning to be reviewed.

Sustainable Finance Competency Standards

We define Sustainable Finance Competency as having the skills, subject matter knowledge, capabilities and technical expertise to discharge the sustainability-related responsibilities of an employee's role.

Given the range of sustainable finance skills required, a one size fits all approach to competency does not necessarily work. Given different international jurisdictions are developing approaches to build sustainable finance competency standards, and given the focus on harmonisation of standards globally, it is important that the Australian Government develops an understanding of the potential opportunities, and challenges, of developing sustainable finance competency standards that align to Australia's financial system.

We recommend that Treasury issue a discussion paper for consultation on sustainable finance competency standards that examines international practices and consider options for the Australian financial system.

Green Finance Skills Centre

It is strategically important for the delivery of the Australian Sustainable Finance Strategy that mechanisms are established that support development of sustainable finance skills and competencies across the whole of Australia's financial system. There is a need for institutional structures that build understanding of the levels

[7] https://www.aicd.com.au/risk-management/framework/climate/biodiversity-resource.html

of competency and emergence of skills gaps. We propose that the Australian Government should establish a transdisciplinary Green Finance Skills Centre that would support the development of skills and competencies, identifying and addressing market gaps through interventions including delivery of an annual Australian Sustainable Finance Employment Report. The Centre could also be a central point for sustainable finance skills collaboration across the Australian university sector.

There are a number of areas of innovation where deep scientific knowledge is required to make informed investment decisions. The Institutional Investors Group on Climate Change Climate Investment Roadmap identifies over 100 technologies that are required for decarbonisation, covering energy-related sectors and agriculture, forestry and other land use.[8] Hydrogen and battery technologies are two immediate areas where Australia's financial system will need to have sufficient understanding of science to make informed decisions. A Centre can also provide a mechanism to bring scientific knowledge, which is often held in Australian universities, to financial system practitioners.

A Centre also has the potential to provide a mechanism for regional and global engagement around skills with potential international partners. International education is one of Australia's largest service exports, and the Centre could provide a catalyst to enhance sustainable finance skills in the region. A Centre that delivered quality learning would attract sustainable finance professionals from across the region.

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

Integrating nature

We note the Strategy's approach focuses on the need for actions to be carefully staged and sequenced. One of the challenges with a sequenced approach is that some issues are fundamentally connected. We would cite nature risks that are fundamentally linked to climate risks. The danger of a sequence approach is the potential to result in a delay in actions which could have catastrophic impacts. Institutional structures are needed to enable evolution of sustainable finance practices including nature-related risks.

The issue of whether TNFD is an appropriate disclosure standard needs to be separated from the issue of nature-related risks. It is important to have a discussion on whether the pathway that is being developed for climate related disclosures, should be adopted for nature risks. Whilst we see benefits in application of TNFD, there is a need for a bottom-up approach that recognises that parts of the economy where nature risks are most material may be small businesses without significant financial resources, particularly farms.

We specifically recognise the need to build skills around nature and circular economy. As the breadth of the technical knowledge that Australia's financial system will require the management of sustainability risks, it will be essential to build partnerships. An understanding of nature risks cannot be achieved without building foundational knowledge around nature risks. Understanding the core principles of the circular economy will also grow in importance, including its cross-cutting ability to address other sustainability risks such as climate change and nature (refer also response to Priority 6 below).

We specifically recognise the opportunity of the Australian Government hosting the Global Nature Positive Summit to facilitate a global dialogue on nature and finance which can benefit Australian financial system participants through an understanding of global best practice.

We also note the 2023 APEC Joint Finance Minister's Statement, describing the shared support for action by APEC economies on sustainable finance.[9]

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?

Priorities

[8] https://www.iigcc.org/resources/iigcc-climate-solutions-guidance
[9] https://www.apec.org/meeting-papers/sectoral-ministerial-meetings/general/2023-apec-finance-ministers-meeting

According to ASFI, the Australian sustainable finance taxonomy is intended to be used to guide capital to achieve Australia's climate, environmental and social objectives. The sustainable finance taxonomy priorities and objectives should therefore be informed by the key climate, environmental and social policy priorities, ambitions and commitments of the Australian Government, while also incorporating international best practice (where this is relevant to Australia) and scientifically determined benchmarks.

International taxonomy priorities and objectives are being developed in various markets globally, and interoperability between these taxonomies will be paramount for the global financial system, including for the Australian financial and business sectors. These objectives have been largely derived from the EU Taxonomy and are focussed on climate and environmental objectives such as nature/biodiversity, water, pollution prevention and circular economy. These should be considered in the Australian context, as well as Australia's international commitments to not only the Paris Agreement and Kunming-Montreal Global Biodiversity Framework, but also the UN SDGs.

Taxonomy priorities and objectives should also consider those Government policy priorities that are still under development or evolving, for example on climate/net zero planning, nature positive and activities to support the transition to a more circular economy in Australia (including the activities of the Circular Economy Ministerial Advisory Group as well as nature positive and circular economy initiatives disclosed in the Environment Ministers communiques).

It is positive to see that Government intends to incorporate nature and biodiversity in the Sustainable Finance Strategy to align capital to nature positive outcomes, as well as that nature and biodiversity objectives are also to be considered in the taxonomy. Supporting the transition to a more circular economy is also recognised as a key initiative for Government sustainable finance leadership, and remains work in progress. Importantly, it should also be viewed as a de-risking strategy for sustainability risks (including climate and nature), and should form a key cross-cutting part of the strategy (please refer Priority 6 below). Water stress as well as pollution (and impact on air, water and soil) are also important environmental issues for Australia that should be incorporated in the taxonomy priorities.

Further to the climate and environmental priorities, a set of social priorities and objectives should also be considered that could contribute to Australia's social goals. A taxonomy focussed on social priorities could help to direct investment into areas such as social housing, education, healthcare and First Nations initiatives. These priorities could also be aligned to Treasury's "Measuring What Matters" national wellbeing framework.

It is also important to acknowledge the interconnectedness of the various Government policy priority areas relevant to the taxonomy, ie, climate change is linked to not only nature/biodiversity loss, but also other environmental objectives. The EU Taxonomy, for example, acknowledges the overlap between its sustainable finance climate and environmental objectives, and the important role of transitioning to a circular economy in meeting these objectives. This is also acknowledged in the development of the Government's Net Zero 2050 plan, which has a focus on the circular economy as a cross-cutting issue in the development of decarbonisation plans for all sectors.

Use cases

An Australian sustainable finance taxonomy has the potential to have a range of use cases.

- Sustainable finance regulatory framework: the taxonomy should be used as a key pillar in a future Australian sustainable finance regulatory framework, including financial product disclosure (such as product labelling standards, as is further discussed in Priority 4 below), as well as corporate and financial institution sustainability reporting disclosure (as is done in other markets, including to address greenwashing). This would align with the proposed corporate disclosures to commence in 2024.
- Sustainable finance skills: the taxonomy could be used to set the foundation for sustainable finance skills development, to ensure skills are appropriate to guide capital to achieve Australia's climate, environmental and social objectives.
- Corporate due diligence: the taxonomy can be used by banks, investors and businesses to form a basis for corporate sustainability due diligence undertaken in financial decision-making. Key concepts may be able to be incorporated in risk (and opportunity) assessment tools.

- Foundation for GSSS debt products: The taxonomy can also be used as a foundation for Green, Social, Sustainability and Sustainability-Linked (GSSS) bonds, loans and securitisation markets. To maximise the development of Australian green and sustainable finance debt markets, the Australian Government's green bond program should aim to stimulate best practice by offering green bonds that finance specific sustainable activities.

International experience

International taxonomies are largely still under development, with the EU Taxonomy the most advanced (including its context within the EU sustainable finance disclosure framework). The EU Taxonomy has had its challenges, and it continues to be refined, but there appear to be increasing levels of alignment of capital to sustainable activities that are prioritised by the EU.

There has been only limited academic research on the effectiveness of international sustainable finance taxonomies. It is however noted that using regulation to nudge corporate investments towards sustainability requires clear sector specification and definitions of sustainable activities.

Expanding Taxonomy Coverage

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

As noted above, the sustainable finance taxonomy priorities and objectives should cover the sustainability-related policy priorities of the Australian Government to guide capital to meet Australia's climate, environmental and social goals, while also considering international best practice. This includes policy priorities beyond climate, including nature positive, water, pollution prevention, circular economy and social objectives.

Taxonomy Governance

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

We support the concept that the Australian Sustainable Finance Taxonomy is embedded in Australia's financial regulatory architecture. We highlight that a necessary pre-condition is that the requisite skills and competencies exist.

There is a logic that the CFR could be responsible for the ongoing management of the taxonomy on the basis that the taxonomy will impact across different regulatory functions, including the involvement of the CFR Climate Working Group.

For the CFR to be responsible for the ongoing management of the taxonomy there is a need to develop deep climate and broader sustainability-related financial expertise. There are a number of models that could be adopted including the European Central Bank's approach to integrating climate change into its operations which has included establishing a Climate Change Centre[10] which consists of ten staff working with existing teams across the bank, reporting to the ECB's President who oversees the ECB's work on climate change and sustainable finance.

One option is for the CFR to establish a Climate Financial Risk Governance Board to provide a mechanism for Australia's financial system regulators to work with Australian financial system participants to implement climate-related financial risk management practices across Australia's financial system and support prudential regulation of climate risk. The establishment of a Climate Financial Risk Board would be consistent both with the way Australia's financial system has worked over the last twenty-five years, where industry expertise is harnessed to support system outcomes, and with international regulatory practices where collaboration is being institutionalised.

A Climate Financial Risk Governance Board could provide the skills and competency foundation would then support ongoing governance of the Australian Sustainable Finance Taxonomy.

[10] ECB sets up climate change centre (europa.eu)

A Climate Financial Risk Governance Board should be sufficiently resourced. APRA collects Financial Institutions Supervisory Levies from the financial sector that are used to fund elements of financial industry-related operations. As a key purpose of a Board would be to support the prudential regulation of climate risks including through a sustainable finance taxonomy, then the use of APRA levies to fund its operations would in our view be appropriate.

A core aspect of Australia's principles-based regulatory system is to involve financial system participants in the development of regulatory practices. Examples of institutions where this occurs include the Payment Systems Board, Financial Reporting Council, ASX Corporate Governance Council and Gateway Network Governance Body Ltd.

Important aspects of Australia's financial system regulation are supported by collaborative bodies such as those outlined above. On the issue of greenwashing, a formal bridge has not yet been built between Australia's financial system regulators and Australia's financial sector. This is the same as for other aspects of sustainable finance. A CFR Climate Financial Risk Governance Board could focus on greenwashing and would provide a mechanism for Australia's financial system regulators to work with Australian financial system participants to implement best practice, consistent with the foundations laid through the Wallis Inquiry.

The CFR Climate Working Group could continue to support ASIC, ACCC, APRA, RBA and Treasury with a forum to consider sustainable finance issues for a government perspective. A CFR Climate Financial Risk Governance Board would provide a mechanism for collaboration across Australia's financial system.

Priority 3: Support credible net zero transition planning

Capability and practice

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?

We recognise that transition plans are still in an embryonic development stage, but quality of transition plans needs to rapidly improve to provide adequate, high integrity information. Currently there is no standard form of transition plan in use in the Australian market. This leads to inconsistencies in levels of detail and quality of data provided, lack of comparability between plans, difficulty with tracking progress and lack of clarity on whether plans align with scientifically determined decarbonisation pathways. This increases the risk of greenwashing and the risk of Australia missing its decarbonisation targets.

Frameworks like TPT and UN High Level Expert Group (HLEG) provide the basis for high integrity transition plans that could be adapted to the Australian context.[11] Priorities for plans would include, at a minimum, disclosure of:

- scope and coverage of short-, medium- and long-term decarbonisation targets
- alignment of targets to scientifically robust target setting methodologies based on relevant sectoral decarbonisation pathways
- sufficient quantification of measures to achieve the targets and allocation of capital
- consistent and transparent progress reporting against targets

The building of capability will be enhanced if there are structured mechanisms through which individuals and institutions can learn and build their own capabilities.

We reiterate our proposal in Priority 1 that the Australian Government should establish a Green Finance Skills Centre as an institutional structure to support the development of sustainable finance skills and competencies. A key area of focus for a Centre can be building capabilities around transition plans.

ISSB aligned corporate disclosure practices

[11] https://www.un.org/en/climatechange/high-level-expert-group

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?

Australia has a strong financial system regulatory framework that has enabled Australia to successfully weather financial market storms. A key to this success is the principles based regulatory framework that enables the Australian Government and financial system regulators to work collaboratively with financial system participants. Australia's financial system regulatory framework is based on the reforms proposed by the Australian Government's 1996 Financial System Inquiry (Wallis Inquiry). Successive Australian Governments have continued to evolve regulatory frameworks.

Consistent with Australia's financial system regulatory frameworks we support the issuance by ASIC of guidance on transition plans. Without the issuance of regulatory guidance we are concerned that difference in transition plan practices will continue, resulting in fragmentation that would make it difficult for stakeholders, including investors, to make informed decisions on the integrity of an individual institution's net zero transition plan.

ASIC guidance should reflect that there are some areas where prescriptive standards will be required. In particular there is a need for standards around particular metrics to enable comparison. There is a need for guidance around assurance and verification. There is also a need for community confidence on ASIC guidance. This requires an open and transparent consultation process.

Transition Planning for Nature and other sustainability issues

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

It is important to acknowledge that climate and nature are fundamentally interlinked. An example is extreme heat events with the Bureau of Meteorology's State of the Climate 2022 Report expecting "continued warming, with more extremely hot days and fewer extremely cool days". We discuss this further in Priority 6 in our section on nature systemic risk.

We believe nature and climate risk must be integrated. Whilst we understand that rational of a sequence approach to deliver the Sustainable Finance Strategy, this should not apply to nature risk. The danger of a sequence approach to nature has the potential to result in a delay in actions which could have catastrophic impacts.

As noted in our response to Pillar 1 priorities above we propose two institutional structures, the Green Finance Skills Centre and a Climate Financial Risk Governance Board as foundations to build nature-risk standards and practice. Both of these institutional structures would have the ability to adapt to meet future needs including transition plans for nature and other sustainability issues. The benefit of these structures is to institutionalise collaboration across the whole of Australia's financial system including banks, investors, businesses, regulators, academia and research institutions.

Priority 4: Develop a labelling system for sustainable investment products

Certification schemes

What should be the key considerations for the design of a sustainable investment product labelling regime?

Certification schemes in the Australian market, such as RIAA's Responsible Investment Certification were built at a time when sustainable investment standards did not exist. Certifications have evolved as market participants have become more sophisticated through voluntary practices around ESG integration. As sustainable investment matures it is important for consumer confidence that labelling standards support the integrity of certification schemes. The issuance of guidance on labelling is consistent with Australia's principles based regulatory framework.

Key issues for consideration is to ensure that the cost of operating certification schemes does not become prohibitive. This would have an impact on parts of the Australian financial system that do not necessarily have a depth of resources.

A key issue that guidance can address is how labelling links to the Australian sustainable finance taxonomy. Thinking on alignment of labelling standards with the Australian sustainable finance taxonomy needs to occur in parallel with the development of the taxonomy. We propose that regulators issue a discussion paper on potential pathways.

Aligning with international developments

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

There is a need for Australia's financial system regulators to stay connected to global developments around labelling. Australia's financial regulatory frameworks have been developed to reflect our own needs. Whilst there are lessons that can be learned from labelling schemes in other jurisdictions Australia's regulatory framework should form the basis of our own approach to labelling.

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?

Addressing greenwashing

The ability of regulators to respond to evolving market challenges without requiring legislative changes provides the foundation to be able to address greenwashing. We identify that a challenge has been that until now regulators had not, up until now, taken an active approach to providing guidance around greenwashing. We support guidance such as ASIC's Information Sheet 271.

A priority for addressing greenwashing is to develop robust guidance around transition planning, drawing on gold standard transition planning frameworks, and to ensure that organisations that set a net zero target publish robust transition plans detailing how the target will be achieved.

ESG Ratings

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

ESG ratings need to be seen in the context of the development of voluntary responsible investment practices over the course of twenty years.

The context on how ESG ratings developed and how they are currently used is important.

Initially there were concerns that investors were not able to legally consider what were termed 'non-financial' factors. The United Nations Environment Program Finance Initiative played a key role in addressing the right of investors to consider what they termed as environmental, social and governance (ESG) issues through the 2005 "Freshfields" report.[12] Over the course of the next decade investors began to commission services from providers to understand the ESG risks their portfolios were exposed to. ESG research firms used a rating of a company to summarise an overall assessment on how ESG risk were being managed.

As ESG research has become more sophisticated in response to demand from investors we are seeing an evolution of practice with investors increasingly demanding disaggregated data from ESG research firms.

Research based on interviews with superannuation funds conducted by ISF PhD student Donna Lopata has found that superannuation funds are using multiple providers with divergent ratings with divergence largely linked to differing methods of forward-looking analysis. Data is often used as launch pad for corporate engagement. Funds are seeking providers that have as broad data coverage as possible including physical risk. No single provider is yet offering a complete package.

There is no clear purpose to regulating ESG ratings separately to other investment research particularly given the evolution of investor practices focused on disaggregated data. ESG ratings may, or may not, be demanded at all by investors in the future. ESG data will be. A next step should be to conduct research to understand how investors are using ESG ratings and ESG data.

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?

Systemic risks

A key issue we identify is the lack of broad knowledge across Australia's financial system of systemic sustainability risks posed by breaching planetary boundaries. We highlight the dangers of extreme heat as an example.

[12] https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

ISF, together with CSIRO, recently presented a 50° scenario to the Australian Superannuation Investment conference.[13] Our work focused on the plausibility of a 50° day, linkages to climate scenarios for super funds, and impacts on investment portfolios.

Extreme heat poses a number of systemic risks. A Lancet 2022 study that looked at 7,360 studies found that 1°C increase in temperature is positively associated with increased mortality and morbidity.[14] Extreme heat events can lead to a collapse of a pollinator colonies Researchers have found that with six hours at 42°C, 50 percent of male honeybees die.[15] A 50° scenario for south-east Australia, which is plausible, has the potential to lead to an increase in mortality and morbidity that will impact place pressures on Australia's health system with significant impacts on productivity. There are a range of nature risks posed from extreme heat that include productivity impacts to the economy as impacts on pollinators would flow through to agriculture productivity.

Nature itself should be considered a systemic sustainability risk. According to the World Economic Forum (WEF), as well as underpinning human activities and wellbeing, more than half of global GDP is dependent on biodiversity and ecosystem services.[16] Further, according to the WEF 2023 Global Risks Report, climate change and nature-related risks are the top global long-term risks ranked by severity.[17]

Australia is facing a nature crisis. The Australian Government's most recent State of Environment Report indicates that the state and trend of the environment of Australia is poor and deteriorating because of increasing pressures from climate change, habitat loss, invasive species, pollution and resource extraction. Existing environmental legislation (the EPBC Act) is also recognised as being inadequate to address these pressures and their impact on Australia's natural environment. The Australian Government has recognised these issues, and in 2022 set out its key nature-related policy reforms, including plans to establish a nature repair market, update the EPBC Act and the release of a Nature Positive Plan. It is also positive to see that nature and biodiversity is intended to be incorporated into the Sustainable Finance Strategy, including through the taxonomy.

We note that there is a broad range of expertise around systemic sustainability risks across Australia's university sector. The challenge is that there is an absence of institutional structures that enable research to be presented to financial system participants. We highlight our proposals for a Green Finance Skills Centre and CFR Climate Financial Risk Governance Board as creating the institutional architecture to support integration of climate-related financial risks into practice. These structures would also provide a mechanism to research and discuss systemic sustainability risks.

Linear economy systemic risk

The current dire state of the climate and environment is due not only to the way we produce and use energy, but also due to the way we produce and consume products and food – the current "take-make-use-waste" linear economic model. This linear economic model is unsustainable and a systemic risk, with growing levels of production and consumption impacting on earth systems, including driving the multiple planetary crises of climate change, biodiversity loss and pollution.[18]

Addressing these climate and environmental challenges is increasingly urgent from a resources point of view as we are overshooting planetary boundaries, ie the safe operating space for humanity based on the biophysical processes that regulate the stability of the earth system, including climate change and biosphere integrity.[19] Overshooting planetary boundaries increases the risk of generating large-scale and irreversible environmental changes, with impacts on humanity and the planet's ecosystems on which we rely.

Much of the focus of reducing greenhouse gas (GHG) emissions to address climate change has been on the energy sector, with much less focus on GHG emissions caused by materials, products and food. These

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[13] https://www.financialstandard.com.au/news/how-to-warm-up-for-a-50-degree-day-179801094
[14] https://www.thelancet.com/journals/lanplh/article/PIIS2542-5196(22)00117-6/fulltext
[15] McAfee, A. (2022). Extreme heat waves threaten honeybee fertility and trigger sudden death. The Conversation. theconversation.com/extreme-heat-waves-threaten-honeybee-fertility-and-trigger-sudden-death-178504
[16] https://www3.weforum.org/docs/WEF_New_Nature_Economy_Report_2020.pdf
[17] https://www3.weforum.org/docs/WEF_Global_Risks_Report_2023.pdf
[18] https://www.oneplanetnetwork.org/SDG-12/natural-resource-use-environmental-impacts
[19] https://www.apec.org/press/news-releases/2023/apec-finance-ministers-announce-joint-statement

account for ca. 45% of total global GHG emissions that contribute to climate change, ie, including those GHG emissions that are embodied in food (including land management) and products made from energy and process emissions intensive materials such as steel, cement, plastics and aluminium.[20] Further, according to the UNEP International Resources Panel, the extraction and processing of natural resources contributes to more than 90% of biodiversity loss and water stress.[21]

Circular economy as de-risking strategy

The transition to a more circular economic model is increasingly recognised as a systems solution that is key to addressing sustainability risks such as climate change, biodiversity loss, pollution, water as well as linear risk.[22] It is also notable that at the recent APEC Finance Minister's meeting that, in the context of sustainable finance, the Ministers' agreed to continue to support implementation of the Bangkok Goals on Bio-Circular-Green Economy, including to advance towards zero waste by increasing cooperation to advance circular economy approaches.[23]

It is encouraging to see that the Australian Government has also recently prioritised transitioning to a more circular economy as a key environmental policy goal and a way to achieve sustainable consumption and production as well as nature positive outcomes.[24] This initiative builds on the existing waste management and recycling policies already in place in Australia. The Circular Economy Ministerial Advisory Group is advising Government on the development of a national circular economy framework, which will be developed with state governments. It also considers key product stewardship initiatives, including for plastics, packaging, household electronics, textiles and other products.

The financial sector can be an important enabler in the transition from the current linear economy to a more circular economy in Australia, which will help to achieve Australian climate and other sustainability policy priorities and goals. As per the recent Circularity in Australian Business Report (2023), over 80% of Australian survey participants said that making the transition to a more circular economy was either extremely, very or somewhat important to the future of their business (including by reducing costs and increasing efficiency).[25]

Australian federal and state environment ministers have also committed to achieving a more circular economy by 2030, and given likely financing gaps to achieve this goal, these should also be considered in the Sustainable Finance Strategy. Australian investor and bank interest is growing in this area, and the transition to a more circular economy is an important next step to consider in relation to addressing Australian climate, nature positive and other environmental goals.

Much of the emissions caused by the way we produce and consume products, materials and food can be addressed by applying circular economy principles. Negative impacts on nature and biodiversity can also be addressed by incorporating circular principles for example in land and water systems. The transition to a more circular economy is also critical to ensuring that humanity can thrive within safe planetary boundaries, while also playing a role in meeting net zero targets and the UN SDGs.

There are however challenges, including that there is no agreed definition of the circular economy, including in the context of sustainable finance - however there is growing consensus in the Australian and global policy, business and financial communities. This defines the circular economy as a systems solution framework based on the following three principles, driven by design: i) eliminate waste and pollution; ii) circulate products and materials (at their highest value) and iii) regenerate nature.[26] It decouples economic activity from the consumption of finite resources and is underpinned by the transition to renewable energy

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[20] https://www.ellenmacarthurfoundation.org/topics/climate/overview
[21] https://www.resourcepanel.org/reports/global-resources-outlook; https://www.ellenmacarthurfoundation.org/topics/biodiversity/overview
[22] https://www.ellenmacarthurfoundation.org/; https://acehub.org.au/; https://circularaustralia.com.au/
[23] https://www.apec.org/meeting-papers/leaders-declarations/2022/2022-leaders-declaration/bangkok-goals-on-bio-circular-green-(bcg)-economy
[24] https://www.dcceew.gov.au/environment/protection/circular-economy
[25] https://acehub.org.au/knowledge-hub/research/circularity-in-australian-business-2023-perceptions-knowledge-and-actions
[26] https://www.ellenmacarthurfoundation.org/

and materials. The circular economy also promotes sustainable consumption and production based on the 9-R concept of refuse, reuse, reduce, redesign, repurpose, remanufacture, repair, refurbish and recycle.

There are a number of global initiatives underway to encourage the financial sector to consider circular economy in financial and investment decision-making, led by organisations such as the Ellen Macarthur Foundation (EMF), UNEP FI, Circle Economy and the EU through implementation of the EU Green Deal. These initiatives are considered global best practice and also relevant to the Australian financial sector:

- UNEP FI Principles for Responsible Investment (PRI) and Principles for Responsible Banking (PRB) have released guidance on circular economy for global banks and investors - note that all major Australian banks and institutional investors have signed up to these initiatives:
  - PRI (2022) recommends that investors "identify sectors with high linear material use and environmental impact… and allocate capital to sectors or business models that support circularity." PRI also provide guidance on ESG incorporation, stewardship, reporting & disclosure (including metrics and standards), linear risks (and circular economy as a solution) and regulatory drivers.[27]
  - PRB in early 2023 released updated guidance on "Resource Efficiency and Circular Economy Target Setting", which makes recommendations on how banks can support their clients in improving the resource efficiency and circularity of their activities (including through positive and negative screening), impact pathways and target setting.[28]
- The EU has been a key driver of both the transition to a circular economy (with the launch of the Circular Economy Action Plan in 2020 in support of the EU Green Deal) as well as sustainable finance.[29] A key regulatory driver (which is also relevant to large Australian companies that operate in the EU) is through the EU Taxonomy, which has the transition to a circular economy as one of six environmental objectives. It also recognises the relevance (and complexity) of the circular economy transition and its role in reducing pressure on other objectives such as climate, biodiversity, water and pollution.
- The International Capital Markets Association (ICMA) released a working paper in 2021 with guidance on suggested impact reporting metrics for circular economy. This is one of the ten categories of eligibility under the voluntary Green Bond Principles (international best practice for green bond issuance).[30]

All of these initiatives are globally relevant, including for the Australian financial sector. The PRB and PRI initiatives are voluntary (but considered best practice), whereas the EU is driven by regulation. These global initiatives all focus on circular business models, with best practice defined by higher value activities (such as sharing business models), rather than lower value activities (such as recycling).

In Australia, the Investor Group on Climate Change (IGCC) and Circular Australia have been active in promoting best practice in circular economy financing:

- IGCC in 2022 released a discussion paper for investors on the circular economy, which provides recommendations on embedding circular economy considerations within existing frameworks (such as the TCFD), as well as providing best practice case studies, resources and engagement guidance.[31]
- Circular Australia (previously NSW Circular) has been actively promoting best practice in financing circularity since 2020, with a Finance and Investment Taskforce made up of key stakeholders from across the financial system – including investors, banks, peak bodies, government and academics.[32]

[27] https://www.unpri.org/sustainability-issues/environmental-social-and-governance-issues/environmental-issues/circular-economy
[28] https://www.unepfi.org/industries/banking/guidance-on-resource-efficiency-and-circular-economy-target-setting-version-2/
[29] https://environment.ec.europa.eu/strategy/circular-economy-action-plan_en, https://finance.ec.europa.eu/sustainable-finance_en
[30] https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/GBP-IRWG-Suggested-Impact-Reporting-Metrics-for-Circular-Economy-andor-Eco-Efficient-Projects-June-2021-100621.pdf
[31] https://igcc.org.au/regenerate-restore-circular-economy-discussion-paper-for-investors-released-today/
[32] https://circularaustralia.com.au/finance-taskforce/

The NSW Circular Finance & Investment Rapid Review (2022) by UTS and UNSW presents more information on global initiatives and best practice in financing the transition to a circular economy relevant to Australia.[33]

Although the transition to a more circular economy is not a panacea or easy fix to solve the world's climate and environmental problems, it is an important tool in the sustainability toolkit. It will also require changing current entrenched systems, including transforming the global financial system - from banks and investors to government, industry bodies and business - to incorporate strong sustainability and circular economy principles in financial decision-making to better serve people and planet.

Priority 7: Addressing data and analytical challenges

Data priorities

What are the priorities for ensuring that data-related initiatives already underway are tailored to meet the needs of firms and investors?

We acknowledge the importance of data for Australia's financial system participants to make informed decisions. A range of initiatives, including mandatory climate-related financial disclosures, will have the impact of enabling financial system participants to access quality of data.

We anticipate that a market will develop for data with a number of providers already active in developing products and services for financial institutions and businesses.

The priority of the Australian Government should be to ensure that there are no structural impediments that prevent data from being efficiently accessed, including consideration of how to make existing databases more accessible and useful.

Government itself has a role to provide data to the market. One area where we identify an opportunity is the range of data held across federal and state governments that is relevant to the management of nature and climate risks. As recommended in Kelly et al 2020[34], we urge the Australian Government to work with key data holders including state governments, the Australian Bureau of Statistics, the Bureau of Meteorology, CSIRO, researchers and peak bodies to identify data gaps, issues and solutions for addressing data access and consistency issues.

Given the likely fast evolution in the market for climate-related data the Australian Government will need to review market developments on an ongoing basis. This is another example that demonstrates the need for institutional architecture that can support engagement on data challenges. A Climate Financial Risk Governance Board could for instance convene a Climate Related Data Working Group as an efficient means to identify and address emerging challenges in the market for climate-related data. Such a structure would enable future data needs in areas such as nature and circular economy to be efficiently address.

Sustainability Data Gaps

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

The CFR's key focus should be on ensuring that the market for data is efficient and that impediments to accessing data do not emerge. This includes evolving data needs such as nature and circular economy. We propose that the CFR Climate Financial Risk Governance Board could play a role in enabling financial system participants to communicate challenges around data.

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[33] Kobelentz et al (2022) Identification and measurement of circular assets and risks for the finance and investment sector in the transition to a circular economy. https://circularaustralia.com.au/wp-content/uploads/2022/03/NSW-Circular-Finance-Investment-Rapid-Review-2022.pdf

[34] Kelly, S., Vines, K., Kobelentz, K., Rutovitz, J., Atherton, A., Herring, J., 2020. The Use of Climate Scenarios in Australia. Climate-KIC & UTS Institute for Sustainable Futures.

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

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

Climate risk governance

Overall Australia's financial regulatory frameworks have served Australia well. A criticism of Australia's regulatory approach to sustainability is the initial lack of regulatory focus on sustainability. In recent years this has begun to be addressed including through release of guidance such as CPG 229 and ASIC Information Note 271.

However, a missing piece in Australia's regulatory frameworks when it comes to climate-related financial risks is the absence of institutional structures that enable collaboration between regulators and financial institutions. We highlight our proposals for a Green Finance Skills Centre and CFR Climate Financial Risk Governance Board as creating the institutional architecture to support integration of climate-related financial risks into practice.

Risk Assessment and Financial Decision-Making

Risk assessment is a key part of investment and lending decisions undertaken in the financial sector, as is risk management when reviewing portfolio investments and loans. Traditional risk assessment tools may overlook or underestimate exposure to sustainability risks, including risks related to climate change, nature and other sustainability issues. Skills and competency in sustainability risk assessment need to be built across the system. Regulatory intervention should be considered to ensure that sustainability risks beyond climate are adequately incorporated into risk assessment tools used by financial institutions in financial decision making.

An emerging area of sustainability risk is linear risk, ie the risk that a business is exposed to by following the dominant linear economic model (as outlined in Priority 6 above), including an organisation's using scarce or non-renewable resources, prioritising sales of new products as well as the failure to innovate, collaborate or adapt to changing market conditions.[35]

In research led by UTS and UNSW for Circular Australia (2022), it was recommended that linear risks should be considered in financial decision-making, as well as circular economy as a de-risking strategy.[36] A first step is to understand differences between linear and circular business models and their risks, with linear risks ranging from market (resource scarcity) and operational (supply chain) to legal (plastic bans) and reputational risks. Adopting circular approaches can help businesses insulate themselves against linear risks. Valuing externalities (such as pricing environmental impacts on linear products) could also help to facilitate the transition to a more circular economy.

The Netherlands, who are a leader in financing the transition to a circular economy, have acknowledged the importance of factoring linear risks into financial decision-making. This is a key priority of the Circular Finance Roadmap released by the Sustainable Finance Platform of De Nederlandsche Bank (the Dutch central bank) in 2022. The transition to a circular economy is also seen by the Dutch government as key to meeting environmental objectives related to climate, nature, pollution as well as supply risks. The major Dutch banks also view the circular economy as integral to their climate/sustainability strategies, including supporting their clients to become more circular.

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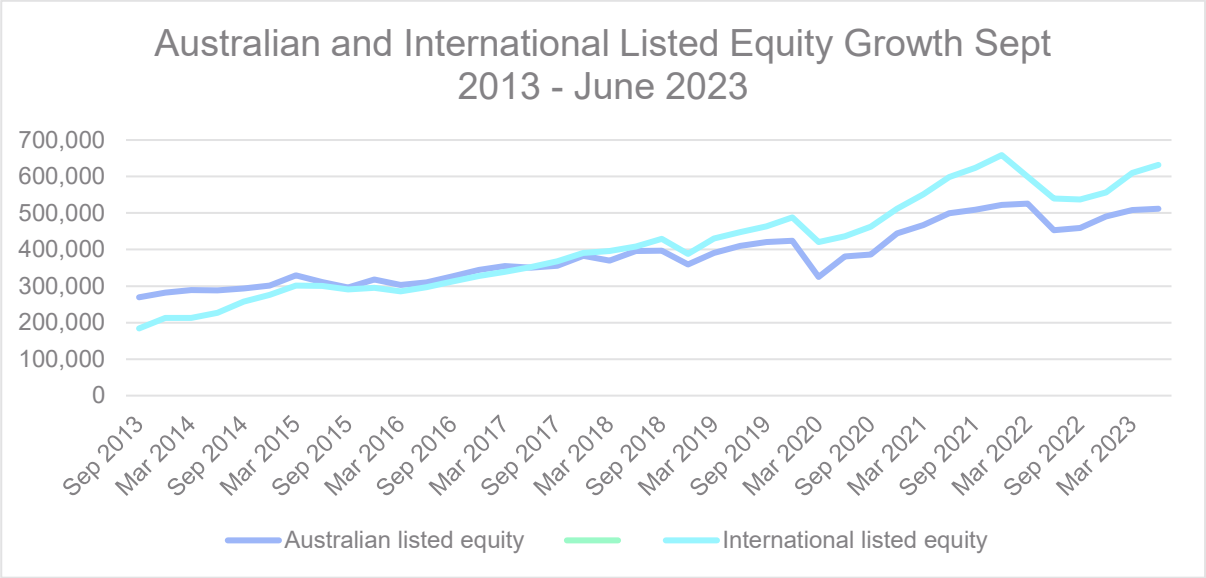
[35] https://www.circle-economy.com/resources/linear-risks-how-business-as-usual-is-a-threat-to-companies-and-investors
[36] Kobelentz et al (2022) Identification and measurement of circular assets and risk for the finance and investment sector in the transition to a circular economy. https://circularaustralia.com.au/rapid-review/

Superannuation Investment

Australia has the fourth largest pool of retirement assets in the world, with Australia's superannuation system currently at $3.4 trillion projected to grow from 116 per cent of GDP in 2022–23 to around 218 per cent of GDP by 2062–63[37]. Australia's superannuation system has the potential to reach $9 trillion in assets by 2041[38]. Australia's superannuation system is increasingly seeking to invest offshore. A number of large Australian superannuation funds have set up offices in New York and London to facilitate increasing investments offshore. A key component of superannuation asset allocation is listed equities. Over the last decade we have seen international equity outstrip investment in Australian listed equity.



Source: Australian Prudential Regulation Authority Superannuation Statistics https://www.apra.gov.au/quarterly-superannuation-statistics

Increased allocation to international investments has positive benefits to superannuation fund members through investment diversification. A key question is whether impediments exist for superannuation funds to make investments that support the Australian economy to transition to net zero.

Impediments to investment in net zero aligned early-stage companies

A significant proportion of superfund capital needs to be allocated to investment in net zero.[39] There is anecdotal evidence from superfunds that the YFYS benchmark conflicts with net zero goals due to the composition of the benchmark. At the same time, for many reasons, it is challenging for superfunds to invest in new technology, business models and innovation, which are critical to the net zero transition. Combined, these challenges create significant barriers to superfunds allocating sufficient capital to the transition. We urge the Government to undertake a systemic review of barriers and solutions to superfund allocation of capital to the net zero transition. This is not an issue that can wait because the urgency of transition requires a rapid response to overcome systemic barriers to release allocation of Australia's most substantial capital funds.

An area we identify is that superannuation funds find it hard to invest in early-stage companies. We use the words 'early-stage companies' rather than venture capital because we understand that the venture capital model which is associated with fees at exit of an investment does not work well for superannuation, not least because of intergenerational issues. Liquidity issues do not prevent superannuation funds from investing in early-stage companies, but they do constrain investment. There is a need to understand how constraints to

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[37] https://treasury.gov.au/sites/default/files/2023-08/p2023-435150.pdf

[38] Dynamics of the Australian Superannuation System | Deloitte Australia

[39] https://theconversation.com/making-money-green-australia-takes-its-first-steps-towards-a-net-zero-finance-strategy-214063

investing in early-stage companies could impact the ability of superannuation funds to make investments in emerging technologies that are critical to net zero transition.

There is a need to address the absence of benchmarks for early-stage companies through YFYS. The reality is that YFYS benchmarks determine the investment universe for superannuation funds. The bias of ASX towards certain sectors of the economy will, unless addressed, lead superannuation funds to invest more in offshore markets. With the right market encouragement there is the potential that early-stage companies move on to become ASX listed companies that provide opportunities for superannuation funds to invest in ways that align with net zero ambitions.

Net zero aligned technology innovation framework

A further challenge when investing in early-stage companies is that there are currently no mechanisms that provide assurance around the maturity of a new technology. This is particularly important as investors and banks will ultimately need to make decisions based on an understanding of science in emerging areas including hydrogen, battery technologies and carbon capture. There may be value in developing a net zero aligned technology innovation framework that provides a mechanism for investors to understand the overall level of maturity and commerciality of an innovation.

Aligning science and superannuation a $1 trillion opportunity

With Australia's superannuation system projected to grow to $9 trillion, aligning Australia's science expertise with our superannuation capital offers the opportunity to create the next generation of ASX listed companies. This is (conservatively) a $1 trillion opportunity. We note that Australia's university sector, including UTS, is the larger investor (one-third) of the 1.68% of GDP spent on research and development funding in 2022; the national total representing a 17-year low with universities playing a more important role. With the Australian Government increasingly encouraging the university sector to translate and commercialise their intellectual property, Australia's institutions are establishing venture capital funds that are limited in scale, being considerably smaller than the national opportunity. From a net zero transition perspective it can be expected that many of the new businesses that will drive transition will be based on new innovations, many of which will come out of, or rely on expertise within, Australia's university sector. Enabling investment by Australia's superannuation system in university research and development will accelerate the development and deployment of world-leading net zero and circular economy technologies, at speed and scale.

Complementing the above, building a bridge between Australia's science community and Australia's superannuation system requires can be facilitated through a partnership with the Federal Government. 'Science meet finance' skills and competency programs would provide invaluable support for superannuation funds to build understanding of science capabilities (and associated risks) that are needed for global investment opportunities.

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 proposed issuance of Australian Government Green Bonds has the potential to support the Australian Government to fund its net zero emissions objectives but also has the potential to support the development of Australia's green and sustainability finance markets.

The establishment of a Green Bonds Framework based on international best practice, that is supported by Australia's sustainable finance community is the foundation for the establishment of a trusted green finance market in Australia. Australian superannuation funds should be a key target for green bonds as this supports building local capabilities.

A Green Bonds Framework needs to continually evolve in response to market feedback. There is a need to establish institutional structures, as outlined earlier in the submission, that can provide a mechanism for ongoing governance review.

As the global financial system moves to integrate climate risk and sustainability factors into financial and investment decision making, a strong, vibrant Australian green bond market not only has the potential to support Australian financial institutions to meet their net zero emissions targets but can provide opportunities for Australia to become a genuine green financial market centre for the Asia Pacific.

Australian Government Bonds play an important role in Australia's financial system by providing a 'risk free' rate of return which becomes the foundation of risk management frameworks. Trading in government bonds establishes the yield curve which then becomes the benchmark for other borrowers including state government, and businesses.[40]

The issuance of Australian Government green bonds should be seen from a strategic perspective. The United States has the advantage of a deep municipal bond market with participants including cities, water and energy businesses and universities. From an efficiency perspective, the Government may wish to have large size bond issuance. From a market perspective there is a benefit in supporting a variety of bonds, that may have smaller transactions that build the depth of the green finance market.

As the Australian Government approaches issuance of green bonds, a key consideration should be how its activities support creation of the market not only of green bonds, but of green lending.

There are a number of opportunities of building the depth of Australia's green bond market:

- Finance for new and existing projects that offer climate change and environmental benefits, such as renewable energy, pollution prevention, sustainable agriculture, clean transportation, circular economy products and green buildings.
- State and local governments, including water businesses issuing bonds for nature-related and circular initiatives.
- Banks providing green loans to customers for a range of purposes including energy retrofits as well as circular and nature-related initiatives.
- Local governments in partnership with State Governments issuing green bonds to redevelop community infrastructure such as municipal swimming pools.

Nature investments financed by green bonds

A question is how the Government could establish initiatives that support lending for SME customers for the purposes of investing in nature. One option is for the Government to provide credit enhancement for bonds and loans that focus on nature-related investments.

[40] https://15years.futurefund.gov.au/documents/Future-Fund-Celebrating-15-Years.pdf

For a farmer that faces the decision to make investments focused on the productivity of the farm asset, the ability to access loans at an interest rate that is cheaper than the interest rate that they pay for other lending, would create an incentive to finance nature-related initiatives on a property.

There are lessons that the Government can learn from the challenges to build data sets to support lending decisions. In particular we note the challenge that banks face lending for residential energy efficiency retrofits. A key issue identified is the need for data. We note the work the Australian Government is doing to extend the Nationwide House Energy Rating Scheme (NatHERS) to apply to existing homes. NatHERS will give prospective buyers and renters information about the energy performance of existing homes on the market. This will help households find opportunities to save and help lenders verify green investments so they can offer green loans.[41]

We propose the Australian Government leverages the issuance of Green Bonds to establish foundations that can support lending for nature. The establishment of a credit enhancement scheme, or bond aggregator model, could enable banks to offer innovative products for customers focused on nature-related initiatives. There is an opportunity that such schemes could establish a foundation for voluntarily reporting of nature-related information at the point of sale. The point of such an initiative would be to establish harmonised data standards that would ultimately link to TNFD.

Green Finance Markets

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

There are opportunities for Australia to become a centre for green asset backed securities (ABS). We highlight distributed solar, batteries, energy retrofits and community infrastructure as areas where green ABS could thrive.

Initiatives to develop green finance markets need to align to the large pools of capital in the Australian economy. In Priority 8 we discuss some of the structural reasons why superannuation funds find it challenging to invest in early-stage companies.

When considering opportunities for green finance markets a key question is whether superannuation funds are likely to be able to invest. In relation to nature-related investments, the opportunity to align superannuation capital is through either fixed interest or equity investments.

A key opportunity is green infrastructure. Opportunities exist not only for assets that support decarbonisation but for infrastructure that supports biodiversity outcomes. We specifically highlight the opportunity to invest in water infrastructure, including recycled water pipelines, as a mechanism to deliver water to where it has greater value. The opportunity to take recycled water from cities as an alternative to ocean outfalls supports marine environments and has the potential to provide agriculture with water alternatives that in turn enables release of water for environmental flows across regional Australia. From an investment perspective, infrastructure investment can be unlocked through off-take and availability payments. Infrastructure investors and governments are familiar with these structures which have been used for renewable energy investments and desalinisation plants.

In order to build green capital market opportunities there is a need to establish institutional structures, as noted previously. We note that Recommendation 33 of the Australian Sustainable Finance Roadmap proposed that “Australia’s financial system participants produce a regular report that considers whether Australia’s sustainable finance markets are functioning efficiently to support the delivery of net zero emissions by 2050, consistent with science-based targets”. This recommendation is relevant to green capital markets. There is a need for a mechanism to regularly review if markets are actually efficient and whether capital is flowing. A Green Capital Market Report would provide a mechanism for financial system participants to contribute thoughts on changes that can be made that would facilitate future investments.

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[41] https://www.dcceew.gov.au/sites/default/files/documents/delivering-cheaper-cleaner-and-smarter-energy-households-fs.pdf

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?

CEFC's core focus is on delivering transactions. There is scope for CEFC to adopt a leadership role in shaping the underlying system architecture for sustainable investment. There is also scope for greater CEFC involvement in the retail end of the electricity sector including small-scale distributed energy. There is further scope for CEFC to take on more risk, particularly in relation to deployment of storage technology to support market development.

The CEFC is playing an important role investing in pre-seed to growth-stage technology companies focused on decarbonisation. CEFC's role would be supported if the Australian Government worked to build a bridge between Australia's science community and Australia's superannuation system through the proposals we recommended in Priority 9.

Circular business model SMEs (including start-ups/micros) often struggle to gain access to finance. Although there has been significant growth in sustainable finance and responsible investment in Australia in recent years, there appears to be only limited activity in supporting circular initiatives, especially for SMEs. In contrast to global innovative financings, much of the investment to date in Australia in the circular economy has been in lower value waste management and recycling (with a few notable exceptions).

The CEFC has supported some circular initiatives (where these are aligned with its mandate, including addressing embodied carbon). Some examples of recent innovative CEFC financings include investment programs and co-financings, such as the CEFC Timber Building Program, CEFC Australian Recycling Investment Fund, Rino Recycling Project and Circular Plastics Australia project (co-financing with CBA of joint venture with Cleanaway, Pact Group, Asahi and Coca-Cola).

CEFC also invested in Samsara Eco, a relatively rare example of a successful circular start-up that has accessed equity funding successfully from both the public and private sectors. Samsara Eco is an innovative start-up circular business model that has successfully raised equity finance – from an initial A$1 million in start-up capital to A$56 million raised in 2022 to build Australia's first infinite recycling facility.[42] Investors range from Main Sequence, Australia's deep tech investment fund founded by the CSIRO, to the CEFC and Assembly Climate Capital.

The CEFC should consider additional ways to support circular business model SMEs and start-ups, similar to the successful SME loan program supported by Export Finance Australia. CEFC can also consider providing funding to larger corporates and projects that incorporate greater circularity, where there are market gaps and subject to its mandate.

Future Fund

We also highlight that the Australian Government has other avenues to support scaling of sustainable investment through the Future Fund. The Future Fund currently stands at $205.2bn with total funds under management through various funds at $255.1bn.[43] We note that the Future Drought Fund and the Disaster Ready Fund are themselves funds set up for emergency purposes that climate risks may be a factor in leading to future redemptions.

Whilst the Future Fund has built capabilities around ESG there is much it can do to invest in climate opportunities. The Future Fund's benchmark average return of "at least the Consumer Price Index (CPI) +4.0 to +5.0 per cent per annum over the long term" is consistent with investing in opportunities that for a range of reasons superannuation funds may find it difficult to invest in. We highlight infrastructure projects that require a number of years of construction before revenues are generated as an area where the Future Fund's long-term investment mandate aligns with opportunities. Because the Future Fund does not currently face redemptions it does not have the same liquidity management challenges that Australia's superannuation

[42] https://www.samsaraeco.com/
[43] https://www.futurefund.gov.au/en/investment/investment-performance/portfolio-updates

sector must manage. The Australian Government should also encourage the Future Fund to establish a net zero transition plan.

Barriers and opportunities for CEFC

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?

We highlight the opportunity for CEFC to develop financial markets in areas that are currently not mature. Examples include the development of green ABS markets which the CEFC can play a role in facilitating. The CEFC should be given a clear mandate to work towards addressing market impediments where they exist.

Where circular business models and projects fall outside of the CEFC mandate, the recently established A$15 billion National Reconstruction Fund could establish a programme to support circular SMEs (similar to the Export Finance Australia SME programme noted above) as well as larger scale businesses and projects that incorporate circular principles (such as in the resources, transport, renewable and agriculture sectors). This could provide a new opportunity to provide co-financing (public-private) for innovative circular economy initiatives to address market gaps.

It is encouraging to see the Government's recently announced Industry Growth Program to support eligible startups and SMEs. Government support could also look beyond co-financing and grant funding to risk sharing via for example first loss tranches, guarantees or tax incentives. This would encourage the development of more investable/bankable circular business models and projects.

Priority 11: Promoting international alignment

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

The role that the G20 Sustainable Finance Working Group (SFWG) has played in supporting global harmonisation of standards is recognised. The Australian Government's support for the work of the G20 SFWG, and its secretariat United Nations Development Program (UNDP) is important, and positive to see this reflected in the Sustainable Finance Strategy.

We reiterate our comments in Priority 1 on the importance of skills and competencies. The 2023 G20 Sustainable Finance Report[44] recommended that financial market participants should consider developing sustainable finance competency frameworks to help measure and align relevant governance processes with the gaps identified in employee skills, knowledge, and attributes with relevant climate- and sustainability-aligned plans. A key priority for the Australian Government should be to support financial system capacity building aligned to the G20 SFWG.

Standardisation of definitions, metrics and indicators (including to incorporate sustainability measurement into corporate reporting and accounting frameworks such as the ISSB, TCFD and TNFD) will be important for both businesses and finance in driving sustainable investment, including in Australia. These indicators need to be scientifically sound, and globally comparable and harmonised – and should be aligned between business and finance. This can also be considered as the sustainable finance taxonomy is developed.

From 2024, the EU will require businesses to adopt the European Sustainability Reporting Standards (ESRS). These EU reporting requirements will be relevant to Australian businesses that have substantial operations in the EU. The Australian government, regulators and industry should monitor these developments, and apply those that are relevant.

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?

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[44] https://g20sfwg.org/wp-content/uploads/2023/10/Volume-I-G20-India-Final-VF.pdf

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?

Sustainable Finance Leadership

We again highlight the importance of sustainability-related skills and competencies. We cite the example of the United Kingdom which took a strategic approach to the benefits of transitioning to net zero for the City of London with the establishment of the Green Finance Institute.[45]

Australia has the opportunity to become a regional sustainable finance hub. Key to this opportunity is the strength of Australia's university sector engagement with our region. Sustainable finance skills and competencies should be seen as a mechanism through which Australia provide education and learning services to our region. The benefit of education and learning that is driven from Australia includes the long-term relationships that are forged which then translate into commercial opportunities for Australia's financial system.

We recommend the establishment of a Green Finance Skills Centre (Priority 1) has a mandate to support sustainable finance skills and competency development across the region.

From the perspective of leadership we highlight the need not only to build technical skills and competency but culture. This can be supported through competency frameworks in a similar way that other professions focus on ethics.

Blended Finance

ISF was invited to present on the challenges adapting blended finance approaches to drive net zero transition at the UNCTAD World Investment Forum held in Abu Dhabi in October 2023. Our comments reflect the opportunity to adapt blended finance approaches to suit local circumstances.

The challenge is that blended finance has yet to scale. According to the UN, most blended finance currently goes to middle-income countries because of the size and ease of their transactions. Only a small portion goes to the least-developed countries (LDCs). There is an opportunity to go beyond individual transactions and projects to investing in businesses and markets. Specifically blended finance can be adapted to establish businesses that are jointly owned by governments and institutional investors on local stock exchanges. Adapting the focus of blended finance towards institutional investors and government investing together in businesses on local stock exchanges would provide a structure that enables ongoing deployment of capital.

Adapting blended finance would particularly align to opportunities across Pacific Island Countries (PIC). With over 25,000 islands scattered over an area equivalent to 15% of the earth's surface and a combined population of around 2.3 million people the remoteness of the Pacific has always represented a logistics challenge. PICs have a historical dependence on imported fuels for power generation. Significant work is being done in the region to support a structural shift toward renewable energy. However, providing energy to last mile communities remains a challenge.

Technology is providing a solution with the growth of off-grid solar through PAYGo systems. PAYGo is a payment technology that is embedded into products during manufacture. The technology 'locks' the product until the customer makes an initial deposit payment and then subsequent payments. When all payments are made the product 'unlocks' and is free to use. According to the World Bank, the off-grid solar PayGo sector is now a USD 1.75 billion annual market currently serving 420 million users. With 840 million people without access to electricity and over 1 billion people connected to unreliable grids, the development of off-grid solar enables developing countries to access affordable electricity for all their communities. The opportunity for off-grid solar has come not just from the development of solar technology but from the availability of mobile

[45] https://www.greenfinanceinstitute.com/about-us/

phones and bank payment systems that are supported through significant investment in fibre-optic cables across PIC.

Distributed energy is suited to a business structure. Distributed energy does not involve a single transaction. A better approach is to support the capitalisation of a business that is able to deliver off-grid solar products at scale across the region. In the context of the Pacific the South Pacific Stock Exchange can provide the market mechanism to support the development of businesses that can develop distributed energy solutions. Support for the Pacific's local stock exchange supports development of finance in the region. The Australian Government can collaboratively work with Australian financial institutions to co-invest.