Supporting Australian Exports

Submission by the Australian Council of Trade Unions to the Joint Standing Committee on Trade and Investment Growth Inquiry into the Prudential Regulation of Investment in Australia's Export Industries

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Summary

Since its formation in 1927, the Australian Council of Trade Unions (ACTU) has been the peak trade union body in Australia. There is no other national confederation representing unions. For more than 90 years, the ACTU has played the leading role in advocating in the Fair Work Commission, and its statutory predecessors, for the improvement of employment conditions of employees. It has consulted with governments in the development of almost every legislative measure concerning employment conditions and trade union regulation over that period.

The ACTU consists of affiliated unions and State and regional trades and labour councils. There are currently 39 ACTU affiliates. They have approximately 2 million members who are engaged across a broad spectrum of industries and occupations in the public and private sector.

The ACTU and its affiliated unions played a foundational role in winning superannuation as an industrial right for all working people, and with employers established and continue to be custodians of workers' retirement savings through industry superannuation funds. Living well after work is fundamental to the wellbeing of working people and attaining dignity and independence in retirement for all working people is a core goal of the union movement.

The Australian Superannuation system is a $3 trillion dollar industry that today represents a significant part of the Australian economy. Assets have now climbed to 175 per cent of GDP in 2020[1], with over $670 billion[2] invested internationally. Globally, institutional pension fund assets in the 22 largest markets continued to rise in 2020 despite the pandemic, up by 11 per cent to US$52.5 trillion ($67.3 trillion) with Australia currently ranking 5th in the world[3]. A key challenge and opportunity for superannuation funds is the effective stewardship of these assets and a proactive approach to ESG considerations. To derive value for members, funds will need to continue to adjust to an evolving global market for investments.

Australian superannuation funds must therefore embrace the challenges and opportunities this presents to export markets and ensure that they are able to meet ongoing changes to prudential standards and practices. The impact of not adjusting to the shifting sentiment of the global economy, one that is moving quickly towards a zero-emissions environment, is to put Australian jobs and the retirement savings of all workers at risk.

Climate change is a systemic risk to the Australian financial system.

The investments of superannuation funds in Australia's export industries are vital to the sustainability and growth of the Australian economy. They must therefore be responsive to both domestic and global influences and one of the most significant today is climate change. It is well established that climate change is creating systemic risks to the Australian financial system. It is in this environment that superannuation funds must therefore have a strict set of governance practices and systems in place for both themselves and their investment managers to assess and integrate these ESG risks and value drivers when choosing and managing investments. In establishing these strict standards, a long term view of their portfolios must be taken so as to mitigate against all current and foreseeable risks over these timeframes.

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[1] *Global Pension Assets Study* by Willis Towers Watson's Thinking Ahead Institute in Super assets rise to 175% of GDP - InvestorDaily

[2] SuperStats-Mar2021.pdf.aspx (superannuation.asn.au)

[3] *Global Pension Assets Study* by Willis Towers Watson's Thinking Ahead Institute in Super assets rise to 175% of GDP - InvestorDaily

Climate change risk is often described in terms of risks related to the physical impacts of climate change and risks related to the transition to a lower-carbon economy. As with any form of disruption, climate change is creating risks and opportunities for business in a diverse number of ways. Investors must therefore be able to respond to these risks and adjust their portfolios as required.

In managing climate change risk, there are several business stewardships practices that are utilised by superannuation funds to both protect their asset portfolios and member returns. These include company engagement to influence and improve ESG practices and proactively managing their investment decisions. However, this must be achieved with the collaboration of all stakeholders who are all aligned to the same climate change goals and emission profiles used for investment.

Regulatory Guidance provides clear fiduciary duties on Directors

Superannuation funds are under increasing scrutiny from stakeholders, regulators, peers, and members to consider and disclose the impact of climate related risks on company investments and operations. The guidance of financial regulators and legal opinions are increasingly clear about the fiduciary duty of directors and trustees to respond to climate risk and Australian regulators have made increasingly direct statements to this effect. These statements are consistent with guidance from equivalent bodies in other national economies, with many moving towards mandatory climate risk disclosure regimes and comprehensive emissions mitigation policy frameworks. By consequence, actions taken by global investors to minimise climate risk are likely to impact on Australian export markets.

ASIC views climate-related risk as a systemic risk in our market that has the potential to significantly impact companies, investors, and consumers. They are therefore focused on ensuring listed companies have appropriate governance structures in place to manage this issue and provide the market with reliable and useful information on their exposure to material climate-related risks and opportunities. They are also focused on reporting by companies and proactively support the framework established by the Financial Stability Board's Taskforce for Climate-related Financial Disclosures (TCFD) and other climate-risk disclosure practices of companies. ASIC sees the fiduciary obligations of company directors as paramount in maintaining its strict governance standards for climate risk. It therefore recommends that ASIC Directors continually reassess existing and emerging risks including climate risk, that they are comfortable with the level of oversight they maintain over climate risks and opportunities and that they have the governance structures in place to assess, manage and disclose these risks and opportunities.

Since the Australian Government became a party to the Paris Agreement, APRA has also been raising awareness of climate-related risks to the financial sector. Most recently, the draft *Prudential Practice Guide CPG 229 Climate Change Financial Risks* (CPG 229) that was released in April 2021, has been designed to assist banks, insurers, and superannuation trustees to manage the financial risks of climate change. These draft guidelines are asking banks, insurers, and superannuation funds to elevate climate change risk to the same level as traditional threats such as credit risk, underwriting risk, and liquidity risk. Superannuation funds are therefore facing increasing obligations from regulators in how they manage their investment portfolios during a period of transition to a low carbon economy. CPG 229 is also aligned with the recommendations from the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) and has been developed in consultation with both domestic and international regulators.

Both APRA and ASIC are working to ensure that their regulatory practices are consistent with international standards, therefore aligning Australian superannuation funds with a global framework of regulatory benchmarks. The boards of superannuation funds are now expected to have or obtain an appropriate level of understanding of climate risks, develop a framework for managing these risks and tolerance thresholds while taking a short and long term view of their portfolio. Where financial institutions have identified material risks, they are also expected to consider mitigating them through "risk-based pricing", "applying limits" on sectors or "considering the institution's ability to continue the relationship"[4].

Reinforcing these obligations on superannuation funds is legal opinion of directors' duties that relate to climate change. A memorandum of opinion prepared by Noel Hutley, Senior Counsel and Sebastian Hartford-Davis (the "Hutley opinion") was made public by the Centre for Policy Development and Future Business Council in 2016 and which was updated again in 2019. This opinion found a clear duty of care for Australian company directors in relation to climate change and that they should manage those risks with due diligence.[5]

These regulatory and legal obligations reinforce the fiduciary obligations of Superannuation fund directors to consider climate risk and therefore impact export industries by consequence. However, they also ensure a uniform approach to managing investments and provide standards of governance that are in alignment with other international jurisdictions. If a superannuation fund is to be competitive within the global economy, this is vital.

International Policy Obligations on Investments.

In a global economy, the international policy signals are clear - the transition to net zero emissions is already underway and irreversible. The Paris Agreement set in motion a pathway for our economy that is continually being reinforced. This transition will create risks and opportunities for Australian exports with 70% of Australia's two-way trade currently with countries that have commitments to reaching net zero emissions by or near mid-century. Some 78% of the world's GDP is also covered by net zero commitments at or near mid-century. The Australian economy will need to demonstrate that it is reducing its emissions-intensity in order to maintain our export industries.

The international investment community tackles the global challenge of climate change through many voluntary bodies that have established global standards and frameworks to measure the effectiveness of companies. These obligations guide investors in how they meet their stewardship responsibilities. Key bodies such as the Principles for Responsible Investment (PRI) is a United Nations-supported international network of investors working together to implement its six aspirational principles, whilst the UN Global Compact is a voluntary initiative based on CEO commitments to implement universal sustainability principles and to take steps to support UN goals. These are complemented by investor groups such as the Climate Action 100+ who collaborate as part of 440 global investors representing US$40 trillion in assets. These bodies are now ingrained in the operating mechanisms of Australian investors and companies both domestically and globally. The consequence of non-adherence to these obligations is both reputational and financial. This has a direct flow into the value of Australia's export industries.

A superannuation fund not holding sustainable portfolio is likely to encounter three types of risk:[6]

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[4] draft *Prudential Practice Guide CPG 229 Climate Change Financial Risks* (CPG 229) April 2021 P. 14
[5] From Victorian Government, Managing Climate Change Risk, Guidance for Board Members and Executives of Water Corporations and Catchment Management Authorities
[6] draft *Prudential Practice Guide CPG 229 Climate Change Financial Risks* (CPG 229) April 2021 P. 7

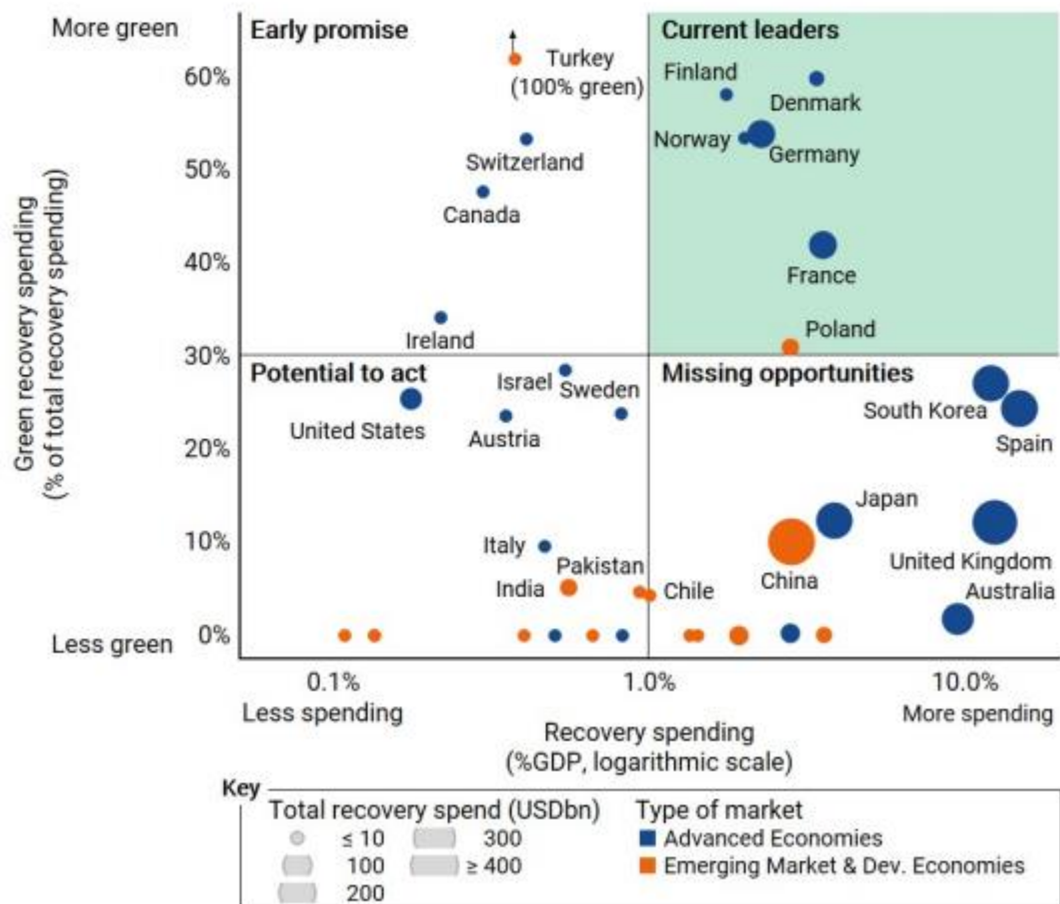
- Physical risk from changing climate conditions - lower asset prices, defaults on loans and insurance claims.
- Transition risk from policy changes, technological innovation, and social adaptation - stranded assets, decreased demand and lower prices, and supply chain disruption.
- Liability risk from stakeholder litigation and regulatory enforcement - business disruption from this litigation and penalties through enforcement.

Protecting Australian Jobs

In managing these systemic risks, the impact on Australian jobs is a critical consideration in an environment of heightened climate change risk. Fourteen of Australia's largest trading partners have now committed to net zero emissions. Given our reliance on exports of coal, gas, beef, petroleum, and other carbon-intensive products, this represents a significant threat to our export industries and the workers in them. The USA, Japan, China, South Korea, Europe, and Britain have all committed to net zero emissions in recent months.

Collective planning for this inevitable transition would allow Australia to access new export and employment opportunities and ensure workers and communities are not left behind; conversely the cost of inaction would be significant as a disorderly transition would create significant economic disruption, including implications for employment, healthcare, taxes, and education, with disproportionately high impact on some regional communities. However other countries are already actively managing their climate-related risks and opportunities into their post-COVID-19 economic and industry policies at a rate that greatly overshadows Australia's approach. An analysis of COVID-19-related fiscal rescue and recovery efforts by 50 leading economies so far and led by Oxford's Economic Recovery Project and the UN Environment Programme (UNEP), shows poor 'green' recovery investment spending by Australia compared to other countries[7]. Australia is the worst performer on a list of the world's 50 largest economies for "green recovery" spending to revive economic growth after the Covid pandemic, according to research conducted for the United Nations environment program.[8]

[7] *Are We Building Back Better*? Evidence from 2020 and Pathways for Inclusive Green Recovery Spending by Oxford's Economic Recovery Project and the UN Environment Programme (UNEP) P.12
[8] Australia lags far behind other top economies on 'green recovery' pandemic spending | Australian politics | The Guardian 19 March 2021



[9]

The government must be investing now in creating new jobs and investing in new industries in communities that are being impacted by divestment. Australian unions support action to address global warming and a jobs-rich energy transition. When the Hong Kong-based owners of power station Yallourn brought forward its closure date by four years the Victorian government acted to ensure the construction of a new energy storage project in the Latrobe Valley. Internationally, many countries are ensuring that job creation and zero emissions work is in alignment. The Germany Government established the German Coal Commission to plan the phaseout of the country's coal power stations without a single worker being forced into unemployment. The German government also committed 2 billion euros a year to creating new jobs and industries in coal regions, ensuring their future prosperity.

[9] Green recovery spending as a percentage of total recovery spending versus recovery spending as %GDP. Colour represents market type. Turkey's recovery spending (0.4% of GDP; 100% green) is a commendable outlier, not accurately represented on the graph due to visual limitations. Many countries are clustered at 0% green recovery spending, from left to right on the figure: South Africa, Thailand, Malaysia, Egypt, Saudi Arabia, Argentina, Portugal, Nigeria, Peru, Iraq, Mexico, the Netherlands, and the Philippines. Countries with less than 0.1% recovery spending as %GDP do not feature and are listed in Appendix A. Advanced, emerging market, and developing economies are as defined by the IMF (2020a) and are limited to those covered by the Observatory (Appendix B). Sources: Global Recovery Observatory; interest rate data from OECD (2020c) and CEIC (2021).

With the renewable energy sector likely to continue its rapid growth over coming years and decades, this industry must in particular be established on solid foundations and the benefits shared with workers and communities supporting clean energy projects in the form of secure, safe, and well-paid jobs with training and career progression opportunities.

Driven by the imperative of climate change and rapid technological development, global energy markets are changing rapidly. This growth in renewable energy jobs is being replicated globally and is predicted to accelerate over coming years due to declining renewable energy technology costs, converging global efforts to slow global warming and the retirement of these ageing fossil fuel plants. The future competitiveness of energy-intensive industries such as mining, metals smelting, recycling, and manufacturing is also increasingly dependent upon having access to low emissions, low cost electricity. Significantly, this transformation is occurring in Australia with no enduring or overarching national planning, policy, or coordination.

As the renewable energy industry has grown there has been an evolving discussion about 'community benefit' and 'social licence'. Industry super funds, who are investing worker's capital are an increasingly important source of equity for financing new renewable projects and so are a critical stakeholder. Industry super funds have been instrumental in normalising ESG principles and demonstrating that companies who uphold ESG principles tend to maximise shareholder return. By ensuring renewable energy companies are also upholding these ESG principles and providing decent and secure employment they will raise employment standards in the industry, improve shareholder returns and minimise investment and climate risk.

While government policy has supported investment in renewable energy projects, this support has not always been tied to minimum expectations for labour standards. Many new renewable energy jobs have been short-term, insecure, and poorly paid, compared with the permanent, secure, well-paid, and unionised jobs in coal, oil and gas that often underpin regional economies. There are as a result, many structural and operational challenges that need to be overcome to make the renewable energy industry an industry of choice for workers and one where exports will grow in the world market. For instance, the renewable energy industry's practice of outsourcing construction of renewable energy projects to labour hire contractors, is encouraging insecure work practices. On the benefits side, investors and governments can ensure project developers are maximising local job creation through procurement, hiring and local content.

Queensland is an example of poor practices in the newly emerging solar industry. This has led to the Queensland Government undertaking a "blitz of inspections across regional solar farms" and issuing 30 notices (as of September 2018) to a number of companies — "including 23 breaches of the Work Health and Safety Act and seven breaches of the Electrical Safety Act. These have included notices for unlicensed electrical work, failing to provide personal protective equipment for workers and failing to implement safe systems."[10] There are also several examples of project developers, equipment providers and EPC contractors going broke mid-project, often leaving workers in the lurch. The common cause is contractors bidding to deliver projects at unsustainably low prices, which then translates to these same companies exploiting overseas workers, underpaying workers, and providing poor working conditions.

If Australia is to fully optimise the opportunities of an emerging economy, it must provide strict labour standards that ensure workers are protected and communities are supported through this

[10] Queensland solar farms actively hiring backpackers, insider claims - ABC News (Australian Broadcasting Corporation)

critical transformation phase. The flow through will be a strong export market that is both competitive and sustainable in the global economy.

Conclusion

Australia's export industries are critical to the growth of the Australian economy. As the world moves towards zero-emissions, so must Australia in how superannuation funds invest its capital and manage their investment portfolios. This also means aligning their business strategy with the risks and opportunities of climate change. This is critical to being competitive within world markets and to ensuring a strong economy and secure jobs for workers. Climate change represents a real threat to the economy that must be considered in how a superannuation fund manages its investment strategy. The demand for ongoing climate risk disclosure and adherence to regulations in this area will only increase over time and these regulations must therefore be in line with international jurisdictions for effectiveness. It is important though to also invest in emerging industries for long term economic growth. Therefore, we need a strong national plan for investing in renewable energies and to transition those impacted industries and communities. Australian superannuation funds are uniquely positioned to support this global transition by providing sustainable investment in export industries which also support secure jobs and improved working conditions. It is imperative though that they have the freedom to undertake this investment in line with their fiduciary obligations to act in the best interests of members.

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