Investor Group on Climate Change

Recent climate policy improves investment environment

Policy brief, December 2022

Climate change policy stability and political consensus is critical for investors' confidence to deploy capital towards climate solutions. Credible long-term market signals, as well as stronger political consensus, are required to reverse the historic trend of turbulent climate policymaking in Australia and avoid capital flight.

The Investor Group on Climate Change (IGCC) has recently surveyed institutional investors covering around 60% of the total assets under management (AUM) in Australia.

Three of the most policy-relevant findings are:

1. **Policy certainty is improving off a low base:** Last year around 70% percent of investors highlighted policy uncertainty as a key barrier to investment in Australia, compared to 56% this year.
2. **Other major barriers to capital deployment** include:
    - a lack of appropriate investment opportunities (58%),
    - the lack of clear definitions of what constitutes a climate solution (33%).

   Policy solutions will be required to address these barriers and support investment.
3. **The next three priorities for further climate policy reform:**
    - setting 1.5°C aligned sector pathways and plans (46%),
    - an improved approach to carbon pricing (e.g. Safeguard Mechanism reforms) (44%),
    - setting 1.5°C aligned national emissions targets (40%).

Based on discussion with investors and analysis after the survey period, factors that have contributed to increased investor confidence include:

- a stronger 2030 emissions target and passage of Australian Climate Change Act,
- bipartisan support for net zero emissions by 2050, and,
- the acceleration of other climate policy reforms at a sector level and state level.

About the Investor Group on Climate Change

IGCC is a collaboration of Australian and New Zealand investors focusing on the impact that climate change has on the financial value of investments. IGCC represents investors with total funds under management of more than $30 trillion around the world. IGCC members cover over 7.5 million people in Australia and New Zealand. IGCC aims to encourage government policies and investment practices that address the risks and opportunities of climate change, for the ultimate benefit of superannuants and unit holders.

Introduction

Since 2017, IGCC has undertaken annual surveys of investors, which include questions about how the market defines and invests in climate-aligned opportunities, and the barriers to increased investment. During September 2022, IGCC surveyed institutional investors (superannuation funds, sovereign wealth funds and asset managers) regarding net zero aligned investing. Responses came from 53 institutional investors with funds representing more than A$30 trillion AUM globally and A$2.1 trillion AUM within Australia. The findings therefore represent the views of approximately 60% of total AUM in Australia.

This brief covers the results of the survey as they relate to Australia's policy environment. The full, more detailed report on how investors are responding to climate change risks and opportunities will be released in early 2023.

Stable long-term climate policy is central to investment

Under the right policy conditions, private investors can deploy significant capital to help achieve the policy objectives of government, including, to drive a just transition to net zero emissions, build resilience to the physical impacts of climate change, and support national goals around energy security and industry development.

Government policy provides the signals and incentives that direct the flow of capital across the economy. Credible, investable, and durable policy frameworks put in place today will not only support strong investor and beneficiary returns into the future but also enhance Australia's economic competitiveness and help attract international capital.

In Australia, a lack of political consensus and unstable climate policy settings have affected risk perceptions and, ultimately, financing costs. This has been driving investment offshore into other markets where greater policy certainty exists.[1]

Credible long-term market signals are needed to reverse the historic trend of turbulent climate policymaking in Australia. Any policy with the potential to be dismantled under a change of government may promote some short-term investment but will not remove the long-term risk premium associated with the lack of political consensus on policy in Australia. Reversing this historic trend will require strong climate policy signals to support investment decisions as well as stronger political consensus.[2]

---

[1] See for example, previous surveys have shown around 40% of investors have shifted capital to other markets in response to policy uncertainty in Australia.
[2] IGCC (2022), *Making the transition happen: Investment Policy for a Net Zero Emissions Economy*: https://igcc.org.au/wp-content/uploads/2022/09/IGCC-Policy-2025-PrioritiesWeb.pdf

Recent policy announcements have improved the investment environment

Policy uncertainty has been seen as a key barrier to investment since the commencement of this survey in 2017.

Engagement with investors indicates that a stronger 2030 emissions target, bipartisan support for net zero emissions by 2050, the passage of Australian Climate Change Act, and other climate policy reforms at a sector and state level, are starting to address policy and regulatory uncertainty for investors in Australia.

Last year around 70% percent of investors highlighted policy uncertainty as a key barrier to investment in Australia, compared to 53% this year.

However, climate policy uncertainty does remain a barrier, along with a lack of appropriate investment opportunities[3] (58%), and the lack of clear definitions of what constitutes a climate solution (33%) (Charts 1 and 2).

It is important to note theses three issues are interrelated. The perceived lack of opportunities with the right risk return parameters can be addressed by policy settings that explicitly consider the role of institutional investors in the capital stack, a policy mix that drives both supply and demand for climate solutions, and policy instruments that support the aggregation of multiple projects into institutional investment scale opportunities (e.g. >$0.5 billion).

The complexity of clear measurement frameworks and inconsistent definitions on what constitutes climate aligned investment is a growing constraint hindering investment activity. This points to the need for globally consistent mandatory climate-related risk and opportunities disclosures, sustainable finance taxonomies[4] and the implementation of a minimum standard for climate transition plans. Corporate climate transition plans help enable investors to differentiate between companies that are operating 'business as usual' or 'greenwashing', and those that are on a long-term credible transition pathway.

[3]As one investor noted that in the Australian listed equity market, companies with low carbon or climate align investment solutions are typically micro-cap (market capitalisation between $50-$300 million) and don't have enough daily volume to create a meaningful enough position.[3]

[4] A sustainable finance taxonomy is a classification tool helping investors and companies make informed investment decisions by providing precise and consistent definitions for sustainable economic activities. Green finance taxonomy projects and regulations are rapidly emerging globally. This is in response to the strong demand for and rise in ESG and sustainability-driven financial products prompting a need for clearer definitions and transparency regarding these products. As global investors, Australian institutional investors are exposed to these to these emerging rules and are seeking alignment of frameworks to avoid market fragmentation.

Chart 1: Main barriers to increasing exposure to low carbon or climate aligned investment solutions – 2022

Note: investors were asked to select the 'top 3' responses.

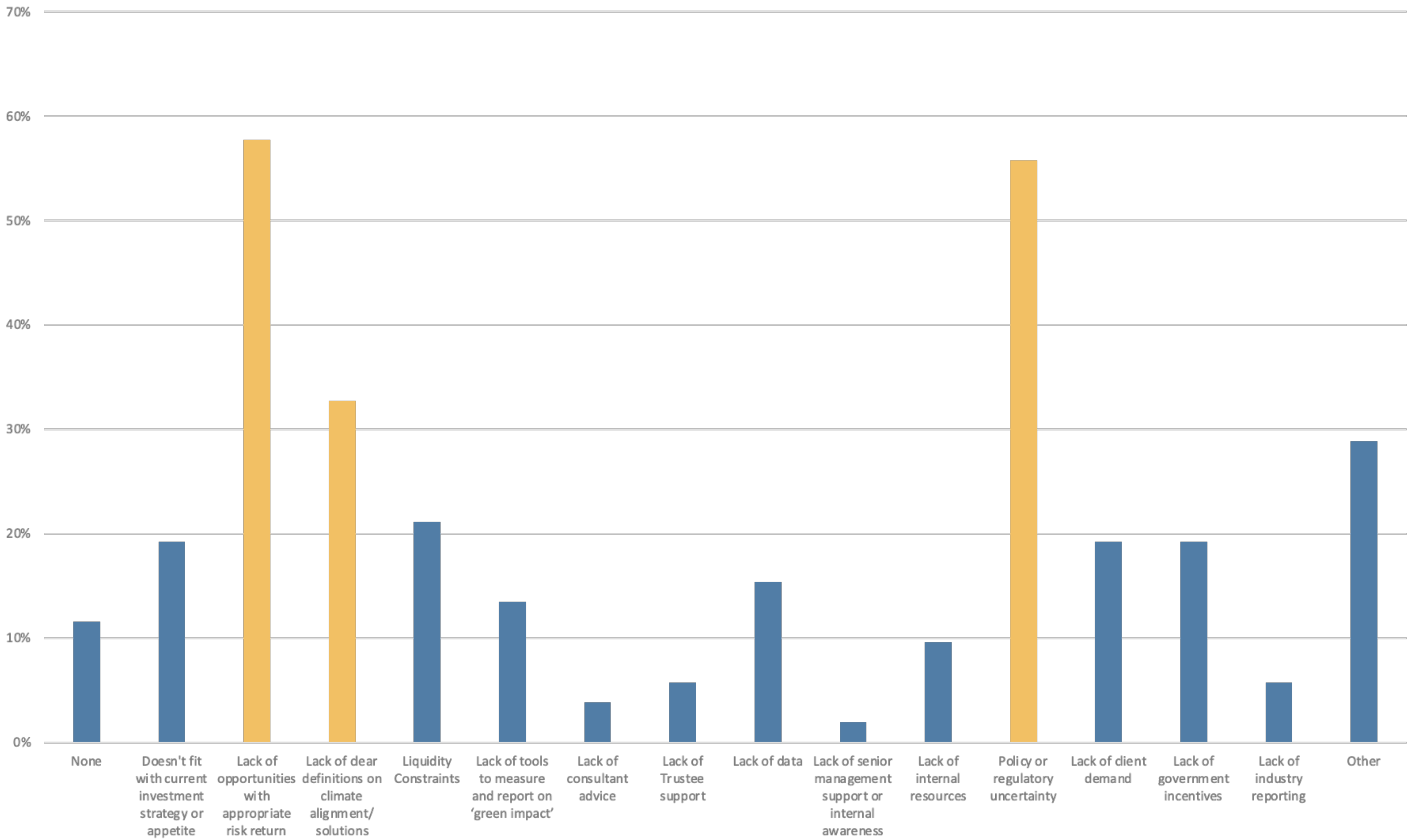
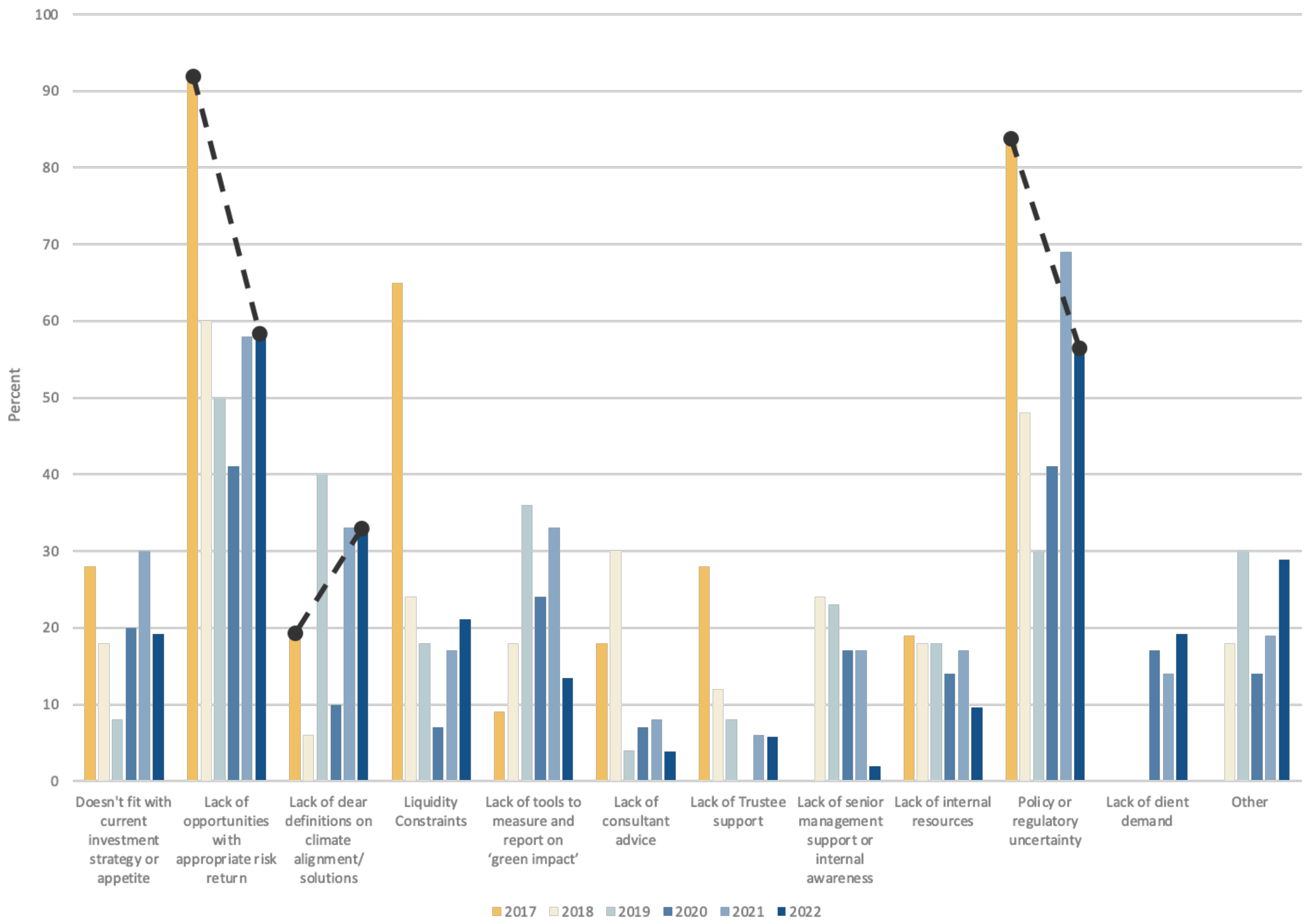


Chart 2: Main barriers to increasing exposure to low carbon or climate aligned investment solutions – 2017 – 2022. Dotted lines show how the three major barriers have changed since the first survey. *Note: investors were asked to select the 'top 3' responses. Questions without three years of data are not included.*



Key priorities for the Parliament and Government

Further climate policy reform is needed. Investors noted a significant range of pressing priorities for the Australian government.

The three top priorities (in order) noted by investors for the Australian government and Parliament are (Chart 3):

1. **46% - Setting 1.5°C aligned sector by sector pathways and plans**: Establishing 2030 to 2050 sector targets to guide policy development will inform investor expectations on future policy. It will also establish performance benchmarks for future policy review and development. Sector targets contribute to a clear framework for investors and the companies they own, guiding business strategy, targets and metrics and allocation of capital towards new technology and/or other expenditure.
2. **44% - Improved approach to carbon pricing (Safeguard Mechanism, etc):** Clear and transparent carbon pricing sends market signals and incentivises behavioural change and investment flows into lower and zero emissions solutions. The more carbon is explicitly priced, the more investment will flow to net zero emissions technologies and the more efficiently industry will be able to ensure economic and overall policy objectives are met. An immediate priority in Australia is to ensure the country's existing carbon pricing mechanism – the Safeguard Mechanism – is aligned with avoiding climate damages from warming above 1.5°C. IGCC's submission on the proposed Safeguard Mechanism Reforms is available here.
3. **40% - Setting 1.5°C aligned national emissions 2030 and 2035 targets[5]:** The greatest net benefit to the economy can be achieved by early policy interventions to align national economic strategies to the objective of the Paris Agreement to limit average global warming to 1.5°C.[6] National targets provide investment signals to capital markets and should guide all national decision-making. For example, the future decision on Australia's 2035 target is very important to investors. A Paris Agreement–aligned 2035 target will give investors longer term visibility of national policy goals and promote early investment to achieve greater emissions reductions over the coming decade.

These priorities above are reflected in IGCC's recent three-year priorities for the Australian government.[7] Credible, investable and durable policy frameworks put in place today will not only support strong investor and beneficiary returns into the future but also enhance Australia's economic competitiveness and help attract international capital.

[5] Government investment in new technology also has a similar result. IGCC is releasing detailed analysis of investors views on investable policy frameworks for clean innovation in 2023.

[6] See, for example, Network for Greening the Financial System (2020), *NGFS climate scenarios for central banks and supervisors*, https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf; T. Kompas et al. (2019), *Australia's clean energy future: Costs and benefits* [Issues Paper No. 12], MSSI, The University of Melbourne, https://sustainable.unimelb.edu.au/__data/assets/pdf_file/0012/3087786/Australias_Clean_Economy_MSSI_Issues_Paper12.pdf; Deloitte Access Economics (2020), *A new choice: Australia's climate for growth*, https://www2.deloitte.com/content/dam/Deloitte/au/Documents/Economics/deloitte-au-dae-new-choice-climate-growth-051120.pdf?nc=1.

[7] IGCC (2022), *Making the transition happen: Investment Policy for a Net Zero Emissions Economy*: https://igcc.org.au/wp-content/uploads/2022/09/IGCC-Policy-2025-PrioritiesWeb.pdf

Chart 3: What should be the key priority of the Australian government *Note: investors were asked to select the top 3*