IGCC Statement on the Australian Sustainable Finance Taxonomy

Summary of IGCC's Response to the ASFI consultation

November 2024

Background

The Investor Group on Climate Change (IGCC) welcomes the publication of an Australian Sustainable Finance Taxonomy ('Australian taxonomy').

Given the multi trillion-dollar climate financing gap,[1] IGCC welcomes all tools that investors can draw on to identify credible opportunities to invest in decarbonisation.

The IGCC has provided comment on the Australian taxonomy as part of ASFI's second consultation as informed by practitioner discussions in the IGCC Climate Solutions Sub-Working Group. Our responses are available on the ASFI website, along with those of our partner investor networks PRI and RIAA.[2]

This statement elaborates on IGCC's submission and sets out what is needed to ensure the taxonomy is useful for institutional investors that may choose to draw on it. IGCC emphasises the importance of ensuring all activities and performance criteria are aligned with credible, science-based 1.5°C scenarios and decarbonisation pathways.

The IGCC welcomes the work of ASFI to develop the Australian taxonomy. We note that the Australian Government intends to explore use cases for the taxonomy in the financial and regulatory architecture in 2025 and look forward to engaging on what is needed to ensure the taxonomy is useable for institutional investors to maximise the role it can play in mobilising investment in the decarbonisation of the Australian economy.

Summary

Institutional investors may use the Australian taxonomy in a range of ways, including as an input to inform capital allocation and to disclose how they are investing in the net zero transition.

It is important to note that institutional investors have interests outside of Australia and use a range of frameworks and taxonomies as appropriate for their global portfolios and investment strategies. As such, the Australian focused taxonomy is most appropriately seen as an optional tool that investors might use among others.

For the taxonomy to nevertheless be a useful tool for institutional investors, there must first be broad based uptake and entity-level disclosure by companies. We outline several proposals to facilitate this below.

Finally, consulting investors on the useability of the taxonomy will be critical to investor adoption. Initial discussions indicate that institutional investors need the Australian taxonomy to (1) clearly demonstrate its interoperability with other credible taxonomies and (2) adopt a user-friendly interface to enable users navigate the complexity and detail.

For more information

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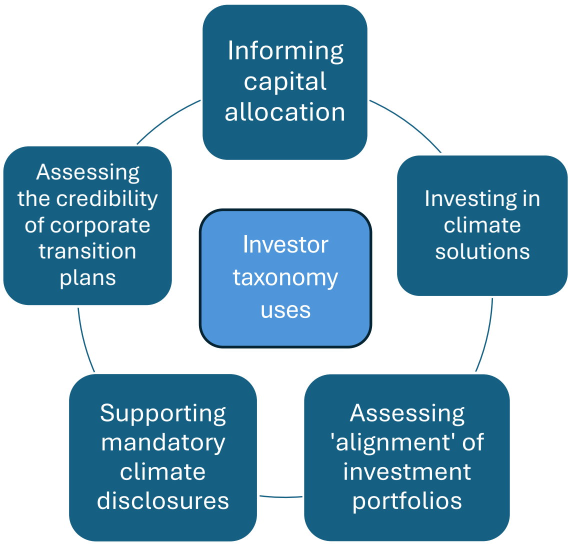
[1] BloombergNEF estimates US$2.4 trillion investment in Australia's energy sector alone will be needed between now and 2050: *New Energy Outlook (2024): Australia.*
[2] Available at www.asfi.org.au/taxonomy-public-consultation

Taxonomy uses for investors

It is important to note at the outset that institutional investors have interests outside of Australia and use a range of frameworks and taxonomies as appropriate for their global portfolios and investment strategies (such as the EU Taxonomy, SDI AOP, among others). As such, the Australian focused taxonomy is most appropriately seen as an optional tool that investors might use among others.

The Australian taxonomy could be employed by institutional investors for a range of purposes as illustrated below.



However, the success of the Australian taxonomy for any of these investor uses depends on several key factors, including:

- Availability of widespread and reliable data
- Interoperability with other taxonomies
- Consistency of domestic market signals

We detail investor needs in these areas below.

Availability of decision-useful data

Investors need entity-level taxonomy data

Institutional investors invest across a range of asset classes. To maximise the potential of the taxonomy to mobilise capital to activities that will decarbonise the Australian economy, the taxonomy must inform investments beyond green bonds and use-of-proceeds finance for discrete activities.

This requires widespread and reliable entity-level data on the proportion of a company's activities (revenue/capex/opex) aligned to the taxonomy. Without strong incentives for companies to voluntarily disclose this data at the very least, the value of the taxonomy to institutional investors will be limited.

- In providing the taxonomy to Government, we encourage ASFI to highlight the need for measures to ensure uptake and disclosure by companies against the taxonomy.

- To incentivise disclosures in the interim, government could make eligibility for concessional finance, subsidies or grants tied to public disclosure of taxonomy alignment at an entity level.

Introducing mandatory entity-level reporting against the taxonomy by companies in relevant sectors – potentially phased in by company size – is an option the Government should consider to operationalise the taxonomy. Companies are already preparing to satisfy mandatory climate disclosure requirements, and the taxonomy is a credible, evidence-based tool that can assist companies to satisfy these requirements.

Australia's existing mandatory climate disclosures will require companies to disclose the amount and percentage of assets or business activities aligned with climate-related opportunities and the amount of capital deployed towards climate-related opportunities (AASB S2 para 29(d) and (e)). These requirements provide an opportunity for Government to consider mandating use of the taxonomy by companies for these purposes in time. Doing so would improve consistency and lend credibility to these disclosures. More broadly and in the more immediate term, IGCC supports regulatory guidance that points to the taxonomy as a recommended tool that could be used by companies for these disclosures.

Additionally, company use of the taxonomy to classify planned capital expenditure and set capex/revenue targets at an entity level as part of a forward-looking transition plan would provide investors with a common reference point for assessing the credibility of companies' plans – a priority for investor engagement with companies.[3] We encourage Treasury to make reference to the taxonomy in its forthcoming guidance for companies on transition planning.

For investors, access to taxonomy-related disclosures would provide decision-useful information on companies' progress towards decarbonisation. As the taxonomy consultation paper notes, this will provide a robust basis to inform decisions about investing in climate-related opportunities and supporting sustainable finance products, further supporting the Government's sustainable finance objectives.

Create an on-ramp for company alignment disclosures

Expecting companies to assess and disclose the proportion of their activities (capex/revenue/opex) aligned with the Do No Significant Harm (DNSH) and Minimum Social Safeguards criteria is a high bar due to the significant resources required to gather and evaluate the comprehensive additional evidence needed. Setting this expectation from the outset risks deterring any voluntary uptake of the taxonomy at all.

What is most material for investors is information on the proportion of company activities that are **eligible under the taxonomy and meet technical screening criteria (performance thresholds etc)**. Encouraging – or indeed mandating – disclosure of this information in the first instance would ensure the Australian taxonomy is a useful tool for institutional investors.

The IGCC sees company-level disclosure and evidencing of alignment with DNSH and MSS criteria as a longer-term exercise. As such, it would be helpful for guidance to set out **progressive levels of alignment disclosure** to provide companies with an on-ramp for using and reporting against the taxonomy.

For example:

- 'Level 1 alignment': disclosure of % activities eligible under the taxonomy that meet technical screening criteria
- 'Level 2 alignment': disclosure against some DNSH/MSS criteria
- 'Level 3 alignment': disclosure against all applicable DNSH and MSS criteria ie full taxonomy alignment as per the current methodology

Such an approach would encourage early adoption of the taxonomy and make the introduction of any mandatory reporting by companies a more reasonable prospect in the short term. It would also introduce transparency over progress to encourage companies to make more complete disclosures over time in order to move up the 'alignment disclosure ladder'.

This staggered approach would also give companies the time to build the necessary capability and for relevant bodies to provide support where needed. For the avoidance of doubt, any use-of-proceeds debt issued by companies for specific activities under the taxonomy would still need to meet all applicable DNSH and MSS criteria.

IGCC agrees that the DNSH and MSS criteria are key sustainable finance considerations and worthy inclusions in the Australian taxonomy. However, company disclosures against these criteria are not the only source of relevant information for investors. In the absence of company DNSH and MSS disclosures, investors can continue to draw on their existing frameworks and data sources for assessing ESG risks and impacts associated with investments – many of which draw out DNSH and MSS criteria that are material to investment decisions.

[3] See, for example indicator 6 of the CA100+ Benchmark used by over 600 investors globally.

Investor needs to ensure data availability

- Consider phasing-in of **mandatory *entity-level* taxonomy disclosures**.
- Start with requiring disclosures on the proportion of capex/revenue/opex that is **taxonomy eligible and meets technical screening criteria** to ensure availability of data most material to investors.
- Enable companies to **progressively disclose and evidence alignment** with the Do No Significant Harm and Minimum Social Safeguards criteria as a longer-term exercise.
- **Incentivise voluntary company disclosure** by tying eligibility for government grants and financial support to entity-level reporting against the taxonomy.

Interoperability with other taxonomies

IGCC would welcome the opportunity for the Government to engage with institutional investors on what is needed to maximise the useability of the taxonomy.

As the Australian taxonomy classifies activities within Australia only, **demonstrating its interoperability with other taxonomies** will be essential to enable institutional investors to integrate the Australian taxonomy into their internal processes along with other tools and frameworks.

Guidance mapping the overlap with and key differences between the Australian taxonomy and other major credible taxonomies will therefore be critical to facilitate uptake by investors both to inform their investment decision-making and any future disclosures about climate finance.

Identifying the overlap with and key differences between the Australian taxonomy and other major credible taxonomies will therefore be critical to facilitate uptake by investors.

This mapping might involve:

- identifying sectors only present in the Australian taxonomy
- explaining differences in the eligibility of activities and classification methodology
- explaining deviations or differences in technical screening criteria

IGCC also encourages consideration of how to best enable users to navigate the complexity and detail of the taxonomy, as this will also heavily influence its adoption by companies and investors. We note, for example, the EU Taxonomy Navigator has a Compass too[4]) that allows users to check which activities are included in the taxonomy, which objectives these activities contribute to, and what criteria must be met for the activities to be considered taxonomy aligned.

Attracting international capital

Mapping the Australian taxonomy to other credible taxonomies and adopting a user-friendly interface would also assist international investors to use the taxonomy to identify investment opportunities in Australia – supporting further capital mobilisation to climate solutions in Australia to drive decarbonisation of the domestic economy.

Facilitating uptake by data providers

Global data providers are a vital link between companies and investors. Mapping the overlap and highlighting key differences would help ensure that global data providers can navigate and integrate the Australian taxonomy into their existing datasets and products (which to date largely draw on the EU taxonomy). In turn, this would improve availability of data on Australian investment opportunities for use by local and foreign investors.

Supporting convergence in the longer term

IGCC recognises that sustainable finance taxonomies must address the specific decarbonisation needs of the local economy and as such will differ depending on the primary sectors underpinning the economy and their decarbonisation status.

However, if sustainable finance taxonomies are to be a useful tool for investors whose portfolios span investments across markets, there is a need to work towards a consistent, science-based approach to classifying activities across all jurisdictions. This would balance the need for a common and interoperable framework while still accommodating market differences at the level of the technical screening criteria through locally appropriate performance thresholds, timeframes and potentially metrics.

[4] https://ec.europa.eu/sustainable-finance-taxonomy/home

To this end, the IGCC supports the introduction of the new green enabling classification given its prominence in the EU Taxonomy and other international frameworks such as the International Capital Markets Association's Green Enabling Projects Guidance.

Investor needs to ensure international interoperability

- Consultation on how to maximise the useability of the taxonomy for institutional investors
- Guidance mapping the overlap and differences between Australian and other credible taxonomies
- User-friendly interface to navigate the detail of the taxonomy

Consistent market signals

Institutional investors also need public policies to send clear and consistent signals about where the opportunities are to invest in the decarbonisation of the Australian economy.

Where possible, established Specialist Investment Vehicles (SIV's), such as the Capacity Investment Scheme and the Clean Energy Finance Corporation (CEFC) and proposed policies, such as those under the Future Made in Australia (FMIA) agenda, should identify how the investments that they facilitate are consistent with the taxonomy and will fill gaps in the capital stack for climate-related technologies and activities. This will provide clear signals to institutional investors about the opportunities to invest in Australia's decarbonisation.

Where these vehicles and policies seek to drive investment in technologies and activities outside of the taxonomy (for example, to encourage early-stage innovation), there should be a clearly stated policy rationale and explanation for the divergence. Policy coherence across government is vital to avoid conflicting and mixed market signals that jeopardise the ability of the taxonomy to deliver on its objective 'to drive capital into activities that will decarbonise the economy'.

Investor needs to ensure clear market signals

- Ensure government policies and investment facilitation vehicles encourage investment in activities that are consistent with the taxonomy or otherwise provide a clear policy rationale for any divergence.

A note on investor disclosures

As outlined above, investors are users of company taxonomy disclosures. These disclosures serve as an additional input to guide capital allocation to credible decarbonisation activities.[5]

Once adequate data from companies is available, some investors may also look to aggregate their taxonomy-aligned investments to identify how they are financing the transition in Australia. Some may choose to include this as part of their mandatory climate-related disclosures and transition plans or other public reporting.

However, the Australian taxonomy would be one of several tools used to assess transition credibility and inform decision-making in global portfolios. As such, there is not a compelling case for investors themselves to be required to disclose taxonomy alignment and the Australian taxonomy is most appropriately seen as an optional tool for investors.

Adaptation and resilience: An investor priority

The taxonomy is currently limited to activities that support the objective of reducing emissions to mitigate climate change. For IGCC, it is a matter of priority that the taxonomy be expanded to classify activities that support the objective of **climate change adaptation and resilience**.

As IGCC's latest report[6] finds, investment in adaptation and resilience is an economic necessity to maintain a vibrant and productive economy. Australia's $3.9 trillion superannuation sector and global capital markets could be a significant source of funds under the right settings – and the Australian can play a critical role in helping director capital to the right places.

[5] Noting, however, the constraints and barriers some investors face in this area. See, IGCC (2024), State of Net Zero Investment report, p. 41.
[6] IGCC (2024) *Activating Private Investment in Adaptation*.