Melbourne Climate Futures

Sustainable Finance Hub

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Submission to Australia's Sustainable Finance Strategy consultation

We are grateful for the opportunity to make a submission regarding Australia's Sustainable Finance Strategy.

This submission comes from researchers associated with Melbourne Climate Futures (MCF) at the University of Melbourne – see Appendix A for biographies of the authors. MCF is the University's interdisciplinary initiative on climate change. It also includes the Sustainable Finance Hub (SFH) that provides research aiming to integrate environmental, social and governance factors (ESG) into the financial system.

Our overarching view is that the Sustainable Finance Strategy has laid down an important and much needed framework for sustainable finance in Australia. It has helped to address the large and growing regulatory and policy gap on sustainable finance relative to other large economies and our regional neighbours. The strategy will go some way to help ensure Australia remains a competitive destination for inbound investment, as the global financial markets increasingly integrate sustainability risks and opportunities and to ensure our financial system can manage increasing sustainability related shocks. However, the strategy is the first step, and we encourage Treasury to keep its ambitions high as the various elements of the strategy are implemented.

Our recommendations concentrate on a few of the priorities and questions outlined in the Consultation Paper which we consider to be a priority and over which we have some expertise. We have organised this submission by recommendation and noted the specific pillar and priorities of the Sustainable Finance Strategy to which it relates. A summary of our recommendations, and their relevance to pillars, priorities and questions identified in the Consultation paper is included below.

Strategy Reference	Recommendation
Pillar 1, Priorities 1 & 3 **Pillar 2, Priority 6**	Recommendation 1: Support credible disclosure and net zero transition planning, as well as integration of liability and systemic risks.
Pillar 1, Priorities 2 & 4 **Pillar 2, Priorities 5 & 8**	Recommendation 2: Develop an integrated regulatory architecture for sustainable finance in Australia.
Pillar 2, Priority 7	Recommendation 3: Position the Australian Government, including Treasury, as the intermediary for sustainability data.
Pillar 3, Priority 12	Recommendation 4: Ensure that public/hybrid financing entities and tools provide a 'gold standard' in sustainable finance.

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Recommendation 1: Credible Disclosure, Transition Planning, Risk Management

Recommendation 1:

Support credible disclosure and net zero transition planning, as well as integration of liability and systemic risks.

Relevance to the Sustainable Finance Strategy

Pillar 1 Improve transparency on climate and sustainability

Priority 1 Establish a framework for sustainability-related financial disclosures

Priority 3 Support credible net zero transition planning

Pillar 2 Financial system capabilities

Priority 6: Identifying and responding to potential systemic financial risks

Disclosure and liability risks

Reporting against the new mandatory climate disclosure framework will be a step up for all entities. This is not only for entities reporting on climate risks and opportunities for the first time but also for entities who have previously reported against the Task Force on Climate-related Financial Disclosure's (TCFD) framework.

The International Sustainability Standards Board (ISSB)'s sustainability standards, which Australia's incoming provisions intend to mirror, arguably represent a transformative moment in entity reporting. For example, while traditional financial reporting was largely based on the past balance sheet, the new standards will require entities to plan based on an assessment of the future. Indeed, the TCFD's 2023 status report remarked that the resilience of company strategy under different scenarios has proved to be most challenging for entities to date.

There are also risks that excessive reporting requirements will mean that companies expend resources on developing reports without having the capacity to actually implement their plans in practice. Unintended consequences could flow from climate disclosure e.g. companies not contracting with SMEs because they are unable to provide them with scope 3 data. Firms may not disclose information for fear of liability risk and accusations of greenwashing.

We therefore suggest that there is a role for government to play in mitigating these risks and supporting reporting entities to provide credible climate reporting. This could include:

- Supporting opportunities for firms within sectors (and beyond sectors) to collaborate and learn from each other. This may involve reforms to competition laws.
- Providing leadership by creating spaces to work with the private sector and civil society on priority issues e.g. sector decarbonisation and adaptation. One example could be regulatory sandboxes or pilots where firms are exempt from regulatory actions but have an obligation to share information about worked and what did not work, therefore allowing others to learn from their experiences, allowing firms to 'learn by doing'.
- Addressing concerns around greenwashing from disclosure. For example, interventions to address greenwashing might focus on entities causing actual or potential harm to market participants and the market system, rather than entities acting reasonably to address climate risks. The SFH has forthcoming research on greenwashing.
- Ensuring firms report on liability risk in mandatory disclosure. Liability risk is the risk of a financially material lawsuit against them. A forthcoming article from the SFH explains why this category of risk is substantial and underappreciated by firms but ought to be considered.

Transition planning

In addition, and more specifically in relation to transition planning, from a policy perspective, real economy change cannot be achieved unless there is a focus on securing finance flows into new clean technologies and a process for winding down incumbent damaging technologies, assets and companies.

Transition planning is therefore a critical part of the sustainable finance regulatory regime. As set out in the ISSB sustainability standards, these are '[a]n aspect of an entity's overall strategy that lays out the entity's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions'.

Effective transition planning is not only of interest to policymakers and regulators. Investors, for example, are calling for transition planning in shareholder resolutions. We maintain a record of all climate and sustainability resolutions filed at ASX company meetings in the SFH Shareholder Resolution Database. As of November 2023, there have been at least 56 shareholder resolutions for entities in banking and finance, mining, oil and gas, and insurance sectors related to transition planning.

For investors, 'best practice' transition planning includes some of the following information. This is based on an analysis of the five different 'types' of shareholder resolutions on transition planning filed at company annual general meetings to date:

Resolution 'type'	No.	Key requests
Asset Management	17	Disclose information demonstrating how the company's capital asset allocation is aligned with net zero, including: • Production guidance for the lifetime of assets; • Details of how capital expenditure will facilitate efficient managing down of assets; • Plans and capital expenditure expectations for decommissioning and rehabilitating sites; • Plans and provisions for supporting staff to transition to future employment following asset closures; • Details of how remaining value in assets will be redeployed or returned to investors.
Financing	17	Disclose information demonstrating how the company will manage its fossil fuel exposure, aligned with net zero, including: • Commitment to no longer provide banking and financing for new fossil fuel projects; • Targets to reduce fossil fuel exposure; • Provide further details where the company has introduced requirements for fossil fuel customers to have a transition plan in place to receive lending and renewals e.g. timelines for plans, how plans will be assessed for credibility.
Investment and underwriting	6	Disclose targets and plans to reduce investment and underwriting exposure to fossil fuel assets, along with plans and progress to achieve the targets set, consistent with the goals of the Paris Agreement.
Company planning	4	Provide shareholders with an annual vote on the company's climate report, with the report including details of transition planning.
Target setting	12	Disclose short, medium and long-term targets to reduce greenhouse gas emissions, aligned with the goals of the Paris Agreement.

However, we recognise that legislating a requirement for companies to create transition plans may not be sufficient to reduce their climate-related risks and to ensure that they help to achieve climate-related mitigation and adaptation goals. For example, in other markets that require climate-risk disclosure, and in Australia in response to voluntary disclosures, companies are already pursuing so-called 'brown spinning' activities, where they move fossil fuel assets through corporate restructuring or divestment rather than winding down the life of these assets responsibly. Companies may also continue to invest in the short-term financial profit associated with fossil fuels.

These types of activities are a reasonable and rational response from companies seeking to manage their climate liabilities in the context of a market increasingly focused on climate risks. However, because companies focus on their own individual climate liabilities and commercial positions, they are not considering the systemic impact of these brown spinning activities. Namely, that moving high polluting assets around does not reduce Australia's economy-wide financial risk, nor does it reduce their own systemic climate risks. We think this is a case of a market failure justifying an increased role for the government.

It is therefore important to minimise these 'unintended consequences', emphasised by the Transition Planning Taskforce (TPT) in the United Kingdom, and the need to take a 'strategic and rounded approach' to transition. To achieve this, the TPT, for example makes some high-level suggestions on how each sector can decarbonise.

In the Australian context, one way to minimise unintended consequences and to take a strategic approach is to require Transition Plans to be linked to the sectoral decarbonisation pathways which are being developed by the Australian government and national adaptation planning, as well as tools like the Safeguard Mechanism. For example, reporting firms might be explicitly required to report against these pathways and to achieve certain targets. Treasury may also consider including incentives – for instance, additional allowances under the Safeguard Mechanism, for firms to hold onto and decommission high polluting assets. This may be more politically palatable than other more 'direct' measures such as an effective price on carbon.

Systemic risks

We support the focus on incorporating systemic financial risks, and the work of the CFR Climate Working Group to better understand this risk. There is a cognitive gap, however, between the prognosis by global and scientific leaders that we are heading towards a 'hellish' 3°C world with existential consequences (e.g., UNEP Emissions Gap Report 2023), and the relatively optimistic forecasts by Australian businesses of their prospects in this future 3°C world (e.g., in scenario analyses).

This cognitive gap is potentially based upon a lack of conceptual understanding of the complex pathways of economic breakdown, and the reliance upon understandably limited economic modelling. For example, while the Kompas et al. (2018) economic modelling increased the number of hazards and economic complexity, it did not incorporate the full extent of future 3℃ forecasts. Small reductions in GDP or even 'significant macroeconomic and financial implications' substantially underplay the economic impacts of a 3℃ world, especially given the exponential increase beyond the 1.5-2℃ goals of the Paris Agreement.

In integrating systemic risks, it is important to appreciate how acute and chronic climate impacts will increasingly be 'cascading, compounding and aggregating' (IPCC Working Group 6, 2022), with subsequent exponential economic impacts. Losses in property, agricultural productivity, and physical health are often considered, but less so are the second-order impacts upon mental health, relationships, migration and war, all with economic, social and political impacts. This will have implications for government fiscal resources, as demands for relief from extreme climate events are coupled with the need to invest in adaptation, all while the tax-base is eroded by these events.

Economists are continuing to build more complexity into their modelling, see, for example, Simpson et al. (2021) and the Climate Council (2019). Macro-economists are well positioned to understand the complexity of economic damage of our current 3℃ trajectory, given their understanding of multiplier effects, aggregation, tipping points and 'animal spirits'.

As such, we suggest including systemic risk in individual firm assessments and reporting of climate risk. This goes beyond APRA guidelines and proposed mandatory reporting that focuses only on physical and transition risks. The issue here is for regulators is how to influence longer-term, systemic behaviours by firms within a system where individual firms do not have a responsibility for system-level effects, per se, and where current market, regulatory and social pressures are insufficient.

Properly identifying and evaluating systemic, macro-economic risks for firms of our current climate trajectory could incentivise longer-term systemic actions, despite market pressures and regulatory allowance of individualised, free-riding behaviours.

Recommendation 2: Regulatory Architecture

Recommendation 2:

Develop an integrated regulatory architecture for sustainable finance in Australia.

Relevance to the Sustainable Finance Strategy

Pillar 1 Improve transparency on climate and sustainability

- Priority 2 Develop a Sustainable Finance Taxonomy
- Priority 4 Develop a labelling system for investment products marketed as sustainable

Pillar 2 Financial system capabilities

- Priority 5 Enhancing market supervision and enforcement
- Priority 8 Ensuring fit for purpose regulatory frameworks

Legal and regulatory architecture

We suggest that the Sustainable Finance Strategy is an opportunity to develop an integrated legal and regulatory architecture to govern sustainable finance in Australia.

Developing this 'fit for purpose' regulatory architecture is particularly important, especially recognising that sustainable finance regulation has developed most prominently in the European Union, a civil law system. Civil law systems operate based on an assumption and practice that regulations and codes can be regularly updated to reflect changing conditions; whereas our common law system places greater emphasis on the role of precedent through the courts to progressively interpret overarching legislation and regulations. There is a need for caution about how these innovations are brought across to a common law system and our economic regulatory system, whilst also developing new approaches that maximise our advantages as a common law jurisdiction.

We include some reflections on what this could look like below.

Governance

Implementation of a legal and regulatory architecture could be led by a 'Sustainable Finance Taskforce', a permanent governance body situated within or exterior to Treasury that aims to draw together all the different components of sustainable finance in Australia. This may include a larger pool of participants than the Council of Financial Regulators (CFR) such as the ACCC, FIRB, DCCEEW and others. The Taskforce might report annually to Treasury with law, regulation and policy recommendations that are necessary to achieve priority outcomes on sustainable finance.

At a general level, the Taskforce would adopt a 'regulatory instrumentalist' (put simply, a problem-solving approach) where law and regulation is used as a means to implement policy to address sustainable finance problems (Chiu, 2021). Broadly, the Taskforce would aim to ensure that the Australian financial system and economy is not exposed to sustainability risks and that Australian firms and financial institutions have equal access to opportunities created by sustainability transitions. Perhaps more ambitiously, a Taskforce could aim to ensure that the financial system supports the government's sustainability goals.

The Taskforce would play an important role in engaging the private sector, civil society and government to collaborate on these problems.

Mapping and review

The first task for the Taskforce could undertake three mapping and review exercises of the regulatory actors, existing legal and regulatory frameworks, and new policy/legal instruments relevant to sustainable finance in Australia. These are elaborated below.

First, the Taskforce could undertake a mapping and review exercise of the different actors involved in regulatory standard setting and policy development relevant to sustainable finance in Australia. This would recognise that sustainable finance regulation is broader than those in the CFR. The aim would be to assess the scope of their current mandates and consider what role each entity could play in the future, as well as interrelationships between entities.

These public entities included in this might include the following, which touch on sustainable finance in the following indicative ways:

Commonwealth

Attorney-General's

- Attorney-General's Department: Providing legal advice about risks/opportunities for the government e.g. disclosing public sector climate risks.
- Administrative Appeals Tribunal: Independent merits review of government decisions around sustainable finance.
- Federal Court of Australia: Enforcement role and developing case by case guidance in relation to sustainable finance.

Climate Change, Energy, The Environment and Water

- Department of Climate Change, Energy, The Environment and Water: Integrating sustainable finance laws/regulation with climate policy, vice versa.
- Clean Energy Regulator: Integrating sustainable finance tools such as disclosure with emissions reduction measures e.g. safeguard mechanism.
- Climate Change Authority: Providing independent scientific advice in relation to sustainable finance work.
- Australian Renewable Energy Agency: Opportunity to tie financial tools to measures to incentivise renewable energy uptake.
- Clean Energy Finance Corporation: Using innovative finance mechanisms to achieve sustainability goals.

Finance

- Department of Finance: Managing sustainability risks and opportunities for the Australian government.
- Future Fund Management Agency: Aligning investments with sustainability risks and opportunities.
- Commonwealth Superannuation Corporation: Using superannuation as a tool to respond to respond to sustainability risks and opportunities.

Foreign Affairs and Trade

- Department of Foreign Affairs and Trade: Working together with international partners to develop financing mechanisms to achieve sustainability outcomes.
- Austrade: Integrating sustainability concerns in trade and investment.
- Export Finance and Insurance Corporation: Providing finance aligned with sustainability risks and opportunities.

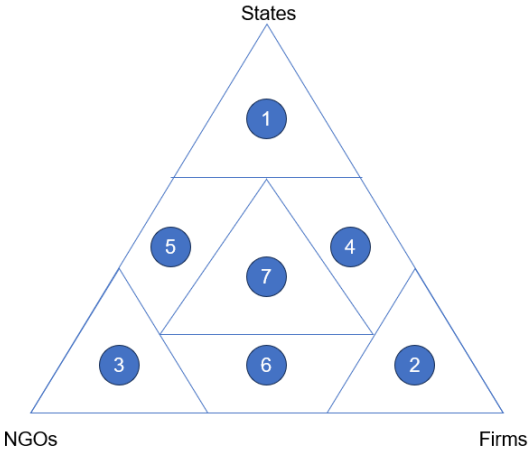
Treasury

- Department of the Treasury: Implementing Australia's sustainable finance strategy and integrating across government and others.
- ACCC: Ensuring competition and consumer protection laws are aligned with sustainability outcomes.
- Australian Office of Financial Management: Ensuring the Government's debt portfolio is resilient to sustainability risks.
- APRA: Integrating sustainability into prudential regulation.
- ASIC: Integrating sustainability into market conduct regulation and consumer protection.
- AUASB: Providing guidance and support to report on sustainability risks and opportunities.
- AASB: Providing guidance and support to report on sustainability risks and opportunities.
- Productivity Commission: Research and advice on how Australia might be transformed in the face of sustainability challenges and opportunities.
- Australian Reinsurance Pool Corporation: Responding to climate risks in the insurance sector, incentivising resilience.
- Housing Australia: Using innovative finance mechanisms to achieve sustainability goals in relation to housing e.g. adaptation, mitigation.
- RBA: Managing macroeconomic sustainability risks and opportunities.

Second, the Taskforce might undertake a mapping and review exercise of existing legal frameworks in Australia relevant to sustainable finance. The aim would be to assess the scope of these existing legal and regulatory frameworks (including identifying any gaps) and to assess the role of these in the future. As identified in the Consultation Paper, this would include a review of corporate governance obligations, prudential frameworks and oversight, and review of the superannuation system. It would also include all the regulatory frameworks relevant to the groups identified above.

Third, the Taskforce might undertake a mapping and review exercise of the new legal and regulatory tools that are being developed. This includes tools like the climate disclosure requirements, the Sustainable Finance Taxonomy, a labelling regime for sustainable finance investment products, as well as other climate policy tools such as national adaptation plans and sectoral decarbonisation pathways. The aim would be to assess how these interact with existing regulatory actors and legal frameworks identified above, to identify appropriate legal and governance arrangements going forwards, and to identify how these tools and actors could be used into the future ('use cases').

One way to bring together these three mapping and review exercises above might be to use a regulatory space/governance triangle approach (Abbott & Snidal, 2009). This sees regulatory authority as divided between states, firms and NGOs/civil society. Regulatory/legal schemes enacted by regulatory actors are then mapped onto a governance triangle that situates these based on who is responsible for their implementation. See the diagram below, adapted from (Abbott & Snidal, 2009).



Zones 1 to 3 are situations where an actor(s) from one group (states, firms, civil society) implement regulatory schemes alone. Examples of this could include current corporate law reporting requirements, implemented by the state, or the 2017 TCFD recommendations, led by the private sector.

Zones 4 to 6 are where actors from two groups share governance responsibility. An example of this could include the Banking Code, developed by banks, approved by the ASIC or the Sustainable Finance Taxonomy, led by ASFI and the Treasury.

Zone 7 includes schemes where all three actors play a vital role. This could include the new ISSB standards, developed by civil society and implemented by states and the private sector.

Based on these three mapping and review exercises, the Taskforce could start to develop an integrated legal and regulatory architecture to address sustainable finance in Australia. This would draw on Australia's strengths as a common law jurisdiction e.g. law evolves naturally in response to changing circumstances (Dalhuisen, 2019) and legislation is a tool to provide course correction and guidance rather than provide an overarching codification of the law. For more on regulatory design, see Godwin et al., 2021.

Some outcomes of this could include as follows:

- Reforming competition laws to ensure that companies are able to collaborate to achieve climate outcomes. There is a role for government, private and civil society to work together in this regard.
- Ensuring that climate disclosure frameworks are not 'tick box' exercises and imposing significant reporting burdens on companies, without achieving good climate and business outcomes. Ensuring that there is 'upskilling' to help entities effectively report to these standards whilst making sure they are not afraid of greenwashing/liability risk.
- Recommending that ongoing updates to the Taxonomy might be most appropriately led by a quasi-judicial body like the AAT or AFCA with subject matter speciality, rather than being embedded in legislation. This is in recognition that the Taxonomy fits more naturally in a civil law jurisdiction, rather than a common law jurisdiction. Such a body could be formed to make decisions on complex interpretation issues that inevitably arise when interpreting the Taxonomy. The body could also be proactively engaged on these topics.
- Updating superannuation legislation to reflect alignment with sustainable finance goals going forwards. MCF's Sustainable Finance Hub has an ARC research council grant on the role of superannuation and will be reporting on this in coming months.
- Implementing reform recommendations of other inquiries including the ALRC's inquiry into financial services regulation, especially aiming to reduce complexity in the Corporations Act.
- Greenwashing action might be seen as the 'enforcement' arm of sustainable finance, led by regulators like ASIC and the ACCC. Greenwashing enforcement might be directed particularly at addressing potential or actual harm to market participants and the market system. MCF's Sustainable Finance Hub has forthcoming research on this topic.

- The Taskforce's mandate could be embedded in legislation like the Climate Change Act and aim to provide integration throughout the system.

Sustainable finance outcomes

Once the review exercises above have been undertaken, the Taskforce might organise an ongoing work mandate around sustainable finance outcomes, and ensuring that there is a fit for purpose regulatory architecture to achieve these.

Completing the exercise above will help Treasury to better understand what outcomes track to different stakeholders. This reflects the fact that different stakeholders are pursuing different outcomes. For example, firms might only act on climate risks and opportunities where there is a business case, leaving behind gaps that ought to be filled. Different government departments have different priorities that may not necessarily be aligned with sustainability goals. Civil society groups could have a greater role to play in providing a neutral, accountability mechanism.

As one example of a tool to achieve sustainability outcomes like increased adaptation or mitigation finance, the government might consider developing new tools like 'regulatory sandboxes'. This would be a space for government, firms and NGOs to come together to plan for future sustainability problems.

Recommendation 3: Sustainability Data

Recommendation 3:

Position the Australian Government, including Treasury, as the intermediary for sustainability data.

Relevance to the Sustainable Finance Strategy

Pillar 2 Financial system capabilities

Priority 7 Addressing data and analytical challenges

Treasury as intermediary of sustainability data

We suggest that the Treasury has an important role to play in acting as a repository and collector of sustainable finance data in Australia. While the comments below are situated at a higher level, it is important to think about the appropriate role of government in collecting and disseminating sustainable finance data. This is especially because, as the Consultation Paper notes, there are several actors involved in the collection of sustainable finance data, including public institutions and private firms.

To elaborate, across sectors, there is an increasing trend of private firms collecting data and excluding their use to paying customers or subscribers. This turns data into a 'private good'. This is useful because it allows market dynamics to meet demand for sustainable finance data.

However, relying on private firms to supply data also limits access to that data to the public and public institutions. For example, there is strong demand for climate risk analytics on household mortgages from banks and other financial institutions that is being met by specialist analytics firms. Yet, analytics firms are unlikely to disclose the information to affected households or public institutions without payment. We note, for instance, that Treasury had to purchase data on climate risks at the household level from private firms in the context of its 2023 Intergenerational Report.

While it is useful to stimulate markets for technical and specific sustainable finance data, in some cases this is creating information asymmetries which could have profound welfare implications for households and (small to medium sized) firms. In addition, providing climate data to private firms and to their network of supply partners for scope 3 calculations is extremely costly and inefficient for businesses. Moreover, some data is being underprovided such as scope 3 emissions from small firms, emissions and climate risks from and for public assets and land.

An alternative approach to sustainable data would be for the government to collect and release data publicly. This is the approach taken with activities like the census. This turns data into a 'public good'.

However, while this has the benefit of enabling all actors – private and public – to access the data, it undermines the ability of market forces to form around the provision of that data and thus falls on governments to decide and allocate resources to its collection. As such, under this approach, some sustainable finance data may be under-supplied and the public sector would need to spend resources which might otherwise have been provided by market actors.

We endorse a third, middle ground approach. This would see the government consider sustainable finance data as 'club good' or 'commons' good. An example of a club good is a public swimming pool or a toll road. Governments can manage access to these assets to ensure that they remain useable by everyone. They may collect fees to access the asset, but they can vary access rights to different cohorts. Governments can raise funds to collect the data, by charging for access to it, which means that data is less likely to be underprovided.

In addition, by managing sustainability data as a 'club good', governments can give access to key impacted members of the public to reduce the welfare costs of data privatization. For example, the government could collect sustainability data on small and medium-sized enterprises, and it may be able to charge financial institutions to access such data.

Due to its quasi-private nature, this structure allows governments to work with private data experts through public-private partnerships. But it may also provide that data to other government agencies or affected firms for free or a reduced cost.

As a final comment, it is important that Treasury support capacity building in the economy on sustainable finance. This fits well with a middle ground approach we advocate for above, where the Treasury is positioned as a key enabler.

Recommendation 4: Public/hybrid finance

Recommendation 4:

Ensure that public/hybrid financing entities and tools provide a 'gold standard' in sustainable finance.

Relevance to the Sustainable Finance Strategy

Pillar 3 Australian Government leadership and engagement

Priority 12 Position Australia as a global sustainability leader

Public entities should pursue 'gold standard' of sustainable finance practice

We recommend that Australian public/private financing entities and tools ought to provide the 'gold standard' in sustainable finance.

While much of the Sustainable Finance strategy focuses on investor-owned firms and financial institutions, it is important for Treasury to think holistically across the domestic economy (and global economy) in how it manages sustainability risks/opportunities. In other words, it is important for the government to 'get its own house in order' in terms of its own management of sustainability risks and opportunities. An analogy here is the expectation for government to be a 'model litigant' in court hearings.

Nevertheless, despite the need for the government to 'lead the way' so to speak, at present, as Australian firms and financial institutions come under increasing demands to manage climate risk, there is arguably a market distortion occurring as public authorities and state-owned funds are not facing the same pressure.

This market distortion is especially significant given that the Australian Government and states and territories are significant financial and economic players in their own right. For example, the Future Fund represents $255.1 billion funds under management. The Northern Australia Infrastructure Facility has a total financing capacity of $7 billion. The NSW Government's fund manager TCorp provided $37.7bn in cumulative investment returns for the state in 2021-22.

Private sector efforts are therefore being undermined by ongoing public investment in activities which will continue to maintain climate risk across the economy. For example, one report has found that the Future Fund is likely not meeting international best practice in aspects of its climate response across disclosure, strategy and collaboration (Arup 2022). Such market distortion creates a macro-disincentive for investment. It punishes 'leaders' in the field whose competition benefit from fossil fuel investment by public institutions.

Aside from market distortions, from a geostrategic point of view, in view of Australia's bid to host COP31 with Pacific neighbours, it important for the Australian Government to demonstrate leadership with respect to climate-aligned investment.

As a prerequisite for taking a leadership role abroad, Australia should ensure that its own portfolio of financing is truly climate aligned. It is expected that scrutiny of the Australian state's climate alignment will increase over time, as international and civil society capacity is built to evaluate state performance. For example, the IPSASB is developing sustainability report standards for the public sector. The OECD is also now looking at this issue more closely and Australian public entities will be benchmarked against their peers.

In addition, and more specifically, public/private tools including debt financing, grants, and investments through state-owned entities, including the Clean Energy Finance Corporation and Future Fund, should be mandated and supported to exemplify the 'gold standard' of sustainable financing. Similarly, the development and deployment of novel green financial instruments should exemplify best practice. This includes alignment to international best practice templates, such as the OECD's *Blended Finance Principles and the Blended Finance Guidance*, as well as demonstrating true innovation in tailoring such instruments to the local contexts of our Indo-Pacific neighbours.

Moreover, international state-owned banks and other non-listed financial institutions continue to invest in assets which are creating climate risks in the Australian economy. There is therefore an important role for the Australian Government to encourage international organisations, such as the OECD and development finance institutions, to help create comparable

sustainability risk standards which are applicable to listed and non-listed companies, including those owned by the state. Otherwise, Australian firms will carry significant costs to reduce climate risks, without being able to achieve a real reduction in such risks.

Finally, there is an opportunity for Australia to be a global sustainability leader by shaping what the 'gold standard' is for sovereign responses to the intersection of the sovereign debt crisis and climate financing needs.

The task of scaling climate finance takes place in the context of high sovereign indebtedness and reduced fiscal space for low- and middle-income countries, following COVID-19, and amid elevated global inflation. Many of these countries are also amongst the most climate vulnerable and have high adaptation and mitigation financing needs. International organisations including UNEP, the World Bank, and IMF have called on states to address the climate crisis and sovereign debt crisis as compounding and inseparable issues.

Australia is a regionally significant sovereign creditor and has capacity to implement gold standard climate and debt solutions in bilateral and multilateral contexts. These solutions could include the facilitation of conditional grants, debt-for-climate swaps, trilateral debt swaps, debt forgiveness or restructuring, or climate resilient debt clauses and other creditor nations.

Appendix A – Bios of Authors

Dr. Arjuna Dibley is the Head of Sustainable Finance Hub, Melbourne Climate Futures, The University of Melbourne and Honorary Research Associate, Smith School for Enterprise and Environment, University of Oxford. Dr. Dibley is a law and economics expert whose research focuses on global sustainability issues, including climate change policy, sustainable finance, and energy innovation. His work in these areas has been published in world leading academic and press outlets, and cited by the Intergovernmental Panel on Climate Change. Dr. Dibley was previously a corporate lawyer, investment adviser and senior policy analyst at leading private and public sector organisations in Australia, Asia and the US. He holds undergraduate honours degrees from the Australian National University and in 2016 was a Sir General John Monash Scholar, earning a doctorate in climate change law and economics from Stanford University.

A/Prof Ben Neville is a Deputy Director of Melbourne Climate Futures, The University of Melbourne and Associate Professor in the Department of Management & Marketing, Faculty of Business and Economics. A/Prof Neville researches and teaches in the area of sustainable business and society, including corporate social responsibility, business ethics, ethical consumption and social entrepreneurship. This work investigates how business can be a force for good and not harm, including from strategic, ethical and critical perspectives. A/Prof Neville is the Coordinator of the Governance, Policy and Markets Stream in the Master of Environment, and Program Director of the Graduate Certificate in Sustainable Business.

Mr Nanak Narulla is a Senior Policy Advisor at Melbourne Climate Futures, The University of Melbourne and Consultant at the Oxford Sustainable Law Programme, The University of Oxford. Mr Narulla is a lawyer and strategy consultant, specialising in matters relating to climate change, the energy transition, and environmental protection. His career to date has focused on the use of legal interventions as systemic drivers of climate action. He previously worked on climate litigation in the Pacific for the Environmental Defenders Office and renewable energy transactions in Australia for Herbert Smith Freehills, as well as a public sector consultant for the Boston Consulting Group. Mr Narulla holds bachelor's degrees in Law and Arts (International Relations and Philosophy) from the University of New South Wales and a MSc in Environmental Change and Management and a Master of Public Policy at the University of Oxford, where he studied as a Rhodes Scholar.

Ms Rebekkah Markey-Towler is a Research Fellow at the Sustainable Finance Hub, Melbourne Climate Futures, The University of Melbourne and a PhD Candidate at the Melbourne Law School. Ms Markey-Towler has expertise on legal and regulatory matters relevant to sustainable finance such as specific new tools like disclosure, greenwashing, and their intersection with existing frameworks. Her PhD, in particular, looks at the topic of climate change and mortgage lending. Prior to commencing her PhD, Ms Markey-Towler was a researcher at the Melbourne Law School and the Executive Associate to a Judge on the Federal Court of Australia. Ms Markey-Towler holds a Bachelor of Arts/Law (International Relations and Political Science) from The University of Queensland and is admitted as a lawyer in the Supreme Court of Victoria.