Staying the course on net zero

To continue to seize opportunity and manage risks, investors must move beyond net zero commitments and focus on delivering outcomes

May 2023

Right Lane Consulting is headquartered on the land of the Wurundjeri People of the Kulin Nation.

We pay our respects to their Elders past and present.

Right Lane acknowledges and celebrates Aboriginal and Torres Strait Islander peoples across Australia.

This was and will always be their land.

This research paper, ***Staying the course on net zero,*** forms one chapter of Right Lane Consulting's *2023 Forces at Work Report*. While the full report is available to subscribers only, this and another chapter, ***Bridging the gap in a gendered superannuation system*** (co-authored with Women in Super), have been made publicly available to support the advocacy around these important issues.

If you would like a copy of either of these research papers, or to subscribe to the full ***2023 Forces at Work Report,*** please contact info@rightlane.com.au).

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About Right Lane Consulting

Right Lane Consulting is a flourishing, purpose-driven, management consulting firm serving the purpose economy.

Right Lane Consulting became the first strategy consulting firm in Australia to be B Corp certified in 2015. Right Lane has since recertified as a B Corp in 2017 and 2021. Certified B Corporations meet higher standards of social and environmental performance, transparency, and accountability.

Taking this commitment one step further, in July 2022, we transitioned to majority Foundation ownership – the first Australian consulting firm to adopt such a structure.

Our vision is to create and lead a new, disruptive, ethical consulting category that reflects a more sustainable balance of interests between Right Lane Consulting, our team, our clients and society.

We employ our distinctive ideas and processes, and our absolute commitment to delivery, to help clients we care about pursue their inspiring missions.

We work alongside clients who do great work within the sectors they operate, and we are excited to be involved in creating outcomes that truly make a difference.

Right Lane Consulting was established in 1997 to help private, not for profit and public sector clients to clarify and accelerate their future plans. Over the past 26 years, we have helped the executive teams and boards of around 400 organisations to define and adapt their direction and strategy, identify and clarify their priorities, align their efforts with their aspirations, get their major projects started and finished, and measure and improve their performance.

Members of the Right Lane Consulting team at the launch of the Right Lane Foundation, October 2022.

Left to Right: Aaron Richards (Engagement Manager, Foundation Board Member), Zoe Pappas (Principal), Lauren Spiteri (Head of New Client Development and Digital Assets), Chiara Lawry (Chief Executive Officer), Marc Levy (Founder & Chair), Jess Cossens (Engagement Manager), Chloe Mitchell (Foundation Board Member), Gemma Pinnell (Principal)

About Melbourne Climate Futures

Melbourne Climate Futures drives the University of Melbourne's leadership role on creating transformative solutions to the climate crisis for a future worth living.

We bring together research and expertise from across the University, not only to learn and educate, but to become a guiding voice for policy makers and industry so that we can enact real change in the face of this urgent and complex issue.

Our vision is to accelerate the transition to a positive climate future, using transformative thinking to build vibrant communities nationally and globally, with particular attention to serving our growing Indo-Pacific region.

While we develop inspirational ideas, technology and design, it is vital that the transitions and transformations we make as we strive for greater sustainability are safe, healthy, and equitable.

To this end, Melbourne Climate Futures unites disparate yet constantly interacting disciplines – such as health, justice, finance and policy – to create holistic solutions.

Melbourne Climate Futures connects and amplifies the depth and breadth of University of Melbourne research, creates a portal to share ideas and collaborate on real action, and empowers the next generation of climate leaders.

Read more about Melbourne Climate futures at unimelb.edu.au/climate.

Introduction

2023 is the eleventh year Right Lane Consulting has published its significant superannuation research paper, the *Forces at Work Report*. It is a chance for Right Lane Consulting to engage with some of the big issues facing our profit-to-member superannuation partners, from industry structure, scale and competition to the biggest policy issues facing the sector.

For the first time, this subscription-only report includes two publicly available, standalone chapters exploring the net zero transition and gender in the superannuation system respectively. These issues are of great import and immediate concern to the superannuation sector and have wide-ranging ramifications that extend beyond the sector to impact society more broadly.

Right Lane Consulting is proud to have collaborated with Melbourne Climate Futures at the University of Melbourne on this chapter.

Staying the course on net zero

We sometimes characterise funds' approaches to sustainability as either: show me how it will impact the company's long term value creation thesis or I'm not interested; or climate change, natural resource conservation and other sustainability and social license factors will impact our members' futures and we have an obligation to exercise our influence in capital markets to protect their best interests. Increasingly, we are seeing a third way, which combines these approaches. On one hand, climate change is creating material financial risks for funds and companies that need to be managed. On the other, the economic transitions inherent in meeting globally agreed emissions goals are creating significant new investable opportunities.

benefits and avoid the risks of net zero investing. We discuss the rapid increase in net zero commitments and investments, the increasing demands on investors to deliver on these commitments, headwinds they face in doing so, and the imperative for funds to stay the course and further lean into the opportunities provided by the net zero transition.

By pushing for policy change in the now more favourable political context, uplifting climate-related investment capabilities and accelerating integration of net zero investment strategies, funds can meet and exceed the demands of the challenging but rewarding investment environment in the era of decarbonisation.

This chapter and more broadly, the *Forces at Work Report* is a collaborative effort with the clients we serve and the profit-to-member superannuation ecosystem we are part of. We would like to thank the 35 CEOs and senior executives who gave interviews for this year's report, along with subscribers and contributors who shared comments on the drafts. More information about subscribing to the full report is available on page 2.

The authors would especially like to thank the industry leaders and experts that generously contributed their time to participate in interviews and provide feedback for this chapter. Your significant input and invaluable insights have made this truly a collective effort, and we look forward to collaborating with you in future on the essential work of the net zero transition.

Chiara Lawry

CEO, Right Lane Consulting

Arjuna Dibley

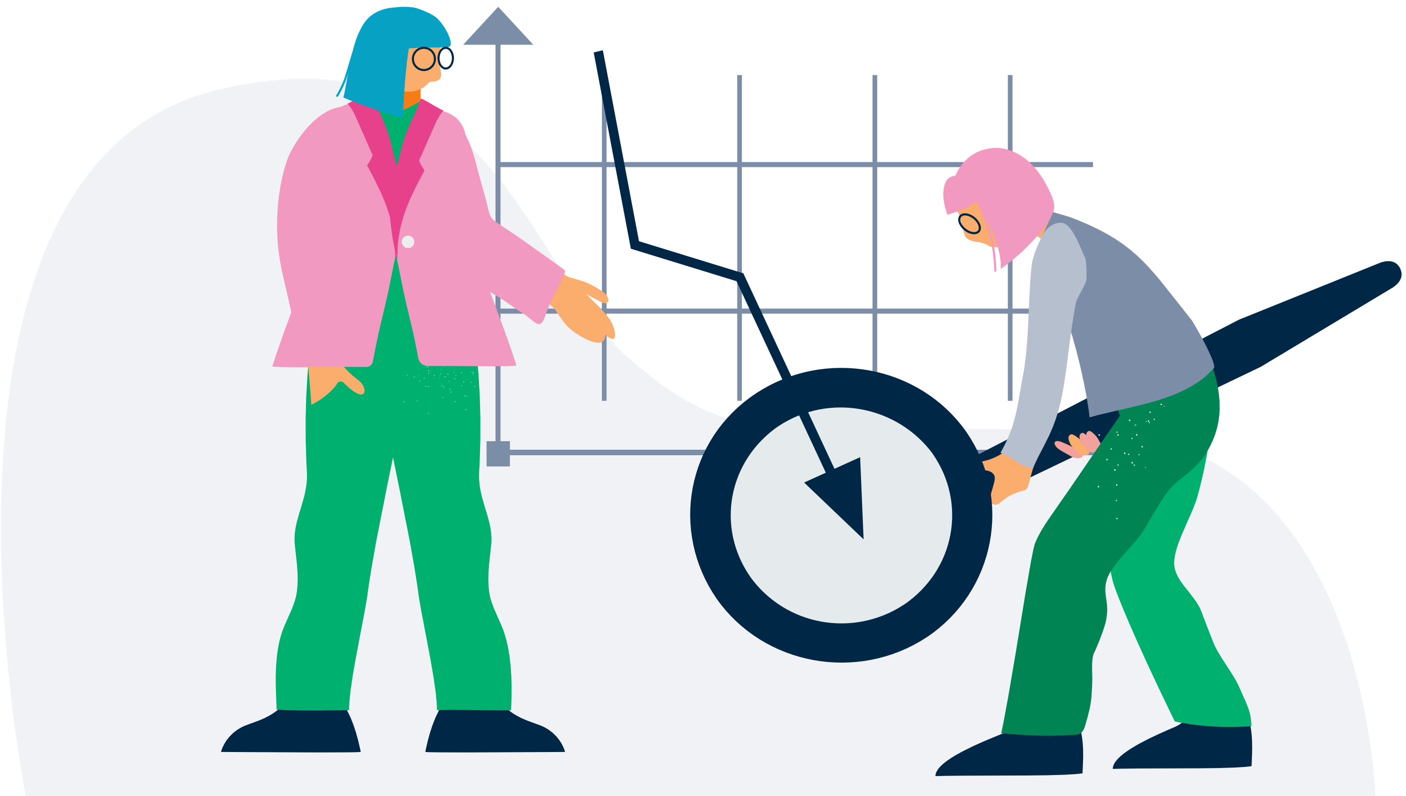
Head of the Sustainable Finance Hub, Melbourne Climate Futures

Note: As well as the growing understanding of climate risks, another key trend in 2022 was the developing awareness of nature-related financial risks. In December 2022, 196 countries agreed to the Kunming-Montreal Global Biodiversity Framework to address nature and biodiversity loss, and the Taskforce on Nature-related Financial Disclosures is currently in development. As a consequence, funds are increasingly aware of the need to integrate the way they deal with climate and nature-related financial risks. We may cover this further in future years, but the focus of this report is on climate-related financial risks.

Sources: Right Lane Consulting. (2023); UNEP. (2022, December 20). COP15 ends with landmark biodiversity agreement; TNFD. (2022, November). The TNFD Nature-related Risk and Opportunity Management and Disclosure Framework Beta v0.3.

Methodology of this report

The report draws on several sources of insight, including APRA data, publicly available reports and commentary, and in-depth interviews with industry leaders. This year, we interviewed 35 leaders for the report, 75% more than in previous years, including 15 CEOs and ESG leaders and fund executives with an expert perspective on women's retirement outcomes, all from subscribing organisations. The analysis in this chapter was co-developed with Melbourne Climate Futures, and an early draft was iterated based on in-depth feedback from ESG investment experts.



Summary: Staying the course on net zero

1	**There has been a rapid increase in net zero commitments and investments:** • To limit the effects of global warming, policymakers have agreed to pursue ‘net zero’ emissions by 2050, requiring deep and immediate emission reductions across the global economy • Achieving net zero emissions is required to keep global warming to within 1.5°C this century, the goal of the Paris Agreement • Governments, the private sector and institutional investors have taken steps to try and reduce emissions and manage climate-related risks • There has been significant growth in net zero commitments by companies and financial institutions, including super funds.
2	**There are increasing calls for investors to deliver outcomes on net zero commitments:** • As climate change is mainstreamed across the global economy, net zero investing is transitioning into a challenging ‘realisation’ phase • In wake of increasing commitments to net zero, there have been high-profile critiques about their effectiveness or lack thereof • Some governments, companies and financial institutions have been stepping back from net zero commitments • Financial regulators are increasingly seeking to understand how net zero strategies are being implemented • Litigation is being advanced to test the effectiveness of net zero commitments, particularly in Australia.

3	**There remains a strong business case for ongoing implementation of net zero-aligned investing:**
	• Physical and transition climate risks pose a significant and increasing threat across the economy
	• Government policy ambition towards net zero in major global economies is increasing, with substantial announcements made during 2022
	  • Policies such as the EU’s Carbon Border Adjustment Mechanism and the US’ Inflation Reduction Act are creating significant macroeconomic incentives for net zero aligned investment
	  • As Australia’s policy settings have changed, there may be substantial net zero aligned investment opportunities.

4	**Funds should continue to sharpen their ability to rapidly deliver outcomes and manage legal and reputational risk:**
	• Funds can capitalise on the favourable political environment by pursuing policies and initiatives that accelerate net zero opportunities
	• Investing in capability uplift will enable funds to address the sharpening climate risk environment
	• Funds can accelerate their work integrating net zero strategies into mainstream investment processes through various activities:
	  • Measuring financed emissions
	  • Setting net zero targets
	  • Aligning portfolios
	  • Utilising climate risk management tools.

1 The increase in net zero commitments

There has been a rapid increase in net zero commitments and investments.

To limit the effects of global warming, policymakers have agreed to pursue 'net zero' emissions by 2050, requiring deep and immediate emission reductions across the global economy.

Governments, the private sector and institutional investors have taken steps to try and reduce emissions and manage climate-related risks.

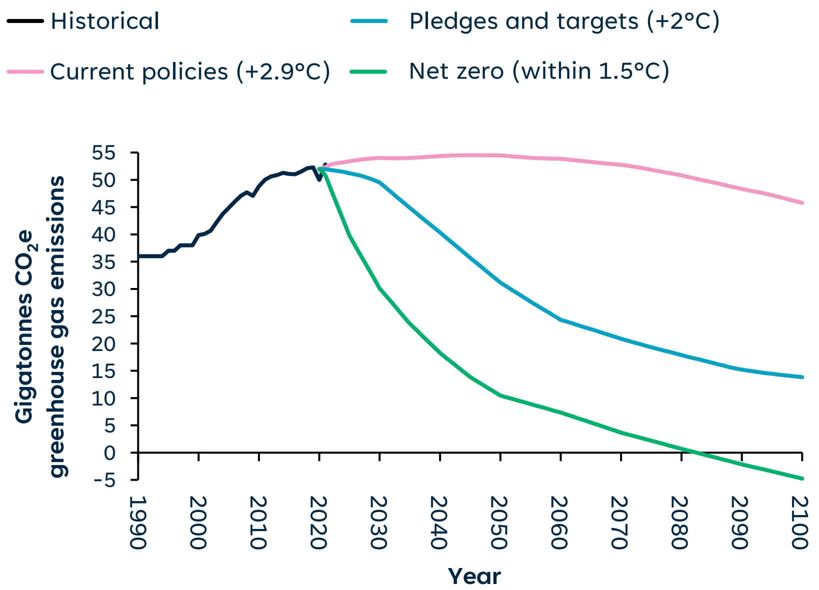
There has been significant growth in net zero commitments by companies and financial institutions, including super funds.

To limit the effects of global warming, policymakers have agreed to pursue 'net zero' emissions by 2050, requiring deep and immediate emission reductions across the global economy

Achieving net zero greenhouse gas emissions by 2050 is required to keep global warming to within 1.5°C this century, as called for in the 2015 Paris Agreement.

Current pledges and targets will result in a temperature rise of +2°C, and current policies will result in a rise of +2.9°C.

Historical and projected global greenhouse gas emissions scenarios and temperature increase, gigatonnes CO_2 equivalent, 1990-2100

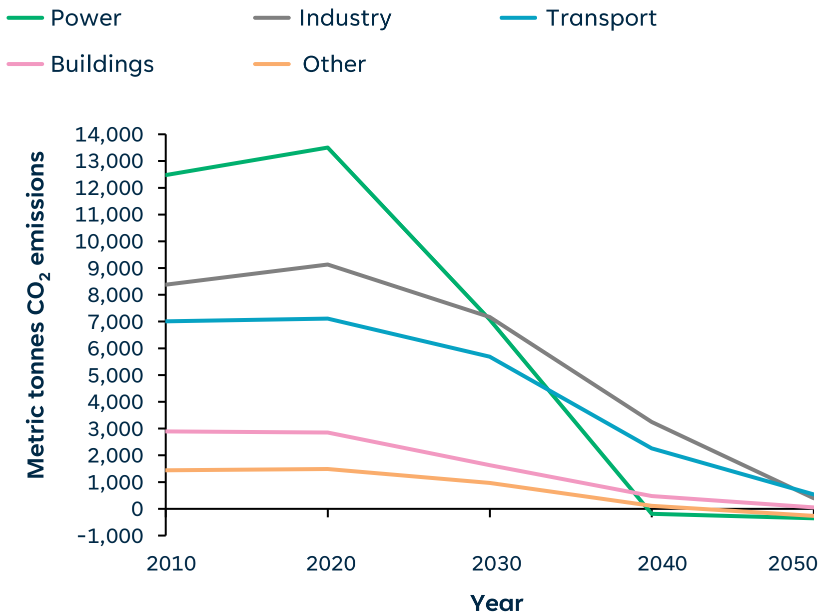


The transition to net zero will require a steep reduction in CO_2 emissions across all sectors.

'We need to eliminate global emissions of greenhouse gases by 2050 ... Getting to zero will be the hardest thing humans have ever done ... We need to revolutionize the entire physical economy'

Bill Gates, December 2022

Projected change in CO_2 emissions needed to achieve net zero by sector, metric tonnes CO_2, 2010-2050

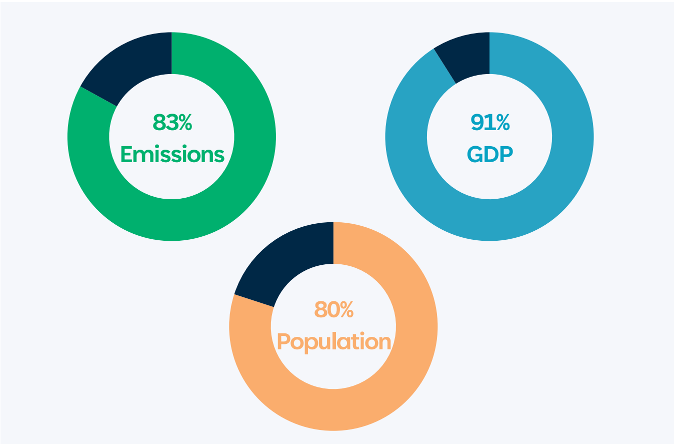


Sources: Right Lane Consulting. (2023). Climate Action Tracker. (2022, November 10); Global emissions time series; UNEP. (2022, October 27). Emissions Gap Report 2022. 5; IEA. (2022, November). World Energy Outlook 2022; Gates, B. (2022, December 20). The future our grandchildren deserve. GatesNotes.

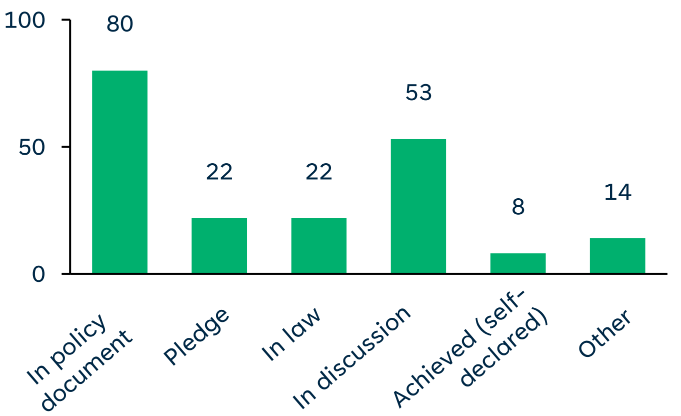
Governments, the private sector and institutional investors have taken steps to try and reduce emissions and manage climate-related risks.

Significant progress has been made towards achieving net zero, with over 80% of global emissions, GDP and population now covered by net zero commitments. 124 countries have committed to net zero in a policy document, pledge or in law.

Global net zero coverage as of 26 January 2022



Number of countries with net zero commitments as of 26 January 2022



Established by former Bank of England Governor, Mark Carney in 2017, the **Taskforce on Climate-related Financial Disclosures (TCFD)** is the basic guideline used by asset owners and regulators to manage climate-related risks, both voluntarily and through regulations.

The TCFD provides a framework for investors to drive emission reductions through engagement with companies in which they invest. The rate of reporting aligned with the TCFD framework among companies with the greatest impact on climate change[1] doubled from 2018 to 2021.

The four pillars of the Taskforce on Climate-related Financial Disclosures framework[2]:

Governance

'Disclose the company's governance around climate-related risks and opportunities'

Strategy

'Disclose the actual and potential impacts of climate-related risks and opportunities on the company's businesses, strategy, and financial planning where such information is material'

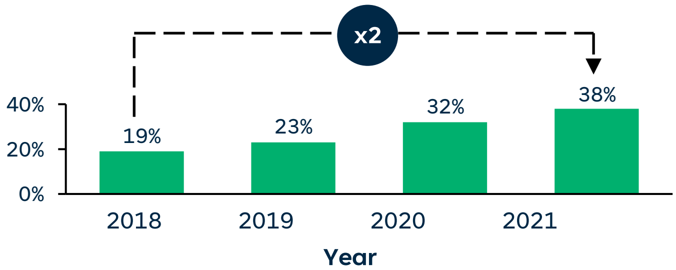
Risk Management

'Disclose how the company identifies, assesses, and manages climate-related risks'

Metrics and Targets

'Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material'

Average rate of company reporting aligned with TCFD recommended disclosures, %, 2018-21. n=1126-1734



Notes: 1. See TCFD reports for methodology on company selection; 2. TCFD. (2022, October). 2022 Status Report. 11.

Sources: Right Lane Consulting. (2023); New Climate Institute. (2023, January 26). Net zero tracker; TCFD. (2022, October). 2022 Status Report. 12; (2021, October). 2021 Status Report. 30.

There has been significant growth in net zero commitments by companies and financial institutions, including super funds.

The number and size of net zero initiatives in the global financial sector continues to grow[1].

Climate Action 100+

Members: 700
AUM: US$68tn

GFANZ Glasgow Financial Alliance for Net Zero

Members: 550
AUM: US$152tn

NET ZERO ASSET MANAGERS INITIATIVE

Members: 301
AUM: US$59tn

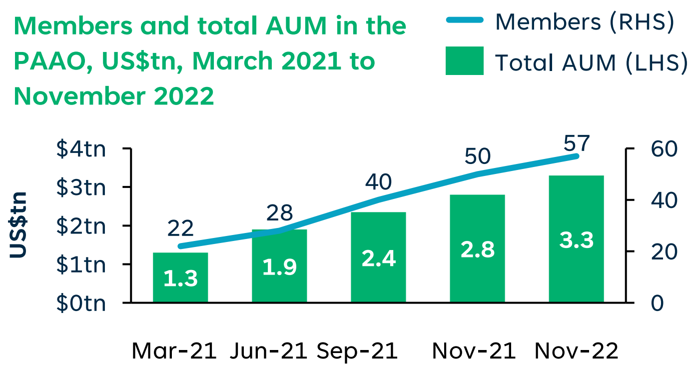
THE NET-ZERO ASSET OWNER ALLIANCE

Members: 83
AUM: US$11tn

As of November 2022, there are 57 Paris Aligned Asset Owners (PAAO) signatories with a combined US$3.3tn in AUM.

PARIS ALIGNED ASSET OWNERS

Members and total AUM in the PAAO, US$tn, March 2021 to November 2022



Most large Australian super funds have now made net zero commitments and are developing strategies to implement these.

Large[2] super funds that have committed to net zero by 2050

AMP | Australian Retirement Trust | AustralianSuper | cbus | HOSTPLUS | Rest | Colonial First State | UniSuper

HESTA

HESTA was the first large superannuation fund to commit to net zero emissions by 2050.

The fund has announced an interim target to achieve a 33% reduction in emissions (against a 2020 baseline) by 2030. As part of its assessment of climate change transition progress, HESTA has implemented an engagement escalation framework and developed a watchlist for companies that are key contributors to portfolio emissions.

aware SUPER

Aware Super has created listed equities benchmarks to support their net zero emissions goal by 2050.

The highest carbon emitters both locally and globally are excluded from their existing benchmark indices. This enables investment managers to implement strategies that produce lower emissions equity portfolios and leverages internal teams to deliver results best suited to Aware Super members.

Notes: 1. Selection is non-exhaustive, membership and AUM may overlap, members and AUM as of December 31 2022; 2. 'Large funds' are those with assets under management >AU$50bn.

Sources: Right Lane Consulting. (2023); Climate Action 100+. (2022). Initiative snapshot; GFANZ. (2022, October 21). 2022 Progress Report. 10; NZAOA. (2022, September). Advancing Delivery on Decarbonisation Targets. 3; (2022, December 20). NZAOA's ten most significant moments in 2022; IEA. (2022, June). World Energy Investment. 11. HESTA. (2022, September 6). HESTA sets stronger 2030 emissions reduction target [media release]; Aware Super. (2020, November 25). Aware Super's new share market benchmarks reduce carbon footprint of equities portfolio by 40% [media release]; Net Zero Asset Managers. (2022, December 31). The Net Zero Asset Managers initiative; Paris Aligned Investment Initiative. (2021-2022). Media releases.

2 The shift from commitments to outcomes

There are increasing calls for investors to deliver outcomes on net zero commitments.

As climate change is mainstreamed across the global economy, net zero investing is transitioning into a challenging 'realisation' phase.

In wake of increasing commitments to net zero, there have been high-profile critiques about their effectiveness or lack thereof.

Some governments, companies and financial institutions have been stepping back from net zero commitments.

Financial regulators are increasingly seeking to understand how net zero strategies are being implemented.

Litigation is being advanced to test the effectiveness of net zero commitments, particularly in Australia.

As climate change is mainstreamed across the global economy, net zero investing is transitioning into a challenging 'realisation' phase.

1 'Acceptance phase'

Climate science accepted by government and industry.

A major confluence of events affirms the importance of climate science to the economy.

2015: The Paris Agreement aligns parties on the need to reduce emissions to keep global warming 'well-below 2 degrees'.

2018: The Intergovernmental Panel on Climate Change publishes a report focusing on the importance of achieving 'net zero' by 2100.

2015 – 2019: Financial regulators in large capital markets and Australia agree that climate change poses systemic financial risks.

2021: The International Energy Agency publishes *Net Zero by 2050*, outlining the immediate need and pathway to transition to net zero carbon emissions by 2050.

2 'Commitment phase'

Pledge to act and adopt net zero tools and methods.

Investors coordinate through net zero groupings, which encourage the investment community to pledge to reduce emissions.

2017: The Financial Stability Board launches the TCFD, the first of a set of tools and metrics developed by investor groups and the private sector to help evaluate climate risk and exposure of portfolios and achieve net zero alignment in investment strategies.

2021: The Glasgow Financial Alliance for Net Zero is announced, seeking pledges from 500+ financial institutions globally and becoming the high watermark of net zero commitments.

2021: The Australian Government commits to achieving net zero carbon emissions by 2050.

3 'Realisation phase'

Growing stakeholder expectation of material outcomes.

In this phase, investors face growing expectations from key stakeholders to deliver on their net zero investing strategies.

Investors are seeking to realise material outcomes from implementation of net zero commitments.

Traditional industries are pushing back as capital outflows impact their sectors.

Regulators are increasingly requiring investors to disclose and/or substantiate their green claims. Activists are bringing legal cases against laggards.

Sources: Right Lane Consulting. (2023); IPCC. (2018). Special Report: Global Warming of 1.5ºC; UNFCCC. (2015). The Paris Agreement; CPD. (2020, December 10). Roundtable: Discharging director's duties relating to climate risk – some practical applications; GFANZ. (2021). Accelerating the transition to a net-zero global economy; IEA. (2021, May). Net Zero by 2050; TCFD. (2022, October). 2022 Status Report; Taylor, A. (2021, October 26). Australia's plan to reach our net zero target by 2050 [media release].

In wake of increasing commitments to net zero, there have been high-profile critiques about their effectiveness or lack thereof.

In 2022, high-profile investment industry insiders have criticised the emphasis of climate-related financial risk management and the effectiveness of climate-related investment approaches.

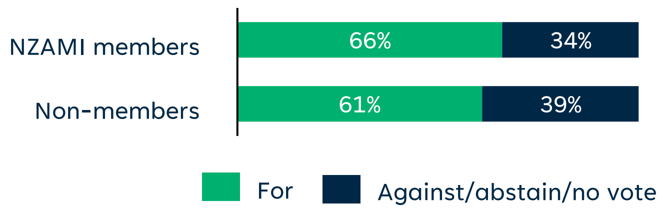
ESG advocates such as ex-Blackrock CIO for Sustainable Investing Tariq Fancy have published high-profile critiques of ESG investment ('ESG 1.0') alleging its ineffectiveness.

Others such as Stuart Kirk, former head of Responsible Investing at HSBC, have argued that banks and other financial institutions are over-emphasising climate risk given the incentives and investment time horizons of many investors.

Research also highlights that net zero commitments are not necessarily translating into effective manager engagement approaches.

A study of voter behaviour showed that NZAMI members only voted in favour of environmental shareholder resolutions 5% more than non-members.

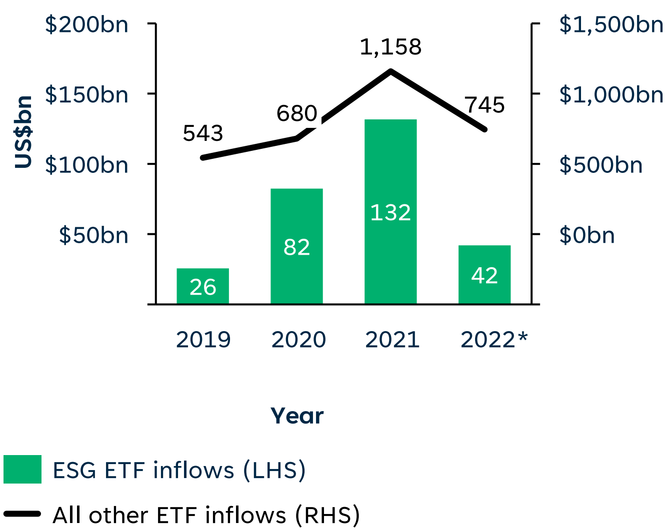
Voting behaviour on environmental shareholder resolutions, NZAMI members and non-members, 2022



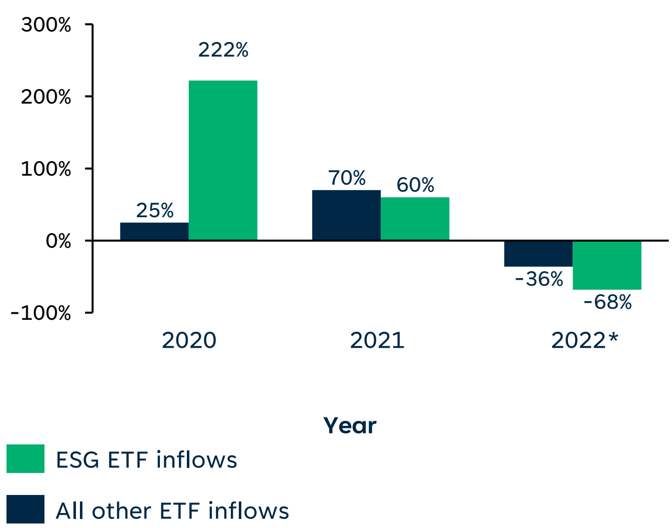
Criticisms of climate-related investment approaches have been buoyed by a decline in certain ESG capital inflows in 2022 after years of growth.

Global ESG ETF inflows declined by 68% from 2021-22*, compared to a 36% decline for all other ETFs.

Global ETF inflows by calendar year, US$bn, 2019-22



Global ETF inflows by calendar year, % change, 2020-22



Note: *2022 inflows from January to November.

Sources: Right Lane Consulting. (2023); Gray, C., Nagrawala, F., Monnickendam, I. & Stewart, K. (2023, January). Voting Matters 2022. Shareaction; Bullard, N. (2022, December 15). Sustainable Debt, ESG Markets Turn Frosty in 2022. Bloomberg. ETFGI. (2020-2023). Media releases.

Some governments, companies and financial institutions have been stepping back from net zero commitments.

2022 saw a ‘backlash’ against ESG in the US, with some governments and managers stepping back from net zero commitments.

US legislators have introduced 35 anti-ESG investment bills since December 2020, and 6 states pulled a combined $3.54bn from Blackrock in 2022, with UBS downgrading Blackrock’s stock rating in October in response.

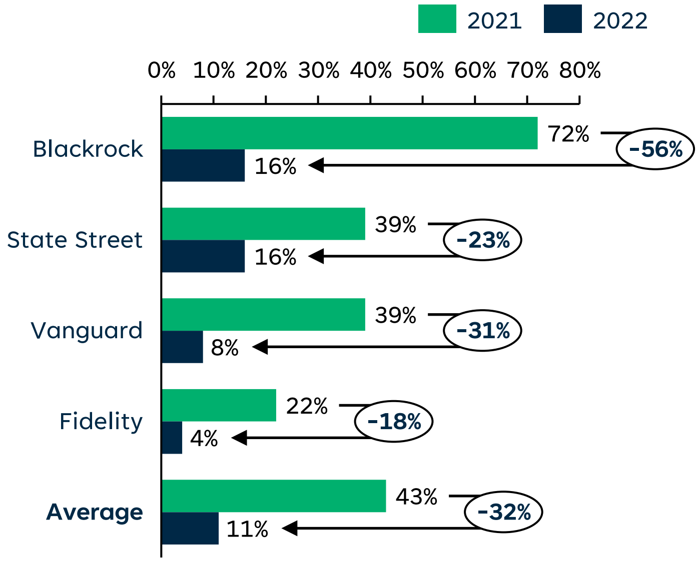
This has led some asset managers to step back their public commitment to ESG initiatives.

Vanguard withdrew from the Net Zero Asset Managers Initiative in December 2022

Four of the world’s largest asset managers significantly reduced their public support for ESG shareholder resolutions in 2022.

Support for environmental shareholder resolutions at energy companies from Blackrock, State Street, Vanguard and Fidelity fell from 43% to 11% on average from 2021-22.

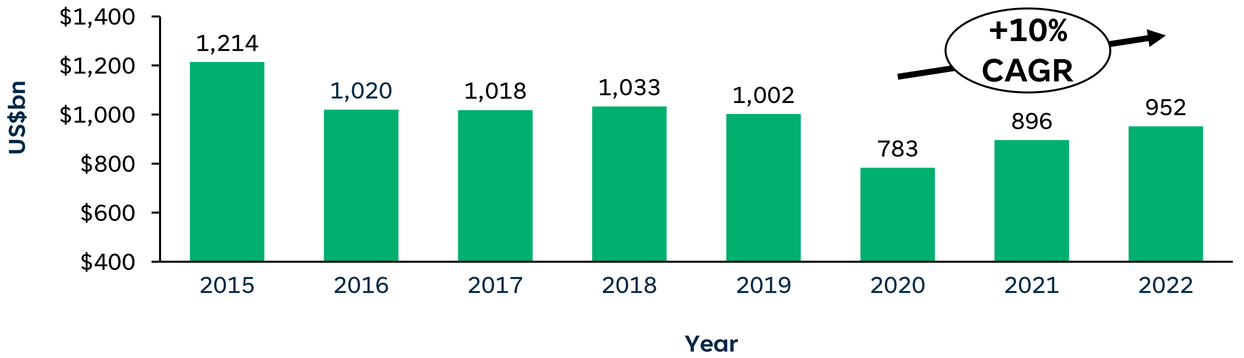
Change in support for environmental shareholder resolutions at energy companies, 2021-22



The ESG backlash has also been invigorated by the energy crisis driving an increase in capital flows into coal and gas.

Russia’s invasion of Ukraine created significantly volatility in the energy market, driving up prices and stimulating investment in fossil fuels as European states attempt to ensure short-term energy security. After a period of stagnation and decline, global investment in fossil fuels experienced a CAGR of 10% from 2020 to 2022.

Global investment in fossil fuels, US$bn, 2015-22



Sources: Right Lane Consulting. (2023); Pollard, A., Brush, S. & Hoffman, C. (2022, December 16). BlackRock Is Caught in the ESG Crossfire and Struggling to Get Out. Bloomberg; Kishan, S. Moran, D. & Marques, F. (2022, December 2). BlackRock faces $2 Billion Hit as DeSantis Escalates ESG Fight. Bloomberg; Vanguard. (2022, December 7). An update on Vanguard’s engagement with the Net Zero Asset Managers initiative (NZAM); Gray, C., Nagrawala, F., Monnickendam, I. & Stewart, K. (2023, January). Voting Matters 2022. Shareaction; IEA. (2022, November). World Energy Outlook 2022. 19. IEA. (2022, June). World Energy Investment Datafile.

Financial regulators are increasingly seeking to understand how net zero strategies are being implemented.

Global financial regulators are increasing their understanding of systemic climate-related financial risk through scenario-based stress tests, and these analyses are guiding supervisor priorities:

- On 30 November 2022 APRA published the findings of its first Climate Vulnerability Assessment to model the financial impact of climate change on ANZ, Commonwealth Bank, Macquarie Bank, National Australia Bank and Westpac
- The US Federal Reserve is currently conducting its first climate scenario analysis to gauge the resilience of American financial institutions to climate-related risks
- On 24 May 2022 the Bank of England published results from the first Climate Biennial Exploratory Scenario exploring financial risks posed by climate change.

Corporate and financial regulators are also increasingly asking firms to disclose climate change risks:

- On Monday 19 December 2022 the Treasury released a climate-related financial disclosure consultation paper, foreshadowing increased disclosure requirements for Australian funds.
- In March 2022 the United States' Securities and Exchange Commission proposed disclosure rules for climate risk and carbon emissions to prevent greenwashing
- From April 2022 there is mandatory Task Force on Climate-related Financial Disclosures reporting for large firms in the United Kingdom.

ASIC
Australian Securities & Investments Commission

The Australian Securities and Investments Commission (ASIC) has begun investigating and engaging in legal action against greenwashing. ASIC announced it was investigating multiple super fund trustees in October 2022, and action against greenwashing is one of ASIC's 2023 Enforcement Priorities.

Actions against greenwashing taken by ASIC to date:

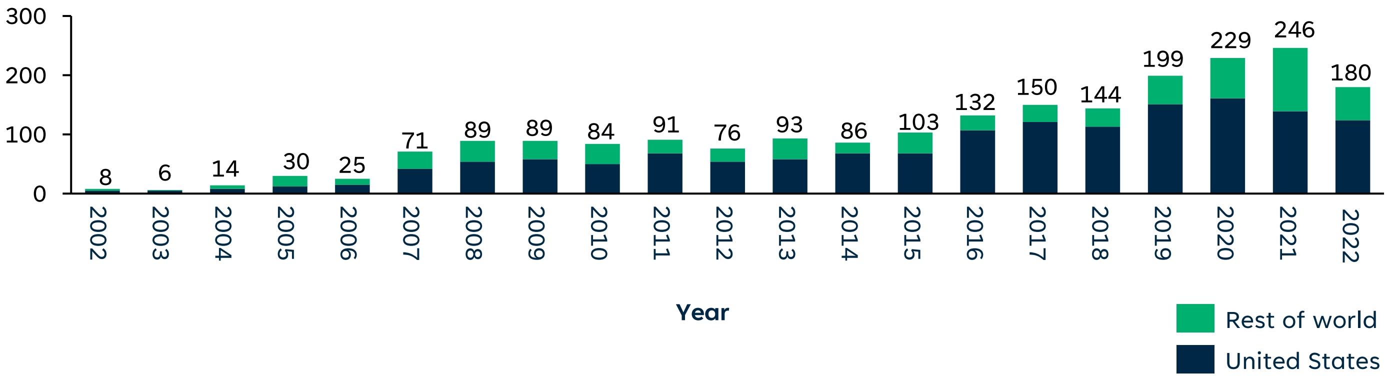
- ASIC issued 3 infringement notices for greenwashing against Vanguard Investments Australia on 2 December 2022
- On 23 December 2022 ASIC issued its first infringement notice for greenwashing in relation to a superannuation product, to superannuation trustee Diversa
- On 28 February 2023 ASIC launched its first court action alleging greenwashing, against Mercer Superannuation Limited
- On 2 May 2023 ASIC issued an infringement notice to Future Super.

Sources: Right Lane Consulting. (2023); Bank of England. (2022, May 24). Results of the 2021 Climate Biennial Exploratory Scenario; APRA. (2022, November 30). APRA releases results of inaugural Climate Vulnerability Assessment; Manifest Climate. (2023, January 20). Fed releases climate risk exercise details. IEA. (2022, June). World Energy Investment 2022. 205; ASIC. (2022-2023). Media releases.

Litigation is being advanced to test the effectiveness of net zero commitments, particularly in Australia.

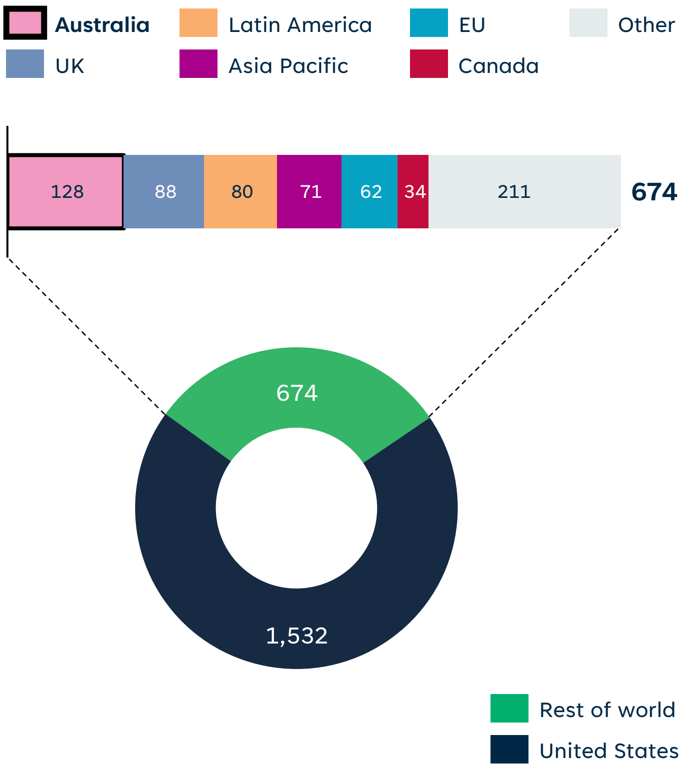
Climate litigation has been increasing rapidly over the past 2 decades.

New climate litigation cases by year, global, 2002-2022



While the vast majority of cases are from the US, Australia has the 2nd highest volume of climate litigation in the world, with 128 of 674 cases (19%) outside the US occurring in Australia. Globally, Australia has a relatively high rate of climate cases compared to economic output, although few cases have yet been advanced against super funds. Increasingly, legal actions are focused on claims of greenwashing, and are testing the veracity of funds' net zero commitments.

Number of climate litigation cases brought as of December 2022, selected regions[1]



Case studies: Legal actions against profit-to-member super funds

Rest

In 2018, member Mark McVeigh sued REST for failing to disclose how it would manage climate-related risks in its investments. The case was settled in 2020 with REST agreeing to align its investments with NZ by 2050 and report on climate-related outcomes.

HESTA

On 4 August 2022, the Environmental Defenders Office sent a letter to HESTA on behalf of members Sue and Rod Campbell-Ross stating that maintaining fossil-fuel investments and voting against environmental shareholders proposals may be in breach of obligations to manage climate-related risks, and that the fund may be engaging in greenwashing by claiming to be a leader on climate action despite engaging in these activities.

Notes: 1. 'Asia Pacific' excludes Australia; 'Other' includes non-specified regions and international litigation.

Sources: Right Lane Consulting. (2023); Pollard, A., Brush, S. & Hoffman, C. (2022, December 16). BlackRock Is Caught in the ESG Crossfire and Struggling to Get Out. Bloomberg; Kishan, S. Moran, D. & Marques, F. (2022, December 2). BlackRock faces $2 Billion Hit as DeSantis Escalates ESG Fight. Bloomberg; Vanguard. (2022, December 7). An update on Vanguard's engagement with the Net Zero Asset Managers initiative (NZAM); Gray, C., Nagrawala, F., Monnickendam, I. & Stewart, K. (2023, January). Voting Matters 2022. Shareaction; IEA. (2022, November). World Energy Outlook 2022. 19. IEA. (2022, June). World Energy Investment Datafile.

3. The business case for staying the course

There remains a strong business case for ongoing implementation of net zero-aligned investing.

Physical and transition climate risks pose a significant and increasing threat across the economy.

Government policy ambition towards net zero in major global economies is increasing, with substantial announcements made during 2022.

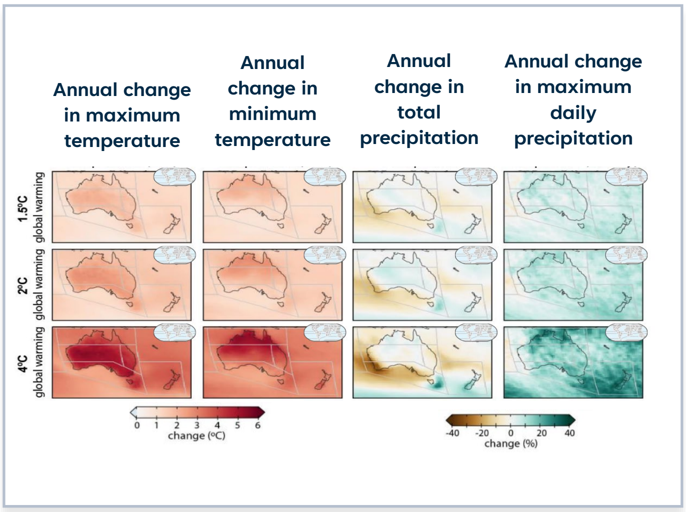
As Australia's policy settings have changed, there may be substantial net zero aligned investment opportunities.

Physical and transition climate risks pose a significant and increasing threat across the economy.

As global warming increases, Australia is expected to experience more extreme temperature and precipitation variability.

46% of jobs and 41% of GDP in Australia come from industries highly exposed to physical risk from climate change, and the devastating 2019/20 bushfire season and 2022 floods demonstrated how physical risks from climate change transmit to the real economy.

Projected change in annual maximum temperature, annual minimum temperature, annual precipitation and annual maximum daily precipitation compared to 1850-1900 under different warming scenarios, Australia[1]

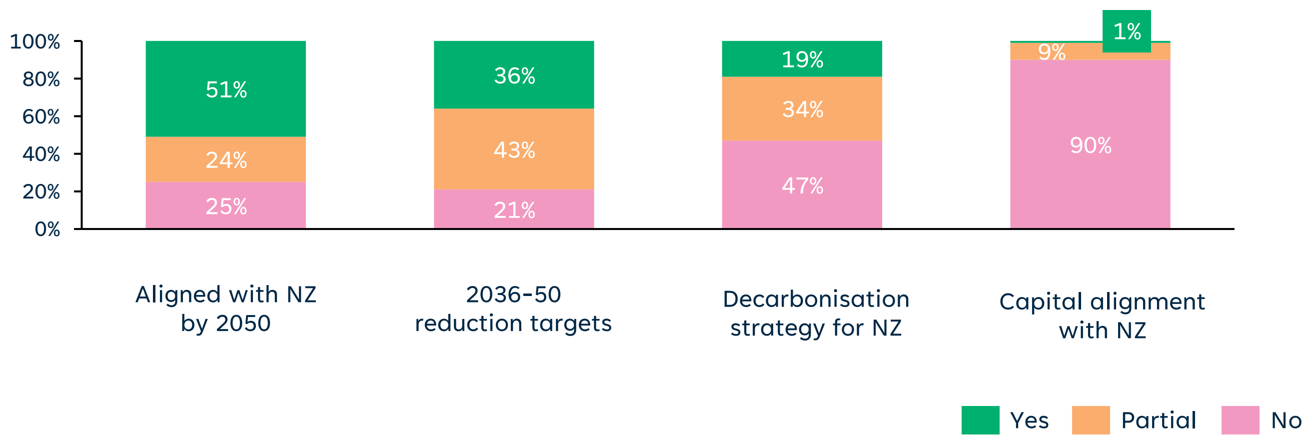


Lack of substantive alignment with net zero targets means there is significant transition risk across the global economy.

Despite 51% stated alignment with net zero by 2050, only 36% of companies have reduction targets for 2036-50, only 19% have a comprehensive decarbonisation strategy, and only 1% have complete capital alignment with net zero by 2050 [2].

Exposure to Australia's resource sector means super funds will face increasing transition and reputational risks. Australia's resources investments and exports are projected to grow to meet global demand, and this is likely to increase social license pressures that do not easily distinguish between resources sector investments that help or hinder decarbonisation efforts.

Company alignment with net zero transition metrics[2]



Notes: 1. From IPCC. (2022, February 11). Sixth assessment report, Regional fact sheet – Australasia. 1; 2. Of 159 focus companies assessed by Climate Action 100+ Net Zero Company Benchmark Interim assessments in October 2022.

Sources: Right Lane Consulting. (2023). Consultation with ESG investment experts (n=6); Deloitte Access Economics. (2020, November). A new choice: Australia's climate for growth; IEA. (2022, November). World Energy Outlook 2022; Climate Action 100+. (2022, October). Net Zero Company Benchmark Interim assessments; Department of Industry, Science and Resources. (2022, December). Commonwealth of Australia Resources and Energy Quarterly December 2022.

Government policy ambition towards net zero in major global economies is increasing, with substantial announcements made during 2022.

Transition is underway in most major economies, as government policy creates significant macroeconomic incentives and mainstreams net zero aligned investment.

Emissions targets by nation as of December 2022

Country	Latest emissions targets
CHINA	Peak emissions by 2030, net zero by 2060
EU	55% by 2030
AUSTRALIA	Net zero by 2050
INDIA	45% cut of emissions intensity of GDP by 2030, net zero by 2070
JAPAN	46% by 2030
SOUTH KOREA	40% under BAU by 2030
UK	78% by 2035
US	52% by 2030

Government policy is creating significant macroeconomic incentives and mainstreaming net zero aligned investment.

With a transition period beginning on 1 October 2023, the **European Union's (EU) Carbon Border Adjustment Mechanism (CBAM)** creates a tariff on products imported to the EU to cover the cost of carbon used in their production, matching the EU's carbon pricing rules. By putting a carbon price on imported products, the CBAM incentivises trade partners to implement emission reduction schemes. This may impact Australia's exports to the EU, which totalled AU$23.8bn from January to November 2022, 4.40% of total exports for that period. However, if non-EU producers can show a carbon price has already been paid, the cost can be deducted.

Legislated on 16 August 2022, the United States' US$592bn **Inflation Reduction Act** contains US$394bn of economic incentives to promote the net zero transition. The IRA is expected to substantially increase investment in clean energy initiatives in the US, as incentives for clean energy providers and technology manufacturers give them a distinct advantage over carbon-intensive competitors.

The Albanese government is reforming Australia's **Safeguard Mechanism** to limit Australia's largest carbon emitters in line with a pathway towards net zero by 2050, and initiatives such as Powering Australia and the National Energy Performance Strategy outline government policies to drive the net zero transition – this includes committing AU$20bn through Rewiring the Nation to modernise Australia's electricity grid.

Sources: Right Lane Consulting. (2023); European Commission Taxation and Customs Union. (2022, December). Carbon Border Adjustment Mechanism; World Economic Forum. (2022, December 19). CBAM: What you need to know about the new EU decarbonization incentive; ABS. (2023, January 12). International trade in goods and services, Australia. Table 14b. Merchandise imports, country and country groups, customs value; McKinsey and Company. (2022, October 24). The Inflation Reduction Act: Here's what's in it; Manifest Climate. (2023, January 20). ISSB to publish climate, sustainability standards in June; Department of Climate Change, Energy, the Environment and Water. (2023). Powering Australia; National Energy Performance Strategy; Clean Energy Regulator. (2022, August 22). The Safeguard Mechanism; New Climate Institute. (2023, January). Net Zero Tracker.

As Australia's policy settings have changed, there may be substantial net zero aligned investment opportunities.

There is significant demand for renewable energy investment, both globally and in Australia. To achieve the net zero transition it is estimated that ~US$35tn of investment in renewable energy will be needed globally by 2030[1], and renewable energy investment is expected to peak in Australia in 2030 at ~US$24bn[2]. The policy environment following the 2022 election is favourable for profit-to-member funds, with government not only supporting, but pushing for sector involvement, and calling on super funds to invest in renewable energy and help drive the net zero transition.

The Treasurer's Investor Roundtable on 21 April 2023 brought funds and government together to discuss renewable energy investment.

However, the complexities of the transition may pose challenges for aligning government policy and sector interests:

- There are concerns from sector leaders about moving from a hostile government trying to 'hobble' super to a friendly government trying to use it as a piggy bank indiscriminately
- Premature commitment to renewable energy projects may limit funds' ability to manage investment risk
- Government requests for 'reasonable returns' may create a tension with fiduciary obligations and limit funds' commitment
- Questions of equity may create challenges for aligning government and fund priorities for some projects
- Existing regulation may hinder funds' ability to invest in renewable energy assets
- There may be a limited pipeline of investable assets of sufficient scale, especially as the renewable energy market gets more crowded with international investors.

'Australia is open for business, with a stable investment environment to unleash billions of dollars of renewable energy and zero emissions technology investment'
Chris Bowen, Minister for Climate Change and Energy, Annual Climate Change Statement to Parliament, 1 December 2022

'We are up for reform if we can agree the way forward ... the interests of members, funds, the economy and the country are inseparable'
Jim Chalmers, Treasurer, address to Superannuation Lending Roundtable, 22 August 2022

'Most opportunities are subscale, not sure that's understood by government'
Director at large fund

Australia is bidding to host COP31 in 2026 alongside Pacific Nations. If successful, this will provide additional momentum and improve the domestic investment environment for the net zero transition, reducing short-term exposure risk. This would also provide a unique opportunity for funds to promote their net zero investment activities and build international relationships at the highest level.

Notes: 1. IRENA. (2023, March 28). *World Energy Transitions Outlook Preview*. 4; 2. Arcadis. (2021). Supercharging Net Zero. 14. Converted from Euros to USD and adjusted for inflation to March 2023 prices.

Sources: Right Lane Consulting. (2023). Consultation with ESG investment experts (n=6). 14; Bowen, C. (2022, December 1). Annual Climate Change Statement to Parliament; (2022, November 5). Australia's International Climate Engagement [media release]; Chalmers, C. (2022, August 22). Address to the Superannuation Lending Roundtable hosted by AFR, Sydney; (2022, October 7). Treasurer's Investor Roundtable [media release]; (2023, April 21). Investor Roundtable aligns efforts to deliver cleaner, cheaper energy [media release].

4. Delivering outcomes and managing risk

Funds should continue to sharpen their ability to rapidly deliver outcomes and manage legal and reputational risk.

Funds can capitalise on the favourable political environment by pursuing policies and initiatives that accelerate net zero opportunities.

Investing in capability uplift will enable funds to address the sharpening climate risk environment.

Funds can accelerate their work integrating net zero strategies into mainstream investment processes through various activities:

- Measuring financed emissions
- Setting net zero targets
- Aligning portfolios
- Utilising climate risk management tools.

Funds can capitalise on the favourable political environment by pursuing policies and initiatives that accelerate net zero opportunities.

The end of Australian climate-policy stagnation has started to create conditions for enabling net zero investment, but more needs to be done.

After a 'lost decade' in which inaction on climate change was combined with a challenging policy environment, super funds now face a favourable political context in which the aims of the federal and state governments and the profit-to-member superannuation sector can be well aligned to drive the transition to a net zero and nature positive economy.

Important preliminary steps have already been taken, such as the government affirming its long-term emissions reduction plan to achieve net zero, reforming the Safeguard Mechanism, committing to co-fund development of an Australian Sustainable Finance Taxonomy, and announcing a process to introduce climate-related risk disclosures.

However, gaps remain which will slow the transition.

Sector specific targets, policies and transition plans are key priorities to advance decarbonisation. Governments have an important role to play in setting the most carbon intensive industries on a path that aligns to net zero.

Practically, this might involve establishing a 'Transition Authority' or similar body, as has been done in other countries. This body could issue guidance to reduce the impact of transition on multiple stakeholders including investors, companies, communities and state and local authorities, workers and others. It could also develop sector specific plans to achieve an orderly transition consistent with 1.5 degrees.

The Legal Framework for Impact outlines further policy priorities, including strengthening regulatory support for stewardship, and addressing the impact of financial performance assessments on sustainability outcomes.

Funds and government will both gain from codeveloping approaches for an orderly phase out of fossil fuel subsidies and managed phaseout of high emitting assets.

Funds can engage in the following actions to accelerate net zero opportunities:

- Support and actively engage with industry groups that are pursuing net zero and nature positive aligned policy shifts, such as IGCC, GFANZ, and the Australian Council of Superannuation Investors (ACSI) – ACSI plays a direct role in researching, engaging and advocating for net zero policy on behalf of superannuation funds
- Pursue sectoral guidance as soon as possible and more ambitious policy change in 2026, as this is the year that Australia will pursue UN climate conference presidency
- Ensure that funds and, through engagement activities, investee companies are not supporting industry groups (such as representatives of the fossil fuel sector) that are pushing against net zero aligned policy positions
- Develop preferred policy and investment approaches for dealing with hard to abate sectors, financing transition of incumbent assets and sectoral pathways.

> *'What's missing is key industry policies for sectors that need to decarbonise, plans and implementation mechanisms for them'*
> **Executive at asset manager**

Melbourne University has recently established a Sustainable Finance Hub as part of Melbourne Climate Futures, to collaborate, and develop thinking with partners in these areas.

Sources: Right Lane Consulting. (2023). Consultation with ESG investment experts (n=6); GFANZ. (2022, June). The Managed Phaseout of High-emitting Assets; (2021). Act Now: Financial leaders urge more climate action from the G20; IGCC. (2022). New Government Has Opportunity to Unlock More Than $130 Billion In Climate Investment; ACSI. (2022, December). A just transition to a clean energy economy; House, M. & Wiseman, D. (2022). A Legal Framework for Impact: Australia. UNPRI; Chalmers, C. (2023, April 21). Investor Roundtable aligns efforts to deliver cleaner, cheaper energy [media release].

Investing in capability uplift will enable funds to address the sharpening climate risk environment

The net zero transition will require new capabilities to address climate risks and take advantage of opportunities.

It will require a significant change in asset selection, including by increasing investment in untested greenfield technologies that pose significant investment risk and working out how to decarbonise fossil-fuel intensive industries. Building knowledge in these areas is essential for funds to navigate the challenging but potentially rewarding investment environment of the near future.

'There may never have been a more challenging time to be a long-term investor with fiduciary duty ... you have to deal with these challenges today'
Executive at asset manager

This will require an uplift in capability across the sector, as net zero investment and climate risk assessment is an underdeveloped capability for many funds. Implementing net zero investment strategies requires significant uplift for key operational roles including analysts, portfolio managers, and ESG and energy specialists, as well as knowledge uplift in senior strategic roles in boards and executive teams to ensure that net zero is embedded as a central element of organisational strategy.

The Bank of England's Climate Biennial Exploratory Scenario identifies lack of data collection and analysis capability as a significant limitation of financial institutions when it comes to adequately ascertaining climate-related financial risk.

As the pace of decarbonisation quickens, demand for skills and knowledge around climate risk and renewable energy will increase. The relative novelty of decarbonising investment strategy means there is a lack of formal training pathways for developing expertise, and as the net zero transition gathers pace, funds will be competing with sophisticated international actors for a limited pool of ESG experts.

'[Lack of resourcing] is going to get acute as we go forward, there's not enough people out there ... to fill the growth in ESG teams'
Director at large fund

Funds can work together to invest in collective capability building initiatives across the sector. Funds can share the costs of capability building by collaborating with each other and external partners such as universities to establish centres of excellence and run training programs for sustainable finance. Existing initiatives such as the Australian Sustainable Finance Initiative (ASFI) are working to promote greater collaboration between universities and financial institutions.

Sources: Right Lane Consulting. (2023). Consultation with ESG investment experts (n=6); Bank of England. (2022, May 24). Results of the 2021 Climate Biennial Exploratory Scenario; ASFI. (2021). Roadmap Recommendations; NAB. (2021). Skilling bankers to support big carbon emitters transition; Monash University. (2022). Climate Change and Business Risk.

Funds can accelerate their work integrating net zero strategies into mainstream investment processes through various activities.

Net zero asset owner initiatives recommend that funds take similar approaches to integrate climate risk and opportunities into investment practices. Australian funds are at different stages in implementing these approaches, but more can be done to create standardisation across the sector.

Measuring financed emissions	**Evaluate the emissions profile of your investments by:** • Measuring emissions in absolute terms within certain sectors using standards such as the Partnership for Carbon Accounting Financials (PCAF) • Measuring emissions in a **normalised**/comparative way through widely accepted intensity metrics, such as weighted average carbon intensity (WACI).
Setting net zero targets	**Set targets and investment strategies to decarbonise portfolios in line with a net zero by 2050 trajectory. This might include:** • Setting targets for Scope 1 and 2, and where possible Scope 3 emissions • Setting short- and long-term targets • Allocation targets for climate solutions • Setting targets for engagement • Setting targets for policy advocacy. There are a range of tools to assist with target setting, including the UNPRI's Inevitable Policy Response (IPR), which provides modelling and scenario analysis to help understand transition risks from climate-related policy change.
Aligning portfolios	**Allocate capital in ways that capture the benefits and reduce the downside of the transition, including:** • Tilting towards already low emitting firms • Rebalancing towards companies that have strong targets and strong track records • Looking at lower emissions options in asset allocation and selection across asset classes including infrastructure and private equity • Including clauses in Investment Management Agreements (IMAs) to help achieve net zero goals.
Utilising climate risk management tools	**Systematically understand and proactively manage transition and physical risks in portfolio through:** • Scenario analysis to understand impact of risks across portfolio • Shadow carbon pricing to manage future risk • Scoring approach to exclude high risk sectors/firms • Category/sector-based approach to exclude or manage sectors. Tools such as Investor Climate Action Plans (ICAPs) provide guidance around specific actions investors can take to strengthen their net zero investment approach.

Sources: Right Lane Consulting. (2023). Consultation with ESG investment experts (n=6); NZAOA. (2022, January). Target Setting Protocol: Second edition; IIGCC Paris Aligned Investment Initiative. (2021, March). Net zero investment framework: Implementation guide; Dietz, S. Bienkowska, B., Jahn, V., Hastreiter, N., Scheer, S. & Sullivan, R. (2022, February). TPI Sectoral Decarbonisation Pathways. Transition Pathway Initiative; Science Based Targets. (2020, October). Framework for Financial Institutions to Set Science-based Targets; Proudlove, R., Bravo, C. & Denis-Ryan, A. (2020, September 16). Net zero momentum tracker – superannuation sector. Climateworks Centre.; UNPRI. (2021, December). What is the Inevitable Policy Response?; The Investor Agenda. (2023). Investor Climate Action Plans.

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