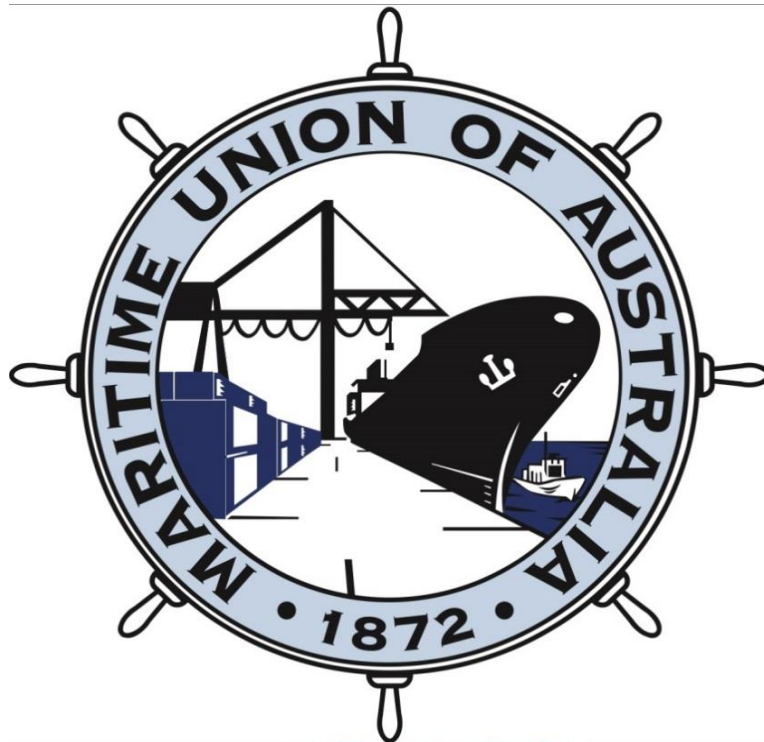


# Submission by the Maritime Union of Australia

## Joint Standing Committee on Trade and Investment Growth

### Inquiry into the prudential regulation of investment in Australia's export industries



30 April 2021

Submitted electronically.

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**Introduction**

This submission has been prepared by Maritime Union of Australia (MUA). The MUA is a Division of the 120,000-member Construction, Forestry, Maritime, Mining and Energy Union and an affiliate of the 20-million-member International Transport Workers’ Federation (ITF).

The MUA represents approximately 14,000 workers in the shipping, offshore oil and gas, stevedoring, port services and commercial diving sectors of the Australian maritime industry.

The MUA represent workers across various areas of maritime operations that contribute to Australia’s export industries and in supply chains supporting both exports and imports as well as in domestic supply chains.

Officials of the MUA are trustee directors on Maritime Super and play an active role through the ACTU and the Global Unions Committee on Workers Capital in ensuring that profit to member superannuation funds in Australia and pension funds more broadly invest responsibly in the best financial interests of members, and in ways that supports national economies.

**Overview**

The MUA welcomes the opportunity to make a submission to the inquiry and would be happy to appear before the Committee if public hearings are scheduled.

As a labour union representing the workforce involved in key elements of supply chains servicing Australia’s export industries we have a vital interest in the success and transformation of Australia’s existing export industries and the companies (including new entrants) in those industries so they are sustainable, productive and efficient, and actively contribute to Australia’s pollution reduction obligations and responsibilities under the Paris Climate Agreement. That requires substantial new investment.

Equally, we want to see investment in new export industries (or in exiting industries so they transform to zero carbon production through use of renewable energy to power production and application of new carbon free production processes), many of which will create new export opportunities, requiring

secure, reliable and sustainable transportation, particularly shipping in the export component of those supportive supply chains.

What is critically important to the MUA and the workforce it represents, particularly those segments of the workforce employed on ships and associated onshore roles in ports supporting carbon emitting offshore oil and gas projects and existing high energy intensity manufacturing industries such as aluminium, steel, building products and fertilizers is that Australia develops and adopts long term and robust industrial policy frameworks, support by substantial public and private capital, to transform those industries and in so doing, transition the workforce so no worker is disadvantaged.

In that context, we welcome the intervention of Australia's financial regulators who are rightly and responsibly responding to market signals and to international frameworks to which Australia has voluntarily signed on to, in providing guidance to investors and financial institutions aimed at assisting those investors and financial institutions in dealing with current and emerging investment risk. Those regulators would be failing in their statutory duty if they did not provide that guidance. It is essential to the stability, purpose and ethical behavior of financial markets.

It is critically important that the regulators are requiring the directors and managers of financial institutions to conform with the highest standards of fiduciary duty to act in the best financial interest of those whose money they are investing and holding in trust, be they banks, insurers, superannuation funds, asset managers or fintech companies. In some cases that will mean not investing in particular entities or divesting where already invested.

Assets in danger of becoming stranded or losing value in response to consumer preferences, in response to policy priorities of democratically elected governments or in response to existential scientifically determined threats such as climate change and loss of biodiversity are most likely not assets that investors should hold in the long term interests of their members, contributors or customers.

However, that does not mean that directors/trustees should be discouraged from innovating, from taking considered risk within robust investment policy frameworks and from taking an active interest in the corporate behaviour of the entities in which they invest and to seek to transform those entities in ways that mitigate risk in the best interests of their members or customers.

What is also important to the MUA as a labour union is that investors place social considerations on an equal footing with environmental and governance considerations in making investment decisions. This is crucial given the human impact implications of investment decisions.

For example, under the industrial policy framework we mention earlier, we would want to see government (carrying a public investment mandate), institutional investors, corporations and labour unions working collaboratively to transition the offshore oil and gas workforce to new energy ventures such as offshore wind energy production, to hydrogen production, to new value added manufacturing production so as to deliver the least disruption to lifestyle choices and income and wealth security as possible as the demand for oil and gas products inevitably declines. This is achievable under appropriate transition models that have proven successful around the globe.<sup>1</sup>

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<sup>1</sup> Sheldon, P., Junankar, R. & De Rosa Pontello, A. 2018. *The Ruhr or Appalachia? Deciding the future of Australia's coal power workers and communities*. IRRRC Report for CFMMEU (Mining and Energy Division), October 2018,

To help support that type of transition, which should be replicated across all climate change induced declining industries, be it resources, energy, agriculture or transport, we would urge the financial market regulators to significantly improve the guidance provided to investors on ways to identify, measure and mitigate social factor risk, whether climate change induced or otherwise. Stranded workers and communities, or workers denied basic rights, is damaging to social stability and costly not just to individuals but to society as a whole and must be avoided.

## Emerging carbon free export opportunities requires responsible investment

Australia's vast wind and solar resources are assets with increasing value as global trade and energy flows shift. Australia could be an important source of supply in global markets for:

- Renewable energy powered fuels such as hydrogen, and hydrogen-based synthetic fuels such as ammonia, methane or methanol, which are widely projected to play an increasing role in meeting global demand for energy by the middle of this century;
- High-voltage direct current (HVDC) transmission lines to directly export renewable energy to South East Asian neighbors;
- Energy intensive goods, including metals, produced using renewable electricity, or synthetic fuels created using renewable energy. If well managed, these export focused industries could deliver significant benefits to the domestic economy, in addition to the export revenues generated.<sup>2</sup>

According to experts like Professor Ross Garnaut<sup>3</sup>, Australia's international competitiveness in electricity supply will strengthen as all nations move away from use of fossil fuel in electricity supply. This is because fossil-based energy can be imported relatively cheaply by countries with poor energy resources (like Japan), but renewable energy is not as readily transportable for both technical and cost reasons.

If key industrial processes such as the production of steel, aluminium, silicon, ammonia and lithium (where Australia is already an exporter) can all transition away from fossil energy to use of renewable energy, Australia can potentially become a major metals and chemicals processing nation (rather than an ores/fossil fuel exporting nation) based on industrial production using electricity produced from renewable energy, where we have an abundance of supply at internationally competitive prices.

Such projects are already being developed, for example:

- The A\$53 billion Asian Renewable Energy Hub project in the Pilbara (claimed to be the country's first renewable energy project at oil and gas scale), planned to power 14GW of electrolyzers that will convert desalinated seawater into green hydrogen, some for export as green ammonia, which is safer to transport and created by blending hydrogen with nitrogen (its first shipment of

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[https://me.cfmeu.org.au/sites/me.cfmeu.org.au/files/uploads/Campaign%20Materials/RuhrorAppalachia\\_Report\\_final.pdf](https://me.cfmeu.org.au/sites/me.cfmeu.org.au/files/uploads/Campaign%20Materials/RuhrorAppalachia_Report_final.pdf)

<sup>2</sup> Energy Transition Hub, *Innovation and export opportunities of the energy transition: Insights from the Australian-German Energy Transition Hub*, September 2019, [https://www.energy-transition-hub.org/files/resource/attachment/innovation\\_and\\_export\\_opportunities\\_of\\_et\\_final\\_0.pdf](https://www.energy-transition-hub.org/files/resource/attachment/innovation_and_export_opportunities_of_et_final_0.pdf)

<sup>3</sup> See Ross Garnaut's book entitled *Superpower: Australia's Low Carbon Opportunity*, La Trobe University Press, 2019

green energy into Asia is planned for 2027) and to power mining sites and large trucks, replacing some 3 billion litres of imported diesel fuel used in the Pilbara each year;<sup>4</sup>

- The A\$22 billion Sun Cable proposal which involves building a 10GW solar farm with battery storage on land about 750 km south of Darwin;<sup>5</sup> largely intended for transmission via sub-sea cables to Singapore;
- The A\$10 billion Star of the South offshore wind farm project which plans to construct a 2.2GW windfarm in Bass Strait off Port Albert and Mcloughlins Beach in South Gippsland which could meet about 20 per cent of Victoria's electricity needs, and could commence a new offshore marine and port support industry capable of transferring to the other 5 offshore wind energy projects under consideration in Australia;<sup>6</sup> and
- The New South Wales government announced in November 2020 a A\$32 billion Renewable Energy Plan along with a Manufacturing Renewables Taskforce involving representatives from the steel, aluminium, cement, concrete and manufacturing industries and other stakeholders including unions to explore ways to give NSW manufacturers a competitive advantage in emerging 'green' supply industries and to support its Renewable Energy Zones, which will require large quantities of manufactured products like steel (presumably steel produced from renewable energy sources), and as the hydrogen industry develops, the use of hydrogen to replace metallurgical coal in the steel making process.

All these projects, and others like them, could deliver additional export opportunities for Australia, and diversify the nation's export markets.

The Coalition Government's Modern Manufacturing Strategy (MMS), supported by a \$1.5 billion investment over 5 years from 2020–21 to support the MMS, will help in a small way to continue the revival of Australian manufacturing and increase exports of both simply transformed manufactures (STM) and elaborately transformed manufactures (ETM), the export value of which rose 20.5 per cent to \$18.0 billion and 15.0 per cent to \$35.9 billion respectively in 2018-19 compared to a year earlier.

By focusing on six national manufacturing priority areas with a perceived advantage or strategic priority, including: resources technology and critical minerals processing; food and beverages; medical products; recycling and clean energy; defence; and space, Australia will continue to substitute manufactured products in its export composition, if there is sufficient investment, both public and private.

We welcome Labor's commitment announced on 29 March 2021 to create a \$15 billion National Reconstruction Fund to be seeded by contributions from government, industry and superannuation funds. We regard the commitment to \$15 billion as more like what will be needed to drive the export replacement of manufactured goods to make up for the decline in export of unprocessed primary products.

The composition of Australian exports is already changing with a significant decline in the proportion of unprocessed primary production over the 5 years 2013-14 to 2018-19 as shown in Figure 1. This trend

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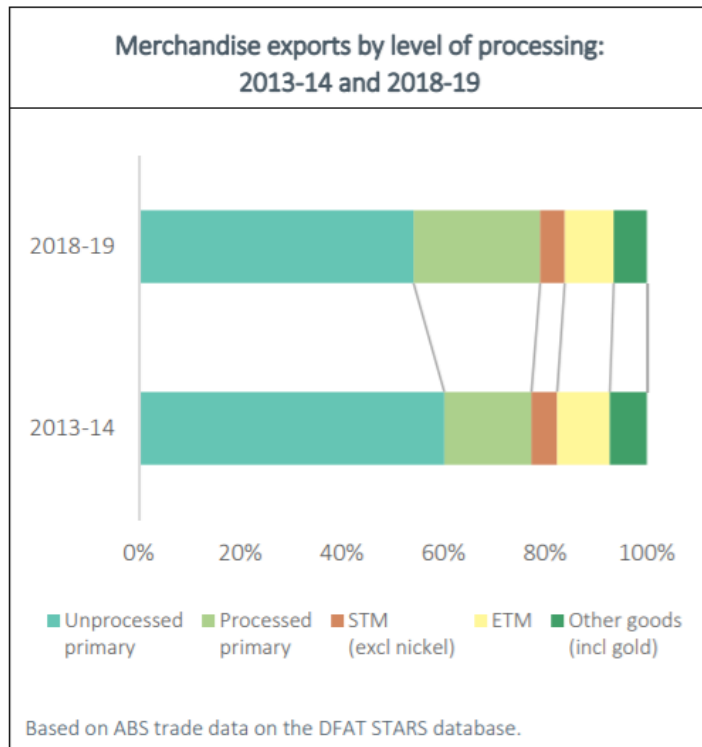
<sup>4</sup> The Guardian, *Green giants: the massive projects that could make Australia a clean energy superpower*, 14 November 2020, <https://www.theguardian.com/environment/2020/nov/14/green-giants-the-massive-projects-that-could-make-australia-a-clean-energy-superpower>

<sup>5</sup> Ibid

<sup>6</sup> Ibid

will increase at a faster pace in the coming years as alternatives to thermal coal, gas and petroleum products enter the market. Coal and natural gas are among Australia’s top 5 exports.

**Figure 1: Merchandise exports by level of processing: 2013-14 and 2018-19**



**Source:** DFAT, *Composition of Trade Australia 2018-19*, P6, <https://www.dfat.gov.au/sites/default/files/cot-2018-19.pdf>

The Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES) and the Department of Industry, Innovation and Science (DIIS) have forecast the value of Australia’s commodity exports to fall 0.7 per cent in 2019-20. The forecast falls in Australia’s key exports of crude oil, LNG and coal, especially thermal coal are particularly marked as shown in Table 1.

**Table 1: Forecasts for major commodity exports**

	2018-19 \$m	2019-20 \$m	2020-21 \$m	2018-19 to 2019-20 % change	2019-20 to 2020-21 % change
<b>Energy</b>					
Crude petroleum	9,071	10,689	10,138	17.8	-5.2
LNG	49,727	49,371	46,660	-0.7	-5.5
Coal	69,601	56,363	54,328	-19.0	-3.6
Metallurgical	43,638	35,576	35,566	-18.5	-0.0
Thermal	25,962	20,787	18,762	-19.9	-9.7
<b>Total resources &amp; energy exports</b>	<b>279,367</b>	<b>280,814</b>	<b>256,100</b>	<b>0.5</b>	<b>-8.8</b>

**Source:** DFAT, *Composition of Trade Australia 2018-19*, P7, <https://www.dfat.gov.au/sites/default/files/cot-2018-19.pdf>

In parallel with these opportunities, industry stakeholders, security and supply chain experts, respected media commentators and representatives from across the political spectrum are calling for a rethink of Australian domestic supply chain security and resilience. In December 2020, the Senate Standing Committee on Rural and Regional Affairs and Transport tabled its Report on its Inquiry into the policy, regulatory, taxation, administrative and funding priorities for Australian shipping. The Productivity Commission is currently inquiring into the vulnerability of supply chains. These developments provide an opportunity to take a fresh look at the functionality, efficiency, security and resilience of the maritime elements of Australia's supply chains, particularly due to the critical role that ships play in servicing Australian exports.

The Australian shipping and maritime industries must be viewed as a vital component of national transport infrastructure, integrated with the functionality, productivity and efficiency of other industries such as manufacturing, agriculture/aquaculture, resources, energy and tourism.

Ten per cent of the world's sea trade passes through Australian ports and Australia relies on sea transport for 99 per cent of its international trade (by volume).<sup>7</sup> In 2016–17, the value of Australia's exports by sea was \$252.1 billion and it imports by sea, \$193.1 billion. This involved 28,584 ship arrivals by 5,981 individual foreign-flagged ships in 2019.<sup>8</sup>

Australia is the largest iron ore exporter with 57 per cent of the world market, the second largest coal exporter with 30 per cent of the global market and the eighth largest grain exporter with 4 per cent of the world market. Globally, Australia is the fourth largest user of ships.<sup>9</sup>

Ships and the ports they use are a critical component of the supply chains that support other wealth generating industries. Ships are critical to the import and export supply chains for all facets of manufacturing, resources and energy including refined petroleum products, agriculture, aquaculture, fishing, tourism (including the growing marine tourism and cruise sectors), wholesale and retail distribution, and construction.

Bulk commodity ships and other trading ships used in these supply chains create demand for a range of other marine services including towage, pilotage, bunkering (refueling), mooring, waste removal, provisioning, firefighting, salvage and marine rescue as well as requiring port services and stevedoring services. Ships perform vital supply and support roles to the offshore oil and gas production sector and will perform similar marine support roles as offshore wind energy production takes hold.

With the right policy settings, and with just modest levels of new investment, Australia could develop a substantial national shipping industry to support the transportation of its industrial exports, which would strengthen supply chain security, reduce the nation's unhealthy dependency on foreign ships, and take the pressure off our external account. In 2018-19 freight transport services (chartering of foreign

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<sup>7</sup> Department of Infrastructure and Regional Development, *Trends: Transport and Australia's Development to 2040 and Beyond*, 2016, [https://www.infrastructure.gov.au/infrastructure/publications/files/Trends\\_to\\_2040.pdf](https://www.infrastructure.gov.au/infrastructure/publications/files/Trends_to_2040.pdf)

<sup>8</sup> Australian Maritime Safety Authority, *Port State Control Australia, 2019 Report*, p.2.

<sup>9</sup> United Nations Conference on Trade and Development (UNCTAD), *Review of Maritime Transport 2019*, [https://unctad.org/en/PublicationsLibrary/rmt2019\\_en.pdf](https://unctad.org/en/PublicationsLibrary/rmt2019_en.pdf). Note that the Report of the Senate Rural and Regional Affairs and Transport References Committee Inquiry into Policy, regulatory, taxation, administrative and funding priorities for Australian shipping says at Para 1.33 that Australia is the fifth largest user of shipping.



ships to transport Australian exports) was the 7<sup>th</sup> largest Australian import costing the nation \$10.12 billion, up from \$8.43 billion just two years earlier in 2016-17.<sup>10</sup>

The MUA submits that a legitimate and practical strategy to improve supply chain security is to establish a national strategic fleet. There appear at present to be three key (interconnected) drivers of the need for a strategic fleet:

- The fuel/energy security driver (the role of ships in ensuring Australia meets its International Energy Agency (IEA) obligations and the role of ships in contributing to the transition to renewable energy production and distribution);
- The supply chain security/resilience driver (the role of ships in maintaining functional and efficient supply chains for imports and exports and national freight distribution); and
- The economic or level playing field driver (the detrimental role that the predominance of foreign ships offering uncompetitive freight rates in domestic supply chains is having across all freight modes and the need for a policy response to level the playing field).

A national strategic shipping fleet would comprise ships which are of strategic importance to the nation, contribute to national sovereignty and to maintaining supply chain security, assist in achieving national self-sufficiency in critical supplies required by businesses and citizens and provide a social and or community service benefit to the nation.

Establishment of a strategic fleet is now regarded by many security experts as an essential part of the package for delivering energy security for Australia. A strategic fleet would ensure a proportion of the seaborne transportation needs for the movement of (i) oil for Australia's remaining refineries; (ii) refined petroleum products from refineries and refined petroleum products import storage facilities to population centres around the Australian coast; (iii) gas from gas producing areas for distribution to mobile floating storage and regassification units (FSRUs) located in regional ports and to supply imported gas (from Australian and international gas producing regions) to enter the domestic gas distribution network; and for offshore wind farm construction, supply and maintenance ships involved in expansion of Australian renewable energy production is to commit to operate a number of dedicated Australian oil, refined petroleum products tankers, gas ships and offshore wind farm construction, supply and maintenance ships, to Australian ship registration.

There are several positive spin-offs to be gained from establishment of a strategic fleet, including:

- Provision of additional ships on which seafarer training can take place, including mandatory sea time in gaining occupational licenses and VET qualifications (to overcome the declining access to ship's berths for trainee ratings and cadet engineers/officers);
- Improved reliability of supply of gas as a transitional fuel to keep Australia's manufacturing plants open with positive consequences for well-paid secure jobs – in industries such as steel, cement and other building products, aluminium, fertiliser and other chemicals/explosives etc; and
- A vastly increased capacity for the Defence forces and emergency management agencies to requisition ships to supplement Navy ships in times of national emergency.

It is important that investors are tracking and investing in these trends and new industry opportunities, not just because Australia and the projects themselves require that investment to succeed, but because

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<sup>10</sup> DFAT, *Australia's Top 25 Imports, Goods and Services*, 19 November 2019, <https://www.dfat.gov.au/sites/default/files/australias-goods-services-by-top-25-imports-2018-19.pdf>

these investments are creating investment value to help contribute to the wealth, including retirement income wealth (when the investor is a superannuation fund) of Australian citizens, including the millions of superannuation fund members and bank depositors.

However, investment and the business practices of companies who are the beneficiaries of that investment must be based on international norms and guidance derived from UN framework agreements to which nations are signatories. In relation to global warming, Australian and most nations have signed the Paris Climate Agreement. In relation to human rights and labour rights, Australia and most nations have signed to the Core Conventions of the International Labour Organization (ILO), The ILO Maritime Labour Convention (MLC), the ILO Declaration on Fundamental Principles and Rights at Work, and the UN Universal Declaration of Human Rights.

Despite commitments to the standards provided in these international instruments, the COVID-19 pandemic has resulted in governments abrogating their obligations under labour and human rights instruments, particularly the ILO MLC. This was evidenced in the buildup in early 2021 of some 50 or more ships off China carrying Australian coal whereby seafarers were unable to leave those ships and had worked well beyond the terms of their employment contracts. That coal was sold by Australian mining companies under Free-On-Board (FOB) shipping contracts where the seller hands over the transportation of the product to the buyer, thus losing control of the ship and ability to regulate labour rights and labour standards on those ships. That is another reason why Australia needs to rethink its supply chain security and consider a strategic fleet.

The violation of international instruments to protect seafarer rights, including in Australia's export industries has rightly become an issue for investors. Large global asset managers such as Blackrock, Fidelity International and Prudential along with the PRI have been raising the issue of seafarer rights in their engagement with shipping companies and their customers. This has resulted in development of The Neptune Declaration on Seafarer Wellbeing and Crew Change<sup>11</sup>, and some 80 investors writing to the UN Secretary General urging it to ensure governments adhere to their international obligations. That is responsible investment at work.

## **Prudential regulation/guidance and responsible investment**

The MUA is a strong advocate of superannuation funds adopting responsible investment policies, strategies, practices and disclosure/reporting. Responsible investment requires the adoption of robust environmental, social and governance (ESG) practice across all facets of the investment chain.

We advocate such an approach through our role as trustee directors on superannuation funds, as directors on banks, as participants in collective bodies like Industry Super Australia, through our engagement in international bodies such as the Global Unions Committee on Workers Capital, the US Council of Institutional Investors and in public policy discussion.

We therefore welcome and strongly support climate risk guidance provided by prudential regulatory bodies such as the Australian Prudential Regulation Authority (APRA) and the Australian Securities and

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<sup>11</sup> The Neptune Declaration on Seafarer Wellbeing and Crew Change, January 2021  
<https://imcaweb.blob.core.windows.net/wp-uploads/2021/02/The-Neptune-Declaration-on-Seafarer-Wellbeing-and-Crew-Change.pdf>

Investments Commission (ASIC), as well as bodies with a strong interest in financial system stability such as the Reserve Bank and interest in good corporate governance such as the ASX.

We note that on 23 April 2021, APRA released for public consultation its draft guidance to banks, insurers and superannuation trustees on managing the financial risks of climate change. APRA says the draft Prudential Practice Guide CPG 229 Climate Change Financial Risks (CPG 229) is designed to assist APRA-regulated entities in managing climate-related risks and opportunities as part of their existing risk management and governance frameworks. In releasing the guidance for comment, APRA makes the following points:

- The risks of a changing climate extend to all sectors of the economy. The need to adapt to the changing climate will also bring new business opportunities. Within the financial sector, a prudent institution will consider both the opportunities and the financial risks of climate change as it sets its strategy.
- APRA's mandate is to ensure that, under all reasonable circumstances, financial promises made by APRA-regulated institutions such as superannuation funds are met within a stable, efficient and competitive financial system. APRA is seeking to ensure that APRA-regulated institutions are managing the risks and opportunities that may arise from a changing climate, in line with APRA's approach to other types of risks.
- The guide does not impose new requirements in relation to climate risks; rather, it supports compliance with APRA's existing risk management and governance requirements and provides guidance to assist an institution to manage climate risks. In keeping with APRA's mandate, this guidance does not seek to determine an institution's individual investment, lending or underwriting decisions, but does aim to ensure that these decisions are well-informed.
- The guide reflects the established framework for considering and managing climate risks developed by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) as well as good practice observed through APRA's own analysis.
- An APRA-regulated institution has the flexibility to configure its approach to climate risk management in a manner best suited to achieving its business objectives.<sup>12</sup>

We note that the draft APRA guidance refers to:

- Transition climate risks include risks related to changes in domestic and international policy, technological innovation, social adaptation and market changes, which can result in changes to costs, income and profits, investment preferences and asset viability; and
- That climate change may also give rise to liability risks which have implications for businesses and directors' duties. Liability risks stem from the potential for litigation if institutions and boards do not adequately consider or respond to the impacts of climate change.

The draft guidance refers to the following types of risk that should be considered by investors:

- Credit risk – through a potential increase in defaults on loans by businesses and households that may be affected by adverse climate events, as well as the potential for assets used as collateral to decline in value;
- Market risk – through the impact of potential re-pricing of financial instruments and corporate debt affecting the value of securities held on an institution's balance sheet;
- Operational risk – including the risk of supply chain disruption and forced facility closures;

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<sup>12</sup> APRA, *Prudential Practice Guide, Draft CPG 229 Climate Change Financial Risks*, April 2021, [https://www.apra.gov.au/sites/default/files/2021-04/Draft%20CPG%20229%20Climate%20Change%20Financial%20Risks\\_1.pdf](https://www.apra.gov.au/sites/default/files/2021-04/Draft%20CPG%20229%20Climate%20Change%20Financial%20Risks_1.pdf)

- Underwriting risk – through a potential increase in insured losses as a result of more frequent and/or extreme weather events;
- Liquidity risk – through an increased demand for liquidity to respond to extreme weather events or the difficulties that may be faced in liquidating assets negatively impacted by climate risks; and
- Reputational risk – including an institution’s ability to attract and retain customers and employees due to changing employee and community expectations.

We note from an initial examination of the draft APRA guidance that it has not referred to the human element or social risk from climate induced industrial transitions, such as the loss of jobs and income that sustains workers, families and communities and the loss of skills and experience in which large public, corporate and individual investments have been made. Social factors can have a material impact in terms of redundancy and related payments. These are legacy risks which investors must consider and why it is critical that government and investors work together to have in place transition strategies to address the human and social impacts of industrial transition arising from investment decisions that are responding to climate risk.

The PRI which represents investors with over US\$2.75 trillion assets under management, says that neglecting ESG issues can lead to asset owners mispricing risk and making poor investment decisions.<sup>13</sup> Furthermore, Principle 2 (of its 6 Principles) encourages PRI signatories to be active owners and incorporate ESG issues into their ownership policies and practices. PRI says that *“Active ownership is generally regarded as one of the most effective mechanisms to reduce risks, maximise returns and have a positive impact on society and the environment – for passive and active investors.”*<sup>14</sup>

A 2018 report entitled *Climate change and the just transition A guide for investor action*, prepared jointly by The Grantham Research Institute on Climate Change and the Environment at the London School of Economics and Political Science and The Initiative on Responsible Investment, a part of the Hauser Institute for Civil Society at the Harvard Kennedy School, Harvard University, concluded that *“The evidence shows that the shift to a resilient, low carbon economy will boost prosperity and be a net driver of job creation. There will be transitional challenges, however, for workers, communities and countries as this shift takes place. To address this, investor strategies to tackle the growing threat of climate change need to incorporate the full range of environmental, social and governance (ESG) dimensions of responsible investment. As fiduciaries, investors can make an important contribution to achieving a just transition, as stewards of assets, allocators of capital, and as influential voices in public policy.”*

The report set out five motivations for investor action which are aligned with core duties and interests of investors and also show that contributing to the just transition is a way for investors to deliver positive social and environmental impacts. The five motivations are:

1. Broadening the understanding of systemic risks from climate change, by factoring in issues such as social exclusion and increasing inequality.
2. Reinvigorating fiduciary duty by better capturing the interrelated environmental and social drivers of long-term performance and by taking better account of beneficiary interests in sectors and regions affected by the transition.

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<sup>13</sup> Principles for Responsible Investment (PRI), *Investment Consultants and ESG: An Asset Owner Guide*, <https://www.unpri.org/asset-owner-resources/investment-consultants-and-esg-an-asset-owner-guide/4577.article>

<sup>14</sup> PRI, *A Practical Guide to Active Ownership in Listed Equity*, <https://www.unpri.org/listed-equity/a-practical-guide-to-active-ownership-in-listed-equity/2717.article>

3. Recognising material value drivers in terms of corporate practices in the workplace and the broader social licence to operate business performance will be increasingly conditioned by the just transition.
4. Uncovering investment opportunities that combine climate and social goals such as inclusive growth, identified through the lens of the just transition.
5. Contributing to societal goals including existing responsibilities to respect international human rights and labour standards as well as new ways of realising the Sustainable Development Goals.

Based on these motivations, the report identifies five areas for action through which investors can make the just transition part of their core operating practices:

1. Investment strategy: Assessing exposure to the social dimension (including employment impacts) of the transition, pursuing dialogue with workers and other key stakeholders, and integrating just transition factors into investment beliefs and policies.
2. Corporate engagement: Including just transition factors in investor expectations, requesting disclosure, benchmarking performance, and pressing for improvement. The guide provides an initial set of questions for corporate engagement.
3. Capital allocation: Incorporating the social dimension into strategies for climate investment across all asset classes, including listed equities, bonds, private equity and real assets.
4. Policy advocacy and partnerships: Making the just transition a part of policy dialogue at sub-national, national and international levels as well as taking part in place-based partnerships.
5. Learning and review: Understanding emerging lessons and disclosing results so that the efficiency and effectiveness of investor action on the just transition continue to improve.

We believe that APRA should be incorporating these types of investor actions in its updated guidance.

The European Commission also regards mitigation of climate change as a means to create more jobs than it will cost, but notes that the changes will be sectoral. It says that realising employment opportunities will require substantial investment in employee skills and innovation and that it is important for the benefits and costs of low-carbon restructuring to be evenly shared across various sectors, occupations, population groups and regions.

The EU says successfully transitioning to a carbon-neutral society will not only require emission reduction measures and business and energy policies, but also employment, social welfare, education and regional policies and notes that the principle of a just transition will seek to meet these challenges. This means implementing emission reductions in a way that is fair to workers. It is about creating new, decent and sustainable jobs, in-service training for new employment, and security of earnings. The goal of a just transition is to increase the participation and commitment of workers in deciding policies for mitigating climate change nationally, regionally and within businesses, thereby promoting a smooth transition to a carbon-neutral society.

In December 2020, the European Parliament agreed to establish the Just Transition Fund, one of the three pillars of the Just Transition Mechanism (JTM) which is part of the European Green Deal to create a climate-neutral economy in Europe by 2050. Among other things it is designed to address the social aspects of the transition, in particular the creation and safeguarding of jobs.<sup>15</sup>

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<sup>15</sup> European Commission, Commission welcomes the political agreement on the Just Transition Fund, 11 December 2020, [https://ec.europa.eu/regional\\_policy/en/newsroom/news/2020/12/12-11-2020-commission-welcomes-the-political-agreement-on-the-just-transition-fund](https://ec.europa.eu/regional_policy/en/newsroom/news/2020/12/12-11-2020-commission-welcomes-the-political-agreement-on-the-just-transition-fund)

We urge the Committee to recommend that APRA consider social and human risk in finalising its guidance on managing the financial risks of climate change.

We note that ASIC says disclosing and managing climate-related risk is a key director responsibility because climate-related risk is a systemic risk in financial markets that has the potential to significantly impact companies, investors and consumers.

ASIC says its focus is on ensuring listed companies have appropriate governance structures in place to manage this issue, and providing the market with reliable and useful information on their exposure to material climate-related risks and opportunities.

ASIC also considers that the law requires listed companies to undertake an operating and financial review which includes a discussion of climate risk when it is a material risk that could affect the company's achievement of its financial performance.<sup>16</sup>

The Reserve Bank has concluded that *"climate change is exposing financial institutions and the financial system more broadly to risks that will rise over time, if not addressed. According to the Intergovernmental Panel on Climate Change (IPCC), it will take significant effort to limit global warming to 1.5°C above pre-industrial levels, as targeted in the Paris Agreement. Even if targets are met, this level of warming is likely to be accompanied by rising sea levels and an increase in the frequency and intensity of extreme weather (including storms, heatwaves and droughts). Some of these outcomes are already apparent. These changes will create both financial and macroeconomic risks."*<sup>17</sup>

The Reserve Bank says that the financial risks arising from climate change can be classified as either:

- Physical: disruptions to economic activity or reductions in asset values resulting from the physical impacts of climate change;
- Transitional: the impact of changes in regulation or pricing introduced to facilitate a transition to a low-carbon economy; or
- Liability: an inadequate response to these risks also raises the potential for reputational and legal risk.

It says that while climate change is not yet a significant threat to financial stability in Australia, it is becoming increasingly important for investors and institutions to take account of and manage these risks.

It nevertheless identifies some material risks to Australian financial institutions as follows:

- The physical effects e.g. inflation-adjusted insurance claims for natural disasters in the current decade have been more than double those in the previous decade. This impact is likely to grow over time; reduction in certain types of business income that is used to service loans. Examples include changing rainfall patterns that result in lower or less predictable income from agriculture, more frequent storms disrupting supply chains and therefore sales, and damage to natural assets that reduces tourism income.

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<sup>16</sup> Australian Securities and Investment Commission (ASIC), *Managing climate risk for directors*, <https://asic.gov.au/about-asic/news-centre/articles/managing-climate-risk-for-directors/>

<sup>17</sup> Reserve Bank of Australia (RBA), *Financial Stability Risks From Climate Change*, <https://www.rba.gov.au/publications/fsr/2019/oct/box-c-financial-stability-risks-from-climate-change.html>

Importantly, the Reserve Bank notes that “Banks (and other lenders) are also exposed to physical risks because climate change can result in a decline in the income or value of collateral that they are lending against. Such effects can go beyond the industries directly affected by climate change (such as agriculture and tourism), to the households and businesses that rely on income from those industries. Australian financial institutions that have exposure to carbon-intensive industries – such as power generation and mining, or to energy-intensive firms – will also be exposed to transition risk. Transition to a lower carbon economy can also affect institutions with exposures to individuals and communities reliant on these industries. Sudden or unexpected regulatory change could quickly lower the value of such assets or businesses, some of which may become economically unviable or ‘stranded’. Such regulatory changes could either be domestic or come from abroad, given the carbon intensity of Australia’s exports. Transition risk could also arise if large investment in technologies allowed new entrants to displace established but emissions-intensive practices, or if consumer preferences shifted rapidly towards ‘green’ products. If such changes occur abruptly, and certain sectors or firms face large losses, there could be broader dislocation in financial markets, despite the opportunities created for some firms from these changes.

*Transition risk will be greatest for banks that lend to firms in carbon-intensive industries and to individuals or businesses that are reliant on these firms. Other financial institutions investing in carbon-intensive industries, such as superannuation and investment funds, are also exposed to the risk that climate change will diminish the value of their investments. This could occur both through direct investments in carbon-intensive industries, or indirect investments in banks that lend to these industries.*

*Financial institutions may also face reputational damage if they are seen to be contributing to climate change or failing to manage climate risks. This could affect an institution’s ability to retain customers and raise funding. Firms also face legal risks if directors fail to address the potential exposure of their firms to climate-related risks, according to the Hutley opinion (a landmark legal opinion on directors’ duties in relation to climate change under Australian law).<sup>18</sup>*

The Australian Securities Exchange (ASX) reports that it is playing an important role in supporting a smooth and orderly transition to a low carbon economy by fulfilling its purpose as a marketplace for capital to be allocated and risk to be assessed and priced. Company reporting and disclosure is central to how capital is allocated and risk priced. ASX supports and promotes disclosure of material risks, including climate change risks, so that investors can make informed decisions when allocating capital.

In 2019, the ASX endorsed the Task Force on Climate-related Financial Disclosures (TCFD) framework as best practice disclosure for those companies that have a material exposure to climate change risks. The ASX says this endorsement has two important outcomes:

- For companies, it encourages self-assessment of their climate change exposure, which can have significant implications for their ability to create long-term value; and
- For investors, it allows meaningful comparison across companies, sectors and segments of the listed market.<sup>19</sup>

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<sup>18</sup> Ibid

<sup>19</sup> Ibid

## Recommendations

1. That the Committee recommend that APRA consider social and human risk factors in finalising its guidance on managing the financial risks of climate change to be incorporated in a revised Prudential Practice Guide, CPG 229 Climate Change Financial Risks.
2. That the Committee recommend that the Australian Government establish a task force to consider a national strategic fleet, one objective being to improve Australia's supply chain security, to reduce the nation's dependency on foreign owned ships and to examine ways to move away from Free-on-Board (FOB) shipping contracts in Australia's commodity exports.