Climate capital needs right policy settings to stem exodus

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Last week's announcement by AusSuper, Australia's biggest super fund with over $300bn in assets under management, that it will dramatically upscale its investments offshore, including A$15.5bn into large-scale, long-term energy transition opportunities in the UK, should be a wake-up call to Australian energy policymakers. It follows the recent decision by Aware Super to invest in a US-based energy transition finance firm, taking advantage of US "green new deal" Inflation Reduction Act incentives, and a tidal wave of superfund capital looking to deploy overseas.

Australia has one of the world's largest pools of pension capital, some $3.6tn, trebling to $9tn by 2041. Climate Energy Finance has argued that it is imperative we crowd-in and leverage this capital to accelerate our domestic transition, in the long term interests of climate, helping underpin the inevitable wholesale transformation of our economy as the world decarbonises.

This transformation presents Australia, with our world-leading reserves of critical minerals and superabundant sun and wind resources, a once in a century opportunity to secure our future prosperity, and, if super funds are bought-in, to optimise members' financial position in retirement while avoiding some of the rising financial costs of the climate crisis.

We are not alone in seeing an opportunity here. Last year, AusSuper joined eight major industry superfunds, with a collective ~$1.3tn under management, to advocate that with the right policy architecture, the multitrillion dollar industry super sector could become a key investor in the renewable energy transition, deploying capital into decarbonisation of key industry sectors, including in electricity, transmission and storage. IFM Investors spoke to this key investment theme at COP28.

As the funds note, policy solutions that enable significant investment into Australia's energy transition also deliver "strong risk adjusted returns for working people's retirement savings".

Reforming Your Future, Your Super (YFYS) is a good place to start. Last year's review by Treasury found that the YFYS Performance Test, introduced by then-Treasurer Josh Frydenberg in 2021, "can unintentionally affect investment decisions of all funds to reduce the risk of failure and closure by encouraging short-termism and benchmark hugging as well as discouraging certain investments". These benchmarks, which currently favour incumbent firms, became heavily skewed by fossil fuel companies' temporary windfall gains due to Russia's war on Ukraine.

Changing the benchmark to prioritise lower-carbon, forward-facing indices would help to unlock Australia's rapidly growing super assets for climate-responsible investments, and ensure that funds are not penalised for prioritising their members' long term interests in a liveable planet and financial risk management over occasional short term cyclical windfall returns from highly polluting industries.

Another key enabler of energy transition investment is nation-building strategic public interest capital investment by government at scale, to send a signal to investors and create investor confidence. The Clean Energy Finance Corporation, Australia's 'green bank', last year reported a 5:1 crowd in ratio, i.e. it attracted $5 private capital for every $1 it invested into projects.

Federal energy minister Chris Bowen's expanded Capacity Investment Scheme is a case in point, quadrupling investment into utility-scale renewables infrastructure to some $67bn and providing investor certainty by paying the project owner a percentage of the shortfall if generation revenue falls below a nominated "floor" price, and sharing upside back with the government.

Greater ambition is needed to position Australia alongside other nations' decarbonisation packages, such as the US with its $1tn IRA incentives, and to protect and grow new-economy industries onshore. CEF estimates that an additional Australian $100bn public policy investment into Australia's generational opportunity as a renewables and zero-emissions trade and investment superpower would catalyse $200-$400bn of private capital.

There is no shortage of sustainability-seeking private capital in Australia. CEF's research quantifying climate financing by the Big 4 banks has revealed that they have pledged a collective $400bn in sustainable finance this decade – a testament to the capital waiting at the door ready to be deployed to accelerate our national decarbonisation pathway.

ANZ has the largest sustainable finance target of $150bn cumulative financing this decade, having achieved $56bn in the four years from FY2020 to FY2023.

NAB has already hit its $70bn in environmental financing over seven years to financial year 2022, and it promises to establish a new financing target this year.

CBA has allocated $44bn over three years towards its $70bn sustainable funding target.

Westpac has allocated $6.5bn over the past three years, increasing its climate solutions target from $15bn to a still weakest of its peers $55bn in total committed exposure (TCE) by 2030, plus an additional $40bn commitment toward bond facilitation in this area.

However, currently the banks channel six times more capital into green buildings than renewable energy. We need our commercial and residential real estate to be energy efficient and electrified, but buildings are only truly green once the grid is also decarbonised.

It's time for the banks to expand their commitment to and capabilities in executing long duration clean energy infrastructure deals, rapidly increase their share of financing, and commit to a fossil fuel phase out across their financed emissions portfolios. They should also be advocating for ambitious and coordinated policy, regulatory and investment settings that reflect and enable our national climate goals.

Aligning the monumental firepower of super and our big banks with the net-zero transformation will make Australia an unstoppable player in the global energy transition.