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Climate Change Authority – Special Review Second Draft Report: Australia's Climate Policy Options

The Westpac Group thanks the council for the opportunity to lodge a submission to the Special Review regarding Australia's Climate Policy Options.

Overview of Westpac Response

Westpac is well known in the market for adopting strong risk management practices and a forward-looking, progressive approach to identifying emerging material risks and opportunities for our business and the businesses of our customers. We recognise that managing environmental risk is also about managing financial risk; climate change is ultimately a business issue requiring the same approach. Westpac views climate change, and the policy and market response to climate change, as a critical business risk that warrants precautionary, prudent action to ensure the best outcome.

Climate Change will have significant physical implications for our customers and the community and we understand that Westpac has a role to play in helping them understand, adapt and become resilient to the range of possible future climate outcomes.

We are committed to developing practical solutions to assist Australian business manage the transition to a carbon constrained operating environment and believe that effectively identifying, managing and mitigating climate and environmental risk in the near term will have positive financial benefits in the future.

Westpac is an active participant in ongoing public policy dialogue on an appropriate national response to climate change and the design and implementation of suitable policies and measures to help Australia achieve its emission reduction targets and to support an effective global response. We welcome the opportunity to provide a submission on the Climate Change Authority's *'Special Review: Australia's climate policy options'* ('the Report').

This submission draws upon the Bank's considerable experience in factoring environmental considerations into business policies, decisions, procedures, our investment and lending experience. It also draws upon practical and extensive participation in carbon and environmental markets across a number of jurisdictions, including Australia, the EU and New Zealand emissions trading schemes over the last decade.

Westpac has a strong track record in the carbon market, both in Australia and internationally. Westpac Institutional Bank has also a dedicated team of carbon specialists, focused on carbon and carbon related solutions. This team brings together expertise from across the business to focus on delivering integrated carbon solutions for our customers. This includes debt and equity funding for emerging business opportunities in the domestic offset sector (forestry and agriculture), clean energy opportunities, energy efficiency, internal abatement financing requirements and carbon credit off-take, price risk management or origination activities. *For further details see appendix A*.

Westpac has consequently and consistently sought to play a constructive and responsible role in the development of an appropriate policy response for Australia, under both current and several previous Commonwealth governments and at the state and regional level. In doing so, Westpac has provided practical feedback on the market and business implications of proposed policy solutions, while supporting our customers to manage risk and to pursue emerging commercial opportunities.

Westpac recognises that the release of the Second Draft Report of the CCA Special Review and the creation of a fresh framework for evaluating policies is a key next step in the development of a detailed policy design process to meet Australia's emission reduction targets beyond 2020 and in a post-Paris world.

This submission seeks to provide feedback on key aspects which we believe will assist in shaping the design of an effective and efficient policy response.

Westpac's position on Australia's climate policy options

Principles for assessing policies

Westpac agrees with the appropriateness of the principles proposed by the Authority to assess climate policy options - cost effectiveness, environmental effectiveness and equity.

Any policy response capable of achieving Australia's post-2020 objectives needs to deliver a clear framework of sufficient tenor that it matches investment horizons which are, by nature, long term. An absence of a long-term framework has created uncertainty, hindering investment and decisions regarding emission-intensive infrastructure as well as in clean technology.

Emissions reduction market and policies are necessarily created by regulation. After multiple iterations over the last decade, it is imperative for Australian businesses that policies intended to achieve post-2020 targets at least cost are also assessed for their ability to endure, providing the certainty of scheme which will unlock genuine investment and innovation.

Preferred policy options

For well over a decade, Westpac has been an active participant in the development of an appropriate policy response for Australia, and during this time Westpac's preferred policy position has remained consistent, comprising three core pillars.

Firstly, Westpac has long maintained that a broad-based price on carbon is the most effective, affordable, flexible and equitable means of achieving emissions reductions at the least cost across the economy.

Secondly, as a financial institution with a strong track record for prudent fiscal management, Westpac believes that market based mechanisms, such as a robust emissions trading system, provides the most efficient means of achieving that price on carbon across the economy – delivering objectives while still allowing both business and government the flexibility and nimbleness to achieve abatement, without unnecessarily impacting economic and industry competitiveness.

Thirdly, Westpac has played a fundamental role in supporting the emergence, design, consultation and implementation of a range of carbon trading and carbon finance market frameworks in the Asia-Pacific region. Westpac's experience and that of its customers has highlighted that any further policy developments in this area should consider the legacy of capital investment and skills that Australian businesses have built in this area, particularly in response to previous regulatory solutions. Westpac would encourage the CCA to consider how any changes to Climate Policy can make best use of this legacy and minimise the need for duplication of investment. Consideration should also be given to how an Australian scheme would match existing and already operational schemes in the form of the New Zealand Emissions trading Scheme and European Emissions Trading Scheme. This would greatly smooth the path for potential future linkages with international schemes.

Importantly, Australian businesses are already very accustomed to dealing with price volatility – in the form of foreign exchange rates, interest rates and commodity prices - and indeed are genuinely adept at managing and interpreting these markets. Carbon prices would be little different once fully established. From a financing perspective, having a price on carbon means investors who might hesitate to take on an uncertain liability are better able to price the risk, determine the actual level of liability, and estimate whether they can earn an adequate return for that risk. Once carbon risk can be actively managed, low emissions projects will appear increasingly attractive to investors since the carbon liability is lower than for high emissions projects.

Lessons on mandatory carbon pricing

As noted above, market based mechanisms are well understood by Australian business and are highly effective in delivering outcomes. Westpac believes a market based carbon pricing mechanism performs extremely well against the specified principles. But there are key learnings from international schemes.

Firstly, the market must be allowed to function effectively, without overt interference from buffering policy mechanisms or from overly-generous compensation allocations which distort the market, risking undermining the intent or integrity of the scheme.

Secondly, the policy should seek to provide granularity on the desired trajectory *within* the nationally determined post-2020 targets which are long term in nature. The additional structure provides market participants with greater ability to forecast the outcome of these regular announcements, enabling them to shape their behaviour and investment decisions accordingly and ultimately smooth the path to the desired objectives.

Finally, in line with the above, in any scheme designed to incentivise change and deliver innovation, it is impossible to expect regulators to be able to accurately estimate supply and demand. There will always be known unknowns and a requirement to adjust settings as developments occur. In designing policy, consideration should be given to the inclusion of pre-legislated review mechanisms at pre-scheduled intervals, to avoid market perception of investment risk as a result of market interference or regulatory change.

Voluntary carbon pricing

Westpac believes that there will always be a role for voluntary carbon markets within Australia and internationally, particularly when conducted in concert with the mandatory market. A voluntary market needs and can be supported by appropriate certification and verification regimes under Government auspices and has the capacity to deliver meaningful outcomes in the right circumstances.

However, Westpac believes that voluntary carbon pricing is unlikely to deliver environmental outcomes with the certainty required – specifically its ability to continue to deliver through the inevitable downturns of economic cycles. It is therefore not the equal of mandatory carbon pricing when measured against the principles of environmental effectiveness and cost effectiveness but should remain facilitated.

Renewable energy and energy efficiency targets

Westpac's position is that a broad-based, economy-wide, market-based price on carbon can and should be part of a suite of complementary policy responses and indeed there have been successful applications of renewable energy targets and energy efficiency standards worldwide.

They have been most effective in providing desired boundaries and ensuring ongoing progress in specific sectors or activities targeted as being of overweight importance within a given economy. Consequently, they act in support of a well-designed carbon pricing framework. Being narrower in scope by definition and with a correspondingly smaller range of impacted entities, the improvements incentivised are more likely to be incremental rather than delivering step-change technological innovation.

A key lesson from the implementation of Australia's Renewable Energy Target (RET) is the importance of clear and consistent approach to regulation, to avoid uncertainty that can create barriers to investment, particularly evident in a market with long lead times and investment horizons for infrastructure.

In a market characterised by these long lead times and investment horizons, such as renewable energy generation, certainty of cash flows is crucial. The cost to deploy the technology can be more expensive compared to other fuel sources. Regulatory uncertainty around the RET contributed to a delay in investment in renewable energy projects in Australia, as projects were unable to demonstrate their future viability sufficiently to secure the requisite Power Purchasing Agreements. Any changes to policy should consider how best to provide long term certainty for investment, beyond the current timeframe.

International Competitiveness

To ensure ongoing economic competitiveness, Westpac recognises that any market based carbon pricing mechanism needs to ensure that trade-exposed sectors (import and export) are not severely impacted as Australia transitions to a low-carbon economy.

There is a case for a number of adjustment support mechanisms to be established with the introduction of any scheme to allow business and members of the community to transition into a carbon-constrained economy. However, Westpac notes that this must be balanced to ensure compensation measures do not undermine the integrity of the scheme or alleviate the impact of the introduction of a carbon market, as this will only delay action and increase the national cost.

Westpac would note however, that following the global agreement reached that the Paris Conference of Parties (COP), the divide between industrialised and developing nations has narrowed significantly. There is now greater commitment globally to reducing carbon emissions; this leads Westpac to believe the risk of carbon leakage (a reduction in emissions in Australia leading to an increase in emissions offshore as the market moves to a less regulated economy) is reduced.

Concluding comments

As policy frameworks develop as a means of taking greenhouse gas emissions out of everyday lives, financial institutions have a key role to play in partnering with customers across all areas of our business to help transition to a low-carbon operating environment.

Westpac is well known in the market for adopting strong risk management practices and a forward looking progressive approach to identifying emerging material risks and opportunities for our business. We recognised a number of years ago that climate change is ultimately a business issue requiring the same approach and we are committed to assisting our customers to manage this transition to a low carbon economy.

Westpac's position for over a decade has been to support flexible, broad-based, market-based mechanisms as the cornerstone of a wider policy response to climate change.

Westpac will continue to work with government, with the relevant authorities and industry bodies, with other market participants and with our customers as investment and market frameworks emerge.

Westpac would welcome the opportunity to continue to engage constructively with the Climate Change Authority on the best climate policy options for Australia to meet its national emission reduction targets.

Appendix A – Westpac's Carbon and Climate Expertise

Westpac's longstanding commitment to working with clients to transition into a low carbon operating environment is built upon our broader commitment to sustainability as a key differentiator of our business.

Westpac is determined to play a constructive and positive role in promoting effective and practical solutions for our customers and across our business. As a facilitator of the growth of the Australian economy for the last 200 years, we will work with all of our customers to make this transition happen.

Recent significant achievements include:

- For the second consecutive year Westpac was ranked as the global bank industry leader in the 2015 Dow Jones Sustainability Indices (DJSI) Review, with our strongest ever score of 94. Westpac has been recognised as a global leader for banks in the DJSI since 2002 and has been ranked global bank industry leader 8 times in that period.
- Westpac was recognised as one of the Global 100 Most Sustainable Corporations at the 2015 Davos World Economic Forum in Switzerland.
- The Westpac Group was listed in the CDP ASX 200 and NZX 50 Climate Disclosure Leadership Index in 2014 & 2015 and has been included in the global Carbon Disclosure Project Climate Leadership Index since 2003.
- Westpac Institutional Bank has been voted as Best Trading Company in Australasia in the global Environmental Finance Awards, every year awarded, beginning 2010.
- In 2003, Westpac was the first Australasian bank, and one of only ten founding signatories globally to sign the Equator Principles, a voluntary global set of guidelines developed for managing social and environmental issues related to the financing of projects. Today there are over 50 signatories worldwide.
- In 1991 Westpac was one of six founding members globally of the United Nations Environment Programme Finance Initiative (UNEP FI). Today there are over 250 signatory institutions, in more than 45 countries.

Westpac first launched an Environment Policy in 1991 and began measuring and reporting on operational greenhouse gas emissions and broader environmental impacts in 1996.

The Westpac Climate Change Position Statement was first published in 2008 and is endorsed by the Westpac Group Executive and the full Westpac Board. Progress is reported to the Board on a quarterly basis and performance against Key Performance Indicators is built into the remuneration scorecard of the full Group Executive. In 2014, Westpac revitalised its Climate Change and Environment Position Statement and developed a 2017 Action Plan, which reaffirms our commitment to finding economic solutions to environmental challenges. Westpac lends over $6 billion to CleanTech sector businesses across Australia and New Zealand. Today, 61% of our global infrastructure and utilities financing is directed towards hydro and renewables.

Westpac has a strong track record of market firsts:

- Westpac has been trading the EU ETS since 2006.
- Westpac undertook the very first trade of Australian compliance credits in May 2008.
- Westpac was the first and remains the principal financial institution making a market in the New Zealand Emissions Trading Scheme (NZ ETS), which has been operating since January 2010.

Westpac Institutional Bank has also established a dedicated team of carbon specialists to hothouse carbon and carbon related solutions. This team brings together expertise from across the business to focus on delivering integrated carbon solutions for our customers. This includes debt and equity funding for emerging business opportunities in the domestic offset sector (forestry and agriculture), clean energy opportunities, energy efficiency, internal abatement financing requirements and carbon credit off-take, price risk management or origination activities.

Westpac believes that managing the risks and opportunities posed by climate change will be a defining factor in achieving long term profitability for our clients and for business. Westpac is committed to developing practical and effective solutions for our customers at every level of the economy.