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In-depth with The Conexus Institute

Climate-related investment activity by superannuation funds

An outline of the issues

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Executive summary

We investigate climate-related investment activity by Australia's superannuation (super) funds, including what funds are currently doing, influences on their activities around climate change and developments that might expand the scope of those activities. Our central message is that super funds face no compulsion, limited incentives and meaningful constraints around climate-related investment activities. But they also have latitude in how they respond to the threats and opportunities of climate change given that member best financial interests are open to interpretation and high uncertainty exists over how climate impacts on investment outcomes. In short, there is meaningful room to exercise judgement. Against this background, we observe a range of climate-related investment activities being undertaken by super funds. While direct investment is modest in aggregate, consideration of climate risk is more common. The upshot is considerable dispersion in climate-related investment activities, but the actual impact on portfolios remains constrained and relatively small. Significantly expanding the scope of climate-related investment activity by super funds probably requires a coordinated set of developments, including policy measures and changes in incentives for funds, such as a significant shift in community expectations, redirection of assets by members and adjustment of fund remuneration structures to take climate considerations into account explicitly.

1. Introduction

1.1. Background

The spectre of climate change, and what can and should be done to address it, is a major challenge facing the global economy and society at large. We investigate how Australia's institutional[1] super funds respond to the climate challenge. We call these responses 'climate-related investment activities', which might entail either portfolio adjustments in anticipation of potential impacts from climate change or investment, and other activities directed at supporting the energy transition. We discuss the following:

- *Scope* of climate-related investment activities being undertaken by super funds.
- *Major influences* on how super funds approach climate-related investing, including their 'mandate', relevance of climate considerations for investment outcomes, assessment of investment performance, policy and regulatory settings, and various 'business' considerations.
- *Policy and other developments* that might change the way super funds approach climate-related investing.

Climate change, and attempts to respond to the potential impacts, are highly relevant to super funds for two main reasons. Most important is the potential relevance for investment outcomes, which is the primary focus under their mandate. First, climate change will have direct impacts. It poses risks that might be financially important, potentially significantly so. There are many channels through which climate change could cause financial loss, including lowering economic

[1] We implicitly write with APRA-regulated funds in mind.

growth, boosting costs and inflation, creating stranded assets and causing physical damage. Second, climate change might also give rise to some 'winners'. Climate change could throw up opportunities for generating returns. Most notable is the need to invest large amounts of capital in the energy transition as the world shifts towards a lower-carbon economy. The United Nations estimates that this will require around US$4 trillion per annum. Australia's super system would seem an obvious funding source for at least part of the transition, with over A$4 trillion[2] in assets that are growing and invested towards a long-term purpose[3].

Climate change and the energy transition also give rise to other considerations for super funds, including meeting their legal and regulatory obligations, possible impacts on their own business operations, dovetailing with community expectations and associated reputational effects. Against this background, we consider how super funds might respond to the threats and opportunities posed by climate change.

The shift to a low-carbon economy requires input from all sectors. Investors should not be expected to address the issue alone. However the focus of this paper is the role played by investors, specifically superannuation funds.

1.2. Key messages

We think what is observed in the super industry can be explained by two aspects. First, super funds face *no compulsion, limited incentives and meaningful constraints* around undertaking significant climate-related investment activities, for reasons that we document in Section 3 through Section 7. Second, super funds nevertheless have *latitude* to choose how they respond to the risks and opportunities of climate change. This is because what is relevant to member best financial interests is open to interpretation (Section 3), and potential climate-related impacts on *expected* investment outcomes are highly uncertain and leave considerable room to exercise judgement (Section 4). Basically, super funds can choose how far they go within the limits imposed by their mandates and other influences such as performance assessments (Section5), policy and regulation (Section 6), and various other business considerations (Section 7), provided that actions can be justified *ex ante* on the basis that they are financially relevant. From a legal perspective, it is very clear that such decisions are judged on an *ex ante*, and not an *ex post* basis. If it made sense at the time, subsequent events do not upset that conclusion.

This situation manifests in super funds allocating capital to targeted climate-related investments (whether through a pooled vehicle or direct purchase of assets, an example being a solar electricity farm) only on a modest scale so far. The reality is that super funds have committed only a relatively small proportion of assets towards *directly* addressing climate change (see Section 2). Meanwhile there is meaningful activity from *some* funds around taking climate considerations into account in their investment and other activities. There is also significant dispersion across super funds in their commitment and scope of activities. Personal beliefs of key decision makers appear to play a significant role in driving this dispersion, with other potential influences including the interpretation placed on legal and regulatory requirements, degree of concern with relative performance (e.g. peer groups and the importance of the Your-Future Your-Super performance test, or 'YFYS test'), perceived opportunity to attract and retain members and reputational considerations. Funds have scope to set their own path within constraints, provided that any activities can be linked to expected investment outcomes. Some funds appear to have enthusiastically integrated climate considerations into their investment process and related

[2] Around $3 trillion of assets resides in APRA-regulated funds.
[3] Capital from super funds and other investors can only do so much. For instance, much of the required capital may be early stage venture and not necessarily appropriate for asset owners to supply at scale.

activities, even if it has resulted in only modest reallocation of capital. Other funds seem to be investing in the same manner as before, while glossing over the climate challenge.

We suspect the situation of modest levels of climate-related investment activity from super funds will persist unless something major changes. Two main classes of development could change the behaviour of the super industry at large. The first would be *policy changes that facilitate and compel* super funds to take more aggressive action to help address the climate challenge. Second would be *events that create strong incentives* to ramp up climate-related investment activity. One possibility might be a major change in community expectations around the need to address climate change, coupled with members moving their assets accordingly. Another might be to introduce significant elements into remuneration structures to incentivise action in support of decarbonisation. Ultimately, multiple coordinated actions are probably required, as no one single initiative is likely to boost activity significantly. We currently see nothing on the immediate horizon that is likely to act as a catalyst for meaningful change. Developments that might shift the dial are discussed in Section 8.

1.3. Context and terminology

Before proceeding, it is worthwhile outlining the context in which this report is written and definitions we will be using, especially given the expansive jargon being used in investment and climate discussions. Our focus is climate-related investment activities by super funds, which largely involves allocating capital, but also incorporates 'stewardship' activities. We recognise the potential for climate change to have investment-related impacts, but take no stance on ethical, social, economic or political considerations, apart from acknowledging that they exist. As discussed in Section 3, we adopt the position that the primary mandate of super funds relates to expected and realised investment outcomes that are measured in financial terms, i.e. risk and return.

Noting that a variety of terms are used in the area of sustainable and responsible investing, we have attempted to restrict our use of terminology. In addition to the characterisation of various climate-related investment activities presented in Section 2, we choose the following terms to capture concepts that we refer to repeatedly:

- *Climate-related investment activity* – Portfolio adjustments in response to expected impacts from climate change (which entails mitigating risk exposures and steps to adapt to the impacts), and allocation of capital and other actions aimed at addressing climate change (including impact and other investment in supporting energy transition and stewardship activities to bring about change).
- *Responsible investment' (RI)* – Sometimes known as sustainable or socially responsible investment, we use this term to span broad-based approaches to investing that factor in impacts on people, society and the environment in addition to financial performance[4]. We use the term 'RI activities' to describe actions taken by super funds and 'RI options' to describe standalone investment options.

2. Current super fund activities around climate

In this section, we explore climate-related investment activities undertaken by super funds. We estimate capital allocated to climate-related investments and explore the degree to which climate-related considerations are incorporated into investment practices.

[4] We follow Responsible Investment Association Australia (RIAA) definitions, see https://www.responsibleinvestment.org/learn/what-is-ri

2.1. Capital allocated to targeted climate-related investments

It is difficult to estimate the amount of capital allocations to targeted climate-related investments due to insufficient disclosure across the super industry. We estimate that the amount of capital allocated to climate-related investments is less than 1%, while the total amount invested in RI options is probably less than 2%. Our estimates are based on the following observations:

- A portion of the largest 20 super funds (representing 66.7% by number and 77.1% by capital, as per Figure 1) have capital directly allocated to targeted climate-related investments. Some funds have climate-related investment targets, with most of these having allocation targets of less than 1% of total assets[5].
- The largest 20 super funds (comprising more than 90% of total APRA-regulated super assets) managed $33.3 billion in dedicated RI options, equal to 1.2% of those total assets[6]. Many of these products run on a screening basis, we assume that the targeted climate-related investments of these funds to be less than 5% of total portfolio assets.
- Two super funds with a dedicated focus on RI – Australian Ethical and Future Super – collectively managed $20.2 billion of assets as at September 2024[7] or only 0.7% of assets in APRA-regulated funds. We estimate that targeted climate-related investments of these funds would be less than 5% of total portfolio assets, although negative screens and other climate-related activities are employed.

Aggregating these numbers suggests a total estimate of 0.9% of APRA-regulated super assets are allocated to targeted climate-related investments. We believe 1% is a conservative upper bound estimate of the degree of targeted allocated capital.

Adding the assets under management by Australian Ethical and Future Super to the amount invested in dedicated RI options of the top 20 funds suggests that RI options might still be less than 2% of super system assets.

An initial observation is that there appears to be no strong signal from members to their super funds of any widespread support for RI activities. If there is a greater level of support, it is not being reflected in concrete member action. We will explore this observation further in Section 3.

2.2. Climate-related considerations incorporated into investment practices

There exists a broad range of climate-related activities that super funds can undertake as part of their overarching investment process, each of which may be pursued to different degrees of intensity. Figure 1 provides an overview of these activities and our estimate of the current degree of industry adoption, which we subsequently map back to the RI activity categorisations of RIAA in Figure 2. To produce Figure 1 we searched and analysed materials produced by super funds utilising (but not relying on) large language models. A degree of subjectivity is unavoidable, a good example being what constitutes a 'climate' or 'sustainability' report. Also, we did not share our assessments with funds for comment.

[5] As an example, Rest is targeting a 1% allocation of its total funds under management to impact investments by 30 June 2026. Rest defines impact investments as investments made in members' best financial interests that provide both a financial return and a social and/or environmental return. See Rest - Sustainability, Responsible Investment and Climate Change Supplement (7 November 2024).
[6] UniSuper had by far the largest amount of assets in this category.
[7] Data sourced from APRA's *Quarterly Superannuation Product Statistics*.

Figure 1: Overview of climate-related activities observed amongst largest 20 super funds

Activity	Description	Fund application (% of funds)	Fund application (% of capital)
Climate investment risk acknowledged	Climate as a source of investment risk is acknowledged by fund.	95.2%	98.6%
Integration of climate considerations into investment process	The fund's investment processes show a reasonable degree of integration of climate considerations.	85.7%	95.1%
Climate / sustainability report	Detailed climate report, or sustainability report with sizable climate component, published within the last three years.	57.1%	71.8%
Self-identifies as a universal owner	The fund publicly self-identifies as a universal asset owner.	33.3%	48.1%
Net zero carbon emissions target	Formally stated 'hard' net-zero carbon emissions target.	81.0%	92.7%
TCFD-linked reporting[8]	Climate reporting that is linked to Task Force on Climate-Related Financial Disclosures (TCFD).	66.7%	78.4%
Stated alignment with Sustainable Development Goals	The fund's approach to climate and sustainability makes formal reference to the Sustainable Development Goals (SDG).	52.4%	65.7%
Dedicated RI options	Fund offers dedicated RI investment options, including multi-asset and/or asset class based.	85.7%	91.5%
Climate-related screens	'Hard' climate-related exclusions applied across all portfolios.	14.3%	13.0%
Targeted climate-related investments	Targeted investments into climate-related opportunities.	66.7%	77.1%
Engagement on climate-related issues	Corporate engagement undertaken over climate-related issues.	76.2%	81.2%
Voting by trustee on climate-related resolutions	Fund exercises its vote on climate-related resolutions.	90.5%	97.0%
Climate-related investor group membership	Member of group(s) that support climate-related investment practices and advocate for climate policy[9].	90.5%	97.0%

[8] We note that the new Australian Sustainability Reporting Standards will replace any need to reference TCFD, but that TCFD represented a good point-in-time connection to climate reporting.
[9] Examples include Australian Council of Superannuation Investors (ACSI), Australian Sustainable Finance Institute (ASFI), Better Futures Australia, Climate Action 100+, International Corporate Governance Network (ICGN), Investor Group for Climate Change, Nature Action 100, Net Zero Asset Managers Initiative, Paris Aligned Asset Owners, RIAA, Transition Pathway Initiative, and PRI.

Commenting on the activities as defined in Figure 1:

- While nearly all funds acknowledge climate change as an investment risk, the degree and depth of activities undertaken to manage this risk varies.
- Production of a climate / sustainability report is more commonly undertaken by larger funds. There is sizable variation in the quality and depth of these reports. These funds also often have net zero carbon emissions targets, make targeted climate-related investments, linked to the SDG, and have established engagement programs which would generally produce higher quality reports.
- Only a minority of funds explicitly self-identify as universal owners (explored further in Section 3.1). However, most funds undertake a range of activities linked to integration of climate into investment processes and stewardship that are common to universal owners.
- Platform super funds (i.e. master trusts and wraps) tend to undertake fewer climate-related activities. We identify challenges for platforms in accounting for climate given the business objective of facilitating choice for financial advisers.
- Few funds have hard climate-linked investment screens, presumably because this entrenches tracking error (to the YFYS test and to peers) and reduces the flexibility to deal with nuanced situations as they arise. Negative screens can also put pressure on a fund to demonstrate that they are in the best financial interests of members when they are outwardly 'social' such as the exclusion of munitions manufacturers, for example.

Figure 2 outlines the range of investment activities undertaken by super funds with respect to climate[10] mapped back to the RI activity categories of RIAA. Climate integration and stewardship activities appear to be the most significant climate-related investment activities undertaken by funds. The degree and depth of these activities is difficult to identify but appears to vary substantially across funds. This result is unsurprising given the latitude that super funds have to interpret their 'mandate', as discussed in Section 3. It was not possible to ascertain the degree to which climate integration impacts on the construction of portfolios. Stewardship activities are relatively common, but their scope is difficult to identify[11]. Here the sheer number of investments made by super funds requires them to trade off breadth and depth in undertaking stewardship activities, which can be consuming of management time and effort if given the close attention needed to make them effective. Collaboration and collectives provide efficiency and coordinated messaging.

Our investigation leads us to conclude that financial considerations have greater direct influence than climate considerations on super fund investment activity. Climate considerations appear to be incorporated into financial considerations to varying degrees. As discussed in Section 3, this is consistent with fund mandates where the dominant (and historical) focus of super funds is portfolio returns, and a range of uncertainties exist around latitude and motivation to incorporate climate-related activities. This affords a degree of flexibility around how much climate is weighted in investment processes. Our argument is that these forces dilute the incentive for super funds to make capital allocations to targeted climate-related investments or pursue related opportunities appears borne out by the data.

[10] Figure 2 is constructed drawing on the definitions of RIAA with some adjustment.
[11] Engagement by super funds may occur directly or via investment managers or investor groups.

Figure 2: Assessing RI activities related to climate using RIAA categories

Activity	Description	Extent of climate-related activities
ESG integration	Consideration of ESG factors when investing, often aimed at improving risk-adjusted returns.	Majority of funds acknowledge climate risk and state that it is integrated into their broader investment processes, albeit to varying degrees.
Screens	Process to determine which investments are or are not permitted in a portfolio by applying rules-based criteria.	A small number of funds apply climate-related exclusions broadly. Such screens are applied more commonly within RI options. Climate impacts generally accounted for on a more integrated basis, i.e. assessed alongside other investment considerations.
Thematic investing	Top-down process to portfolio construction to access benefits from medium- to long-term trends.	Climate is one of many candidate investment themes considered by funds. It does not appear to be given priority, except to a degree within some RI options.
Stewardship	Using rights and influence (beyond capital allocation) to protect and enhance long-term value.	Climate considerations are commonly expressed through stewardship activities including climate reporting, net zero carbon emissions targets, corporate engagement on climate-related issues, voting on climate change resolutions, alignment to SDG, and membership of climate-related groups. Advocacy is also an element of stewardship.
Impact investing	Investing with intent of generating positive social and/or environmental change alongside a financial return.	Modest degree of activity, estimated to be less than 1% of APRA-regulated super assets (see Section 2.1). Most activity occurs in private markets.

It is important to reflect on the nature and possible impact of these different activities. Capital allocations to targeted climate-related investments may have a more direct impact, especially if they represent new private capital to fund specific decarbonisation projects. In contrast, the outcomes of the integration of consideration of climate risks and opportunities into the investment process and stewardship activities, while expected to have positive impacts, are likely less certain and difficult to attribute[12]. The degree to which portfolio construction accounting for climate risk results in materially different asset allocations and the subsequent effects are unclear. Further, the outcome of any activity to aid the transition to a lower-carbon world, can be impacted by a range of other factors such as inconsistency in global policy settings[13].

In summary, the super industry is presently allocating a small amount, less than 1% of portfolios, to targeted climate-related investments, while a majority of super funds emphasise integration and stewardship as primary management tools. There is also variation in the degree of

[12] We note the reporting work undertaken on stewardship activities, a good example being ACSI's Stewardship Report.
[13] For example, increased anti-ESG positioning of the Trump administration might result in less aligned stewardship activities across pension funds globally.

implementation. Meanwhile the climate-related outcomes from these activities are difficult to measure, uncertain, and likely longer term in nature.

3. The mandate of super funds

This report is written from the stance that the primary mandate of super funds is to deliver financial outcomes to members to support a dignified retirement. This aligns with a raft of legal and regulatory requirements. In the Superannuation Industry (Supervision) Act 1993 (SIS Act), Section 52 covenants require trustees "to perform the trustee's duties and exercise the trustee's powers in the best financial interests of the beneficiaries". The Sole Purpose Test (s.62 of the SIS Act and Part 13 SIS Regs) directs that funds must be maintained solely for one or more "core purposes" — mainly the provision of retirement benefits or benefits on death. This objective is clearly expressed in legislation via the Best Financial Interests Obligation[14] (2020) or duty, also known as 'BFID'[15] and the Objective of Superannuation (2024)[16]. It is further reinforced in the Retirement Income Covenant (2022) which focuses on maximising expected retirement income and managing related risks. APRA regulatory standards, such as SPS 530 (Investment Governance) and SPS 515 (Strategic Planning and Member Outcomes) reference "members' best financial interests" and "promoting the financial interests of beneficiaries". The financial nature of super fund mandates is supported by the presence of other influential financially-based objectives such as passing the YFYS test and posting good peer-relative performance, which we discuss below.

There is a strong case that trustees are required to take ESG considerations, including climate change, into account because they have financial relevance, as argued globally by UNEP FI and UNPRI[17] and Freshfields Bruckhaus Deringer[18]. Domestically the 'Hutley opinions'[19] have been influential, concluding that (i) climate risk is foreseeable and must be considered, (ii) failing to consider climate risk is increasingly a breach of duty, and (iii) climate risk is mainstream and ignoring it exposes directors/trustees to serious legal liability, including for greenwashing. APRA's prudential practice guide on climate change financial risks[20] sets out what it considers to be good practice, without creating any additional obligations beyond those set out in various prudential standards[21] which address climate risk generally, rather than explicitly. The primacy of financial considerations was reinforced in feedback provided by super funds and others on an earlier draft of this report, with BFID featuring prominently as the primary lens.

Nevertheless, the financial mandate is open to interpretation along two related lines. First is whether and how climate directly impacts on returns. We delve into this central issue in Section 4. Second is how member 'financial interests' are defined. The remainder of this section identifies and discuss the points of contention over this matter.

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[14] See *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Best Financial Interests Obligation*
[15] The SIS Act requires trustees of both registrable superannuation entities and SMSFs to perform their duties and exercise trustee powers in the best financial interests of the beneficiaries.
[16] See *Superannuation (Objective) Act 2024 (No. 129, 2024) – Sect. 5*
[17] *Fiduciary Duty in the 21st Century – Final Report*, 22 October 2019
[18] *A Legal Framework for Impact: Sustainability impact in investor decision-making*, 2021
[19] Noel Hutley SC and Sebastian Hartford-Davis, *2016 Hutley Opinion*, *2019 Hutley Opinion*, *2021 Hutley Opinion*
[20] APRA Prudential Practice Guide, *CPG 229 Climate Change Financial Risks*, 2021
[21] APRA Prudential Standards CPS 220 Risk Management (CPS 220), SPS 220 Risk Management (SPS 220), CPS 510 Governance (CPS 510), SPS 510 Governance (SPS 510)

3.1. Scope of what is included in member best financial interests

A key issue is whether 'financial interests' should be defined strictly with regard to direct impacts on portfolio outcomes (i.e. portfolio returns), or whether broader economic benefits and costs, and time horizons, should be imputed into financial interests[22]. One aspect is that greenhouse gas (GHG) emissions entail externalities where the cost is not fully borne by the emitter. The question arises as to how these externalities should be accounted for and whether they can be addressed under BFID, which requires considering how this connects through to portfolio outcomes. It also links to how portfolio outcomes are defined. The current situation is that 'outcomes' relate to returns generated for the member in the past. This raises questions over the validity of imputing a value on externalities into portfolio value (e.g. a shadow carbon price) which factors in potential future eventualities, when making investment decisions under current settings. Factoring in such potential future events is, however, integral to many investment orthodoxies (diversification of future risks being the prime example). Is the problem with integrating climate change risk that it is both relatively new and remains contested ideologically or doesn't seem 'financial'? If it is treated as relating **solely** to financial risk and opportunity, then integration seems a foregone conclusion. The challenge then is for funds to conceive and document their thinking on these issues. Perhaps the best way to do this is via a 'transition plan' contemplated by the new Australian Sustainability Reporting Standards[23].

The concept of *universal ownership*[24] offers one way of addressing the apparent dilemma over how BFID might be more broadly interpreted. Universal ownership principles postulate that the beneficiaries of asset owners like super funds are impacted by the broader creation or destruction of value as they will always effectively own a slice of the entire economy (or global economy in the case of super)[25]. This is so due to the scale of assets under management and the long time-horizons of the beneficiaries. In other words, super funds cannot disinvest from the global economy. From this perspective, incorporating long-term economic benefits and costs into investment decisions may be interpreted as valid under the assumption that overall impacts on the total portfolio are what matter. For example, an impact investment that offers lower portfolio returns over the short-to-medium term might be justified if it is expected to generate offsetting long-term benefits for the overall economy and hence portfolio returns. Another example would be investing in a manner that reduces returns in one part of the portfolio[26] with the aim of creating more-than-offsetting climate-related benefits in other parts.

Universal ownership is faced with multiple challenges in a superannuation setting. Actions by individual funds must pass the BFID regardless of other motivations. A linked issue is that the connection between action taken by an individual fund and the improvement in overall portfolio outcomes is often tenuous. Relatedly, free rider problems can emerge to the extent that members suffer lower returns to create overall benefit for the economy that is enjoyed by all. Combined

[22] It is generally accepted that non-pecuniary benefits flowing to members should not be taken into account, at least where they comprise financial outcomes, or unless all beneficiaries agree (Cowan v. Scargill, 1985; Treasury Wine Estates v. Cox, 2016).

[23] An Overview of Australian Sustainability Reporting Standards (2025)

[24] Gosling T. (2025), "Universal Owners and Climate Change", *Journal of Financial Regulation*, 11(1), 2025, pp.1–40) provides an excellent overview of universal ownership and conditions under which asset owners may take action to help address climate transition in ways that are consistent with fiduciary duty.

[25] A more extreme position, which might be called 'welfare maximisation', would recognise that members have both financial and non-financial preferences and that trustees should try to satisfy both. This is broader than universal ownership, which focuses on maximising financial interests at the total portfolio. It is clearly at odds with best financial interests duties and is difficult for trustees to pursue without a clear mandate from members. Refer Gosling (2025) for a discussion.

[26] Gosling (2025) gives the example of pushing an oil company to reduce production that harms its share prices, which prompts reflecting on the debate over Woodside Energy's proposed expansion of gas production and climate transition plans.

action by many asset owners could make a difference, but raises questions over whether effective coordination across asset owners is feasible.

The relevance of universal ownership continues to be debated[27], and the latitude that trustees have to invest under a universal ownership lens is not entirely clear. This adds to the uncertainty around the scope of what may be incorporated into investment decisions.

3.2. Issues around time horizon

The fact that the financial interests of super fund members in different age cohorts might differ across a range of time horizons complicates matters when financial cost and benefit is traded off over time, e.g. a cost is incurred now to generate long-term financial benefit. For instance, impact investments might face a payoff 'J-curve'. On the other hand, climate-related investment activities undertaken from a universal ownership perspective might create benefits that accrue through better overall returns or lower risk only over the very long run. While younger members might benefit more from long-term returns to maximise wealth accumulation, older members in drawdown might have shorter horizons in part due to sequence-of-return impacts (albeit this will partly depend on *when* they intend to utilise their balance). Shorter-term returns might have relevance for other reasons, including that members could suffer financial detriment if their fund fails the YFYS test or underperforms peers, or simply because volatility in their balance is relevant to their particular circumstances. The fact that a range of horizons are relevant creates considerable uncertainty over making trade-offs across time.

3.3. Can (and should) trustees consider expressed member preferences

A useful perspective on the issue of how preferences might play a role is the distinction between 'value' and 'values' motivations for investing in the RI/ESG space[28]. The underlying message for trustees is that climate-related investment activities that are expected to generate value are fully consistent with their obligations while investing for values-sake alone is not. While people should have the prerogative to invest in line with their values and sacrifice returns in support of their beliefs, trustees of ARPA-regulated funds that invest in accordance with values motivated by an assumption around the preference of members will be operating on questionable ground.

This position has legal backing. Trustees have no obligation to take member preferences into account and indeed face an obligation *not* to do so where in conflict with BFID[29]. However, it remains open to members to express their preferences through investment choice, e.g. choosing an RI option from the super fund's menu. A further complication is that, even if trustees wanted to take member preferences into account, members can hold and express differing preferences. For example, members might have wide-ranging views about addressing climate change[30].

The limited amount of assets directed at RI options (see Section 2) raises questions around the degree to which the majority of members care about sustainability issues, although apathy and lack of agency would also play a role here. RIAA research[31] indicates that 73% of Australians want to see their super funds support environmental and social goals. Reconciling this survey result with the observed low levels of explicit choice of RI options is challenging. We make the following reflections:

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[27] An article by Russell Baker in Investment Magazine on 5th March 2024 summarises some of the issues.
[28] Starks, L.T. (2023), "Presidential Address: Sustainable Finance and ESG Issues – Value versus Values", *Journal of Finance*, 78(4), 1833-2411
[29] For instance, see Treasury Wine Estates v. Cox (2016).
[30] See Donald, M.S. (2025), "Annual super fund members' meetings: The evidence so far", *Australian Journal of Corporate Law* (forthcoming), for which presentation slides can be found here.
[31] RIAA, *From Values to Riches 2024: Charting consumer demand for responsible investing in Australia*, 2024

- While the trade-off between returns and RI has been well-examined, the trade-off between preferences for RI versus investment returns is little explored. It might be that there is little tolerance to forgo investment returns to facilitate undertaking RI activities.
- There could be an expectation among some members that funds undertake RI activities across all (including default) investment options, akin to presumption that it is part of the social licence to operate. This makes sense in a system where defaults are prominent.

We suspect that both of the above observations are at play to some degree. The majority of Australians expect their investments to be invested responsibly, and assume that funds undertake RI activities across all investments without forgoing investment returns, i.e. they are not considering the possibility of any trade-off. The notion that many members care about RI might also be helping to encourage funds to adopt RI activities (including accounting for climate risk).

It seems tenuous for trustees to undertake climate-related investment activities primarily on the basis that a majority of members support climate action.

3.4. Whether other interests may be considered when there is no financial detriment

The final grey area is the extent to which trustees could take climate considerations into account where doing so does not give rise to any financial detriment or benefit. Consider the following situations:

- If two investment opportunities offer equivalent profiles from a risk/return perspective, could the opportunity that does more to address climate change be validly chosen?
- Is screening acceptable if it is unlikely to impact on returns or risk, e.g. excluding pure coal stocks or weapons manufacturers on the basis that they have minimal impact on portfolio outcomes, say by virtue of being a small part of the equities index?
- Is it acceptable for super funds to undertake activities such as advocating to government or engaging with companies to encourage climate action, even though there may be little or no direct impact on portfolio outcomes (noting that no activity is totally costless)?

There would seem to be greater scope for super funds to undertake climate-related investment activities in such situations. First, there appears to be no legal barrier to doing so, provided that there is no clear financial detriment. Second, a case that there is at least some financial benefit may be made, either through the universal ownership lens or as a matter of helping to limit climate risk and its impact on portfolio outcomes. Third, from a practical and somewhat cynical perspective, investment always occurs under uncertainty, and it is usually possible to make a case that a decision is *expected* to create value under borderline situations. Nevertheless, to be on a very sound footing, such actions should arguably only be taken where it is clear that no financial detriment exists. In all such cases, trustees should have a sound justification for their decisions and clearly document why they were made.

3.5. Where this leaves us

The bottom line is that the mandate of super funds remains open to interpretation, and in some cases could be subject to future legal determinations around matters such as universal ownership. Even though there might be agreement that the mandate is primarily financial in nature and that climate change can have financial impacts, there remain many grey areas with respect to what trustees can and should do in incorporating future climate effects into portfolio decisions.

The implication is that super funds trustees have a reasonable amount of latitude to interpret their mandate with regard to undertaking climate-related investing activities. For instance, super funds would appear to have scope to choose whether or not to embrace universal ownership principles depending on how they frame their financial relevance; to place more weight on long-term versus

short-term outcomes; and to pursue (or steer clear of) climate-related investment activities where there is no clear financial impact in doing so. Latitude to interpret the mandate also leaves scope for super funds to embrace investing in support of climate transition to differing degrees.

This situation could be made much clearer by a fund's trust deed. While a trust deed cannot override SIS covenants, it could articulate investment exclusions or memorialise universal ownership principles and it would not be incumbent on trustees or their directors to change any such provisions on the ground of 'best financial interests' or for any other reason.

It might now help to explain dispersion across super funds in climate-related and other RI activities.

4. Climate and investment outcomes

The financial impact of climate-related investment activities is a central consideration. Financial and climate considerations are fully aligned where an activity either enhances returns and/or mitigates investment risk. As discussed in Section 3, trustees are obligated to take climate risks and opportunities into account where this is the case. However, whether and how climate-related investment activities could have significant impacts on *expected* investment outcomes is quite unclear and often debatable for reasons we outline in this section. Our theme is that there are some very significant uncertainties over the relevance of climate change for investing, and that this provides super funds with considerable latitude to incorporate climate impacts as they see fit. This will always be subject to them undertaking a robust and documented process that evidences objectives directed at member best financial interests.

We do not dispute that the effects of climate change and measures to further the energy transition have the potential to impact on portfolio outcomes, and that some impacts could be highly significant. We also have no argument with the notion that climate change might manifest in substantial economic losses, and that the impacts could be non-linear in nature[32]. The energy transition involves transforming economies in ways that could result in stranded assets, substantial costs and significant investment and associated opportunities. While the potential for impacts, costs and opportunities seems clear, how the effects play through into investment returns and risks is complex. Translating through into expected investment outcomes that justify action within a portfolio is far from straightforward, but trustees will always be judged *ex ante* and not *ex post*. If they have done their homework and documented their reasons for making decisions that are objectively reasonable at the time, they should not be found to have breached their duties based on what happens in the future. A more detailed exploration of these, essentially legal, issues is outside the scope of this paper.

4.1. Uncertainty is rife over implications for investment outcomes

Many uncertainties exist over the extent to which climate change and/or investing for the energy transition could impact on *expected* investment outcomes. We initially highlight some of the key uncertainties, before moving onto the implications in Section 4.2.

4.1.1. Extent to which climate impacts are 'priced'

The extent to which climate-related impacts are already priced by markets is pivotal. If climate impacts are not fully priced, then it makes sense to avoid exposed assets and favour assets that

[32] For instance, see Kemp, L. and others (2022), "Climate Endgame: Exploring catastrophic climate change scenarios", *Proceedings of the National Academy of Sciences*, 119(34), e2108146119.

might benefit from the energy transition, at least until markets adjust. If climate impacts are priced, then exposed assets might offer a risk premium and higher expected returns and non-exposed assets the reverse, which Pastor, Stambaugh and Taylor (2024) call a 'greenium'. Funds could then face into potential financial underperformance by avoiding exposed assets and favouring low-emission assets[33] relative to common return-based benchmarks, including CPI-plus objectives, the YFYS test and peer-relative comparisons. However, evidence on whether carbon impacts are currently priced is quite mixed (a brief overview appears in Section 3 of Pastor, Stambaugh and Taylor, 2024). Our own sense is that climate impacts are sometimes priced (e.g. coal stocks) and at other times are not, and that the degree of pricing could change over time[34]. This is hardly surprising given that the future impacts of climate change are not discernible from any prior events during the Anthropocene era and are largely dependent on scientific models and the degree and pace of future emissions, among other things.

4.1.2. Mitigating risk is not straightforward

Climate change gives rise to the potential for significant risks for individual assets and economies at large. More extreme impacts could include unprecedented levels of global dysfunction. Potential exists for meaningful impacts on asset values, cash flows, economic activity, wealth and inflation. Channels include physical damage, higher input costs, the burden of funding the energy transition, stranded assets, and more.

However, identifying and modelling climate risk is difficult and currently underdeveloped. It is hard to gauge where impacts will be felt (and not yet priced), especially given uncertainty over the trajectory of climate change and the energy transition (discussed below) and the need for complex modelling. Scenario analysis may be informative[35] but can be difficult to implement in portfolios to the extent that scenarios are never certain and usually suggest differing actions.

Even if risks could be effectively identified and modelled, how they might be managed within portfolios is far from straightforward. Investors face into multiple scenarios and potential events, some of which are low probability but high impact in nature (e.g. physical damage), which can be difficult to hedge beyond merely diversifying. A central issue is that risk is multi-faceted. Super funds might care about a range of risks, including broader portfolio losses, YFYS test tracking error (see Section 5.1) and risk of them underperforming peers (see Section 5.2). Reputational risk might also come into play. A further complicating issue is whether focusing on mitigation of climate change or adaptation to the impacts is better from the perspective of maximising investment outcomes, as the strategies required can differ significantly.

Another issue is the extent to which it is appropriate to sacrifice returns in order to mitigate risk. Balancing between risk and return can be a delicate exercise. For instance, accepting lower returns to insure against a particular risk can lead to a greater probability of lower wealth accumulation over the long run and perhaps underperformance over the shorter run, and yet only pays off if the risk comes to fruition[36].

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[33] A further issue is whether any greenium arises from investor preferences or is associated with potential climate-related impacts (e.g. stranded asset or physical damage risk), noting that in the former case exposed stocks could offer attractive-risk adjusted returns against common performance measure.

[34] For example, renewable energy stocks were afforded a price premium some years ago, but this has since disappeared and appears to have turned into a discount following the election of Donald Trump.

[35] For example, see "No Time To Lose: New Scenario Narratives for Action on Climate Change", University of Exeter and USS, September 2023.

[36] The YFYS performance test implies that underperformance of 50 basis points per annum is the threshold tolerance level in terms of accepting lower returns in exchange for management of risk.

4.1.3. Sometimes it is better to run towards danger

There are two ways of approaching exposure to climate impacts. One strategy is to limit or avoid exposure, e.g. excluding high emitters. Another is to invest in exposed assets such as high emitters where they are cheap and have potential to transition their business, and then advocate for change. While exclusionary screening tends to manage risk, 'invest and engage' strategies offer the possibility of generating higher returns (while aiding the energy transition) by securing a value uplift through business enhancement or risk reduction. The question here is whether super funds have the track record, skills and capacity to make meaningful change via stewardship. As considered in Section 2 we found it difficult to identify the impact of stewardship activities undertaken by super funds.

4.1.4. Investing in the energy transition does not guarantee an adequate return

The fact that the energy transition presents an opportunity to deploy significant assets[37] is not enough. Investments also need to be value-accretive or at least risk absorbing. Whether this is generally the case is unclear. Key issues include whether market structures (e.g. degree of competition) support high returns on an investment, technological risks[38] and potential policy developments (which could be either beneficial or detrimental i.e. 'transition risks'). Availability of attractive climate-related investments at a reasonable entry price might be limited if the market for opportunities is competitive such that excess returns tend to be quickly bid away. Whether there exist sufficient *clearly attractive* opportunities in which to invest at meaningful scale is debatable.

Having said that, the renewable energy market, including in Australia, is rapidly evolving. Even in the space of months, things can change dramatically. For example, since the introduction of the government's Cheaper Home Batteries Scheme on 1 July this year, more than 1,000 new home solar installations have been carried out every single business day, totalling more than 72,000 installations equating to more than 1GWh of new renewable energy storage capacity by late September 2025[39]. For context, the new **Waratah Super Battery in NSW[40]**, currently the largest battery in the world, will have over 1 GWh in storage capacity when fully operational.

This point raises another very topical issue regarding climate-related investment activities and that is the capacity of super funds to keep up with the scientific, technological and financial issues involved. This is probably outside the scope of this paper, but it is nonetheless a significant challenge.

4.1.5. Uncertainty over future trajectories

Investing to avoid the adverse impacts and capture opportunities from climate change is partly a bet on the future trajectory of the climate itself and the shape of the energy transition, both of which are related. There is considerable uncertainty over whether sufficient climate action will occur to limit GHG emissions below critical thresholds, which will partly depend on aspects such

[37] For instance, the United Nations has suggested that US$4 trillion per annum needs to be invested in the energy transition by 2030.
[38] Under fast-moving technologies, there is a risk (transition risk) that current technology might prove redundant or high-cost (e.g. cost of renewal generation and battery storage have been falling), which can create an incentive to hold back from investing.
[39] Renew Economy – 2 October 2025.
[40] Reported as costing around $1.1 billion to build – NBN News Central Coast, NSW.

as how technology and policy evolve over time. It is also unclear where the critical thresholds sit, above which the adverse impacts might become extreme.

4.1.6. Timing of payoffs

A final consideration is when returns to investment will accrue. As discussed in Section 3.2, shorter-term returns are not necessarily irrelevant given the differing time horizons of members and the presence of shorter-term investment objectives related to the YFYS test and peer comparisons. The time horizon over which returns accrue adds uncertainty around investment outcomes in two ways. First, it is uncertain if and when markets will price climate-related impacts. Markets can at times discount far into the future. For example, low valuations are being placed on coal stocks despite high current profitability; while the premium paid for some technology stocks based on their long-term growth potential is another example of markets taking a long view. At other times, markets can remain largely concerned with shorter-term developments such as near-term earnings, reacting to changes only when they become apparent. For instance, a 'Minsky moment' with respect to climate risk[41] might arrive at any time, or perhaps not at all.

4.2. Uncertainty prevails … so what?

The implication of the investment uncertainties highlighted in Section 4.1 is that the financial relevance of climate-related investment activities can often be quite hard to pin down. A pessimistic interpretation is that the risk-return incentives to invest in response to threats and opportunities related to climate change and the energy transition do not seem sufficiently compelling to drive *large* allocations of capital. This interpretation could abet ongoing low levels of activity around climate change by super funds. The more optimistic interpretation is that high uncertainty provides considerable scope for super funds to adopt the position that more directly pursuing climate-related investment activities will enhance investment outcomes, which in turn might be difficult to refute. Indeed, during feedback on an earlier draft, some senior super fund investment operatives expressed the view that climate impacts were not fully priced. This might broadly help to reconcile our casual observations of a divergence in climate-based investment activities being undertaken by super funds.

The bottom line is that high uncertainty provides super funds with scope to undertake and justify a wide range of actions around climate from the perspective of expected investment outcomes. In short, it is possible for super funds to craft an investment case as they wish, at least within the constraints of their investment processes. Against this background, it seems more likely that the other considerations such as internal ideologies and beliefs (recognised but not discussed in this paper) along with factors that constrain the degree of activity (as discussed in the sections below) might take on more importance.

5. Performance assessment

We initially consider the impact of performance assessments faced by super funds from the perspective of 'official' performance testing including the YFYS test[42] and the APRA Comprehensive Product Performance Package[43] (CPPP), then discuss the potential influence of peer group comparisons. Our broad conclusion is that these forms of performance assessment can significantly

[41] See Kaldorf, M. and Rottner M. (2025), "Climate Minsky moments and endogenous financial crises", *Bank of International Settlements*, BIS Working Papers, No. 1248 (March).
[42] Treasury's 2024 consultation paper provides a good overview of the issues faced by the YFYS performance test.
[43] See Superannuation-product-performance website, which supersedes the APRA Heatmaps.

constrain the scale and scope of climate-related investment activities undertaken by super funds. We also note that they serve to shorten time horizons to the extent that regular performance assessment creates a concern with the return pathway. While 10-year performance might be the period measured under the YFYS test, 1-3-year relative performance attracts significant media attention and might influence super fund investment behaviour.

5.1. YFYS test and APRA CPPP

Both of these forms of 'official' performance assessment are undertaken by APRA, and occur as follows:

- **YFYS test** – Established in 2020, the test was initially applied to MySuper and subsequently extended to trustee-directed choice options (e.g. conservative, balanced and growth funds)[44]. The YFYS test compares performance against a set of benchmarks matched to a fund's strategic asset allocation (SAA). Upon failure, a prescribed letter must be sent to affected members stating that the fund has underperformed and that members should consider other funds. If failure occurs for a second consecutive year, no new members can be accepted until the YFYS test has been passed.
- **APRA's CPPP** – This is a multi-metric approach to assessing investment performance and fees. Results are published, but there are no enforceable outcomes if results are poor. However, APRA may engage directly with funds to discuss results.

Of the two, the YFYS test is of greatest consequence as failure can have existential consequences. The impact of failure is also magnified via adverse media coverage. Funds have a strong incentive to avoid failing the YFYS test as a first priority, resulting in it becoming a significant constraint on their investing activities. Constraints include avoiding investments with a significant probability of underperforming the YFYS benchmark (especially where the fund has a limited 'buffer' around YFYS test failure for the near-term), and managing YFYS tracking error to ensure it remains within tolerable levels.

The implication is that super funds have little incentive to pursue screens, thematic investing or impact investments that give rise to significant risk of failing the YFYS test. For example, excluding BHP or all carbon producers from an Australian equities portfolio would be difficult, while thematic investing could give rise to YFYS tracking error if done at scale. Impact investments may be unattractive due to a combination of the threat of J-curve effects and limited YFYS buffer.

5.2. Case study: Impact of YFYS test

We summarise Conexus Institute analysis[45] of the potential impact of YFYS tracking error as a significant (and quite visible) constraint on climate-related investment activities. Our research suggests that 1% is an appropriately conservative level of YFYS tracking error for super funds to have a high degree of confidence of not running into any adverse challenges from the YFYS test. We explored the YFYS tracking error impact of different portfolio implementations against the 1% tracking error guideline in collaboration with FTSE Russell[46]. The estimation incorporates formal calculations for public markets by leveraging FTSE Russell data and calculation engines, along with experience-based estimates for unlisted assets and correlation assumptions. Results are summarised in Figure 3. Red font indicates a breach of the 1% limit, while green font indicates remaining within.

[44] The YFYS test was initially to seven year rolling performance, and has been extended out to 10 years.
[45] The Conexus Institute: *Your Future Your Super Performance Test: Constraints and Sustainable Tracking Error*
[46] The Conexus Institute and FTSE Russell: *Your Future, Your Super Performance Test: Constraint on ESG, Sustainability and Carbon Transition Activities*

Figure 3: Estimated YFYS test tracking error for climate and sustainability implementations

	Implementation #1: Responsible investing growth option	Implementation #2: Carbon transition aligned portfolio	Implementation #3: MySuper Option
Description	Applies RIAA certification standards to a "70/30" public market portfolio SR activities implemented via equities	Applies Paris-aligned benchmarks to a "70/30" public market portfolio, with climate activities implemented via equities FTSE Russell - developed low-carbon proxy is used for Australian stocks	Passive public market exposures without screens, but stewardship activities Exposures to unlisted "green" assets in sustainability and energy transition: • 1% targeted exposure to unlisted "green" equity assets, implemented over the course of 1-year • 3% targeted exposure to unlisted "green" equity infrastructure, implemented over 3-years (1% pa)
Estimated YFYS tracking error	**1.5% pa**	**1.8% pa**	**Peaks at 0.5% pa**

Implementations #1 and #2 both rely on exclusionary screens and lead to YFYS tracking errors of 1.5% and 1.8% respectively, well exceeding the 1% guideline for a conservative YFYS tracking error. We found that YFYS tracking error in Australian equities is roughly 3–4x higher than that of global shares due to significantly different sector mixes. Unlisted "green" investments coupled with stewardship activities in listed markets generates a more palatable YFYS tracking error of 0.5%. Indeed, one takeaway is that the YFYS test is accommodative of stewardship activities as they do not generate YFYS tracking error.

The research exposes the importance of the YFYS index benchmarks, which establish the starting point for portfolio activity within asset classes from which any deviation incurs tracking error. Exclusionary screens, in particular within Australian equities, generate YFYS tracking error and hence financial risk for super funds under current settings. In effect, the YFYS benchmarks tend to direct where super funds invest, and sit at the heart of constraining the ability of super funds to support addressing climate change.

5.3. Peer group effects

Sizable peer group effects exist in the super industry. Performance comparisons versus peers attract attention from boards, media, regulators, advisers, and some members. Relative performance can also be of concern to investment teams as it can impact on personal incentives (remuneration and career prospects) as well as personal pride. Relative performance can matter in areas such as advertising, fund ratings and the review of employer and award arrangements. AustralianSuper lists peer-relative performance as one of its investment objectives[47].

Peer comparison can motivate herding effects, most notably in asset allocation but also at the level of selection of individual investments. The main implication is that super funds face an incentive not to drift too far from peers in pursuing climate-related investment activities. This tends to generate anchoring around existing industry practice, which inhibits the pace of adjustment towards

[47] See the investment objective disclosure under the various investment options detailed in the AustralianSuper PDS.

incorporating climate considerations into portfolios where it requires breaking from peers. Peer group effects combine with the YFYS test to significantly constrain super fund investment behaviour.

6. Policy and regulations

Figure 4 highlights four policy and regulatory measures that might impact on climate-related investment activity by super funds. Of these four, we consider APRA guidance under CPG 229 and the forthcoming climate disclosure regime to be of most consequence, as they are likely to place pressure on super funds to focus on climate considerations and potentially take action.

We view APRA guidance under SPG 530 as having limited impact beyond CPG 229. With regard to greenwashing, we view it as largely a matter of poor disclosure arising from governance failures (to honour undertakings made to members) than directly a climate-related enforcement action. Further, the impact on climate-related investment activities is unclear. On one hand, addressing greenwashing can have the effect of removing unhelpful activities that are virtue signalling rather than genuine climate action. On the other hand, we are aware of some general caution-based retraction in climate commitments to reduce the risk of greenwashing enforcement.

Figure 4: Climate-focused policy and regulatory measures impacting on super funds

Setting	Description	Impact on fund activity
1. APRA – CPG 229 – Climate change financial risks[48] (2021)	• Applies to all APRA-regulated entities • Frames climate risk into three categories of physical risk, transition risk, and liability risk • Directs institutions to take a strategic and risk-based approach to the management of the various risks and opportunities arising from climate change, recognising the unique nature and far-reaching potential impacts of a changing climate • Institutions required to understand the interaction between climate risks and their business activities, including the compounding effect climate risks may have on other risks • Funds should consider climate risks in their scenario analysis	*Limited* Directly places an obligation on trustees to consider climate impacts and take them into account in portfolio construction. Formalises the potential relevance of climate for investment outcomes. CPG 229 will influence processes in a manner that aligns with integration of climate considerations into broader investment considerations, thus reinforcing existing trustee obligations. Nevertheless, it seems unlikely to have a direct impact on investment activity.
2. SPG 530 – Investment Governance[49] (Updated 2023)	• Promotes incorporation of climate and ESG risk considerations into investment governance practices including investment philosophy formation, investment decision making, and risk management.	*Quite limited* No significant impact beyond that of CPG 229, as it similarly directs super funds towards an integration approach. Unlikely to have a direct impact on investment activity.

[48] See *APRA CPG 229 Climate Change Financial Risks*
[49] See *APRA SPG 530 Investment Governance*

3. Mandatory climate-related financial disclosures[50] (scheduled to take effect FY27)	• Climate-related financial disclosures have been mandated through amendments to the Corporations Act 2001 (Cth) (Corporations Act) and related legislation. • Climate-related financial disclosures are required covering an entity's climate-related risks and opportunities, as per Australian climate disclosure standards, including information on: - Governance, strategy, risk management, and metrics and targets, including Scope 1 and Scope 2 GHG emissions, are required from first year of reporting - Scope 3 emissions are required from second year of reporting with limitations	*Moderate* Disclosing climate-related exposures can have an impact through creating public pressure for action, or perhaps more correctly, being seen to be taking action. Potential for moderate impacts, but will not take effect for a few years. Measurement needs to be accompanied by consequences to have a significant impact, but there is a lack of formal sanctions. It is possible that disclosure could evoke some public (social) pressure. Unlikely to have a direct impact on investment activity. Public/media scrutiny might lead to some divestments.
4. Greenwashing action	• ASIC has taken actions over greenwashing by a number of providers including Mercer Super, Active Super, and Vanguard Super. Total penalties were $34.7m. • Essence of the cases is failure to behave consistently with product disclosures by holding assets inconsistent with stated exclusionary screens. • The implication that internal governance processes need to be improved. • Addressing greenwashing removes activities that are virtue signalling rather than genuine climate action.	*Limited* Core issue is failure to honour undertakings made to members, rather than a climate-related matter *per se*. Should have the effect of removing unhelpful activities that are virtue signalling, but is resulting in some caution-based retraction in climate commitments. Impact on investment activities is unclear. Unlikely to have much influence on genuine climate-related investment activity.

7. Business considerations

In this section we discuss three possible influences within an organisational context under the heading of 'business considerations'. The impacts are potentially mixed, but overall suggest that the context under which a super fund operates could either support or inhibit climate-related investment activities.

7.1. Commercial opportunity

The commercial opportunity relates to the possibility that climate-related investment activities could help attract or retain members, leading to increased inflows and greater assets under management.

At an initial glance, the commercial opportunities currently seem quite limited. The small amount invested in dedicated RI options as outlined in Section 2 suggests that comparatively few members switch funds in support of sustainability issues, including climate. This could be due to

[50] Overview: *Treasury - Mandatory climate-related financial disclosures*

members not caring about these issues, not having sufficient motivation to act on concerns if they exist or not being aware that there are other options. Further reinforcement that the business opportunity is currently limited at best is that *competitive* flows were negative in FY 2024 for super funds marketing themselves as sustainable, including net flows of -$151 million for Future Super and -$6 million for Australian Ethical[51]. Meanwhile, there are limited signs of significant outflows being motivated by climate (and sustainability) considerations.

However, the expressed expectations of the large majority of Australians that their assets will be managed responsibly as outlined in Section 3.3 hints that the limited amount invested in RI options could understate the commercial relevance of RI activities. If members expect their super fund to invest responsibility, funds may face the risk of outflows if it becomes evident that this is not the case. The RIAA survey referred to above found that 76% of respondents said they would consider changing their investment provider if there was a value RI misalignment. Of interest in this regard is that we are not aware of substantial outflows occurring in response to recent greenwashing actions by ASIC against a number of super funds. This casts some doubt over the strength of the potential link between the expressed expectation of many Australians around RI and their willingness to switch funds based on this expectation in practice, particularly given moderate levels of member engagement.

The bottom line is that the commercial opportunity presently seems to create little incentive to undertake RI activities including climate-related investment activity. While we see signs of incorporation of climate-related considerations into investment processes by many funds, we suspect that the absence of any clear commercial opportunity is contributing to limited translation through to portfolios. Of course, this need not remain the case. Incentives may change if there was a major shift in willingness of members to switch funds based on RI considerations. However, it is also the case that there is probably no business disincentive to undertake RI activities including around climate. This provides funds with latitude to pursue such activities i, subject always to the BFID.

7.2. Agency impacts

Investment programs are run by managers who are afforded considerable scope to exercise judgement with respect to incorporation of climate considerations into investment decisions. The importance of judgement is only heightened by climate-related investment outcomes being highly uncertain, as discussed in Section 4. Against this background, the personal beliefs of managers making the decisions can be highly influential. Key decision makers who believe in the importance of addressing climate change will seek out ways to support the cause. Similarly, climate sceptics or those who rank other considerations as more important can easily find ways to de-prioritise climate considerations.

The structure under which investment decisions are being made will have an effect, and appear to vary across the industry. Two key elements include:

- **Responsibility for addressing RI** – One issue is whether RI and climate matters are handled by dedicated RI teams that either sit externally to or alongside portfolio managers, versus whether portfolio managers are directly responsible for integrating RI and climate considerations into investment decisions. This distinction matters as investment staff may have a greater propensity to emphasise investment outcomes[52], while RI teams will be advocating for investment staff to embed RI concerns into portfolios[53]. How this plays out will partly depend

[51] See *State of Super 2025*, Appendix 4

[52] Many investment professionals prefer to focus on asset selection than sustainability considerations, as investing tends to be in their nature.

[53] For an insider account of how views may differ between investment and sustainability teams, see "I'm an ESG insider. Here's the truth behind how it went off the rails", *Australian Financial Review*, 20 February 2025.

on the personalities involved, any beliefs held by investment staff, and the ability of RI teams to influence investment decisions. Various permutations are possible.

- **Incentive structures** – Investment performance dominates incentives through its impact not only on remuneration but also career prospects. Nevertheless, there is also scope to incorporate climate considerations into incentive structures. During feedback, we were made aware of examples of super funds that are progressing towards building carbon reduction targets into balanced scorecards being used to evaluate portfolio managers, and examining ways to impute climate considerations into investment teams incentives. We broadly consider these examples to be coming from climate exemplars and not representative of the majority of super funds.

Our casual observation of the industry suggests that personal beliefs and organisational features are quite influential on how a super fund approaches climate-related investing. We suspect this is a key contributor to the dispersion observed across the industry. Nevertheless, investment performance remains the primary concern, such that the influence of personal and organisational features is constrained by the need to link climate-related investment activity to investment outcomes.

7.3. Reputation

Climate-related investment activities can enhance reputation in some circles. Further, failure to be seen to take climate and sustainability considerations into account might attract criticism[54]. At the extreme, investment behaviour that is deemed to be particularly poor from a societal perspective could lead to a loss of social licence to operate.

On the other hand, more recently there has been push-back on taking climate and sustainability considerations into account, in part motivated by the election of Donald Trump. We have seen the retreat of many large investment managers from global climate change initiatives. Also noteworthy is CPPIB removing its carbon reduction target, albeit due to concern over avoiding the risk of being subject to greenwashing claims rather than necessarily a reduction in commitment. Nevertheless, these developments hint that some major players identify a more difficult trade-off between reputational benefits and reputational risks in being seen to take the lead on climate and the energy transition.

The situation raises question marks over the reputational impacts of climate-related investment activities, which muddies the waters considerably. In any event, potential reputational impacts are likely to be second order relative to investment performance considerations.

8. What might impact the prioritisation of climate

This section explores what developments could change the scope of climate-related investment activity being undertaken by super funds. We discuss five types of developments, with the first requiring government financial participation, three involving policy reform and the fifth entailing other developments such as a significant shift in. We finish this section with a comment on how large a shift in super fund portfolios might occur. We do not enter into the debate over whether a shift in super fund behaviour on climate-related issues is desirable.

Overall, it will probably require a combination of developments for super funds to ramp up their climate-related investment activities significantly. Particularly influential could be a suite of policy measures that is combined with a shift in community expectations that result in many members

[54] For example, AustralianSuper recently attracted criticism over its investment into Whitehaven Coal.

insisting their fund take strong action over climate coupled with a willingness to redirect their assets accordingly.

8.1. Make climate-linked investment opportunities more attractive

A system operating under a strong financial outcomes mindset, entrenched by BFID, will naturally respond to changes in the investment return opportunity set. The Government could provide financial support that either boosts expected return or helps mitigate investment risk for super funds on climate-related investments. Possibilities include subsidies, funding support for projects to help underpin returns (e.g. co-funding on concessionary terms; loan guarantees) and risk participation (e.g. underwriting of development costs; minimum volume or pricing guarantees). ASFA[55] suggests a range of measures the governments might take to improve the financial attractiveness for super funds of climate transition investments.

Policies of this nature would have instant impact, the extent of which would depend on the degree to which any specific changes help more climate-linked investment opportunities reach a threshold level of attractiveness. Existing constraints as discussed previously would continue to impact, unless they were addressed.

Government financial support may attract super fund capital but may also attract other pools of capital such as global asset owners, unless such support was designed in a specifically targeted manner.

8.2. Clearer alignment between financial and climate considerations

Greater alignment would be delivered if funds perceived investing to address climate as more likely to enhance financial outcomes. A number of policy actions could be taken that might enhance alignment, including the following:

- **Universal ownership** – Super funds could be encouraged to adopt universal ownership by providing some form of legal safe harbour for them to do so, e.g. legislation that explicitly permits super funds to consider broader benefits for the economy and hence overall portfolio returns under BFID.
- **Imputed carbon price** – Super funds could be required to estimate the GHG emissions being generated by their investments and then incorporate this into the valuation of assets and estimation of expected returns, thus providing not only safe-harbour to consider the externalities associated with emissions but also creating an obligation to take them into account. One issue with this approach is that it requires in-depth modelling and application of discounted cash flow techniques, which may not accord with many investment processes. In "A mandatory value of emissions reduction framework for super", Jeremy Cooper explores incorporating an imputed carbon price into the investment decision-making framework. Cooper proposes a mandatory VER (value of emissions reductions) framework for super funds which would impose a method of investment analysis that adds a notional surcharge equal to the estimated present value of future CO_2e emissions to proposed (or existing) investments.
- **Carbon pricing mechanism** – While not currently on the agenda and politically fraught, a carbon pricing mechanism would directly connect financial and climate considerations by incorporating the social cost of GHG emissions into asset cash flows. A key issue with this approach being implemented in Australia is that it would only apply to investments domiciled in Australia and hence would not cover significant parts of super fund portfolios. It is also a

[55] ASFA Discussion Paper: Towards an Energy Transition Accord (November 2024)

broader policy issue with a range of impacts and challenges that extend well beyond the super sector.

- **Refinement and calibration of existing policies and frameworks that impute a carbon price** – This includes the Safeguard Mechanism, fuel efficiency standards, diesel fuel rebate, and the Capacity Investment Scheme.

Most of the above measures would be highly contentious, politically challenged and difficult to implement.

8.3. Mandated measures

Super funds could be directed to invest in a certain way to address climate change. One possibility would be to impose hard targets for reduction of portfolio GHG footprints. Another possibility – and one we would not endorse – would be to direct funds to make or exclude certain investments. For example, funds might be required to allocate a percentage of the portfolio toward climate-related impact investing, or all YFYS test benchmarks may be shifted to indices that align with climate change considerations. Mandated measures would be difficult to secure due to conflicts with BFID, the likelihood of being heavily contested politically and difficulties in implementation, measurement and monitoring (especially for SMSFs, if extended that far).

8.4. Provide super funds with more room to pursue climate-related investments

Modifying the YFYS test could provide super funds with more room to pursue climate-related investment activities. The objective would be to address the tracking error that is created by such activities, and hence limit concerns that climate-related investments might result in failure of the YFYS test. Another might be policy change that dilutes the primacy of BFID in relation to climate-related investing activities.

8.4.1. Modifying the YFYS test

Modification of the YFYS test could take either of two directions:

(a) *Broader reform of the YFYS test* – The Treasury YFYS test consultation has raised broader reforms and The Conexus Institute (among others) has proposed a multi-metric approach[56]. This may facilitate transitioning away from emphasis on the index-based benchmarks that are pivotal to generating a YFYS tracking error mindset. In particular, metrics that evaluate total fund performance are less concerned with the source of returns[57]. Our assessment is that this would create a fairer assessment of outcomes and provide more latitude to pursue climate-related investment activities, but might still leave an unstable environment for funds as BFID and peer considerations would remain.

(b) *Modifying the index benchmarks* – This would involve expanding the index menu to incorporate sustainable indices, potentially climate-based. One approach would be to permit funds to elect RI or climate-based index benchmark for an investment option, selected from a defined menu of indices. Another would be to replace the existing indices with RI or climate-based indices, at least in RI or climate-based and possibly mainstream investment options.[58]

[56] The Conexus Institute Submission - Annual superannuation performance test – design options.
[57] We outline this case for refocusing the YFYS test around total returns in an Investment Magazine article titled *It's time to end the tyranny of YFYS benchmarks* (12 September 2025).
[58] Imposing SRI or climate-based benchmarks on mainstream investment options would be highly controversial and politically contested.

Two aspects require careful consideration. First is the policy aim regarding the super products and activities to be facilitated, which could include:

- Supporting existing RI investment options by limiting the potential for YFYS test failure arising from benchmarking rather than performance issues;
- Expanding the availability of RI or climate-focused investment options by making them easier for funds to offer without running the risk of YFYS-test failure; or,
- More broadly supporting RI or climate-related investment activities by specifying or permitting the use of RI or climate-based benchmarks for mainstream options, noting that this is where most of the capital resides.

A second consideration is whether any benchmark changes are introduced retrospectively or on a forward-looking basis only[59]. A central issue is that any index choice would effectively anoint certain activities as desirable or undesirable, and hence is laden with values-judgement. The policy challenge in introducing alternative RI or climate-based benchmarks is quite nuanced.

Of the two approaches, modifying the YFYS test would relieve most of the YFYS-imposed constraints on RI activities, at least as an initial step before considering other reforms. This conclusion aligns with the Government's announcement of a review of the test motivated in part by ensuring that there are "no unnecessary obstacles or impediments" for investing in areas of national interest.

While our analysis suggests that the YFYS test is a key constraint, we wonder if it is also sometimes used as an excuse not to undertake sizable climate activities by some super funds. If so, adjusting the test could have limited impact. Consider a scenario where the YFYS test did not exist:

- BFID would continue to provide market-based discipline that requires opportunities be financially attractive in expectation.
- Peer group effects would continue to constrain funds from looking too different from each other. Although this has most relevance to MySuper and mainstream diversified options, but less for standalone RI options where members have made an explicit choice.
- The propensity of members to invest in RI options and agitate for super funds to invest in a sustainable manner would need to level up to have an influence (see Section 8.5).
- Financially motivated agency effects would remain impactful. For instance, we believe that fund performance would persist as the most prominent driver of incentives under existing settings.

8.4.2. Adjusting the primacy of BFID

A loosening of BFID could provide super funds with more scope to pursue climate-related investment activities[60]. One idea would be to provide an exemption from BFID with respect to climate-related investments[61]. Another might be to amend Section 52(2) of the SIS Act to include an explicit climate-related risk covenant. Policy changes of this type would be politically contested, while exemptions to BFID could prove problematic from an implementation viewpoint. An alternative would be for APRA to amend CPS 220 Risk Management to spell out more clearly the need for super funds to take climate risk into account, as it signalled doing in its 2024-25

[59] For example, if the existing index set is applied to historical performance, then some RI options may have large underperformance locked in.

[60] The idea of permitting or requiring super funds to incorporate universal ownership principles as discussed in Section 8.1 would be of this nature, but is not necessarily inconsistent with BFID.

[61] A more aggressive measure would be to permit trustees to incorporate social benefit and costs into investment decisions.

Corporate Plan[62]. This would be a significant step as CPS 220 is legally binding, rather than just guidance.

8.5. Other developments that might impact super fund behaviours

In addition to policy changes, a range of other developments could influence how super funds approach climate-related investing. The first two developments would create pressure to ramp up activity through a shift in member expectations and behaviours. The third, where climate risk becomes fully priced, would work in the other direction.

- **Shift in community expectations, especially if they impact fund flows** – A ramping up of community expectations that super funds should be taking positive action to address climate change has the potential to place considerable pressure on trustees to more comprehensively embrace climate-related investment activities. The effect could be marked if members start allocating to RI options at scale, thus sending a strong signal by communicating to super funds that members *really* care about addressing climate change while creating clear business incentives related to attracting and retaining members. For many members this would require caring enough to become more engaged with their super. A shift in community expectations should also have implications for social licence to operate and reputational risk. While such a situation is not currently apparent, it could develop over time or more quickly, perhaps in response to a galvanising climate event (see next dot point).
- **Extreme climate outcomes as a galvanising event** – While climate change seems to be tracking the prediction of scientists, so far this has failed to generate a strong response from the community at large, most politicians, many businesses, investors and financial markets. In part this is because there has been no major climate-related event that has galvanised public opinion or led to a major adjustment in market pricing. Nevertheless, an abrupt change in public opinion and market pricing structures in response to a climate event cannot be ruled out at some stage (i.e. a 'Minsky moment'). If this were to occur, it is likely that super funds would view it as necessary to respond accordingly by ramping up their climate-related investment activities. An Australian example could be a catastrophic bushfire season that affected principally urban areas.
- **Climate considerations clearly becoming fully priced** – Climate considerations becoming clearly fully priced by markets would establish the existence of a 'greenium' whereby investments exposed to climate change trade at a discount and offer relatively high rates of return. Meanwhile, investments that benefit from energy transition might trade at a premium and thus offer lower rates of return, although this would be contingent on whether and how significant energy transition occurs. In this situation, the financial incentives to limit exposure to climate-related risk or invest in support of the energy transition could disappear, or possibly even reverse in direction to become a disincentive[63]. The result could be a lessening of climate-driven investment activities by super funds. This line of thinking discounts the possibility that climate change creates such a level of social and economic upheaval that an orderly repricing of financial assets becomes highly unlikely.

8.6. Realistic estimate of potential climate-related investment activities

If super funds were provided both the incentives and a clearer pathway to focus more on climate-related investment activities, to what degree might the scope of activities evolve? This is

[62] APRA Corporate Plan 2024-25.
[63] Perversely, this situation could emerge as a result of climate event that galvanises public opinion and shifts market pricing, placing investing and climate considerations somewhat at odds.

important to consider given the various costs associated with policy reform. We consider this question through the two main forms of climate-related investment activities:

- **Capital allocated to targeted climate-related investments** – Policy action to support climate-related investments may result in greater exposure to private asset opportunities (noting that public market allocations are largely driven by index weightings, even in the absence of a benchmark-based YFYS test). Allocations would mainly be boosted for non-platform super funds[64], and would be governed by liquidity budgets (most funds keep illiquid exposure to unlisted assets to below 30%). The rate of fund growth would influence the ability for funds to re-balance their private asset portfolios. If climate assets were attractive investments, then it would not be unreasonable to see them become a 3% - 5% component of portfolios over time, akin to a major infrastructure sector.
- **Climate integration and stewardship activities** – Policy activities would not directly impact the ability to undertake these activities, but may result in more consistency in adoption and practice across super funds. This would likely have more impact on domestic companies rather than global companies as policy settings would become clearer and the market footprint of super funds is large in an Australian setting.

What about the impact of a sizable change in member preferences, resulting in a sizable (given member inertia we consider 5% - 10% plausible) degree of member switching into dedicated SRI options? In Section 2 our assessment was that these investment options might undertake a higher degree of targeted climate investments, but the degree was modest. Member switching activity may have a larger second order impact on funds to both uplift and demonstrate the effectiveness of their targeted climate investing and their RI activities.

9. Closing comments

Our exploration of climate-related investment activity by Australian super funds comes up with mixed messages. The somewhat limited scope of climate-related investment being undertaken by the super industry and the dispersion across funds seem explainable by the circumstances in which funds operate. Super funds face some significant constraints in the extent to which they are incentivised and able to undertake targeted climate-related investments. Important influences include the primacy of investment outcomes under BFID, the YFYS performance test and peer comparisons, and an absence of any clear business incentives to pursue climate-related investment activities at scale. These influences combine with room to interpret the 'mandate' and uncertainty over returns from climate-related investing to provide super funds with considerable latitude to decide the extent to which they pursue climate-related investments. The consequence is dispersion across funds and limited climate-related investment in aggregate.

Nevertheless, super funds are not ignoring the issue of climate change. The majority of funds recognise that climate can have return impacts, and accordingly have integrated climate considerations into their investment processes. We also see funds undertaking stewardship and related activities, such as membership of climate-related investor groups. These activities are undertaken to varying degrees, and their impact on the management of investment portfolios is difficult to gauge. Overall we view these activities as constructive towards addressing corporate activities that may contribute to climate change. The degree of the impact is nearly impossible to estimate (and well beyond the scope of this paper), but we suspect it is modest. More poignantly,

[64] Private assets are more difficult to accommodate on platforms due to a larger requirement for ready access and hence liquidity.

this activity does not seem to have any significant influence on the shape of super fund portfolios including investment in the energy transition.

The situation could change. However, this would require either significant policy change – which would be difficult to secure and highly contested – and/or a major shift in community expectations around the imperative of addressing climate change, ideally coupled with members showing much greater willingness to direct where their savings are invested. Indeed, we suspect that a combination of developments is required to have significant impact, including multiple policy changes in concert. Isolated policy changes such as tinkering with the YFYS test benchmarks seem likely to have only marginal effects.

Perhaps the best chance for a major shift would be a galvanising climate event that shifts the dialogue on the need to address climate change and manifests into a 'climate Minsky moment' within financial markets. This would provide governments with the political capital to take aggressive policy action, and place strong pressure on asset owners including super funds to respond. It is anybody's guess as to if and when such a development might occur.

Unless something significant changes, we expect more of the same from the super industry, perhaps with some modest expansion in targeted climate-related investment activities.