Equity Trustees

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RESPONSIBLE INVESTMENT

Developments to Watch in 2024

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The landscape for responsible investment is constantly developing and following strong momentum over the last few years, regulation is expected to catch up in 2024. Below we have outlined key regulation and policy developments relating to climate change and the responsible use of artificial intelligence and what they mean for listed companies.

1. Mandatory Sustainability Reporting

Climate change will again be in focus this year as global climate-related regulation accelerates. The Australian Government has released draft legislation on mandatory climate related financial disclosures with the objective of providing investors with more transparency and comparable information about a company's exposure to climate-related financial risks and opportunities and how they are being managed. The final rules will be aligned with global standards and are expected to be released in the coming months, phased in across three groups (according to company size) over 4 years starting in July 2024.

Some of the key disclosure requirements include reporting on scope 1, 2 and 3 emissions and reduction targets, executive remuneration linked to climate, climate resilience assessments, details on decarbonisation capex, internal carbon pricing and the use of carbon offsets.

Implications:

Having more insight into a the way a company is decarbonising, how executives are incentivised to do so and the spend required are useful data points to help better understand the extent to which a company is managing climate related risks, and its ability to comply with current (such as the safeguard mechanism) and developing (discussed below) climate regulation. Overall, we see the ability to transparently view climate related data as a positive step forward which will help drive future engagement discussions and allow for deeper comparison of performance across companies and sectors.

2. Introduction of an Australian Climate Border Adjustment Mechanism (CBAM)

The Australian Government has announced a review into the feasibility of an Australian CBAM policy with the findings expected to be released in September 2024. A CBAM is effectively a carbon tax on imports, aimed at protecting domestic industries by preventing 'carbon leakage' which occurs when carbon-intensive production is moved to low cost countries with weaker carbon reduction policies.

The review follows Europe's lead where a transitional phase of the EU CBAM started in 2023 and is expected to be fully phased in by 2026. The US have also introduced a CBAM policy, and if passed will start in 2025 and will be a potential catalyst for other countries to follow.

Implications:

The introduction of a CBAM in Australia will have implications on the most emissions-intensive industries. Although it is designed to shield these industries, it also has the potential to expose them to higher input costs (if importing emissions intensive products) and increased competitive pressures which could result in an acceleration of green capex investment.

It is still very early days and the development and implementation of a CBAM in Australia will take time, however the outcome of the feasibility review and developments in this space will be interesting to watch over the coming months and years.

3. Artificial Intelligence (AI) Regulation is on the Way

The launch of ChatGPT has led to heightened investor attention on generative AI over the last year and pushed AI regulation into the spotlight for governments around the world. In Australia we do not currently have any specific regulation, however it is on the cards as per the recent announcement of the creation of an AI expert group to advise Government and help ensure the development and deployment of AI is done safely and responsibly.

Implications:

It is still unclear when AI regulation will be finalised and come into force, however we are already seeing a number of ASX companies report their use of AI in their operations, highlighting benefits such as enhanced productivity, improved efficiency and reduced costs. The use of AI can also have a negative impact on ESG performance in areas such as social licence, trust, and data privacy and security if not adopted responsibly. It will be increasingly important for users to design responsible AI frameworks and governance practices to guard against some of these impacts and future regulatory changes.

The CSIRO have partnered with Alphinity Investment Management (one of the invetsment manger's in the EQT Responsible Investment Global Share Fund) to design a framework to help investors assess responsible AI through an ESG lens and we look forward to the release of this tool later in the year.

Equity Trustees Asset Management have a strong belief that ESG factors have the potential to impact the performance of a business over the longer term, and companies managing it well prove to have more sustainable and robust busines franchises. Our objective is to better understand how the issues above evolve, and how they will impact on the companies we invest in and are key topics which will shape our engaments discussons companies this year.

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