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Climate Disclosure Unit
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Via email: climatereportingconsultation@treasury.gov.au

Climate-related financial disclosure – Second consultation paper

The Financial Services Council (FSC) welcomes this second Treasury consultation paper on implementing a climate-related financial disclosure regime for Australia. Investors have been eager supporters of greater domestic availability and consistency in climate-related financial disclosures, and the FSC is broadly supportive of the Treasury proposals outlined in this second consultation paper to achieve this.

We recognise that these proposals are seeking the right balance between the need for greater awareness and transparency with climate risks and opportunities, the fact that many businesses will need to build up their capability, and the current limitations with resourcing and data. The following points summarise our key recommendations and areas where greater clarification is sought:

- It is critical that Treasury clarifies the intended applicability of the regime to asset managers. Asset managers are corporate entities who manage multiple underlying investment schemes (MISs). It is not clear whether the intention is to capture some underlying MISs in addition to asset manager corporate entities, as reporting entities.
- Following on from the above, clarity in the law or standards as to what constitutes scope 3 reporting for asset managers, superannuation trustees and platform providers is also critical to avoid inconsistent reporting practices within these sectors and unintended consequences.
- The liability regime that is attached to sustainability reporting, and scope 3 reporting in particular, should be proportionate to the need for climate-related disclosures to develop over time and to encourage entities to keep building their capacity toward best practice. We submit that the law should explicitly state that reporting is undertaken with the available data at the time, with a comply or explain overlay.
- The regime should allow clearly for Australian subsidiaries of international companies to rely on their group reports to reduce inefficiency and unnecessary cost.

Ultimately, we believe the proposed requirements by Treasury and the consistency it will promote will help lead to more efficient allocation of capital, and we welcome the government moving ahead with implementing its commitment. We look forward to working with the government and the Australian Accounting Standards Board (AASB) on the draft legislation and standards.

1. Reporting entities and phasing

The FSC is supportive of a phased approach for climate-related disclosures, with larger companies reporting first. A phased approach recognises that Australian companies will require time to develop internal capability and expertise and to achieve best practice.

The Treasury thresholds outlined in the paper are reasonable and would lead to broad coverage by 2027-2028. We would welcome government encouraging smaller companies who do not meet the phase 3 threshold, and companies in all phases to undertake early voluntary reporting. Early voluntary reporting will give companies the opportunity to gain experience and refine their internal processes before reporting becomes mandatory. The legislation should support the ability for early voluntary reporting.

We would also welcome greater consideration and clarity on the application of the thresholds and phasing for asset managers given the structure of asset managers and their operations. We submit that consolidated reporting at a group level should be permitted for climate disclosures, in alignment with the International Sustainability Standards Board (ISSB) standards. We understand that the intention is that the reporting obligation is at the corporate entity level, and that entity must make a judgment as to how to report its scope 3 obligations.

With financial reports, each MIS is considered a separate legal entity and requires separate financial reporting to the Responsible Entity. The below diagram demonstrates the different potential reporting entities for financial services firms that may run funds management and superannuation

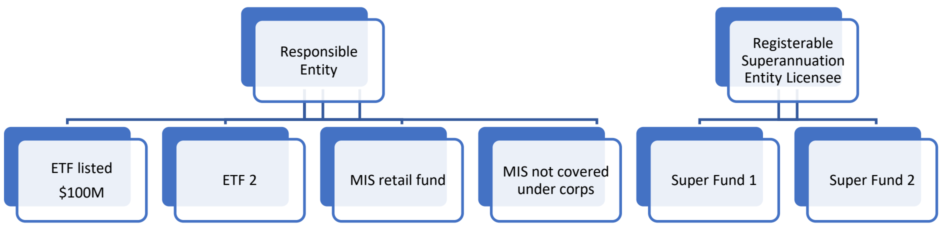

Figure 1: Example of different reporting entities for asset managers and superannuation funds

services. If individual funds are conceived as separate reporting entities, then is possible that under the same Responsible Entity (RE) some individual funds are captured under phase 1 and other funds are captured in subsequent phases (given the characteristics of each fund). This could lead to inefficiencies.

We submit that useful disclosures can be provided by asset managers in an efficient manner by allowing the consolidation of reporting across funds, and where relevant reporting on separate funds can be provided. Guidance could be given by ASIC, APRA or the AASB for disclosures that would be appropriate at the consolidated corporate level and disclosures that would be appropriate at the separate fund level. We provide the following approach as a suggestion for how consolidated and separate fund reporting could occur:

- Certain disclosures could be disclosed at the responsible entity/RSE level with respect for all funds where those disclosures would be consistent across all funds, such as the scenario analysis applied, transition plan, governance, risks and opportunities. This may take the form of booklets in the Annual report.
- Fund level disclosures could focus on portfolio metrics, for example, reporting on the scope 1, and 2 emissions of portfolio companies (see *Part 2 Reporting content* for more detail).

For firms that operate internationally, local non-listed subsidiaries should be able to rely on group reporting that is publicly available. This will limit unnecessary and costly duplication of reporting. We note that the existing regime in Hong Kong and proposals in Singapore allow for this.

For companies who currently voluntarily report and for those who do not, the mandatory reporting regime will be a big step up. We encourage Treasury to consider whether the proposed timing of the three phases (particularly the first phase) will allow for appropriate preparation and build of capability across the economy. We have previously recommended that reporting start one year after the standards are finalised. There may be considerable challenges with a short timeframe given the challenges with limited personnel expertise in the market at this stage and given that, assuming the reporting standards are mostly aligned with the ISSB standards and the principles outlined in the paper, the first entities will have under a year to prepare.

2. Reporting content

We note that further detail about reporting content will be set out for consultation in the standards to be developed by the AASB. At this stage, we are supportive of the principles laid down in the Treasury paper.

In particular, we welcome alignment with the ISSB. We are supportive of the requirement for the disclosure of at least two climate scenarios (one of which is in alignment with the *Climate Change Act 2022*) and the disclosure of targets and a transition plan (including information about the use of offsets). It is important for investors to be able to assess that investee companies have understood the risks that climate change poses to their business and the plans they have to address these risks.

The proposal allows for appropriate flexibility and development, particularly with its allowance of moving from qualitative to quantitative disclosure over time. We submit that one of the two scenarios required could be specified to be a scenario involving current global policy settings, given that information on this scenario would be most useful for investors in understanding the likely impacts of climate change on the company. We also submit that for scenario analysis disclosures to be meaningful and comparable for investors, government should provide additional, industry specific guidance.

The proposed principle of financial materiality is also reasonable and aligns with the key concern of funds to make decisions in the best financial interest of their members.

<u>Emissions reporting</u>

Clarification and guidance is sought regarding the reporting of investee company scope 3 emissions and the level of assurance required around these figures. The expectation for reporting scope 3 needs to be clear otherwise there will be divergent interpretations of the requirements and a lack of consistency with disclosures. We recommend that Treasury or the AASB provide guidance what constitutes scope 3 emissions in portfolios and how that can be assured.

With regard to emissions, the industry considers Scope 1, 2 and 3 in this way:

- Scope 1 and Scope 2 – the operational emissions of the financial institution (noting that for an MIS this figure may not be reported).
- Scope 3 – investment emissions, otherwise called financed emissions or portfolio emissions (category 15 in the Greenhouse Gas Emissions protocol). As defined by the GHG protocol, this represents the scope 1 and 2 emissions of investee companies and as such is reliant on investee company reporting. While there are other aspects of financial institutions operations that are also considered scope 3 (operational scope 3 emissions), they are not the focus of this discussion.

Further, we seek clarity as to the extent to which scope 3 for asset managers should include all underlying funds, registered and unregistered. We submit that inclusion of all underlying funds is preferred, allowing asset managers to aggregate reporting across all underlying MISs, as part of scope 3. This approach would align with modern slavery law in Australia and with IFRS S2 on scope 3 for reporting entities.

Regarding the disclosure of scope 3 emissions, we welcome the commitment to require the disclosure of material scope 3 emissions on a phased basis (from the second reporting year onward). We recommend guidance on how to clearly report on scope 3 emissions, boundaries and estimates, given reliance on investee company reporting, particularly with the proposed phased approach, as not all companies will be required to report in year 1. For instance, an asset manager that falls into phase 1 would need to report scope 3 emissions early on. However, they will not be able to rely on the reports of companies that do not need to report until phase 3, creating a clear timing mismatch for the asset manager reporting entity. As such, we welcome that Treasury has recognised the need for flexibility with reporting scope 3 emissions, in particular the recognition that in the immediate term scope 3 disclosures would be estimates reflecting information that is accessible at the time of disclosure. We would welcome this principle being clearly expressed in the law or standards. This would provide certainty for asset managers and disclosing entities across the economy broadly. As touched on in section 4 of the submission below, this can be enhanced with a 'comply and explain' overlay.

We would also welcome greater clarity being provided for what constitutes scope 3 emissions in other major industries across the economy. This disclosure regime must be useful for investors, and its usefulness will be underscored by greater consistency in the disclosure of scope 3 emissions. There is a risk that confusion as to what constitutes scope 3 in various industries could lead to inconsistent disclosures that cannot be compared by the investor users of those disclosures. We submit that clear guidance would help create greater consistency in scope 3 disclosures and help provide disclosing entities across various industries with greater clarity and confidence to move forward with scope 3 disclosures.

Greater clarity would be welcome as to how this regime will impact RSEs who provide platform services. Some platforms through an investment mandate structure have transparency over most of its assets and has some discretion over the management of the underlying assets. However, certain platforms (wraps) provide access to underlying investment options run by external asset managers where there is no transparency and discretion by the RSE in the management of the underlying assets. The guidance provided under the Hong Kong regime states as a consideration for the applicability of the regime whether an entity has discretion over the investment management processes. The Australian regime should consider a similar approach, where an IDPS operator should be exempt from scope 3 reporting requirements as the individual underlying funds and listed securities would already be reporting to end investors.

Finally, we welcome Treasury's recognition that industry-based and industry-developed metrics should be used, with a requirement that reporting entities use these industry-based metrics where they are well-established and understood. We note that many industries have been working to develop metrics and this should be leveraged to develop industry-specific guidance. We also note that for some industries, methodologies and metrics will continue to evolve. This approach is in line with the ISSB, which has sought to harmonise developed industry metrics through *Industry-based Guidance on Implementing IFRS S2.*

3. Reporting framework and assurance

We are supportive of climate-related disclosures being located in the annual report and the Operating and Financial Report as it is important that climate risks and opportunities are considered in the context of a company's financial position. However, this needs to occur alongside clarification in the law around liability with regard to scope 3 disclosures (see *Part 4 Liability and enforcement*).

We also reiterate our comments above that clarity should be provided to allow asset managers to provide climate-related disclosures in a sensible and workable way given their structure with underlying MISs.

We note that climate-related disclosures will include a greater amount of estimated data compared to ordinary financial data. Assurance requirements should account for this, recognising that climate-related disclosures will require a different standard to ordinary financial disclosures. We also note concerns with market availability and capability for third party assurance and again reiterate that government should consider whether the phased timing proposed is adequate.

4. Liability and enforcement

We are broadly supportive of the approach proposed by Treasury to introduce modified liability relief for forward looking statements through limiting action against misleading and deceptive conduct to regulator-only actions for a fixed period of three years. It is in the interest of investors that companies and their directors are encouraged to disclose their climate risk and develop best practice without the fear of vexatious litigation when they have acted in good faith to produce disclosures with the best information available to them.

However, as noted above, we would welcome clarity in the law with regard to scope 3 disclosures. While Treasury notes there will be allowance for estimates to be made with scope 3 disclosures, the data availability at the time of disclosure might be so scarce (or non-existent) that even reasonable estimates may be difficult, if not impossible. Therefore, we support relief being clearly provided in the law that scope 3 disclosures should be made reflecting information that is accessible at the time of disclosure. This could be enhanced with a comply or explain requirement, with an entity required to explain when appropriate data and estimates are not available.

If you wish to follow up on this submission or have any questions, please contact [redacted], Policy Manager at [redacted]

Sincerely,

[redacted]
Policy Manager