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This submission is in response to the document titled "Climate-related financial disclosure, Consultation Paper, June 2023" (the Paper).

Betashares Capital Limited is a leading Australian fund manager specialising in exchange traded funds (ETFs) and other funds traded on the Australian Securities Exchange (ASX). Since launching our first ETF more than a decade ago, Betashares has grown to become one of Australia's largest managers of ETFs, with over 800,000 Australian clients. As of June 2023, Betashares has more than $28 billion in assets under management in over 80 funds.

We applaud moves by the Government to implement disclosure standards in relation to climate change and the transition to a low-emissions economy, as well as the commitment to achieving greater transparency and accountability in relation to climate change risks and opportunities.

We note the development and publication of ISSB IFRS S2 Climate Related Disclosures (IFRS S2) inclusive of Industry-based Guidance[1]. This standard is largely based on the Recommendations of the Taskforce on Climate Related Financial Disclosures (TCFD)[2]. IFRS S2 will undoubtably become the basis for climate-related financial disclosure across virtually all jurisdictions including Australia. Our comments in this submission relate to the usability of information proposed under IFRS S2, and specific proposals detailed in the Paper from the perspective of a user of disclosure documents, including those issued under the TCFD framework.

Reporting Entities

The Paper proposes that size-based criteria be applied to identify and phase in reporting obligations stating: *"Climate-related risks, either physical or transition, will be material for the vast majority of large companies in the near term, if they are not already."* We consider that investor concern in relation to climate transition risk is very high for a small number of fossil fuel and high emissions companies and largely negligible for most other businesses. Similarly, investors understand climate change physical risk has specific implications for large holders of physical assets (property and infrastructure) and perhaps those that finance and underwrite those assets, and agricultural businesses, but in the main physical risk will affect most businesses through impacts on public infrastructure and the broader economy, over which they have little influence or control.

While we certainly applaud the move to standardised risk disclosures, a one-size-fits all approach risks inadequate disclosure from businesses with high levels of climate risk and the imposition of costs for little benefit on companies with negligible risk. We note the Paper rejects the use of 'judgements about materiality' in determining reporting entities, however an industry or sector-based filter, that also has regard to relatively smaller businesses via a revenue-based metric or

[1] https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/
[2] https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf

similar, should be considered to prevent the imposition of costs on enterprises with negligible climate risks.

We also note the intention to cover registrable superannuation entities and the recognition that "banks, superannuation funds and insurers are likely to need to model or estimate a significant proportion of the economy." For most institutional investors, including superannuation funds and insurers, securities issued by the Australian Government and State Governments constitute a material proportion of investment portfolios. Australian federal and state governments face both transition risk (reliance on tax and royalty payments from fossil fuel companies and high emitters), and physical risk (impact on communities and public infrastructure from extreme weather events, costs of adaptation to infrastructure and public assets)[3]. Consequently, baseline disclosure of climate-related risks by federal and state treasuries will be required to enable superannuation funds and insurance entities to meet their reporting obligations. Therefore, consideration should be given to extending coverage of the Standard to government, semi-government, and supranational issuers of securities in the Australian market.

Reporting Content

IFRS S2, which the Paper describes as a 'global baseline' is largely based on the Recommendations of the TCFD which were published in June 2017. A number of countries, including France and New Zealand, have already made disclosures under the TCFD framework mandatory. The TCFD framework provides companies with substantial discretion in their choice of scenarios and metrics. Investor experience (including our own), and academic research have shown that most TCFD reports do not provide investors and stakeholders with meaningful information and are characterised by 'cheap talk' and 'cherry picking'[4]. This decreases the value of disclosures and perpetuates a situation where, by choosing to disclose metrics that paint each organisation in the best possible light, risks are systematically underestimated by stakeholders, e.g., investors, regulators, and policy makers, as well as the companies themselves.

By way of example the Paper contains the following:

> *The Proposal: From commencement, reporting entities would be required to disclose climate resilience assessments against at least two possible future states, one of which must be consistent with the global temperature goal set out in the Climate Change Act 2022.*

It is noted that there are thousands of climate scenarios and many of these are consistent with the objective of limiting global warming to 'well below two degrees Celsius'. However, the extent to which these scenarios are technically feasible, consistent with market structures, available technologies and stated policies varies significantly. In a recently published climate strategy report '*structured to align with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations framework*', a large Australian energy company used IPCC 2-degree Celsius pathways[5] that incorporate material carbon dioxide removal (CDR) to describe (minimise) the transition risks relating to its strategy and capital expenditure decisions. These IPCC pathways are designed to facilitate climate modelling – not as inputs to the risk modelling of capital expenditure decisions by fossil fuel companies. It is noted scenarios falling under IPCC Category C2 or IMP- neg

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[3] https://www.imf.org/en/Publications/WP/Issues/2020/12/18/Feeling-the-Heat-Climate-Shocks-and-Credit-Ratings-49945

[4] https://www.sciencedirect.com/science/article/pii/S1544612322000897

[5] Refer Working Group III contribution to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change with specific reference to IMP- neg classified scenarios.

classifications in particular, are not fit-for-purpose for transition risk scenario analysis, given the substantial and growing "CDR gap"[6].

To prevent 'scenario shopping' of this type, the Australian Standard should be prescriptive as to the specific, fit for purpose, transition scenario to be modelled, which is consistent with the objective of the Paris Agreement of limiting warming to well-below 2-degrees Celsius (for example the IEA Net Zero Emissions by 2050 Scenario (NZE)). By being prescriptive as to the specific scenarios reporting entities should use, Government not only improves comparability across company reports, but it also mitigates the *behavioural* risk posed by companies having the discretion to 'cherry pick' scenarios that minimise the apparent risks inherent in their operations and strategy. It would certainly not 'embed the risk that significant climate-related risk or opportunity is overlooked', given companies would have the ability to present modelling from additional scenarios should they choose to do so.

Similarly, in relation to physical risk, at least one physical risk scenario should be prescribed – (or at least the provision of a standardised set of heuristics in relation to future climate hazards). Without at least one set of prescribed metrics, the value of disclosure reports to investors is materially reduced. Again, it is noted that there are substantial costs involved in physical risk scenario analysis and that while investors have a high degree of concern in relation to certain industry sectors, for most companies, investors are not concerned by climate change physical risk at the individual company level. Further, we question the value of physical risk analysis outcomes produced by relatively unsophisticated users of climate models, given the well documented risk of climate data being misconstrued and used inappropriately.[7] More fundamentally, there is evidence the TCFD framework allows for the systematic underestimation of the risks associated with high warming scenarios, and we have concerns that the proposed disclosure regime will lead to an increase in systemic risks in the financial system. We quote from a recent paper published by the UK Institute and Faculty of Actuaries[8]:

> *"This means the usefulness of the current scenarios is limited, as they do not communicate the level of risk adequately. More dangerously, the artificially benign results can easily serve as an excuse for delaying action, as consumers of these results, such as policymakers and business leaders, may reasonably believe the results to adequately capture the risks."*

Financing – Information Asymmetries and Double Materiality

The objective of the Paper relates to both individual and systemic climate-related financial risks. Banks and financial intermediaries play an important role in the economy and are frequently the only parties with information that informs climate-related risks to the broader financial system, but not necessarily their own businesses. As an example, the Australian residential mortgage-backed securities (RMBS) market is an approximately $90 billion market with RMBS held by superannuation funds, insurance companies, and institutional and retail investors. Convention does not require the issuers of RMBS to provide climate change physical risk metrics in relation to the residential properties covered under a particular RMBS pool, nor would the issuer need to provide disclosure under IFRS S2 as the risks no longer reside on the balance sheet of the issuer. Buyers of the securities who are reporting entities under the Standard would not have sufficient information to meet reporting obligations without such disclosures. We recommend consideration be given to the

[6] https://policycommons.net/artifacts/3444788/untitled/4244826/
[7] https://www.nature.com/articles/s41558-020-00984-6
[8] https://actuaries.org.uk/media/qeydewmk/the-emperor-s-new-climate-scenarios.pdf

inclusion under the Standard of baseline climate-related risk metrics for all asset-backed securities issued in the Australian market, with that obligation falling on the issuer of the securities.

We note the Paper states; 'double materiality is not currently the main objective of the proposed mandatory climate disclosure requirements.' It is generally recognised that private sector investment is crucial to Australia achieving its emissions reduction targets[9]. A fundamental and systemic climate-related risk to the Australian economy is that the amount of finance directed toward fossil fuels on the one hand and renewable energy on the other is inconsistent with the achievement of Australia's emission reduction targets. Currently bank disclosure of fossil fuel financing is inconsistent and generally incomplete. It almost universally ignores off-balance sheet activity, and most bank's net-zero commitments ignore off-balance sheet financing including project finance facilitation[10]. This makes it difficult for investors to understand the climate-related risks to bank revenues but more importantly, the systemic risks to the Australian economy. The GHG Protocol Standard for the Financial Industry does not currently extend to off-balance sheet activity[11], although there is momentum in this regard with a proposed methodology published by the Partnership for Carbon Accounting Financials (PCAF)[12]. IFRS S2 is inclusive of Industry-based Guidance. We recommend guidance for the Finance Sector in the Australian Standard be expanded to explicitly require the reporting of both on and off-balance sheet financing activities, to enable investors a better understanding of the systemic climate-related risks to the Australian economy and financial system.

We thank you for this opportunity to provide feedback on this important area of policy development.

Yours sincerely

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Director – Responsible Investment

Betashares Capital Limited.

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[9] https://budget.gov.au/content/factsheets/download/factsheet_clean_energy-20230510.pdf

[10] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/cop26-banks-net-zero-pledges-ignore-most-fossil-fuel-financing-67266332

[11] https://carbonaccountingfinancials.com/standard

[12] https://carbonaccountingfinancials.com/files/downloads/pcaf-capital-market-instruments-proposed-methodology-2022.pdf

Contact details

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