Treasury consultation paper on climate-related financial disclosure

Adamantem Capital and Melior Investment Management (the "Adamantem Group") submission

INTRODUCTION

The Adamantem Group welcomes the opportunity to provide feedback on the second Treasury Consultation paper on Climate-related financial disclosure ("Consultation Paper"). This submission is made by our two key operating businesses, our private equity business Adamantem Capital[1], and our public equities business Melior Investment Management[2].

WHO WE ARE

Adamantem Capital

Adamantem Capital is a private equity investment manager, established in 2016, specialising in the Australian and New Zealand mid-market. It invests with conviction behind clear, well-articulated and well-researched value creation opportunities. Adamantem Capital currently manages three private equity investment funds. Adamantem fully integrates responsible investing into its investment approach, focussing on delivering financial returns, including through a strong focus on creating positive environmental and social outcomes. A key area of focus as part of its environmental sustainability agenda is assessing and managing climate risk in its investments.

Melior Investment Management

Melior is a specialist impact investment equities manager founded in Australia in 2018, and is manager of the Melior Australian Impact Fund. Melior's vision is to seek to invest for a better future by delivering long term competitive returns and contributing to the United Nations Sustainable Development Goals. Melior's investment philosophy is that investing in companies that contribute to the SDGs, and have strong financial and ESG credentials, has the potential for benchmark outperformance over time. Melior seeks to contribute to the SDGs through allocating its investment capital, engaging management and boards to improve their sustainability and impact practices and publicly advocating for better social and environmental outcomes and measuring progress.

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[1] Adamantem Capital Management Pty Ltd (ABN 31 616 283 124)

[2] Melior Investment Management Pty Ltd (ABN 16 629 013 896)

WHY WE WANT TO RESPOND

We believe that our collective experience in: 1) advocating, and actively supporting, private and public companies to enhance their climate reporting and strategies; and 2) integrating climate risk analysis into the investment decision-making process and reporting to our investors, will provide useful insights to the Treasury consultation from an investment manager perspective. Implementation of standardised, internationally-aligned requirements for disclosure of climate-related financial risks creates the opportunity to guide and harmonise the private sector in meeting the objective of the *Climate Change Act 2022*. Companies and investors will benefit from adopting appropriate disclosure requirements as it will promote more effective measurement and management of transition and physical climate risk, and more efficient allocation of capital, as the global economy transitions to net zero.

OUR RESPONSES TO THE TREASURY CONSULTATION PROPOSALS

Following our submission to the initial Treasury consultation paper, we provide responses below to certain proposals put forward in the Consultation Paper.

Reporting entities and phasing (consultation paper p6-9)

Reporting entities

We agree with the approach of having a number of different thresholds to categorise companies into reporting tiers for the purposes of phasing in mandatory disclosure. We agree with taking into account both the size of an organisation (based on employee numbers and financial metrics) and NGERS reporting thresholds. We encourage Treasury to consider the following:

- Ensuring that the "end state" reporting thresholds are suitable for, and can over time become consistent with, reporting thresholds for other sustainability related issues, such as modern slavery and gender diversity reporting. As sustainability disclosures grow in scope and increasingly converge across a range of sustainability topic areas under the upcoming set of ISSB standards expected to be released, it will reduce compliance burdens if there is a single set of thresholds that apply consistently across all disclosure areas.
- Having distinct and clear thresholds or definitions for asset managers, which are based on funds under management thresholds and similarly phased in over time, starting with the asset managers with higher levels of funds under management (as has been considered by the UK Financial Conduct Authority[3]). While the Consultation Paper notes that registrable superannuation entities will fall within the requirements of Chapter 2M from 1 July 2023, this level of clarity would enhance reporting by assets managers who are not registrable superannuation entities. Treasury should also make clear if the disclosure obligations and thresholds apply to asset managers at an entity or product level, as this distinction will drive a vastly different approach to climate disclosure by asset managers.

[3] PS21/24: Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers | FCA

Phased implementation approach

Implementation of a phased approach to climate disclosure requirements was a key recommendation in our first Treasury Consultation submission. Whilst we agree with the proposed phasing approach, we encourage Treasury to consider the following;

- **Shortening the final reporting deadline.** We believe that shortening the phasing to occur over 3 years (from 24-25 to 26-27) rather than 4 years would be more appropriate – i.e. expanding from Group 1 to Group 3 in 12 month increments. This is more likely to ensure that Australia keeps pace with international jurisdictions (for example, the final deadline for the current phase of EU Taxonomy disclosures will be implemented by 2025[4] [5]), providing the benefits of continued international capital flow to Australia as outlined in our response to the initial Treasury consultation. It will also ensure that aggregators of information, such as asset managers, will have a wider set of higher quality reporting available in a shorter time frame in order to make their own disclosures under the regime. (We do note that the level of reporting required under the proposal is a significant step up for Australian corporates and organisations, however the combination of phased timing as well as the transitional arrangements in relation to the scope of reporting could be structured to support capacity and capability building over this period.)
- **Guidance for asset owners and managers on estimating financed emissions.** Treasury should consider providing explicit guidance on how asset managers and asset owners should report on their Scope 3 (financed) emissions where those emissions relate to Scope 1 and 2 emissions of entities that do not simultaneously fall within the scope of mandatory climate disclosure. This should include guidance on:
    - appropriate reporting periods to be included in asset managers' Scope 3 (financed emissions) disclosures (similar to the proposed Scope 3 emissions reporting on page 16; "*……….the scope 3 emissions disclosed could have accrued in any one-year period that ended up to 12 months prior to the current reporting period. For example, scope 3 emissions reported in the 2027-28 financial year could be those incurred (either actual or estimated) in the company's supply chain in the 2026-27 financial year. This recognises that other reporting entities' scope 1 and 2 emissions may form inputs for an entity's scope 3 estimation*."
    - how asset managers should approach estimating emissions from investee businesses which will always fall outside the mandatory climate disclosure provisions (whether due to size or other reasons, for example they are foreign companies where the local jurisdiction does not mandate emissions reporting).

[4] FAQ: What is the EU taxonomy and how will it work in practice? (europa.eu)
[5] New Draft Disclosure Rules Change Timelines and Scope of EU Taxonomy (sustainalytics.com)

Reporting content (consultation paper p10-18)

Phasing of reporting requirements

We agree with the concept of a transitional period which would see increasing disclosure requirements over time in order to allow for the building of capability and capacity. The scope of reporting under this proposal is a significant enhancement to the level of emissions and climate reporting currently done in Australia; based on our analysis[6], we believe that 74% of ASX 300 companies currently report Scope 1 & 2 emissions and 41% report in line with the TCFD framework. In our experience working with unlisted equities, we expect that a far smaller proportion of smaller or unlisted companies are currently reporting this data. Therefore, whilst we are wholly supportive of adopting internationally-aligned climate disclosure frameworks, we stress the importance of working with education providers (such as universities and professional education bodies) to ensure that the necessary skills are acquired in order to implement these standards, as part of the transitional approach.

We also strongly encourage Treasury to be explicit in detailing exactly what is required to be reported under each phase. Given the resource and time required to meet new climate disclosure standards, clarity and guidance is key to support reporting entities and ensure that reliable and comparable data is disclosed. A roadmap in relation to the phased scope of reporting (similar to the assurance roadmap provided on page 26 of the Consultation Paper) would be significantly helpful.

Governance

We fully support the proposal requiring companies to disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities. This will improve transparency and risk management for investors exposed to climate-related risks and opportunities of investee companies.

Strategy - Scenario Analysis

We believe that quantitative scenario analysis by end state would provide valuable information for investors to understand climate risks relevant to various investment opportunities. This is particularly valuable for high-emitting companies or companies relying on the development of new technologies to achieve their net zero plans.

Consistent with our comments above, we consider that Treasury should be explicit in setting out the timing in which each group of reporting entities is expected to move from qualitative to quantitative scenario analysis reporting.

The design of a quantitative disclosure regime (including the timing for its commencement and the prescriptiveness of its requirements) should take into consideration the following:

[6] Melior ESG Framework & Melior GHG Calculator

- Climate scenarios are still emerging and changing, and as noted in the Consultation Paper there is currently a lack of Australia-focused climate scenarios.
- The enormous range of approaches and tools for quantitatively assessing and disclosing climate risk that are emerging - with an equally large range of quantitative outcomes that are produced given the disparity in the scenarios and other assumptions underpinning the analysis. (See for example The United Nations Environment Programme Finance Initiative *The 2023 Climate Risk Landscape* report published in March 2023[7]).

For both of these reasons, the disclosure regime should focus on ensuring that reporting entities must clearly and transparently report on the methodologies and assumptions that underpin their quantitative scenario analysis. This will help investors contextualise the disclosures. Over time, and as the market develops, Treasury should reconsider whether mandating a more standardised approach would be appropriate, particularly as downscaled Australian scenarios become available.

Transition planning and climate-related targets

We agree with the transition plan proposals and we encourage Treasury to consider setting clear minimum requirements for transition plans in this disclosure framework, having regard to international guidance which has already been developed in this area (for example the ISSB as well as the work of the UK Transition Plan Taskforce). For all the reasons outlined in our response to the initial Treasury consultation, it is important to ensure that Australia's approach is aligned to international practice on all areas of mandatory climate reporting, including in relation to transition plans.

Some factors that we would propose considering for inclusion in transition plan disclosures are;

- Clear definition of the scope of the net zero target. For example, does the target apply to operational emissions (Scope 1&2) or total emissions (including Scope 3; noting current SBTi guidance that Scope 3 targets are required 'if a company's scope 3 emissions are 40% or more of total scope 1, 2, and 3 emissions' [8])? What proportion of the target will be achieved using offsets?
- Full disclosure of offsets purchased and relevant verification / due diligence that has been carried out in selecting those particular offsets
- Disclosure of interim targets set in order to achieve the transition strategy (and progress to date towards these targets)
- Accounting policy amendments consistent with the transition strategy, for example, alignment of depreciation policies / useful life of assets being made redundant as a result of the transition plan (mostly relevant to fossil fuel producers)
- What impact does nature risk have on the transition pathway?

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[7] The 2023 Climate Risk Landscape – United Nations Environment – Finance Initiative (unepfi.org)
[8] Scope 3: Stepping up science-based action - Science Based Targets

- Just Transition factors. For example, what considerations / allowances have been made for human capital displaced by the transition plan?

We would strongly encourage Treasury to consider a phased “transitional period” in relation to the mandated content in transition plans, similar to that considered on page 11 of the Consultation Paper, as similar considerations in relation to capability and capacity apply.

Metrics and Targets

Greenhouse gas emissions

We agree with the proposal to require reporting of total greenhouse gas emissions (Scope 1, 2 & 3) by end state, and stress the importance of reporting gross emissions and net emissions (to ensure transparency and comparability across data). We note that in the 2022 financial year, there was a significant increase in ASX 300 companies reporting Scope 1 & 2 emissions (now 74% of ASX300 companies report operational emissions)[9], however the majority of companies do not yet report Scope 3 emissions. Whilst we recognise the significant resources required to mandate greenhouse gas emissions reporting, we believe that these disclosures are essential for companies and investors to be able to understand and effectively manage climate risk (and ultimately achieve the national Net Zero emissions target).

We understand Treasury’s desire to use NGERS methodology, however note that the number of entities that will be within the scope of the mandatory climate disclosures by end state will be far greater than the number of companies currently covered by the NGERS legislation. It is important to consider international alignment of greenhouse gas emissions reporting and to avoid a situation where companies have to use different methodologies to calculate their emissions for different purposes. It is also relevant to note that NGERS does not cover international emissions, which will be relevant under the mandatory climate reporting framework.

Industry based metrics

We encourage the development of industry-based metrics in order to improve usability and comparability of metrics across sectors. One example of a useful industry-specific metric could be banks' financed emissions. Lending to fossil fuel companies represents a material risk to the Australian financial system, and creates significant climate risk associated with banks' loan books. By ensuring that financed emissions are reported consistently for commercial banks, and ensuring that inclusion of financed emissions in Net Zero targets is disclosed consistently, investors could make better judgement of the risk associated with investments in banks[10].

[9] Melior GHG Framework
[10] The critical role the big four banks play in climate action - Melior Investment Management (meliorim.com.au)

We believe that it is important to ensure that these climate metrics can ultimately be reported on and incorporated into executive remuneration, therefore increasing the likelihood of climate targets being met.

Reporting framework and assurance (consultation paper p19-26)

Location

As noted in our initial submission, we believe that climate disclosures of listed companies should be published in an entity's Annual Report. This would be a useful step towards integrated reporting and avoid multiple reporting periods for companies. Where this is not possible, or there are initial assurance concerns with including these disclosures in the Annual Report from the outset, we suggest that climate disclosures are made in a separate Sustainability Report (released concurrently with the Annual Report). Over time, and as 'reasonable assurance' is required (as per Table 3: Proposed assurance roadmap), we expect that these disclosures can be included in the annual report.

As bodies such as the ISSB release further guidance on sustainability risks outside of climate change, integrated reporting will be the most efficient way for stakeholders to interpret both the financial and ESG risks of a company simultaneously.

We note that many private companies do not release an annual report, and it should be expressly provided that these companies may make their climate-related disclosures in a standalone report.

Assurance

We are in broad agreement with the proposals for a phased approach to assurance, noting that these should be subject to the finalisation of the IAASB Sustainability Assurance standards[11]. These requirements should be reviewed on the completion of the IAASB standards and recommendations (expected to be finalised by September 2024[12]).

We believe that, like financial-related disclosures, climate risk reporting carries significantly more value and reliability once data disclosures have been audited and assured. Therefore, we would encourage new climate-related financial disclosures to be designed to be able to be fully assured and be subject to the same independence and quality management standards as financial reports by the end of the phasing period (i.e. audited by a registered company auditor and signed off by company directors, pending IAASB guidance). This is consistent with international best practice; for example, the EU CSRD (Corporate Sustainability Reporting Directive) will make it mandatory for companies to carry out an audit of the sustainability information that they report from financial year 2024[13].

[11] Sustainability Assurance | IAASB
[12] Sustainability Assurance | IAASB: project timeline
[13] Corporate sustainability reporting (europa.eu)

Liability and Enforcement (consultation paper p27-28)

We understand that the proposed disclosure framework requires directors to make a declaration that information in the Annual Report (including climate disclosures) provide a 'true and fair' view and declare compliance with the climate disclosure standards. Whilst we believe that climate disclosures should ultimately be subject to the same governance and assurance principles as financial statements, we reiterate the director liability concerns noted in previous submissions.