Responsible Investment Association Australasia

Climate Disclosure Unit
Market Conduct and Digital Division
The Treasury Langton Crescent PARKES ACT 2600

climatereportingconsultation@treasury.gov.au

Submission: Climate-related financial disclosure Consultation paper June 2023 (Design consultation)

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Overview

The Responsible Investment Association Australasia (RIAA) thanks the Treasury for the opportunity to comment on the Australian Government's Climate-related financial disclosure Consultation paper of June 2023.

RIAA's Policy Platform, *Sustainable Finance for a thriving Australia*, released in April 2022, recommended that the Australian Government:

- immediately mandate reporting against the Taskforce on Climate Related Financial Disclosures (TCFD) framework for listed and unlisted companies;
- promptly integrate the new International Sustainability Standards Board standards in Australia; and
- continue to support the rapid development of a robust TNFD reporting framework and promptly adopt the TNFD framework in Australia.

(RIAA-Policy-Platform-2022_Sustainable-finance-for-a-thriving-Australia.pdf (responsibleinvestment.org))

RIAA is pleased to see progress on all three of these disclosure-related policies, and RIAA congratulates the Australian Government on moving forward with mandating climate-related reporting. This constitutes a significant step forward in giving investors the information they need to appropriately identify and manage climate-related risks, and to mobilise capital to harness opportunities in support of a sustainable economy.

Existing and potential investors, lenders and other creditors need high-quality, comprehensive, comparable information about companies to make decisions about where to direct capital to align with both financial and sustainability objectives. Internationally, company sustainability reporting is hence developing at pace.

Mandatory climate disclosures, provided they are harmonised with leading global developments, and cover an appropriate range of entities, will play a key part in supporting Australian markets. They will send a strong signal that Australia is one of a growing number of countries that acknowledge the significance of accurate and useable sustainability information in markets through the climate transition. This will in turn attract capital to Australia. This disclosure regime is critical for the competitiveness of key Australian industries into the future.

RIAA recommends the following:

1. **Develop this regime to allow for the incorporation of other sustainability disclosure requirements into the reporting mechanism in the future.**

2. **Companies which are covered by the Safeguard Mechanism and/or reporting requirements under the *National Greenhouse and Energy Reporting Act 2007 (NGER)* scheme be covered by this regime.**

3. **Equivalent Commonwealth reporting entities that are required to prepare annual financial statements should be covered by this regime.**

4. **As far as possible, the end state of the Australian and Aotearoa New Zealand reporting regimes should be alignment between the categories of entities required to disclose.**

5. **The Government support SMEs indirectly covered by the mandatory reporting regime, at minimum, through Regulatory Guidance on scope 3 reporting.**

6. **Alignment as far as possible with New Zealand's climate related disclosures regime.**

7. **Phase 1 reporting, commencing 2024-25, cover S&P/ASX300 companies, financial institutions with consolidated annual revenue of over $100 million or $5 billion or more in AUM, and any other companies covered by the Safeguard Mechanism and/or NGER Scheme, as well as equivalent Government entities.**

8. **Reduce the timeline to incorporate full reporting by end year 2026-27.**

9. **A phased approach be introduced for asset managers and asset owners, given they will be relying on information from their investee companies.**

10. **The ISSB's definition of materiality be legislated for use in mandated climate-related disclosures from commencement.**

11. **The disclosures legislation be drafted in a way that allows for the incorporation of a full double materiality approach in the future.**

12. **RIAA recommends a quicker move to full reporting and to incorporating quantitative reporting requirements for larger entities.**

13. **The disclosures regime require reporting entities to disclose climate resilience assessments against a 1.5C above preindustrial levels scenario, as well as at least one other defined scenario that will account for a much bigger temperature increase, drawn from and based on international work.**

14. **Ensure the transition plans align with the EU and UK work on transition planning and provide regulation and guidance to support entities to produce transition plans that are useful to investors.**

15. **Transition plans be made to include information on how the entity's capital expenditure and investment commitments support the transition.**

16. **Include a requirement to disclose interim targets in order that investors understand the trajectory towards long-term goals.**

17. **Transition plans demonstrate how entities will align their targets, milestones and activities to a 1.5C decarbonisation pathway.**

18. **The Government provide Regulatory Guidance to SMEs on scope 3 reporting.**

19. **Establish a free, fit-for-purpose repository of climate-related data for company use.**

20. **Consider whether entities making climate-related claims should be required to disclose their level of alignment with the forthcoming Taxonomy.**

21. **As an end state, minimum assurance requirements for sustainability disclosures be equivalent to audit requirements for financial statements, subject to targeted transitional arrangements.**

22. **Issue Regulatory Guidance on what constitutes a 'reasonable basis' for forward looking statements in climate and broader sustainability disclosures.**

23. **Legislate the transition to the end state of non-modified liability settings for climate disclosures within the fixed timeline.**

Broader sustainability disclosures

RIAA supports the Government's intention to align these climate disclosures the final standards developed by the International Sustainability Standards Board (ISSB) as a global minimum baseline. As sustainability reporting develops internationally, investors would expect that future sustainability disclosures in Australia align with the future work program of ISSB, as well as mandate disclosures on issues that Australian investors care about, such as nature. Consistency in this reporting will be important for company incorporation as well as investor use.

1. **RIAA recommends developing this regime to allow for the incorporation of other sustainability disclosure requirements into the reporting mechanism in the future.**

Coverage

Government Proposal: that all entities that meet prescribed size thresholds and that are required to lodge financial reports under Chapter 2M of the Corporations Act 2001 (Cth) (Corporations Act) would be required to make climate-related financial disclosures.

RIAA supports the Proposal that all entities that meet prescribed size thresholds and that are required to lodge financial reports under Chapter 2M of the Corporations Act 2001 (Cth) (Corporations Act) would be required to make climate-related financial disclosures.

In addition, it will be important to ensure all heavy emitters are covered; therefore, companies which, due to the emissions intensity of their activities, are covered by the Safeguard Mechanism and/or reporting requirements under the *National Greenhouse and Energy Reporting Act 2007 (NGER)* scheme, including Government, public and proprietary entities, that my fall outside the Corporations Act coverage, should be covered.

Further, in order for Australia to meet, and understand progress towards, our Paris Agreement commitments, an understanding of national emissions will be required. All emitters should be required to disclose. RIAA understands there will be a separate process for developing a climate reporting regime for government entities. A different system and regime for government entities is not appropriate from the perspective of overall national emissions contribution and risk. It is surprising that the current Government, with its focus on climate change, has not already shown leadership on this, in a context when many ASX companies are already reporting, and moved forward with government reporting of its own climate impacts.

All Government entities equivalent to large proprietary companies and large financial institutions should be covered by the regime. At the end of any transitional arrangements, all equivalent Commonwealth reporting entities required to prepare annual financial statements should be covered by the climate reporting regime. This is particularly important for large government public finance organisations, such as the Future Fund, such that they demonstrate leadership in transparency to the broader industry. Government entities which are not covered by phase 1 should be a priority in subsequent phases – this would include state and territory Government entities.

RIAA notes the Aotearoa New Zealand regime covers "large financial organisations such as banks and insurers, with total assets of more than $1 billion", and highlights the intention of the Australian and New Zealand Governments to align their regimes.

2. **RIAA recommends that companies which are covered by the Safeguard Mechanism and/or reporting requirements under the *National Greenhouse and Energy Reporting Act 2007 (NGER)* scheme be covered by this regime.**

3. **RIAA recommends that equivalent Commonwealth reporting entities that are required to prepare annual financial statements should be covered by this regime.**

4. **RIAA recommends that, as far as possible, the end state of the Australian and Aotearoa New Zealand reporting regimes should be alignment between the categories of entities required to disclose.**

It is likely that a significant number of smaller companies which are not required to report under the mandatory regime will nonetheless need to prepare some climate information to provide to larger entities. For example, an entity may need to provide data on their emissions to a large financial institution for that large entity to report on its scope 3 emissions. There will be a particular need for

Government support for SMEs indirectly brought under the regime. This should include at minimum, clear Regulatory Guidance for SMEs required to provide information to investors or other financial institutions for the purpose of scope 3 emissions reporting.

5. **RIAA recommends that the Government support SMEs indirectly covered by the mandatory reporting regime, at minimum, through Regulatory Guidance on scope 3 reporting.**

Finally, RIAA has members in both Australia and Aotearoa New Zealand (representing 58% and 72% of AUM respectively) and we encourage the government to align where possible with the climate related disclosures legislation already in place in New Zealand, to ensure strong trans-Tasman interoperability, in a manner that supports the recent commitment by both government through the 2+2 Climate and Finance Dialogue, whereby "Ministers committed to better coordinate the implementation of climate-related disclosure requirements for financial market participants against internationally aligned standards.". (Media release https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/inaugural-australia-new-zealand-22-climate-and-finance).

6. **RIAA recommends alignment as far as possible with New Zealand's climate related disclosures regime.**

Government Proposal: Phased approach: Proposed roadmap for mandatory disclosure requirements

RIAA agrees that the reporting should commence for FY 2024-25.

However, RIAA believes the phased approach as articulated on pages 8 and 9 of the Consultation paper does not capture a sufficient number of companies of the size, scale and climate impact in Group 1 that would make the phased reporting meaningful to investors. Group 1 should be broadened to all S&P/ASX300 companies, financial institutions with consolidated annual revenue of over $100 million or $5 billion or more in AUM, and any other companies covered by the Safeguard Mechanism and/or NGER Scheme.

As above, this disclosures regime should also include equivalent Government entities, which will give investors and potential investors, the Government and the public the information they need to ensure all polluters are transitioning to a net zero economy.

Furthermore, the unique position of asset managers and asset owners in relation to the chain of information must be recognised that asset owners and asset managers will be required to report on their portfolio emissions, using information provided by their investees or the funds they manage. This time-lag needs to be recognised. There will be a longer time lag for asset owners, including superannuation funds, as they may also be dependent on information sourced from asset managers, who will in turn be waiting on information from investees, or from entities not covered by this reporting regime.

7. **RIAA recommends that Phase 1 reporting, commencing 2024-25, cover S&P/ASX300 companies, financial institutions with consolidated annual revenue of over $100 million or $5 billion or more in AUM, and any other companies covered by the Safeguard Mechanism and/or NGER Scheme, as well as equivalent Government entities.**

8. **RIAA recommends reducing the timeline to incorporate full reporting by end year 2026-27.**

9. **RIAA recommends that a phased approach be introduced for asset managers and asset owners, given they will be relying on information from their investee companies.**

Content

Government Proposal: Phasing of reporting requirements (page 11).

RIAA supports reporting commencing in FY 2024/25.

The finality of reporting at end of FY 2027-28 is also too long. Given the climate crisis and the need for information to inform decisions and actions aimed at reducing Australia's and global emissions in line with the Paris Agreement, it will be necessary for the phased timeline to be truncated. This could be achieved by incorporating more companies and entities into Group 1, and combining the remainder of Group 2 with Group 3 for a phase-in ending in 2026-27.

Government Proposal: Principles of financial materiality would apply.

In general, RIAA supports a double materiality approach to sustainability disclosures.

Investors, issuers and lenders have diverse information requirements when it comes to sustainability issues, depending on the structure and type of investment product, and will increasingly desire information on sustainability issues that affect valuation, as well as companies' exposure to and impact on systemic risks. Companies will therefore increasingly need to assess materiality with a view to the company's impact on climate, environment, people and other sustainability issues, as well as assess possible longer-term effects of this impact on the company's enterprise value.

RIAA welcomes the Government's move towards incorporating the ISSB's approach to materiality to ensure consistency for reporting entities.

Under the IFRS definition, companies must factor in things that may lead to changes in future business activities or planning, taking a long-term view. RIAA notes the IFRS/ISSB's definition of materiality is wider than a standard single materiality approach. Enterprise value is determined by calculating the net present value of forecast future cash flows and encompasses all available information, incorporating a long-term view. While the ISSB/IFRS standards look at sustainability factors that are material to the 'enterprise value' of a company, it is not always straightforward to separate one form of materiality from the other. The ISSB definition incorporates how enterprise value can be affected by events, which include things like the environmental impact that company is having or is likely to have.

Understanding external views – particularly those of investors when pricing shares or debt – is important in calculating enterprise value. Climate issues can therefore affect the likelihood, timing and amounts of potential cash inflows and outflows resulting from a company's activities over the short, medium and long term. In addition, enterprise value needs to incorporate things such as legal or regulatory issues – so a materiality assessment must take into account a company's impact on the climate (or other sustainability issue).

The ISSB's (and the US Securities and Exchange Commission's) version of enterprise value incorporates what affect cash flows over the short, medium and long term should be reported in disclosures. This means that much of the information on impact would need to be incorporated. For many sustainability issues, the impacts of the company externally generally lead to impacts on the company in the longer-term.

RIAA notes that the ISSB standards should act as a baseline, and that this leaves open the opportunity to adopt an even more fulsome approach to materiality in the future. RIAA also notes and draws Treasury's attention to the moves by the European Parliament towards enshrining the principle of double materiality into the GRI's work on material impact as well as the European Sustainable Reporting Standards. We see the EU standards in particular as a critical precedent that will drive the direction of sustainability and climate related disclosures, including having major impacts for the many Australian reporting entities who have operations or business that intersects with Europe. In short, we recommend that Australia aims to remain as consistent with this as possible for greatest interoperability.

10. **RIAA recommends that the ISSB's definition of materiality be legislated for use in mandated climate-related disclosures from commencement.**

11. **RIAA recommends that the disclosures legislation be drafted in a way that allows for the incorporation of a full double materiality approach in the future.**

Government Proposal: From commencement, companies would be required to disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities.

RIAA supports the requirement that companies must disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities.

Government Proposal: From commencement, reporting entities would be required to use qualitative scenario analysis to inform their disclosures, moving to quantitative scenario analysis by end state.

RIAA notes the importance of quantitative scenario analysis for investment decision making. Many entities covered under the Consultation papers Group 1 category are of the size and sophistication that would means they are likely to have the capability to move to quantitative scenario analysis reasonably quickly.

12. **RIAA recommends a quicker move to full reporting and to incorporating quantitative reporting requirements for larger entities.**

Government 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 ('holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels.').

Scenario analysis is a significant challenge for preparers and poses a challenge to developing the consistency investors require to make the reporting comparable and hence inform decision-making.

RIAA supports the phased approach to scenario analysis, commencing with qualitative and encouraging more where appropriate, then moving to a quantitative regime.

However, the proposal for the consistent analysis to be consistent with the global temperature goal set out in the Climate Change Act 2022, whilst it will ensure at least one internationally-aligned standard scenario, is too broad to be meaningful. 1.5C-2C is a big range and does not allow for useful cross-comparison.

Further, to allow comparability, investors will need the second scenario to be consistent across reporting entities and to account for a bigger temperature increase. A scenario should be stipulated by reference to international work, or be produced by a credible, independent third party, such as the Climate Change Authority.

13. **RIAA recommends that the disclosures regime require reporting entities to disclose climate resilience assessments against a 1.5C above preindustrial levels scenario, as well as at least one other defined scenario that will account for a much bigger temperature increase, drawn from and based on international work.**

Government Proposal: From commencement, transition plans would need to be disclosed, including information about offsets, target setting and mitigation strategies.

RIAA supports the mandatory disclosure of transition plans, including transparency around offsets, target setting and mitigation strategies. These should be consistent with emerging international transition planning requirements, including the EU's and UK's approach.

14. **RIAA recommends ensuring the transition plans align with the EU and UK work on transition planning and provide regulation and guidance to support entities to produce transition plans that are useful to investors.**

15. **RIAA recommends transition plans be made to include information on how the entity's capital expenditure and investment commitments support the transition.**

Government Proposal: From commencement, all entities would be required to disclose information about any climate-related targets (if they have them) and progress towards these targets.

RIAA supports the proposal that all entities be required to disclose information about climate-related targets and progress.

16. **RIAA recommends including a requirement to disclose interim targets in order that investors understand the trajectory towards long-term goals.**

In addition, investors will need to see how these targets align with the 1.5C decarbonisation pathway.

17. **RIAA recommends transition plans demonstrate how entities will align their targets, milestones and activities to a 1.5C decarbonisation pathway.**

Government Proposal: From commencement, entities would be required to disclose information about material climate-related risks and opportunities to their business, as well as how the entity identifies, assesses and manages risk and opportunities.

RIAA supports this proposal that entities disclose information about material climate-related risks and opportunities to their business, as well as how they identify, assess and manage these.

Government Proposal: From commencement, scope 1 and 2 emissions for the reporting period would be required to be disclosed.

RIAA supports the inclusion of scope 1 and 2 emissions in mandated disclosure requirements from commencement.

Government Proposal: Disclosure of material scope 3 emissions would be required for all reporting entities from their second reporting year onwards. Scope 3 emissions disclosures made could be in relation to any one-year period that ended up to 12 months prior to the current reporting period.

RIAA agrees that excluding scope 3 emissions would significantly reduce the value of disclosures, and supports the phase-in of scope 3 emissions from year 2, as proposed.

RIAA appreciates the proposals' recognition of the challenges posed by the fact that other reporting entities' scope 1 and 2 emissions may form input for an entity's scope 3 emissions, and that the phased approach outlined will therefore ensure banks, superannuation funds and insurers have the information to model or estimate their scope 3 emissions.

Smaller companies that are not required to report under the mandatory regime will likely nonetheless be required to prepare some climate information to provide to larger entities. There will therefore likely be a number of SMEs that are indirectly covered by the mandatory reporting regime. As the Consultation paper recognises, there exists a capacity and skills constraint in this regard. The regime would benefit from assistance to SMEs in the form of data support and Regulatory Guidance on scope 3 reporting.

18. **RIAA recommends that the Government provide Regulatory Guidance to SMEs on scope 3 reporting.**

Government Proposal: By end state, reporting entities would be required to have regard to disclosing industry based metrics, where there are well-established and understood metrics available for the reporting entity.

RIAA notes the Consultation paper's acknowledgement of gaps in data and potential for the Government to play a role in helping the industry meet these needs, and looks forward to engaging with the Government on this issue in the context of the development of the Government's Sustainable Finance Strategy. RIAA agrees clear guidance in this area will be useful.

19. **RIAA recommends establishing a free, fit-for-purpose repository of climate-related data for company use.**

Other

RIAA highlights the work of the Australian Sustainable Finance Institute (ASFI) and the Australian Government, through the Council of Financial Regulators, to develop a Sustainable Finance Taxonomy as recommended by the Australian Sustainable Finance Roadmap. This taxonomy will assist entities to validate climate-related claims, including whether they are aligned with the Paris Agreement.

20. **RIAA recommends – pending finalisation of the Sustainable Finance Taxonomy – considering whether entities making climate-related claims should be required to disclose their level of alignment with the forthcoming Taxonomy.**

Framework and Enforcement

Government Proposal: The preferred policy parameters for climate disclosure assurance include:

- ***a requirement for limited assurance, moving to reasonable assurance over time***
- ***reasonable assurance of scope 3 as a final step in scaling requirements***
- ***assurance would need to be provided against the Australian equivalent standards to the ISSB and Corporations Act/Corporations Regulations, in line with AUASB standards.***
- ***assurance to be carried out by a qualified and experienced independent provider (conducted or led by the financial auditor).***

Given the reliance investors will place on the accuracy of the disclosures in making investment decisions, as they currently do in relation to financial information, assurance of sustainability disclosures will need to be equivalent to the requirements for financial statements. RIAA appreciates, however, the requirement to uplift capability.

RIAA looks forward to engaging in consultations on Australia's climate-related disclosures assurance requirements once the International Auditing and Assurance Standards Board (IAASB) assurance on sustainability reporting project is complete.

21. **RIAA recommends that, as an end state, minimum assurance requirements for sustainability disclosures be equivalent to audit requirements for financial statements, subject to targeted transitional arrangements.**

Government Proposal: Climate-related financial disclosure requirements would be drafted as civil penalty provisions in the Corporations Act. The application of misleading and deceptive conduct provisions to scope 3 emissions and forward-looking statements would be limited to regulator-only actions for a fixed period of three years.

Existing legislation, as outlined on page 27 of the Consultation paper, is adequate to protect those involved in producing and approving climate disclosure reports, including in relation to forward looking statements. The legal opinion of Sebastian Hartford-Davis and Kelly Dyon of Counsel, as well as is evident through the current practice of voluntarily issuing climate disclosures by a significant proportion of ASX-listed companies confirm that the reasonable grounds threshold is flexible enough to account for any uncertainty surrounding forward looking statements.

Counsel's opinion states that:

- The draft ISSB requirements are consistent with existing directors duties: The ISSB draft standards require disclosures which are more numerous and specific than, but broadly consistent with, existing requirements for listed companies. Company directors should already be considering these things in the proper discharge of their directors duties. It follows that 'for diligent company directors properly supported by competent management, the ISSB Draft Standards should not increase directors' exposure' (para 6).
- The 'reasonable basis' requirements acknowledge uncertainty: The requirement to have a 'reasonable grounds' for making forward-looking statements is 'capable of being sensitive to the inherent uncertainties in the scope, distribution, impacts and timing of the impacts of climate change'. The Corporations Act requires genuine assessment of the appropriateness of forward-looking statements when they are made, but directors will not be liable solely because an assessment is later found to be incorrect (para 6).

- A safe harbour is not required: A safe harbour for climate and/or sustainability-related disclosures is not necessary or desirable (Section D.2). 'Investors and courts do not expect companies to predict the unpredictable, but instead to make sensible disclosures on a reasonable basis, and to update earlier disclosures if they become misleading by reason of later events' (para 59). For example, for scope 3 emissions disclosures, using a supplier's scope 1 and 2 emissions data would likely form a 'reasonable basis', provided there was not a reason to mistrust that data, and that it included disclaimers about the reliability of the data (para 60).
- ISSB standards may assist directors and companies to manage liability: The draft ISSB standards have a 'significant capacity to assist company directors' by clarifying the things that may already be required under existing directors duties and company reporting requirements. The draft ISSB standards may also help directors to ensure management is doing what is required to minimise liability risks (para 33).

Investors rely on climate disclosures, including forward looking statements, to inform significant decision-making. They must be able to have confidence in the information on which they are basing decisions, and climate-related risks and opportunities are highly relevant to company valuation and performance. In this context, companies and directors should be legally required to make forward-looking statements about climate risks and opportunities on a reasonable basis.

Investors recognise that uncertainty and assumptions are inherent in some types of disclosures. However, reduced liability for disclosures risks diluting the value of the regime.

The challenges faced by companies preparing climate disclosures, particularly in the early reporting periods, could be addressed through, for example:

- Regulatory Guidance on what constitutes a 'reasonable basis' for forward-looking statements in climate and broader sustainability disclosures,
- disclosure of data sources, assumptions, methodologies and use of disclaimers which will assist investors to understand the 'reasonable basis' for forward-looking statements, and
- collaborative development of best practice guidance and tools for climate disclosures by companies, investors and regulators.

It will be crucial to ensure that the temporary settings proposed, if accepted, do not under any circumstances extend beyond the three years stipulated. The period for this approach to liability must be strictly fixed.

RIAA agrees that a safe harbour option is not appropriate in this case.

22. RIAA recommends legislating the transition to the end state of non-modified liability settings for climate disclosures within the fixed timeline.

23. RIAA recommends the issuing of Regulatory Guidance on what constitutes a 'reasonable basis' for forward looking statements in climate and broader sustainability disclosures.

About RIAA and our members

RIAA champions responsible investing and a sustainable financial system in Australia and Aotearoa New Zealand, and is dedicated to ensuring capital is aligned with achieving a healthy society, environment, and economy.

With more than 500 members managing more than USD29 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across Australia and Aotearoa New Zealand. RIAA's membership includes superannuation funds, KiwiSaver default providers, fund managers, banks, consultants, researchers, brokers, property managers, community trusts, foundations, faith-based groups, financial advisers, financial advisory groups, and others involved in the finance industry, across the full value chain of institutional to retail investors.

RIAA represents 58% of all managed funds in Australia.

RIAA's membership list can be found here:

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