Mandatory Climate-related Disclosure Framework - Second Consultation Paper

Australian Sustainable Finance Institute | July, 2023

Australian Sustainable Finance Institute

Treasury Mandatory Climate-related Disclosure Framework – Second Consultation Paper – ASFI Submission

1. Introduction

The Australian Sustainable Finance Institute (ASFI) welcomes this opportunity to make a submission on the Government's proposed Climate-Related Risk Disclosure Framework.

ASFI's members are Australian financial institutions – including major banks, superannuation funds, insurers, asset managers, and financial services firms – that are working to align the Australian financial system with a sustainable, resilient, and inclusive Australia. ASFI members collectively hold over AU$18 trillion in assets under management and are committed to allocating capital in a way that creates positive social and environmental outcomes.

ASFI supports the introduction of mandatory climate disclosures for the Australian market. A robust and workable climate disclosures framework will help financial institutions make better decisions, firms understand and manage climate risk and opportunity, and regulators combat greenwashing. A key plank of the sustainable finance policy architecture, climate disclosures will ultimately support capital allocation consistent with Australia's national emissions reduction and adaptation goals.

ASFI is broadly supportive of the positions set out in the Consultation Paper, including the proposal to align with ISSB standards where possible. We provide over-arching comments in section 2 below, and comments on specific areas in section 3 below. We recognise that Treasury intends to invite stakeholder views on broader sustainable finance topics as part of its forthcoming Sustainable Finance Strategy consultation. Nevertheless, in section 3 we also set out brief comments on some aspects of how the disclosures regime relates to broader policy settings including transition plan guidance, provision and management of data, digitisation, and the Australian sustainable finance taxonomy.

2. Over-arching comments

Disclosure for financial institutions

ASFI notes that financial institutions are aggregators of data and, to an extent, will rely on entity-level disclosure to support their own reporting of scope 3 'financed emissions'. A significant number of large Australian financial institutions will be required to report in Group 1 and as a result will have limited access to entity-level data and a high reliance on estimates particularly in the early years.

We expect that the quality and quantity of data available for financial institutions to report will improve over time, as more entities are captured by the disclosure framework, the quality and scope of entity-level reporting improves, reporting methodologies are developed and refined, and data solutions are developed by government and/or market participants.

Further implications of the proposed disclosure framework for financial institutions are outlined below in this submission – including ASFI's recommendation that the Government provide specific guidance for asset owners where required, and provide guidance on methodologies for financed emissions.

Broader sustainability-related reporting

We note the recent issuance by the International Sustainability Standards Board of its first two IFRS Sustainability Disclosure Standards, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures.* We recognise the Australian Government has made a policy decision to proceed with the introduction of climate-relate disclosures in advance of considering implementation of broader sustainability-related disclosures.

We make two points in relation to this. First, we underscore the expectation from financial institutions that Australia will adopt IFRS S1 as soon as practicable. This will help ensure international alignment and signal that Australia is appropriately managing broader sustainability related risks. Second, we note that parts of IFRS S1 (such as materiality assessment, comparative information, and changes in estimates and errors) are necessary in order to properly implement IFRS S1. We expect the AASB's guidance will incorporate relevant aspects of S1 into its climate-related disclosures guidance as appropriate.

Reporting by Government entities

We recognise that disclosure requirements for Government-entities are being developed by the Department of Finance through a separate process. We stress the need for effective inter-departmental cooperation to align the framework for Government entities with the corporate disclosure framework to the extent possible. We also consider that Government entities should take a leadership role in producing high quality disclosures and credible transition plans connected to the APS Net Zero by 2030 target.

The Net Zero target and the disclosure framework should apply as widely as possible to government entities and include scope 3 'financed emissions'. This would enable Government, as a major procurer of infrastructure (directly and via funding to state and territory governments), to play an important role in creating demand for green materials including steel, aluminium and concrete. This would support Australia's decarbonisation transition and the development of our domestic zero carbon industries, consistent with the Government's ambitions for Australia to become a renewable energy superpower.

We note that the Department of Finance has not yet invited public consultation regarding its plans for APS Net Zero and disclosures. We look forward to the opportunity to provide views on this important policy process. We would also welcome clarity regarding the application of disclosure requirements to state and territory government entities.

Resourcing the Australian Accounting Standards Board

The Australian Accounting Standards Board (AASB) has a pivotal role to play in developing Australia's climate disclosure standards. We note that the increased funding the AASB received in the October 2022 budget was reversed in the 2023-24 Federal Budget announced in May 2023. We consider it fundamental that the AASB be adequately funded and appropriately resourced to deliver its expanded scope of work while maintaining an ability to carry out pre-existing AASB functions relating to financial reporting.

Communication and capacity building

ASFI underscore the importance of effective communication, education, and capacity building by Government as the disclosure framework is developed and implemented. In particular, continued public support and acceptance of climate-related disclosure requirements will be aided if prospective disclosing entities understand that:

- Government and regulators recognise there will be gaps and limitations in disclosures in the early years;

- the disclosure framework will build-in flexibility – including through phased coverage; delayed requirements to report scope 3 emissions; concepts of 'materiality' and 'undue cost or effort', and a period of limited liability;
- further guidance will be developed to support reporting entities. Providing clear information about the proposed nature, scope, and timing of forthcoming guidance would be welcome.

3. Comments on specific positions

Coverage and phasing

ASFI supports the Treasury Paper's proposal for ultimate coverage. We note that the thresholds for initial coverage (both Group 1 and Group 2) capture fewer organisations than what ASFI had recommended, and the phase-in time is longer (4 years, where we recommended 3 years). For financial institutions who rely on entity-level reporting to inform their own disclosures, this means a longer timeframe during which there will be less and/or lower quality information available to support disclosures. ASFI's preference would be for the total phase-in period to be 3 years rather than four, and/or for Group 2 to commence reporting in year 2 (instead of year 3 as proposed).

However, we recognise the need to allow time for an up-lift of capability in firms, regulators, and assurance providers. If the thresholds and phase-in period remain as proposed, we consider it important that the limited liability period not be extended. This is because the 3-year fixed period for limited liability serves as a useful incentive for firms to upskill and even to begin reporting on a voluntary basis, supporting better quality disclosures.

ASFI and our members would welcome the publication by Treasury of information and analysis on how many and what type of entities they expect to be included in each Group under the proposed thresholds.

Scenario analysis

The Treasury Paper proposes that initially entities will be required to report qualitative scenario analysis, moving to quantitative over time. ASFI recognises that quantitative analysis requires additional capabilities and considers a phased-in approach is appropriate. Scenario analysis would be expected to improve in quality over time as entities build capabilities, data improves, and sector decarbonisation scenarios become available. We consider that clear guidance should be provided on when entities would be expected to commence quantitative scenario analysis.

The Treasury Paper proposes that entities will be required to disclose against two possible future states, one of which must be consistent with the global temperature goal set out in the Climate Change Act. ASFI considers that this level of guidance is insufficient to support proper risk analysis, comparable reporting, and clarity for disclosing entities. Aligning with the legislated national temperature goals has some merit, but the currently legislated goal is a range ("well below 2 degrees, with efforts to 1.5 degrees") rather than a single temperature. Requiring entities to disclose against a scenario aligned with this range would result in disclosing entities selecting different temperatures within the range, undermining consistency and comparability.

ASFI suggests that the disclosure framework require reporting entities to disclose scenario analysis against at least two future states: one that is consistent with a global temperature rise of 1.5 degrees; and one which is aligned with a high warming scenario (with the disclosure requirements specifying the temperature increase). Entities could also be required or encouraged to conduct a third scenario analysis against a specified scenario in between the two mandatory scenarios.

In each case, entities should base their scenario analysis on credible scenarios, down-scaled for the Australian context (as appropriate).[1] Guidance should be provided on how to produce scenarios, as well as on how to report scenario analysis (including explaining key assumptions and limitations) to promote clarity, transparency and comparability. Entities should consider and disclose relevant physical risks as well as transition risk, getting started where possible while the limited liability period applies and improving the quality of analysis over time.

Transition Plans

ASFI supports the Treasury Paper proposal to require disclosure of transition plans including information about offsets, target setting and mitigation strategies. To support comparability and adequacy of disclosure, the disclosure framework should outline clear minimum requirements. To support firms to produce high quality plans, the Government should produce more detailed transition plan guidance, aligned with relevant international guidance. While this guidance is being developed, the disclosure framework should reference relevant international transition plan guidance that disclosing entities can apply. We look forward to providing further comments in response to the Government's sustainable finance strategy consultation later this year.

Taxonomy alignment

We note that the Australian sustainable finance taxonomy is currently under development. Once established, we expect the taxonomy to play an important role in supporting entities to validate climate-related claims, by demonstrating alignment of capex, revenues or portfolios with Paris goals. Where entities make such claims, they should be required to disclose the level of alignment with the Australian taxonomy. We note that some reporting entities will already be disclosing alignment with taxonomies in other jurisdictions, in particular the European Union taxonomy. This underscores the importance of inter-operability between taxonomies, which we note is a proposed guiding principle for the development of the Australian taxonomy. We anticipate there will be opportunity to provide further comments in response to the Government's sustainable finance strategy consultation later this year.

Metrics & Targets

We support the proposal to develop further guidance on metrics. In particular, noting that there is not currently guidance under National Greenhouse Emission Reporting Scheme (NGERS) on land use, land use change and forestry (LULUCF), this should be developed as a priority.

We agree that greenhouse gas emissions are fundamental to understanding transition risk. We note that emissions should be considered in the context an entity's broader assessment of business risks and opportunities, and anticipated developments in technology, consumer preferences, policy, etc.

ASFI considers the proposal to allow entities to report scope 3 emissions from up to 12 months prior to the reporting period is appropriate, particularly for financial institutions in reporting financed emissions that are the scope 1 and scope 2 emissions of other reporting entities. We note however that where financial institutions are required to report "financed scope 3 emissions", the option for underlying entities to report scope 3 emissions up to 12 months in arrears could result in financial institutions reporting emissions data that is up to 24 months old at the time of reporting. We recommend Treasury consider providing guidance on how financial institutions should manage this.

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[1] ASFI has recommended that the Climate Change Authority produce decarbonisation scenarios down-scaled for the Australian context from credible international modelling: https://www.asfi.org.au/publications/submission-to-the-climate-change-authority-consultation

NGERS reform

The Treasury Paper proposes that NGERS will not be expanded to cover all reporting entities. As Australia's sustainable finance policy framework continues to be developed, it is important to look wholistically at the various component pieces and ensure they work together to support sustainability outcomes and promote useability and streamlining of requirements. As set out in our recent submission to the Climate Change Authority's NGERS Review, ASFI's view is that NGERS should be updated to reflect modern needs and use cases. Specifically, we see value in aligning NGERS requirements with requirements under the climate disclosures framework.

Capability building and implementation support

ASFI supports the proposal in the Treasury Paper to develop further guidance in particular areas including: materiality, boundaries for estimation, disclosure of data gaps, and changes in methodologies and assumptions. We also see an urgent need for the development of sector decarbonisation scenarios[2] and transition plan guidance. And we recognise and underscore the need for the Government to provide capability building support, particularly for smaller entities.

We note that ISSB has produced guidance for asset managers, banks and insurers but not for asset owners and there may be some gaps or areas that require adaptation specifically for this group. There is also a need for guidance to be provided for financial institutions on a 'financed emissions' methodology. This guidance should be developed in consultation with industry stakeholders and aligned with international standards such as those developed through the Partnership for Carbon Accounting Financials.

Data production, management, and accessibility

We also note that the Government has an important role to play in helping to ensure the integrity, availability and appropriate management and use of sustainability-related data. This will help promote the disclosure of high quality, decision-useful information – particularly by financial institutions as aggregators of information from a wide variety of sources.[3] Private entities (such as data and analytics firms) also have an important role to play in this area, and in some cases, collaboration between the Government and private firms may be required.

The respective roles for Government and private firms will be different at each step in the data chain, from the production of raw data, to generation of 'information' based on that data, to information collection and reporting, to management and access. Examples of where Government intervention may be required include: establishing frameworks for quality control, privacy, ownership, management and access; and establishing – in consultation with industry and other stakeholders – agreed methodologies for translating raw data into useful, standardised information. Key principles for data governance include that it should be useable, comparable and accessible.

ASFI considers there would be value in the Government convening relevant stakeholders – including data and analytics firms, as well as the main users of information – to identify what is needed to improve access to high quality information to support the anticipated climate and broader sustainability disclosure requirements.

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[2] This is outlined in more detail in ASFI's recent submission to the Climate Change Authority Consultation on setting, measuring and achieving Australia's climate change targets.

[3] For example, banks will need to disclose information related to the energy use and emissions of millions of residential homes, as well as from agricultural properties. Accessing this information from existing public or privately-held databases could be more efficient and reliable than seeking it directly from householders and farmers, respectively.

Location of reporting and digitisation

ASFI supports the integrated reporting approach proposed in the Treasury Paper. ASFI recognises that, given that climate reporting will be integrated with financial reporting, digitisation needs to considered in a wholistic manner. We note the importance of moving to digital reporting as soon as possible to promote efficient, tech-enabled management of what will be increasingly large bodies of information. This is particularly important for financial institutions as information aggregators.

Internationally, many jurisdictions are moving towards digitisation of sustainability reporting. For example, the European Financial Reporting Advisory Group (EFRAG) has recently formed the digital reporting consultative forum which will advise the EFRAG sustainability reporting board on their activities related to digital reporting including EFRAG's goal to develop and maintain an XBRL Taxonomy of the European Sustainability Reporting Standards.

XBRL is the main global framework for exchanging business information. An XBRL taxonomy for sustainability disclosures will enable companies to make their financial reports machine-readable, which in turn makes it easier for investors and others to digitally access, extract and compare the information they are interested in. It is not to be confused with taxonomies developed by jurisdictions to classify economic activities as environmentally sustainable.

The IFRS is also consulting on the development of a digital XBRL taxonomy in parallel with the development of IFRS sustainability disclosure standards, in recognition of the clear benefits in considering digital consumption of sustainability disclosures from the outset. The IFRS Sustainability Disclosure Taxonomy would be the counterpart to the IFRS Accounting Taxonomy developed to enable digital consumption of information provided by companies applying IFRS Accounting Standards issued by the International Accounting Standards Board.

National jurisdictions will require their own reporting taxonomies to reflect local accounting and other reporting regulations. We note that in Australia, ASIC's financial reporting taxonomy (also referred to as "IFRS AU Taxonomy") is based on the IFRS Taxonomy with additional tags for Australian specific disclosure requirements. However, the lodgement of digital financial reports remains voluntary in Australia and for this reason uptake has been limited.

The development of the climate disclosure framework is an opportunity to progress the digital reporting agenda in Australia. ASFI strongly encourages the development of digital reporting for Australian sustainability standards, which could be adapted from the IFRS digital XBRL taxonomy, once complete. We also recommend the phasing in of mandatory digital lodgements, which will require appropriate levels of Government funding to support the upgrade of government/regulator IT systems and efforts to build capabilities of reporting entities.

Group level reporting

The Treasury Paper notes that most large financial institutions are already captured under Chapter 2M of the Corporations Act. For financial institutions with global operations, we would welcome clarity regarding the ability to fulfil Australian disclosure requirements through group-level reporting (i.e. by an internationally domiciled parent entity).

Liability

In ASFI's submission to Treasury's issues paper on climate disclosures earlier this year, we stated our view that exemptions of liability would not be required. We note the Treasury Paper proposes an exemption to liability for misleading and deceptive conduct for scope 3 emissions and forward-looking statements for a fixed period of three years. ASFI considers that it is important that regulator action is enabled during the three year exemption period (as proposed), and that this period is fixed (as proposed) rather than rolling. Allowing a rolling period for limited liability (for example, three years limited liability from the first reporting year of each Group) would weaken the incentive for Group 2 and Group 3 firms to proactively prepare for disclosure obligations.

We also suggest that ASIC develop guidance on how disclosures should be framed, including disclosure of assumptions, uncertainties and methodologies, along with guidance as to what constitutes a ‘reasonable basis’ under the proposed limited liability regime to give reporting entities comfort that their disclosures align with regulatory requirements.