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Climate-related financial disclosure: Second consultation

The Australian Financial Markets Association (**AFMA**) is providing comment on the Climate-related financial disclosure: Second consultation paper (*CP*).

AFMA is the leading industry association promoting efficiency, integrity, and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, carbon, and other specialist markets. Our membership base is comprised of over 125 of Australia's leading financial market participants, including Australian and foreign banks, securities companies, state government treasury corporations, fund managers, energy firms, as well as other specialised markets and industry service providers. AFMA's membership basis represents the major infrastructure and participants of Australia's financial markets and are therefore all within scope for reporting requirement.

Introduction

AFMA was pleased to provide comment on the discovery consultation paper in which we highlighted our support for the Government endeavours in supporting the Australian community in general, and investors, having access to greater transparency to assist in climate-related planning, identifying financial risks, and opportunities.

AFMA agrees with the objective of standardised, internationally aligned reporting requirements for businesses to make disclosures regarding governance, strategy, risk management, targets and metrics. However, AFMA remains concerned that some of the proposals are unrealistic and unachievable within the proposed timeframes and will place undue liability risk, reputational damage and unattainable requirements on reporting entities. Capacity building, particularly in terms of human resources is necessary and this

takes more time than the three year transition period allows for. The scale of this project is unprecedented by comparison to other regulatory reporting frameworks, such as OTC derivatives reporting, which took a decade to implement, had a much smaller reporting population and still is sorting out the teething problems with global harmonisation to this day. The shift from voluntary to a mandatory reporting and the much expanded population of reporting entities presents enormous compliance and assurance hurdles that need resourcing to be accounted for. Being realistic about the task in front of industry is crucial to successful implementation of the disclosure regime.

In response to this CP, AFMA continues to support the broad range of proposals being put forward. There are several points around which we have specific concerns. These are:

1. *Foreign financial institutions – Acceptance of Group level disclosure:*
    - An Australian branch of an overseas bank forms part of the same legal entity as its head office. The financial statements are those of the head office legal entity and will correspondingly be prepared in accordance with the home jurisdiction accounting standards.
    - Subsidiaries of foreign companies operating in Australia should be permitted to leverage the group or parent company climate-related policies and procedures to meet the climate-related disclosure requirements.
    - Global groups manage their climate risk at a global level. This aspect is particularly important with regard to sectoral exposures. Subsidiaries of global groups should be allowed to report their sectoral targets by reference to global not local Australian targets.
2. *A five-year transition period should apply.*
3. *Scope 3 reporting by financial institutions should remain voluntary during the transition period, which we have recommended to be five years to allow companies time to adjust, be appropriately resourced and for the outstanding data and information systems issues, which the disclosures rely on, to be worked through.*

AFMA has provided a table of key points and our recommendations across proposal areas within the CP followed by our detailed comments in the Attachment below.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au regarding this letter.

Yours sincerely

David Love
General Counsel

AFMA re: Climate-related financial disclosure: Second consultation

Attachment

Table of key points and AFMA recommendations

1. Reporting entities and phasing *1.1. Reporting entities*	The proscribed size thresholds and that are Chapter 2M reporting entities proposal is supported; Treasury should develop an engagement and capacity building strategy; subsidiaries of foreign companies should be permitted to leverage the group or parent company climate-related policies and procedures to meet the climate-related disclosure requirements; consider implementation timeframes in other jurisdictions; ensure foreign bank branches are not triggering the Australian reporting obligation through the NGER 'controlling corporation' route. Because global groups manage their climate risk at a global level, subsidiaries of global groups should be allowed to report their sectoral targets by reference to global not local Australian targets.
2. Phased implementation approach *2.1. Timeline and scaled thresholds for phasing*	The proposed three-phased approach is supported as are the transition and phasing plans; a five-year transition should apply.
3. Reporting content *3.1. Climate-related financial disclosure standards.* *3.2. Phasing of reporting requirements* *3.3. Materiality* *3.4. Governance* *3.5. Strategy* *3.5.1. Scenario analysis*	AFMA supports ASSB standards being aligned to IFRS S2 Climate-related Disclosures requirements and that detailed consultation should be held. The three-year transitional period is not supported and should be extended to five to be feasible. The proposal that the principles of financial materiality would apply is supported; do not include the proposed novel accounting concept; the Government should adopt the European ESRS use of the concept of double materiality. The proposal for companies would be required to disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities is supported; mitigate governance duplication for APRA regulated entities in the Financial Accountability Regime; provide further clarity on personal exposure to liability of directors. Conducting climate-related scenario analysis presents a range of challenges; as such, mechanisms for sharing experiences and approaches across reporting entities to advance the proficiency in the use of scenario analysis, would be beneficial. Qualitative scenario analysis during transition period should be extend to five years; should be commensurate with the reporting entities' level of sophistication, experience, level of exposure and availability of supporting

	information; protection from false or misleading representation claims from private litigants in relation to forward looking statements for the first three years should be included and AFMA supports the climate resilience assessment metrics.
3.6. Transition planning and climate-related targets	AFMA supports the requirement for transition plans to be disclosed, including information about offsets, target setting and mitigation strategies; AFMA supports the proposal that reporting entities would be required to disclose information about any climate-related targets (if they have them) and progress towards these targets.
3.7. Risks and Opportunities	AFMA supports requiring entities 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; detail for these is required in the forthcoming Australian standards.
3.8. Metrics & Targets *3.8.2. Scope 3 Emissions and financial institutions*	The proposal that 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, is not supported; mandatory Scope 3 emissions disclosure is not supported until a point of maturity is reached for Scope 1 & 2 entities before the mandatory requirement for financial institutions can begin; where disclosures rely on third party or estimated data; safe harbors should be provided; ASIC could encourage Scope 3 emissions disclosures outside of the proposed mandatory climate; mandatory Scope 3 reporting standards with penalties represent an unacceptable compliance risk and burden on financial institutions; AFMA's alternative proposal is that Scope 3 reporting by financial institutions remain voluntary during the transition period, which we have recommended should be 5 years.
3.8.3. Industry-based metrics	AFMA queries whether it is realistic to rely on such standards being developed, consulted on, and settled within three years and alternatively recommends five years.
4. Reporting framework and assurance *4.2. Continuous disclosure and fundraising documents*	AFMA agrees any actual material short-term financial impact would have to be disclosed under the current law but the drafting of the standards should not infer that there is an obligation to update a climate risks report before the next periodic report; Forward-looking statements should not be required to be constantly updated or disclosed based on revised thinking about uncertainties unless there is actual certain information which is of a material price sensitive nature; as the ;aw governing disclosure of fundraising documentation is not appropriate to be included in disclosures for the specific purpose of raising equity and debt funding.
4.3. Assurance and professional requirements	The present assurance procedures will need to continue through the transition period which in our view requires five years to reach a satisfactory end state; AFMA does not agree with the proposition that while capability is being developed, it is proposed that scope 3 calculation methodologies would be assured at a minimum; AFMA supports the proposal that assurance standards should be aligned with IAASB standards as far as possible.

5. Liability and Enforcement	
5.1. Modified liability approach	*Scope 3 emissions should only be voluntary for financial institutions and that a five-year transition period should apply.*

1. Reporting entities and phasing

1.1. Reporting entities

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 would be required to make climate-related financial disclosures is supported.
Over time it is expected that there will be increasing convergence with AASB financial reporting standards, and it is desirable, from an efficiency perspective, that there be commonality with existing financial reporting entity definitions.

AFMA considers that Treasury may need to consider an engagement and capacity building strategy, especially for unlisted corporates that meet the threshold requirements to build best practice in disclosures, especially in respect of transition planning, where global transition guidance and best practice is still evolving. Many firms have global green frameworks and are still working on transition frameworks, and which is expected to be an iterative process.

1.1.1. Foreign bank branches

It is noted in the CP that most large financial institutions are required to report under Chapter 2M. A significant portion of AFMA's membership consists of foreign bank (ADI) branches. As an Australian branch of an overseas bank forms part of the same legal entity as its head office, the financial statements are those of the head office legal entity and will correspondingly be prepared in accordance with the home jurisdiction accounting standards. There are specific APRA reporting standards applying to the reporting by foreign bank branches of financial information to it, as the regulator. To the extent there is international alignment under the *IFRS S2 Climate Disclosures*.

It is also important that the implementation timeframes of other jurisdictions is also considered within Australia's implementation plan, particularly given the large number of foreign bank branches operating in Australia. A branch cannot be expected to comply with requirements when their home jurisdiction have not yet implemented

1.1.2. Acceptance of Group Disclosure

More generally, given the global nature of climate risk, AFMA proposes that subsidiaries of foreign companies operating in Australia be permitted to leverage the group or parent company climate-related policies and procedures to meet the climate-related disclosure requirements (where the home jurisdictions standards are of sufficient quality to Australia and where

aligned). The disclosure by subsidiaries can be from consolidated at group level (i.e. 'Group report').

Allowing parent level disclosures would be consistent with the treatment in some of the other countries in Asia, for example Singapore and Hong Kong, which have rolled out climate related disclosure requirements (i.e. Monetary Authority of Singapore: *Guidelines on Environmental Risk Management* (Banks) and Hong Kong Monetary Authority: *SPM GS-1 Climate Risk Management* respectively), but have permitted parent level disclosures to be considered for compliance.

Global groups manage their climate risk at a global level. *IFRS S2 Climate-related Disclosures* recognises this fact and allows it to be factored into local jurisdictional reporting. This aspect is particularly important with regard to sectoral exposures. Subsidiaries of global groups should be allowed to report their sectoral targets by reference to global not local Australian targets.

1.1.3. NGER Act – Controlling Corporation

All entities registered as a 'Controlling Corporation' for the reporting under NGER are covered by the requirements.

According to the NGER Act, a controlling corporation is a 'constitutional corporation' that does not have a holding company incorporated in Australia (Section 7 NGER Act). This infers that it is generally the corporation at the top of the corporate hierarchy in Australia, and which can be a 'non-operational' holding company. It may also be a foreign incorporated entity that operates directly in Australia (that is, does not operate through an Australian incorporated subsidiary). Care needs to be taken to ensure foreign bank branches are not triggering the Australian reporting obligation through the NGER 'controlling corporation' route. It is noted that the corporate group threshold under the NGER Act covers Scope 1 & 2 emissions, not Scope 3.

2. Phased implementation approach

The proposal for a three-phased approach, starting with a small number of large entities that expands over two years applying to progressively smaller entities is supported.

2.1. Timeline and scaled thresholds for phasing

Transition and phasing are supported. A five-year transition period should apply years to allow companies time to adjust, be appropriately resourced and for the outstanding data and information systems issues, which the disclosures rely on, to be worked through.

3. Reporting content

3.1. Climate-related financial disclosure standards

AFMA supports the ASSB standards being closely aligned to the requirements in *IFRS S2 Climate-related Disclosures*. As noted in the CP, it will be important for the ASSB to follow its normal practice with other IFRS standards and hold a detailed consultation on their standards development with affected entities and their representative bodies.

3.2. Phasing of reporting requirements

The three-year transitional period from 2024-25 to 2026-27 is still considered to be too short given the major challenges faced by entities in shifting from a qualitative to quantitative assessment given the need to build up the data ecosystem necessary to support such reporting. A more realistic minimum transition period would be five years. AFMA is concerned that the necessary quality and quantity of data required to provide meaningful and most reflective disclosures will not be fully developed within three years. The current transition period could undermine the policy intent.

3.3. Materiality

The proposal that the principles of financial materiality would apply is supported.

The CP accords with the ISSB determination to use the same definition of ‘material’ that is used in IFRS Accounting Standards – that is, information is material if omitting, obscuring or misstating it could be reasonably expected to influence investor decisions. This determination was arrived at after considerable consideration.

The mandates of most investment institutions are expressed in terms of a single materiality: to secure the best realistic financial return over the long term given the need to control for risks. These risks are deemed to be financial risks. Environmental, social or governance risks can be incorporated when considered in financial terms, such as: causing environmental degradation; poor treatment of customers, suppliers, and employees; or poor governance might risk a company’s brand value and incur legal or regulatory penalties and other financial costs.

Climate and sustainability impacts in any direction will eventually be reflected in financial performance. The single materiality framework currently in place is long understood and Australia does not need to make an already challenging implementation path more complex and uncertain with a novel accounting concept.

The financial impacts of climate-related issues are not always clear and for many companies, identifying the issues, accurately assessing potential impacts, and ensuring material issues are reflected in financial reports is challenging. The alternative path taken with the European ESRS use of the concept of double materiality, meaning a disclosure is material if it is material from an impact perspective (e.g. affects employees, customers, vendors, environment), a

financial perspective (e.g. investors, creditors) or a combination of both; expands the concept beyond what is important to an investor determining the value of the business to what is important to other stakeholders related to the company's impact on the climate and society. It goes beyond the purpose and structure of the Australian accounting practice and the objective of converging climate and sustainability disclosure with other IFRS standards.

3.4. Governance

The proposal for companies would be required to disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities is supported.

Information that is to be included concerns how the company's governance bodies are involved in overseeing and monitoring climate-related risks and opportunities, including an explanation of how this role is incorporated in company policy and procedures and whether (and how) climate-related performance metrics are factored into executive remuneration. This is considered an extension to existing remuneration-related disclosures under current annual reporting obligations. In this regard, account should be taken of the requirements of APRA regulated entities and their reporting obligations under the Financial Accountability Regime to avoid duplication and double jeopardy for directors and senior managers of APRA regulated entities.

The standards will bring a new compliance requirement and we have suggested previously that further clarity is required on the question of personal exposure to liability of directors to ensure that the obligations imposed on them which are directed towards securing compliance with the standard are clear, measurable, and achievable.

3.5. Strategy

Conducting climate-related scenario analysis present a range of challenges. Firstly, most current scenarios have been developed for global and macro assessments of potential climate-related impacts that can inform scientists and policy makers. These climate-related scenarios do not always provide the ideal level of transparency, range of data outputs, and functionality of tools that would facilitate their use in a business or investment context. For example, many transition scenarios provide outputs such as the energy mix under given circumstances in the future, but not sector- or activity-specific results in most instances. The outputs of climate modelling of physical scenarios, undertaken within the framework of the IPCC, are currently not easily accessible to the wider group of reporting entities.

Secondly, the availability of data and the granularity of data can be a challenge for reporting entities attempting to assess various energy and technology pathways or carbon constraints in different jurisdictions and geographic locations.

Thirdly, the use of climate-related scenario analysis to assess potential business implications of climate change is still at an early stage. Although a limited number of the world's largest companies and investors are applying climate-related scenario analysis as part of their strategic planning and risk management processes, many reporting entities will be only at the start of the exploration of its use and are just beginning to explore its use.

Accordingly, it would be beneficial if mechanisms for sharing experiences and approaches to scenario analysis across reporting entities become available for advancing the proficiency in the use of scenario analysis. Industry associations can play a role in this regard by facilitating information and experience exchanges among members and collectively develop tools, data sets, and methodologies; and work to set standards for their industry.

3.5.1.Scenario analysis

In relation to the proposals that reporting entities would be required to use qualitative scenario analysis to inform their disclosures, moving to quantitative scenario analysis by end state, AFMA has the following points to make:

- Consistent with our comments about the transition a five-year period the qualitative scenario analysis during transition period should extend to five years. This would work in with reporting entities will be encouraged to undertake before this time while modified liabilities settings apply.
- AFMA agrees with the proposition that the scenario analysis should be commensurate with the level of sophistication and the experience of reporting entities, their exposure to climate-related risk and the availability of supporting information (methodology and datasets).
- Consistent with our comments about the transition a five-year period, reporting entities should be given to entities for protection from false or misleading representation claims from private litigants in relation to forward looking statements for the first three years.
- The proposed target for reporting entities 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 gives a certain reference point against which to construct and select an appropriate scenario, are supported
- Given the nascent field of scenario analysis and the increasing need to account for climate risks, developing financial sector capabilities in this area will take some time. To date, many financial institutions have been directly engaging their counterparties to better assess climate-related counterparty risk. This contributes towards generating important data on firm-level exposures, facilitating new analyses to better understand the risks to financial firms, as well as the overall financial system.

3.6. Transition planning and climate-related targets

AFMA supports the proposal that transition plans would need to be disclosed, including information about offsets, target setting and mitigation strategies; and welcomes the commitment by Treasury to consider arrangements that could develop disclosure of plans later this year as part of the Sustainable Finance Strategy.

AFMA supports the proposal that reporting entities would be required to disclose information about any climate-related targets (if they have them) and progress towards these targets.

3.7. Risks and Opportunities

AFMA supports the proposal that 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. To do this, it will be necessary that detail be providing in forthcoming Australian standards.

3.8. Metrics & Targets

3.8.1. Greenhouse gas emissions

3.8.2. Scope 3 Emissions and financial Institutions

The proposal that there be 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 is not supported.

For financial institutions – defined for this discussion as APRA regulated entities - mandatory Scope 3 emissions disclosure is highly problematic because of the nascent state of this proposed reporting frame. For banks, Scope 3 emissions represent the entire supply chain and value chain. The proposed climate-related disclosure framework will need to be developed to a point of maturity for Scope 1 & 2 reporting by entities before financial institutions can be expected to meet mandatory reporting standards. It should also be borne in mind that a large part of the client base of banks, such as individuals and small businesses will not be required to report their Scope 1 & 2 emissions. Thus, banks will be faced with the problem of missing or absent data.

The commentary in the CP does not address such problems previously raised with Scope 3 reporting raised by AFMA and others in previous consultations. AFMA assesses that oversight of gaps within the disclosure framework presents integrity concerns. Where disclosures rely on third party or

estimated data, AFMA affirms that government should reconsider the inclusion of safe harbors do address the sizeable risk faced by business.

Scope 3 reporting would not result in consistent, comparable, or reliable disclosure given the significant challenges around Scope 3 emissions data quality, availability, and the continuing evolution of Scope 3 calculation methodologies- and would not result in useful information for investors. Many members are already voluntarily providing Scope 3 emissions data, where possible, in their sustainability reports. ASIC could encourage Scope 3 emissions disclosures outside of the proposed mandatory climate. Moving in that direction would encourage more robust climate risk disclosures at an appropriate pace as the quality and availability of information increases.

Because consistent, comparable, or reliable disclosure by financial institutions is not possible in the near-term, mandatory Scope 3 reporting standards with penalties represent an unacceptable compliance risk and burden on financial institutions. In addition, the reputational damage that could flow from a penalty being imposed for an unreasonable reporting requirement is also unacceptable. AFMA is concerned that such risks to business and unrealistic short-term requirements could cause an exodus from the Australian market. AFMA would therefore caution the Government to reassess the viability of these requirements and risk to Australian business.

AFMA's alternative proposal is that Scope 3 reporting by financial institutions remain voluntary during the transition period, which we have recommended should be 5 years.

3.8.3. Industry-based metrics

The proposal that 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; being three years from the commencement, is highly ambitious. AFMA queries whether it is realistic to rely on such standards being developed, consulted on, and settled within three years. Again, a five-year period is reasonable based on Australian experience with the implementation of other statutory reporting regimes.

3.9. Supporting information

AFMA welcomes the statement in the CP that further guidance and progress on data challenges is necessary to support broad adoption of best-practice disclosure in the medium term and that stakeholders will have an opportunity to provide further input on these issues as part of the Sustainable Finance Strategy consultation process.

4. Reporting framework and assurance

4.1. Reporting, location, frequency and timing

AFMA has no specific comments to make on the 'Reporting location, frequency and timing' proposals.

4.2. Continuous disclosure and fundraising documents

It is noted that the climate-related disclosure obligations would extend to continuous disclosure and fundraising document obligations. Listed companies must disclose material price sensitive information on a timely basis. It is agreed that any actual material short-term financial impact would have to be disclosed under the current law. However, the drafting of the standards should not infer that there is an obligation to update a climate risks report before the next periodic report. Forward-looking statements in climate risk reports should not be required to be constantly updated and disclosed based on revised thinking about uncertainties unless there is actual certain information which is of a material price sensitive nature.

With regard to corporate fund raising, the current law governing disclosure in fundraising documentation is not to be changed based on our understanding from the wording of the CP. This means that rules concerning disclosure of risks and prospects will continue to prevail. As many of the matters that will be coved by the forthcoming climate disclosure standards based on a reading of the *IFRS S2 Climate-related Disclosures* are inherently uncertain, so hence they are unreliable. This would make such matters inappropriate to be included in disclosures for the specific purpose of raising equity and debt funding.

4.3. Assurance and professional requirements

AFMA has previously queried whether a separate assurance requirement will require a significant capacity build. In this regard, the present assurance procedures will need to continue through the transition period which in our view, requires five years to reach a satisfactory end state.

AFMA does not agree with the proposition that while capability is being developed, it is proposed that Scope 3 calculation methodologies would be assured at a minimum. As we have previously noted that Scope 3 is the most underdevelop aspect of the reporting regime and needs considerable effort and resources to get to a state where assurance could be relied upon.

AFMA supports the proposal that assurance standards should be aligned with IAASB standards as far as possible to allow for international compatibility.

5. Liability and Enforcement

5.1. Modified liability approach

In relation to the proposal that climate-related financial disclosure requirements would be drafted as civil penalty provisions in the Corporations Act, and 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; we reiterate our points about Scope 3 reporting only being voluntary for financial institutions and that a five-year transition period should apply.