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Director
Climate Disclosure Unit
Climate & Energy Division
Treasury
Langton Cres
Parkes ACT 2600

By email: ClimateReportingConsultation@treasury.gov.au

Climate-related financial disclosure: exposure draft legislation

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the draft *Climate-related financial disclosure: Exposure Draft Legislation* (Exposure Draft). This consultation has been reviewed in conjunction with the parallel consultation by the AASB on the *Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information* (Sustainability Standard).

AFMA is the leading financial markets industry association promoting efficiency, integrity and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, and other specialist markets, including environmental products, carbon and sustainability related and linked products. Our membership base is comprised of over 125 of Australia's leading financial market participants, from Australian and international banks, leading brokers, securities companies and state government treasury corporations to asset managers, energy companies and industry service providers. AFMA members are some of the major issuers and intermediaries of sustainability products, as well as many of the key investors in sustainable activity and products.

1. General

As stated, in our previous submissions, most recent of which was in December of 2023 on the Sustainable Finance Strategy Consultation Paper, we agree with the direction and framework that the Government has set for Australia on sustainable finance. This include agreement across the breadth of the measures that are currently being put in place through legislation to give market participants greater transparency and consistency.

In respect of the Exposure Draft, we are in general agreement with the proposed measures, which have been previously flagged in policy discussions and accord with our expectations. We have several

reservations around the limitation on protections provided by modified liability, which are of great importance to our members and the function of the market more broadly.

1.1. Role of the finance sector in economy wide decarbonisation

Generally, and with particular regard to point 1.7 in the Explanatory Memorandum, is that that banks and other financial institutions should not, as has been observed of the approach in a number of other jurisdictions, be viewed as the drivers of transition, to be penalised if that transition is not affected. Rather the core role of the finance sector is to facilitate access to capital that can support the transition of the real economy. It is up to public sector leadership is put in place policies that spur long-term and large-scale capital deployment for low-carbon solutions initiated and carried out in the real economy, facilitated by the finance sector.

1.2. Group Level Reporting

To reduce the considerable compliance burden and utilise group level disclosure, which will yield better insights for global institutions with diversified business across jurisdictions, we propose to have non-listed company to be exempted from preparation of the sustainability report with substituted compliance with the below conditions:

- Its immediate, intermediate, or ultimate parent (local or foreign), is preparing climate or sustainability reports in accordance with globally acceptable climate reporting framework such as US SEC rules (when issued), Global IFRS standards, GRI and TCFD); and
- Its business activities are included in that parent's report, which is available for public use.

1.3. Timing between reports

As recommended in the Exposure Draft, climate-related financial disclosures will sit within a sustainability report, which will form the fourth report required as part of annual financial reporting obligations and be contained in a company's annual report. Timing of annual report lodgement, including for those required to lodge with ASIC, will stay consistent with current requirements under section 319 of the Corporations Act 2001. Climate-related financial disclosure is an additional compliance burden to in-scope companies and the disclosure is separate from the financial information.

AFMA therefore recommends allowing more time to prepare and file climate related disclosure. Allowing a further three months from the existing reporting and filing timelines for financial reports would ease this burden. Staggered reporting and filing deadline can offer delivery reliability whilst avoiding overburdening the reporting entities.

2. Modified liability – Section 1705B

AFMA generally welcomes efforts to limit civil liability during the introduction of the regime. Restriction on ASIC enforcement actions is important given the challenges in data, assurance, and human resources

available during the transition to the reporting regime. This allows for disclosure to be operationalised in collaboration with ASIC, without diversion of resourcing to handling litigation risk.

Because of its importance in promoting confidence in operationalised sustainability reporting under financial standards compliance frameworks, we have several points we want to raise. We also welcome the role of the AASB in the creation of standards and trust that they will play a leading guiding and educational role for reporting entities, complementing ASIC in its supervision role, during implementation of this new regime and transformational process.

2.1. Coverage of all forward-looking statements

Forward-looking disclosures beyond Scope 3 disclosures, covered by forthcoming reporting standards, including transition plan disclosures, need to be covered by modified liability protection. Forward-looking disclosures contemplated by Australian Sustainability Reporting Standards, ED SR1, many of which would feature in a transition plan, include:

- Anticipated effects of climate- related risks and opportunities on the entity's business model and value chain[1]
- Anticipated changes to the entity's business model, including its resource allocation[2]
- How the entity expects its financial position to change over the short, medium, and long term given its strategy to manage climate-related risks and opportunities, taking into consideration its investment and disposal plans and its planned sources of funding to implement its strategy[3]
- How the entity expects its financial performance and cash flows to change over the short, medium, and long term, given its strategy to manage climate-related risks and opportunities[4].
- How the entity plans to respond to climate-related risks and opportunities in its strategy and decision-making, and how it plans to resource this.
- Anticipated direct and indirect mitigation and adaptation efforts.
- Any climate-related transition plan the entity has.
- How the entity plans to achieve any climate-related targets, including any greenhouse gas emissions targets.

All forward-looking disclosures, not just scenario analysis disclosures, have considerable latitude in measurement and outcome uncertainty, and are new to the Australian market. The uncertainties that underpin scenario analysis disclosures similarly apply to a disclosure of (for instance) how, in 15 years' time, an entity expects that climate change will impact its financial performance or cash flows. These uncertainties relate to the requirement to make projections many years or decades in the future on the basis of incomplete or unknown information. Assumptions and data, which are fed into models, are

[1] Paragraph 13 IFRS S2
[2] Paragraph 14(a)(i) IFRS S2
[3] Paragraph 16(c) IFRS S2
[4] Paragraph 169(d) IFRS S2

imprecise and subject to quality and access issues. There is no discernible policy rationale for modified liability to apply to scenario analysis but not the remainder of the forward-looking disclosures which also have the same degree of uncertainty and may be more susceptible to litigation risk. Enhanced litigation risk also poses a substantial threat to the attractiveness of Australia as place to do business.

2.2. Statements made outside a sustainability report

Another aspect of the proposal does cause us concern. The note following subsection *1705B(1)* states that the immunity *"...does not apply to a statement made other than in a sustainability report (even if such a statement is also made in a sustainability report)*". AFMA considers the drafting of the note to be problematic and requiring adjustment. It appears to suggest that a statement made in the sustainability report that is also used outside the report would have the effect of vitiating the liability protection for such a statement. Statements and messaging made in sustainability reports are likely to be repeated elsewhere in the annual report and in forums or venues. It will be likely common for statements made in the sustainability report to be used elsewhere. For example:

1) Sections 199 and 299A of the *Corporations Act* may require disclosure of climate-related information in the director's report.
2) The sustainability report to be laid before the entity's annual general meeting. The reporting entities representatives and/or auditors may be required to repeat statements made in the sustainability report verbally and/or in the notice of meeting to address the content of the sustainability report and answer shareholder questions or respond to resolutions.
3) Similarly, during investor updates, or other forums for corporate public accountability, reporting entity representatives may repeat statements made in the sustainability report, verbally, in a written presentation, in answer to questions about the sustainability report.
4) Market information through other reports on the firm's website may draw out statements from a sustainability report for use in published reports or an entity's website.
5) Entities operating in multiple jurisdictions may be subject to disclosure requirements of foreign laws, many of which continue to evolve.

AFMA proposes that the modified liability period expressly permits reasonable duplication and discussion of statements made in a sustainability report outside of the sustainability report.

2.3. 3-year immunity to apply to each reporting Group

As currently drafted, only Group 1 and Group 2 will have any benefit from the Limited Immunity. Further, because organisations are not required to make Scope 3 disclosures in their first year of reporting, Group 2 will not have the benefit of the Limited Immunity as it relates to Scope 3 disclosures. Group 3 entities will not have any recourse to the Limited Immunity.

We consider that the fixed approach creates an uneven policy outcome where Group 1 entities would be the only cohort subject to the full period of liability relief, whereas the smaller Group 2 and Group 3 companies will be provided with limited or no relief.

A three-year immunity period should apply to each Group.

3. Directors' Declaration

Section 296A(6)(b) of the Exposure Draft requires that directors declare that the Sustainability Report is in accordance with the Sustainability Standards and the Corporations Act. While we understand the policy rationale for requiring directors to attest to compliance with the Sustainability Standards, such a declaration must be suitably qualified. It should reflect the uncertainty inherent in implementing such a complex new reporting, and the lack of reasonable assurance currently available.

Ultimately, boards cannot be expected to provide unqualified sign-offs at a time when nobody knows what full "compliance with Sustainability Standards" looks like, when there are well-recognised skills shortages, and where reasonable assurance over all mandated disclosures is not required until the financial year commencing 1 July 2030 (presumedly because the assurance industry has advised they are incapable of providing reasonable assurance on disclosures before this time due to capability constraints).

It is anomalous that auditors are unable to attest to whether all disclosures comply with the Sustainability Standards until 1 July 2030, but directors are required to do so from commencement.

The case we are making is for reasonable application of liability. Directors and entities should be responsible for putting in place robust due diligence processes to enable verification of the accuracy and completeness of corporate reporting. It needs to be recognised that in practice there is an ongoing dialogue between the external auditor and directors, and this is a critical part of directors fulfilling their financial, and climate reporting oversight function. The provision of an unqualified sign-off in the absence of reasonable assurance creates significant liability risk, exposing directors to a broad range of causes of action, most of which will be outside the scope of the modified liability protection.

In addition, whether an entity has obtained assurance is likely to be relevant to a director or entity seeking to establish that they had "reasonable grounds" for making the kind of forward-looking statements required by the Sustainability Standards.

We understand that the reference to "an explicit and unreserved statement of compliance" in section 296A(6)(a) only applies to entities voluntarily disclosing against the ISSB standards and will not apply to entities applying the Australian Sustainability Standards. There is comment that this section is confusing and creates the misleading impression that such a statement is mandatory. In any event, for the reasons set out above, the provision of an "explicit and unreserved statement of compliance" is not possible given the nascent nature of climate disclosures and in the absence of reasonable assurance. To avoid any confusion, we therefore suggest deleting this section.

AFMA would be pleased to assist the Committee with any questions it may have on the submission. Please contact Monica Young either on 02 9776 7917 or by email myoung@afma.com.au regarding this letter.

Yours sincerely

David Love
General Counsel