PRI RESPONSE

AUSTRALIAN TREASURY'S SECOND CONSULTATION ON CLIMATE-RELATED FINANCIAL DISCLOSURE

21 July 2023

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To inform this briefing, the following investor group has been consulted: PRI Regional Policy Reference Group for Australia. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing.

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to Treasury's request for feedback and comments on key considerations for the design and implementation of standardised, internationally aligned requirements for disclosure of climate-related financial risks and opportunities in Australia.

ABOUT THIS CONSULTATION

On 27 June 2023, Treasury released a secondary consultation on climate-related financial disclosures that builds on its discovery consultation in early 2023. The secondary consultation sets out a detailed proposal for the implementation and sequencing of standardised, internationally-aligned requirements for disclosing climate-related financial risks and opportunities. The consultation seeks views on whether Treasury's proposals for climate disclosure coverage, content, framework, and liability are workable, proportionately targeted, and provide sufficient clarity.

This current consultation will precede separate but interrelated consultations by Treasury on the exposure draft legislation for mandatory climate disclosures and by the Australian Accounting Standards Board on associated standards.

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KEY RECOMMENDATIONS

The PRI welcomes Treasury's proposal to implement mandatory climate-related disclosures aligned with the International Sustainable Standards Board's (ISSB) IFRS S2 Climate-related Disclosure Standard (IFRS S2). Signatories regularly report to the PRI that the lack of comparable, decision-useful corporate climate *and* broader sustainability data is a substantial barrier to their responsible investment practices. We therefore strongly support the Australian Government's intention to uphold a global baseline for climate disclosures that achieves maximum possible interoperability with ISSB standards, and that is scalable and flexible to accommodate future sustainability reporting developments.

We acknowledge the proposed plan attempts to ensure disclosure reforms support Australia's climate goals (including its transition to net zero emissions by 2050 and promoting a sustainable financial system). It also aims to provide investors and regulators with clear information to assess and manage systemic risks whilst being proportional. The PRI supports these principles.

Nevertheless, Treasury's proposals could be improved to better generate the comprehensive disclosures investors urgently need and achieve the underlying reform principles. In particular, we highlight that the phased timing for Group 2 could inhibit investors from receiving information necessary for them to achieve their 2030 interim targets. Additionally, without mandating specific scenarios for climate resilience assessments and linking transition plans to the goal of limiting temperature rises to 1.5°C, the proposed approach may limit investors' ability to adequately assess the risks and opportunities faced by their investments and effectively steward investee companies to reduce emissions. Our key recommendations relating to these matters are set out blow.

RECOMMENDATIONS

- Treasury should firstly articulate how the fundamental components of IFRS S1 General Reporting Requirements for Disclosure of Sustainability-Related Financial Information Standard (IFRS S1) will be incorporated into Australia's climate disclosure standards and further consider mandating IFRS S1 and future ISSB standards in due course.
- Treasury should assess whether additional entity criteria for broader sustainability standards are needed to ensure entities with substantial dependencies and impacts on the relevant sustainability issues are appropriately required to report.
- Group 2 entities, which purportedly cover companies within the ASX300, should be required to begin reporting for the 2025/26 financial year.
- Entities should be required to undertake climate resilience assessments against three scenarios: (1) a measured, orderly transition; (2) sudden disorderly transition; and (3) no transition.
- Treasury should establish a clear framework for entities to develop and disclose transition plans that support a whole of economy, just transition aligned with limiting global temperatures to 1.5°C.
- Treasury should legislate that the three-year period for modified liability applies on commencement of the disclosure regime.

- Treasury should consider the interlinkages between the current proposal and the development of Australia's sustainable finance strategy. It should identify what additional information will be needed to facilitate the implementation and use of the taxonomy, and consider how this can be incorporated into the climate disclosure framework.

These recommendations broadly align with our recent letters and submissions on climate and general sustainability disclosures:

- PRI joint statement with IFAC and WBCSD calling for stronger alignment of regulatory & standard setting efforts around sustainability disclosure (June 2022).
- PRI's response to ISSB: Exposure Draft IFRS S1 general requirements for disclosure of sustainability-related financial information and Exposure Draft IFRS s2 climate-related disclosures (July 2022).
- PRI's response to AASB: Request for comment on ISSB Exposure Drafts (July 2022).
- PRI's joint letter with AIGCC, CDP, Ceres, IGCC, IIGCC to the Treasurer and RBA Governor (October 2022).
- PRI's response to Treasury: Empowering the AASB to deliver sustainability standards (December 2022).
- PRI's response to Treasury: Discovery Consultation on Climate-related Financial Disclosure (February 2023).

DETAILED RESPONSE

REFORM PRINCIPLES

We welcome the six reform principles underpinning Treasury's proposed plan to implement climate disclosures. However, we restate our view that Treasury should ensure the structure and infrastructure of the disclosure framework provides sufficient flexibility to permit the introduction of broader mandatory sustainability reporting and standards in due course.

Two of the principles underpinning these reforms are that they are "*internationally aligned*" and "*scalable and flexible*" to accommodate future developments in climate and sustainability reporting. Yet, we note that Treasury's proposed plan does not contemplate introducing IFRS S1.

IFRS S1 sets out the conceptual foundations for how to report on sustainability information – such as the fundamental and enhancing characteristics of quality, materiality definition, and connectivity requirements – which are needed to ensure decision-useful reporting against all other ISSB standards, including IFRS S2. Incorporating these foundational components into Australia's climate standards is critical to support effective climate disclosures.

Further, IFRS S1 directs entities to disclose additional sustainability-related information to meet investors' needs. Beyond climate change, investors need information on the broader environmental, social, and governance risks facing investee companies to inform assessments of their investments' financial performance. Many institutional investors also now accept that, in acting in their clients' and beneficiaries' best financial interests, they should consider and respond to system-level risks that may affect long-term returns. With issues like biodiversity loss, human rights violations and income inequality emerging as material system-level risks,[1] investors also need decision-useful data on their investments' risks, opportunities, and impacts across these sustainability issues.

Accordingly, we recommend Treasury articulate how the fundamental components of IFRS S1 will be incorporated into Australia's climate disclosure standards. We further encourage Treasury to consider mandating IFRS S1 and separate sustainability standards developed by ISSB in due course.

COVERED ENTITIES

The ultimate threshold proposed for entities required to make climate-related financial disclosures is appropriate. We welcome the coverage of reporting obligations to large proprietary companies and the controlling corporation of Australia's highest emitting facilities under the *National Greenhouse and Energy Reporting Act 2007* (Cth) (NGER) as climate disclosures by these entities is proportional and:

- is needed by investors to meet their own regulatory reporting requirements, including but not limited to those under this proposed rule.
- could address scope 3 data gaps by facilitating the flow of climate-related information from entities within large financial institutions and listed companies' value chain.

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[1] PRI (2022), A Legal Framework for Impact: Australia (p.8).

- better enables investors to analyse where climate risks and opportunities lie across their entire portfolios particularly given investors can be directly or indirectly exposed to unlisted entities that contribute to their own portfolio emissions.
- would provide governments and regulators with a more comprehensive understanding of the Australian economies' carbon exposure and its climate risks and opportunities to enable them to facilitate a just and orderly transition to net zero emissions by 2050 in a manner that maintains a sustainable financial system.

While we support the proposed threshold for climate disclosures, we encourage Treasury to assess the appropriateness of criteria solely based on revenue, assets, and employee size in its application to additional sustainability standards. We encourage the consideration and application of additional criteria that would promote reporting by entities that have substantial dependencies and impacts upon the relevant sustainability issue to ensure investors can adequately identify risks and opportunities to their portfolio (akin to Treasury's proposal to require climate reporting by NGER's controlling corporations).

We further welcome the Minister for Finance's separate work stream to implement appropriate arrangements for comparable Commonwealth entities. We encourage Treasury to coordinate with the Australian Public Service Net Zero 2030 on these plans so that they align with expectations for corporate entities and ensures the Australian Government demonstrates best practice.

PHASED TIMING

We welcome Treasury's intention to begin reporting requirements for Group 1 by 2024/25. However, we note that the proposed timeline for phasing in reporting requirements presents challenges for investors.

We understand that the proposed criteria for Group 1 covers the ASX200. We consider that these companies are already well placed and resourced to disclose climate-related financial information and, to that end, note that over 50% of ASX200 companies are already reporting in line with the TCFD framework.[2] While we maintain our position that preferably ASX300 companies begin reporting from initiation of the disclosure regime,[3] we acknowledge Treasury's aim to allow reporting entities time to develop internal capabilities and capacity.

Nevertheless, given the scale and immediacy of the risks posed by climate change, investors urgently need climate-related information to take investment and stewardship decisions aligned with their long-term investment goals. The proposed one-year delay between Group 1 and 2 (which we understand covers the ASX300) is unwarranted and may inhibit investors from achieving their own emission reduction targets. We recommend that the reporting obligations for Group 2 be brought forward from 2026/27 to 2025/26.

Since 2019, the ASX Corporate Governance Council has encouraged all listed companies to assess their climate risks and report them according to the TCFD.[4] ASIC analysed climate disclosures by

[2] ACSI (July 2022), Promises, Pathways & Performance: Climate Change Disclosure in the ASX200.

[3] PRI (February 2023), Response to Treasury's Discovery Consultation on Climate-related Financial Disclosures (p.9); CDP, IGCC & PRI (2021), Confusion to Clarity: A Plan for Mandatory TCFD-aligned Disclosure in Australia (p.37).

[4] ASX Corporate Governance Council (February 2019), Corporate Governance Principles and Recommendations: 4th Edition.

ASX300 in 2018 and likewise advised listed companies with material exposures to provide voluntary TCFD reports.[5] Investors and proxy advisors have increasingly been engaging with ASX300 companies around their climate risks, targets, and transition plans.[6] Where listed companies have been urged to provide TCFD-aligned disclosures for half a decade, we consider that the Group 2 has already had ample time to prepare and build capacity for mandatory climate reporting. In addition, where IFRS S2 largely aligns with and builds on the TCFD framework, we consider that Group 2 should be able to report in 2025/26 being the year following Group 1.

Both global and Australian investors urgently require disclosures from all covered entities to ensure they meet their own interim targets. A 2022 study by IGCC identified that 70% of surveyed institutional investors in Australia had set 2050 net zero targets and 35% had also set interim decarbonisation targets for 2030 or sooner. To meet their 2030 interim targets, investors need to understand the scope 1, 2, and 3 emissions of their investee companies with sufficient time to allow them to implement strategies that decarbonise their portfolio.

Treasury's current proposal would mean that investors may not have information on the ASX300's scope 1 and 2 emissions until 2027 and their scope 3 emissions until 2028. The proposed approach may not provide investors with sufficient time to meet their targets and could have the unintended consequence of exposing them to allegations of greenwashing.

Accordingly, reporting obligations should begin for Group 1 in 2024/25 and Group 2 in 2025/26. We support the initial reporting year for Group 3 remaining in 2027/28 to ensure this group builds capacity and alleviate regulatory burden.

SCENARIO ANALYSIS

We welcome the proposal to require disclosure of climate resilience assessments upon commencement and are supportive of the phased approach from qualitative to quantitative analysis in due course. Nevertheless, this proposal could be improved by setting a clear expectation of the exact scenarios that entities must use.

QUALITATIVE TO QUANTATIATIVE SCENARIO ANALYSIS

Disclosure from climate scenario analysis is not necessarily a quantitative exercise but can be narrative based to set a learning process in motion and build understanding of how climate-related risks and opportunities could evolve over time. As entities gain experience, the use of more quantitative information with greater rigor and sophistication may be warranted. For these reasons, we support Treasury's proposal to permit qualitative scenario analysis in the transition period before requiring some form of quantitative scenario analysis by end state.

SCENARIOS FOR CLIMATE RESILIENCE ASSESSMENTS

As its currently expressed, the proposal to require climate resilience assessment of transition risks to be undertaken against a scenario consistent with the global temperature goals in the *Climate Change Act 2022* (Cth) sets out a range of scenarios entities could report against. It would permit entities to

[5] ASIC (September 2018), Report 593: Climate Risk Disclosure by Australia's Listed Companies.

[6] See for example, HESTA (28 September 2022), Media Release: HESTA calls for ambitious response from ASX300; ACSI (October 2022), Climate-related Financial Disclosure Statement.

assess their climate resilience against either a 1.5°C scenario and any temperature scenario that is less than 2°C. To accurately understand and compare the risks and opportunities facing their investments, investors require information on companies' resilience to both physical and transition risks based on consistent scenarios. What is material for financial markets is not only the temperature outcome of a particular climate scenario, but also whether the path to this outcome is orderly or disorderly. To address this, the PRI recommends Treasury requires the following family of climate scenarios to be reported against:

- **A measured, orderly transition**, which takes place with climate policies being introduced early and becoming increasingly more stringent, in line with an interim emission reduction target and a net-zero Australian economy consistent with meeting the 1.5°C temperature goal in the *Climate Change Act 2022* (Cth);
- **A sudden, disorderly transition**, which takes places with climate policies and wider action on climate change not happening until late (for example, introduced around 2030) – this scenario gets towards, but does not achieve, the global temperature goals in the *Climate Change Act 2022* (Cth) and is characterised by a higher level of transition and physical risk than in an orderly transition; and
- '**No transition**', which assumes only currently implemented policies are preserved, current commitments are not met, and emissions continue to rise (i.e., a 4°C or higher climate scenario). This would mean climate goals are missed and physical risks are high, accompanying severe social and economic disruption.

On the "No transition" scenario, the PRI notes that the IPCC's central projection for temperature rise this century is now 3.2°C, and therefore a 4°C scenario is appropriate to assess the resilience of an entity to physical climate risk.

TRANSITION PLANS

We support Treasury's proposal to require entities to disclose transition plans from commencement. This approach appropriately builds on the ISSB's expectations under IFRS S2, which only mandates that entities disclose transition plans *if* they have one. The proposal will enable investors and regulators to understand how entities' assessment of climate risks and opportunities inform their strategies and decisions to pivot assets, operations, and business model to reduce emissions. We urge Treasury to build on this proposal to establish a clear framework for entities to develop and disclose transition plans that support a whole of economy, just transition aligned with limiting global temperatures to 1.5°C.

Investors increasingly expect to understand how companies plan to align with a 2050 net-zero trajectory and limit global temperatures in line with the Paris Agreement goals. Accordingly, the 2022 Global Statement to Governments, which was signed by 602 global investors with USD$42 trillion AUM, called for governments to strengthen reporting frameworks by requiring large listed and unlisted entities to disclose 1.5°C pathway-aligned, science-based, and independently verifiable transition plans.[7] Various global jurisdictions are now beginning to do so. The EU is developing a directive that companies adopt plans to ensure their business model and strategy are aligned or compatible with

[7] Investor Agenda (2022), 2022 Global Investor Statement to Governments on the Climate Crisis.

the transition to a sustainable economy and with limiting global warming to 1.5°C in line with the Paris Agreement. Conversely, the UK Transition Plan Taskforce (TPT) is finalising guidance for companies to develop transition plans that explicitly recommends companies set ambitious objectives and priorities that contribute to a rapid and orderly economy-wide net zero transition. The TPT emphasises that, in developing transition plans, companies should be informed by both national commitments and the latest international climate change agreements.[8]

As a system-level risk, climate change threatens Australia's economic and financial stability and real-world emission reductions in line with the Paris Agreement's goals are needed to maintain an orderly transition and protect financial returns for investors' ultimate beneficiaries.[9] To achieve these objectives, investors have and are actively stewarding investee companies to set 2050 net zero and interim emission reduction targets. For example, in the five years since initiation, Climate Action 100+ members have driven 75% of their target companies to set net zero commitments.[10] As in the case of Climate Action 100+, it can often take investors successive engagements over multiple years to achieve similar outcomes for a select group of investee companies within their portfolio.[11] Accordingly, there are limitations on investors ability to scale stewardship activities across their portfolio and drive improvements for all investee companies' transition planning and target setting in line with Treasury's presumptions.[12]

To support investors to mitigate climate risks and maintain a sustainable finance system, the Australian Government should set expectations for, guide, or otherwise incentivise entities to develop transition plans that drive their strategies and business models to align with its commitments to the Paris Agreement goals. Doing so would set a standardised benchmark amongst companies that could then better enable investors to assess the credibility of companies' transition plans, monitor their implementation, and ensure companies are taking actions to actively reduce emissions in line with those plans.[13]

Whilst we acknowledge Treasury's comments that mandating a specific target for entities' transition plans is outside of its aim to improve transparency, we highlight that setting a clear framework for entities to develop transition plans that support a whole of economy transition in line with a 1.5°C pathway is arguably consistent with Treasury's principles for disclosure reforms, specifically the intention to support Australia's climate goals. We encourage Treasury to take respective actions as part of its commitment to consider additional actions to improve transition planning through its Sustainable Finance Strategy work program.

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[8] Transition Plan Taskforce (November 2022), Implementation Guidance Consultation.

[9] Freshfields Bruckhaus Deringer, PRI, UNEP FI, Generation Foundation (2021), A Legal Framework for Impact (p.12; p. 27); PRI (2022), A Legal Framework for Impact: Australia; PRI (2022), Climate Risk: An Investor Resource Guide.

[10] Climate Action 100+ (2023), Progress Update 2022: Five Years of Climate Action 100+.

[11] PRI (2023), Strengthening Effective Stewardship in Australia (p.12).

[12] Treasury (2023), Second Consultation on Climate-Related Financial Disclosures (p.15).

[13] Climate Action 100+ (2023), Climate Action 100+ Announces its Second Phase.

MODIFIED LIABILITY

Whilst we maintain our view that the existing 'reasonable grounds' requirements provide directors with an appropriate amount of protection,[14] the proposal for modified liability suitably achieves the goal of incentivising credible disclosures of scope 3 emissions and forward-looking statements while building reporters' confidence in the initial reporting years. We encourage Treasury to legislate that the three-year period remains fixed from the commencement of the disclosure regime, as opposed to a rolling commencement from the time an entity begins reporting. Doing so could encourage early voluntary disclosures by entities in Groups 2 and 3, which may improve the flow of information about emissions within their value chain to enable more accurate scope 3 reporting by Group 1 entities.

ADDITIONAL CONSIDERATIONS REGARDING AUSTRALIA'S SUSTAINABLE FINANCE TAXONOMY

We highlight the Australian Government's commitment to developing a sustainable finance taxonomy[15] and therefore, consistent with our previous recommendations, encourage Treasury to consider requiring additional disclosure requirements for entities to facilitate the implementation and use of that taxonomy.[16]

PRI signatories have reported that a key challenge with the use of the EU's Sustainable Finance Taxonomy, for example, has been limited sustainability data about their portfolios resulting from the fact that companies have not yet been required to report the alignment of their turnover, capital expenditure, and operating expenses with the EU Taxonomy's technical screening criteria.[17] Instead, investors have had to rely on third-party services to provide relevant information and assessments, which could inadvertently lead to investors making inaccurate disclosures.

We encourage Treasury to identify what additional disclosures will be required to provide sufficient information for users of the taxonomy to identify whether a companies' activities meet the developed criteria. We encourage Treasury to proactively consider how disclosure of taxonomy-related information interlink with the current proposal.

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of Treasury further to improve climate and other sustainability-related financial disclosures in Australia.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org

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[14] Sebastian Hartford Davis and Kellie Dyon (2022), Advice regarding potential liability of directors under the ISSB draft standards for forward looking statements.

[15] Treasury (21 April 2023), Media Release: Investor Roundtable aligns efforts to deliver cleaner, cheaper energy.

[16] PRI (February 2023), Response to Treasury's Discovery Consultation on Climate-related Financial Disclosures (p.10-11).

[17] PRI (2022), Implementing the EU Taxonomy: An Update to the PRI's 'Testing the Taxonomy' report (p.16). Nb., taxonomy-alignment reporting against the environmental objectives of the EU Taxonomy began on 1 January 2023 (see PRI (2022), Investment briefing: EU Taxonomy).