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Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Via online submission portal

Dear Committee Secretary

Senate Inquiry into the Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024

Thank you for the opportunity to provide a submission to the Senate Standing Committees on Economics' Inquiry into the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024* (Bill).

We confine our submission to Schedule 4 of the Bill, being the proposed introduction of a mandatory climate reporting regime. The Australian Institute of Company Directors (AICD) welcomes the opportunity to comment on the development of this important policy and stands ready to support its effective implementation.

We believe that mandatory, internationally aligned climate reporting will support a clearer picture of Australia's climate risk exposure to emerge, which will ultimately support the nation's emissions reduction targets.

We thank Treasury for its thoughtful consultations with industry and note the wide support amongst stakeholders for a well-balanced regime that is capable of being implemented as soon as practicable.

The AICD's mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership of 51,000 reflects the diversity of Australia's director community, comprised of directors and leaders of not-for-profits, large and small businesses and the government sector.

1. Executive Summary

The AICD supports the introduction of a mandatory climate-related disclosure regime which is internationally aligned and that meets the policy objectives of high-quality, comparable and useful climate disclosures.

While there are some aspects of the Bill that could be enhanced (including the thresholds and coverage of Group 3 cohort, with recommendations noted below), we consider the Bill strikes a sensible and pragmatic balance which should achieve its stated policy objectives. To provide business certainty and facilitate a timely uplift in reporting practices, we encourage the Bill to be passed without undue delay.

In summary, our key comments are as follows:

1. The **Modified Liability** and **Qualified Director Declaration provisions will be critical to the implementation of the regime.** It is appropriate that this once-in-a-generation reform to corporate reporting is accompanied by transitional measures. Modified Liability will encourage fulsome reporting, while the Qualified Director Declaration appropriately reflects the reality of implementing a novel and complex new reporting regime.

2. To encourage discussion of key climate issues outside of the narrow confines of the mandated Sustainability Report, we would encourage **the Modified Liability regime to apply to protected statements subsequently replicated outside of the Sustainability Report (not just those required by law)**.

3. **The proposed thresholds for Group 3 entities are too low**, which will mean the compliance burden for these entities will be disproportionate to their climate impact**.** We recommend that the **revenue threshold for Group 3 entities be increased from $50 million to $100 million and the gross assets threshold from $25m to $50m and/or that Group 3 entities be subject to a simplified climate reporting standard** (similar to the simplified financial accounting standards that apply to Tier 2 entities.)[1] By Treasury's own estimates, almost all Group 3 entities are unlikely to face material climate risk or opportunity,[2] undermining the rationale for their inclusion.

4. **We are concerned about the inclusion of Not-for-Profits (NFPs) that are reporting entities under Chapter 2M of the Corporations Act in the absence of specific consultation with the sector,** particularly given the acceptance that charities registered with the Australian Charities and Not-for-Profits Commission (**ACNC**) be excluded. The global standards that Australia is seeking to mirror have been drafted specifically with investors in mind.

5. **The broad, unfettered nature of the Minister's powers under sections 296A(4) and (5) and 296C(2) should be reconsidered** given any expansion of mandatory sustainability reporting should be subject to the usual public consultation and parliamentary process.

6. **We support the decision to tie the regime's commencement to the passage of the Bill. We also support the delay of the regime's commencement from 1 July 2024 (as was previously proposed by Treasury) to 1 January 2025.**[3] This should allow for the AASB and AUASB to finalise the Sustainability Standards and sustainability audit standards, albeit the timing remains challenging.[4]

[1] See AASB 1060 General Purpose Financial Statements - Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 entities.
[2] Treasury (January 2024), Policy Impact Analysis at page 26 – "*We assume 5 per cent of companies in this group have material climate risks that they would be compelled to disclose against in accordance with the Australian standards.*"
[3] On the basis that the legislation is passed, receives royal assent, and commences by 2 December 2024.
[4] Particularly given the International Sustainability Assurance Standard (ISSA 5000) is not due to be finalised until September 2023.

1. Modified Liability

We strongly support the Bill's Modified Liability regime and consider it is critical to incentivising fulsome, high-quality and useful climate disclosures.

Why it is necessary and what it should cover

Throughout various Treasury consultations,[5] AICD has argued that a transitional modified liability regime is necessary to give organisations adequate time to develop internal capability to navigate the significant uplift in climate reporting required. It will also enable organisations to make complex and highly uncertain forward-looking disclosures without undue private litigation risk. Other major industry and business groups have reiterated this need.[6] We are pleased to see that the Bill's modified liability regime covers all forward-looking statements required under the Australian Sustainability Reporting Standards (**Sustainability Standards**) for the first year, and scope 3, scenario analysis and transition planning disclosures for the first three years of the regime (**Modified Liability**).

It is imperative that the Modified Liability regime, which covers the most uncertain disclosures, remains in its current form. Many forward-looking disclosures required under the Sustainability Standards suffer from a high degree of measurement and outcome uncertainty and are highly novel in the Australian market. These uncertainties relate to the requirement to make projections many years or even decades into the future, on the basis of incomplete or unknown information and assumptions.

Assumptions and data, which are fed into models, are imprecise and subject to quality and access issues. Such disclosures, particularly in the absence of reasonable assurance, expose directors to a broad range of causes of action,[7] and have historically created material litigation risks. The Modified Liability regime, as drafted, incentivises entities to make fulsome disclosures in the most complex and uncertain areas.

The United States' Securities and Exchange Commission (SEC) recognised the significance of liability protections in incentivising fulsome disclosures when it adopted its climate reporting rule in March 2024. In fact, the SEC's modified liability is far broader than what is being proposed by the Bill – it is not time-bound and explicitly covers disclosures regarding scenario analysis, transition planning, internal carbon prices and targets and goals disclosures.[8]

The SEC did so on the basis that such an approach will *"help incentivize more comprehensive disclosures on these matters to the benefit of investors,"*[9] noting that the US already has existing safe harbour provisions for forward-looking statements, such that litigation risk for US companies is far less than for Australian organisations.

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[5] See the AICD's submission to Treasury's First Climate Reporting Consultation (February 2023), submission to the Second Climate Reporting Consultation (July 2023), and submission to the Third Climate Reporting Consultation (February 2023). Also note the AICD's submission to the AASB on the draft Australian Sustainability Reporting Standards.
[6] Such as the Business Council of Australia's submission (at page 5); the Insurance Council of Australia's submission (at pages 4 - 7); the Australian Banking Asssociation's submission (at section 3.1); the Property Council of Australia's submission (at page 4) and the Chartered Accountants Australia & NZ and CPA Australia's joint submission (at page 9).
[7] See section 3.1 on pages 9 and 10 of the King and Wood Mallesons legal advice at Annexure B of the AICD's February climate reporting consultation submission to Treasury.
[8] Noting that on 4 April 2024 the SEC stayed the commencement of the climate disclosure rule pending the outcome of judicial review proceedings seeking to challenge the rule.
[9] Page 398 of the SEC Final Rule.

The AICD has previously commissioned legal advice from Herbert Smith Freehills (HSF) [10] which set out the heightened liability risk faced by Australian organisations relative to comparative jurisdictions, including the US and UK.

In addition to the scope of protected statements covered by the Modified Lability regime, we strongly support the Bill's approach whereby the Modified Liability protection applies to:

- **Any legally required disclosures made outside the Sustainability Report**: This is necessary to cover organisations' compliance with their legal obligations, such as listed entities' continuous disclosure obligations; and

- **Voluntary disclosures made in compliance with the Sustainability Standards,** to encourage companies to make thorough disclosures and provide useful information to investors and other users prior to a formal requirement.

Modified Liability should apply to protected statements replicated outside the Sustainability Report

To further encourage fulsome, easily navigable disclosure and engagement with investors, we consider the Modified Liability protection should apply **to protected statements replicated outside of the Sustainability Report or Audit Report.** This includes statements made in the other 'parts' of the Annual Report (namely the Financial Report and Statements and Directors' Report), as well as investor briefings, website statements and public speaking engagements.

We are concerned that the proposed limiting of the protection to the Sustainability Report and Audit Report (being the audit of the Sustainability Report) would stifle engagement with climate issues more broadly. We say this for two reasons:

First**,** the practical effect of this limitation could be to encourage entities to avoid public disclosure on critical issues covered by the Modified Liability regime outside of the (likely long and complex) Sustainability Report for fear of private litigation. Entities are likely to be advised that it would be prudent to avoid discussion of their transition plan, scope 3 emissions or climate resilience assessment in any other forum, such as at an investor briefing, public speaking engagements or even a simple statement on their website. This will be a counter-productive outcome – rather than encouraging fulsome, easily navigable disclosure on these critical issues, the provision is likely to lead to limited, less accessible reporting. In particular, the proposed limited application of the Modified Liability is most problematic for Group 3 users, who are less likely to review a long and detailed Sustainability Report and might ordinarily rely on other digestible forms of content, such as presentations or website copy. As such, the failure to broaden the Modified Liability may lead to limited, less accessible reporting.

Second, the limiting of the Modified Liability to Sustainability Reports runs contrary to current ASIC and AASB guidance, which provides that climate may need to be disclosed in the financial statements[11] and/or listed entities' Operating and Financial Review (OFR).[12] It may also act as an impediment to those entities currently, or intending to, report on an integrated reporting basis.

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[10] See pages 18 to 21 of the HSF Legal Advice dated 4 April 2023 provided to Treasury.
[11] See AASB And AUASB (April 2019) 'Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2.'
[12] ASIC's current guidance in Regulatory Guide 247 to disclose climate information in the Operating and Financial Review (OFR) where climate risks could affect the entity's achievement of its financial performance or outcomes.

Implications of diluting or removing the Modified Liability regime

Removing or diluting the Modified Liability regime proposed under the Bill will undermine the objectives of mandatory climate reporting regime because organisations will be advised to make more generalised climate disclosures (or make none at all where this is an option, such as in respect to transition plans or climate targets) to avoid liability.

Such generalised disclosures will be of limited use to investors, will encourage reduced climate ambition, and inhibit a clear picture from emerging of the climate risk exposure of the Australian economy.

Accordingly, retention of the Modified Liability regime is essential for the successful implementation of the regime.

2. Qualified Directors Declaration

We **strongly support the retention of the Qualified Directors Declaration** for the first three years of the regime. Directors are unable to make an unqualified sign-off on compliance with the Sustainability Standards at a time when: detailed disclosures are highly novel; we are unaware of any entities here or globally currently producing a report which would satisfy the International Sustainability Standards Board (**ISSB**) standards (on which the Sustainability Standards are based); where there are well-recognised skills shortages; and where reasonable assurance is not mandated until 1 July 2030 (noting that the Auditing and Assurance Standards Board (AUASB) is considering mandating reasonable assurance over all Group 1 disclosures by 1 July 2027).

We are pleased to see the Government acknowledge these concerns, and that the Bill allows for the making of qualified directors' declarations in the first three years of the regime (being that the directors' must state that, in their opinion, the entity has taken "reasonable steps" to comply with the Corporations Act). This approach ensures that directors attest to the reasonableness of the process, rather than guarantee an outcome of "full compliance" with the Sustainability Standards (noting that we are unaware of any entity in Australia or overseas currently producing a report which would satisfy the ISSB standards).

We are also pleased to see the AUASB proposing to mandate reasonable assurance over all mandated disclosures[13] for Group 1 entities from 1 July 2027, which aligns with the end of the Qualified Director Declaration. This is a sensible outcome as it means that an unqualified director declaration will only be required once reasonable assurance over all disclosures is mandated. We appreciate that reporting that has been subject to reasonable assurance is of greatest value to the market.

[13] Noting that 'industry-based metrics' are not required to be disclosed until 1 July 2030 (see page 3 of Treasury's January 2024 Policy Position Statement.

3. Group 3 and Not-for-Profit entities

We consider the Bill could be enhanced by raising the threshold for Group 3 entities and omitting not-for-profit (NFP) entities from coverage.

As submitted to previous Treasury consultations, the compliance burden for these entities is not commensurate with their climate impact or the expected benefit of climate reporting for their users (whose information needs are different from those for which the ISSB standards were drafted). [14]

NFPs should be excluded

We are unaware of a clear policy rationale having been offered for why NFPs are not afforded the same exemption as that offered to charities. The fact that NFPs are reporting entities for the purposes of Chapter 2M of the Corporations Act should not, in our view, be justification for their inclusion in the regime.

We are also not aware of any significant consultation with the NFP sector regarding the regime's potential application. In our view, any coverage of NFPs must be preceded by detailed consultation with the sector and a comprehensive cost-benefit analysis.

In our experience, NFPs have, to date, had limited engagement with climate reporting, and compliance with the proposed regime will require significant upskilling and external support. This will create significant compliance costs that are difficult to justify given the focus of the reporting regime should be on the largest entities with the largest carbon footprints.

Group 3 thresholds should be lifted

Group 3 thresholds are too low and should be raised[15] and/or Group 3 entities should be subject to a simplified reporting regime. We say this for two main reasons.

First, ISSB-based climate reporting was primarily designed to address the information needs of existing and potential investors, lenders and other creditors[16] of for-profit public companies, rather than the users of smaller privately held companies and NFPs reporting. We are particularly concerned that some of the Sustainability Standard disclosures, such as scope 3 emissions, scenario analysis and complex forward-looking disclosures, will not be relevant or useful to Group 3 entity users. This appears to be acknowledged by the AASB itself.[17] Further, by Treasury's own estimate, only 5% of the estimated 4,555 - 5,560[18] Group 3 entities will face material climate risk or opportunity.[19] It is unclear why, in these circumstances, the low thresholds for Group 3 entities remain unchanged.

[14] See section 4 at pages 11 to 12 of the AICD submission on the Draft Legislation.
[15] Ibid at section 3 at pages 9 to 11.
[16] See IFRS S1 Appendix A (definition of 'primary users of general purpose financial reports (primary users).'
[17] In the AASB's 'Basis for Conclusion' document (BC41(b)), the AASB states that governance and qualitative information on the current effects of climate-related risks and opportunities on the business model and strategy and decision-making and on the entity's overall risk profile and risk management processes do not require exhaustive costs or efforts. The converse of this statement suggests that the remaining disclosures would require exhaustive costs or efforts.
[18] Note that Treasury has provided two different numbers for the number of entities falling within Group 3. On page 20 of the Policy Impact Analysis Treasury states that "Group 3 will capture, at a minimum, 4,555 entities," however it later states on page 26 that 5% of Group 3 is 278 entities (such that 100% of Group 3 would be 5,560 entities).
[19] See page 26 of the Policy Impact Analysis.

Second, the cost of reporting against the full gamut of climate reporting requirements is likely to be significant, and disproportionate to the individual impact of those entities. Research suggests that significant uplifting in climate reporting practices is required to satisfy ISSB-based reporting, even amongst the largest Australian companies,[20] let alone Group 3 entities which are significantly smaller and resource-constrained.

In light of the above, **we strongly recommend that the revenue threshold for Group 3 be increased from $50 million to $100 million, and the gross assets threshold increased from $25m to $50m.** If the proposed thresholds are left unchanged, we would strongly recommend that the question of the breadth and detail of reporting for Group 3 entities be covered as part of the future statutory review required to take place under section 1707G of the Bill.

Group 3 and NFPs (if still covered) should be subject to a simplified reporting regime

We consider there is a strong case for Group 3 entities (depending on where the thresholds are ultimately determined) to only be required to disclose under simplified reporting standards (similar to the simplified financial accounting standards applying to Tier 2 financial reporting entities).[21] The European Union (EU) and Malaysia have taken this approach.

The content of such simplified climate reporting standards (including what disclosures should be removed and/or simplified) should be the subject of detailed consultation with the relevant sector/s. Based on our engagement with AICD members, including senior NFP directors, we consider that disclosures that could be removed or simplified include scope 3, scenario analysis and complex forward-looking disclosures.

Audit of statement of no material climate risk or opportunity

We are also concerned about the compliance burden of a mandatory *audit* of a statement of no material climate risks or opportunities.[22]

Given the requirements of a formal audit, we understand from our discussions with auditing professionals that the cost of such a requirement will be significant, and ultimately unjustified, given Treasury estimates that the vast majority (95%) of Group 3 entities will face no material risks or opportunities.[23]

Accordingly, we recommend that the audit requirement be substituted for a review or similar mechanism that provides some external assurance over the directors' statement without requiring significant unnecessary expense to be incurred. Equally, we note that the negative consequences of requiring an audited statement of no material climate risk or opportunity would be reduced were Group 3 suitably narrowed (per the discussion above).

4. Commencement date

We support the commencement date being tied to the passing of the legislation, such that a delay in the parliamentary process will delay the commencement of the regime. Given the regime's reach and impact, it is appropriate that organisations are provided with sufficient time to prepare and to seek appropriate expert assistance, where needed.

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[20] For instance, more complex disclosures required under the Sustainability Standards, such as internal carbon prices and remuneration, remain challenging and relatively limited, with only 20.5% of the ASX200 making internal carbon price disclosures, while less than half of the ASX100 are making remuneration disclosures: See AASB and AUASB (November 2023), Trends in climate-related disclosures and assurance in the Annual Reports of ASX-listed entities at page 11 and ACSI (August 2023), and Promises, Pathways & Performance: Climate change disclosure in the ASX200 at page 14.
[21] See AASB 1060 General Purpose Financial Statements - Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 entities.
[22] Section 301A of the Bill; Paragraph 4.131 of the Explanatory Memorandum.
[23] Page 26 of the Treasury Policy Impact Analysis (January 2024).

More broadly, we support the decision to delay commencement from 1 July 2024[24] to 1 January 2025 (on the basis that the legislation is passed, receives royal assent and commences by 2 December 2024). This timing should allow for the AASB and AUASB to finalise the Sustainability Standards and sustainability audit standards, albeit the timing remains tight, particularly given the International Sustainability Assurance Standard (ISSA 5000) is not due to be finalised until September 2023.

5. Minister's discretionary powers

We respectfully disagree with the Government's conclusion, at paragraph 4.94 of the Explanatory Memorandum, that the use of delegated legislation to give the Minister broad, unfettered powers under sections 296A(4) and (5) and 296C(2) to require disclosure of financial matters beyond climate, is appropriate.

The content of reporting, including requiring disclosure of sustainability matters beyond climate (which has not been the focus of consultation) go to significant policy matters which are inappropriate for delegated legislation. In particular, it appears contrary to the standard wording suggested in paragraph 24 of the Office of Parliamentary Counsel (OPC)'s Drafting Direction No 3.8 [25] and the ALRC's Draft Guidance on Delegated Legislation (Annexure D to the ALRC's Final Report on the Inquiry into simplification of the legislative framework for corporations and financial services regulation (**ALRC Draft Guidance on Delegated Legislation**).

Notably, the ALRC stated that:

> "*unconstrained or open-ended delegations that effectively enable delegates to determine matters of significant policy risk undermining the law's predictability and the federal separation of powers*"[26] and that "*as a general rule, therefore, matters of significant policy and principle should be contained in an Act. Generally, delegated legislation should deal with minor or technical matters that relate to implementing the objectives and intent of the Act, and the Act's operation.*"[27]

The content of reporting, including extending mandatory reporting beyond climate to "*financial matters concerning environmental sustainability*" is a substantive policy issue which would require significant public consultation, and the usual parliamentary scrutiny. Such an approach would go beyond the "minor or technical matters" appropriate for delegated consultation.

The desire for mandatory disclosure requirements to be able to be expanded "*quickly in response to the severity of risks facing the financial market regarding sustainability disclosures*" (paragraph 4.94 of the Explanatory Memorandum) does not justify circumventing the well-established process for substantive policy matters to be debated and ultimately legislated.

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[24] As proposed by Treasury in its January 2024 Exposure Draft Legislation.
[25] Paragraph 3.8 provides that the standard form of Ministerial or other delegation suitable for Delegation Legislation is to confer powers to prescribe matters required or permitted by the legislation or matters that are necessary or convenient to be prescribed for carrying out or giving effect to the legislation.
[26] See page 293 of the Report (or page 299 of the PDF) of the ALRC January 2024 Report (Appendix D – Draft Guidance on Delegated legislation).
[27] Pages 293 - 294 of the Report (or 299 -300 of the PDF), Ibid.

6. Next steps

If you would like to discuss any aspects further, please contact Christian Gergis, Head of Policy at [redacted] or Anna Gudkov, Senior Policy Adviser at [redacted].

Yours sincerely,

[redacted]

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