11 April 2024

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

***Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024* – Climate-related financial disclosures**

Dear Committee Chair,

The Financial Services Council (FSC) welcomes the opportunity to provide a submission to the Committee on the ***Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024*** (the Bill). We wish to comment specifically on the Schedule 4 of the Bill on Sustainability Reporting.

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.
Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, investment platforms and financial advice licensees.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is one of the largest pools of managed funds in the world.

Support for passage of the Bill

The FSC is supportive of the Bill being passed. The Bill has been the result of extensive stakeholder engagement across the industries that will be the primary preparers of these reports. It is important that the regime is workable for all stakeholders to allow for confidence in reporting. We have appreciated the collaborative approach of the government and Treasury in working with us to ensure that the Bill is both workable for fund managers and superannuation funds as users and preparers of climate-related financial disclosures. We also note broad business community support for this Bill to pass.

We propose only minor amendments in the next section in order to better achieve the clear intent of the Bill with respect to the thresholds applicable to fund managers and superannuation funds with their particular structures.

A climate-related financial disclosures regime will provide greater investor confidence in Australia. As fund managers and superannuation funds, our members, as stewards of the savings of millions of Australians, are key allocators of capital in the Australian economy. They have an important role as fiduciaries in seeking to maximise the returns of their investors. Climate-risk is now well recognized as a material risk to the financial returns of investments, and the information from a climate-related financial disclosure regime will help funds to price in the financial risk that climate change poses to investments, as well as climate-related opportunities for financial return. It will enable more efficient allocation of capital, providing investors with more reliable and consistent data over time to identify where there are material investment risks and opportunities created by climate

change, potentially impacting an investee company's cash flows, business operations and strategy, and therefore the valuation investors attribute to that company.

A disclosure regime is also vital in helping Australia to achieve its bi-partisan national emissions reduction target of net zero emissions by 2050, which will need to be largely financed by private sector. It will also contribute to the resilience of the Australian economy by requiring large Australian companies to turn their mind to and prepare for any material risks climate change poses to their business and operations, including their physical assets, supply chains, or transition risks from technological change and changing consumer preferences as more jurisdictions and companies globally seek to align their activities with a temperature increase below 1.5°C as aspired to in the Paris Agreement.

It is also important that Australia aligns with international developments to be competitive as an attractive investment destination for climate-risk and opportunity aware capital. We consider that this Bill aligns well with the International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards (also known as the ISSB Standards), which have become the internationally recognized sustainability disclosure standards with which jurisdictions should seek to align. Jurisdictions such as the European Union, the United States, UK, Canada, New Zealand, Singapore and Hong Kong already have in place or are in the process of implementing a mandatory climate-related financial disclosures regime. We also note that many Australian companies already produce climate-related financial disclosures voluntarily. According to KPMG, as of June 2023, 78% of ASX 100 companies report against the Taskforce on Climate-related financial disclosures (TCFD).[1] ACSI reported that as of August 2023, 75% of the ASX200 report against the TCFD.[2] However, the quality of voluntary disclosures can vary with inconsistency in the use of scenario analysis and metrics, adding to the cost for investors in assessing disclosures. Having a mandatory regime will help to streamline reporting, especially for global entities, reducing the burden on reporting entities from multiple and various requests for climate-related information from investors, data providers, regulators, and other stakeholders.

We recognise that this regime will be a big step up for Australian companies, requiring across the economy the development of skills, governance processes, data, and auditing capability. We believe this Bill strikes the right balance in requiring disclosures that are meaningful and useful for investors, allowing for the improvement of the quality of disclosures over time, phasing in disclosure requirements for different sized companies and scope 3 emissions, and providing flexibility for preparers of disclosures so that they can report without undue burden and with the data or information available to them at the time of reporting.

We also welcome the ways the Bill has addressed the following key points of concern for our industry:

- **Materiality:** We welcome the regime's focus on material financial risks and opportunities, recognizing that the impact of climate change in terms of physical and transition risks will be

[1] https://assets.kpmg.com/content/dam/kpmg/au/pdf/2023/australian-sustainability-reporting-trends-june-2023-update.pdf
[2] https://acsi.org.au/wp-content/uploads/2023/08/Promises-Pathways-Performance-Climate-reporting-in-the-ASX200-August-2023.pdf

significant for some entities, but minimal for others. Therefore, entities for which the impacts are minimal are not unduly burdened by disclosure requirements.

- **Scope 3 emissions**: The disclosure of scope 3 emissions presents one of the biggest challenges of the regime given the need to look through an entity's value chain and therefore reliance on the disclosure of other entities and the need to deal with the current lack of data by using estimates. However, scope 3 disclosures form a vital part of climate-related financial disclosures given that a large part of the climate risks and opportunities faced by an entity will arise from its business operations and supply chains. We submit that the Bill has struck the right balance with Scope 3 disclosure requirements:
  - We welcome that scope 3 requirements will be phased in at the second year of an entity's reporting date to allow for time to prepare.
  - We also welcome the current draft AASB standard requirements that an entity is only expected to use all reasonable and supportable information that is available to it at the reporting date without undue cost and effort (see ASRS1 B10). This should help alleviate concerns about reporting scope 3 emissions and provide confidence for continual development and improvement over time. We also welcome the allowance for the use of estimates in scope 3 reporting.
- **Liability flexibility:** We are supportive of the approach proposed by Treasury to introduce modified liability relief for forward looking statements through limiting action against misleading and deceptive conduct to regulator-only actions for a fixed period of three years. We welcome Treasury providing more confidence for industry under the proposed modified liability approach in the Bill compared to the Exposure Draft, now providing that a 'protected statement' under section 1707D(3) is a statement about scope 3 greenhouse gas emissions (including financed emissions), scenario analysis and a transition plan. Scope 3 disclosures, scenario analysis and transition plans are disclosures where capability will take time to develop, given their reliance on uncertain forward-looking projections and nascent data. It is in the interest of investors that companies and their directors are encouraged to consider and disclose their climate risk and develop best practice without the fear of vexatious litigation when they have acted in good faith to produce disclosures with the best information available to them.
- **Applicability for superannuation funds and fund managers:** We welcome the collaborative consultation process undertaken by Treasury to ensure that this Bill as drafted is now clearer than the consultation Exposure Draft as to the applicability of the regime to fund managers and superannuation funds, particularly with respect to the $5 billion threshold for registered schemes (MIS) and registrable superannuation entities (RSE). We believe the Bill ensures that large financial institutions that are major allocators of capital in the economy are appropriately captured by the requirements. ***We propose minor amendments in the next section with regard to making the policy intent clearer.***

We recognise that given the greater amount of estimated data required to prepare climate-related financial disclosures initially compared to ordinary financial data, assurance requirements should provide a reasonable approach to the level of assurance required. Getting the balance right will be part of industry's engagement with the AASB and should not delay the passage of the Bill.

We also note concerns with market availability and the need to develop capability across the Australian economy for third party assurance. The Explanatory Memorandum (EM) sets out that where an entity has determined that it has no material climate risks or opportunities, this statement must be audited (EM 4.131). This expectation may place an undue burden on auditing professionals, particularly given the existing concerns around market capacity.

Minor amendment proposals

We submit for the consideration of the Committee some minor drafting proposals to better give effect to the intent of the government.

<u>Applicability and phasing of entities</u>

For context, a funds management and superannuation business structure involves a public company or corporate entity (usually a Responsible Entity or Registrable Superannuation Entity Licensee (RSEL)), and underlying funds (MISs RSEs). The company and the underlying funds are both potentially reporting entities for the purposes of the regime.

We welcome the Bill's phasing of entities from large entities to smaller entities. The clear policy intent of the Bill is that the corporate entity is phased in under the revenue, asset and employee threshold, and that 'asset owners' defined by the EM as registered schemes (MISs) and registrable superannuation entities (section 296B(5) and 292A(6), EM 4.68), are phased from phase 2 if they meet the assets under management threshold of $5 billion. The reason for this distinction is to account for the particularities of the trust structure, where an MIS and RSE does not have revenue, assets and employees in the same way that a company does (as EM 4.68 recognizes by stating that 'the $5 billion threshold is designed to capture large asset owners that do not otherwise have employees or traditional sources of revenue'.)

Extensive consultation was undertaken by Treasury with industry, such that the Bill now provides more clarity than the Exposure Draft that the revenue, asset, employee threshold applies at a corporate entity level if meets two of the three asset, revenue and employee size thresholds, and that the $5 billion assets under management threshold applies at the registered scheme (MIS) and RSE level (now addressed in subsections 292A(6)(a), 296B(5)(a) and 1707B(1)(b)(ii)).

However, there is still some ambiguity in the drafting that is causing some confusion around whether this policy intent is clear. Subsections 1707B(2)(b) and (4)(c) expressly state that the size/NGER thresholds (for the purpose of the transitional periods) apply to entities that are not registered schemes/RSEs/CCIVs for the first transitional period. However, the substantially equivalent threshold tests in subsections 292A(3) and (5) (about the final threshold), as well as subsections 296B(2) and (4), do not make this clear in the same manner.

Ambiguity is also created by 4.44 and 4.47 of the EM. 4.44 states that *'An entity that is an asset owner that meets the corporate size thresholds in subsection 292A(3) must prepare a sustainability report, even if it does not meet the requirements of subsection 292A(5) (regarding NGERs registered corporations) or 292A(6) (regarding asset thresholds).'* 4.47 of the EM states '...asset

owners below the corporate size thresholds are not required to prepare reports unless they are NGER reporters.' As noted above and recognised in EM 4.68, the corporate size thresholds of revenue, assets and employees are difficult to apply to an 'asset owner' defined as a registered scheme (MIS) and RSE. It appears that the intent of 4.44 of the EM is to ensure that a large financial institution with an RSE or MIS in their corporate structure does not thereby avoid reporting despite being a large company that meets two of the three employee, revenue and asset thresholds.

Recommendation: We submit that the Bill's drafting further clarifies that the asset, revenue, employee size thresholds and NGER tests under subsections 292A(3) and (5) and subsections 296B(2) and (4) apply to entities that are **not** registered schemes/RSEs/CCIVs to align with the policy intent of the regime and subsections 1707B(2) and (4). That is, wherever a relevant company size/NGER threshold is stated, it should include the additional limb that "*the entity is not a registered scheme, registrable superannuation entity or retail CCIV*".

We also submit that EM 4.44 and 4.47 be amended to avoid inconsistency in the use of the term 'asset owner' by changing the reference from large 'asset owners' to 'financial institutions'.

This would help to achieve clarity for asset owners and align with the policy intent that the $5 billion threshold is only intended to apply in respect of registered schemes and RSEs, and the revenue, asset, employee threshold is only intended to apply to a corporate entity/RE/RSEL, not to an MIS or RSE.

We would be pleased to assist the Committee with any further information it requires.

Sincerely,

Chaneg Torres
Policy Director
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