19 January 2023

Climate Disclosure Unit
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: climatereportingconsultation@treasury.gov.au

Dear Dr Chalmers,

Consultation on climate-related financial disclosure

We refer to Treasury's December 2022 Consultation Paper relating to climate-related financial disclosure. We welcome the opportunity to make a submission as part of Treasury's consultation process.

Background

Allan Gray Australia are investors in Australian equities. We currently manage approximately AUD9bn on behalf of both institutional and retail clients. A significant proportion of the funds we manage are managed on behalf of superannuation funds. We are long-term investors and may invest across the entire range of sectors represented on the ASX.

We note and largely agree with Treasury's remark that Australia's corporate disclosure obligations "need to provide investors with decision-useful information about the financial risks that firms face from climate change." Indeed, the need to provide investors with decision-useful information goes to the very heart of the purpose of corporate disclosure laws. However, Treasury's proposal to introduce mandatory "standardised internationally-aligned reporting requirements for businesses to make disclosures regarding governance, strategy, risk management, targets and metrics – including greenhouse gas" goes well beyond the purpose of corporate disclosure. In our opinion, the proposal is likely to introduce unnecessary costs and risks to listed companies without providing a significant, if any, benefit to investors, being the individuals corporate disclosure laws are designed to protect, or to society at large. Worse still, many of these disclosures will be subjective and result in false precision and, were they to be relied upon (which they almost certainly will), could result in a misallocation of capital and a "greenwashing" problem already more severe than that which exists today.

Our position

Our position is explained in detail below. In summary:

- We do not agree that mandatory climate-related disclosure rules are necessary to maintain or increase Australian companies' access to capital. Australia's existing continuous disclosure rules ensure investors have access to the information they require to make informed investment decisions.
- Even if it is not accepted that the continuous disclosure obligations are sufficient, the climate-related information voluntarily disclosed by most companies is preferable and more useful to investors than what would be required under a mandatory, standardised regime.
- There are significant costs and risks associated with the proposed climate-related disclosure regime which are not outweighed by corresponding benefits to investors.
- If, notwithstanding such concerns, a mandatory climate-related disclosure framework is introduced in Australia, it should be introduced on a comply or explain basis in order to minimise the associated risks and costs.

Existing continuous disclosure obligations

Australian listed companies are required to comply with the continuous disclosure obligations that arise under Part 6CA of the *Corporations Act* 2001 (Cth) (***Corporations Act***) and ASX Listing Rule 3.1. Pursuant to the relevant provisions, listed companies must "immediately" notify the ASX of any information that "a reasonable person would expect to have a material effect on the price or value" of the securities of the company.[1] The continuous disclosure obligations are far reaching and cover *any* risks or information relevant to the company that a reasonable person would expect to be material, including climate risks and other climate-related information.

The inclusion of the "reasonable person" test in Australia's continuous disclosure rules ensures the continuous disclosure obligations are dynamic enough to reflect changing views as to what information is material. The test means that the disclosure provided by any given company will (assuming such disclosure is compliant) reflect what the company considers to be material to its business, given its own unique circumstances, at that particular point in time. If, at a point in time, a reasonable person is likely to consider that certain climate-related information will have a material effect on the price or value of a company's securities, that information must be disclosed. If, however, at a different point in time, a reasonable person would not consider that same information likely to have a material effect on the price or value of a company's securities, it does not need to be disclosed, and there should be no requirement for that information to be disclosed.[2] Corporate disclosure is costly, and the scope and operation of the existing continuous disclosure rules mean that companies are only required to incur costs in disclosing information that is of real use to investors.

As investors in Australian equities, we are confident that if companies comply with their continuous disclosure obligations, we have access to the information we require to make informed investment decisions. Prior to making an investment decision, we carry out extensive research into relevant companies. This includes researching and forming opinions about, *inter alia*, a company's financial performance, the markets in which it operates, its competitors, and relevant micro and macro risks to its future cash flows. We collect information from companies' annual and financial reports, as well as various external sources. The key information that is held by companies and needed to make investment decisions is the information already disclosed in financial reports and under the continuous disclosure obligations. Other key information is otherwise publicly available, including in relation to climate-related risks. Given this, we do not consider that mandatory climate-related disclosure would provide a tangible benefit to investors such that it would have any effect on Australian companies' access to capital.

Voluntary climate-related disclosure

Even if it is not accepted that the existing continuous disclosure obligations adequately capture climate-related risks, we consider that the voluntary climate-related disclosure already made by most companies is not only more than sufficient, but also preferable to a mandatory, standardised climate-related disclosure regime.

According to our research, approximately 95% of companies in the ASX200 either voluntarily release a Sustainability or Climate Report each year, or include a Sustainability, Climate, or ESG section in their Annual Reports. As these reports and sections are voluntary, companies can choose what information to include, provided the information, or the omission of it, is not misleading or misrepresentative. Whilst there is of course the possibility that this leeway may mean companies only voluntarily disclose favourable information, we do not consider this to be a particularly significant risk. This is because, first, Australia has strong laws and regulatory oversight in relation to misleading conduct and misrepresentation, secondly, material information, whether favourable or not, will be disclosed pursuant to the existing continuous disclosure rules, and thirdly, most investors are simply not naïve to the significant climate-related risks to different businesses.

In our experience, Australian companies are continually refining their approach to voluntary climate-related disclosure. Without the restraint of a mandatory, standardised framework in accordance with which they are required to report, companies are able provide bespoke disclosure of the information and risks *most relevant to them*. Companies are not required to incur the costs of disclosing information that is irrelevant to their business and risk management, nor are investors burdened with large volumes of such useless information. As companies develop their overall approach to climate-risk management, they have freedom to adapt the content and / or form of their climate-related disclosure to reflect those

[1] *Corporations Act 2001* (Cth), ss674-677; Australian Securities Exchange, *Listing Rules*, r 3.1.
[2] See, for example, *Jubilee Mines NL v Riley* [2009] WASCA 62; (2009) 253 ALR 673.

changes. Additionally, the extent to which companies can accurately make forward-looking statements is dictated by the particular circumstances of the company. When climate-related disclosure is voluntary, disclosed predictions can be limited to those in respect of which the company has enough existing information to be useful. This means that, as compared to a situation in which companies are *required* to make certain predictions, investors are less likely to be presented with information or predictions that are so reliant on assumptions and plagued by uncertainties that they are no more than a mere guess. Disclosure of those sorts of predictions will not only be of little use to investors, but may in fact be to their detriment, particularly if the difference in the extent of assumptions and uncertainties in different companies' disclosures is not made clear. This problem may be exacerbated by the inherent contradiction in requiring companies to make and disclose long-term predictions and strategies relating to climate risks and greenhouse gas emissions when, for the very reason that it is too uncertain to do so, they do not make similar long-term predictions in relation to profitability.

The costs of mandatory climate-related disclosure

Requiring disclosure of non-material climate-related information as required by or in a manner substantially similar to the International Sustainability Standards Board (**ISSB**) Framework will introduce additional and arguably unnecessary costs and risks for companies and investors without providing a significant, if any, corresponding benefit for investors.

Although they are difficult to quantify, the types of costs and risks associated with corporate disclosure are well documented. Among other things, there are direct costs to companies, costs to investors (e.g., in seeking advice as to the meaning of disclosed information), and litigation risks and potential costs arising from alleged non-compliance. All such risks and costs are ultimately borne by shareholders, even when they commence the relevant litigation.[3] As the scope of mandatory corporate disclosure widens, so too do the associated costs and the magnitude of any associated risks. The ISSB standards are extremely prescriptive and onerous, and compliance with certain requirements (e.g., the need to quantify the climate-related risks within a company's entire value chain) will be time consuming and costly.[4] The ISSB standards require companies to make significant estimates and judgments based on inherent uncertainties, and this increases the compliance and litigation risks associated with mandatory disclosure. Because of a more prescriptive approach, additional assurance requirements, potential liability for insignificant or immaterial omissions or misstatements, and the heightened overall regulatory and litigation risks, these increased costs and risks are likely for companies that already voluntarily disclose climate-related information in accordance with all or part of the ISSB framework as well as those that do not.[5]

Of course, disclosure laws do not operate in isolation, and it is therefore important that they are considered in the context of Australia's broader corporate regulatory regime. In this regard, potential changes to the requirements for a breach of the continuous disclosure rules may be relevant. We understand that the Attorney-General is considering winding back changes made to the continuous disclosure provisions in the *Corporations Act 2001* (Cth).[6] More specifically, we understand that the requirement for "knowledge, recklessness or negligence" in order for there to be a breach of those obligations may be removed in favour of the previous strict liability approach. A strict liability approach would make it far easier for shareholders to commence class actions against directors for alleged breaches of disclosure obligations. The consequences

[3] Australian Law Reform Commission (2018) Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders, ALRC Report 134, 263.

[4] This point has been raised by many companies in submissions made directly to the ISSB. See, for example, Letter from Westpac to International Sustainability Standards Board, 27 July 2022, available at: https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-comment-letters/w/westpac-banking-corporation-43446934-0908-463b-acb0-16066f14066a/westpac-banking-corporation-issb-draft-ifrs-s1-and-draft-ifrs-s2-comment-letter.pdf; Letter from EY to International Sustainability Standards Board, 29 July 2022, available at: https://www.ifrs.org/content/dam/ifrs/project/general-sustainability-related-disclosures/exposure-draft-comment-letters/e/ey-ff220ee9-fc6d-4f5b-a541-7e2f3cc7d6ab/ey-comment-letter-issb-s1-july-2022-eyg.006649-22gbl.pdf.

[5] Hester M. Peirce (2022, 21 March) Statement: We are Not the Securities and Environment Commission – At Least Not Yet. https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321#_ftnref9.

[6] See Michael Pelly (2022, 24 March) Labor could make it easier for shareholders to sue 'dodgy' directors, *The Financial Review*, https://www.afr.com/companies/financial-services/labor-could-make-it-easier-for-shareholders-to-sue-dodgy-directors-20220322-p5a6xd.

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of such a change would likely be a re-emergence of the trends described by the Australian Law Reform Commission prior to the introduction of the "knowledge, recklessness or negligence" requirement as follows:

> *…a greater propensity for Australian corporate entities, as compared with those in cognate jurisdictions, to be the target of funded shareholder class actions, a diminution in the value of investments of those shareholders (including the investments of the class members themselves) of the company at the time the company is the subject of the class action, and the impact on the availability of directors and officers insurance (D&O insurance) within the Australian market*.[7]

Even if the strict liability approach is reintroduced in the context of continuous disclosure (something we do not support), it should not be extended to any climate-related disclosure regime. Applying a strict liability approach to disclosures that are unavoidably grounded in assumptions and uncertainties would generate significant and arguably unfair risks for companies, directors, and officers, likely with many potential associated negative ramifications (e.g., an increase in the cost of D&O insurance).

Limited, if any, corresponding benefit to investors

The costs of corporate disclosure are generally justified by the corresponding benefit that investors receive from being able to make properly informed investment decisions. However, Treasury's proposed mandatory climate-related disclosure regime will not provide investors with any benefit beyond that which they receive from the existing continuous disclosure regime.

A common argument in support of mandatory climate-related disclosure regimes is that they promote comparability between companies and across sectors and provide certainty as to the way climate-related information is reported. However, the ISSB Framework and Treasury's proposed regime will not achieve this. Disclosure in accordance with the ISSB Framework necessarily requires the adoption of significant assumptions and subjective decision-making not only about companies' own businesses and the risks thereto, but also in respect of what suppliers, customers, and employees might do in predicted states of the world, what technological advances will occur in specified periods of time, and what Government policy may exist. As discussed above, the extent to which such predictions can be accurately made differs significantly between companies. Additionally, there is no way companies can usefully predict what policies might look like under future governments or future global economic and political environments. In the absence of detailed guidance as to what assumptions should be made (which we do not support because such guidance could never itself be accurate or account for the particularities of individual companies), there will never be true comparability in respect of companies' assessment of climate-related risks and potential scenarios. Additionally, the level of disclosure contemplated by the ISSB Framework necessarily requires companies to rely on information from external sources and other companies. If those sources and companies have not adopted the same assumptions, the disclosures made by the company relying on that information will be inherently flawed.

Further, apart from that information already captured by the continuous disclosure obligations, the information required to be disclosed under the ISSB Framework can best be described as of "interest" or "non-financial" importance to *some* investors. The distinction between information that is material to a company's share price and information that is of mere interest or non-financial importance to investors and stakeholders is important and, for the reasons outlined below, must be maintained in the context of corporate disclosure regulation. Information that is not material to the price or value of a company's shares is not important to *all* investors, and there is no reason why investors should have to incur the costs and risks associated with the mandatory disclosure of that information.[8]

[7] Australian Law Reform Commission (2018) Integrity, Fairness and Efficiency – An Inquiry into Class Action Proceedings and Third-Party Litigation Funders, ALRC Report 134, 263.

[8] See, for example, Hester M. Peirce (2021, 21 July) Speech to the Brookings Institution.

The prescriptive requirements of the ISSB Framework together with the increased litigation risk of mandatory climate-related disclosure are likely to result in companies disclosing significant volumes of immaterial information, something which does not assist investors to make properly informed decisions.[9]

Proposal: Introduce standardised climate-related disclosure on a comply or explain basis
If, despite the above, Treasury remains minded to introduce mandatory climate-related disclosure, we suggest that one way to minimise unnecessary risks and costs is to introduce standardised disclosure on a comply or explain basis. Under this approach, companies would be required to provide disclosure in accordance with the framework prescribed by Treasury or provide an explanation as to why it is unnecessary, undesirable, or impossible to do so in respect of certain elements of that framework. Companies should be able to provide any explanation for noncompliance with the framework, provided it is consistent with the long-term interests of shareholders.

Around the world, there are numerous examples of a comply or explain approach being used in the context of corporate governance. In Australia, a comply or explain approach already applies to the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (**ASX Governance Principles**).[10] In the United Kingdom, the Corporate Governance Code sets out standards of "best practice" for the governance of listed companies. In their annual reports, companies listed in the United Kingdom must disclose whether they comply with the code and if they do not, explain why.[11] The comply or explain approach has also been adopted across Europe, including by the European Commission, and in Canada.[12]

In respect of climate-related disclosure, a comply or explain approach has been adopted in respect of TCFD reporting in both the United Kingdom and Switzerland.[13] However, the nature of the comply or explain obligation differs between those jurisdictions. In the United Kingdom, companies that do not comply with the TCFD must explain both why they have not included such disclosures and the steps they are taking or plan to take "in order to be able to make those disclosures in the future, and the timeframe within which [they expect] to be able to make those disclosures."[14] The second limb of the explain obligation arguably suggests that the comply or explain approach is being used as a way to transition towards mandatory TCFD reporting. For the reasons discussed below, requiring companies to explain how and by when they will comply does not achieve the true purpose of comply or explain rules. On the other hand, under the Swiss Civil Code of Obligations, companies that do not report in accordance with the TCFD framework must disclose other "CO_2 goals" or declare that they "do not follow any climate concept and justify this decision."[15]

The rationale for using a comply or explain approach in the context of corporate governance is two-pronged. First, because of the differences between companies, and the heterogenous choices they make (and which should be encouraged for the purpose of competition), no one approach can possibly be optimal for all companies and their shareholders. Indeed, in a 2007 paper, researchers from the London School of Economics presented empirical evidence that not only is "mere adherence to general accepted principles of good corporate governance…not necessarily associated with superior performance", but that "companies that depart from best practice because of genuine circumstances outperform all others."[16] A 2014 study conducted by researchers at Queen's University in Canada similarly found evidence in support of the proposition that a comply or explain approach to corporate governance provides tangible financial benefits to

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[9] See, for example, the comments of Marshall J of the United States District Court in *TSC Industries, Inc et al v Northway, Inc* 426 U.S. 438 (1976), 448-449; David A. Katz and Laura A. McIntosh, 'Corporate Governance Update: "Materiality" in America and Abroad' (2021, 29 April) *New York Law Journal*.
[10] ASX Corporate Governance Council (2019) Corporate Governance Principles and Recommendations, 4th edition, 2.
[11] Financial Report Council (2018) The UK Corporate Governance Code, 1-2.
[12] See, for example, European Union Directive 2013/34/EU, Article 20; Canadian National Instrument 58-101 *Disclosure of Corporate Governance Practices*; Canadian National Policy 58-201 *Corporate Governance Guidelines*.
[13] UK Listing Rule 14.3.27; Swiss Ordinance on Climate Disclosures; Swiss Civil Code of Obligations, Article 964b.
[14] United Kingdom Listed Rule 14.3.27(2) and (3).
[15] Swiss Civil Code of Obligations, Article 964b.
[16] Sridhar R. Arcot and Velntina G. Bruno "One size does not fill all, after all: Evidence from Corporate Governance" (2007) 1st Annual conference on Empirical Legal Studies, 26.

investors.[17] Secondly, because it is not a one-sized-fits-all approach, a comply or explain approach diminishes the risk of companies simply "box ticking" in order to comply with the letter, but not the spirit, of the law.[18] In the context of climate-related disclosure, both points are important. As discussed above, relevant climate-related information and risks will differ between companies for a variety of reasons. Further, disclosure of a large volume of information that is irrelevant to a company's business and risk-management but produced in order to comply with rigorous, prescriptive disclosure standards is of no assistance to investors, but it may in fact be detrimental to them. A company's costs of disclosure are ultimately borne by investors. In addition, investors incur their own costs in dealing with disclosed information. These costs include, for example, the time spent reviewing disclosed material and expenses associated with obtaining advice (if necessary). If burdened with excessive immaterial information, such costs are likely to increase. Moreover, the disclosure of a significant volume of immaterial information risks distorting difference between material and immaterial information, thereby potentially leading to a situation in which investors are misinformed. Targeted disclosure of information relevant to the specific circumstances of any given company will be of much more use to investors, in addition to being less costly for companies to produce.

A common concern with a comply or explain approach to matters of corporate governance is that companies' explanations for non-compliance are unsatisfactory.[19] As we explained in relation to voluntary disclosure, the extent of Australia's continuous disclosure obligations suggest to us that this should not be a significant issue in the context of Treasury's proposed climate-related disclosure regime. Evidence from the United Kingdom and Germany suggests there are three further reasons as to why unsatisfactory explanations for non-compliance are unlikely to be a significant issue in Australia.[20] First, through the provisions relating to the ASX Governance Principles, public companies in Australia already have experience with comply or explain obligations. They are therefore aware of how the market perceives non-compliance and what is required for an explanation to be considered adequate. Evidence in relation to Australian companies' explanations for not having an audit committee suggest that noncompliant companies generally provide adequate explanations.[21] Secondly, within the Australian market, an increasing proportion of capital is concentrated in the hands of institutional investors. Unlike in jurisdictions with higher levels of individual share ownership at the voting level (as opposed at the level of beneficial ownership), Australian companies are subject to monitoring and pressure by investors with the skills and resources to exert meaningful influence and ensure companies act in the interests of their shareholders.[22] Thirdly, the Australian corporate sector is rigorously regulated by several entities including, relevantly, Treasury, the ACCC, and ASIC. Strong regulatory oversight of corporate behaviour, even if not directly related to comply or explain obligations, is likely to incentivise companies to properly fulfil those obligations. Further, depending on how the relevant regulation is drafted, regulators may have direct oversight of certain aspects of companies' explanations.[23] For example, it is possible that statements made by companies in relation to why they have not complied with certain climate-related disclosure provisions will fall within the ambit of ASIC's greenwashing investigations.

Concluding remarks

The introduction of a mandatory, standardised climate-related disclosure framework with which Australian listed companies are required to comply will introduce significant unnecessary risks and costs to those companies and their shareholders without providing a corresponding benefit to shareholders. We urge Treasury to reconsider whether the

[17] Yan Luo and Steven E. Salterio, "Governance Quality in a 'Comply or Explain' Governance Disclosure Regime" (2015) 22(6) *Corporate Governance* 460.

[18] The Committee on the Financial Aspects of Corporate Governance (1992) The financial Aspects of Corporate Governance ("The Cadbury Review") [1.10].

[19] See, for example, David Seidl, Paul Sanderson and John Roberts, "Applying 'Comply-or-Explain': Conformance with Codes of Corporate Governance in the UK and Germany" (2009) Centre for Business Research, University of Cambridge, Working Paper No. 389.

[20] Ibid.

[21] Michael E. Bradbury, Diandian Ma and Tom Scott, "Explanations for Not Having an Audit Committee in a 'Comply or Explain' Regime" (2019) 29(4) *Australian Accounting Review* 649.

[22] Deidre Ahern, "Replacing 'Comply or Explain' with Legally Binding Corporate Governance Codes: An Appropriate Regulatory Response?" (2010) ECPR Standing Group on Regulator Governance Biennial Conference Regulation in an Age of Crisis.

[23] Andrew Keay, "Comply or explain in corporate governance codes: in need of greater regulatory oversight?" (2014) 34(2) *Legal Studies* 279.

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implementation of entirely mandatory, standardised, internationally aligned requirements for disclosure of immaterial climate-related information is in fact in the best interests of corporate Australia, investors, or everyday Australians.

The comply or explain principle is not foreign to Australian corporate governance. Introducing a climate-related disclosure framework on a comply or explain basis will reduce the unnecessary risks and costs of a mandatory framework whilst also ensuring the information disclosed pursuant to such a regime remains relevant and useful to investors. Use of the comply or explain principle in this context should be carefully considered.

We have addressed Treasury's specific questions in the Appendix to this letter. Despite our answers to those questions, our position remains that if a standardised, internationally aligned framework for climate-related disclosure is to be introduced in Australia, it should only be implemented on a comply or explain basis.

Yours sincerely,

[redacted]

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Appendix: Response to specific questions in Consultation Paper

Question 1: What are the costs and benefits of Australia aligning with international practice on climate-related financial risk disclosure (including mandatory reporting for certain entities)? In particular:

1.1 What are the costs and benefits of meeting existing climate reporting expectations?

1.2 What are the costs and benefits of Australia not aligning with international practice and in particular global baseline standards for climate reporting ?

The direct costs of a mandatory climate-related disclosure regime are set out above. There are a number of other indirect costs and potential unintended negative consequences of a mandatory climate-related disclosure regime that should be carefully considered before such a regime is introduced.

For example, mandating climate-related disclosure may encourage the flow of capital into those sectors that perform well on climate-related metrics and away from those that do not, even if those sectors are essential for a well-functioning society. Whilst this may assist in the attainment of some short-term climate-related goals, it will not assist with long-term climate-related goals, nor will it be beneficial for society. This is because, first, concentrating capital in a select number of sectors may destabilise and reduce the resilience of the Australian economy. A resilient economy is paramount to avoiding or minimising the consequences of global economic downturns and uncertainties in Australia. No policy should undermine the strength of the nation's economy. Further, without a strong, resilient economy, any long-term climate-related goals, which are very costly, will simply not be achieved. Ambitions to be a world-leader in green technology and climate-related innovation will also not be met if strong and profitable sectors are deprived of capital. Secondly, encouraging the flow of capital into particular sectors necessarily involves diverting that capital and associated resources away from other current needs. Current needs which may not be satisfied if capital is diverted towards other sectors include the need for affordable, reliable energy, building materials, and potentially even healthcare.

A further potential risk of introducing a mandatory climate-related disclosure regime is the fact that, unless also imposed on private companies (which, so as to not unfairly disadvantage public companies, the regime should be) a mandatory climate-related disclosure regime may discourage companies from becoming or staying public in Australia.[24] This may occur as a result of the increased costs and litigation risks associated with more stringent disclosure requirements. Not only would this reduce the number of investible assets available to ordinary investors (thereby reducing their ability to diversity etc.), but it would also result in less oversight of companies' activities and emissions reduction efforts. In some cases, it could also result in companies abandoning Australian operations and moving to countries with less stringent environmental regulations.

Question 2: Should Australia adopt a phased approach to climate disclosure, with the first report for initially covered entities being financial year 2024-25?

2.1 What considerations should apply to determining the cohorts covered in subsequent phases on mandatory disclosure, and the timing of future phases?

Even if introduced on a comply or explain basis, mandatory climate-related disclosure should be implemented using a phased approach.

The phases should relate to what sections of the ISSB (or equivalent) framework are covered by the comply or explain obligation, not the type or size of companies that are covered.

As companies will be required to develop their skills and processes to ensure they are able to provide proper disclosure or adequate explanations for non-compliance, we propose introducing the less stringent and onerous disclosure requirements first. For example, in the first phase, companies should only be required to provide disclosure in relation to

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[24] Paul H. Mahoney and Julia D. Mahoney, 'The New Separation of Ownership and Control: Institutional Investors and ESG' (2021) Columbia Business Law Review Symposium, The Future of Securities Regulation, https://www.sec.gov/comments/climate-disclosure/cll12-8855236-238441.pdf.

matters that are entirely within their control and knowledge (e.g., Scope 1 and 2 emissions, their governance arrangements). Generally speaking, disclosures that rely on information provided by other companies (e.g., the requirement in paragraph 12 of the IFRS Exposure Draft to provide "a description of the current and anticipated effects of significant climate-related risks and opportunities on its value chain") should not be required until after the information has been subject to disclosure by the relevant primary companies. There will necessarily need to be exceptions to this position including, for example, where the primary companies are located overseas and not subject to the same disclosure obligations.

In order to address issues of reliability and comparability, scenario analysis and other disclosure requirements that involve a significant number of assumptions should not be required in the first phase. Rather, time should be taken to develop a set of assumptions that can be used when fulfilling these requirements (see our response to question 14 for an explanation of who should set those assumptions). Of course, it will not be possible to address all the assumptions companies are required to make, nor to develop a set of assumptions that are appropriate for each and every company but having a set of assumptions companies can choose to apply may be beneficial.

The efficacy of the regime in achieving its stated goals, together with its costs and other associated consequences, should be carefully examined before future phases. If necessary, changes to the regime could be made before each new phase (or earlier, if necessary). In order to be able to properly examine the operation of the regime in any form, we suggest that a minimum of two years between phases would be required. A minimum of two years for each phase would also enable companies to have sufficient time to develop their skills and processes so they are able to comply with the most stringent and onerous disclosure obligations by the time they are introduced.

Introducing a comply or explain regime in 2024-25 is unlikely to provide most companies with enough time to adequately prepare to provide proper disclosures.[25] To avoid a situation in which a large proportion of companies simply explain their non-compliance with disclosure requirements, we suggest waiting until at least 2025-26.

Question 3: To which entities should mandatory climate disclosures apply initially?
3.1 What size thresholds would be appropriate to determine a large, listed entity and a large financial institution, respectively?
3.2 Are there any types of entities (that is, apart from large, listed entities and financial institutions) that should be included in the initial phase?
See our answer to question 2.

Question 4: Should Australia seek to align our climate reporting requirements with the global baseline envisaged by the International Sustainability Boards?
4.1 Are there particular considerations that should apply in the Australian context regarding the ISSB implementation of disclosures relating to: governance, strategy, risk management and / or metrics and targets?
4.2 Are the climate disclosure standards being issued by the ISSB the most appropriate for entities in Australia, or should alternative standards be considered?
No response, but the comments in our answer to question 5 are applicable.

Question 5: What are the key considerations that should inform the design of a new regulatory framework, in particular when setting overarching climate disclosure obligations (strategy, governance, risk management and targets)?

[25] See, for example, Letter ExxonMobil to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 17 June 2022, Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors, p12 ("The work effort for the implementation actions described above will require substantial time: at least three years from the date of adoption to the beginning of the first period for which disclosures consistent with the Proposal would be required.").

The paramount consideration should be whether the benefits likely to be brought about by the new regulatory framework outweigh the associated costs. Additionally, when setting overarching climate disclosure obligations, Treasury should ensure it does not encroach on companies' ability to run their businesses in ways they consider will sustainably maximise future profits. Company directors and managers are, generally speaking, best placed to know what is in the interests of their shareholders. The unique characteristics of each different company mean that no one approach to climate-related strategy, governance, risk management, or targets will be appropriate for every company. Accordingly, other than requiring companies to act in the long-term financial interests of their shareholders, governments should not impose on companies a set approach to strategy, governance, risk management or targets. Among other things, doing so may in fact limit competition between companies for capital and / or in the markets in which they supply goods and services. Each of these points can be addressed, at least in part, by implementing a comply or explain framework, our strong preference.

Question 6: Where should new climate reporting requirements be situated in relation to other periodic reporting requirements? For instance, should they continue to be included in an operating and financial review, or in an alternative separate report included as part of the annual report?

For the reasons discussed above regarding investors' ability to make properly informed investment decisions, any information that is not material to a company's financial performance and position (and therefore not already required to be disclosed in financial reports) should be disclosed in a separate report. Information material to a company's financial performance and position is already required to be disclosed.

Question 7: What considerations should apply to materiality judgments when undertaking climate reporting, and what should be the reference point for materiality (for instance, should it align with ISSB guidance on materiality and is enterprise value a useful consideration)?

Any mandatory climate-related disclosure regime should retain the financial materiality threshold that dictates the continuous disclosure obligations of Australian companies. That is, materiality should relate to matters that a reasonable person would consider likely to have a material effect on the price of a company's securities.

Question 8: What level of assurance should be required for climate disclosures, who should provide assurance (for instance, auditor of the financial report or other expert), and should assurance providers be subject to independence and quality management standards?

Other that in respect of that information already covered by the continuous disclosure obligations or required to be disclosed in financial reports, there should be no requirement for the assurance of climate-related disclosure. Mandatory assurance of climate-related disclosure will add to the costs of such a regime at the expense of shareholders without any corresponding benefit. Owing to the significant uncertainties and numerous assumptions embedded in the climate-related information, it is doubtful that assurance will provide any benefit to investors, particularly if an overriding obligation of good faith applies (see our answer to question 15 below). In fact, external assurance of climate-related disclosure may result in investors having more faith in that information than is warranted given those uncertainties and assumptions. Assurance will not mean investors are more informed, but it may mean they are *mis*informed.

Question 9: What considerations should apply to requirements to report emissions (Scope 1, 2 and 3) including use of any relevant Australian emissions reporting frameworks?

Companies should be required to calculate their actual Scope 1 and 2 emissions in accordance with how emissions are calculated under the NGER Framework. It should not be the case that companies can rightly report one figure to the NGER and another to the market. When reporting net emissions, companies should be required to provide details of the type of offsets (if any) they have used, and how those offsets relate to the actual abatement of emissions.

Companies should not be required to report Scope 3 emissions unless such data falls within the ordinary materiality threshold. This is similar to the approach that has been taken in the United Kingdom in respect of its comply or explain obligation for companies to provide disclosure in accordance with the TCFD framework and to what has been proposed in the United States by the Securities and Exchange Commission (**SEC**). The SEC has also proposed that companies be required to disclose Scope 3 emissions if they have set an emissions reduction target or goal that includes Scope 3 emissions.[26] Such an approach may also be appropriate in Australia, though for the reasons below, we are doubtful as to the validity with which companies can set and "achieve" targets relating to Scope 3 emissions and whether such targets should therefore be set at all.

Measuring Scope 3 emissions is likely to be challenging, if not impossible, for many companies. It necessarily requires reliance on data from third parties who cannot generally be compelled to provide such information and a significant amount of estimation. It also requires companies to disclose information over which they often have no control (e.g., if there is no viable alternative to a particular product or service generating a company's Scope 3 emissions). There is currently no accepted methodology for calculating Scope 3 emissions and it is highly unlikely that most public companies will be able to accurately report them. Additionally, reporting Scope 3 emissions and the reduction thereof unavoidably involves "double counting". Not only will one company's Scope 3 emissions be Scope 1 or 2 emissions from another company, but those Scope also 3 emissions may be counted as such by multiple companies. This means time and resources will be spent reporting the same emissions and that companies may be "rewarded" for a reduction in their emissions brought about by the efforts of other companies.

As has been proposed by the SEC, *if* Scope 3 disclosure is mandated (even on a comply or explain basis), there should be a safe harbour in respect of disclosure made in good faith.[27] A safe harbour may encourage companies to disclose what Scope 3 emissions they can, rather than simply relying on their ability to explain noncompliance, without the liability risks attached to the disclosure of information that is grounded in assumptions and about matters over which they have no control.

Question 10: Should a common baseline of metrics be defined so that there is a degree of consistency between disclosures, including industry-specific metrics?
Yes, but still on a comply or explain basis (as proposed in our answer to question 2).

Question 11: What considerations should apply to ensure covered entities provide transparent information about how they are managing climate related risks, including what transition plans they have in place and any use of greenhouse gas emissions offsets to meet their published targets?
As discussed in our letter above, we consider that the existing continuous disclosure obligations ensure investors are informed about the material risks to a company. Transparency is already promoted through the strict regulatory oversight of corporate behaviour in Australia including, for example, ASIC's recent statements regarding its intention to monitor greenwashing more carefully. We believe there are already sufficient safeguards in place to ensure companies' climate-related disclosure is transparent.

Question 12: Should particular disclosure requirements and / or assurance of those requirements commence in different phases, and why?
See our answers to questions 2 and 8.

Question 13: Are there any specific capability or data challenges in the Australian context that should be considered when implementing new requirements?
13.1 How and by whom might any data gaps be addressed?
13.2Are there any specific initiatives in comparable jurisdictions that may assist users and preparers of this information in addressing these challenges?
No response.

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[26] Securities and Exchange Commission, 'The Enhancement and Standardization of Climate-Related Disclosures for Investors', Release Nos. 33-11042; 34-94478, Particularly Part II(G).
[27] Securities and Exchange Commission, 'The Enhancement and Standardization of Climate-Related Disclosures for Investors', Release Nos. 33-11042; 34-94478, Particularly Part II(G).

Question 14: Regarding any supporting information necessary to meet required disclosures (for instance, climate scenarios), is there a case for a particular entity or entities to provide that information and the governance of such information?
As discussed in our answer to question 2, there could be some benefit in there being a standard set of supporting information that companies can choose to use when making climate-relate disclosures, particularly in the context of forward-looking estimates. Again, we reiterate that the use of such information should be on a comply or explain basis only.

In order for climate-related disclosure to be most useful, scenarios and other assumptions should be developed by independent bodies with the necessary skill. Given the breadth of skill required to properly develop the required scenarios and assumptions, we suggest that a partnership or coalition of relevant organisations / industry bodies (e.g., including economists, scientists, business leaders) would be appropriate. There should be strict rules to ensure the independence of those developing scenarios and assumptions (e.g., personal and organisational political neutrality, term limits) and international input and collaboration should be encouraged.

Question 15: How suitable are the 'reasonable grounds' requirements and disclosures of uncertainties or assumptions in the context of climate reporting? Are there other tests or measures that could be considered to ensure liability is proportionate to inherent uncertainty within some required climate disclosures?
A safe harbour should apply to any climate-related disclosures made in good faith in the interests of shareholders. This is a departure from the "reasonable grounds" test that applies in the context of the continuing disclosure obligation, though one that we believe is appropriate given the inherent uncertainties in climate-related disclosure and the fact that any climate-related disclosure regime supplements the material information already disclosed under the continuous disclosure obligations. Although "objective reasonableness" (being what is required to be proved under the "reasonable grounds" test) is not an overly high burden, when a safe harbour provision operates in the context of comply or explain obligations, it is likely that a less stringent "good faith" test will best achieve the goal of encouraging companies to provide more climate-related information (e.g., to "comply" rather than "explain"). A less stringent test is arguably also more appropriate in the context of non-material disclosures.

Question 16: Are there particular considerations for how other reporting obligations (including continuous disclosure and fundraising documents) would interact with new climate reporting requirements, and how should these interactions be addressed?
The most relevant interaction between different reporting obligations is the extent to which a climate-related reporting regime will increase the overall disclosure costs to companies. It should be acknowledged that material information is already covered by the existing continuous disclosure obligations and information covered by any additional regime is supplementary.

Question 17: While the focus of this reform is on climate reporting, how much should flexibility to incorporate the growth of other sustainability reporting be considered in the practical design of these reforms?
None. As we have made clear above, information material to a company is already required to be disclosed under Australia's existing continuous disclosure obligations. Australian investors have access to the information they need in order to be able to make informed investment decisions. Disclosure is costly and the associated costs are ultimately borne by shareholders. In circumstances in which additional disclosure requirements will not assist investors, there is no justification for imposing on them additional costs. For the reasons discussed in our letter and this Appendix, mandatory sustainability reporting will not assist with the efficient allocation of capital within Australian markets but may become a hinderance to that aim.

Question 18: Should digital reporting be mandated for sustainability risk reporting? What are the barriers and costs for implementing digital reporting?
No response.

Question 19: Which of the potential structures presented (or any other) would best improve the effectiveness and efficiency of the financial reporting system, including to support introduction of climate related risk reporting? Why?
No response.