16th February 2023

Submission to "Climate-related financial disclosure" Consultation Paper

Introduction

I was Australia's Sustainable and Liveable Planet Delegate at the 2022 Youth G20 Summit. Alongside youth representatives from other G20 countries, we developed a communiqué with over 120 actionable policy proposals for G20 Leaders. Realising the importance of finance in achieving climate and environmental goals, eight of these proposals are targeted at integrating sustainable finance within G20 economies. In particular, one of the proposals calls attention to the need for climate-related financial disclosures:

> Mandate comparable, interoperable, transparent climate- and nature-related financial disclosures, aligned with science-based no overshoot 1.5°C scenarios and full emission scopes coverage, published annually by 2025;

Recognising the pace at which sustainable finance is developing in other jurisdictions, particularly the United Kingdom (UK), the United States (US) and the European Union (EU), and Australia's comparative lack of action, following the Summit I wrote a policy paper titled "Sustainably Financing the Transition to Net Zero". The paper, which was published by the NGO Global Voices, outlines key recommendations to facilitate the introduction of globally aligned, high-quality and interoperable climate-related financial disclosures across the Australian economy, to ensure our country remains competitive for the capital needed to fund the transition to net zero. The paper was developed following months of comprehensive research and interviews with over ten stakeholders in the public sector, private sector and civil society.

I therefore welcome Treasury's climate-related financial disclosure consultation paper as a tangible step forward towards realising mandatory, economy-wide reporting of climate risks. While I am supportive of many reform elements proposed in the consultation paper, I consider there is insufficient consideration of the systemic shift that climate-related financial disclosures will create in the Australian financial system. In my view, this represents a fundamental flaw. Climate-related financial disclosures are not simply additional reporting requirements that can be applied to the financial sector. Rather, these disclosures (and the broader sustainability-related disclosures that are gaining traction globally) mark a systemic shift in how environmental matters are considered in fiduciary systems. Rather than undesirable externalities that are only discussed in annual sustainability reports, climate-related risks must be integrated within existing core financial reports and used to inform business strategies. A shift of this scale cannot be achieved by the finance sector alone, as inputs and engagement are required from disparate fields such as climate science, supply chain management, data analytics and strategy development.

Given the significantly broader array of stakeholders involved in climate-related financial disclosures, a new regulatory framework and governance entity for the financial system are needed. To create this new regulatory landscape, existing functions, structures, and capabilities used for financial system oversight should be leveraged. Crucially, however, the new framework must also create mechanisms for 1) input from a broader array of government stakeholders and 2) more effective cross-governmental coordination. Further, to ensure the regulatory framework is fit-for-purpose, mechanisms for regular engagement with non-government stakeholders impacted by the reforms must also be embedded. Failure to include all stakeholders impacted by the reforms – both governmental and non-governmental – would reduce the efficacy, efficiency, flexibility, and cost-effectiveness of the implementation process.

Recommendations

To overcome these limitations, I propose the following measures. These proposals build on approaches adopted in similar jurisdictions:

1. **Establish a new governance entity to coordinate the introduction of climate-related financial disclosures. The entity should be composed of a cross-departmental and cross-regulator governance board, and an expert sub-committee which includes all relevant stakeholder groups.**
2. **Develop a Roadmap for the phase-in of mandatory climate-related disclosures, outlining the implementation mechanisms, expected coverage, timelines and required regulatory actions.**

Specific responses to the consultation questions are provided below to justify the rationale for these recommendations and further outline potential implementation mechanisms.

Specific Responses

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?

Reform design must be conducted with a view to the new climate risk reporting framework being highly scalable, flexible and able to efficiently incorporate the growth of other sustainability-related financial reporting. Widespread recognition of the need to rapidly reduce emissions has resulted in a significant global focus on climate-related risks and disclosures to date. However, additional sustainability-related metrics, such as those related to nature/biodiversity and the circular economy, are increasingly informing investment decisions. This dynamic is expected to accelerate soon, as evidenced by the upcoming release of the biodiversity-related Taskforce on Nature-Related Financial Disclosures and IFRS General Requirements for Disclosure of Sustainability-related Financial Information. These standards reflect a broadening of investor information requirements from solely climate to other types of sustainability reporting.

Restructuring the regulatory landscape to support the introduction of climate-related financial disclosures must consider this broader context and be treated as an exercise in enabling the transition towards a more broadly sustainable financial system. This approach would enable the government to introduce new sustainability standards rapidly, efficiently and cost-effectively as they evolve, while minimising administrative burdens. Further, this approach would benefit private sector entities by providing the regulatory certainty that they require to warrant investment in developing new sustainability-related financial systems. Finally, this more holistic reform strategy would send a clear signal to prospective investors that Australia is developing a longer-term regulatory framework to support high-quality disclosures which enable capital investment. **The creation of a new governance entity for the financial system, composed of a cross-departmental and cross-regulator governance board plus expert sub-committee (as outlined below - see Question 19) would provide an effective means of obtaining the flexibility and scalability required.**

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?

The complexity of Australia's financial regulatory landscape has caused uncertainty amongst financial regulators and standard-setting bodies on the best mechanism to introduce and supervise climate-related disclosures. While the Council of Financial Regulators' (CFR) existing climate change working group (established in 2017) provides a good basis for cross-regulatory collaboration, more high-level government coordination is needed to effectively introduce mandatory climate-related financial disclosures across the Australian economy in the short-term and to enable the efficient introduction of further sustainability-related disclosure requirements in the future.

Potential Structure 3 (single, flexible entity) goes some way to developing such an entity. As noted previously, however, the sole inclusion of finance-related bodies within the new entity fails to account for the systemic changes that climate-related financial reporting will have on the financial system. Given this systematic shift, effectively designing, implementing and overseeing climate-related disclosures requires the involvement of additional government stakeholders. While any new entity should be built around the core existing financial regulatory and standard-setting bodies (FRC, AASB, AUASB and CFR members), it must also include a broader range of government stakeholders with the necessary expertise, knowledge, experience and skills to effectively oversee climate-related financial reporting. This coordinated approach will result in a more robust regulatory structure for climate-related financial disclosures and facilitate economy-wide implementation.

A cross-departmental and cross-regulator governance board could provide an effective means to achieve this objective. Similar approaches have already been adopted in other jurisdictions, with the UK, Hong Kong and EU all developing cross-agency taskforces/steering committees to aid in climate-related disclosure framework implementation. In 2022, the UK became the first G20 country to introduce mandatory climate-related financial disclosures. The decision represented the culmination of the work of a cross-departmental and cross-regulator taskforce established in 2019 to understand the most effective approach to implementing the Taskforce on Climate-related Financial Disclosures' (TCFD) recommendations across the entire UK economy. The taskforce included members from all departments and regulatory bodies involved in the financial sector. Similarly, in 2020 Hong Kong established a sustainable finance cross-agency steering group, with a core component of the group's remit to manage climate and environmental risks to the financial sector. The steering committee included representatives from a broad array of public institutions including the Environmental Protection Department and the stock exchange. Finally, the EU, recognising the need for input from a diverse range of stakeholders impacted by climate-related disclosures, established an additional technical expert group composed of members from civil society, academia and the private sector to provide recommendations on TCFD implementation and sustainable finance more generally.

Australia should learn from the approaches taken by the UK, Hong Kong, and EU and establish a new sustainable finance governance entity which is grounded in finance-oriented organisations but includes a broader range of stakeholders. At the heart of the new regulatory body should be a cross-departmental and cross-regulator governing board which includes members from all CFR bodies, financial accounting and auditing bodies (AASB and AUASB) and the Australian Securities Exchange (ASX). Building upon the above international models, the board should also include members from the Department of Climate Change, Energy, the Environment and Water (DCCEEW) and the Department of Foreign Affairs and Trade (DFAT), to ensure that, respectively, the integration of climate-related disclosures in Australia supports domestic environmental policy objectives and also aligns with global TCFD-related activities.

To ensure that the reform principles of “2. improve information flows” and “3. well-understood” are achieved, it is also important that the new governance entity include mechanisms for efficient and continuous consultation with impacted stakeholders. The systemic shift that climate-related reporting will create in the financial sector has generated significant uncertainty and concern amongst many impacted entities that are ill-equipped to deal with this transition. The introduction of novel climate risk disclosure requirements (and, in the future, broader sustainability-related reporting requirements), also has the potential to significantly increase the transparency of the financial system and flows of information to investors and civil society. To ensure disclosures and the associated information are translated to action on climate, it is crucial that the information being provided is decision-relevant to investors and also fit-for-purpose for civil society, to enable better scrutiny of the environmental and social impacts of private entities.

The governance board should therefore be accompanied by an expert sub-committee to ensure that all stakeholders impacted can provide relevant and practical advice. While this recommendation generally aligns with the sub-committee idea put forward in Potential Structure 3, the sub-committee should not be composed solely of technical experts but rather should also include representatives from key stakeholder groups. The expert group should be composed of representatives from the private sector, investor groups and the Australian Sustainable Financial Institute. Aligning with the approach taken in the EU, the sub-committee should also include representatives from academia and relevant civil society bodies, including First Nations and youth-led organisations. Involving stakeholders with expertise in environmental and social issues will be important to ensure that climate-related disclosure requirements reflect the interests and needs of the Australian community, in addition to channelling investment towards decarbonisation initiatives.

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 of mandatory disclosure, and the timing of future phases?***

Investors have indicated the desire for a clear signal of when mandatory climate-related disclosures will become compulsory in Australia. Similarly, many businesses are hesitant to invest the resources required for climate-related financial reporting while regulatory expectations, reporting requirements and implementation mechanisms remain murky. There is therefore **a need to develop a clear, specific, and detailed roadmap outlining when different types of financial institutions will be required to produce TCFD-aligned disclosures, the mechanisms used to implement these requirements and the associated governmental and regulatory actions that will be taken to support businesses and financial institutions.**

This approach was adopted by the UK TCFD taskforce. The UK has a very similar financial regulatory landscape, with multiple government agencies responsible for regulating different types of financial institutions (e.g. publicly listed companies, banks). To assist in the economy-wide implementation of disclosures while providing investors and the financial sector with clear regulatory signals, a UK TCFD taskforce was tasked with establishing a roadmap. The 14-page document, published in late 2020, outlined the "indicative milestones" that regulatory agencies would implement over the subsequent three to five years and the associated impacts on different types of financial institutions. More specifically, the roadmap outlined the policy mechanisms, phase-in dates and qualifying criteria for the proposed disclosure requirements, while outlining the key next steps that would be taken by taskforce members to both realise and build capacity for the new disclosures. Overall, the roadmap provided clear signals to the private sector of when and how disclosures would be introduced, while also maximising the efficiency of government resources by charting required actions and next steps from each agency.

The governance board recommended above (see Question 19) should be tasked with developing a similar roadmap applicable to the Australian context, which should aim for a first report by early to mid 2024. The roadmap should clearly outline the strategy, scope, and mechanisms for implementing mandatory disclosures and obtaining full-economy coverage. The governance board structure outlined in Recommendation 1 means that all government bodies that could be impacted by the new disclosures would be engaged in the roadmap development process. Similarly, the expert advisory panel will enable consultation on industry-specific phase-in timelines, to account for differences in capabilities across private sector institutions. The success of the roadmap could be quantified via the number of financial institutions and the amount of capital covered by mandatory, TCFD-aligned disclosures each year. Following the completion of the roadmap, implementation progress and outcomes should be monitored and reported on annually by the new governance entity.

Conclusion

As the world's biggest economies move towards mandatory climate-related financial disclosures, there is a need to implement policies that facilitate the rapid, economy-wide integration of such disclosures in Australia. This action is crucial if we are to be competitive in attracting the international capital needed to enable emission reduction targets to be met. The recommendations outlined in this submission offer an actionable, implementable, and targeted approach that would provide a scalable, flexible and efficient model for introducing further sustainability-related financial disclosure requirements in the future. The proposed recommendations would also meet the demands of investors, businesses, regulators, civil society and the broader Australian public.

Yours sincerely,

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