

Climate Disclosure Consultation Seven Advisory Submission



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Corporations Branch
Market Conduct Division
Treasury
Langton Cres
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Climate-related financial disclosure in Australia

Submission to Treasury by Seven Advisory

Seven Advisory

Seven Advisory is an ESG advisory firm specialising in impact strategy, sustainability reporting, and climate risk and opportunity. Seven Advisory leverages deep expertise within the institutional investor environment to help organisations – from family offices, superannuation funds, start-ups and established corporations – navigate the rapidly evolving landscape of sustainability reporting and climate risk.

Our mission is simple: to progress authentic system change for a better, more equitable world.

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Perspective

This submission is presented through the lens of investment reporting entities (predominantly long-term and institutional, including those internationally exposed).

Recommendations

We welcome the opportunity to respond to this consultation paper. Our key considerations include:

1. We recommend mandating alignment with the forthcoming ISSB Standards. This is a timely opportunity for Australia to catch up with international jurisdictions and to meet the accelerating investor demand for complete and consistent reporting across borders.
2. The systemic nature of climate risk cannot be understated. Our national response to date has been insufficient. For this reason, we reference the importance of double materiality, suggest widening the net for reporting entities and support the establishment of a dedicated climate standards board.
3. Reporting entities must connect the dots between awareness and action. We believe this necessitates inclusion of Scope 3 emissions in the earliest phases, liability for non-compliance and enhancing directors' access to supportive tools (concerning climate science, transition plans and scenario analysis). We do not believe there is a strong need for a safe harbour provision.

Thank you

Thank you for the opportunity to share our perspective and we look forward to continuing the dialogue as the sustainability reporting landscape evolves.

Sincerely,

A solid black rectangular box redacting the signature of the sender.

Managing Director

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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?

From an investor [1], market operator [2] and domestic regulator perspective [3], climate-related risks and opportunities are already financially material to many Australian businesses. While 4 in 5 of the top 500 ASX-listed companies disclosed in 2021, only 9% of these disclosures were explicitly TCFD-aligned [4]. The benefits of *mandating* alignment with these existing expectations are two-fold:

1. Increasing consistency across reporting entities, thereby improving efficiency in investment decisions.
2. Improving sub-standard practice, thereby maintaining Australian access to foreign and institutional capital. (We note that investors pay attention to the absence of disclosure).

The cost of alignment (with TCFD) arises when secondary reform is required to 'upgrade' the financial reporting system to align with ISSB Standards (see 1.2).

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

We recommend Treasury consider not using TCFD as a steppingstone, and instead mandate alignment with ISSB Standards from the outset, which is designed to better meet all reform principles.

In the absence of clear precedent from comparable jurisdictions (which are TCFD-aligned), we recognise this approach front-loads compliance costs, but believe this is outweighed by the benefits of efficiency for the financial reporting system and enhanced credibility and access to capital for Australian reporting entities.

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?

A phased approach with FY25 as the first reporting period is appropriate, particularly considering our response to 1.2.

Aotearoa New Zealand's XRB climate standards expect 200 entities to report in the first year [5]. The UK expects over 1000 [6]. The pathway to mandatory climate reporting is a 'marathon not a sprint' [7]. In its first year, Australia should target 500 reporting entities. This is a meaningful proportion of Australian listed entities and aligns with the ambition of comparable jurisdictions relative to the size of our economy.

We recommend determining this cohort by market cap and revenue thresholds for listed entities. We note there are also reasonable voices suggesting this cohort may be determined by emissions, this warrants exploration.

Revenue threshold is concrete, understandable across a broad group of stakeholders and, in future, applicable to unlisted entities (we note that climate change is material to every company).

We support the use of 'total assets under management' as an appropriate metric for financial institutions.

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?

Listed entity: one of \$500M (revenue) or \$500M (market cap).

Financial institution: \$1B.

3.2 Are there any other types of entities (that is, apart from large, listed entities and financial institutions) that should be included in the initial phase?

For investors, smaller listed entities in hard-to-abate sectors should be included in FY25.

For real-world climate outcomes and to avoid discouraging listing or restructuring, requirements should also be extended to unlisted entities in these sectors, large unlisted entities and trusts.

Further, we encourage the public sector to be included where they meet comparable thresholds. This enables the government to lead by example and demonstrate 'best practice' reporting from the initial phase, whilst observing firsthand where there are gaps in guidance.

Treasury should consider implementing a grace period of one year for financial institutions such as large asset owners and asset managers, where reports will be dependent on those produced by investee companies in the initial phase.

We also note that the exclusion of smaller entities and those listed on page 9 of the consultation paper will impact data availability for Scope 3 reporting in the initial phases. In addressing this gap, we encourage Treasury to incentivise / mandate Scope 1 and 2 reporting among excluded entities sooner (see 9), rather than extending allowances for reporting entities (see 15).

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?

From an investor perspective, alignment with global baselines is key. Deviation that involves subtracting requirements from ISSB is not recommended, though we do support Treasury augmenting the standards where insufficient (see 7).

A roadmap should make clear that ISSB standards will be adopted in full and expanded to initially excluded entities (see 3.2) over a specific period (e.g. three years).

We encourage guidelines to focus on connecting the dots between awareness and action. As such, strategy must be a key focus for reporting entities, including credible transition plans supported by highly granular strategic objectives and investments to meet targets (see 11).

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?

We endorse this. (see 1.2).

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)?

In reporting, investors are concerned with completeness and consistency.

These outcomes are driven by clarity and certainty in the regulatory framework. This would be best achieved by legislating the overarching obligations.

This approach aligns with that of comparable jurisdictions and signals the importance of climate change (and Australia's net-zero goals) to directors and broader stakeholder groups.

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?

As addressed in 4.1, climate-related disclosures must meaningfully inform decision-making.

The board and executives should consider material climate-related risk and opportunity as part of their business fabric. This can be facilitated by integrating climate reporting with existing periodic requirements. Such an approach is also efficient from a regulatory and compliance perspective.

Question 7: What considerations should apply to materiality judgements 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)?

Enterprise value is a useful consideration for materiality alongside sustainability impacts.

A double materiality approach is more useful for long-term investment decisions, enabling investors to play an active role in decarbonisation and to manage

sustainability risks before they become financially material. Beyond investors, a double materiality lens is necessary for Australia to manage systemic risk and meet net-zero goals.

We recommend aligning with the IFRS accounting standards (and thereby AASB and likely ISSB), whilst including provisions to augment this baseline towards European Sustainability Reporting Standards (or comparable reference points) over time. In other words, if Treasury follows NZ, the UK and the US with an 'enterprise value' approach to materiality, we encourage a commitment to revisiting this definition within three years.

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?

We note that carbon emissions are measurable and verifiable, and recommend Scope 1 and 2 emissions be subject to independent reasonable assurance after the initial phase (i.e. FY26). This service is likely be provided by the auditor of the financial reports but need not be set out as a requirement.

Regardless of who provides assurance, we support the expansion of the Auditing and Assurance Standards Board to develop auditing and assurance standards for sustainability purposes.

Over time, this should encompass limited assurance for the common baseline of metrics provided by Appendix B of IFRS S2 (see 10).

Though carbon emissions serve as an early conduit between financial reports and climate-related issues, they are ultimately limited in the context of future developments (e.g. TNFD).

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?

In reports, investors seek plausible decarbonisation pathways. This requires disclosure of and response to Scope 1 and 2 – and for many companies – Scope 3 emissions.

To assess plausibility, reports must be internationally comparable. We recommend aligning with the Greenhouse Gas Protocol (on which NGERs reporting is based) and mandating disclosure of Scope 3 emissions from the initial phase, in alignment with the proposed SEC implementation timeline.

Question 10: Should a common baseline of metrics be defined so that there is a degree of consistency between disclosures, including industry-specific metrics?

We agree that Appendix B of IFRS S2 will provide a common baseline per industry for climate-related metrics.

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?

Investors are concerned with:

1. The financial risks posed by climate change.
2. The effectiveness of a company's response to these risks.

Transition plans therefore represent half of the equation, yet to date have been insufficiently reported [8]. To determine credibility of climate risk management, investors require:

- Short-, medium- and long-term objectives that build up to long-term goals
- Capital allocation to execute on such objectives
- Evidence of past performance

Assumptions and inputs to strategy – particularly around business model resilience and what a climate-changed world looks like – must be included (see 14).

Question 12: Should particular disclosure requirements and/or assurance of those requirements commence in different phases, and why?

As per 9, we recommend mandating disclosure of Scope 1, 2 and 3 emissions from the initial phase.

This likely aligns with ISSB timelines, including the one-year temporary exemption for reporting of Scope 3 emissions.

Mandatory assurance for Scope 1 and 2 emissions should be phased in at FY26 and Scope 3 at FY27.

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?

Access to tools enabling robust scenario analysis could be facilitated by the government, CSIRO or RBA; ensuring datasets are publicly available, aligned with IPCC reports and reflective of Australian idiosyncrasies.

Complete case studies could also be distributed to highlight best practice.

This might also be enabled if the public sector is included from the initial phase (see 3.2).

13.2 Are there any specific initiatives in comparable jurisdictions that may assist users and preparers of this information in addressing these challenges?

Investors expect boards – and individual directors - to accept climate science and to hold adequate climate expertise.

We endorse AICD joining the Climate Governance Initiative and encourage the delivery of comprehensive courses in alignment with the WEF Climate Governance Principles and responding to Australian legislation resulting from this consultation.

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?

Investors need reporting entities to ‘avoid black box disclosure’ [8].

Variables and assumptions affect the outputs of climate models, and company resilience strategies are currently responding to markedly different future worlds.

We recognise that forward-looking models are inherently uncertain and scenario analysis must be flexible enough to meet a company’s circumstances, but comparability should be a key goal within these constraints.

We recommend that companies use a Paris-aligned and publicly available model such as the Network for Greening the Financial System or one developed by an Australian authority (see 13.1).

Where a bespoke model is deemed necessary by the reporting entity, this could be provided in addition to models recommended by Australian climate standards.

We note that the ISSB draft requires more granular forward-looking information than the TCFD framework and will also provide guidance on which climate scenarios an entity should use.

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?

We refer to paragraph 30 of the legal opinion by S.H. Hartford-Davis and K. Dyon, published by ACSI [9]:

‘In our opinion, the ISSB Draft Standards require disclosure of material information about sustainability risks in a manner which is broadly consistent with existing requirements that apply to listed companies in Australia, and requires disclosure of things which company directors should already be considering in the proper discharge of their duties as directors. In this sense, for diligent company directors properly supported by competent management, the ISSB Draft Standards will not increase directors’ exposure.’

We note that grace periods and ‘safe harbour’ regimes have been proposed in comparable jurisdictions but believe the cost of this approach outweighs the benefit.

Liability risks improve investor access to decision-useful information. ‘Reasonable grounds’ are not requiring directors to make the uncertain certain, but to meaningfully engage with current science and the processes and standards to be provided by the ISSB [9].

We believe existing 'reasonable grounds' requirements are proportionate to the risks our economic system and reporting entities face. Providing protection will only undermine the principles and purposes of this reform.

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?

Not in the first phase.

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?

Where possible, we encourage Treasury to design initial standards as though incorporation of TFND will happen.

However, we strongly agree that the provision of concrete requirements for climate reporting is the priority. Future flexibility and scalability should not be pursued where it delays or weakens the optimal delivery of the initial phase.

We note the interconnectedness with question 19.

Question 18: Should digital reporting be mandated for sustainability risk reporting? What are the barriers and costs for implementing digital reporting?

Digital financial reporting is mandatory in the US, the UK, France and Germany. In the context of climate-related risk and opportunity, this unlocks comparability and better enables investors to undertake independent analysis on company responses.

In general, digital reporting is highly desirable; however, we understand the AASB work program sets digital reporting as a small 'monitor and influence' project for the 2022 – 2026 period [10].

Considering our response to question 6, we do not recommend mandating digital reporting until this is also the case for general financial reporting. Even then, it is important to resist boiling climate-related issues down into a set of tidy metrics formatted for iXBRL.

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 benefits listed for Structure 1 are largely short-term and can be transferred to Structure 2.

Structure 2 is likely best equipped to respond to the ongoing development of ISSB standards and broader future issues of nature and wellbeing.

Access to a separate board and body of expertise also acknowledges that methods of financial and sustainability reporting necessarily diverge at points, thereby ensuring that best practices are built first and foremost to support climate goals.

Structure 3 potentially offers similar benefits to structure 2 but is poorly defined and the cost of delay outweighs the cost of duplication of effort.

Further consultation with a broader set of stakeholders might also see the existing set and relative importance of reform principles diluted.

We endorse structure 2.

Sources:

1. <https://igcc.org.au/wp-content/uploads/2021/11/IGCC-Climate-Change-Board-Report.pdf>
2. <https://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf>
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