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17 February 2023

Corporations Branch
Market Conduct Division
Australian Treasury

Climate reporting consultation
Sent by email: climatereportingconsultation@treasury.gov.au

Thank you for the opportunity to make a submission on framework arrangements for Australia's mandatory climate risk disclosure scheme.

The Climate Risk Group is an Australian-based group of companies with over fifteen years' experience in modelling the physical risks of climate change and providing the outputs of our analysis in decision-useful information to lenders, investors, governments and citizens. Our group includes XDI - the Cross Dependency Initiative - which services global clients in infrastructure, banking, investment and government, and Climate Valuation, which provides homeowners and homebuyers with information about extreme weather and climate change risk to Australian homes. We are a leader in providing data for climate stress tests by financial regulators and operate in Europe, Asia and North America, as well as Australia.

We welcome Australia's commitment to implementing mandatory climate risk disclosure reporting consistent with the emerging global architecture and see this measure as crucial to ensuring Australia attracts investment and builds economic, environment and social resilience to the impacts of climate change. We would be happy to discuss the matters raised in this submission in more detail and make our experience and expertise available to assist with the development of this framework.

The principles Australia has established for the regime are a useful and appropriate framework for it. We particularly note the principle that, "Climate disclosure requirements should be proportional to the risks they seek to address, particularly regarding whom they apply to, what costs those entities will incur, what data or capability they will require and what liability they may enliven."

In the area of physical risk, it has been observed by many that disclosure is still in its infancy. Applying the principle of proportionality requires particular attention to the granularity, prominence and thoroughness of physical risk disclosure. This is because unlike transition risk, physical risk is not limited to a particular window of time and will escalate even if the Paris temperature agreement goals are met. Furthermore, the consequences of physical risk are not limited to particular sectors, but will broadly, profoundly and irreversibly affect every aspect of Australia's society and economy. This is in keeping with the finding from the latest scenarios from the Network for Greening the Financial System that, "For all scenarios and time scales, physical risks outweigh transition risks."[1]

Just as early identification and action to reduce greenhouse gas emissions mitigates transition risk, early identification and action of physical risk enables investment in climate resilient business, infrastructure and housing. Similarly, there is a necessary link between the two, since delayed transition worsens physical risk and meaningful reporting of physical risk underpins the case for decarbonisation.

Capabilities in physical risk modelling and analysis are ahead of reporting and many entities are unaware of the data, metrics and methodologies available to them to explore, respond to and disclose their physical risk. The Climate Risk Group would welcome the opportunity to share our expertise in the identification, assessment and management of climate physical risk as Australia's disclosure standards are developed.

We provide answers to some of the questions raised in the consultation paper below.

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)?

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

International climate change reporting expectations have emerged from two main drivers. The first is climate change. Climate change is directly damaging the Australian economy. Climate change is a current and future material risk to most businesses, as already recognised by ASIC. This makes consistent and transparent reporting of climate change risk part of the fiduciary responsibility of all company boards and shareholders. Failure to meet disclosure expectations exposes companies, shareholders and the broader community to loss, and directors and companies to reputational, legal and other repercussions. The second driver is the investment sector. Recognising that climate change transition and physical risk pose significant risk to earnings, investors are seeking transparent, consistent and decision-useful information about climate risk. Investors want to invest in companies that have understood climate change risk and incorporated it into their business strategy and governance. Alignment with international practice will enable Australian businesses to attract capital and will make the entire economy more resilient to the disruption of climate change. Moreover, international alignment will ensure Australian companies remain abreast of practices

[1] NGFS Scenarios for Central Banks and Supervisors. September 2022.
https://www.ngfs.net/sites/default/files/medias/documents/ngfs_climate_scenarios_for_central_banks_and_supervisors_.pdf.pdf

overseas and make it easier for Australian companies to expand their operations overseas if already compliant.

Mandatory disclosure has particular importance for physical risk. Quantitative disclosures are more common for transition risks, as has been observed by the TCFD, the ECB, the SEC and the NGFS. It has become increasingly clear that voluntary frameworks will not lead to uniform market-wide disclosure of information on climate-related physical risks.

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

Mandatory reporting for publicly listed entities and financial institutions should begin in FY2023/24.

We note that the ASX Corporate Governance Council, ASIC and the Reserve Bank have each been communicating to the entities under their regulatory guidance since 2019 about the systemic and enterprise risks posed by climate change. ASIC regulatory guidance makes clear that climate change is a "systemic risk that could have a material impact on the future financial position, performance or prospects of entities" (RG 247.66) and have referred in their guidance to those entities to the recommendations released by the Taskforce for Climate-Related Financial Disclosures (TCFD) in 2017.

ASIC guidance already requires listed entities to consider climate change among material environmental and social risks and referred specifically to the TCFD in the 4th edition of the *Corporate Governance Principles and Recommendations*, issued in February 2019 and in effect since January 2020.

In short, listed companies in Australia should already be disclosing climate risk, and many are doing so. Further delay will not assist Australian companies. There are many organisations and guidances available to help companies with their reporting requirements. The earlier companies understand their risk, the sooner they will start building their resilience and taking action to decarbonise.

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

The principles outlined by Treasury in the consultation paper provide guidance in answer to this question: to assist regulators in assessing and manage systemic risk, strengthen transparency and give investors useful information and to ensure that Australia will meet its climate change goals, mandatory reporting should apply broadly and consistently, regardless of legal architecture. Clearly, size is relevant both to the contribution entities make to achieving Australia's climate change goals and to the ability of the entity to undertake climate change risk assessment.

The principle of double materiality is relevant here: no cohorts are isolated from the broader economy and Australian society. Failure to assess, disclose and manage physical and transition climate risk among private companies and other entities not proposed to be covered in the initial phase of mandatory disclosures could have knock-on effects for other businesses, lenders, communities and individuals.

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

Standardised climate-related financial disclosure requirements should apply not only to listed entities but to private companies and government entities. The risks and benefits of standardised disclosure apply equally to public and private companies. Similarly, it is appropriate that statutory bodies of state governments also be required to disclose climate risk since the risk they carry has broader implications for the functioning of Australian society. Indeed, some state governments are already producing and publishing TCFD-aligned reports. It is assumed that such entities have sufficient resources to be included in the initial phase. Including these entities in mandatory disclosures for physical risk will build understanding about the necessity of investment, planning and action for both decarbonisation and resilience.

Consistent with the financial reporting requirements of the *Corporations Act 2001*, mandatory disclosure in the first phase should apply to all entities listed in s292 (1) of the Act. Similarly, as for general financial reporting obligations, it should be available to ASIC or shareholders to direct small companies to make climate risk disclosures.

Question 4: Should Australia seek to align our climate reporting requirements with the global baseline envisaged by the International Sustainability Boards?

Yes, however we note that for physical risk there is less specificity, breadth and granularity in many global standards than Australia needs. We encourage Australia to put architecture in place that will ensure that our disclosures are consistent with global baselines and provide additional attention and detail to physical risk requirements, given Australia's particular vulnerability in this area.

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?

In the Australian context, particular consideration should be given to developing physical risk requirements of sufficient detail and breadth to provide a confident basis to inform climate resilient investment. Australia is reliant on international investment and has elevated vulnerability to climate change impacts. This presents a strong rationale to develop a world-leading framework for physical risk disclosures that can underpin investment confidence and ensure that investment is climate resilient. For this reason, we recommend that there be specific attention paid to physical risk requirements in the area of risk management, metrics and targets. For example, risk management for physical risk should include disclosure of a company's adaptation options, including its regional adaptation context. It should also include discussion of physical risks that are unmanageable and/or unquantified. Metrics and targets for physical risk should include resilience targets and adaptation metrics, including in engagement and advocacy with regional, state and federal adaptation planning and delivery.

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?

The ISSB standard is the most appropriate basis for mandatory reporting by Australian entities and, as the paper indicates, provides sufficient specificity to make climate risk disclosure comparable and consistent in the area of transition risk. In the area of physical risk, there is a strong rationale for Australia to develop a world-leading standard that extends the ISSB, given standard setting is less developed in this area.

ISSB has acknowledged there is more work to do on physical risk. International investors are developing a Climate Resilience Investment Framework that includes targets and metrics for resilience, as well as decarbonisation. Failure to assess and disclose physical climate-related risks can be a barrier to accelerating adaptation finance and can skew decision-making if transition risks are more fully quantified and prominent. Comprehensive physical risk disclosure also supports the business case for decarbonisation strategies at the company, state and country level.

We note that current Australian guidance links climate risk to s299A (1) (c) of the *Corporations Act 2001* - which deals with "business strategies, and prospects for future financial years." Given the advanced state of climate change and global warming, it is appropriate that climate risk disclosure not be solely considered as a future prospect and that the draft rules of the US SEC and some other international proposed rules (for example, in India) include requirements to report the effects of climate change on the entity in the current year.

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)?

The architecture established by this reform needs to be enforceable, enduring, adaptable and proportionate to the issue it is seeking to address. Climate change disruption will define the operating environment for Australian businesses for generations to come. Over time, the currency of different aspects of climate change risk will change, but the disruptive risk environment will remain.

The overarching obligations for climate disclosure should be built into legislation, and the detail of those obligations built out through mandated standards. Guidance should then be used to support understanding and implementation and encourage best practice.

For reasons outlined in this submission, we suggest that the legislative framework for climate-related disclosure specify that in the area of physical risk, disclosure regulations, standards and guidance will include and provide for key categories of physical risk: **direct risk** (to assets and operations), **cascading risk** (second- and third-order effects on supply and value chains), **contextual risk** (effects of physical risk on material macro-economic factors like GDP, productivity, inflation etc) and **unmanageable** risk (to describe risks beyond the capacity or scope of the entity to manage, mitigate or transfer.)

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?

Integrating reporting within annual reports with full audit and director sign off will give users of climate-related disclosures access to and confidence in the information. This will also enable decision makers in the reporting entity to consider climate change risk in the context of the broader organisation and its business strategy: it will be effectively mainstreaming climate change risk which is critical to both decarbonisation and resilience.

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, but materiality should not be limited to this framework. Using enterprise value solely raises the possibility that risk which cannot be quantitatively calculated or which applies to the operating environment of the enterprise without a known direct channel of transmission to enterprise value will remain unforeseen, undisclosed and unmitigated. This is particularly the case for physical risk, which is generally assessed in longer timeframes, and which has the potential to tip into cascading unbounded risk if the world follows a high emissions pathway or feedbacks come into effect. For example, for Australasia, the IPCC Sixth Assessment Report identified failure of institutions and governance systems to manage climate risks as a key risk for the region. This would clearly have material impacts on most Australian businesses but is difficult to quantify the impact of this systemic risk on enterprise value. Australian standards should take a broad approach to materiality and require companies to consider both external impacts of their operations, because these often migrate into internal risks overtime as litigation, reputation or regulation, *and* risks to the broader social and environmental conditions upon which the business relies which will also migrate internally in unknown ways.

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?

Assurance should be required for all aspects of climate disclosures and assurance providers should be subject to independence and quality management standards. The assurance can be provided by the auditor but an accreditation system is necessary and such accreditation should be available to other experts and subject to oversight.

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?

Emissions disclosures as part of Australia's mandatory climate-related financial risk disclosure framework should be consistent with reporting under NGERs but clearly will need to include disclosure of emissions beyond those required under that scheme - specifically Scope 3 emissions, enabled emissions through lending activities, emissions in the upstream supply chain or downstream value chain. If there is variation between the emissions reported under these frameworks, these should be explained in the climate risk disclosure. It is necessary and appropriate to include Scope 3 emissions in Australia's mandatory reporting framework. As the consultation paper outlines, these emissions are included in the ISSB standard and the draft US SEC standard, and in any case are a material consideration for investors. Since investment attraction and consistency are among the chief purposes of this framework, then the inclusion of Scope 3, where material, is critical.

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, Australia needs a common baseline of metrics and we would note that prescribed metrics for physical risk disclosures are still in their infancy. ISSB has indicated it will do more work on physical risk but ISSB's draft standard, while we support it, was far from comprehensive in this area.

We encourage the Australian government to create a framework that provides for the creation of metrics and targets for physical risk that fully capture the breadth and complexity of risks the physical impacts of climate change pose to Australian business and the broader society and economy. Crucially, to forestall the risk of capital flight from high-risk parts of Australia, metrics and targets for physical risk should from the outset include metrics and targets for resilience and adaptation. It would not be in the national interest for physical risk disclosure to lead to divestment from high-risk regions or high risk sectors and inclusion of metrics and targets for resilience, and a framework for disclosing contextual risk that cannot be transferred will mitigate this.

We would be happy to discuss the above in more detail and make our experience and expertise available to assist with the development of this framework.

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?

Transparent and consistent disclosure standards for transition plans are important. Similarly, resilience and adaptation planning must be in place and part of physical risk disclosures.

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?

The government should develop Australian-specific scenarios for transition and physical risk, drawing from the scenarios of the NGFS, IPCC and IEA, and ensuring a 1.5 consistent scenario is included in transition risk, and a high emissions scenario for physical risk.

There should also be guidance on the preparation of resilience and adaptation plans for physical risk, given that many entities will not previously have experience in the development of such plans.

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?

The 'reasonable grounds' requirement of the *Corporations Act* is suitable and appropriate in the context of climate reporting and capable of accommodating the inherent uncertainties.

It would not be appropriate to create a loophole that might encourage disclosing entities to not rigorously interrogate the grounds upon which their disclosures are made. This is as necessary in the area of physical risk (*have I reasonably investigated the risks that chronic and acute climate change hazards pose to my business and its operating environment?*) as it is for transition risk *(have I reasonably considered the effect on my business of a more rapid decarbonisation than I have anticipated?*) to ensure shareholders, investors, lenders, employees and the public do not wear the costs of unreasonable or ill-founded assumptions about climate change risk. Allowing safe harbour for boards that fail in their fiduciary duty to satisfy themselves they have reasonable grounds to draw the conclusions they have drawn on climate physical risk essentially transfers this risk to shareholders, investors, insurers, and ultimately the public.

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?

Australia is a strategic funding partner of the TNFD and the Treasury paper notes that ISSB's global baseline for sustainability-related financial disclosures will eventually include social and governance disclosures. Climate reporting requirements should be made adaptable to accommodating future iterations of nature and other sustainability reporting considering the inter-relatedness of all these matters.

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

Yes, this should be the expectation.