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Market Conduct Division
The Treasury
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PARKES ACT 2600

Via email: climatereportingconsultation@treasury.gov.au

Climate-related financial disclosure

First Sentier Investors (FSI) is an asset management business and the home of investment teams FSSA Investment Managers, Igneo Infrastructure Partners, Realindex Investments and Stewart Investors.

Our vision is to be a provider of world-leading investment expertise and client solutions, led by our responsible investment principles. We are stewards of assets under management of AU$215.5 billion (as at 31/12/22) across listed equities, fixed income and direct infrastructure on behalf of institutional investors, pension funds, wholesale distributors and platforms, financial advisers and their clients.

As both a reporting entity and a consumer of reported climate information, we welcome the opportunity to provide feedback on the Treasury's consultation on climate-related financial disclosure in Australia, and support the aim of creating a standardised and internationally aligned disclosure framework.

As allocators of capital, stewards of our clients' assets and active shareholders in companies, we know that the decisions we make will influence the nature and speed of the transition to a low carbon economy. We need access to reliable and consistent information to identify where there are material climate related risks and opportunities, in order to adequately price in those risks and opportunities. This will in turn, help us protect and grow our clients' wealth.

When disclosures are inconsistent and poor quality, investors need to spend significant resources to purchase, collect, estimate and reconcile gaps in climate disclosures and data. Poor corporate disclosures around climate change governance, climate risk management, risks and opportunities may lead to material risks and opportunities not being uncovered. It is only by identifying risks that we can manage and mitigate them.

Mandating climate-related disclosure will accelerate the awareness of climate impact and lead to a better understanding of the risks and opportunities related to climate change. Companies will be better prepared and can plan for the transition. It will create more effective capital markets and improve the attractiveness and competitiveness of the Australian economy.

FSI has also been an active participant and contributor to the responses submitted by the Investor Group on Climate Change (IGCC) and The Financial Services Council (FSC). Below are our responses answers to key questions.

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?

FSI welcomes the mandatory and internationally-aligned climate reporting requirements. Climate change risk is a global systemic risk that needs a coordinated approach across multiple jurisdictions. Clear standards will lower the hurdles that stand in the way of consistent and effective reporting. Effective disclosure will lead to better informed investment decisions and better evaluate risk and exposure across investment portfolios. In the absence of comparable disclosure, investors won't have the ability to properly price in climate risks and opportunities associated with their investments. This would be a barrier to efficient capital allocation, which is needed to finance an orderly transition to a low-carbon world. Investors are spending a lot of time and effort reconciling inconsistent data and disclosures, identifying and clarifying varying definitions and terminology and would benefit from global standardisation. We would see the benefits of climate reporting outweighing any costs.

Given the global investor base of Australian companies, it would make little sense to have an Australia-specific disclosure regime as it would exacerbate the lack of access to consistent and comparable data. It would also increase the reporting needs in order to comply with individual frameworks.

Most global climate disclosure regimes take a starting point in the Taskforce for Climate-Related Financial Disclosure (TCFD) principles which already have been adopted by many Australian reporting companies. Treasury would be able to from an existing framework that has been successfully adopted by both reporting entities and financial market participants. As global investors, aligning Australian reporting requirements with global reporting requirements would also-reduce our cost of compliance

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?

As climate change affects all companies, the mandatory requirements should apply to both listed and private companies, financial institutions (banks, insurance, investment management companies as well as superannuation funds), and government-owned companies.

An initial reporting period from 2024/25 seems appropriate given that the International Sustainability Standards Board (ISSB) standards are expected to be finalised in 2023. Sectoral and industry specific considerations should form part of a phased implementation with high-emitting industries mandatory reporting from the outset

Question 4: Should Australia seek to align our climate reporting requirements with the global baseline envisaged by the International Sustainability Boards?
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 would recommend the adoption of ISSB global reporting standard as a baseline. Global investors with global diversified portfolios are increasingly calling for clear, reliable, and comparable reporting by investee companies on climate and other environmental, social and governance (ESG) matters.

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?

It is vital that companies are able to effectively disclose and communicate their approach to climate change. Information on material climate-related risks and opportunities are financial in nature. It is the type of information that shareholders would reasonably require in order to assess the reporting entity's understanding of those risks and their impact on its business strategy, its prospects for future years and its ability to create enterprise value. Hence, it would make sense to have them reflected in the operational and financial review (OFR), which is a key part of a reporting entity's annual reporting.

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)?

Reporting entities make materiality judgements to shape their disclosure on sustainability-related information that is most meaningful to existing and potential investors, lenders and other creditors. The focus must be on providing information that is relevant for their business model, and on identifying the climate-related drivers that create/erode value and impact the company's future prospects.

The ISSB's definition of materiality will be aligned with the definition of materiality in the International Financial Reporting Standards (IFRS) accounting standards and seems to be consistent with the above.

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?

We support the work done by the GHG Protocol, the accounting standard for GHG emissions. As an investment manager, it is critical to understand and consider portfolio emissions, and this starts with an understanding the scope 1, 2 and 3 emissions of investee companies.

Existing GHG emissions data is a combination of both reported and estimated data. Unfortunately, the models used for those estimated emissions numbers can vary significantly across data providers and may lead to inconsistent reporting.

We support the idea that companies should only disclose emissions estimates for any of the fifteen Scope 3 categories that are *material* to them. Disclosure across all 15 categories would lead to an unnecessary burden and cost for the reporting entities, and would not add any additional value to stakeholders.

In the Australian context, FSI would support the expansion of the current reporting obligations under the National Greenhouse and Energy Reporting (NGER) to include “material and industry-relevant” Scope 3 and support its alignment with reporting against the ISSB standards. We would also like to look into expanding the Scope 1 and 2 emissions data to cover all operations/assets including overseas activities.

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 support a common baseline of metrics and targets, including industry-specific and sector-specific metrics, based on TCFD, Sustainability Accounting Standards Board (SASB) and the forthcoming ISSB climate standard. Industry and sector-specific metrics and targets are central to achieving consistent and comparable data cross entities.

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?

FSI supports the recommendation that entities should undertake scenario analysis. As investors, we assess company level scenario analysis for our investee companies, but we also consider scenario analysis at investment portfolio level.

At company level, the use of scenario analysis will allow the user to get a better understanding of the impact of various climate outcomes on its business model, financial performance and future prospects. Scenario analyses are not meant to be a forecast or a prediction but should help evaluating the company’s resilience to different possible future climate conditions. It should also be noted that the reporting entity should disclose why certain scenarios have been chosen (International Energy Agency (**IEA**), Network for Greening the Financial System (**NGFS**), Intergovernmental Panel on Climate Change (**IPCC**) and the underlying assumptions (such as plausible future growth projection of the company’s product or product mix, economic growth, policy and socio-economic changes,...)

At portfolio level, scenario analysis allows the user to better understand how aligned portfolios are with various pathways to a low-carbon economy. Top-down climate scenario analysis poses challenges, including the large number of assumptions that go into the model and the lack of available and up to date data. However, we do find that this forward-looking analysis allows investors to gain a more complete picture of a portfolio’s expected carbon emissions over time, as well as improvements on the commitments the underlying companies have made for the future. This is particularly the case when combined with backward looking metrics such as historical carbon emissions, together with an assessment of how prepared a company is to transition to a low carbon economy.

Our experience is that the quality and application of scenario analysis varies widely across reporting entities. Many companies are not stress testing their operations against the 1.5 degree scenario or other scenarios, if disclosing scenario analysis at all. As every model is based on a multitude of assumptions, we would recommend that the Government, as part of a mandatory regime, should work to develop and provide guidance on applying scenario analysis, including the key assumptions that are to be used.

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?

FSI recognises the urgency of climate related disclosure, and believes this should continue to be a focus until reliable, standardised climate risk reporting is well-established. However, climate change is closely connected with a number of other sustainability issues such as social issues (including the importance of a just and equitable transition) and natural capital and biodiversity and cannot be considered in isolation of these issues. All of these issues need to be incorporated into the practical design of these reforms.