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1 December 2023

Submitted via email: SustainableFinanceConsultation@treasury.gov.au

EY Submission on the Sustainable Finance Strategy consultation paper

Ernst & Young (EY) welcomes the opportunity to comment on the Treasury's Sustainable Finance Strategy consultation paper, published in November 2023.

Our views have been informed by our extensive depth and breadth of experience in sustainable finance, including assisting our public and private clients and other stakeholders to manage climate- and sustainability-related financial risks, promote effective sustainable finance operations and governance, accelerate transition to net zero greenhouse gas (GHG) emissions, and building trust through effective disclosure and assurance.

Overall comments

EY supports the overarching objectives of the Sustainable Finance Strategy to mobilise the private sector investment needed to support net zero, ensuring access to capital and opportunities to support the transition to positive sustainability outcomes and ensuring risks are well understood and managed at the entity and systemic level. Our attached response provides EY's views on selected questions within the first two pillars to support these overarching objectives.

In our response, we also provide detail on key considerations and challenges, which Government should develop further guidance on. Key amongst these are:

1. It is fundamental that the industry develops greater capability in Sustainable Finance and that there be an impetus to do this through appropriate regulation and enforcement. Mandatory adoption of the taxonomy over time would support this goal.

2. There is a need for the Government to enable access to data, potentially through the establishment of a centralised repository.

3. Continue to seek to alignment with global peers in terms of regulation and disclosure to maintain comparability, consistency and interoperability of requirements with regulators and financial institutions (FIs) across the globe.

We thank you for the opportunity to consult on Australia's Sustainable Finance Strategy.

Should you wish to discuss our comments further, please contact me at lara.gaede@au.ey.com or on +61 296 945 237.

Yours sincerely,

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Attachment 1: EY's Responses to Treasury's *Sustainable Finance Strategy* consultation.

Attachment 1 EY's Responses to Treasury's Sustainable Finance Strategy consultation

1. Pillar 1: Improve transparency on climate and sustainability

EY is generally supportive of the Treasury's proposals under Pillar 1. Priorities 1 through to 4 represent material changes to Australia's financial regulatory and disclosure landscape which will support both the private and public sector in undertaking additional strategic initiatives. These priorities should enable and drive greater understanding and capability in sustainability-related disclosures in the private sector, through setting clear expectations for incumbents to follow. Over time, these expectations will increase as industry capabilities and understanding matures. Importantly, delivering on these priorities will assist Australia in keeping pace with requirements that exist in peer economies around the world.

1.1 Priority 1: Establish a framework for sustainability-related financial disclosures

Consistent with our response to Treasury's June 2023 Consultation Paper Climate-related financial disclosure, EY continues to:

- be very supportive of Treasury's proposals to introduce a mandatory climate-related financial disclosure regime in Australia; and
- recognise the value of a 'climate-first' approach—but not a 'climate only' approach—for mandatory sustainability-related financial disclosures in Australia.

We agree it is important that, over time, mandatory disclosure be comparable to global disclosures and extend beyond climate-related financial disclosures to include all other sustainability-related risks and opportunities that are within the scope of the International Sustainability Standards Board (ISSB) Standards. The market is truly global and any material discrepancies could add to the regulatory burden of and limit trade and investment opportunities for many Australian entities.

What are the opportunities for Government, regulators and industry to support companies to develop the required skills, resources and capabilities to make climate disclosures under the proposed new obligations?

Supporting Australian companies to prepare for mandatory climate disclosures is crucial to the goal of informing the capital markets and the broader Australian economy of companies' exposures and responses to climate-related risks and opportunities. Government, regulators and industry each have roles to play to ensure the success of the disclosure regime, including through:

- **expectations**—regulators with financial reporting oversight responsibilities should clearly and consistently communicate their expectations and the degree of regulatory scrutiny they apply should mature with the market.
- **education and enablement**—standard setters including the Australian Accounting Standards Board (AASB) and the Auditing and Assurance Standards Board (AuASB) should be adequately resourced to support the consistent application and understanding of the mandatory disclosure regime and to work collaboratively with the ISSB and other organisations on application guidance, including on preparing scenario analysis and transition planning (see also our response on Priority 3 below).

- **encouragement**—industry groups should be encouraged to develop agreed industry-based metrics and to consider approaches to meet common information needs such as information about value chains including Scope 3 GHG emissions data.

Access to data is a significant issue with respect to the calculation or estimation of certain metrics, particularly Scope 3 GHG emissions. We recommend that the Government and industry bodies collaborate to develop and maintain certain information, including factors that are used in these calculations. This will enhance comparability within key sectors as well as reduce the burden on entities required to meet sustainability disclosure.

How should the Government, regulators and industry prepare for global developments in sustainability-related financial disclosure frameworks and standards, including the TNFD?

While high-quality, credible and comparable disclosure is essential, we note that assurance is mentioned only once in the consultation document. As independent verification of reporting and disclosure is key to enhancing trust and confidence in climate disclosures, we recommend recognising the important role of assurance in the establishment of a sustainable finance strategy.

We welcome the Sustainable Finance Strategy consultation paper's proposed approach for Priority 1, which includes that "The Government is closely monitoring the development of other international sustainability related financial disclosure frameworks and standards, with a view to establishing other globally aligned sustainability-related financial disclosure requirements (including nature) over time". In the consultation paper, Treasury refers to the work of the Taskforce on Nature-related Financial Disclosures (TNFD) and states that the Australian Securities and Investments Commission (ASIC) will consider how regulatory guidance could support voluntary nature-related disclosures. In our view, voluntary application of the TNFD recommendations should be an interim step to build knowledge and experience in providing nature-related financial disclosures for the capital markets. EY and the Department of Climate Change, Energy, the Environment and Water's Australian case study report on piloting the TNFD framework can be leveraged as sector guidance for any voluntary applications against these TNFD recommendations, with the Government and regulators continuing to play a role in uplifting these guidance and recommendations.

A decision to extend mandatory sustainability-related financial disclosures beyond climate should be made in the context of extending Australia's alignment with the ISSB Standards wherever possible, which would mean adopting, or aligning to, any future specific nature-based disclosure standard developed by the ISSB. Introducing local sustainability standards would increase compliance costs for Australian companies to prepare sustainability disclosures and reduce the international comparability of those disclosures because of actual or perceived differences in Australian requirements.

The Government and/or regulatory bodies should be setting expectations to assist entities with understanding how to approach any requirements and to ensure that there is effective enforcement activity by regulators.

1.2 Priority 2: Develop a sustainable finance taxonomy

EY strongly endorses the development of a sustainable finance taxonomy.

> *What are the most important policy priorities and use cases for an Australian sustainable finance taxonomy? What are the key insights from international experience to date?*

We agree that climate change mitigation should be the most immediate policy priority given the market's urgent need for credible and usable guidance on the types of activities aligned with Australian net zero transition pathways. We note that there is also strong support to address climate change adaptation requirements in an integrated manner. After this initial focus, secondary priorities should be informed by international developments, applied to the Australian context. As the ISSB looks to develop their standards in a specific order, Australia should be guided by these timelines, noting that issues such as nature and human capital are of particular importance for Australia as immediate priorities after climate change.

Clear labelling guidance should accompany the taxonomy in order to ensure its usability.

> *What are appropriate long-term governance arrangements to ensure that the taxonomy is effectively embedded in Australia's financial and regulatory architecture?*

EY supports the mandatory adoption of the taxonomy over time. Maintaining adoption of the taxonomy as voluntary increases the risk that sustainable labelling requirements would create an additional cost and implementation burden, inadvertently acting as a disincentive for financial sectors actors adopting higher sustainability practices.

We believe that once the taxonomy is mandatory, it should be overseen by a Commonwealth Entity that is connected to but independent from the Government.

We support the comments made in the ASFI Australian Framing Paper *Designing Australia's sustainable finance taxonomy* that there are many different roles that current regulators could play to embed the taxonomy into Australia's existing regulatory architecture. APRA could integrate a sustainable finance taxonomy into Prudential Standards or Practice Guidance and could incorporate the taxonomy into risk weightings for Authorised Deposit-Taking Institutions. ASIC could establish principles-based guidance on labelling that would support intermediaries to label and rate investment products. We are supportive of regulators playing these types of roles and providing clarity on mandates, roles and responsibilities across different agencies.

1.3 Priority 3: Support credible net zero transition planning

EY support the proposed approach for ASIC to set expectations and supervisory priorities for the disclosure of transition-related targets, plans and claims.

> *What are key gaps in Australian capability and practice, including relative to 'gold standard' approaches to transition planning developed through the TPT and other frameworks?*

We believe that the introduction of industry-specific guidance for transition plan disclosures would be beneficial given the different risks and opportunities inherent across different sectors. We note that many organisations are utilising different international and industry sector specific approaches in their climate transition plans. The publication of detailed guidance would increase comparability and standardisation and strengthen the ability of investors and other financial actors to better assess the approach and response of companies with material financial impacts. An example of this is the Transition Plan Taskforce in the UK.

To what extent will ISSB-aligned corporate disclosure requirements improve the transparency and credibility of corporate transition planning? What additional transition disclosure requirements or guidance would be most useful in the medium-term?

In our view, ISSB-aligned disclosures proposed by the AASB in its draft Australian Sustainability Reporting Standards will greatly improve the transparency and credibility of transition planning for the following reasons:

- it will indicate how many entities have transition plans.
- users of an entity's general purpose financial reports will be able to assess the basis of the entity's transition plan through reviewing the key assumptions used in developing the transition plan, and dependencies on which the entity's transition plan relies.
- the disclosures about an entity's transition plan will be subject to independent assurance.

Any guidance on the preparation of transition plans should be developed collaboratively with the ISSB (or other organisations using the ISSB Standards as a global baseline) to maintain alignment with the ISSB's requirements. In the medium-term, any guidance that is developed should be in response to improvements that can be identified based on the initial disclosures made by entities that are disclosing in accordance with the ISSB's global baseline, including Australian entities disclosing in accordance with Australian Sustainability Reporting Standards.

Are there related priorities and opportunities for supporting enhanced target setting and transition planning for nature and other sustainability issues?

We recognise that climate change mitigation should be the first priority on the journey to net-zero. There will be other nature and sustainability-related matters that will require organisational transitions, however, these will each have distinct objectives and implications for the organisation. Where there are interdependencies across these issues, companies should consider disclosing these links as part of their transition planning.

We believe relevant target setting and transition plans should be set in alignment to the Global Biodiversity Framework goals and targets, the Environmental Protection and Biodiversity Conservation Act reforms and the Nature Repair Market Bill. For further details, see our submission in response to the Nature Repair Market Bill.

1.4 Priority 4: Develop a labelling system for investment products marketed as sustainable

What should be the key considerations for the design of a sustainable investment product labelling regime? *How can an Australian model build off existing domestic approaches and reflect key developments in other markets?*

EY support the proposal to create a product labelling regime grounded in a credible and consistent framework for evaluating and reporting sustainability performance. An Australian taxonomy will provide regulators and financial institutions with a set of science-, principles- or normative-based criteria for classifying finance, lending, investment and underwriting activities as having certain sustainability attributes. It is also important that there be coordination between the Australian Competition and Consumer Commission and ASIC with respect to labelling of consumer facing products. We suggest that this regime:

- be applied to all investment products, not only those “marketed as ‘sustainable’ or similar”, so that these products are not unfairly disadvantaged in terms of compliance and disclosure burden.
- be designed in a manner which will allow it to be applied to other types of retail financial products.
- be aligned to the sustainable finance taxonomy.
- have interoperability as a key consideration. Given the global nature of investment and Australia’s financial system, if ratings are misaligned with key capital markets overseas, it may disincentivise or increase the burden of foreign investment.
- ensure that the regulatory burdens imposed on labelled products and activities does not act as a disincentive.
- be synchronised with recommendations and greenwashing-related messages published by regulators.

In line with recommendation 15 of the ASFI Australian Framing Paper *Designing Australia’s sustainable finance taxonomy*, we believe that reporting on taxonomy alignment should become mandatory where users are seeking to make claims around the sustainability objectives of activities covered by the Taxonomy. Alignment to the taxonomy will serve to reduce the risk of greenwashing and unsubstantiated claims.

2. Pillar 2: Financial system capabilities

EY is generally supportive of the Treasury’s proposals under Pillar 2. We support the proposal that new regulation should be met with a proportionate increase in regulator funding and enforcement action to support its implementation and embedment.

2.1 Priority 5: Enhancing market supervision and enforcement

Are Australia's existing corporations and financial services laws sufficiently flexible to address greenwashing? What are the priorities for addressing greenwashing?

We recommend clearly defining "greenwashing" to provide the regulators with more clarity regarding the sustainability-related nature of the disclosures which are the current subject of regulatory scrutiny.

Is there a case for regulating ESG ratings as financial services?

We believe regulating ESG ratings would provide greater rigour, transparency and credibility to the market around the methodologies applied by ratings agencies.

2.2 Priority 6: Identifying and responding to potential systemic financial risks

EY supports the proposed approach for alignment of regulators via the Council of Financial Regulators to have a consistent and coordinated approach to improving financial resilience and management of climate and nature related risks.

Are there specific areas where the Government or regulators could further contribute to market-wide understanding of systemic sustainability related risks, including climate-related financial risks?

APRA should consider a system-wide Climate Vulnerability Assessment exercise to consider a consolidated impact on the financial system as a whole, rather than impacts to banking, insurance or wealth management in isolation. We recognise that in order to do this effectively, continued investment into APRA and other regulators' capability to understand, respond and regulate climate and related risks in Financial Institutions will be needed.

The focus of regulator activity should be to increase the impetus for financial institutions to develop and mature in-house climate risk management and scenario analysis capabilities. This could be aided, for example, by moving CPS 229 towards an enforceable prudential standard.

2.3 Priority 7: Addressing data and analytical challenges

What are the priorities for ensuring that data-related initiatives already underway are tailored to meet the needs of firms and investors?
What key sustainability data gaps or uncertainties faced by financial institutions in Australia should be prioritised by the CFR?

Complete, accurate, credible and consistent data is central to effective sustainability-related disclosure, risk management and decision making. It is important that any data-related initiatives result in consistency or interoperability with international frameworks and standards. We believe Government and Regulators will have a role to play in supporting Australian entities navigate data gaps and challenges through:

- Developing a centralised repository of data (such as the National Greenhouse and Energy Reporting Scheme (NGERS) data) by bringing together contributions from stakeholders and regulators across industries. We believe that Government has a role in overcoming barriers associated with data sharing and privacy concerns. Data sharing between various Regulators, Government departments and rating agencies could assist in providing a central data set for all reporting entities. Alternatively, the Government could act in a 'data broker' capacity to provide information upstream and downstream. By way of example, we note that Dutch banks worked collectively with utilities and regulators for energy to set up a process for getting actual energy consumption data for their portfolios. This supported both more accurate reporting of portfolio emissions as well as the identification of lending opportunities. We believe that similar collaborations would be beneficial in Australia.

- Publishing emissions factors and proxy data where data availability remains a challenge, for use in disclosure and risk management by industry, or developing guidance so that industry can use such proxies and factors consistently.

As there are currently no sector-specific metrics prescribed in the draft Australian Sustainability Reporting Standards, we believe the development or adoption of these metrics should be prioritised. Given the priority placed on the NGERS in the AASB exposure draft, these standards should be reviewed to ensure that they remain fit for purpose. We also encourage the Government to consider the feasibility of allowing an NGERS reporting entity to align its NGERS reporting period with its financial reporting period to reduce compliance costs.

We would support the introduction of a requirement for digital reporting, given the need to manage a growing complex and varied data set. Digital reporting is the only efficient mechanism to manage this reporting.