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Climate-related financial disclosures: exposure draft legislation

The Financial Services Council (FSC) is a peak body which develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services. Our Full Members represent Australia's retail and wholesale funds management businesses, and superannuation funds.

The FSC is supportive of the climate-related financial disclosure regime. It is appropriate that fund managers and superannuation funds are required to prepare climate-related financial disclosures given their importance to stewarding the savings of millions of Australians. It is also important that members of these funds understand the climate-related risks and opportunities to their portfolios.

The key issues for FSC members with the current exposure draft are:

(i) the draft Bill does not give effect to the intention set out in the explanatory materials that entities that are exempt from lodging financial reports are also exempt from lodging sustainability reports (that is, only Chapter 2M reporting entities are within scope); and

(ii) the **application of thresholds to entities that are required to lodge a sustainability report** is not clear in the context of a funds management or superannuation business. The current draft Bill does not make clear which threshold is to apply at the **entity level** (the Responsible Entity (RE) or the Registrable Superannuation Entity licensee (RSEL)) and which is to apply at the **fund level** (the Managed Investment Scheme (MIS) or the Registrable Superannuation Entity (RSE)).

This submission proposes minor changes to the drafting of the Bill to make these two issues clear and to achieve the policy intent set out in the explanatory materials. The proposal would apply the following thresholds at these levels:

- **Entity level** (RE and RSEL): consolidated revenue, consolidated gross assets and employee thresholds.
- **Fund level** (MIS and RSE): assets under management.

Further, this submission also covers the following issues for consideration:

(iii) **Consolidated reporting**: While the draft Bill appears to allow for consolidated reporting**,** greater clarity is needed for fund managers and superannuation funds that have a variety of corporate structures. Generally, there should be flexibility to allow an RSEL and RE to report on behalf of their underlying RSEs and MISs in consolidated reports. Where an Australian parent corporation has several RSELs and REs underneath it, the corporate group should be able to produce consolidated reports for the parent entity and its RE and RSEL subsidiaries and their underlying MISs and RSEs. This will help to reduce compliance cost.

(iv) **Financed emissions boundaries for choice platform providers**: The applicability of the regime and scope 3 emissions reporting should be considered for choice platform providers who perform an administration service and do not make investment decisions. Clarity is also needed on the interpretation of financed emissions organisational boundaries for fund managers and superannuation funds.

(v) **Reporting requirements for Scope 3 financed emissions:** Clarity is needed regarding the additional reporting obligations for asset management businesses under AASB ASRS2 B61.1 and how this should be applied to superannuation and funds management businesses.

(vi) **Phasing and timing:** We are supportive of a 1 January 2025 commencement to provide companies additional time to uplift their capabilities and processes. We submit that REs and RSELs, and the underlying MISs and RSEs should be phased in together in Group 2, so that all the reporting obligations of an entity commence at the same time. This would be more logical, given RSELs and REs rely on data from the underling RSEs and MISs to report their climate risks and opportunities. However, in the current draft legislation, RSELs and REs are reporting first.

(vii) **Liability:** We note Treasury's position on a modified liability regime with regulator only action permitted for a period of three years. While we have previously called for the law to explicitly state that reporting is undertaken with the available data at the time, we support the AASB standard's reflection of this principle that the entity will use all reasonable and supportable information available to it at the reporting date without undue cost or effort.

If you have any questions about this submission, please do not hesitate to contact me.

Sincerely,

Chaneg Torres
Policy Director
Investments & Funds Management

Appendix A – Climate Related Financial Disclosures Drafting Proposals

a) Clarity on asset managers and superannuation funds as reporting entities and clarity on phasing

A significant concern for asset managers and superannuation funds is **continued uncertainty around the applicability of the regime at the entity and the fund level, and the potential mismatch in phasing for funds management and superannuation businesses.**

To begin with first principles, climate-related financial reporting for REs and RSELs should occur in this way; the RE or RSEL should consider their material climate risks and opportunities. In considering their material climate risks and opportunities, regard should be had to the assets under management and how climate risk might affect the entity's prospects. Climate-related financial disclosures for an RE and RSEL will therefore also include both entity level disclosures and MIS or RSEs level disclosures. The RE or RSE licensee should determine the form of disclosure that makes sense for its business. We have previously suggested that this may look like:

- Entity or RE/RSEL level: The focus at the entity level would be on the climate-related risks and opportunities to fees earned and any impact on assets under management. Certain disclosures which would be consistent across the entity and all its underlying funds could include the scenario analysis applied, transition plan, governance, risks and opportunities.
- Fund or MIS/RSE level: The focus at the fund level would be on the climate-related risks and opportunities to the value of portfolio companies/value of the total assets under management and the returns paid to members/investors. Disclosures specific to the underlying fund could focus on portfolio metrics, for example, reporting on the scope 1, and 2 emissions of portfolio companies.

We note the International Sustainability Standards Board (ISSB) standards make allowance for both entity level and fund level disclosures and provides guidance on the disclosures to be made at an entity and fund level.[1]

We set out below the issues which require clarification within the draft Bill and our minor suggested drafting changes to achieve that clarity. The effect of these changes is that at an entity level (RE and RSEL) it will be clear that the consolidated revenue, consolidated gross assets and employee thresholds apply, and that at the fund level (MIS and RSE) the assets under management threshold is applied.

Recommendation 1:

- Amend section 292A(1) to clarify that entities that are exempt from lodging financial reports are not required to prepare sustainability reports.
- Simplify the drafting by creating a 'reporting asset owner' definition, defined as 'a registered scheme or registrable superannuation entity'.
- Amend section 292A so that section 292A(3) only applies to entities that are not 'reporting asset owners'. That is, the consolidated revenue, consolidated gross assets and employee thresholds only apply to disclosing corporate entities, public companies and large proprietary companies (including at the RE and RSE licensee level).

[1] See IFRS S2 Accompanying Guidance, IE25-IE38

- Amend section 292A so that section 292A(7) only applies to entities that are 'reporting asset owners'. That is, the $5 billion assets under management threshold only applies to 'registered schemes' (MISs) and RSEs.
- Amend section 1705 of the phasing of the requirements to make explicit that corporate groups that include REs and RSELs are excluded from 1705(1)(a) (Group 1) and fall under 1705(1)(b) (Group 2), allowing RSELs/REs and the underlying RSEs and MISs to commence reporting at the same time.

Policy Intention	Reference	Drafting flaw	Drafting proposal
Entities that are exempt from lodging financial reports are not required to prepare sustainability reports.	Para 1.1, 1.17, 1.22, 1.30 and 1.31 of the EM First paragraph beneath the heading 'Who will be included' in the policy position statement.	The draft legislation introduces a new section 292A titled 'Who has to prepare annual sustainability reports'. Proposed section 292A sets out that entities that meet the size thresholds under subsections (3), (6) or (7) must prepare sustainability reports. However, proposed section 292A does not exclude entities that are "not generally required to report under 2M" (see para 1.31 of the EM). Under the current draft section 292A, an entity that meets the size thresholds will be required to report even if it is not required to prepare a financial report for that financial year under section 292 (titled 'who has to prepare annual financial reports and directors' reports'). There do not appear to be any other draft provisions that operate to exclude these entities.	We propose that section 292A is revised to clearly implement Treasury's intention that an entity must prepare a sustainability report for a financial if both (a) the entity must prepare an annual financial report and directors' report under section 292 for the financial year; **and** (b) the entity meets an applicable size threshold. Refer to our drafting proposal in section 292A(1).

		For example, under the proposed draft legislation, there is no provision that would operate to exclude an unregistered wholesale trust with assets over $5b from the sustainability reporting requirements even though such an entity may not be required to prepare a financial report under Chapter 2M.	
Entities that are 'asset owners' (such as registrable superannuation entities and registered schemes) must apply an alternative 'value of assets' threshold.	Para 1.30, 1.46, 1.109 of the EM Second paragraph beneath the heading 'Who will be included' in the policy position statement. Table set out within the section titled 'Phasing' in the policy position statement which sets out asset owners distinctly from other large entities and NGER reporters.	The draft legislation introduces the $5b 'value of assets' threshold in the following places: - section 292A(7) - section 296B(5) Section 296B(5) is also referenced in section 1705(1)(b)(iii) in relation to phasing. However, the draft legislation does not specify that the 'value of assets' threshold is an alternate test for asset owners that applies *instead of* the size or NGER thresholds. Instead, the 'value of assets' threshold is an *additional* test with the effect that: • the size thresholds that seem intended to apply only to large entities may also apply to asset owners, and • the 'value of assets' threshold that seems intended to apply only to asset owners	To give effect to the stated intention, we have proposed a new defined term of 'reporting asset owner' to be inserted in section 9 (see Item 3 of the draft legislation) and includes registered schemes and registrable superannuation entities. We have also proposed changes to sections 292A, 296B and 1705 to clarify that the size thresholds do not apply to asset owners and the value of assets threshold only applies to asset owners. Taking this approach, the term 'applicable entity' which is defined in subsection 1705(2) is no longer necessary and consequential changes have been made to remove this term.

		may also apply to other entity types. Whilst the explanatory memorandum refers to 'asset owners' and suggests that this includes registrable superannuation entities and registered schemes, the term is not defined or used in the legislation.	

b) Consolidated reporting

We reiterate the need to provide flexibility for funds that rely on group level reporting to ensure that unnecessary regulatory costs are not incurred. While section 292A(2) allows for the sustainability report to be prepared on a consolidated basis where the group parent company is required to prepare consolidated financial statements across its subsidiary entities, the legislation should make clear that consolidated reporting is also permitted for consolidated groups that include an RE or RSEL and can include the asset owners for which they provide investment management and/or trustee services to. This will allow REs and RSELs to undertake sustainability reporting in a way that makes most sense for their business and the primary users of the financial reports.

Recommendation 2: In order to alleviate undue cost and effort and unnecessary duplication:

- Amend the legislation to allow an RE and RSEL the option to report on behalf of the underlying RSEs and MISs in consolidated reports that can be referenced in the MIS and RSE financial statements and in the PDS of associated ED securities.
- Corporate parent entities who are required to prepare consolidated financial statements with subsidiary RSEL and RE entities under 292A(2) should also be provided the option to produce one consolidated report across all underlying RSELs, REs, RSEs and MISs. This will alleviate undue cost and effort spent on producing a range of sustainability reports in locations that would not be helpful to the users of general-purpose financial reports.

Policy Intention	Reference	Drafting flaw	Drafting proposal
Allow superannuation and funds management businesses the ability to consolidate reporting at an entity level to reduce compliance costs and support the policy intention to provide climate disclosures in a format that aids decision	Para 1.36-1.38 of the EM	It is not clear whether RSELs, REs, RSEs and MISs may also be provided the option to report on a consolidated basis.	Add an additional clause under 292A (2): Responsible entities or registrable superannuation entity licensees may consolidate reporting for related reporting asset owners of which they provide investment management or

making of primary users of general-purpose financial reports.			trustee services to. Where there is a corporate holding company for the registrable superannuation entity licensee and/or the responsible entity, the corporate group head may also have the option to produce a consolidated report.

c) Scope 3 reporting boundaries for choice platform providers

We have previously submitted the need to clarify the applicability of the climate-related financial disclosure regime to choice-based investment platforms, particularly with regard to the disclosure of scope 3 emissions.

Choice-based investment platforms provide investment administration services for clients to invest their funds into their choice of a range of pooled investment options. Typically, there are thousands of investment options on these investment platforms. Clients may independently direct their investments or do so through a financial advisor. As such, the platform is not involved in the investment decision. The clients who make investment decisions will hold vastly different portfolios, and accordingly, aggregated reporting on the scope 3 emission profile on a platform level is of little utility.

The platform entity through its administrators and custodian acquires or disposes of specific investments in accordance with instructions provided by investors or their financial advisor. Any gains or losses are quarantined within each member's account. The platform operator charges the client an administration fee only (not an investment management fee).

When it comes to the proposed mandatory climate reporting regime, the corporate entity of these platforms would generally report under Chapter 2M and some would be of a size to be included in Group 1.

FSC members consider that funds on choice-based investment platforms would *not* fall within the boundaries of Scope 3 for the purposes of financed emissions reporting as these funds are considered 'funds under administration' not 'funds under management' as explained above. The FSC seeks clarity from Treasury that these funds may be excluded for the purposes of climate reporting, though the FSC notes that ambiguity also stems from relevant international standards, which also do not provide clarity for choice platforms (GHG Protocol, Corporate Value Chain Reporting Standard, and PCAF Financed Emissions Standard). We also note that some members will have RSEs that are platform-based. Clarity is needed on how platform-based RSEs should report with regards to their underlying investments.

This can be achieved through clarification by the AASB on how the GHG protocol should be interpreted for those businesses, clarifying that capturing scope 3 emissions should only be necessary in instances of control of the investment decision making process where the entity itself benefits (or accrues losses) directly as a result of the outcomes of those investments. A provision could specify that 'assets under management' means assets where the trustee exercises control over the investment decisions pertaining to the underlying assets.

Separately, but in a similar vein, we expect that scope 3 reporting for separately managed accounts (SMA) (one type of investment option referred to above) will be of limited use to clients. Clients can select from a variety of different model portfolios within an SMA. Aggregated scope 3 reporting at the SMA level would therefore be of limited usefulness. Flexibility in the AASB standards to address this issue would be welcome.

Recommendation 3: The regime should provide certainty for platform providers and the disclosure of scope 3 emissions, recognising that platforms do not exercise investment decisions with regard to the funds on their investment menu.

d) Reporting requirements for scope 3 financed emissions

We believe that the regime as it stands, read together with the AASB standards, allows for confidence in the reporting of scope 3 emissions, recognising that it will take time for the quality and the availability of data to develop. We would welcome greater clarity as to how the reporting requirements for Scope 3 reporting at the entity level and the fund level connect with the requirements under the AASB standards. That is, clarity should be provided as to what is mandatory or optional.

Section 31.1 of draft ASRS2 makes it mandatory for an entity to disclose Scope 3 emissions. B37 also states that an entity that participates in activities 'associated with asset management…shall disclose additional information about financed emissions associated with those activities as part of the entity's disclosure of its scope 3 greenhouse gas emissions'. However, the Corporate Value Chain methodology states that for 'managed investments and client services' which includes 'investments managed by the reporting company on behalf of clients or services provided by the reporting company to clients including investment and asset management', that companies **may** account for emissions from managed investments in scope 3 (investments). B61.1 states that an entity that participates in 'asset management' '**shall consider** disclosing…' This implies that for fund managers and superannuation funds, disclosure of financed emissions, which is Scope 3 for MISs and RSEs, is optional.

It is also not clear how an entity that participates in asset management activities or asset management is to be understood, and as noted above, we consider platforms as engaged in 'asset administration' rather than 'asset management'. While this may be primarily a matter for the AASB, we encourage Treasury to communicate with the AASB to flow through any clarification of 'asset owner' in the legislation as we have suggested in this submission onto the AASB standards.

Recommendation 4: We support the flexibility provided by the regime for the reporting of scope 3 emissions. Greater clarity around the boundaries for scope 3 reporting for fund managers and superannuation funds is needed.

e) Timing of the regime

We have previously raised the need to ensure appropriate timing in the regime for asset managers, given that asset managers who fell under phase 1 would have to report their scope 3 emissions early on without being able to rely on the reports of many underlying companies, creating a significant timing mismatch. Any extra timing to allow reporting entities to prepare is welcome and we would support a 1 January 2025 commencement. If a 1 January 2025 commencement is agreed to, clarification would be welcome around the expectation for reporting entities given only half of the year's data would be available for FY25 reporting.

We welcome the exposure draft providing that scope 3 emissions would only apply from the second reporting year onward for an entity. The FSC's concerns about phasing would be further addressed if REs and RSELs were clearly phased in under phase 2 (from 1 July 2026 onward under the current draft) to commence at the same time as the underlying RSEs and MISs. The issue of a mismatch in phasing for asset managers and superannuation funds is also addressed by the allowance of estimates under the AASB standards. We note the standards explicitly recognize that a reporting entity may have a different reporting period from some or all of the entities in its value chain, and the entity is therefore only expected to use information that it can obtain without undue cost or effort. (ASRS2 B19)

Recommendation 5: We support a 1 January 2025 commencement. We also submit that consolidated corporate groups that contain funds management and superannuation entities and their underlying funds should report together in Group 2.

f) Liability regime

In order for companies to be confident in providing climate-related financial disclosures with more detail there should be flexibility with the regime's liability provisions. We have previously submitted that the legislation should clearly state that reporting entities should do everything reasonably possible to comply with the reporting regime or explain the reasons why they are unable to meet certain obligations (such as lack of data availability or reliable estimates). The law should also explicitly state that reporting is undertaken with the available data at the time.

We welcome the exposure draft's limitation of litigation in the first three years to regulator only action for certain forward-looking statements. We also note that the AASB does appear to reflect the principle we have proposed by stating in several provisions including scope 3 emissions and scenario analysis that the entity will use ***'all reasonable and supportable information available to it at the reporting date without undue cost or effort.'***

Recommendation 6: We support the flexibility provided by the AASB standards. This can be bolstered by greater certainty provided in the legislation.