1 March 2024

Australian Accounting Standards Board

Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information

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 welcomes the opportunity to provide comment on the draft *ASRS 1 General Requirements for Disclosure of Climate-related Financial Information* and *ASRS 2 Climate-related Financial Disclosures.*

Our submission primarily proposes two areas where the standards should provide greater clarity for fund managers and superannuation funds: scope 3 emissions, and disclosures required at the entity and fund level. Our submission also provides comment on other areas of key interest for our members.

We emphasise that given that companies will need time to develop their capability and that it will take time for data availability to mature, there needs to be a flexible approach for the reporting of scope 3 emissions and other forward-looking statements such that the entity is only expected to use the information available to it at the reporting date without undue cost or effort. We support the inclusion of this principle in the AASB standards.

1. Scope 3 emissions

A key issue for our funds management and superannuation fund members is determining the boundaries for scope 3 emissions reporting, which is not clear in the standards and the GHG Protocol: Corporate Value Chain Reporting Standard methodology.

<u>Clarity needed for financed emissions reporting obligations</u>

We submit that clarity is needed regarding the additional reporting obligations for 'asset management' businesses under draft ASRS2 B61.1 and how these reporting obligations should be applied at the **entity level** to registrable superannuation entity licensees (RSEL) and the responsible entities (REs) and at the **fund level** to registrable superannuation entities (RSEs) and managed investment schemes (MISs).

A lack of clarity around what is required for the reporting of financed emissions at the entity level and the fund level can create unnecessary duplication and cost. Under the current draft proposed reporting framework, a group head prepares a sustainability report, the RE or RSEL has its own sustainability report, and MISs or RSEs as separate reporting entities may also have to prepare separate sustainability reports. If reporting entities that 'participate in asset management activities' are deemed the group head via its subsidiaries, an RE or RSEL, and each MIS or RSE, and therefore must disclose scope 1, 2 and 3 emissions, the end result is that the same emissions data will be disclosed multiple times, in relation to the one financing arrangement: (a) by the group head; (b) by the MISs and RSEs; and (c) REs or RSELs that are invested in the MIS or RSE or whose assets are managed by the asset manager entity within the consolidated reporting entity, in addition to the disclosures that are made by the entity that is being financed. This could be streamlined by

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clarifying the phrase 'participates in activities associated with asset management' to apply to one reporting entity.

As currently drafted, it is not clear how an entity that participates in asset management activities or asset management is to be understood, and specifically whether disclosure is on a voluntary or compulsory basis across certain scope 3 disclosures. The inconsistency is as follows:

- 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…'
- These sections taken together imply that for RSELs, REs or a corporate group entity (that we have submitted above should be able to provide a consolidated report) disclosure of financed emissions, which is Scope 3 for MISs and RSEs, is optional.

Specific clarification is also needed for fund managers who are engaged to manage the money of a fund that is under an unrelated RE or RSEL under an investment management agreement. In this situation, assuming that consolidated reporting is permitted, we submit that the obligation to report the scope 3 emissions of the MIS or RSE would sit with its RE or RSEL. The external investment manager would still need to consider whether there are any material climate-related risks and opportunities arising from their investment management activities that would need to be included in the investment manager's entity level reporting.

Clarification is also needed where an MIS or RSE invests directly in another MIS whose units are issued by another RE. Therefore, the MIS or RSE invested in the other MIS has no direct exposure to the underlying companies. In this situation, we submit that the obligation to report the scope 3 emissions of the comingled MIS would sit with its RE. Again, the RE or RSEL of the MIS or RSE invested into the external MIS would still need to consider in their entity level reporting whether there are any material climate-related risks and opportunities with respect to the units it holds.

Recommendation 1.1: Greater clarity around financed emissions reporting requirements for RSELs, REs, RSEs and MIS is needed. This should be done through the AASB standards making it clear that the reporting requirements for an entity that participates in activities associated with asset management can apply to the relevant group head or reporting entity for the purposes of consolidation. Clarity should be provided for investment managers who are operating under an investment management agreement and are not primarily responsible for the reporting of the MIS or RSE that falls under another RE or RSEL. Clarity should also be provided where an MIS or RSE invests in another fund and therefore holds units, but not the underlying asset.

Clarity needed for choice-based investment platforms

For choice-based platform providers, clarity is needed around the applicability of the reporting requirements to platforms. Platforms do not undertake investment decisions with regard to the investment options on their platform, so cannot be characterised as engaging in 'asset management'. Our view is that they are engaged in 'asset administration' rather than 'asset management'. Accordingly, our view is that it should be expressly clearly by the AASB standards that platforms which do not provide their own asset management services, but are merely asset administrators, are excluded from the requirements.

Recommendation 1.2: Greater clarity needed on how a choice-based platform can or should determine its reporting boundary. We recommend that choice-based platforms should be characterised as engaging in 'asset administration' rather than 'asset management'.

2. Guidance needed on entity and fund level disclosures

Another key issue, closely related to the above, is clarity in the standards as to what is expected at the entity level (RE and RSEL) and the fund level (MIS and RSE). In the FSC's submission to Treasury, we have submitted the need to allow for consolidated reporting 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 one consolidated report.

Assuming consolidated reporting is provided for clearly under the regime, the FSC would welcome further guidance under the standards as to what should be disclosed at an entity level and a fund level.

We suggest that any guidance should recognise that in climate-related financial reporting for REs and RSELs, the RE or RSEL (the entity level) 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 (reflecting their assets under management). The RE or RSE licensee should determine the form of disclosure that makes sense for its business model and operations. We have previously suggested that guidance could provide the following at the entity and fund level:

- 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.

Recommendation 2: The standards should allow for consolidated reporting at an RSEL and RE level. Greater clarity is also required and guidance should be provided for what disclosures should be undertaken at an entity (RSEL and RE) and fund (RSE and MIS) level.

3. Forward-looking disclosure requirements strike a good balance

Generally, the AASB standards, read together with the exposure draft legislation, allows for confidence in the reporting of scope 3 emissions and other forward looking information like scenario analysis, recognising that it will take time for the quality and the availability of data to develop, but that entities should begin turning their minds to the reporting and improvement of reporting scope 3 emissions and scenario analysis even with the use of estimates and nascent data.

We welcome the explicit reference in the standards to investments being a category of scope 3 emissions which helps provide clarity for MISs and RSEs as the investments sit on the balance sheets of these entities. We again emphasise the need for a flexible and pragmatic approach to scope 3 emissions disclosure.

We welcome the recognition in the standards that an entity might have a different reporting period from some or all of the entities in its value chain is therefore only expected to use information that it can obtain without undue cost or effort. We also welcome the allowance in the standards for the entity to report information that may be different from its own reporting period in reporting information from entities in its value chain (ASRS2 B19).

We consider that the standards attempt to strike the right balance for scope 3 emissions by allowing for estimates to be used and by explicitly stating that it is expected that scope 3 emissions in the immediate term will mostly be estimates, reflecting information that is accessible to the reporting entity at the time of disclosure. We also support the standards stating that an entity will use ***all reasonable and supportable information available to it at the reporting date 'without undue cost or effort'*** in relation to:

- Financial position, financial performance and cash flows
- Identifying climate-related risks and opportunities
- Climate-related metrics such as transition risks, physical risks, opportunities
- Scenario analysis
- Scope 3, particularly where an entity has a different reporting period from entities in its value chain.

We would welcome further guidance on the threshold at which it would be appropriate to determine that there are undue costs involved, and guidance on where estimations would be appropriate to use. For fund managers and superannuation funds, it should be appropriate to rely on data where the underlying investee company has disclosed their scope 1 and 2 emissions under a mandatory regime. Where investee companies fall out of the regime, are in a jurisdiction that does not have mandatory disclosure requirements, or have not reported information due to falling under a different reporting period, it should be appropriate to rely on estimates and it should be considered undue cost or effort to seek data exhaustively that covers every underlying investee company if they do not fall under a mandatory reporting regime.

Finally, an appropriate balance appears to be struck in clarifying that an entity need not undertake an exhaustive search for information to identify climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects and that the assessment of what constitutes undue cost or effort depends on the entity's specific circumstances and requires a balanced consideration of the costs and efforts for the entity and the benefits of the resulting information for primary users (ASRS1 B10).

Recommendation 3: We are supportive of the balanced approach taken by the standards with regard to forward-looking disclosures but would welcome further guidance on situations where it would be appropriate to determine that there is 'undue cost or effort' and situations where it would be appropriate to use estimates. It is important to maintain a pragmatic and flexible approach to scope 3 emissions.

4. Financial materiality

We welcome the inclusion of materiality into the standards, allowing reporting entities to determine the extent to which disclosure topics represent financially material climate risks and opportunities (ASRS1 ss17-19, B13-B37).

Recommendations 4: We are supportive of including a materiality threshold for the disclosure of climate risks and opportunities.

5. Climate Scenarios

The AASB draft standards require climate resilience assessments against at least two possible future states, one of which must be consistent with the most ambitious global temperature goal set out in the *Climate Change Act 2022*. (ASRS2 s22.1). The entity can rely on estimates ,and needs to disclose inputs and assumptions used in its climate-related scenario analysis, but not detailed modelling. (ASRS2 s22.2).

We welcome the standards requiring climate resilience assessments. We submit that one of the two scenarios required could be specified to be a scenario involving current global policy settings, given that information on this scenario would be most useful for investors in understanding the likely impacts of climate change on the company. Specifically, entities should be encouraged, in addition to the mandatory scenario analysis based on the most ambitious global temperature goal settings (i.e 1.5 degrees), to undertake scenario analysis for current global policy settings or otherwise for no transition at 4 degrees, with sufficient flexibility to build capability overtime and having regard to resourcing and data availability.

The government should work to develop and provide guidance on applying scenario analysis, including key assumptions to be used, as part of the mandatory regime.

Recommendation 5: The AASB should consider requiring one of the climate resilience scenarios to be a scenario involving current global policy settings.

6. Transition plans

It is important for investors to understand how a company that is exposed to significant climate-related risks plans to address these risks. The standards mention transition plans but they do not appear to be strictly required. The standards require the reporting entity to disclose its strategy including the effects of identified climate-related risks and opportunities on the entity's strategy and decision-making, including information about its climate-related transition plan (ASRS2 9.1). Section 14 refers to the disclosure of 'any climate-related transition plan the entity has…' which suggests that there is flexibility as to whether an entity has a transition plan or not.

We submit that transition plans should be mandatory where the operations of large companies are exposed to material climate-related physical and/or transition risks. If they are to be mandatory, then the AASB should take a flexible and facilitative approach as entities develop their transition plans. Guidance should be provided on what constitutes materiality.

Recommendation 6: We submit that transition plans should be mandatory where climate-related physical and/or transition risks are material to the operations of large companies. If they are to be mandatory, then the AASB should take a flexible and facilitative approach as entities develop their transition plans. Guidance should be provided on what constitutes materiality.

7. Industry specific metrics and industry specific guidance

We have previously submitted that government should provide industry specific guidance, developed in collaboration with industry, on what good reporting looks like (such as minimum requirements for specific industries) to create greater comparability and reduce barriers to reporting, including guidance for managed funds and superannuation funds. Guidance can include:

- guidance on reporting scope 3 (financed emissions for MISs and RSEs) for specific industries (including boundaries and estimates),
- guidance on how disclosures should be undertaken for funds with complex corporate structures and allowance for consolidated reporting,
- guidance on industry metrics, creating clearly defined and consistent metrics for strategic sectors, and
- guidance on scenario analysis.

As noted above, we welcome the exposure draft released by Treasury pointing to the Corporate Value Chain Accounting and Reporting Standard. We also welcome the AASB recognising scope 3 for asset managers as financed emissions. As submitted above, we would welcome the AASB providing further guidance around the boundaries for scope 3 emissions for asset managers. (ASRS2 B58-B61)

We also note that the AASB standards allow for industry-based metrics or entity developed metrics. Where an entity elects to make industry-based disclosures, the standards state that an entity shall consider the applicability of well-established and understood metrics associated with particular business models, activities or other common features that characterise participation in the same industry. (ASRS1 ss 48.1, 55.1, 58.1 and B20.1, ASRS2 ss 32.1, 37.1, B63.1, B67.1) This provides a sensible balance between flexibility and consistency as entities will need to have regard to industry metrics. However, there remains the risk that without clear guidance, there could be inconsistencies within developed industry metrics. As the industry-based guidance accompanying IFRS S2 becomes comprehensively internationalized and settled, we recommend the AASB looks to adopt these for the Australian context.

Recommendation 7: As industry-based guidance matures globally, the AASB should look to adopt these for the Australian context.

8. Auditing requirements

As the AASB sets out the pathway for phasing in assurance requirements, it should recognise that it will take time to build expertise and capability across the industry for audit and assurance, audit requirements should be phased over a longer time horizon. We recommend that audit requirements could be focused at first instance on companies with material emissions and for other reporting entities the first phase of reporting should require board sign off of reports.

The first phase should not require mandatory external assurance, but reports should be signed off by the board and there should be disclosure about the company's approach to assurance. Requirements for assurance could be phased in based on the relative risk of climate to particular industries.

Recommendation 8: The AASB should provide flexibility with the auditing requirements, recognising that it will take time to develop expertise and capability across the industry.

9. The use of offsets

We agree that companies should disclose separately any use of greenhouse gas emissions offsets and be transparent on how they intend to use those to meet their published targets. They should provide transparency on the types of carbon offsets they intend to use.

We welcome that the AASB standards (ASRS2 s36) requires the entity to disclose its planned use of carbon credits to offset GHG emissions including:

- the extent to which, and how, achieving any net greenhouse gas emissions target relies on the use of carbon credits;
- which third-party scheme(s) will verify or certify the carbon credits;
- the type of carbon credit, including whether the underlying offset will be nature-based or based on technological carbon removals, and whether the underlying offset is achieved through carbon reduction or removal; and any other factors necessary for users of general purpose financial reports to understand the credibility and integrity of the carbon credits the entity plans to use (for example, assumptions regarding the permanence of the carbon offset).

Recommendation 9: We support the standards requiring transparency around the use of greenhouse gas emissions offsets.

If you have any questions about this submission, please do not hesitate to contact me at ctorres@fsc.org.au.

Sincerely,

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