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SUBMISSION

Submission to Treasury: Climate-related financial disclosure

17 February 2023

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Climate Disclosure Unit

Market Conduct Division

The Treasury

Langton Crescent

PARKES ACT 2600

Via email: climatereportingconsultation@treasury.gov.au

17 February 2023

Dear Sir/Madam

Climate-related financial disclosure: consultation paper

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Treasury consultation paper on climate-related financial disclosure.

About ASFA

ASFA is a non-profit, non-partisan national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $3.3 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 17 million Australians with superannuation.

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If you have any queries or comments in relation to the content of our submission, please contact [redacted], Director of Economics, on [redacted] or by email [redacted]; or [redacted], Senior Policy Advisor, on [redacted] or by email [redacted]

Yours sincerely

[redacted]

Deputy CEO and Chief Policy Officer

Executive Summary

ASFA welcomes the release of Treasury's consultation paper on climate-related financial disclosure.

ASFA supports the adoption by Australia of international standards for climate-related financial disclosure, which will help facilitate the transition to a low-carbon economy. It should be acknowledged that the international process to develop the disclosure standards is still in its early stages, and that the draft standards, in their current form, would not be appropriate for *direct* adoption by Australia. In this regard, ASFA acknowledges the work of the Australian Accounting Standards Board (AASB) in representing Australia's interests.

APRA-regulated superannuation funds have a responsibility to manage the impact of risks (and opportunities) arising from climate change on long-term investment performance. A well-constructed risk disclosure framework will help manage these risks.

- Superannuation funds will face mounting expectations from their members for information on the climate risks, and their impact, that are embedded in investment portfolios.
- Good-quality disclosure of climate-related risks implies market pricing that better reflects the cost of those risks, and would facilitate a more efficient and sustainable allocation of capital than otherwise would be the case.
- Over the long-term, this would help ensure that fund investment decisions are made in the best financial interests of members.

The implementation of international disclosure standards by superannuation funds (and other entities) will not be simple and, in some cases, will require significant changes to business operations and increases in associated operational costs.

The most significant challenge for superannuation funds relates to the availability and quality of the required data from third parties.

With respect to capabilities, superannuation funds, like the broader group of business entities, will need to update, and in some cases develop, systems to collect and process the necessary data and to generate the required outputs for reporting and disclosure.

The current skills gap is significant. There is a lack of sufficiently skilled people in the global and domestic market, and it will take time to develop and educate the required number of people to support widespread compliance with disclosure standards. This includes internal teams, as well as capacity in third-party organisations that will provide related services – such as modelling and particularly assurance.

The significant challenges that superannuation funds (and broader business entities) face around the implementation of international disclosure standards, and the assurance of disclosures, warrants a well-structured phased approach to implementation.

In broad terms, ASFA considers that there should be a transition or 'trial' period (of two to three years), after the issuance of the final standards where full compliance is not required. As has been the approach with other major policy reforms across financial services, this might take the form of a facilitative compliance period.

ASFA would support a longer 'phase-in' for reporting of Scope 3 emissions, which reflect emissions within an entity's supply chain, and are dependent on other entities' reporting of their emissions. In practical terms, a more formalised late phase-in would mean that the trial period for superannuation funds would be longer than for the entities in which funds invest.

Introduction

ASFA supports the adoption of an internationally-aligned climate risk disclosure framework applicable to large business and financial institutions, including institutional investors such as APRA-regulated superannuation funds.

As more jurisdictions around the world move to implement mandatory climate risk disclosure requirements, and capital markets and investors' expectations for quality, comparable risk disclosures increase, Australia will need to keep pace. To date, superannuation funds have made good progress in developing approaches to measuring and managing climate risks as well as aligning disclosures to existing frameworks.[1] However, without consistent requirements across the economy these approaches will remain incomplete and comparability difficult.

In responding to the Consultation Paper ASFA has focused on issues around the technical implementation of an internationally-aligned climate risk disclosure framework and transitional arrangements, in particular for superannuation funds. In doing so ASFA has attempted to balance the need for consistent and comparable disclosures to apply as soon as possible, with the need to appropriately manage the operational and regulatory costs associated with implementation.

General discussion

The need for development and implementation of climate-related financial disclosure

Climate change is a source of risk to the financial performance of business entities across all sectors of the economy. Business entities face direct risks from the physical impacts of climate change, as well as risks arising from the process of transition to a low-carbon economy – including changes to policy settings. At the same time, climate change will create opportunities for entities, including investments in new technologies developed to facilitate the economy's low-carbon transition.

As a consequence, investors will demand more, better-quality information from the entities in which they invest – to help investors understand how climate-related risks (and opportunities) may affect financial performance, and how entities are responding to those risks. In the Australian context, superannuation funds will face growing expectations from their members for information on the climate risks, and their impact, that are embedded in investment portfolios.

With respect to the disclosure of climate-related risks, the development and wide-spread adoption of uniform global standards has potential to deliver net benefits. Good-quality disclosure of climate-related risks implies market pricing that better reflects the cost of those risks, and would facilitate a more economically-efficient and sustainable allocation of capital than otherwise would be the case. Over the long term, this implies more sustainable economic outcomes. In this regard, wide-spread adoption would help facilitate the transition to a low-carbon economy.

That said, for business entities, the identification and assessment of climate-related risks, and their anticipated impacts on financial performance may also present challenges. For a particular entity, the scale and complexity of the task may vary considerably depending on; the sector(s) in which the entity operates and its carbon intensity, the entity's position in the broader value chain, the scale and complexity of the

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[1] APRA 2022, *Information Paper – Climate Risk Self-assessment survey*, August 2022 (https://www.apra.gov.au/information-paper-climate-risk-self-assessment-survey).

entity's operations, and the entity's degree of dependence on other entities in identifying/assessing climate-related risks. This last point is particularly relevant for APRA-regulated superannuation funds.

The need for an international process for development of climate-related financial disclosure

ASFA considers that there is a need for international coordination on disclosure standards around climate-related risks, ensuring the standards continue to be developed such that they are appropriate for the Australian context.

Climate-related reporting is being developed across many advanced-economy jurisdictions. Broadly speaking, reporting requirements are evolving in line with already-developed international frameworks. In particular, reporting requirements are building on the 2017 recommendations of the G20 Financial Stability Board's Taskforce on Climate-Related Financial Disclosures (TCFD) Taskforce. While the TCFD does provide a foundation for reporting requirements, and comparable metrics with respect to carbon footprint and climate-risk exposure, on its own it is not sufficient to enable jurisdictions to develop comparable metrics at the required specificity.

A consistent approach for disclosure by entities irrespective of jurisdiction would – relative to the counter-factual – have the potential to generate efficiencies. Compared to a 'fractured' global response, it would help limit costs and complexity for reporting entities that operate, raise capital and invest across national borders. For investors, it would facilitate the comparability and useability of disclosed information, and so lead to more efficient investment decision making.

APRA-regulated superannuation funds have significant offshore investments. At the system level, the allocation to offshore assets is around 50 per cent (of total assets under management) and rising.[2] In the main, offshore allocations are diversified across advanced economies, although emerging markets comprise an increasing share. A harmonised approach to disclosure across jurisdictions would make it easier for funds to aggregate climate-related risks and their impacts at the portfolio level, compared with a more fragmented environment.

The current international process for developing climate-related disclosure standards is progressing in the right direction. The responsible organisation – the International Sustainability Standards Board (ISSB) – has been tasked with developing a global baseline of disclosures. This involves two sets of proposed standards; general sustainability-related disclosure requirements, and climate-related disclosure requirements.

ASFA acknowledges that the ISSB is developing climate-related disclosure standards through a robust international consultation process. The ISSB issued draft standards in March 2022, and received 700 submissions on the draft standards. Australian respondents included the Australian Accounting Standards Board (AASB), but also large firms, financial institutions, and superannuation funds.

Observations

- ASFA considers that there is a need for international coordination on disclosure standards around climate-related risks.
- ASFA acknowledges the work of the Australian Accounting Standards Board in representing Australia's interests in the current international process – led by the International Sustainability Standards Board.

[2] ASFA calculation.

Australia should align with the international process for climate-related financial disclosure

Australia's development of climate-related financial disclosure should align with the current ISSB process. It should be acknowledged that the ISSB process is still in the early stages of developing disclosure standards, and that the draft standards, in their current form, would not be appropriate for *direct* adoption by Australia. In this regard, the key Australian body involved in the process – the AASB – raised some concerns with the current draft.

To date, in Australia, the evolution of disclosure of climate-related risk is in line with international practice. ASIC's current guidance around disclosure encourages entities with material exposure to climate change to consider reporting voluntarily under the recommendations of TCFD Taskforce. A recent KPMG report found that of the 250 entities listed on the ASX that reported against a framework or standard, the majority (63 per cent) used the TCFD standards.[3] ASFA notes that ASIC is also contributing input to the ISSB process, as a member of the International Organisation of Securities Commissions (IOSCO) Sustainability Technical Review Coordination Group.

Australia's alignment with international standards has precedent. With respect to accounting standards, alignment with international practice is the norm. The *Australian Securities and Investments Commission Act 2001* (ASIC Act) requires the AASB (which is an Australian Government agency), when making and formulating accounting standards, to work towards the adoption of accounting standards that are the same as those issued by its international counterpart (the International Accounting Standards Board). In this regard, where Australian standards differ from international standards, these typically involve enhancements.

With respect to the current ISSB process, ASFA acknowledges the work of the AASB in representing Australia's interests. The AASB has expressed support for the establishment of the ISSB, and for the scope and direction of the ISSB's work in developing disclosure standards. Broadly speaking, the AASB has emphasised the need for principles-based, rather than rules-based, standards – noting that flexibility will be needed to facilitate the evolution of best-practice reporting. Some of the AASB's particular concerns include the US-centric nature of various definitions and metrics (particularly with respect to industry classifications).

Recommendation
• ASFA considers that Australia's development of climate-related financial disclosure should align with the current international process.

Climate-related financial disclosure: Superannuation funds

APRA-regulated superannuation funds have a responsibility to manage the impact of risks (and opportunities) arising from climate change on long-term investment performance. This is consistent with the trustee duty to act in the best financial interests of fund members, and ultimately, would contribute to more sustainable long-term returns.

In this regard, superannuation funds require information from the entities in which they invest on how climate-related risks (and opportunities) may affect financial performance, and how entities are responding to those risks. Funds can utilise this information in investment decisions and to guide stewardship activity with respect to existing assets.

[3] KPMG and ASX 2022, *ASX Corporate Governance Recommendations: Reporting on Environmental and Social Exposures* (https://assets.kpmg/content/dam/kpmg/au/pdf/2022/asx-corporate-governance-environmental-social-exposures.pdf).

Given that superannuation funds invest in assets across multiple jurisdictions and asset classes, funds would benefit from consistency and comparability of climate-related disclosure. A globally-consistent approach to the development of international climate-related disclosure standards, and the implementation of the standards in Australia, would support fund decision-making.

With respect to disclosures by funds themselves, there are particular challenges – which are described in more detail in the next section. In particular, for superannuation funds (and the financial sector more broadly), the largest component of relevant emissions relate to those of the entities in which funds invest, or so-called financed emissions. Funds' disclosure of financed emissions will depend greatly on the degree and quality of disclosures by third-party entities. As such, superannuation funds can be thought of as being located at the very end of the chain of disclosures within the broader economy, compared with large non-financial corporations for example.

ASFA supports the adoption by Australia of international standards for climate-related disclosure, provided the disclosure standards continue to be developed such that they are appropriate for the Australian context, and that government expectations for compliance with the standards are reasonable. Beyond the standard-setting process, the exercise of implementation by business entities will be costly and will take time. The next sections of the submission set out some of the key challenges that business entities (including superannuation funds) face in implementing disclosure standards, and the need for a phased approach to implementation.

Implementation of climate-related financial disclosure: Challenges

With respect to implementation, there are a number of practical challenges facing business entities, including superannuation funds.

Currently, superannuation funds are at different stages of capacity for the introduction of climate-related disclosure standards. Many large APRA funds already undertake some form of climate risk reporting relating to their direct and financed emissions. However, the experience across the industry is not uniform and some funds will require more time than others to scale-up their expertise and capacity.

The proposed standards are complex. Broadly speaking, the transition process for funds (and other entities) will not be simple and, in some cases, will require significant changes to business operations and increases in associated operational costs (for example, from internal restructuring to the development of various internal capabilities).

The most significant challenge for superannuation funds relates to the availability and quality of the required data from third parties. As noted in the previous section, this largely relates to the disclosures by the entities in which superannuation funds invest (which, in aggregate, would be the largest component of disclosed emissions by funds under the proposed ISSB disclosure framework).

For a typical diversified superannuation fund, investments are distributed across multiple jurisdictions. Even where there is broad international agreement on the adoption of a uniform disclosure framework, it would be expected that the implementation timetable could differ markedly across jurisdictions – particularly between the groups of advanced and emerging markets. This would be reflected in differences in the general availability and quality of required data. Moreover, within a particular jurisdiction, data availability and quality would be expected to differ across industries and sectors, and between listed and unlisted investments.

Ultimately, the availability/quality of disclosures (by the entities in which funds invest), will determine the robustness of funds' disclosures. As such, superannuation funds can be thought of as being located at the very end of the chain of disclosures within the broader economy.

It is certainly the case that the development of disclosure standards will clarify the type and form of data that entities will need to monitor and collect. This would be likely to support a broader improvement in the availability, quality, and comparability of data, and development of the required methodologies for assessing and modelling risks and their impacts. However, this process will take time.

With respect to capabilities, superannuation funds, like the broader group of business entities, will need to update, and in some cases develop, systems to collect and process the necessary data and to generate the required outputs for reporting and disclosure. While analogous to current financial accounting systems that support financial reporting, the requirements may be more complex due to the heavy reliance on external data sources. Within the superannuation system, funds are at varying stages of systems development, with differing degrees of manual/automatic processes – including with respect to data collection, data processing and reporting of outcomes. Ultimately, some funds will need to undertake significant, costly investments to develop the required systems, notably in the development and adoption of systems hardware/software.

The current skills gap is significant. There is a lack of sufficiently skilled people in the global and domestic market, and it will take time to develop and educate the required number of people to support widespread compliance with disclosure requirements. Challenges in this regard reflect a general shortage of workers, and the need to develop the required training courses and then train the required number of workers and types of professions. This includes internal teams, as well as capacity in third-party organisations that will provide related services – such as modelling and particularly assurance. These supply-side pressures would be exacerbated by a non-phased implementation – with entities competing for a limited pool of subject matter experts before the market has had time to develop.

Observations

- With respect to the implementation of new disclosure standards, there are a number of practical challenges facing business entities, including superannuation funds.
- For superannuation funds, the most significant challenge relates to the availability and quality of required data from the entities in which funds invest (financed emissions).
- Within the superannuation industry, funds are at varying stages of systems development required to support new disclosure standards. Funds will need to update, and in some cases develop, systems to collect and process the necessary data and to generate the required outputs for disclosure.
- In terms of workforce capabilities, there is a general lack of sufficiently skilled people. It will take time to develop the required people to support widespread compliance with the disclosure standards. This includes within internal teams as well as capacity in third-party organisations that will provide related services – such as modelling and particularly assurance.

Implementation of climate-related financial disclosure: A phased approach

The significant challenges that funds (and broader business entities) face around the implementation of international disclosure standards warrants a well-structured phased approach to implementation.

For superannuation funds, a phased approach balances the demands for information from end-users of disclosure information (including superannuation members), with providing funds with adequate time to prepare for the new disclosure requirements (including access to the necessary data, developing appropriate systems and processes, and upskilling workforce).

In broad terms, ASFA considers that there should be a transition or 'trial' period (of two to three years), after the issuance of the final standards where full compliance is not required.

As has been the approach with other major policy reforms across financial services, this might take the form of a facilitative compliance period. Under this arrangement regulators take a constructive and educative approach where entities have made best endeavours to fully comply, but where systems are still in the process of being updated and/or relevant data remains unavailable. In other words, where entities have attempted to comply in good faith with the obligations, the regulatory approach would be measured. A supervisory approach focused on enforcement would be reserved for entities that disregard their obligations or do not make a reasonable effort to comply during this period.

This would allow the use of qualitative rather than quantitative data, or the disclosure of reasonable estimates in circumstances where full compliance is not yet possible. Appropriate consideration of how to shift over time to the appropriate level of assurance relating to the standards would need to accompany this transition.

A general transition period could extend from the suggested 2024-25 commencement year as suggested in the Consultation Paper. In this regard, ASFA agrees with the AASB, whereby:

> *the effective date of the [draft] standards should be, at minimum, two to three years after the date of issue with early application permitted. This effective date will help ensure that entities that can do so can apply the requirements while also providing sufficient time for others to develop the capabilities, systems and processes needed to comply with the [draft] standards.*

ASFA would support a longer 'phase-in' for reporting of Scope 3 emissions, which reflect emissions within an entity's supply chain, and are dependent on other entities' reporting of their emissions.

- It is certainly the case that Scope 3 reporting by entities is becoming more common. Recent ACSI research concluded that 93 of the ASX200 listed companies report their Scope 3 emissions.[4]
- While it would be expected that Scope 3 data availability/quality will improve over time (as the international standard-setting process evolves), progress will not be uniform.

Reflecting the particular challenges for superannuation funds, ASFA would support more *formalised* late phase-in.

- Funds' Scope 3 emissions include those that relate to fund investments (Scope 3, Category 15 as per the draft ISSB standards). These so-called financed emissions relate to the disclosed emissions of the entities in which funds invest, including the Scope 1,2 and 3 emissions of those entities.
- For funds, financed emissions will be the largest component of disclosed emissions, and also the most challenging aspect of funds' emissions disclosure.
- Funds would be heavily reliant on the availability and quality of (invested) entities' disclosures.
- Superannuation funds hold assets across a range of jurisdictions and asset classes – which will vary considerably with respect to data availability/quality, and with respect to the degree of qualification around data.

In practical terms, a more *formalised* late phase-in would mean that the trial period for superannuation funds (and for other parts of the financial system) would be longer than for the entities in which funds invest.

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[4] ACSI 2022, *Promises, Pathways and Performance: Climate Change Disclosure in the ASX200* (https://acsi.org.au/wp-content/uploads/2022/07/ACSI-Research-Climate-Change-Disclosure-in-ASX200-July-2022.pdf).

Recommendations

- The challenges to implementation of the new disclosure standards, and the assurance of disclosures, warrants a well-structured phased approach to implementation.
- In general terms, ASFA considers that there should be a transition period (of two to three years), after the issuance of the final standards where full compliance is not required. As has been the approach with other major policy reforms across financial services, this might take the form of a 'facilitative compliance' period.
- Reflecting the particular challenges for superannuation funds, ASFA would support a later phase-in for funds.
    - For funds, financed emissions will be the largest component of disclosed emissions, and also the most challenging aspect of funds' emissions disclosure.
    - The availability/quality of disclosures by the entities in which funds invest will determine the robustness of funds' disclosures.
    - As such, superannuation funds can be thought of as being located at the very end of the chain of disclosures within the broader economy.

Implementation: Assurance

The need for a phased implementation also reflects the challenges in the provision of quality, independent assurance.

There is a critical role for independent external assurance to lend credibility to climate-related disclosures. As a general principle, end-users (including superannuation fund members) should have confidence in the integrity of disclosed information – similar to audited financial statements. This would help engender trust and to avoid confusion among investors and other stakeholders.

Key necessary conditions for this to occur are a consistent, universally-recognised 'baseline' for disclosure standards (the international process led by the ISSB is committed to achieving this goal), coupled with a standardisation in data and methodology. For the Australian context, a well-structured and achievable implementation path for local entities will be required. In the absence of this, the complexity and cost of a 'reasonable assurance' level of audit would be higher than otherwise would be the case. For example, different third-party providers of assurance services may have quite different interpretations of what information is required from audited entities for assurance.

That said, in practical terms the auditability of disclosures (as per the ultimate standards), is likely to be challenging. In particular, Scope 3 disclosures may not be practically auditable to the standard of reasonable assurance, and it is possible that Scope 3 disclosures would remain only subject to limited assurance.

In broad terms, a transition period – as described in the previous section – would provide an opportunity for entities to disclose, but without the requirement for full compliance. It could allow for an initial requirement around procedures or for limited assurance. Correspondingly, it would be reasonable to expect that regulators would adopt a relatively accommodating enforcement posture during this period.

A proposed transition or trial period would not only provide business entities (including superannuation funds) the required additional time to implement systems and processes effectively before they are subject

to independent assurance, but it also would enable the scaling-up of assurance capacity in third party providers of those services. However, the appropriate degree of, and transition arrangements for, assurance – particularly with respect to Scope 3 disclosures – will need further consideration once the final standards are settled.

Observations

- There is a critical role for independent external assurance to lend credibility to climate-related disclosures.
- In practical terms, the auditability of disclosures (as per the ultimate standards), is likely to be challenging.
    - In particular, Scope 3 disclosures may not be practically auditable to the standard of reasonable assurance, and it is possible that Scope 3 disclosures would remain only subject to limited assurance.
    - More broadly, it will take time for third-party providers of assurance services to scale-up their required capabilities.

Recommendations

- The proposed transition period (of two to three years) would enable the scaling-up of assurance capacity in third-party providers.
- However, the appropriate degree of, and transition arrangements for, assurance – particularly with respect to Scope 3 disclosures – will need further consideration once the final standards are settled.

Governance and oversight arrangements

A significant consideration relating to the introduction of an Australian financial reporting framework for climate-related risks is the appropriate governance and oversight arrangements. Given the nature of the new disclosure and reporting requirements, reporting entities will undoubtedly value the certainty and stability associated with an experienced and credible governing body. Entities may also appreciate continuity, for example where a governing body has already begun engaging in such matters.

As outlined in the consultation paper, financial reporting entities must currently comply with the accounting standards issued by the AASB and professional accounting bodies, while auditors and assurance providers comply with standards issued by Auditing and Assurance Standards Board (AUASB). Both operate under the broad strategic oversight of the Financial Reporting Council (FRC).

ASFA believes *Potential Structure 1: Confirm AASB as the entity responsible for developing, making, monitoring climate and sustainability related standards*, is the most appropriate governance and oversight arrangement for the implementation of this framework in Australia. ASFA notes that under this model as described, the AUASB would have responsibility for the relevant assurance requirements.

Notably, the AASB has already begun preparing for the introduction of climate and sustainability related risk disclosure standards in Australia, including by engaging and building relationships with international

counterparts such as the ISSB to discuss the development of relevant standards and consulting on the exposure draft.

The arrangement outlined in 'Structure 1' as proposed benefits from being able to harness the AASB's experience and expertise in standard-setting, and its reputation amongst the accounting profession and broader financial services sector. As outlined above, given the likely adjustments to the availability of resources and skills required in the sector to implement the reporting framework in coming years, the stability and expertise of the AASB (and the professional bodies it engages with), as well as its willingness to take the lead on international engagement, make it a suitable body to facilitate and oversee Australia's implementation of the reporting framework.

Other proposed oversight models – including the establishment of a separate body for climate and sustainability reporting – may risk duplicating functions, effort and resources. Also, a new body may be less likely to be able to leverage existing standards-making expertise and may slow the process of engagement with international counterparts.

That said, to the extent that the reporting environment and requirements change in time to justify consideration of alternative governance and oversight arrangements, including the consolidation into other climate-related oversight bodies, government should be open to reviewing the arrangement.

Recommendations

- ASFA considers that the most appropriate governance and oversight arrangement for Australia, as proposed in the Consultation Paper, is *Structure 1* (the Australian Accounting Standards Board).
- To the extent that the reporting environment and requirements change in time to justify consideration of alternative governance and oversight arrangements, including the consolidation into other climate-related oversight bodies, government should be open to reviewing the arrangement.