Climate-related financial disclosure consultation – February 2023

HESTA welcomes the opportunity to make a submission to the *Climate-related financial disclosure consultation paper*, which seeks views on the introduction of mandatory climate-related financial disclosures in Australia.

HESTA supports the introduction of a mandatory, internationally aligned framework for disclosure of climate-related financial information. HESTA was an early advocate for and adopter of climate disclosure frameworks. Climate disclosures are an important tool for investors, facilitating our ability to deliver long-term financial outcomes for members by providing transparent and consistent information to enable us to assess and manage climate risks and opportunities across our portfolios. HESTA supports the extension of the climate disclosure framework to other areas of sustainability risk over time, where these areas are material to companies' financial performance and broader economic outcomes that impact our members' financial wellbeing.

Summary of recommendations:

1. Introduce a mandatory, consistent, robust, framework for disclosure of climate-related financial information in line with International Sustainability Standards Board (ISSB) standards, to enable investors to more accurately price, stress test and thereby manage climate risks and opportunities across their portfolios.
2. Ensure disclosure framework is enforceable and drives absolute carbon reduction, requiring companies to disclose transition plans with robust mitigation hierarchies aligned to sector-specific transition pathways.
3. Ensure the phased introduction of the disclosure framework prioritises early inclusion of entities based on both carbon footprint (scope 1, 2 and 3) and entity size with initial mandatory disclosure for high emitters, large listed and unlisted entities and financial institutions occurring no later than 2024/25.
4. Capture scope 3 emissions, providing phasing in line with the ISSB approach, with these emissions appearing separately in disclosures.
5. Require climate reporting to be integrated with financial reporting, with limited assurance initially and progressing to assurance equivalent to audited financial statements over time.

6. Ensure guidance supports consistent disclosure of forward-looking scenario analysis that includes the use of credible 1.5°C aligned pathways as a minimum.

Climate change impacts retirement outcomes for HESTA members

HESTA is a super fund that invests around $70 billion of assets on behalf of more than 1 million members who work in caring industries, primarily in the health and community services sectors. Almost 80% per cent of our members are women, and most are on low-to-middle incomes. At HESTA, our purpose is to invest in and for people who make our world better. Our members rely on us to ensure that their experiences are considered in complex policy deliberations that impact their financial security in retirement.

Climate change poses a material, direct and current financial risk that is relevant to HESTA's management of our investment portfolio in the best financial interests of our members. As a large and diversified owner invested across the Australian and global economies, we cannot avoid this risk. A well-managed transition reduces the likelihood of economic volatility, reduces the risk of stranded assets, and provides opportunity to maximise value and outcomes from investment in the new energy economy.

HESTA supports the Government's intention of promoting policy certainty and stability in pursuit of Australia's commitment to reduce national emissions to 43 percent below 2005 levels by 2030 and achieve net zero emissions by 2050. To support achievement of these targets in the most efficient manner possible, investors need predictable policy settings that facilitate portfolio decarbonisation. A mandatory climate related financial disclosure framework, alongside other policy certainty, assists to provide this.

HESTA's approach to emissions reduction and reporting

HESTA was the first major super fund to commit to net zero by 2050, implement restrictions on investment in thermal coal, and be certified as carbon neutral for business operations.

Portfolio emissions

To support a timely, equitable and orderly transition to net zero emissions and address portfolio risk, HESTA has already achieved a more than 30% reduction in normalised emissions in our portfolio (against a 2020 baseline) and has now committed to a strengthened target to halve normalised emissions across our portfolio by 2030. HESTA has also committed to invest 10% of our portfolio in climate solutions by 2030, such as renewable energy and sustainable property, up from the current 7.7% baseline[1].

Consideration of climate change risk is embedded across HESTA's operations, and is incorporated in our investment strategy process, risk framework, stress testing, selection and review of investment managers, company engagement, capital allocation and reporting.

HESTA uses both capital allocation and active ownership to drive a reduction in emissions in our portfolio. Clear, internationally consistent climate-related financial disclosures are a critical enabler of this activity.

HESTA was an early investor in renewables and green technologies. To meet our climate solution target we continue to look for opportunities to invest in the development of renewable energy and innovative technologies and businesses that are at the forefront of the shift to a low carbon economy.

HESTA uses active ownership with emissions-intensive companies to drive down emissions and manage climate risk. HESTA has been engaging with emissions-intensive companies and managers through both direct and collaborative programs for many years. Our focus has been on encouraging disclosure of carbon-emission calculations, financial stress testing, the setting of carbon reduction targets and the development of roadmaps aligned with a 1.5°C transition pathway. Disclosures underpin a cohesive framework for engagement with emissions-intensive portfolio companies and managers, allowing companies to be benchmarked against sector peers, and their trajectories mapped to investor and government targets.

Climate reporting approach

HESTA has been taking action to address climate change and its related risks for more than 20 years. During this time HESTA has sought to progressively measure and disclose our carbon footprint:

2006	• One of the world's first pension funds to become a signatory of the Principles for Responsible Investment (PRI) • Committed to the Carbon Disclosure Project (CDP)
2010	• Participated in the Australian Institute of Superannuation Trustees project to calculate the carbon footprint of HESTA's equities investments
2016	• Reported the carbon footprint of our listed equities
2017	• Reported the carbon footprint of our property investments • Joined the Climate Action 100+ initiative
2018	• Initiated development of HESTA's Climate Change Transition Plan

[1] As at 30 June 2022, Identification of additional opportunities has been based upon the Sustainable Development Investment Asset Owner Platform (SDI AOP) Taxonomy. Investments aligned to SDG 7, 11.1 and 13 have been included in the baseline.

	• Signed on as a supporter of Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) and committed to report in line with TCFD recommendations • Company engagement sought disclosure aligned with TCFD recommendations
2019	• Certified carbon neutral by the Australian Federal Government (Trustee operations only)
2020	• Announced emissions reduction target of 33% by 2030 and net zero by 2050
2021	• Became a signatory of the Paris Aligned Investment Initiative (PAII) • Released HESTA's first climate report, Our Path to Net Zero
2022	• Strengthened our interim normalised emissions reduction target from 33% to 50% by 2030 (against a 2020 baseline) • Committed to investing 10% of the investment portfolio in climate solutions, such as renewable energy or green property, by 2030

HESTA's trustee office operational emissions are reported in the Annual Report. Our portfolio emissions are reported through our annual Climate Change Report which was first released in 2021 and has regard for the recommendations made by the TCFD. HESTA currently measures progress toward our 2030 and 2050 portfolio carbon reduction targets through monthly measurement of emissions for listed equities and annual measurement for all other asset classes.

HESTA's portfolio carbon emissions measurement relies significantly on the public emissions reporting of companies through sustainability and similar reporting. HESTA expects an uplift in the accuracy and consistency of our portfolio climate reporting as a result of the proposed mandatory climate-related financial disclosure framework. This uplift will significantly assist our assessment of the risk to members' retirement outcomes.

Comparable, internationally aligned disclosures of critical importance

Questions 1, 4 and 17

The availability of comparable, robust, internationally aligned climate-related financial disclosures is critical to tracking progress toward and meeting our portfolio carbon reduction targets, with the benefits far outweighing the potential cost of reporting. The benefits of mandatory climate disclosure include:

- Facilitating comprehensive investor analysis of climate risks and opportunities for more efficient allocation of capital and more effective engagement with emissions-intensive companies.
- Enabling policy makers and regulators to facilitate a more predictable, well-managed transition that is based on comprehensive, reliable understanding of the economy's overall climate risks and opportunities.
- Reducing the risk that Australia becomes less attractive to international capital if domestic disclosure frameworks lag global practice.

- Reducing the reporting burden for companies that need to disclose in multiple jurisdictions.
- Supporting trustees/directors in meeting their regulatory obligations to manage climate risks.
- Providing a framework that requires substantiation of climate commitments and credentials, thereby helping to manage the risk of greenwashing.

Failing to provide mandatory disclosure presents significant financial risk and opportunity cost that, for superannuation funds, would ultimately be borne by our members. This includes reduced ability to maximise outcomes from new energy economy opportunities and mispricing or stranding of assets, as well as the broader detriment of reduced ability to meet climate targets.

The Australian market, supported by active ownership from institutional investors, has outpaced regulation in providing climate disclosures. Encouraging companies to adopt the TCFD recommendations has been an engagement priority for HESTA for several years and more than half of ASX 200 listed companies now report in alignment with TCFD.[2]

Adopting internationally aligned, mandatory climate disclosures will provide a much-needed standardised baseline to improve consistency and accelerate take up of reporting across the economy. HESTA supports aligning Australia's disclosure framework with the International Sustainability Standards Board (ISSB) standard for international consistency.

Importantly, the framework should allow entities to extend beyond the baseline, following developments in more advanced markets and extending climate reporting to broader sustainability-related portfolio risks and opportunities.

Recommendation

1. *Introduce a mandatory, consistent, robust framework for disclosure of climate-related financial information in line with International Sustainability Standards Board (ISSB) standards to enable investors to more accurately price and thereby manage climate risks and opportunities across their portfolios.*

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[2] ACSI, 2022, Promises, pathways and performance Climate change disclosure in the ASX200

Ensuring disclosure drives emissions reduction

Questions 5 and 11

Climate-related financial disclosures must ultimately inform decision making for entities and investors, leading to absolute decarbonisation outcomes within the real economy. Importantly, to ensure compliance, obligations should be legislated and enforceable, with detail provided in mandatory standards. The disclosure framework should also include sectoral transition pathways aligned to the goals of the Paris agreement, and require company transition plans that include the following[3]:

- Alignment of carbon reduction targets to sectoral transition pathway.
- 'Net zero' commitments that are supported by appropriate short-, medium- and long-term absolute emissions reduction targets aligned to 1.5^{o}.
- A decarbonisation strategy that that explains how targets will be met.
- The role of green revenues from low carbon products and services in the decarbonisation strategy.
- The alignment of capital expenditure with targets and the methodology used to calculate this.
- The alignment of entity public policy position with targets.
- Board capability and oversight of climate risks.
- Alignment of senior management incentives with decarbonisation strategies.
- Commitment to just and equitable transition principles.

Transition plans should follow a robust mitigation hierarchy, prioritising absolute reduction in emissions over the use of offsets. To achieve economy-wide emissions reduction, reliance on offsets should be minimised. Where offsets are used these must result in genuine emissions reduction from removal rather than avoidance. The Climate Active integrity principles provide a framework that could be applied to ensure that any offsets used are genuine and credible.

Recommendation

2. *Ensure disclosure framework is enforceable and drives absolute carbon reduction, requiring companies to disclose transition plans with robust mitigation hierarchies aligned with sector-specific transition pathways.*

[3] All measures except first point reflect Climate Action 100+ Net Zero benchmark based on the current iteration of the benchmarks, which is subject to ongoing review

Ensuring coverage and phasing approach achieves climate targets

Questions 2, 3 and 9

HESTA supports a phased approach that expedites coverage of disclosures based on both entity size and carbon footprint, with initial mandatory disclosure for the first phase occurring no later than 2024/25.

Currently, Australian equities is the largest single asset class contributor to HESTA's carbon footprint, accounting for around 45% of HESTA's portfolio emissions. These emissions are primarily concentrated in large, listed companies that already report in alignment with TCFD to some extent. Unlisted entities, including significant infrastructure assets, also contribute to portfolio emissions and should be captured in reporting.

The first phase should include large, listed companies, (many of which already produce TCFD-aligned reports), as well as large unlisted entities, that are captured by current National Greenhouse and Energy Reporting (NGER). Prioritising entities based on their relative contribution to Australia's national emissions footprint will ensure early disclosure is aligned with material emissions reduction imperatives. The first phase of disclosures should also capture large financial institutions like banks and super funds that invest across the economy.

For smaller entities with lower emissions that aren't captured initially, reporting should be voluntary and encouraged, with support provided for capacity building, ensuring the total phase-in period doesn't exceed three years.

Scope 3 emissions should be reported separately to avoid double-counting of emissions in investor portfolios. HESTA supports scope 3 emissions being disclosed on a timeframe consistent with scope 1 and 2 but acknowledges the challenges involved in scope 3 reporting. Australia's framework should adopt the ISSB approach to timing for scope 3 reporting, while emphasising the need for disclosure to be expedited. Uplift in the methodologies used to capture scope 3 emissions will occur over time as more advanced markets refine their approaches, and guidance is developed.

Recommendations

3. *Ensure the phased introduction and of the disclosure framework prioritises early inclusion of entities based on both carbon footprint (scope 1, 2 and 3) and entity size – with initial mandatory disclosure for high emitters, large listed and unlisted entities and financial institutions occurring no later than 2024/25*

4. *Capture scope 3 emissions, providing phasing in line with the ISSB approach, with these emissions appearing separately in disclosures.*

Integration with financial reporting and assurance

Questions 6, 8 and 12

Climate-related disclosure is most valuable for incentivising action by entities and for enabling investor analysis when it is well integrated into an entity's financial reporting. Integrated disclosure provides an indicator to investors that entities are evaluating climate risks as part of strategy and risk management, and that they have credible plans in place to reduce emissions. HESTA supports the inclusion of climate related disclosure in the operating and financial review, supported by supplementary reporting aligned to the annual report.

Investors need to have confidence in the information being reported. Initially, a limited level assurance engagement should be required, progressing to assurance equivalent to audited financial statements over time (reasonable assurance). This phased approach to increasing assurance requirements will allow time for capacity building by both reporting entities and auditors and allow time for convergence of existing and emerging assurance frameworks.

Recommendation

5. *Require climate reporting to be integrated with financial reporting, with limited assurance initially and progressing to assurance equivalent to audited financial statements over time.*

Enabling scenario analysis

Questions 14 and 15

Comparable scenario analysis is important in ensuring the disclosures effectively capture how an entity responds to climate-related impacts. Guidance should support the disclosure of forward-looking scenario analysis that includes the use of credible 1.5°C aligned pathways as a minimum. Scenario analysis should be required, and supported by guidance that provides standard, internationally aligned scenarios. Guidance should allow for uncertainties and assumptions in the disclosure of scenario analysis.

Recommendation:

6. *Ensure guidance supports consistent disclosure of forward-looking scenario analysis that includes the use of credible 1.5°C aligned pathways as a minimum.*