CLIMATE-RELATED FINANCIAL DISCLOSURE CONSULTATION

HESTA Submission – July 2023

HESTA welcomes the opportunity to make a submission to the second *climate-related financial disclosure consultation paper*, which seeks views on proposed positions for the detailed implementation and sequencing of standardised, internationally-aligned requirements for disclosing climate-related financial risks and opportunities in Australia.

HESTA previously made a submission to the first consultation on climate-related financial disclosure, which can be found here.

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, supporting delivery of strong, long-term financial outcomes for members by providing transparent and consistent information to enable assessment and management of climate-related risks and opportunities across the investment portfolio. Furthermore, climate-related disclosure by companies allows investors to better communicate climate risk within the portfolio to members and other stakeholders. 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/or broader economic outcomes that impact our members' financial wellbeing.

HESTA is largely supportive of the proposed model set out in the Consultation Paper, including the following specific proposals:

- Proposal 1: All entities that meet prescribed size thresholds and that are required to lodge financial reports under Chapter 2M of the *Corporations Act 2001* (Cth) would be required to make climate-related financial disclosures.
- Proposal 3: From commencement, companies would be required to disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities.
- Proposal 9: From commencement, scope 1 and 2 emissions for the reporting period would be required to be disclosed.

- Proposal 10: Disclosure of material scope 3 emissions would be required for all reporting entities from their second reporting year onwards. Scope 3 emissions disclosures made could be in relation to any one-year period that ended up to 12 months to the current reporting period, noting preparation should be in accordance with industry recognised guidance for consistency and comparability.
- Proposal 11: By end state, reporting entities would be required to have regard to disclosing industry-based metrics, where there are well-established and understood metrics available for the reporting entity.
- Proposal 12: Climate-related financial disclosure requirements would be drafted as civil penalty provisions in the Corporations Act. The application of misleading and deceptive conduct provisions to scope 3 emissions and forward-looking statements would be limited to regulator-only actions for a fixed period of three years.

Below is HESTA's more detailed feedback and recommendations in relation to other proposals set out in the Consultation Paper.

Approach to materiality

Proposal 2: Principles of financial materiality would apply.

Large and long-term investors such as HESTA value materiality-based disclosures, because these enable a focus on areas of greatest risk and opportunity. HESTA supports organisations adopting a materiality-based approach to climate-related disclosures as well as standardisation of the concept of materiality to ensure consistency. However, for large asset owners that must consider risk at a both company and economic system level in order to act in the best financial interests of members, a double materiality approach would better ensure both company-level and system-level risks are comprehensively disclosed for the assessment of climate-related risks.

HESTA believes that the utility of disclosure will increase for investors with a double materiality style disclosure. Comprehensive system-level assessment of climate-related risk for investors depends on building from company-level disclosure. Double materiality style disclosure in practice will allow assessment of the impact of climate change on investments and impact of investments on our portfolio and members.

Recommendation: *Further consideration should be given to how materiality is defined, including reconsidering making a double materiality approach the preferred standardised approach to determine materiality.*

Scenario analysis

Proposal 4: From commencement, reporting entities would be required to use qualitative scenario analysis to inform their disclosures, moving to quantitative scenario analysis by end state.

Proposal 5: From commencement, reporting entities would be required to disclose climate resilience assessments against at least two possible future states, one of which must be consistent with the global temperature goal set out in the Climate Change Act 2022.

The Consultation Paper sets out several principles against which Treasury is seeking to make reform. Two of these principles relate to 'supporting climate goals' and 'improving information flows.' These are important principles for reform and HESTA is supportive of them. However, referencing the global temperature goal in the *Climate Change Act 2022* in proposal 5 could result in a lack of comparability of disclosures, as the goal can be interpreted as a range between 2°C and 1.5°C. As scenario analysis results from 2°C and 1.5°C scenarios could have significant disparity, scenario analysis by reference to the global temperature goal could result in proposals 4 and 5 straying from these principles.

Scenario analysis needs to support comparability of disclosure to support climate goals and improve information flows. As a minimum, a comparable and consistent 1.5^{o}C temperature scenario should form the baseline for scenario analysis.

Recommendation: *Guidance should support the disclosure of forward-looking scenario analysis that includes the use of credible 1.5°C aligned pathways as a minimum.*

Transition plans and emission mitigation

Proposal 6: From commencement, transition plans would need to be disclosed, including information about offsets, target setting and mitigation strategies.

Proposal 7: From commencement, all entities would be required to disclose information about any climate-related targets (if they have them) and progress towards these targets.

The Consultation Paper sets out the principle relating to 'supporting climate goals' which it defines as transition to net zero emissions by 2050. This is an important reform principle of which HESTA is supportive. However, proposals 6 and 7 risk straying from this principle as transition plan disclosure in the current form may not result in real-world decarbonisation. To ensure climate-related financial disclosure supports the climate goal of net zero emissions by 2050, HESTA believes that sectoral transition pathways that are aligned with the goals of the Paris Agreement must be developed. Further, company transition plans should include the following[1]:

- Alignment of carbon reduction targets to relevant sectoral transition pathway.
- 'Net zero' commitments that are supported by appropriate short-, medium- and long-term absolute emissions reduction targets that move toward alignment with a 1.5°C transition pathway.
- 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.
- Alignment of capital expenditure with targets and the methodology used to calculate this alignment.
- Alignment of entity public policy positions with objectives of the Paris Agreement
- Board capability and oversight of climate risks.
- Alignment of senior management incentives with decarbonisation strategies.
- Commitment to just and equitable transition principles.

Current proposals lack detail on the requirement for mitigation strategies within disclosure of transition plans. HESTA believes that transition plans should follow a robust mitigation hierarchy, prioritising absolute reduction in emissions over the use of offsets. Furthermore, transition risk and physical risk should both be appropriately prioritised to enable investors to appropriately assess the financial risk of climate change.

Recommendation: *Align proposals of transition planning and climate-related targets with the principle to 'Support Climate Goals' for meaningful disclosure that prioritises real-world emissions reduction by including requirements for entities to report against points outlined above.*

Opportunities and Taxonomies

Proposal 8: From commencement, entities would be required to disclose information about material climate-related risks and opportunities to their business, as well as how the entity identifies, assesses, and manages risks and opportunities.

HESTA believes that climate-related opportunity disclosure should be in accordance with pre-defined guidelines and frameworks. Climate-related opportunity disclosure aligned

[1] 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.

with agreed taxonomies is an appropriate way to baseline disclosure and will align mandatory disclosure to domestic climate objectives while giving investors the confidence of being able to consistently assess climate-related opportunity capital expenditure. It is essential to acknowledge the ongoing efforts to establish an Australian taxonomy, as this ensures recommendations for climate-related disclosures remain future proof.

Recommendation: *Future proof Australia's climate-related disclosure by including references to future sustainable finance taxonomies (under development) and align guidance for climate-related opportunity disclosure with sustainable finance taxonomies from inception.*