Climate-related Reporting for Financial Services entities

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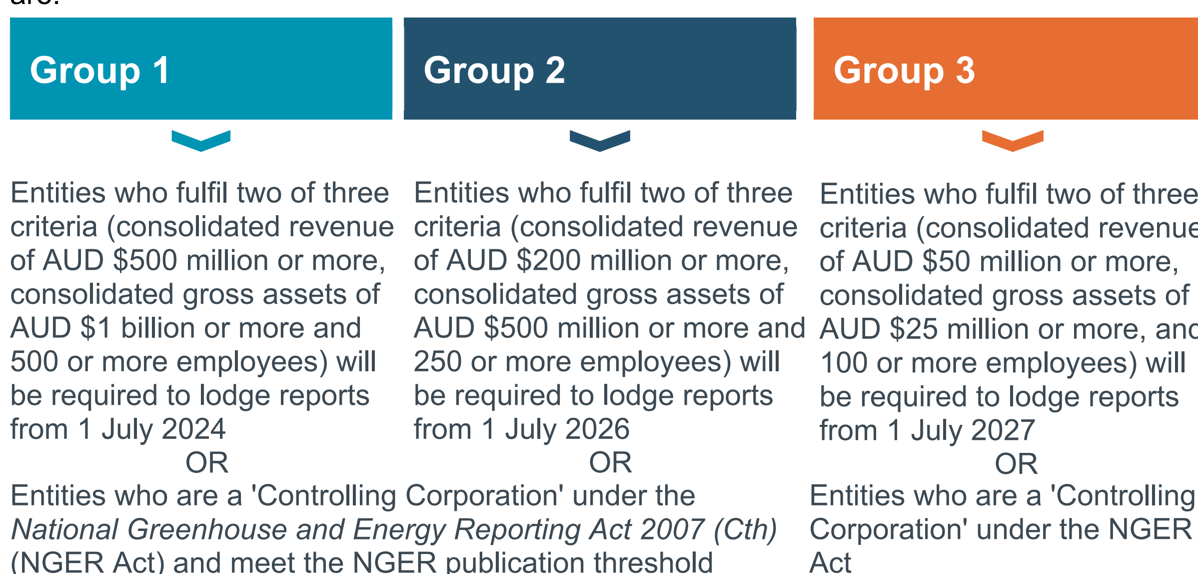
Climate-related reporting for financial services entities

The Australian Treasury's *Climate-Related Financial Disclosure Consultation Paper* (**Consultation Paper**) has proposed to introduce mandatory climate-related financial disclosure standards in Australia.

Phased implementation

Under a phased-in approach, all entities required to lodge financial reports under Chapter 2M of the *Corporations Act 2001 (Cth)* (**Corporations Act**) that meet the prescribed size thresholds (see below) will be subject to the disclosure framework. It is important to note that Chapter 2M captures most financial services entities, including superannuation funds.

The phased implementation approach creates three 'Groups', based on the size of an entity, which will progressively be required to commence reporting under the regime. These Groups are:



Depending on the corporate structure, it is possible that some foreign financial services entities operating in Australia will be subject to the requirements of the Corporations Act however the vast majority will not be caught directly.

That being said, foreign financial services entities engaged by Australian superannuation funds will be asked to provide the information that is relevant to the superannuation funds' own reporting obligations and in that respect the Australian climate-related reporting requirements will need to be actively considered by foreign investment managers.

Content requirements

The Consultation Paper only proposes 'indicative' disclosure requirements (ie governance, strategy, risks and opportunities and metric & targets), with the Australian Accounting Standards Board (**AASB**) to develop Australian standards for consultation by the end of 2023. It is intended that this will align with the standards developed by the International Sustainability Standards Board (**ISSB**) as far as practicable.

Greenhouse gas (GHG) emissions

The most challenging disclosure requirement under both the ISSB standards and proposed Australian standards is the requirement to disclose Scope 1, 2 and 3 emissions.

Scope 1 and 2 emissions

All entities must report Scope 1 (direct emitting activities) and Scope 2 (indirect energy consumption) emissions from their commencement under the regime. For Group 1 entities, this will be from 1 July 2024.

The disclosure of Scope 1 and 2 emissions is expected to be relatively straightforward as financial services entities engage in limited emitting activities or energy consumption themselves.

Scope 3 emissions

All entities must also report 'material' Scope 3 emissions (emissions from upstream and downstream a company's value chain) from their second reporting year onwards. Materiality in this context refers to the relative size of the emissions source. For Group 1 entities, this will be from 1 July 2025.

The Consultation Paper notes that Scope 3 emissions are to be calculated in line with the international GHG Protocol accounting framework, whilst incorporating Australia-specific emissions factors.

As observed below, the GHG Protocol outlines 15 categories of upstream and downstream Scope 3 emissions that entities must consider:

	Upstream		*Downstream*
1	Purchased goods and services	9	Downstream transportation and distribution
2	Capital goods	10	Processing of sold products
3	Fuel- and energy-related activities	11	Use of sold products
4	Upstream transportation and distribution	12	End-of-life treatment of sold products
5	Waste generated in operations	13	Downstream leased assets
6	Business travel	14	Franchises
7	Employee commuting	15	Investments
8	Upstream leased assets		

Studies have found that Scope 3, category 15 'Investments' emissions (also referred to as 'Financed Emissions') can comprise over 99% of total emissions reported by the financial services sector. As these emissions are not under the operation or control of the entity, and originate from complex and diverse sources, financial services entities will inevitably find it challenging to obtain reliable and accurate emissions data. 'Financed emissions' are therefore anticipated to be the most time-consuming, resource-intensive and complex requirement for financial services entities in Australia.

Financed emissions

Whilst the Consultation Paper does not specifically contemplate 'Financed Emissions', financial services entities can consider the Global Standard for Financed Emissions developed by the Partnership for Carbon Accounting Financials (**PCAF**). This provides methodological guidance, approved by the GHG Protocol, to assist financial entities in the measurement and disclosure of emissions associated with seven asset classes:

- Listed equity and corporate bonds;
- Business loans and unlisted equity;
- Project finance;
- Mortgages;
- Commercial real estate;
- Motor vehicle loans; and
- Sovereign debt.

It is important to note that niether the Australian Treasury nor the AASB has provided any indication on whether this global standard will be incorporated into the proposed regime.

Scope 3 emissions reporting relief

Given the anticipated complexity in calculating and estimating Scope 3 emissions, the Consultation Paper has proposed relief and temporary modifications to liability for Scope 3 emissions reporting.

These include:

- a temporary one-year exemption from reporting Scope 3 emissions, such that entities must report Scope 3 emissions from their second reporting year onwards;
- an option to disclose Scope 3 emissions in any one-year period that ended up to 12 months prior to the current reporting period, which is particularly important for financed emissions where superannuation funds may need to model or estimate a significant portion of the economy; and
- a three year moratorium on non-regulator actions for misleading and deceptive conduct concerning Scope 3 emissions.

Liability and enforcement

Breaches of climate-related disclosure requirements will be civil penalty provisions in the Corporations Act, however it is currently unclear how severe these penalties will be.

These requirements will also interact with the existing legal framework, and most importantly be captured by misleading and deceptive conduct provisions. Given ASIC's recent 'greenwashing' regulatory interventions, financial services entities should expect an increased regulatory focus on misleading or deceptive disclosures when the regime commences.

In addition, directors should be aware of the increased standard of care that will be expected of them. As directors are ultimately responsible for approving financial statements of an entity, they may be exposed to personal liability for any misleading climate-related disclosures. Directors must carefully monitor the production of climate-related reports to ensure they present a true and fair depiction of the entity.

Industry-based metrics

Aligning with the ISSB standards, the Consultation Paper outlines that by 2027-28 entities would be required to have regard to disclosing industry-based metrics. Whilst there are currently no industry-based metrics for the financial services industry in Australia, the ISSB Industry-based Guidance provides valuable insight on what to expect. The ISSB standards contain industry-based guidance for the Asset Management & Custody Activities industry, requiring entities to disclose their incorporation of environmental, social and governance (ESG) factors in investment management and advisory.

Assurance

The Consultation Paper also proposes assurance requirements to enhance the credibility of climate disclosures. In order to allow for the anticipated capability uplift needed to meet the growing demand for climate-related assurance services, the Consultation paper proposes the phasing and scaling of assurance requirements.

The assurance requirements follow the same timeline for each 'Group', being:

- from commencement under the regime (eg 1 July 2024 for Group 1 entities), limited assurance of Scope 1 and 2 emissions and reasonable assurance of governance disclosures is required;
- from the second reporting year (eg 1 July 2025 for Group 1 entities), reasonable assurance of Scope 1 and 2 emissions and limited assurance of Scope 3 emissions, scenario analysis and transition plans (specific qualitative assurance) is required;
- from the third reporting year (eg 1 July 2026 for Group 1 entities), reasonable assurance of Scope 1 and 2 emissions and other climate disclosures and limited assurance of Scope 3 emissions, scenario analysis and transition plans (full quantitative assurance) is required; and
- from the fourth reporting year (eg 1 July 2027 for Group 1 entities), reasonable assurance of all climate disclosures is required.

Noting the complexity in calculating Scope 3 emissions, the Consultation paper proposes that Scope 3 calculation methodologies would be subject to minimum assurance while capability continues to be developed.

The International Auditing and Assurance Standards Board (**IAASB**) is in the process of developing overarching standards for assurance on sustainability reporting, which would address both limited and reasonable assurance. The IAASB released an exposure draft in August 2023, and is aiming for final approval in late 2024. The Australian climate-related disclosures assurance standards will be aligned with the IAASB standards as far as possible.

What next?

As we await the impending release of the AASB standards, a threshold issue for financial services entities is to determine which 'Group' they will fall into under the proposed regime.

It is anticipated that many financial services entities will fall into either Group 1 or 2, which means that disclosure requirements (eg Scope 1 and 2 emissions reporting) are fast approaching. For Group 1 and 2 entities, this will be from 1 July 2024 and 1 July 2026 respectively. Scope 3 emissions reporting, on the other hand, will not be required until the following year.

As noted above, the overwhelming majority of emissions for financial services entities is expected to be Scope 3 'Financed Emissions'. Given the complexity of measuring these 'investment' emissions, and the time required to build Scope 3 reporting capability, entities should begin taking preliminary steps towards building capability to collect and report this data in order to comply with the obligations under the new regime.

If you would like to talk about available options and strategy in light of these developments please let us know.

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