Investor Group on Climate Change

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Consultation CP 380: Sustainability Reporting

The Investor Group on Climate Change (IGCC) welcomes the opportunity to comment on ASIC's proposals for regulatory guidance in relation to Australia's mandatory climate-related financial disclosures contained in CP 380 Sustainability Reporting.

As the *Corporations Act* extends the application of the ISSB international sustainability disclosure standards - adopted locally as AASB S2 - to institutional investors[1], there are several areas in the Standard that warrant investor-specific implementation guidance.[2]

IGCC's response to this consultation focuses on the proposed regulatory guidance as it applies to ASIC's expectations of *forward-looking information disclosed by institutional investors* such as climate-related risks and opportunities, targets, strategies and transition plans (Consultation questions C3Q1-2).

As ASIC recognises, climate-related financial disclosures 'tend to be more forward-looking in nature than other reporting requirements in the *Corporations Act*,'[3] and as such clarity for investors on ASIC's expectations in this area is particularly important. We note that the need for additional guidance is even more pressing as the modified liability provisions for future climate statements will only apply to reports prepared for financial years commencing in 2025.[4]

Specifically, IGCC recommends that **ASIC expressly acknowledge that forward-looking statements from institutional investors inherently involve a high degree of uncertainty; and provide guidance with illustrative examples of ASIC's expectations as to how investors should substantiate 'reasonable grounds' for such statements consistent with ASIC's 'pragmatic and proportionate approach' to enforcement.**

In developing this guidance and good practice examples, IGCC would also welcome the opportunity for our members to engage further with ASIC to ensure a common understanding of these expectations.

A well-planned, fair and fast transition to a net zero economy is in the interests of institutional investors as custodians of the retirement savings of everyday Australians. IGCC looks forward to supporting a meaningful climate disclosure regime that enables investors to work towards the best outcomes for their beneficiaries.

For more information on this submission, please contact [redacted] ([redacted]).

Yours sincerely,

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[1] RSEs, registered schemes and retail CCIVs.

[2] IGCC has outlined these in its submissions to Treasury (February 2024) and the AASB (March 2024).

[3] CP 380, para 28.

[4] We note the longer modified liability period for scenario analysis, transition plans and Scope 3 emissions which applies to financial years commencing up until 31 December 2027: RG 000.60.

IGCC Response to ASIC Consultation Paper 380: Sustainability Reporting

About the Investor Group on Climate Change (IGCC)

Th Investor Group on Climate Change is a collaboration of Australian and New Zealand institutional investors focused on the impact of climate change on investments. IGCC represents investors with total funds under management of over $5 trillion in Australia and New Zealand and $35 trillion around the world. IGCC's members are the custodians of the retirement savings of around 15 million Australians.

Response to consultation questions

C3Q1: Do you agree with our proposed guidance? While IGCC agrees that Appendix D of AASB S2 provides helpful guidance to support the preparation of statements containing forward-looking information, additional guidance for institutional investors is needed.

C3Q2: Should we issue more guidance about the facts or circumstances that are more likely to constitute reasonable grounds for forward-looking information in climate statements? Yes, additional guidance is necessary as AASB S2 extends the application of the international sustainability disclosures standards on which it is modelled (IFRS S1 and S2) to institutional investors. And, as outlined below, the business - and consequently climate disclosures - of institutional investors differs in fundamental ways to that of companies.

The distinct nature of investor climate-related disclosures

Institutional investors are different to companies in several fundamental ways. Additional guidance is needed to clarify ASIC's expectations as to how investors should demonstrate 'reasonable grounds' for their forward-looking statements given the relatively significant degree of uncertainty inherent in the business and therefore disclosures of institutional investors.

In referring to 'institutional investors' in this submission, IGCC refers to superannuation funds and their external asset managers, as reflected in the IGCC membership.

Investors are in the business of handling uncertainty

Institutional investors are in the business of managing risk to optimise returns for their clients and beneficiaries over relatively long time horizons. This involves making judgments about the future performance of existing and prospective investments, relying on inputs of varying reliability.

In other words, dealing with uncertainty is inherent to the role of institutional investors as custodians of the retirement savings of millions of Australians.

Investor disclosures relate to the underlying assets in their investment portfolio

Whilst investors have some direct greenhouse gas emissions, these are dwarfed by their indirect emissions. Investor climate disclosures are therefore primarily focussed on the climate-related financial risks and opportunities associated with the underlying assets in their investment portfolios. These portfolios may contain hundreds if not thousands of underlying assets, spanning multiple markets and sectors – often across the entire economy in the case of superannuation funds and other universal owners.

Investors must therefore by necessity rely to a large extent on external data providers to calculate various metrics related to their portfolio. Added to this, investment portfolios are not static, and the constituent investments will change over time.

As a result, institutional investors must deal with a wide range of variables when conducting scenario analysis, assessing potential future impacts of climate-related risks and opportunities on their portfolio, and setting targets. This situation can be contrasted with that of corporate reporters, who arguably have considerably greater visibility and control over the steps needed to manage the climate risks to their own business activities and assets.

Investors have different levers for managing risks and opportunities

The levers available to investors to manage the exposure of their investment portfolio to climate risks and opportunities also differ to the measures and strategies a company might employ.

For example, companies are generally able to exercise direct control over their operations, while an investor may only be able to use indirect means to influence change, without guaranteed outcomes. These means include stewardship practices to influence the behaviour of investees (as divestment is not always an option or the most effective risk management response) and to influence broader economic and policy settings.

As a result, an investor's climate strategy and transition plan are likely to be dependent on a greater range of external variables and involve more assumptions when compared to a company's transition plan.

In summary, these factors mean that investors' forward-looking disclosures involve an inherent and arguably higher degree of uncertainty than disclosures from corporate entities.

C3Q2(a): What should additional guidance cover? It would be helpful for ASIC to issue additional guidance to expressly acknowledge the inherent uncertainty in investor disclosures and to clarify ASIC's expectations of how investors should establish reasonable grounds in the circumstances outlined below.

Establishing 'reasonable grounds' for investor forward-looking statements

ASIC's draft regulatory guidance states that any forward-looking information must be based on 'reasonable grounds' and refers to the application guidance in Appendix D of AASB S2 which requires reporting entities to describe, among other matters, the underlying assumptions, methods of producing forward-looking information, and the inputs for any estimates or approximations.[5] Reporting entities must also maintain adequate sustainability records that explain the methods, assumptions and evidence for all forward-looking information in the climate statement.[6]

It would be helpful for ASIC to provide illustrative examples applying the principles in Appendix D to assist institutional investors in understanding the level of detail ASIC expects in their disclosure of assumptions and inputs to substantiate 'reasonable grounds' for forward-looking statements – taking into consideration the high degree of uncertainty inherent in investor disclosures, investors' reliance on third party data for certain disclosures, and ASIC's 'pragmatic and proportionate' approach.[7]

Disclosing climate-related risks and opportunities

In addition to Appendix D, AASB S2 also specifically requires reporting entities to disclose the inputs and key assumptions in their scenario analysis and whether and how that analysis has informed their identification of climate-related risks.[8]

Climate science and actuarial experts have highlighted the need for financial institutions to account for low-probability, high-risk climate-related risks (tail risks).[9]

It would therefore be helpful for ASIC's regulatory guidance to clarify that there may be reasonable grounds for including low probability but high impact tail risks in disclosures and to provide additional guidance as to what is expected to demonstrate this, noting the broader guidance and legislative requirements such as:

[5] Draft RG 000.75-000.76.
[6] Draft RG 000.77.
[7] https://asic.gov.au/regulatory-resources/sustainability-reporting/asic-s-administration-of-the-sustainability-reporting-regime.
[8] AASB S2, paras 22 and 25(a)(ii).
[9] Institute and Faculty of Actuaries and University of Exeter (2024) *Climate Scorpion: The Sting is in the Tail*.

- AASB S2 which requires entities to consider whether information about low-probability and high-impact risks might be material either individually or in combination with other risks.[10]
- The *Corporations Act* which requires reporting entities to use at least one high (2.5+˚C) and one low (1.5˚C) global warming scenario when conducting scenario analysis to take into consideration the potential impacts of both transition and physical climate-related risks.[11]

Disclosing targets and other aspirational statements

Outside of mandatory climate disclosures, IGCC notes that ASIC has previously dealt with climate targets in its greenwashing guidance for institutional investors.[12] In that document, ASIC sets out the need to explain key details of the target, how progress will be measured, and any assumptions relied on when setting the target or measuring progress.

AASB S2 elaborates on what information about targets must be disclosed and specifically requires disclosure of how the entity plans to achieve its targets.[13] In relation to transition plans, reporting entities must disclose information about key assumptions used and dependencies on which the transition plan relies.[14]

In CP380 ASIC highlights additional guidance in AASB S2 on climate-related targets and plans:

> *'Some climate-related financial information, for example, targets or plans – is aspirational. A neutral discussion of such matters covers both aspirations and the factors that could prevent an entity from achieving these aspirations.*
>
> *Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgements under conditions of uncertainty. The exercise of prudence means that opportunities are not overstated and risks are not understated. Equally, the exercise of prudence does not allow for the understatement of opportunities or the overstatement of risks.* '[15]

It would be helpful for ASIC to clarify how institutional investors should apply the various guidance documents when establishing reasonable grounds for aspirational targets and transition plans.

Aspirational statements in the context of an investor's fiduciary duty

There is an additional dimension to the question of 'reasonable grounds' in the context of aspirational statements that it would be helpful for this guidance to address: the fiduciary duty of investors to act in the best financial interests of their beneficiaries.

Recent research from the Network for Greening the Financial System (NGFS) suggests that under current business-as-usual policies Australia could see GDP cut by roughly one seventh due to the broad effects of climate change, from costs associated with extreme weather and second order effects on labour, capital, land and natural productivity.[16]

The severity of economic impacts in a higher temperature world - and consequent damage to beneficiaries' retirement savings - have also been shown to outweigh the anticipated costs of transitioning to a low carbon economy.[17]

There is, as such, an open question as to how 'reasonable' it would be for an investor to base their forward-looking strategy, targets and plans on current policies/business-as-usual scenarios,

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[10] AASB S2, para B23.

[11] Supplementary Explanatory Memorandum, Parliamentary amendments to Schedules 2 and 5 – Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 at 2.4-2.19.

[12] INFO 271, *How to avoid greenwashing when offering or promoting sustainability-related products.*

[13] AASB S2, paras14(a)(v), and 33-37.

[14] AASB S2, paras14(a)(iv). Transition plans are defined as "An aspect of an entity's overall strategy that lays out the entity's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions."

[15] AASB S2, paras D13 and D14.

[16] See recent NGFS analysis as summarised by IGCC: https://igcc.org.au/6-8-trillion-gdp-hit-if-renewable-energy-transition-is-delayed.

[17] See also analysis by the Thinking Ahead Institute (2022) that finds that current likely temperature rise scenarios will result in significantly worse financial outcomes for investments than scenarios for a transition to a well below 2˚C world: https://www.thinkingaheadinstitute.org/research-papers/pay-now-or-pay-later

considering their duty to pursue the best financial interests of their members. ASIC may wish to provide a specific clarification that the 'reasonable grounds' requirement does not limit or require entities to align with current business-as-usual climate scenarios.

Recommended additional guidance

In summary, IGCC recommends that ASIC regulatory guidance:

- Acknowledge that institutional investors are dealing with a relatively high degree of uncertainty which flows through to their climate-related disclosures – and this is further heightened in the case of forward-looking information.
- Indicate that ASIC will take this into account when exercising a 'pragmatic and proportionate' approach to surveillance and enforcement.
- Provide illustrative examples applying the principles in Appendix D to assist institutional investors understand the level of detail expected by ASIC for disclosures on assumptions and inputs to substantiate 'reasonable grounds' for their forward-looking statements.
- Clarify expectations in relation to demonstrating reasonable grounds for including low probability high impact climate-related risks ('tail risks') in disclosures.
- Clarify that the 'reasonable grounds' requirement does not limit entities to aligning aspirational statements such as targets, strategies and transition plans with current business-as-usual scenarios only.

In developing this guidance, IGCC encourages ASIC to engage with institutional investors to develop a common and practical understanding of these principles and ASIC's expectations through examples of good practice forward-looking statements.

C3Q2(b): Effect on international alignment and comparability. As IFRS S1 and S2 were primarily developed for listed issuers of capital and not institutional investors, there is no risk of non-alignment or impact on international comparability from additional guidance addressing forward-looking disclosures from institutional investors.