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Consultation Paper 380: Sustainability Reporting

The Australian Financial Markets Association (AFMA) is the leading financial markets industry association promoting efficiency, integrity and professionalism in Australia's financial markets, including the capital, credit, derivatives, foreign exchange, energy, and other specialist markets. Our membership base is comprised of over 130 of Australia's leading financial market participants, from Australian and international banks, leading brokers, securities companies, and government treasury corporations to asset managers, energy companies, and industry service providers. The majority of AFMA members are in-scope entities.

1. Operating environment and approach to enforcement

AFMA is broadly supportive of ASIC's pragmatic proposed regulatory guide and enforcement approach. As ASIC is aware, this is an unprecedented large-scale reporting obligation for both regulated entities and regulators alike, with industry facing significant challenges, including data gaps, assurance shortfalls, and adequately experienced resourcing. AFMA's main ask of ASIC is therefore to ensure that the regulatory guide is flexible and can be easily adaptable/updatable, when required, as we navigate this new challenge and evolve in terms of reporting capabilities.

With this in mind, AFMA believes that striving for a collaborative approach with industry will be essential in the initial implementation years. With significant material challenges present and the nascent state of the reporting regime, AFMA encourages ASIC to discharge its enforcement of industry with a best endeavors approach.

AFMA believes it may be beneficial to establish a sustainability reporting working group with industry bodies to discuss and address enforcement and reporting challenges. AFMA would be glad to be part of such a group and would encourage ASIC to establish such a forum.

2. Treatment of financial products and instruments

At its premise, the principal intent of sustainability reporting is to identify and report on the financing of assets that create emissions and how this plays into an organisations' broader sustainability and transition plans. AFMA supports this intent.

Members have not raised much in the way of technical issues with the Guide, but the treatment of certain financial products and instruments is one where we think more thinking needs to be done to produce a workable outcome.

2.1. Repos and Reverse Repos

There are a number of financial products and instruments in which the trading of does not clearly fall in with the logic of sustainability reporting, in particular repos and reverse repos.

AASB S2 does not explicitly require the disclosure of Repurchase Agreements (repos) and Reverse Repos and we believe there are grounds on which reporting on Repos and Reverse Repos should be included but also considered for exclusion:

A decision to include or to allow exclusion of repos and reverse repos should be based on a thorough assessment of their relevance to climate risks and impacts, in line with principles of materiality and transparency. The ISSB standards emphasise the principle of materiality. If repo trades are not material in terms of their impact on an entity's climate-related risks or opportunities, they may not need to be specifically disclosed.

- **Inclusion**: If repos and reverse repos have characteristics of financing underlying environmentally impacting economic activity that produce greenhouse gas and are not short dated trades, then it is likely they should be included in reporting.
    - On this basis a repo / reverse repo ***counterparty*** that is determined to be an economic actor directly or significantly indirectly impacting the environment would likely require disclosure of the trade.
    - The underlying ***collateral*** should also be considered. Even if the counterparty is not determined to be engaged in economic activity that produces greenhouse gas, if the issuer of the collateral security is engaged in activity that produces greenhouse gas, then the trade would likely be included in climate related reporting, particularly if the collateral forms part of a strategy by the counterparty to manage climate/ environment related risk.

  An example of a counterparty where reporting would be required would be a corporation which has material activity in resources extraction or processing or an airline, or where the collateral being repo'd is a bond issued by a similar type of corporation.

- **Exclusion**:
    - If the ***counterparty*** is not engaged in activity that produces greenhouse gas and the ***collateral*** is also not from an issuer with activity that produces greenhouse gas, then the trade should likely be excluded. The exclusion and a brief rationale could nevertheless be disclosed as a note. Such an exclusion would not diminish transparency with respect to climate related footprint.
    - ***Short Term Financial Instruments in Nature*:** As financial instruments, repos are typically not associated with physical assets or operations that have direct environmental footprints. They are more about liquidity management and the transfer of cash and securities, rather than activities with environmental consequences. Repos are often very short-term transactions, sometimes overnight or up to 1 week, with a limited number of transactions out to 1 month and a very small number of transactions out to 3 months. Their temporary nature makes them less relevant in the context of long-term climate risk assessments.

There is a separate related matter to consider on which guidance would be useful:

- If a repo is determined as needing to be reported, is the reporting based on the counterparty's Scope 1 and Scope 3 footprint or that of the collateral issuer. It can be considered that a repo

which is cash collaterised, with a very small haircut which is daily marked to market with cash margining settled by T+1, has negligible risk on the counterparty.
- If the repo counterparty were to default during or at the end of the repo, the cash collateral can be used to acquire replacement securities. In that context, the risk in the repo is the underlying repo'd security.
- If the security underlying the repo were an Australian Government Bond then the reporting would be about the liability side of the Government's Treasury balance sheet, where it would be illogical and a regulatory inefficiency to require a reporting entity to inform the Government about its own carbon footprint which it already knows in more accurate and granular detail than a report using an estimation methodology would achieve and incur an expense.
- If the repo underlying security were issued by an Australian State, an Australian Semi-Government or an Australian domestic registered bank, then these issuers will already be required to report their Scope 1, Scope 2 and in due course Scope 3 emissions, and consequently reporting of the repo will be duplicative.

Given these observations on repo and revese repos, AFMA seeks indication from ASIC as to whether they are required to be included in a sustainability report.

2.2. Syndicated Loan Markets

As a result of the incoming AASB S2 provisions, AFMA would appreciate if ASIC could provide guidance to assist the syndicated loan market. Clarity is important, as this will help in informing corporate/SME borrower clients of banks below the syndicated loan market, as climate reporting is phased in across the various cohorts.

From the perspective of the Australian participants in the syndicated loan markets that utilise standard documentation, particularly the Asia Pacific Loan Market Association (APLMA) documentation, the entities will be required to report as part of the first cohort under the mandatory climate related financial reporting in line with AASB S2. Therefore, AFMA believes it would be beneficial to incorporate (or be referenced for end borrowers) within standard APLMA documents, the information they will be required to provide from the banks and lenders. Consequentially, one would expect that banks and lenders would seek to obtain the relevant data from other borrowers in due course. Smaller end borrowers (i.e., SMEs) are the least prepared for the reporting and early signalling from lenders through standardised loan documents with harmonised requirements in line with the ASIC guidance, would be beneficial for the wholesale lending market as a whole.

3. Areas requiring further clarification

3.1. OFR requirements

With relation to the sustainability-related financial information in the operating and financial review (OFR requirements), AFMA seeks further clarification from ASIC. In its current state, it is AFMA's view that it is unclear how a reporting entity is to weigh up the significance of climate-related strategies, climate-related financial risks and opportunities within the broader context of their corporate strategy and prospects. Further guidance on these requirements would be valued.

3.2. Reporting entities

One section is titled 'asset owners,' while it effectively covers asset managers too. AFMA would appreciate clarification as to the intended in-scope reporting entities.

Members also raised some confusion as to the reporting period for Group 1, which appears six months longer than the other.

3.3. AASB S2

The ISSB recommends use of the SASB standards when AASB recommended standards that are particularly Australian-specific and as we understand it, barely used. AFMA sees an important role for ASIC in clarifying this issue.

3.4. Scenario analysis

While AFMA appreciates that the 1.5-degree scenario was legislated, for sake of future-proofing the guide, AFMA questions the relevance of this. As ASIC may be aware, there is the potential that this threshold will shortly be passed. AFMA would encourage ASIC to work with their counterparts on assessing if this threshold is still the most appropriate.

4. Exemption applications

AFMA acknowledges the swift action taken by ASIC to open exemption applications. AFMA would appreciate if ASIC could please confirm that exemption applications are open to local subsidiaries of foreign banks who have equivalent sustainability reporting obligations at a global or Head Office level, and the criteria ASIC will apply in determining equivalence. Given a scenario of global parent entity equivalency and alignment with ASIC's policy intent, and when considering the likelihood of any reliance being placed on the subsidiaries sustainability disclosures by end users, these circumstances would look to satisfy the conditions for sustainability reporting relief. AFMA considers an exemption of this kind not only would further the policy intent of the sustainability reporting framework as articulated in paragraphs 4.10 – 4.11 of the Explanatory Memorandum to the *Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024* (Cth) which, in particular, emphasises the importance international alignment for sustainability reporting frameworks with the goal of 'minimising compliance costs for companies and maximising comparability for users', but also is contemplated in paragraph 4.57 which discusses that an exemption application may be warranted if 'there are appropriate grounds to prepare a consolidated sustainability report' and consolidated reporting is not otherwise available.

On this basis, we understand that there could be potential to explore the prospect of a class exemption. AFMA has discussed this prospect with members and on the basis of a degree of commonality being discerned in the applications, AFMA stands ready to facilitate a class exemption on a collective basis.

5. Additional comments

AFMA appreciates that this consultation had to be held in a timely manner and that ASIC had to work on a shortened timeframe. With many technical and operational issues to work through and the short timeframe for consultation, AFMA will look to provide further additional comments to ASIC, as and when they are identified or come to the surface.

AFMA would welcome the opportunity to discuss this submission further and would be pleased to provide further information and organise a member forum to discuss as required. Please contact [redacted] via [redacted] or [redacted].

Yours sincerely,

Monica Young

Policy Manager