MANDATORY CLIMATE-RELATED FINANCIAL DISCLOSURE IS COMING FOR AUSTRALIA

The Treasury released its consultation paper on climate-related financial disclosure on 27 June 2023 foreshadowing the standardisation of climate disclosures by large businesses and financial institutions in Australia. They are expected to be closely aligned with the new sustainability disclosures standards published by the International Sustainability Standards Board (**ISSB**).

WHAT IS BEING PROPOSED

The consultation paper follows extensive engagement by the Treasury between 12 December 2022 and 17 February 2023 with a wide range of stakeholders on the design and implementation of standardised, internationally-aligned requirements for disclosure of climate-related financial risks and opportunities in Australia.

The proposals contained in the consultation paper reflect the outcome of such engagement, including the need for greater transparency and accountability when it comes to climate-related plans, financial risks and opportunities and the need for standards to be developed quickly.

The proposals are being progressed by legislation that is currently before the Senate (being the Treasury Laws Amendment (2023 Measures No. 1) Bill 2023) pursuant to which, amongst other things, the Australian Accounting Standards Board (**AASB**) will be tasked with preparing Australian climate-related disclosure standards. These are to be closely aligned with the new sustainability disclosures standards published by ISSB on 26 June 2023, the details of which are addressed in a separate, dedicated Clifford Chance briefing. The proposal is expected to be implemented by future legislation that will amend the Corporations Act 2001 (Cth) to introduce the mandatory reporting requirements.

WHO WILL BE IMPACTED

Conditions to trigger mandatory reporting

It is proposed that all large businesses and financial institutions who meet the necessary conditions will be subject to the mandatory climate disclosures – being applicable if either:

- the entity is required to lodge financial reports under Chapter 2M of the Corporations Act 2001 (Cth) **and** meet the necessary size thresholds (revenue, gross assets and employees – see below); or

Key issues

- Mandatory climate-related financial disclosure is being proposed for large businesses and financial institutions in Australia from 2024
- These mandatory requirements are expected to cover a broad range of topics including:
  - governance;
  - strategy;
  - transition planning; and
  - metrics and targets.
- It is proposed that these mandatory requirements would be drafted as civil penalty provisions and there would be a limited 3 year 'safe harbour' for misleading and deceptive conduct provisions to scope 3 emissions and forward-looking statements.
- The proposed Australian mandatory climate-related financial disclosure regime is expected to be broadly aligned with international practice (including ISSB and TCFD).
- However, there are a number of key differences including on the assessment of materiality (e.g. CSRD in Europe with the mandating of 'double materiality').

- the entity is registered as a "controlling corporation" reporting under the National Greenhouse and Energy Reporting Act 2007 (Cth) and, where relevant, exceeds the Clean Energy Regulator's 'publication threshold' (see below).

Requirement to lodge financial reports

Under Chapter 2M of the Corporations Act 2001 (Cth) all companies, registered schemes, registrable superannuation entities and disclosing entities must keep financial records (see sections 286-291) and some must prepare and lodge financial reports (see sections 292-323D).

National greenhouse and energy reporting

A "controlling corporation" for the purposes of the National Greenhouse and Energy Reporting Act 2007 (Cth) is a constitutional corporation that does not have a holding company incorporated in Australia. It is generally the corporation at the top of the corporate chain in Australia (i.e. it can be a non-operational holding company and it may also be a foreign incorporated entity that operates directly in Australia rather than through an Australian incorporated subsidiary).

A controlling corporation must apply for registration under the Act if it meets one or more of the thresholds under that Act for the relevant financial year.

There are two types of thresholds that a controlling corporation must consider in this regard: (i) the facility thresholds (i.e. emissions of greenhouse gases with a CO2-e of 25kt or more, production of 100TJ or more of energy or consumption of 100TJ or more of energy); and (ii) the corporate group thresholds (i.e. emissions of greenhouse gases with a CO2-e of 50kt or more, production of 200TJ or more of energy or consumption of 200TJ or more of energy). The Clean Energy Regulator will only publish data about registered corporations above certain thresholds – which is referred to as the 'publication threshold'. For a controlling corporation, it means that data is published if that entity (together with its subsidiaries) has combined scope 1 and 2 greenhouse gas emissions equal to or greater than 50kt CO2-e.

WHEN WILL THIS APPLY

Phased approach

It is proposed that there will be a three-phased approach to the implementation of these mandatory climate disclosures, with a gradual scale up during an initial transitional period:

- transitional period (reporting years 2024-25 to 2026-27); and
- end state (reporting year 2027-28 onwards).

This is intended to give entities and their investors time to understand and assess how they will manage, plan for and adopt these mandatory climate disclosures within their respective organisations and develop the necessary internal capabilities to meet these requirements.

Group 1 (reporting year 2024-25)

An entity will fall within Group 1 if it either:

- is required to lodge financial reports under Chapter 2M of the Corporations Act 2001 (Cth) **and** meets any two of the following three criteria:
  - consolidated revenue for the financial year of the entity (and any entity it controls) is AUD 500 million or more;

  - value of the consolidated gross assets at the end of the financial year of the entity (and any entity it controls) is AUD 1 billion or more; and/or
  - entity (and any entity it controls) has 500 or more employees at the end of the financial year; or
- is registered as a "controlling corporation" reporting under the National Greenhouse and Energy Reporting Act 2007 (Cth) and exceeds the Clean Energy Regulator's publication threshold.

Group 2 (reporting year 2026-27)

An entity will fall within Group 2 if it either:

- is required to lodge financial reports under Chapter 2M of the Corporations Act 2001 (Cth) **and** meets any two of the following three criteria:
  - consolidated revenue for the financial year of the entity (and any entity it controls) is AUD 200 million or more;
  - value of the consolidated gross assets at the end of the financial year of the entity (and any entity it controls) is AUD 500 million or more; and/or
  - entity (and any entity it controls) has 250 or more employees at the end of the financial year; or
- is registered as a "controlling corporation" reporting under the National Greenhouse and Energy Reporting Act 2007 (Cth) and exceeds the Clean Energy Regulator's publication threshold.

Group 3 (reporting year 2027-28 onwards)

An entity will fall within Group 3 if it either:

- is required to lodge financial reports under Chapter 2M of the Corporations Act 2001 (Cth) **and** meets any two of the following three criteria:
  - consolidated revenue for the financial year of the entity (and any entity it controls) is AUD 50 million or more;
  - value of the consolidated gross assets at the end of the financial year of the entity (and any entity it controls) is AUD 25 million or more; and/or
  - entity (and any entity it controls) has 100 or more employees at the end of the financial year; or
- is registered as a "controlling corporation" reporting under the National Greenhouse and Energy Reporting Act 2007 (Cth).

WHAT NEEDS TO BE REPORTED

The proposals in the consultation paper as to the content of mandatory disclosures cover a broad range of topics.

Governance

Reporting entities would be required to disclose information about governance processes, controls and procedures used to monitor and manage climate-related financial risks and opportunities. As indicated by the ISSB, it is expected that disclosures would include information about how the entity's governance bodies are involved in overseeing and monitoring climate-related risks and opportunities, including how these roles are incorporated into policy and procedures and whether (and how) climate-related performance metrics are factored into executive remuneration or management incentive plans.

Strategy

Reporting entities would be required to (amongst other things):

- use qualitative scenario analysis to inform their disclosures, moving to quantitative scenario analysis by 'end state' (i.e. reporting year 2027-28 onwards);
- disclose climate resilience assessments against at least two possible futures stages, one of which must be consistent with the global temperature goal as set out in the Climate Change Act 2022 (Cth) which is to contribute to '*holding the increase in the global average temperature to well below 2 degrees Celsius above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 degrees Celsius above pre-industrial levels*';
- disclose their transition plans (including information about offsets, target setting and mitigation strategies) and information about any climate-related targets (if they have them) and progress towards those targets;
- disclose information about material climate-related risks and opportunities to their business as well as how the entity identifies, assesses and manages these risks and opportunities;
- disclose their scope 1 and 2 emissions and disclose their material scope 3 emissions from their second reporting year onwards incorporating material emissions both upstream and downstream in line with a recognised emissions accounting framework (e.g. GHG protocol) and drawing on Australia-specific emissions factors where relevant (e.g. National Greenhouse Accounts Factors); and
- disclose industry-based metrics (where there are well established and understood metrics available) by 'end state' (i.e. reporting year 2027-28 onwards).

WHAT HAPPENS IF YOU DON'T COMPLY

General

It will be important for reporting entities, their investors and the directors who sit on the boards of those entities to understand the consequences of non-compliance with these proposed mandatory climate-related financial disclosures. Regulatory investigations and/or civil liability relating to these disclosures could arise in circumstances involving continuous disclosure, fundraising or M&A.

Modified liability approach

It is proposed that the climate-related financial disclosure requirements would be drafted as civil penalty provisions in the Corporations Act 2001 (Cth), attracting the protection of sections 1317S and 1318 of the Act for entities and company officers who have acted honestly and (having regard to all of the circumstances of the case) ought fairly to be excused for a contravention of the provisions.

In addition, elements of mandatory disclosure including scope 3 reporting, scenario analysis and transition planning would be afforded time-limited protection (i.e. 3 years from commencement of the regime) from misleading or deceptive conduct, false or misleading representations and similar claims brought by private litigants (not regulators). Beyond this period, it is anticipated that the requirement to rely on reasonable grounds when making forward-looking statements and reporting on scope 3 emissions is 'not too high' a threshold, but it remains to be seen how this will be implemented.

Recently released ACCC guideline

The ACCC recently released a draft greenwashing guideline aimed at addressing the concerning conduct that the ACCC identified in its recent greenwashing internet sweep, which found that 57% of Australian businesses reviewed were making potentially misleading environmental claims warranting further scrutiny. These draft guidelines are likely to be a catalyst for increased regulatory focus and enforcement activity in this space in 2023 and beyond.

GLOBAL COMPARISONS

EU Corporate Sustainability Reporting Directive

The European Union's Non-Financial Reporting Directive (**NFRD**) has applied climate-related financial disclosure rules to over 11,000 companies since 2020, and with the introduction of the EU Corporate Sustainability Reporting Directive (**CSRD**), such rules are expected to apply to an estimated 40,000 companies. As an EU directive, the CSRD must be incorporated by each EU Member State into national laws by 6 July 2024.

Notably, the thresholds for Group 1 entities under the CSRD are more akin to those applicable to the Group 2 entities under the proposed mandatory climate-related financial disclosure requirements in Australia, which may encourage accelerated reporting by certain Group 2 entities where they are otherwise expected to report in the EU.

The CSRD applies in the first instance to large EU public interest entities with regulated market listed securities, credit institutions and insurance companies. However, more specifically, these large public interest entities include entities which fulfil any two of the three criteria below:

- a balance sheet total exceeding EUR 20 million;
- a net turnover exceeding EUR 40 million; or
- an average of more than 250 employees during the financial year.

Reporting requirements under EU rules are intended to commence in a phased manner, similar to the Australian disclosure regime, as follows:

- from 1 January 2025 for those companies already in scope of the NFRD;
- from 1 January 2026 for large public interest companies, not presently in scope for the NFRD; and
- from 1 January 2027 for certain SMEs and small and non-complex credit institutions.

The CSRD's scope also extends to certain international companies who operate within the EU. On 1 January 2029, those 'in scope' international organisations will be required to publish global group reports under EU disclosure rules, including in respect of parent companies based outside of the EU. The rules will apply to international companies operating in the EU who are either a subsidiary or a branch of a non-EU company, as well as non-EU companies operating in the EU who are banking institutions or insurance companies with more than 500 employees and an annual balance sheet above EUR 20 million or a net turnover above EUR 40 million.

Transition Planning Taskforce (UK) and Climate Disclosure Rule (US)

Governance of climate and environmental related considerations varies between the US, EU, UK and Australia. The EU in many cases already requires governance across the value chain of a business, and in the US, a comprehensive climate disclosure rule is anticipated in the latter part of 2023.

In the UK, the Transition Planning Taskforce (**TPT**), building on the work of the Taskforce for Climate-related Financial Disclosures (**TCFD**), is pushing to mandate transition plans for certain significant organisations. Given that scope 3 emissions form part of the TPT's recommendations, it may be expected that for those businesses operating across these jurisdictions, the due diligence into climate change and associated decision-making processes will be at a higher standard than may be required under the proposed Australian regime. For those organisations with memberships in initiatives such as the Net-Zero Asset Managers Initiative and/or who are signatories of the UN Principles for Responsible Investing, there are already principles-based governance requirements that are guiding internal policies and decision-making. These are generally aligned with the proposed Australian requirements and will be supported by compliance with the Climate-Related Disclosure Standards once in effect.

In the US, greenhouse gas disclosures are currently subject to a patchwork of requirements from federal and state environmental regulators. The federal Securities and Exchange Commission (**SEC**) is finalising a climate disclosure rule for securities issuers, anticipated in late 2023. The ultimate scope of the rule and its alignment with approaches of other global jurisdictions are still unknown and, once announced, likely will be contested through litigation.

Materiality

The assessment of materiality in Australia with respect to climate-related financial disclosures is expected to follow the approach promoted by the TCFD. Many major markets, including Singapore, Hong Kong, London and Germany, are mandating that listed companies report in alignment with the TCFD.

However, the EU through the CSRD has mandated "double materiality" assessments. Unlike the TCFD, this requires in addition to risks and opportunities to the financial sustainability of the business, an assessment of those risks to the financial sustainability of the business from the environment (and society) ("financial materiality") and an assessment of the impacts from the business on the environment (and society) ("impact materiality").

In contrast, the ISSB (particularly IFRS S2, upon which the Australian regime is expected to be based) only encourages assessment of financial materiality. Companies operating internationally may therefore require materiality assessments be conducted through the double materiality lens to ensure consistency of reporting.

WHAT NEXT

Please contact us for further information about whether your business is likely to be caught by these new mandatory climate-related financial disclosure requirements and we can also compare and contrast against other global requirements to which you may be subject.

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