

17 February 2023

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Dear Sir/Madam,

Treasury Consultation – *Climate-related financial disclosure*
Submission by Australian Finance Group Ltd ABN 11 066 385 822

About AFG

Australian Finance Group Ltd (AFG) was founded in 1994, was listed on the Australian Securities Exchange in 2015, and has grown to become one of Australia's largest mortgage broking aggregators. Approximately 3,700 finance brokers arrange residential mortgages, personal and asset finance loans, commercial finance, and other loan products through AFG's technology platform and relationships with lenders. AFG also distributes its own branded home loan products, funded through an established RMBS programme and white label arrangements.

AFG welcomes the opportunity to respond to the Consultation Paper *Climate-related financial disclosure* issued by the Treasury on 12 December 2022.

Consultation questions:

Question 1: What are the costs and benefits of Australia aligning with international practice on climate-related financial risk disclosure (including mandatory reporting for certain entities)? In particular:

1.1 What are the costs and benefits of meeting existing climate reporting expectations?

1.2 What are the costs and benefits of Australia not aligning with international practice and in particular global baseline standards for climate reporting?

Aligning with international standards would ensure Australia's climate reporting regime is considered credibly on the international stage. This would help attract further international investment by giving international markets confidence in Australian reporting and its approach to addressing climate change. However, reporting to those standards will require substantial time and resources, which has a disproportionate effect on smaller entities using their existing resource base. There is also a lot of uncertainty and lack of clarity, for example the measurement of, and accounting for, Scope 3 emissions.

AFG therefore supports the phased approach to disclosure requirements, initially targeting larger entities, which are better resourced to respond.

Question 2: Should Australia adopt a phased approach to climate disclosure, with the first report for initially covered entities being financial year 2024-25?

2.1 What considerations should apply to determining the cohorts covered in subsequent phases of mandatory disclosure, and the timing of future phases?

AFG supports a phased approach to climate disclosure.

Consideration needs to be given to whether the necessary skills, data and processes within organisations currently exist to enable them to report. Additionally, as the ISSB standards have not yet been finalised, it is very difficult to know what those requirements are.

First reporters should be big emitters and large entities, for example ASX100 companies and unlisted entities with NPAT of greater than \$250 million. These bigger companies would have the resources to deliver on required reporting and test the robustness of the model prior to it being implemented for smaller entities.

Revenue, the sector, and the level of emissions output should determine future cohorts. The requirements should be phased in according to these factors.

In the financial services sector, smaller entities, such as mortgage broking groups that fall within the scope of a large proprietary company and are required to lodge financial statements with ASIC under the *Corporations Act 2001* (Cth), will have very little current capacity to report on climate disclosure.

AFG submits that these smaller non-ASX listed companies will require additional time to prepare their businesses to enable effective reporting given they would not currently have the internal resources and sufficient time would be needed to build up the capacity internally.

Question 3: To which entities should mandatory climate disclosures apply initially?

3.1 What size thresholds would be appropriate to determine a large, listed entity and a large financial institution, respectively?

3.2 Are there any other types of entities (that is, apart from large, listed entities and financial institutions) that should be included in the initial phase?

All climate reporting should be voluntary until clear international guidelines are established, and measures are proven. It is important to introduce mandatory climate reporting, but not until there is clear guidance so it can be effective and achievable.

First reporters should be ASX 100 companies or unlisted companies with a NPAT of greater than \$250 million.

AFG does not consider there are any other relevant entities that should be included in the initial phase.

Question 4: Should Australia seek to align our climate reporting requirements with the global baseline envisaged by the International Sustainability Boards?

4.1 Are there particular considerations that should apply in the Australian context regarding the ISSB implementation of disclosures relating to: governance, strategy, risk management and/or metrics and targets?

4.2 Are the climate disclosure standards being issued by the ISSB the most appropriate for entities in Australia, or should alternative standards be considered?

AFG considers that if Australian entities are to adopt a standard, they should be consistent with global standards. The climate disclosure standards being issued by the ISSB are therefore likely the most appropriate for entities in Australia, however as they have not yet been finalised it is difficult to comment definitively.

While there is no reason these requirements shouldn't apply to an Australian company, it will take a considerable amount of expertise and therefore will introduce significant additional costs and resourcing requirements to report to the new standards. Therefore, the need for a phased approach and significant transition period will be required.

In addition, reporting on climate risks and opportunities involves disclosure on a substantial amount of forward-looking information. Reporting entities and officers in Australia are exposed to risks associated with disclosure of forward-looking information. Regulatory relief must align with those requirements.

Question 5: What are the key considerations that should inform the design of a new regulatory framework, in particular when setting overarching climate disclosure obligations (strategy, governance, risk management and targets)?

A new framework should be designed to ensure disclosure obligations are consistent for all participants, albeit its introduction phased in according to the entity's size.

Good guidance on expectations must be provided, particularly in relation to the challenge of measuring Scope 3 emissions – a task that currently has many grey areas and presents the risk of double counting. A definition of the 'value chain' concept should be limited to activities, resources, and relationships over which the reporting entity has control.

Obligations must also be realistic and achievable.

Question 6: Where should new climate reporting requirements be situated in relation to other periodic reporting requirements? For instance, should they continue to be included in an operating and financial review, or in an alternative separate report included as part of the annual report?

AFG considers that climate reporting should be part of the Operating and Financial Review (OFR) and audited as part of the Annual Report. If climate reporting is outside of the Annual Report, there is likely to be divergence in the quality of the reporting.

However as noted above, Australian entities must be given time to prepare and adjust their internal reporting resources and skills to ensure that they can report in line with the required standards.

Question 7: What considerations should apply to materiality judgements when undertaking climate reporting, and what should be the reference point for materiality (for instance, should it align with ISSB guidance on materiality and is enterprise value a useful consideration)?

AFG submits that materiality judgements should align with AASB guidance.

Question 8: What level of assurance should be required for climate disclosures, who should provide assurance (for instance, auditor of the financial report or other expert), and should assurance providers be subject to independence and quality management standards?

If a climate reporting standard is introduced, climate reporting should be audited alongside the financial accounts, either by the auditor of the OFR or another recognised and credible expert.

However, given increased reporting requirements will be at a significant cost impost to business, it will have a disproportionate effect on smaller entities.

An additional consideration is whether there is sufficient expertise available within Australia to provide such assurance frameworks given the number of entities that this new climate reporting standard will affect. Therefore, we reiterate our submission above that any climate reporting requirements should be phased in, based on the entity's size.

Question 9: What considerations should apply to requirements to report emissions (Scope 1, 2 and 3) including use of any relevant Australian emissions reporting frameworks?

The obligations under the current Australian emissions reporting framework, the *National Greenhouse and Energy Reporting Act 2007* (Cth) (with a threshold for registration of 25,000t Co2e for facilities or 50,000t of Co2e for corporate groups) would be too onerous for smaller entities with lower emissions to comply with.

Nonetheless, there would need to be a clear baseline of metrics for smaller entities with lower emissions.

In the case of Scope 3 emissions, clear guidance is required to ensure consistency and determine where the responsibility of certain emissions fit. This would ensure all emissions are considered and there is no double counting.

Question 10: Should a common baseline of metrics be defined so that there is a degree of consistency between disclosures, including industry-specific metrics?

AFG considers that a common baseline is important to ensure consistency. There also needs to be industry specific consideration.

In the case of the credit industry, there are a number of different entities that can be involved. AFG submits that responsibility for reporting Scope 3 emissions should apply to the entity with the loan on their lending book (credit providers), rather than those that provide intermediary services, such as mortgage brokers or mortgage intermediaries (credit assistance providers).

However, measurement of Scope 3 emissions presents its own challenges. As one example, there is a lack of knowledge or data about the energy efficiency of the homes that customers seeking home loans are buying, given there is no mandatory reporting of energy ratings on properties.

Without knowing the energy ratings of the homes being financed, it is difficult to calculate and measure their emissions. Furthermore, even if an energy rating was determined at the start of a home loan, there is high potential for this to change over the duration of the loan.

Question 11: What considerations should apply to ensure covered entities provide transparent information about how they are managing climate related risks, including what transition plans they have in place and any use of greenhouse gas emissions offsets to meet their published targets?

Clear guidance on reporting Scope 3 emissions is essential to avoid double counting of emissions or leaving holes in calculations along the supply chain.

Entities should report transition plans for managing climate related risks in a transparent and measurable way.

As noted above, AFG submits that climate related financial and risk disclosures should be disclosed in the Annual Report, however AFG reiterates the need for the introduction to such climate reporting be phased to allow entities to adapt and develop adequate resources to meet reporting requirements.

Question 12: Should particular disclosure requirements and/or assurance of those requirements commence in different phases, and why?

The introduction of new disclosure requirements would require significant resources and changes to the current financial disclosure reporting regime, and there will undoubtedly be a strain on internal and external resources to help deliver the requirements.

Smaller, less resourced entities will find it difficult to adapt and costs will be disproportionately high. Therefore, AFG submits that mandatory disclosure requirements should apply to ASX100 companies or unlisted companies with NPAT of greater than \$250 million in the first instance.

The disclosure requirements could extend to a second tranche at least two to three years later, comprising the remainder of ASX listed companies. AFG recommends allowing a further five years for the reporting requirements to be extended to the third phase comprising the larger proprietary companies that are required to lodge financial statements in accordance with the *Corporations Act 2001* (Cth).

In the credit sector this would allow for information sharing across industry bodies such as the Mortgage and Finance Association of Australia and the Finance Brokers Association of Australia, which could help ensure smaller entities build the capability and understanding to deliver on the expected disclosures.

Question 13: Are there any specific capability or data challenges in the Australian context that should be considered when implementing new requirements?

13.1 How and by whom might any data gaps be addressed?

13.2 Are there any specific initiatives in comparable jurisdictions that may assist users and preparers of this information in addressing these challenges?

For the mortgage industry it would be important to know the energy ratings of individual dwellings at the point in time that the home loan is provided. At this point in time that data is not consistently available across the country and is not recorded at the time of financing.

In the case of home loans, it must be ascertained whether the emissions should be accounted for annually, or at the start of the home loan based on its expected duration. The latter would be difficult given the borrower may not stay with the same provider for the duration of the home loan.

There would also be challenges in maintaining accurate emissions data throughout the lifespan of the home loan as improvements could affect the rating (for example the installation of solar panels, insulation or double glazing).

As part of the new requirements, Australia could consider the UK's Australia Energy Performance Certificate rating system. The EPC measures the energy efficiency of a property from A to G, and also information on the property's carbon dioxide emissions. When buying a home, the seller must provide the EPC certificate to the potential buyer.

Question 14: Regarding any supporting information necessary to meet required disclosures (for instance, climate scenarios), is there a case for a particular entity or entities to provide that information and the governance of such information?

The insurance industry collects data on climate impacts in relation to property, but this is not publicly available. If it was to be shared, this would enable lenders and participants in the credit industry, such as brokers, to provide further information on climate risks and more accurate disclosures.

Question 15: How suitable are the 'reasonable grounds' requirements and disclosures of uncertainties or assumptions in the context of climate reporting? Are there other tests or measures that could be considered to ensure liability is proportionate to inherent uncertainty within some required climate disclosures?

Currently, Australia's periodic reporting requirements are principally backward-looking in nature, which affords reporting entities a considerable degree of certainty over disclosure (and carries lower levels of disclosure risk).

However, reporting on climate risks and opportunities involves disclosure on a substantial amount of forward-looking information. Therefore, reporting entities and officers in Australia are exposed to risks associated with disclosure of forward-looking information given Australia does not have a "safe harbour" regime for this type of disclosure (as other jurisdictions do).

The US Security and Exchange Commission's proposed safe harbour regime for disclosures on Scope 3 emissions under its draft climate disclosure rules would be a sensible initiative for the Australian regime.

AFG submits that it is important that the Australian regime incentivises disclosure whilst balancing the 'greenwashing' risk which could be dealt with by introducing specific greenwashing prohibitions, which are more narrow and focused than the current misleading and deceptive conduct regime within in the *Corporations Act 2001* (Cth) and *ASIC Act 2001* (Cth).

Question 16: Are there particular considerations for how other reporting obligations (including continuous disclosure and fundraising documents) would interact with new climate reporting requirements, and how should these interactions be addressed?

AFG submits that climate reporting obligations should be consistent with all existing reporting obligations mentioned.

Question 17: While the focus of this reform is on climate reporting, how much should flexibility to incorporate the growth of other sustainability reporting be considered in the practical design of these reforms?

AFG submits that climate reporting should be the immediate focus, however the framework could be designed so it could readily adapt to accommodate other forms of sustainability reporting if required.

Question 18: Should digital reporting be mandated for sustainability risk reporting? What are the barriers and costs for implementing digital reporting?

AFG submits that digital reporting should not be mandatory because of the associated costs and complexity of delivering such reports. Some existing capability for machine readability in current documents exists but an industry wide standard would need to be developed and made available to participants.

Question 19: Which of the potential structures presented (or any other) would best improve the effectiveness and efficiency of the financial reporting system, including to support introduction of climate related risk reporting?

AFG submits that AASB would be the most effective and efficient financial reporting system because adaption would be more straightforward for Australian entities given they already report under this system.

Please do not hesitate to contact AFG at [REDACTED] or [REDACTED] if you require any further detail about the matters raised in this submission or if AFG can provide any further assistance.

Yours sincerely,

[REDACTED]

Head of Corporate Communications

