Dimensional

DFA Australia Limited
Level 43, Gateway, 1 Macquarie Place
Sydney, NSW 2000

17 February 2023

Climate Disclosure Unit
Market Conduct Division
The Treasury
Langton Crescent
Parkes ACT 2600

Re: Climate-related Financial Disclosure Consultation Paper

Dear Representatives of the Treasury,

DFA Australia Limited ("Dimensional Australia") appreciates the opportunity to respond to the December 2022 Consultation Paper[1] issued by the Australian Treasury ("Treasury") on climate-related financial disclosures. Dimensional Australia is an investment manager holding an Australian Financial Services License and is a subsidiary of US-based Dimensional Fund Advisors LP (together with Dimensional Australia and its affiliates, "Dimensional"). As at 31 December 2022, Dimensional managed approximately A$856 billion in commingled funds and separate accounts for investors around the world, and over A$24 billion of Dimensional's assets under management were invested in Australian listed equities.

As an investment manager, we review and rely on the disclosures made by portfolio companies to help us make investment decisions on behalf of the investors who have entrusted us with their savings, and we are supportive of Australia's efforts to design internationally aligned requirements for the disclosure of climate-related financial risks and opportunities in Australia. In this letter, we explain why we strongly believe that financial materiality is the right lens through which a company should determine what climate-related information to disclose, and we outline our views as to what climate-related metrics a company should and should not be required to disclose.

I. *Materiality of climate risk*

We strongly recommend that Australian regulators continue to require companies to assess climate risk through a financial materiality lens. Because the costs of disclosing specific climate-related information may outweigh the benefits to a company's investors, we believe that a company should be required to disclose specific climate change information only if the company has determined that climate change may have a financially material impact to its business.

Although climate change has the potential to profoundly impact our environment and society, individual companies are not equally impacted by climate change. Requiring a company to disclose specific climate change-related information—even if the company has determined climate change is not a financially material risk to its business—will increase costs for the company without providing much, if any, tangible benefit to the company or its shareholders. Ultimately it is the company's shareholders, including investing funds and their

[1] Australian Treasury, *Climate-related Financial Disclosure, Consultation Paper* (Dec. 2022) (the "Consultation Paper"), available at https://treasury.gov.au/sites/default/files/2022-12/c2022-314397_0.pdf.

shareholders, who bear the costs of regulations that mandate additional disclosures.

Corporate disclosure is expensive.[2] Companies must spend time and resources gathering and verifying information as well as considering how best to explain and present data and associated risk disclosure. Complying with prescriptive disclosure requirements may divert senior management's time and attention away from managing the material risks faced by the company. It could also detract from the company's ability to pursue opportunities to generate value for society by developing goods and services that meet the needs and preferences of consumers—including climate-conscious consumers—which could, in turn, generate value for the company and its shareholders. Some of these opportunities—determining how to make a product more energy-efficient, for example—could even have a tangible positive impact on the environment. For these reasons, we believe that a company should be required to disclose specific climate-related information only if it has determined that climate change may have a financially material impact to its business. And in Australia, disclosure of such climate-related financial risks is already required as part of existing obligations to disclose material risks.

We note that some jurisdictions have been gravitating towards a "double materiality" framework for climate change disclosures. Under a double materiality framework, a company is required to disclose climate-related information if it is material to understanding the external impacts of the company on the environment and society, even if these external impacts do not materially affect the company's enterprise value. Advocates for double materiality often cite demand from diversified investors for information about how their investments contribute to systemic risks that, whilst not material at the company level, may be material at the portfolio level, particularly over the long term. However, in our view, the costs of such an approach outweigh the benefits. There is no limit to what may be deemed material by at least some investors, and therefore, a double materiality standard may lead to reams of extraneous disclosure, substantially increasing costs to companies and potentially confusing investors. It may also compel corporate leaders to spend a disproportionate amount of time managing the disclosure of financially nonmaterial information at the expense of activities that may create value for the company and its shareholders.

Double materiality may also have a negative effect on corporate governance. When corporate leaders are encouraged to serve the interests of other "stakeholders" who are not necessarily shareholders of the company, institutional investors may become more deferential to corporate leaders' decisions, less willing to support challenges to the control of these leaders, and more willing to support or accept corporate governance arrangements that shield management from market pressure.[3] Entrenchment of management is associated with—and may even bring about—a reduction in a company's value, as research by Lucian Bebchuk and

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2 For example, according to a survey of CFOs of public companies conducted by PwC, CFOs estimated that on average, financial reporting (a category separate from incremental auditing fees and legal costs) represented 18% of the annual costs of being a public company. The same survey found that two-thirds of CFOs estimated spending between $1 million and $1.9 million annually on the costs of being public. *See* PwC, "Considering an IPO to fuel your company's future?" (Nov. 2017), available at: https://www.pwc.com/hu/hu/szolgaltatasok/konyvvizsgalat/szamviteli-tanacsadas/kiadvanyok/cost_of_an_ipo_2017.pdf.

3 Bebchuk, Lucian and Roberto Tallarita, "The Illusory Promise of Stakeholder Governance," *Cornell Law Review*, Volume 106, 91-178 (Feb. 26, 2020), available at https://cornelllawreview.org/2020/12/01/theillusory-promise-of-stakeholder-governance-2/ at 165.

Alma Cohen suggests.[4] We believe investors are better served if companies are only required to disclose information that the company has determined is financially material, and we strongly encourage Treasury to maintain a financial materiality framework for assessing climate risk.

II. Reporting of metrics (including emissions), offsets, and transition plans

A. Scope 1 and 2 GHG emissions

As explained above, we believe that a company should be required to disclose specific climate change information only if it has determined that climate change may have a financially material impact to their business. If a company has made such a determination, then we believe it would be appropriate for such a company to disclose its scope 1 and scope 2 greenhouse gas ("GHG") emissions, which should be calculated pursuant to the GHG Protocol. Both scope 1 emissions (*i.e.*, direct GHG emissions from owned or controlled sources) and scope 2 emissions (*i.e.*, indirect GHG emissions from the generation of purchased electricity, steam, heat, and cooling consumed by the reporting company) can be estimated from directly observed data, and it is our understanding that this information is relatively easy for companies to estimate and report cost-effectively.

B. Offsets

To minimize the risk of "greenwashing," it could be helpful to require companies reporting their scope 1 and scope 2 emissions to also disclose details on the amount and type of any contractual arrangements used to lower a company's reported GHG emissions or support sustainability-related claims. For example, renewable energy certificates, known as RECs, can be used to lower a company's gross market-based scope 2 emissions from purchased electricity. Companies that seek "carbon neutral" or "climate neutral"-type designations typically make these claims by purchasing carbon credits or offsets, which support projects that seek to reduce, remove, or avoid GHG emissions. Since companies that make climate-related claims may be incentivized to purchase low quality offsets that may have dubious climate value, we believe that requiring companies to disclose details regarding the nature of such offsets would help investors to better assess a company's efforts to mitigate its impact on the environment.

C. Scope 3 GHG emissions

On the other hand, we do not recommend that companies be required to disclose scope 3 GHG emissions. Assessments of a company's scope 3 emissions (*i.e.*, all other GHG emissions that occur upstream and downstream in a company's ties value chain) can be extremely costly to conduct. Furthermore, companies in most industries are not able to estimate their actual scope 3 emissions with reasonable reliability at this time. Because scope 3 emissions measure activities from assets not owned or controlled by the reporting company, they can be subject to significant variation due to assumptions about a company's value chain. Finally, we note that the GHG Protocol scope 3 standard allows companies discretion over

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[4] *See* Bebchuk, Lucian and Alma Cohen, "The costs of entrenched boards," *Journal of Financial Economics*, Vol. 78, No. 2, 409-433 (2005), available at http://www.law.harvard.edu/faculty/bebchuk/pdfs/Bebchuk-Cohen_Costs-of-Entrenched-Boards.pdf.

which categories to report and is not designed to support comparisons between companies.[5] This limits the usefulness of such information to investors. As a result, we do not currently recommend requiring disclosure of scope 3 emissions; doing so would likely increase costs without providing reliable or meaningful information to investors.

D. Scenario analysis

Similarly, we do not believe that companies should be required to conduct or disclose the results of climate scenario analyses to investors. Climate change scenario analysis—*i.e.*, when companies conduct internal assessments to evaluate the impact of certain climate scenarios—can be a useful tool when company management seeks to better understand the climate change risks that they might face in various potential future pathways. Companies conduct scenario analyses for many different situations outside of climate change—a company might conduct a scenario analysis to determine how it might fare during a global health pandemic, for example. However, to our knowledge, companies do not typically disclose the results of such hypothetical analyses in their disclosure documents. Requiring companies to include results of climate scenario analyses could have a chilling effect—if companies are required to disclose results of their climate scenario analyses, they might purposely avoid conducting certain analyses that could be very important to the company's strategic planning.

Furthermore, even when a company's management has made the determination to conduct a climate scenario analysis, the results may not be useful to investors. Climate scenario models generally rely on, and are sensitive to, many assumptions as to the timing, scope and magnitude of carbon taxes as well as assumptions as to the potential impact of physical risks of climate change.[6] This limits their comparability and usefulness to investors; differences between two climate scenario analyses may say more about the modelling assumptions being made than the climate risk exposures faced by the underlying companies. In addition, the methodologies used by most commercially available climate scenario models are typically opaque and complex and would be difficult to explain clearly and concisely to the average investor. While we do believe it may be helpful for companies to undertake climate scenario analysis, this is primarily to help companies better understand how variables interact and respond to changes in modelling assumptions. We do not believe that climate scenario analysis is a useful tool for predicting the future impacts that climate change will have on a company. For all of these reasons, we do not believe that companies should be required to disclose the results of any climate scenario analyses.

E. Assurance of climate risks

Finally, we do not believe third-party assurance of a company's disclosure of climate-related information or metrics is necessary, as the costs to companies and their shareholders of

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5 Greenhouse Gas Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard* (2011) (noting that "[u]se of this standard is intended to enable comparisons of a company's GHG emissions over time. It is not designed to support comparisons between companies based on their scope 3 emissions"), available at https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporing-Standard_041613_2.pdf.

6 For a discussion of the challenges of assessing the economic costs of climate change, *see* Chi, Joseph, Mathieu Pellerin, and Jacobo Rodriguez, "The Economics of Climate Change" (Oct. 2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3715848.

any such audit would likely outweigh any benefit to investors. In our view, the existing liability frameworks should be sufficient to prevent companies from including disclosure that is misleading or deceptive.

III. Covered entities and timing

In the Consultation Paper, Treasury notes that implementation of climate disclosures could follow a phased approach, starting with large, listed entities and gradually expanding to a wider range of entities. We support the implementation of a phased approach, and we encourage Treasury to clarify whether any proposed framework will apply to listed funds and asset managers. Asset managers face unique challenges with respect to climate-related reporting, particularly as it relates to the assets that they manage. In our experience, disclosure frameworks that have been designed with operating companies in mind can be difficult to apply to asset managers and funds. If listed funds and/or asset managers do fall within any future framework for climate-related disclosures, we strongly urge Treasury to conduct separate consultations to give due consideration to the issues specific to the asset management industry.

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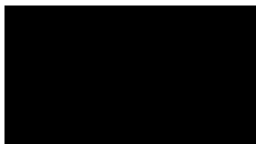
We strongly believe that companies should continue to use financial materiality as the standard for determining what climate-related information to disclose. If a company has determined that climate-related risks are financially material, then we believe it would be appropriate for these companies to disclose their scope 1 and scope 2 GHG emissions and any offsets. As it considers how to increase the transparency and accountability of companies' climate-related plans, financial risks, and opportunities, we urge Treasury to keep top of mind the costs to companies and their shareholders of complying with additional disclosure requirements. If we could be of further assistance, please do not hesitate to contact Lead Counsel, Global Public Policy and Vice President, at or at . We would be happy to make ourselves available for further discussion or to answer any questions concerning this submission.

Sincerely,



CEO, Dimensional Australia