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Director
Climate Disclosure Unit
Climate & Energy Division
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Langton Cres
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By email: ClimateReportingConsultation@treasury.gov.au

Dear Director

Climate-related financial disclosure: exposure draft legislation

Allens welcomes the opportunity to comment on Treasury's exposure draft legislation which seeks to amend parts of the *Australian Securities and Investment Commission Act 2001 (Cth)* and the *Corporations Act 2001 (Cth)* (**Corporations Act**) to introduce mandatory disclosure requirements for large businesses and financial institutions in relation to climate-related risks and opportunities (**Exposure Draft**).

Attached as Schedule 1 to this letter are our submissions in relation to the scope of the Exposure Draft and the annual sustainability reporting obligations contained therein.

Allens supports the long-awaited implementation in Australia of standardised and internationally aligned requirements for mandatory disclosure of climate-related financial risks and opportunities. We hope that the legislative amendments proposed by the Exposure Draft will go some way to closing the information gap between large businesses and financial institutions and their investors with respect to these risks and opportunities, and the actions being taken by individual entities to meet their climate change targets.

Please let us know if you would like to discuss any aspect of our submissions.

Yours sincerely

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Schedule 1 – Scope of the Annual Sustainability Reporting Obligations

Summary

As currently drafted, the scope of the Exposure Draft's annual sustainability reporting obligations appears to extend beyond the subset of 'Chapter 2M Entities' (as that term is defined below) to which the Explanatory Memorandum and Policy Statement indicate those obligations will apply. This, in our view, is at odds with the underlying policy basis of Chapter 2M and should be rectified by defining more precisely the entities that will be required to prepare sustainability reports and to comply with any consequential obligations.

Background

The Explanatory Memorandum and Policy Statement in relation to the Exposure Draft each manifests an intention that the scope of the proposed annual sustainability reporting obligations should be confined to a subset of those entities that are already required to prepare annual financial reports and directors' reports under s292 of the Corporations Act, being disclosing entities, public companies, large proprietary companies, registered schemes, registrable superannuation entities and, in limited circumstances, small proprietary companies and small companies limited by guarantee (each such entity being a **Chapter 2M Entity**).

For example, the Explanatory Memorandum includes the following statement:

Generally, an entity must prepare a sustainability report for a financial year if that entity reports under Chapter 2M and meets any one of the [criteria set out in subsections (3), (6) or (7) of the proposed s292A] for a financial year.¹

Similarly, the Policy Statement provides as follows:

Large entities that are required to prepare and lodge annual reports under Chapter 2M of the Corporations Act will be required to disclose information about climate-related risks and opportunities. This includes listed and unlisted companies and financial institutions as well as registrable superannuation entities and registered investment schemes.²

The Policy Statement also indicates that entities currently exempt from lodging financial reports under Chapter 2M of the Corporations Act (for example, unregistered schemes) will be exempt from the requirement to prepare an annual sustainability report.³

In our view, the above approach, which confines these novel reporting obligations to a subset of Chapter 2M Entities, is a sensible one. In particular, we consider that it accords with the consumer protective policy underpinnings of Chapter 2M, which regulates the conduct of Chapter 2M Entities on the basis of the likely investor composition of those entities,⁴ and the more complex information needs of certain classes of investors. We note, for completeness, that the chapter's policy basis and scope have existed essentially unchanged since the introduction of Chapter 2M as part of the *Company Law Review Act 1998* (Cth),⁵ with the exception of the broadening of the chapter's operation to registrable superannuation entities under the *Treasury Laws Amendment (2022 Measures No. 4) Act 2023* (Cth).

Use of the Term 'entity'

As currently drafted, the Exposure Draft uses the term 'entity' as the relevant hook for the enlivenment of annual sustainability reporting obligations. By way of example, subsection 292A(1) reads as follows:

¹ Explanatory Memorandum at [1.30].

² Policy Statement at p. 1.

³ Policy Statement at p. 2.

⁴ Which is more likely to comprise 'retail clients' within the meaning of the Corporations Act.

⁵ Which originally applied only to disclosing entities, public companies, large proprietary companies and registered collective investment schemes (and so, by negative inference, expressly excluded other entities such as unregistered schemes): see *Company Law Review Bill 1998 Explanatory Memorandum* at [13.18].

- (1) *Subject to subsection (2), an entity must prepare a sustainability report for a financial year if subsection (3), (6) or (7) applies to the entity for the financial year.*

When used outside Chapters 2E, 8A and 8B of the Corporations Act, a reference to an 'entity':

- (a) *is a reference to a natural person, a body corporate (other than an exempt public authority), a partnership or a trust; and*
- (b) *includes, in the case of a trust, the trustee of the trust.*⁶

Accordingly, as it is currently framed, subsection 292A(1) would appear to capture any natural person, body corporate, partnership or trust that meets one or more of the criteria in subsections 292A(3), (6) or (7), regardless of whether the relevant 'entity' is also a Chapter 2M Entity, as defined above.

In our view, the use of the term 'entity' is, therefore, problematic as it appears to conflict both with:

- (a) the underlying policy basis of Chapter 2M, particularly insofar as it extends reporting obligations to entities that have not, historically, been subject to the chapter's mandatory reporting requirements. For example, the proposed subsection 292A(1) would appear to capture unregistered schemes that meet one or more of the criteria in subsections 292A(3), (6) or (7) (where, historically, the reporting obligations of those entities would have been contractually negotiated between the trustee of the scheme and its investors); and
- (b) Treasury's apparent intention, as disclosed in the Explanatory Memorandum and Policy Statement, to restrict annual sustainability reporting obligations to a subset of Chapter 2M Entities.

Arguably, the provisions of the Exposure Draft should be read subject to the proposed subsection 285(1), which provides as follows:

- (1) *Under this Chapter:*
- (a) *all companies, registered schemes, registrable superannuation entities and disclosing entities must keep financial records (see sections 286 to 291); and*
- (b) *some must keep sustainability records (see section 286A); and*
- (c) *some must prepare financial reports and sustainability reports...*

On a plain English interpretation of that provision, the term 'some' in subparagraphs 285(1)(b) and (c) is a reference to the companies, registered schemes, registrable superannuation entities and disclosing entities referred to in subparagraph 285(1)(a). Adopting this interpretation, it may be argued that the intent of Chapter 2M, as modified by the proposed subsection 285(1), is that only a subset of Chapter 2M Entities will be required to keep sustainability records and to prepare sustainability reports.

However, the issue with adopting this approach is twofold:

- (a) first, it requires the user of the legislation to read together provisions of Chapter 2M that are otherwise physically separated, rather than situating the threshold requirement for the relevant entity to be a Chapter 2M Entity in the provisions that impose sustainability reporting obligations; and
- (b) second, the purpose of section 285 is to provide an overview of Chapter 2M only; it should not be understood as an operative or substantive provision of that chapter that is capable of modifying the express terms of other sections (particularly absent any indication that those provisions operate subject to section 285).

Accordingly, we consider that refinements are required to confine annual sustainability reporting obligations to the subset of Chapter 2M Entities that meet one or more of the criteria in the proposed subsections 292A(3), (6) or (7), thereby aligning the legislative drafting in the Exposure Draft with the proposed scope of those obligations as described in the Explanatory Memorandum and Policy Statement.

⁶ Corporations Act, s 64A.

Proposed Approach

While Treasury may form its own view on how best to confine the scope of the Exposure Draft, one approach would be the introduction of the following defined terms, either in a standalone provision in Chapter 2M, or in section 9, of the Corporations Act:

Chapter 2M Entity means an entity required to prepare financial reports and directors' reports under section 292 for so long as it is required to prepare such reports.

Chapter 2M CRFD Entity means an entity required to prepare sustainability reports under section 292A for so long as it is required to prepare such reports.

By narrowing their definitions by reference to the Explanatory Memorandum and Policy Statement, the defined terms 'Chapter 2M Entity' and 'Chapter 2M CRFD Entity' could then be employed to replace any problematic usages of the term 'entity' throughout the Exposure Draft.

By way of example, the proposed subsection 292A(1) could be amended by replacing the term 'entity' with 'Chapter 2M Entity' as follows:

- (1) *Subject to subsection (2), a Chapter 2M Entity must prepare a sustainability report for a financial year if subsection (3), (6) or (7) applies to the entity for the financial year.*

Similarly, the proposed subsection 286A(1) could be amended by replacing the term 'entity' with 'Chapter 2M CRFD Entity' as follows:

- (1) *In respect of each financial year, a Chapter 2M CRFD Entity must keep written sustainability records that correctly explain and record its preparation of the following parts of the sustainability report...*

In the first example, the use of the term 'Chapter 2M Entity' clarifies that an entity will only be required to prepare sustainability reports under section 292A for a financial year if, in respect of that financial year:

- (a) the entity is also required to prepare financial reports and directors' reports under section 292; and
(b) the entity meets one or more of the criteria in subsections 292A(3), (6) or (7).

In the second example, the use of the term 'Chapter 2M CRFD Entity' clarifies that the obligations under that provision attach to certain entities in respect of a financial year because those entities are required under section 292A to prepare sustainability reports for that financial year.

In our view, the introduction of these defined terms is advantageous for at least two reasons:

- (a) first, it rectifies the misalignment between the legislative drafting in the Exposure Draft and the proposed scope of the annual sustainability reporting obligations described in the Explanatory Memorandum and Policy Statement; and
(b) second, it allows for additional legislative tidy-ups throughout Chapter 2M (as detailed below).

Legislative Tidy-ups

Currently, where an obligation attaches to an entity because it is required to prepare financial reports and directors' reports under section 292, Chapter 2M employs the composite phrase 'company, registered scheme, registrable superannuation entity or disclosing entity' to refer to the relevant entity. For example, in defining the contents of an annual financial report, subsection 295(2) provides as follows:

- (2) *The financial statements for the year are:*
(a) *unless paragraph (b) applies--the financial statements in relation to the company, registered scheme, registrable superannuation entity or disclosing entity required by the accounting standards...*

If, however, 'Chapter 2M Entity' was introduced into the into the Corporations Act as a defined term, it could be employed to simplify and replace the various uses of the composite phrase. For example, subsection 295(2) could be amended as follows:

- (2) *The financial statements for the year are:*
 - (a) *unless paragraph (b) applies—the financial statements in relation to the Chapter 2M Entity required by the accounting standards...*

In our view, the advantages of this approach are, again, twofold:

- (a) first, it would simplify the legislative drafting in Chapter 2M; and
- (b) second, it would avoid the need for users of the legislation to infer that the reference to a 'company' in the composite phrase is not a reference to any company, but to the subset of companies required to prepare financial reports and directors' reports under section 292.

Although not directly associated with climate-related financial disclosure, any necessary tidy-ups could be incorporated into the proposed Treasury Laws Amendment Bill and would consistent with more general efforts to streamline the operation of the Corporations Act (including those being undertaken by the Australian Law Reform Commission with respect to Chapter 7).