NOVEMBER 2023 ESG POLICY UPDATE–AUSTRALIA

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Australia Corporate Alert

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AUSTRALIAN UPDATE

Draft Reporting Standards for Australian Climate-Related Disclosures

As previously reported by K&L Gates (blog post | October ESG Update), the Australian Accounting Standards Board released its exposure draft of the Australian Sustainability Reporting Standards (ASR Standards)–Disclosure of Climate-related Financial Information on 23 October 2023 (Exposure Draft). The Exposure Draft, available here, contains the following draft standards:

- **ASRS 1** - n*General Requirements for Disclosure of Climate-related Financial Information*, which is based on International Financial Reporting Standard (IFRS S1) – General Requirements for Disclosure of Sustainability-related Financial Information, but is limited to climate-related financial disclosure (as opposed to broader sustainability-related financial disclosures);
- **ASRS 2** - *Climate-related Financial Disclosures*, which is based on Climate-related Disclosures (IFRS S2)—also climate-related disclosure, but with a more limited scope by not applying to non-greenhouse gas emissions and applying only to climate-related risks and opportunities; and
- **ASRS 101** - *References in Australian Sustainability Reporting Standards*, which is a standard that will periodically be updated to list relevant non-legislative and foreign documents that are referenced in the above standards.

Note that reporting entities must also disclose their planned use of carbon credits, which includes Australian Carbon Credit Units, to offset greenhouse gas emissions in its plan to achieve their climate targets.

The Exposure Draft proposes a phased implementation of the ASR Standards, commencing (for the largest reporting entities) in the 2024–2025 financial year and applying to all reporting entities from the 2027–2028 financial year, onwards.

Opening of AU$2 Billion Program to Power Australian Renewable Hydrogen Industry

On 10 October 2023, the largest Commonwealth funding program for renewable hydrogen, the Hydrogen Headstart (the Program), opened for applications. The Program will be administered by the Australian Renewable Energy Agency and it aims to:

- Bridge the gap between the cost of producing renewable hydrogen and the current market price; and

- Stimulate international investments into the Australian hydrogen industry.

Minister for Climate Change and Energy Chris Bowen announced the Program as a game changer in the development of Australia's renewable hydrogen industry. Mr Bowen said:

'Australia already has the largest pipeline of renewable hydrogen projects in the world. Our regions have the resources, technical skills and key trade partnerships to drive growth in hydrogen and other clean industries, as well as the jobs that come with it. Hydrogen Headstart is about realising the potential of that pipeline and making sure Australia is in the race.'

The Program will utilise a competitive process for the application of funding. Further information is available here.

Australian Carbon Credit Unit Scheme Reforms

On 3 October 2023, the Australian Government finalised its consultations regarding implementation of the recommendations by the independent panel that reviewed the Australian Carbon Credit Units Scheme (ACCU Scheme), formerly known as the Emissions Reduction Fund. Read the independent panel's final report here. The purpose of the consultations is to inform how the Australian Government can improve the ACCU Scheme through legislative changes and better practices to maintain a high level of integrity.

The Climate Change Authority (CCA) is also undertaking its fourth review of the ACCU Scheme. The CCA has focused on the following key issues for its review:

- Securing integrity;
- Valuing non-carbon outcomes;
- Managing supply and demand;
- Scaling emissions removals; and
- Aligning with the Paris Agreement.

Both reviews aim to improve the integrity of the ACCU Scheme, augment its transparency and increase conservativeness in assessing methods and project eligibility.

Australian Government Signals Intention to Establish Sustainability Labelling for Retail Investment Products

On 2 November 2023, Treasury released a consultation paper (Consultation Paper) on Australia's Sustainable Finance Strategy, outlining an ambitious and comprehensive framework that will underpin the development of Australia's sustainable finance markets. The Consultation Paper identifies the Treasury's three objectives:

- **Pillar 1** - Improve transparency on climate and sustainability;
- **Pillar 2** - Enhance financial system capabilities; and
- **Pillar 3** - Promote Australian Government leadership and engagement.

Each pillar contains a range of proposed tools and policies to support sustainable finance in Australia.

One of the key priorities within Pillar 1 is to improve sustainability labelling for investment products. The Australian Government believes more consistent information on the design and sustainability characteristics of products labelled as 'green', 'sustainable', 'ESG' or similar is a critical building block for improving transparency. It is estimated that AU$1.3 trillion worth of financial assets in Australia are managed using a 'responsible' investment approach and there is a growing concern that the diversity of the sustainable finance landscape can be confusing for investors. In particular, it can be difficult for investors to verify sustainability characteristics or even understand how investments are managed. A lack of understanding and trust is a key barrier to the growth of sustainable investment markets.

The proposed regime will seek to introduce labels for investment products marketed to retail investors, including managed investment scheme products and superannuation investment options. Specifically, the Australian Government intends to:

- Standardise the use of sustainability terminology in investment product marketing by setting minimum standards for what qualifies for a prescribed sustainability label; and
- Require product issuers to provide retail investors with additional information on sustainable investment products, both pre-contractually and on a periodic basis. This would include a description of how sustainability is incorporated into the investment process for a particular product.

The intention of the regime is to make the sustainability attributes of financial products clearer and easier to understand for investors and provide regulatory clarity to support the Australian Securities and Investment Commission's ability to address 'greenwashing'.

The introduction of the proposed labelling regime would also help align Australia with offshore jurisdictions. The Consultation Paper notes by way of comparison that:

- The European Union is consulting on fund labelling guidelines to provide further regulatory clarity to its existing Sustainable Finance Disclosure Regulation, which imposes disclosure obligations for investment funds that incorporate sustainability;
- The Financial Conduct Authority in the United Kingdom is consulting on a framework that will require funds to qualify for a label to be marketed as 'sustainable' or similar; and
- The Securities and Exchange Commission in the United States has proposed a framework for classifying ESG funds, with graduated disclosure obligations.

Treasury has stated that it will commence work on this regime in 2024, consulting closely with industry on policy and legislative design.

Submissions on the Consultation Paper for the Sustainable Finance Strategy close on 1 December 2023.

Nature-Related Risks: Australian Directors Beware

Directors must consider nature-related risks to satisfy their duty of care and diligence (Care and Diligence Duty) under section 180(1) of the *Corporations Act 2001* (Cth) (Corporations Act) according to a recent legal opinion authored by barrister Sebastian Hartford Davis and senior solicitor Zoe Bush (Opinion). The Opinion was published on 24 October 2023 and builds on Davis and Noel Hutley SC's previous opinion from 2016, which concluded that directors must consider climate-related risks to satisfy their Care and Diligence Duty.

The Taskforce on Nature-related Financial Disclosures' definition of 'nature-related risks' was adopted in the Opinion, being 'potential threats (effects of uncertainty) posed to an organisation that arise from its and wider society's dependencies and impacts on nature'.

The Opinion concluded that, amongst other things:

- Nature-related risks are risks to the interests of Australian companies;
- Directors of Australian companies should identify the company's nature-related dependencies and impacts, and consider the potential risks they may pose to the company, particularly where those nature-related risks are presently foreseeable; and
- Companies are required to disclose nature-related dependencies and impacts where:
  - They pose a material risk of harm to the company (which should be disclosed in its directors' report and corporate governance statement); or
  - Those impacts 'would, or would be likely to, influence persons who commonly invest in securities in deciding whether to acquire or dispose of the company's securities' or where the company is subject to the European Union's Corporate Sustainability Reporting Directive, regardless of materiality.

THE VIEW FROM ABROAD

European Union Adopts Regulation on European Green Bonds

On 5 October 2023, the European Parliament formally adopted regulations to ensure uniformity of standards for issuers who market bonds as a 'European green bond' or 'EuGBs' (EuGB Regulation). The EuGB Regulation seeks to align with the European Union's taxonomy framework for sustainable investment.

The key elements of this EuGB Regulation include:

- **Transparency** - Disclosure of information on how the bond's proceeds will be used and how this will support the green transition plan of the issuer;
- **External reviewers** - Sets up a framework for independent external reviewers of the green bonds; and
- **Flexibility** - 85% of the funds raised by the bond are allocated to economic activities that align with the European Union's taxonomy framework for sustainable investment, with the issuer explaining the allocation of the other 15%.

The general purpose of the EuGB Regulation is to support the development of the European market for green bonds whilst minimising disruption to existing green bond markets. The goal is that development of this market will help meet the European Union's climate and environment objectives under the Paris Agreement on Climate Change. Another objective in establishing these regulations is to reduce the risk of 'greenwashing' for the issuance of green bonds and to ensure that stakeholders can easily identify credible environmentally sustainable investments.

Green Construction to Create Investment Opportunities in Emerging Markets

In its new report, the World Bank Group's International Finance Corporation (IFC) predicts that the transition to green construction could reduce global carbon emissions in the value chains of the construction industry by approximately 23% by 2035, with the emerging market to account for about 55% of this projected reduction.

As an industry, the construction and operation of buildings, and the manufacturing of related raw materials such as cement and steel, account for 40% of global energy and industrial carbon emissions. A large portion of these emissions is generated in the emerging markets that rely on more carbon-intensive methods and materials to fuel the growing population's demand for infrastructure and housing.

The report identifies methods of sustainable construction practices, materials and technologies the industry can utilise to reduce emissions and predicts that these changes have the potential to create US$1.5 trillion in private investment opportunities in emerging markets over the next decade. IFC Managing Director Makhtar Diop noted that:

> "With the right enabling measures, we could see a surge of private sector financing that will capitalize on the enormous opportunity and huge necessity to transition to sustainable construction in emerging markets."

Investment opportunities will be provided through technical assistance and financial instruments such as sustainability-linked bonds, green mortgages, green funds, carbon transition bonds and carbon retirement portfolios.

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