ESG Around The World: Australia

By **Clive Cachia and Cathy Ma** (September 18, 2023)

ESG investing has recently become one of the most controversial policymaking issues in the U.S., dividing the country into pro- and anti-ESG states. But what does ESG legislation look like elsewhere? In this Expert Analysis series, attorneys across the globe tell us everything we need to know about the state of ESG in each of their countries or regions.

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While not a new concept, environmental, social and governance issues are being discussed more than ever before in corporate boardrooms, company reports, webinars and blogs.

The modern concept of ESG was first mentioned in a 2004 United Nations report titled "Who Cares Wins" and has since developed into a key focus area for companies and governments around the world. Targeted at managers, directors, investors, analysts and brokers, the report encouraged all business stakeholders to embrace ESG long-term and introduced ESG criteria to be incorporated in the financial evaluation of companies.[1]

Australia is no exception: Australian companies and regulatory bodies are increasingly focused on ESG matters.

In the past few years, Australia has started to introduce mandatory ESG-reporting requirements, including those relating to climate risk disclosures for companies. Currently, most ESG disclosures made by Australian companies are on a voluntary basis and in compliance with broad international guidelines.

While Australia has yet to establish a clear and mandatory ESG-reporting regime, emphasis on ESG is growing as investors are making it clear they expect companies to commit to ESG principles. In the 2021 Global Policy Survey on Climate published by Institutional Shareholder Services, 88% of international investor respondents and 75% of international noninvestor respondents indicated that they expect companies to provide clear and appropriately detailed disclosure of climate change governance, strategy, risk mitigation efforts and targets.[2]

Domestic Political Debate

Despite this growing emphasis on ESG, there are those — predominantly from the political right — who ideologically oppose the concept of ESG and its perceived excesses.

Allegations of "woke capital" are routinely invoked by such opponents who view ESG considerations as inappropriately redirecting a company's resources and attention from investor returns, service delivery and customer satisfaction.

Despite such criticism, supporters argue that ESG is not a manifestation of political left activism, but rather, according to an Australian Financial Review article from June, "the latest incarnation of the free market — an institution usually protected and upheld by the political right."[3]

However, it is fair to say that the ideological debate is less febrile here than in the U.S. With a bipartisan commitment to net-zero emissions by 2050, the major political parties are broadly aligned with Australia's corporate and investment communities in recognizing the value-accretive potential of ESG considerations in asset and portfolio construction. ESG performance is increasingly seen as a key investment and corporate differentiator in the fight for global capital.

Features of Australia's ESG Policy

Australia's ESG regulatory framework has historically been fragmented across federal and state jurisdictions and between environmental-, social- and governance-related issues.

Addressing such fragmentation is a key focus of current regulatory reforms. Some emblematic examples are explored below.

Climate Risk Disclosures

The Australian government acknowledges that climate change is a material risk to the global financial system — one that must be managed by regulators and corporations. A useful tool to mitigate the risks of climate change is the transparent disclosure of such risks.

Since the release of recommendations by the Task Force on Climate-Related Financial Disclosures, or TCFD, there has been a steady increase in the demand for disclosure by investors. Regulators in Australia have issued guidance that climate-related financial risks must be disclosed — with the TCFD as the recommended framework — as part of a company's existing obligation to disclose material risks.

While Australia's leading companies have improved ESG reporting over the past few years, this trend will grow as reporting requirements become more standardized, international and comprehensive.

In order to create adequate and consistent reporting standards, legislative changes are required. The Australian government has recently proposed a framework for such obligations that sets out the:

- Criteria of reporting entities;
- Location for the reporting requirements (e.g., annual report); and
- Prescribed standards that such disclosures must meet.

Regarding the scope of disclosures to be made, the TCFD and the recently released International Sustainability Standards Board, or ISSB, standards include both overarching disclosure principles and detailed specific requirements.

Guidance from the corporate regulator in Australia currently recommends the TCFD as a framework for climate disclosures. However, this is likely to change to also include more recently released standards from the ISSB: the International Financial Reporting Standards, or IFRS, S1 General Requirements for Disclosure of Sustainability-related Financial

Information and the IFRS S2 Climate-related Disclosures.

These set out overarching requirements for information disclosures of climate and broader sustainability-related risks and opportunities for investors, and affect that entity's prospects over the short, medium and long term. Such reporting obligations extend to those risks and opportunities that are financially material, relate to an entity's governance processes and controls, and include a disclosure of an entity's strategies for identifying and assessing such risks.

Requiring Australian companies to comply with these ISSB standards is intended to replace the current uncertain and fragmented landscape of regulatory guidance with a clear and globally consistent foundation of sustainability disclosures for investors and financial markets.

The Australian government is proposing for mandatory reporting requirements to commence on July 1, 2024, for Australia's largest companies, with other businesses subject to the requirements over time and with a three-year transition period.

NGER Act

Current mandatory climate reporting requirements — such as the National Greenhouse and Energy Reporting, or NGER, Act 2007 — establish the legislative framework for the NGER Scheme, a national framework for reporting greenhouse gas emissions, greenhouse gas projects, and energy consumption and production by corporations in Australia.

Several legislative instruments sit under the NGER Act, and each imposes prescriptive obligations on companies for environmental reporting. For example, the National Greenhouse and Energy Reporting (Measurement) Determination 2008 describes the methods, standards and criteria to be applied when estimating greenhouse gas emissions, energy production and energy consumption.

Climate Act

In September 2022, the Climate Change Act 2022 (Cth), or the Climate Act, and the Climate Change (Consequential Amendments) Act 2022 (Cth) commenced. The Climate Act operates as an umbrella legislation to implement Australia's net-zero commitments and codifies the country's 2030 (43% below 2005 levels) and 2050 (net-zero) greenhouse gas emissions reduction targets under the Paris Agreement.

While the Climate Act does not impose any obligations directly on companies, it has the following implications:

1. Serves as a guide to new policy by informing new and updated government policy developments;

2. Acts as flow-through legislation: The Climate Act is supported by flow-through changes in the Consequential Amendments Act, which embeds greenhouse gas emission targets and the Paris Agreement into existing legislation; and

3. Affects new projects: This requires the Minister for the Environment and Water to have regard to the emissions budget and targets in the Climate Act when considering whether to approve new projects.

Environmental Approvals and Licensing

The commonwealth, and state and territory governments each regulate matters affecting the environment, with states and territories focused on pollution, contamination and waste, and the commonwealth responsible for environmental approvals for activities that have potential national environmental significance.

Greenwashing

The fragmented regulatory landscape for environmental disclosures facilitates unscrupulous actors misrepresenting the extent to which its products and investment strategies are environmentally friendly, sustainable or equitable — i.e., greenwashing claims. In response, regulatory enforcement activities are common, extensive, and broadly successful and supported.

Social

Commonwealth, and state and territory laws also address matters such as protection:

- Of workers' rights, including work health and safety;
- Against discrimination and for equal opportunity;
- Of native title;
- Of places of indigenous cultural heritage;
- Against modern slavery occurring in an entity's operations and supply chains; and
- Of broader human rights — in some jurisdictions.

Governance

In addition to the reporting of climate-related risks noted above, disclosures of broader ESG risks by listed entities are recommended by the ASX Corporate Governance Council, including gender diversity among an entity's board, senior executives and workforce, and required to report against such recommendations.

Other governance-related requirements include compliance with:

- Anti-bribery and corruption laws;
- Statutory and common law director duties; and
- Protection of whistleblower laws.

Comparison to Other Countries

Australia's federated tiers of government, disparate regulatory agencies and incremental approach to ESG regulation over time have resulted in greater fragmentation between such regulations than exists in other comparable countries. The regulatory framework is further complicated by Australian industries voluntarily adhering to various private sector initiatives to attract foreign capital.

This fragmentation has unsurprisingly led to ambiguity and uncertainty. Efforts are underway to standardize such regulations and make them consistent with international best practices.

Australia's system of compulsory superannuation also means that superannuation funds — with trillions of Australian dollars in funds under management — have significant power and influence to guide corporate Australia's response to ESG risks. This influence can range from passive recommendations to investee companies; to the positive or negative screening of investment proposals based on an investee's ESG performance, risks and opportunities; and to more overt and active engagement with investees in their response to ESG issues.

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[1] 04-37665.global.compact_final (unepfi.org), https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf.

[2] 2021 Climate Survey Summary final (issgovernance.com), https://www.issgovernance.com/file/publications/2021-climate-survey-summary-of-results.pdf.

[3] ESG investing isn't 'woke' – it's capitalism working as it should (afr.com), https://www.afr.com/wealth/investing/esg-investing-isn-t-woke-it-s-capitalism-working-as-it-should-20230605-p5ddy1.