Climate Council of Australia

Submission to:	Climate-related financial disclosure: exposure draft legislation
Addressed to:	Director, Climate Disclosure Unit, Climate & Energy Division, Treasury, Langton Crescent, Parkes, ACT 2060 Email: ClimateReportingConsultation@treasury.gov.au
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8 February 2024

About the Climate Council

The Climate Council is Australia's own independent, evidence-based organisation on climate science, impacts and solutions.

We connect decision-makers, the public and the media to catalyse action at scale, elevate climate stories in the news and shape the conversation on climate consequences and action, at home and abroad.

We advocate for climate policies and solutions that can rapidly drive down emissions, based on the most up-to-date climate science and information.

We do this in partnership with our incredible community: thousands of generous, passionate supporters and donors, who have backed us every step of the way since they crowd-funded our beginning as a non-profit organisation in 2013.

To find out more about the Climate Council's work, visit www.climatecouncil.org.au.

Introduction

The Climate Council welcomes the release of the Australian Government's climate-related financial disclosure exposure draft legislation, and appreciates the opportunity to provide input for this consultation.

July 2023 was the first month in which the global average temperature rise spiked 1.5 degrees celsius (°C) above pre industrial levels. Summer in the northern hemisphere was marked by persistent and intense heatwaves across the United States, Southern Europe and China. Massive fires devastated communities in parts of Northern Africa, Greece, Hawaii and Canada. Smoke from the Canadian wildfires blanketed New York City, forcing schools to close and flights to be grounded. Deadly downpours and flash flooding saw lives lost and thousands displaced in Korea and India (Climate Council, 2023a).

Closer to home, we are midway through the Australian summer of 2023-24, and already seeing both devastating fires and floods. The New South Wales Rural Fire Service announced an early start to the fire danger season in August 2023 (ABC, 2023) and by November 2023, more than 610,000 square kilometres had burnt across north Australia, an area larger than Spain (The Guardian, 2023a). On the east coast, storms and flash flooding tragically took ten lives over Christmas (The Guardian, 2023b).

These are the consequences of climate change, driven by burning fossil fuels, that Australians are already experiencing at 1.2°C of warming (Climate Council, 2023a). Stated climate commitments from global governments have the world on track not only to exceed the 1.5°C goal of the Paris Agreement, but blow past it, with up to 2.7°C degrees of global temperature rise projected (Climate Action Tracker, 2023).

Corporations contribute to harmful climate change through carbon pollution produced in their direct operations and along their supply chains. The Carbon Majors Report has highlighted that just 100 companies have produced 71 percent of the world's greenhouse gas emissions between 1988 and 2017 (Griffin, 2017). At the same time, climate change is itself a risk to corporations as they face an increasingly volatile physical and economic environment. Key climate-related risks include both physical risks from climate change and transition risks associated with moving to a low emissions economy. Globally, a rapid reduction in demand for fossil fuels has been estimated to prompt economic losses of US$1-4 trillion by 2035 (Mercure et al., 2018). Currently no ASX300 company is reportedly on track to reach net zero by 2050 (Morningstar Analytics, 2023).

A changing climate threatens the resilience and long term viability of some entities, while also presenting opportunities for many as the world works to cut carbon pollution. These climate-related risks and opportunities have major implications for investment decisions. Investors need credible, transparent and comparable information to make responsible investment decisions. Unfortunately, large amounts of money is still being funnelled into expanding fossil fuels, which is what's driving climate change. Investors need credible, transparent and comparable climate-related financial disclosures to allocate capital responsibly. Climate-related financial disclosures are a critical mechanism for shining a spotlight on how exposed corporations are to escalating climate risks, and whether they are taking genuine steps to address these. This will help individual corporations and financial markets as a whole better manage climate risks and progressively direct capital to its most constructive uses in a decarbonising economy.

Given this, the Climate Council welcomes and strongly endorses the move to require climate-related financial disclosures by aligning Australian corporate reporting requirements with the international standards set by the International Financial Reporting Standards (IFRS) Foundation. We encourage full adoption as rapidly as possible to build sector capacity to assess climate risks, and then act effectively on them. **We highlight the need to drive early inclusion of Scope 3 emissions reporting (from the first year of reporting) and the importance of including disclosures about the use of credits to offset carbon emissions.**

The Climate Council encourages the Government and the financial accountability community to approach this legislation as the first step in a further series of regulatory reforms requiring companies to actively reduce climate-related risks, once these are transparently identified. Our submission includes a range of recommendations for further action following implementation of this initial legislation.

Within this context of strong support for the proposed direction of reform, we provide the following comments in response to the exposure draft legislation.

Summary of recommendations

Recommendation 1
The Climate Council recommends maximising coverage of the mandate. Option 1 in the Policy Impact Analysis to require full disclosure by Group 3 entities is preferred.

Recommendation 2
The Climate Council recommends the climate-related financial disclosures for Group 1 commence as planned on 1 July 2024, with the regime then phased in over a period of three years (rather than the proposed four year period), with the final year no later than 2026-27.

Recommendation 3
The Climate Council recommends keeping the commencement date for Group 1 entities at 1 July 2024 over commencing on 1 January 2025. Commencing earlier will drive entities to begin the learning process associated with making these disclosures at the earliest opportunity.

Recommendation 4
The Climate Council welcomes the inclusion of qualitative and quantitative scenario analysis of at least two possible future scenarios, with one being aligned with the strongest global temperature goal in the Climate Change Act 2022 (i.e. limiting global warming to 1.5˚C). We strongly support including this requirement in legislation.

Recommendation 5
The Climate Council welcomes the inclusion of Scope 3 emissions reporting and recommends that all entities be required to include Scope 3 emissions from the first year of reporting, with limited liability mechanisms in the first year.

Recommendation 6
The Climate Council strongly supports the requirement for reporting entities to disclose detailed information about their planned use of carbon credits to offset their greenhouse gas emissions.

Additional recommendations for further action beyond the disclosure regime
Use rules applying to all Authorised Deposit-taking Institutions (ADI) to mandate banks conduct climate stress testing on their portfolios, to take into account climate risk and lending for climatic and financial stability.

Direct the Council of Financial Regulators to pursue international negotiations over improvements to the Basel Capital Framework addressing climate risk.

Require fossil fuel projects' remediation costs to be accounted for within corporate balance sheets on a time frame consistent with limiting warming close to 1.5˚C (for APRA).

Mitigate risk to the financial system by increasing minimum capital requirements for banks which have, and/or continue adding to, portfolios with significant exposure to fossil fuels (for APRA).

Lead negotiations for an update to the Basel Framework to embed climate risk within it (for APRA and RBA).

Mandatory climate disclosures are essential for tackling climate risk

Australia's biggest financial institutions are highly exposed to escalating climate risks. What's more, their ongoing investment in expanding polluting sectors like coal, oil and gas are making this problem worse. Extreme weather events like the flooding on the east coast of Australia in 2022 are costing Australian lives, livelihoods and challenging the business model of financial industries like insurance.

Since 2015, when countries around the world united in an international agreement to address climate change through the Paris Agreement, Australia's "Big Four" banks have lent $57.5 billion to companies and projects that expand fossil fuel supply. This includes $19.2 billion to companies with plans to expand fossil fuel production and $9.5 billion directly for new or expanded projects that undermine efforts to invest in zero emissions alternatives (Market Forces, 2023a). On average, across Australia's largest super funds nearly 10 percent of members' investment are funding the top climate wrecking companies globally, accounting to $34.2 billion (Market Forces, 2023b). In the face of clear scientific consensus on the urgent need to phase out the use of coal, oil and fossil gas as quickly as possible, our banks are in fact enabling the opposite: lending billions of dollars to expand the fossil fuel industry.

Developing a standard and mandating the disclosure of climate-related risks and opportunities will provide consistent and clear information on financial institutions' exposure to climate risks, emissions, future scenarios and transition plans. It will also highlight where fossil fuel lending and other investment is intensifying climate risks. Consistent, reliable and comparable information on private entities' climate-related financial risks is critical for investors to make informed decisions and to appropriately assess the risk that entities face. Investors will then be better placed to direct investment towards companies and industries which have a long term future in a clean economy.

Climate Council welcomes the Government's adoption of IFRS which are designed to form a baseline for disclosures around the world,[1] and will ensure Australian disclosures are consistent and internationally comparable. This will give regulators, investors and communities new visibility of the climate risks held on the balance sheets of our biggest financial institutions and major corporations. This information can help transition our economy by allocating capital towards sustainable investments and away from

[1] The Task force on Climate-related Financial Disclosures were fully incorporated into the ISSB IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures standards* in July 2023 (IFRS, 2023).

carbon-intensive industries. **The Climate Council strongly supports the current direction to implement climate-related financial disclosure as a mandatory, legislated regime which aligns with international disclosure requirements.**

Requiring more entities to disclose will increase accountability and capability

Mandatory disclosures will not single-handedly address accountability issues and divert investment from fossil fuels into clean industries. But this provides an important foundation for helping to hold financial institutions, as well as other large corporations, accountable for their decision making around issues related to climate.

Climate risk is divided into two primary categories - physical and transition - that affect our environment, communities and, by extension, businesses and financial institutions. Physical risk arises from the increasing severity and frequency of climate-related events. This can include the acute risk of more frequent and severe extreme weather events like heat waves, floods, cyclones and bushfires (Bellrose et al., 2021). Businesses and investors also face significant transition risks as we seek to rapidly shift away from fossil fuels and towards clean, renewable energy sources to help tackle climate change. These can arise due to policy change, shifts in consumer sentiment and demand, or large movements in capital out of certain industries and into others (Chenet et al., 2021). Transition risks related to nature can result from the negative impact economic actors have on nature, and that businesses may face additional costs in the face of new regulation to restore and protect nature (NGFS, 2023). Litigation or liability risk can also arise out of transition risks, due to liability claims, policy and regulatory changes, and the perceived or actual failure of responsible actors to respond at the speed and scale the climate crisis now demands.

The Climate Council emphasises the importance of mandatory climate-related financial disclosures as a mechanism to expose climate risk so that large corporations and investors can take informed actions to manage them.

Requiring more entities to disclose will increase the accountability on climate risk across industries. **The Climate Council welcomes the inclusion of unlisted companies and asset managers in addition to listed companies.** Many of the country's highest emitters, such as Chevron, Glencore, Anglo American, GFG Alliance, Inpex Holdings, ConocoPhillips, Shell, Centennial Coal and Esso, are not publicly listed on the ASX but contribute significantly to emissions (UNSW Australian Human Rights Centre, 2023).

The policy position statement from Treasury proposes grouping reporting entities into three groups based on size or level of emissions (with Group 1 entities being the largest size and above National Greenhouse and Energy Reporting (NGER) thresholds). Group 3 entities may need to determine whether they need to make climate-related financial disclosures based on whether they face material climate-related risks or opportunities for the financial reporting period. Since Group 3 entities represent a significant number of entities (4,555 entities compared to 729 in Group 1 and 755 in Group 2), having this substantial group be required to report will be important for increasing accountability across industry. **The Climate Council recommends maximising coverage of the mandate. Option 1 in the Policy Impact Analysis to require full disclosure by Group 3 entities is preferred.** Option 1a, which requires Group 3 entities to complete a materiality assessment to determine whether they need to conduct a full disclosure, is the next preferred option.

In any case where Group 3 is not mandated to report, they should be encouraged to voluntarily engage with climate-related financial disclosures as it is becoming an economic imperative to disclose such information in the finance industry (CPA, 2023). As the final group to be phased in, Group 3 entities will benefit from an extra two years to prepare, as well as gaining learnings from the experiences of Groups 1 and 2. Further, Group 3 entities are of a considerable size with consolidated revenue of $50 million or more; EOFY consolidated gross assets of $25 million or more; or 100 or more employees. With forward planning Group 3 entities should be sufficiently resourced to comply with new reporting requirements. Having more entities disclose will enable learning by both reporting entities and the financial reporting and assurance industry, which ultimately gives us high quality climate-related financial disclosures.

Climate-related disclosures should be mandated as soon as possible

We are in the make-or-break decade for climate action. The actions and decisions we take now will determine whether we can hold global warming as close as possible to 1.5°C or tip over into unchecked climate chaos. The environmental, economic and social cost of continued inaction is simply too high. At the same time, the opportunities for Australia to transition our economy to being a zero emissions industry leader are too big and important to ignore. This moment calls for strong and focused action. Mandated climate-disclosures should be introduced as soon as possible. Many countries across the world - including Brazil, Canada, the European Union, Hong Kong, Japan, New Zealand, Singapore, Switzerland and the United Kingdom - have already mandated climate-related financial disclosures for certain entities (UL Solutions, 2024).

The policy position statement from Treasury proposes phasing in mandatory disclosure of the three groups over a four year period from 2024 to 2027. **The Climate Council recommends the climate-related financial disclosures for Group 1 commence as planned on 1 July 2024, with the regime then phased in over a period of three years rather than the proposed four year period** (i.e. Group 1 in FY2024-25, Group 2 in FY2025-26 and Group 3 in FY2026-27). Commencing reporting earlier for Groups 2 and 3 with additional transitional reliefs where necessary is preferable to delaying their start date.

Regarding Treasury's request for feedback on the proposed commencement date for Group 1 entities, **the Climate Council is of the view that commencing earlier will drive entities to begin the learning process associated with making these disclosures at the earliest opportunity. This is why keeping the commencement date for Group 1 entities at 1 July 2024 is preferable over commencing on 1 January 2025.** This will enable higher quality reporting by 1 July 2025, as the longer timeframe between 1 July 2024 and 1 July 2025 will enable entities to observe learnings and make adjustments to their reporting processes.

Disclosures must transparently cover *all* gross emissions

Unless we can genuinely and deeply cut carbon pollution this decade, the world is on track to well exceed 1.5°C of warming, which has been recognised internationally as a threshold beyond which we could trigger irreversible tipping points and unleash climate chaos. Every effort must be made to limit warming as close as possible to 1.5˚C above pre-industrial levels. The Paris Agreement goals have become a global benchmark for action on climate. This is why corporations need to have these goals in their sights and be aware of their climate resilience risks and opportunities.

Climate scenario analysis of the financial system is increasingly recognised as critical in understanding and responding to the risk climate change poses to financial stability. **The Climate Council welcomes the inclusion of qualitative and quantitative scenario analysis of at least two possible future scenarios, with one being aligned with the strongest global temperature goal in the Climate Change Act 2022 (i.e. limiting global warming to 1.5˚C). We strongly support including this as a legislated requirement.**

Deep cuts to carbon pollution must be made through genuine, permanent action to tackle this at its source and throughout supply chains. The international Greenhouse Gas Protocol (GHG Protocol) classifies emissions into three scopes: Scope 1 emissions relates to direct emissions coming from owned or controlled sources; Scope 2 emissions are indirect emissions from the generation of purchased energy; and Scope 3 emissions are all indirect emissions (not included in scope 2) from the value chain of the reporting entity, including both upstream and downstream emissions (GHG Protocol, 2004).

The inclusion of Scope 3 emissions reporting requirements is essential for regulators and investors to properly understand the climate risks that companies are running. Scope 3 emissions represent approximately 70-86 percent of average corporate value chain total emissions (Schenider, 2023; UN Global Compact, 2023). For banks, Scope 3 emissions will capture their financed emissions– the harmful greenhouse gas pollution which results from their lending to fossil fuel companies and other big emitters. As with fossil fuel companies themselves, Scope 3 emissions are by far the largest share of a bank's emissions footprint and so represent its biggest contribution to climate risks. Globally, financed emissions of financial institutions are, on average, more than 700 times larger than direct emissions (Centre for Policy Development, 2021). Failing to report Scope 3 emissions would obscure the most significant source of climate risks and impacts for corporations.

The Climate Council welcomes the inclusion of Scope 3 emissions reporting and recommends that all entities be required to include Scope 3 emissions from the first year of reporting, with limited liability measures in the first year. Based on Treasury's Policy Position Statement, reporting entities are not required to report Scope 3 emissions in year one of their respective phase-in dates. The Climate Council proposes an alternative approach: entities should be required to disclose Scope 3 emissions from year one, but liability may not be applied until a later date. This could be undertaken on a sector-by-sector basis, as for some entities this would be relatively straightforward. For example, calculating Scope 3 downstream emissions is very straightforward for fossil fuel companies as this is simply a function of production volumes combined with the emissions intensity of each individual extraction project. Where Scope 3 emissions are not as straightforward to calculate, there needs to be industry capability building, both for reporting entities and for the assurance industry, to ensure a rapid increase in the quality of disclosure information. This capability building will only be gained through doing.

In pursuing deep cuts in all emissions across the supply chain, the regime should also help incentivise genuine and permanent reductions, rather than reliance on offsets. While there may be some limited instances where it is appropriate to use carbon offsets, they are no substitute for doing everything possible to reduce and eliminate emissions in the first place. As explained in Box 1 below, we cannot offset our way out of dangerous climate change. The concept of 'net zero' is inherently vulnerable to misuse. Too many companies - including some of Australia's biggest polluters - currently promote net zero or carbon neutral claims based on the extensive use of carbon offsets, while taking limited steps to genuinely reduce their emissions. **The Climate Council strongly supports the requirement**

for reporting entities to disclose detailed information about their planned use of carbon credits to offset their greenhouse gas emissions, and recommends this be explicitly included in the legislation. Entities should report on the proportion of any emissions reduction targets achieved through offsetting and provide details of the credits they are using so that external parties can assess the quality of these.

Box 1: Offsets are no substitute for genuine emissions reduction

Carbon offsetting involves buying a 'credit' from an activity that reduces pollution in order to justify a polluting activity, where typically one credit permits the emission of one tonne of carbon dioxide equivalent. Offsets are created through projects which reduce, avoid or capture emissions - like planting trees, restoring damaged environments and capturing landfill gas. While this sounds like a fair balance, offsets can never effectively account for the harmful greenhouse gases created by burning fossil fuels.

That's because carbon dioxide released by burning fossil fuels is fundamentally different from the carbon stored above ground in trees, wetlands and in the soil. When we burn fossil fuels, we release carbon that has been locked away in the Earth's crust for millions of years, pumping vast ***new*** volumes of carbon into the active carbon cycle. This is altering the balance of carbon in the Earth system, and doing so faster than ever recorded in geological history. To make the problem worse, much of the carbon stored in land-based offsets does not stay stored. Forests can easily be destroyed by fire, disease, floods and droughts, all of which are increasing with climate change. So the carbon that has been stored literally goes up in smoke (Morgan, 2023).

Offsets are currently a popular way for companies to claim they are taking action to tackle climate change. This is because they can keep polluting as usual and pay for offsets to account for the emissions they produce on paper. While there is a limited role for offsets to play in hard to abate industries, these should only apply while permanent solutions to genuinely cut emissions are being progressively phased in.

Mandatory disclosures should be a springboard for further action

Increased transparency through disclosure can be a spotlight in the hunt for climate financial risks, shining new light on the places across our financial system where these are too high. However, requiring more disclosure and then hoping for a rational market response will not be enough. Armed with this tool, the Australian Government and financial regulators should use it to full advantage through a next phase of laws and regulatory actions which actively seek to **reduce** financial system climate risk. This would build on the momentum generated by these reforms and other key initiatives underway including the Sustainable Finance Strategy, Green Bonds program and Sustainable Finance Taxonomy. These recommendations and the context for them are discussed in detail in Climate Council's (2023b) report *Dollars and sense: mitigating climate risk in a warming world*.

For the Australian Government

As the recent development of mandatory climate-related financial disclosure demonstrates, the Australian Government works closely with financial system regulators to set the rules of engagement for system participants. The Australian government has also recently acknowledged the systemic risk climate change poses to the value of the country's sovereign bonds. While a significant amount of domestic banking regulation is designed to mirror international standards to ensure market interoperability, there are key steps the Government can take to strengthen this within our borders.

Recommendations:

- **Use rules applying to all Authorised Deposit-taking Institutions (ADI) to mandate banks conduct climate stress testing on their portfolios, to take into account climate risk and lending for climatic and financial stability.** The Commonwealth *Banking Act 1959* defines what an ADI is and the conditions under which financial firms obtain their licence. The Australian Government should amend the Act to require ADIs to take appropriate direct steps to measure and manage their climate financial risks, by undertaking regular climate stress testing of their lending portfolios and then acting on the findings.

- **Direct the Council of Financial Regulators to pursue international negotiations over improvements to the Basel Capital Framework addressing climate risk.** Because much of Australia's banking regulation reflects international standards, updating this to better deal with climate risk will require engagement with global bodies like the Bank for International Settlements, which designs the Basel Framework. The Australian Government should direct the Council of Financial Regulators to explicitly pursue improvements to the Basel Framework relating to the introduction of additional risk weighting for assets with high climate risk, and the establishment of climate risk capital buffers.

For regulators

APRA, ASIC and the RBA are responsible for administering a powerful and extensive framework of rules and regulations. These regulators should use the powers already at their disposal to rapidly address the risks which will become more visible following the implementation of climate financial disclosure. At the same time, they should seek to steer the international design of further improvements to the Basel Framework so that these can flow through to stronger regulations in Australia in the years to come. The design of updates to this framework after the Global Financial Crisis took a significant amount of time and international coordination; Australia's regulators should focus on a specific and discrete set of improvements which can directly deal with climate financial risk.

Recommendations:

- **Require fossil fuel projects' remediation costs to be accounted for within corporate balance sheets on a time frame consistent with limiting warming close to 1.5˚C (for APRA)**. Fossil fuel companies should pay for the total remediation of mining sites from general revenue and this should be included on their balance sheets as a liability due in the short to medium term. Currently, remediation liabilities are recorded, however project lifetimes span decades and the liability is significantly discounted. Regulators should require a test of ability for fossil fuel companies to provide for total remediation if it was required within a 10-year timeframe, consistent with science-based advice on the need to phase out fossil fuels within this period (IEA, 2021; IEA, 2023).

- **Mitigate risk to the financial system by increasing minimum capital requirements for banks which have, and/or continue adding to, portfolios with significant exposure to fossil fuels (for APRA)**. Under the Basel Framework, regulators can increase minimum capital requirements beyond the base level, for banks which have significant risks. This is an existing prudential regulatory tool and APRA has previously used it to address other types of risk in the Australian financial system. For example, following findings of misconduct against Commonwealth Bank, ANZ, NAB and Westpac by the Royal Commission into financial services in 2019, APRA imposed additional minimum capital requirements on all four banks. Commonwealth Bank was required to hold an additional $1 billion against its minimum capital requirement, and ANZ, NAB and Westpac were each required to hold an additional $500 million (APRA, 2019). Using the insights of mandatory disclosures under the Australian climate finance regime commencing in 2024, APRA should impose additional minimum capital requirements on banks with significant reported risks through lending to fossil fuels.

- **Lead negotiations for an update to the Basel Framework to embed climate risk within it (for APRA and RBA)**. In close collaboration with the Australian Government, agencies should actively pursue emerging international proposals to update the Basel Framework to explicitly deal with climate risk.

Conclusion

Communities in Australia and around the world are already facing devastating climate impacts - with homes, lives and livelihoods lost. This is the critical decade for climate action, for rapid emissions reductions and a fast, fair and inclusive transition to a clean, renewable-powered economy. Australia needs to invest upwards of $1.2 trillion by 2030 to renew our energy system while scaling up other clean industries (Net Zero Australia, 2023). It is critical that money flows towards this transition and away from industries which are fuelling harmful climate change.

Investors - whether they are working Australians looking for a super fund or trillion dollar asset managers - need credible, transparent and comparable climate-related financial disclosures to make informed decisions. Climate Council welcomes this legislation and the Treasury's ongoing efforts to mitigate climate risk within the financial system, particularly the inclusion of Scope 3 emissions and requirements to transparently disclose reliance on offsets versus genuine effort.

Tackling climate financial risk calls for coordinated action from financial institutions, the Australian Government, financial regulators and reporting entities. Mandatory climate-related financial disclosures provide an important foundation to pursue further direct action addressing system climate risk. The Climate Council's further recommendations can strengthen Australia's financial system against climate-related risks so that it is more resilient and stable, while facilitating a stronger and faster flow of investment toward clean sectors with a bright and thriving future.

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