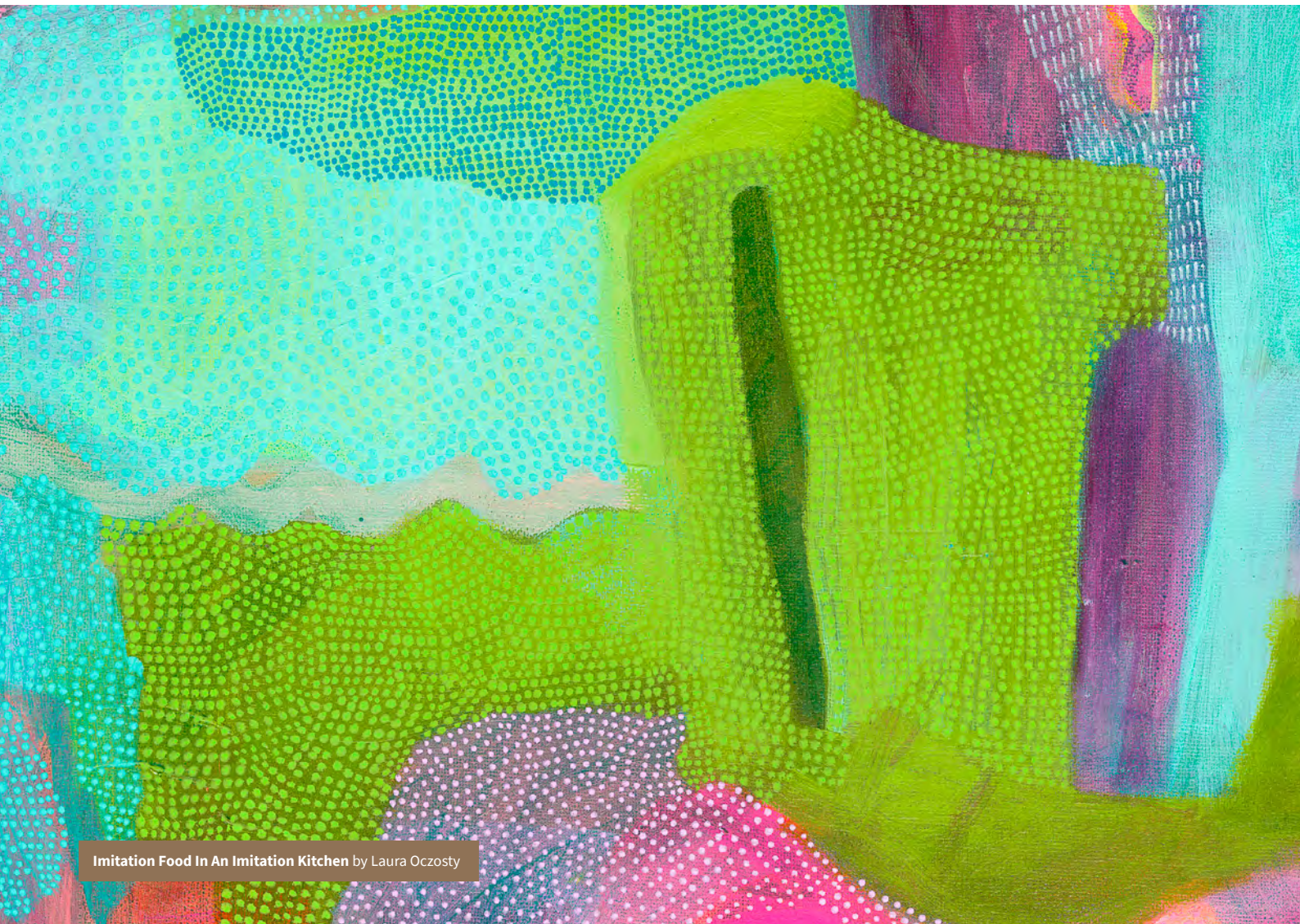


IN PRIVATE

KWM M&A INSIGHTS | 2025



GET READY TO REPORT: AUSTRALIA'S NEW CLIMATE RULES ARE COMING

AND THEY'RE NOT JUST FOR TREE HUGGERS!



2025 marks a fresh chapter for sustainability reporting in Australia, with large entities kicking off their first full financial year of reporting from 1 January 2025. This article explores what this new regime means for private equity sponsors in Australia.

WHO IS AFFECTED?

The new legislation applies to entities that must lodge financial reports with ASIC under Chapter 2M of the Corporations Act 2001 (Cth). This means:

- Excluded entities: Partnerships and trusts (except registered management investment schemes and superannuation funds) don't need to report.
- Foreign managers: GPs / managers incorporated outside of Australia and not conducting business in Australia also don't need to report.
- Local sponsors: GPs / managers incorporated in Australia or conducting business here will need to report if they meet the reporting thresholds (see below).

KEY REPORTING THRESHOLDS

The legislation introduces a phased reporting approach based on specific thresholds. Here's a quick breakdown:

| GROUP | REPORTING START DATE | RELEVANT THRESHOLDS ¹ |
|---------|----------------------|---|
| Group 1 | 1 January 2025 | \$500 million revenue, \$1 billion assets, 500+ employees |
| Group 2 | 1 July 2026 | \$200 million revenue, \$500 million assets, 250+ employees |
| Group 3 | 1 July 2027 | \$50 million revenue, \$25 million assets, 100+ employees |

1. The entity must meet at least 2 of the listed thresholds

IMPORTANT CONSIDERATIONS FOR SPONSORS

For sponsors, the new regime requires careful evaluation from 2 angles:

- Sponsor on a standalone basis: Assess if the sponsor's total fee income and carry interests on a standalone basis (i.e. excluding portfolio companies or AUM) meet the financial thresholds.
- Consolidation of investee / portfolio companies: Determine if the sponsor needs to consolidate the revenue, gross assets and employee count of its portfolio companies for purposes of qualifying as Group 1, 2 or 3.

The test for consolidation of portfolio companies is the 'control' test established under Australian accounting standards (AASB 10). This is different to the test for 'control' under the Corporations Act. The test under AASB 10 focuses on:

- Decision-making authority: Scope of control exercised by sponsor over investee companies.
- Removal rights: Rights of others to remove or replace the sponsor or alter each investee company's strategy.
- Remuneration model: Incentives created by the sponsor's remuneration structure.
- Return variability: Exposure to variability of returns from other interests in each investee company.

The characteristics of ordinary debt (i.e. private credit) don't confer control on sponsors and don't need to be consolidated for testing whether the sponsor is Group 1, 2 or 3. Similarly, structured products like preference shares are unlikely to require consolidation until exercised.

SO, YOU NEED TO REPORT – WHAT DOES THAT MEAN?

Reporting entities will need to include climate-related disclosures as part of a Sustainability Report², the contents of which must include:

- material climate-related risks and opportunities;
- resilience to at least 2 climate scenarios;
- disclosure of Scope 1, 2 and 3 greenhouse gas emissions (Scope 3 emissions reporting starts in year 2); and
- a transition plan for meeting GHG emissions targets.

SCOPE 3 EMISSIONS

Scope 3 emissions include those from:

- Equity investments: minority and non-controlling interests;
- Debt investments: loans and debt instruments;
- Project finance: emissions from financed projects; and
- Managed investments: emissions from these activities.

Sponsors who expect to be caught by the climate reporting regime may face challenges in collecting climate data from portfolio companies and borrowers if they don't have relevant information rights in their shareholders agreements or debt documents and management or other investors are resistant to its collection or disclosure. Separately, it will be important for reporting sponsors to ensure that their portfolio companies and borrowers have systems in place to collect and report reliable, transparent and timely data to the sponsors, so that the sponsors have confidence in their own reporting. For these reasons, starting early on identifying obligations, putting in place information rights and appropriate data gathering systems will be crucial for robust disclosures. This is likely to become especially important since ASIC will pay careful attention to which sponsors are reporting under the new regime, and how they are doing so, consistent with ASIC's increased focus on private markets and demonstrated commitment to taking on greenwashing.³

CONCLUSION

Private capital sponsors must determine if they or their portfolio companies need to report under Australia's new sustainability regime. If reporting is required, they need to prepare and they need to ensure that their portfolio companies and borrowers are preparing for Scope 1, 2 and 3 emissions disclosures, along with climate-related risks and opportunities.

2. The Sustainability Report can be included as part of the financial report in the annual report, as a standalone document as part of annual reporting or included as a separate report to the financial report in the annual report.

3. See KWM's Client alerts (here and here) dealing with ASIC enforcement of greenwashing claims. For this reason, sponsors should seek advice early on their reporting obligations and stay up to date on how industry is addressing it, and ASIC is responding to, mandatory climate reporting.



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