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Submission on climate-related financial disclosures

The Institute of Directors (IoD) appreciates the opportunity to comment on the discussion document *Climate-related financial disclosures – understanding your business risks and opportunities related to climate change* released by the Ministry for the Environment and the Ministry of Business, Innovation & Employment.

Following a recommendation from the Productivity Commission in its *Low Emissions Economy* final report the Government endorsed the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD)[1] as an avenue for the disclosure of climate risk. It is now seeking feedback on how to give effect to a mandatory, principles-based disclosure regime.

Climate change is the defining issue of our time and requires action now to chart a new course for the future. Boards have a critical role in confronting and responding to climate-related issues and risks to ensure the long-term sustainability of their organisations and to understand and mitigate their impact on the environment. Climate change has been a key theme for our membership this year and we have identified it as the top issue for directors in 2020.

About the Institute of Directors

The IoD is New Zealand's pre-eminent organisation for directors and is at the heart of the governance community. We believe in the power of governance to create a strong, fair and sustainable future powered by best practice governance.

Our role is to drive excellence and high standards in governance. We support and equip our members who lead a range of organisations from listed companies, large private organisations, state and public sector entities, small and medium enterprises, not-for-profit organisations and charities.

Our Chartered Membership pathway aims to raise the bar for director professionalism in New Zealand, including through continuing professional development to support good governance.

Summary

Climate-related disclosures can be a powerful mechanism to focus reporting entities on the impacts of climate change on their own activities, and disclosure can enable investors to make decisions across investment opportunities that accurately reflect the climate risk of those choices. We agree that the TCFD framework would be appropriate for climate-related financial disclosures in New Zealand and we:

[1] See Appendix A for an overview of the TCFD framework.

- note that the ‘comply or explain’ approach to implementing the TCFD framework can support good governance and provides flexibility and proportionality for organisations to report in a way that is appropriate and meaningful relevant to their circumstances
- raise questions about how the proposed mandatory requirements will fit with the principles based nature of the TCFD framework, and how it is intended to be implemented, monitored or enforced
- agree that disclosure should apply to listed issuers, banks, general insurers, asset owners and asset managers but we consider that there should be exemptions for some smaller organisations below a certain size (eg assets/revenue) given the existing disclosure burden (particularly for listed companies) and costs associated with complying
- agree that mandatory assurance obligations should not be imposed at this stage
- encourage government guidance, education and support to help organisations report effectively.

Overview

The discussion document addresses the following four key questions:

- should new mandatory climate-related financial disclosures be introduced or should the status quo be retained?
- what should be disclosed?
- which entities should be disclosing?
- when should they start disclosing?

The following proposals included in the discussion document are intended to produce a reporting framework that is clear, consistent and comparable:

- there would be mandatory, principles-based climate-related financial disclosures (on a ‘comply or explain’ basis) for listed issuers, banks, general insurers, asset owners and asset managers
- the TCFD reporting framework would be the default framework, but the ‘comply’ element could also be satisfied by disclosing climate-related financial information under other reporting frameworks that align with the TCFD
- it would be permissible not to comply with the TCFD in the first year only, provided explanations are given as to why (eg because targets and metrics are still being developed). After the first year, non-disclosure would only be permissible if an organisation is not materially affected by climate change - however, it would still need to explain why
- publication of climate-related financial information would be made in annual reports, to a level of detail appropriate to the needs of users, and with the use of cross-references or mappings to assist users to locate further information if needed
- mandatory assurance obligations would not be imposed at this stage, until it becomes clearer what users may want from the assurance process and new or amended standards and guidance have been developed.

The government has not yet formed a view about whether smaller entities should be excluded from the regime or what criteria should be used to assess their exclusion (eg annual revenue, total assets, or a combination of both).

The regime is intended to come into effect for financial years commencing 6 months after the regime is introduced. For example, this means if regulations were introduced on 1 July 2021 then organisations with a March balance date will need to start reporting for the year ending March 2023.

IoD comments

In our 2019 Director Sentiment Survey 35% of directors said their boards were engaged and proactive on climate change (an increase from 29% in 2018). Engagement was significantly higher for directors of listed companies with 51% agreeing (and only 14% disagreeing). In October, The Aotearoa Circle's Sustainable Finance Forum published a legal opinion confirming that directors should (and in some cases must) take climate change into account in their decision-making and that the risk should be assessed in the same way as any other financial risk to the company.

We agree with the Productivity Commission's point in its *Low Emissions Economy* final report that climate-related disclosures can be a powerful mechanism to focus reporting entities on the impacts of climate change on their own activities, and that disclosure can enable investors to make decisions across investment opportunities that accurately reflect the climate risk of those choices.

Some organisations are already expected to disclose material climate-related financial information (eg ESG guidance for NZX listed companies). The Climate Change Response (Zero Carbon) Amendment Act 2019 includes an adaptation reporting power for some public and private sector organisations. And a regulation-making power under the Reserve Bank of New Zealand Act 1989 may be used to ensure registered banks publish climate-related financial information.

Some organisations are also voluntarily reporting on the impacts of climate change on their organisations and reporting frameworks (such as the Global Reporting Initiative and Integrated Reporting) are widely accepted and used by organisations wanting to report more holistically on their performance, intentions and impact.

Climate-related financial disclosures under the TCFD reporting framework
Climate-related financial reporting is an area that is evolving quickly around the world. The TCFD recommendations have received widespread support internationally (including in Australia, the United Kingdom and the European Union) and they are considered best practice for climate-related financial reporting. Against this background, we also agree that the TCFD framework would be appropriate for New Zealand including for the following reasons:

- the principles-based framework provides flexibility to consider individual organisation's circumstances and further developments in best practice and enables organisations to report on elements that are meaningful to them
- the framework sets out four thematic areas (governance, strategy, risk management, metrics and targets) which represent the core elements of how organisations operate and adequately differentiates between the role of board and management
- it will help directors fulfil their legal obligations in relation to climate risk
- it can assist organisations in responding to the growing demand by stakeholders for meaningful climate-related disclosure
- it will help New Zealand align with international thinking and the approach of other similar jurisdictions.

Mandatory nature and implementation
Mandatory 'comply or explain'
There is a growing trend of governments and regulators considering mandatory disclosure, including the United Kingdom which has set up a joint taskforce of regulators to explore the option.

The proposed 'comply or explain' approach to implementing the TCFD framework can support good governance and provides flexibility and proportionality for organisations to report in a way that is appropriate and meaningful relevant to their circumstances. For 'comply or explain' to work effectively there needs to be genuine commitment to good governance and meaningful, open explanations. A constructive culture needs to be fostered where explanations are assessed on their merit rather than assuming non-compliance is inherently negative. Explaining why the entity has not complied and providing sound reasons for why not is important for transparent corporate reporting.

It is unclear how the proposed mandatory requirement will work with the principles based nature of the

TCFD framework, including how it is intended to be implemented, monitored or enforced. In addition, the TCFD framework is still relatively new and there is acknowledgement that it needs time to fully mature. Feedback to date suggests many organisations are not reporting on all 11 recommendations and some are finding certain areas problematic to report on (eg scenario analysis). The intent of the TCFD framework is that implementation of its recommendations will evolve with organisations continually improving the quality and usefulness of their disclosures over time. How this will work if a mandatory requirement is introduced is not clear.

The need for flexibility, alignment and consistency in corporate reporting

Corporate reporting is continuing to change and there are many different reporting frameworks in place globally. It is important that any mandatory climate-related financial disclosure regime in New Zealand provides a foundation framework that:

- is flexible enough to allow organisations to evolve their reporting as needs and demands in this area change, including if other entities are included in the regime at a later date
- is cohesive for organisations intent on developing more holistic reporting and aligns with other common reporting frameworks (eg Integrated Reporting)
- aligns (and can be integrated) with any other reporting obligations that organisations may have to the government (for example under the Climate Change Response (Zero Carbon) Amendment Act 2019) and the frameworks and requirements of other agencies such as the External Reporting Board. This will also be important if mandatory assurance is introduced at a later date
- can be incorporated into companies' annual reports in a cohesive way that avoids unnecessary repetition
- ensures there is alignment with the roles and responsibilities of existing reporting and regulatory bodies (such as the Financial Markets Authority).

Application

The current proposals suggest disclosure would apply to listed issuers, banks, general insurers, asset owners and asset managers (although the list may be extended in the future including to other private organisations). We agree with the intent of the proposed coverage but consider that there should be exemptions for some smaller organisations below a certain size (eg assets/revenue) given the existing disclosure burden (particularly for listed companies) and costs associated with complying.

In terms of any future wider application, the New Zealand Accounting Standards Framework sets out a system of financial reporting tiers to determine which accounting requirements or standards are appropriate for each entity. Consideration should be given to this in determining the reporting requirements of different size entities and this would also help ensure alignment with other existing reporting frameworks.

Assurance

Mandatory assurance obligations are not proposed at this stage. We agree that such obligations should not be imposed until the TCFD reporting framework has been tried and tested and it becomes clearer what users may want from the assurance process and new or amended standards and guidance have been developed.

Guidance, support and education

It is important that there is sufficient government guidance, education and support for organisations to ensure they are in a position to make meaningful disclosure under a new reporting regime. There will also be opportunities for government assistance in reducing the cost of disclosure, for example by producing common sets of assumptions (eg the future price of carbon) that could be used to help offset the cost of forecasting or specialist modelling that each organisation may otherwise be required to produce.

Conclusion

Climate-related disclosures can be a powerful mechanism to focus reporting entities on the impacts of climate change on their own activities, and disclosure can enable investors to make decisions across investment opportunities that accurately reflect the climate risk of those choices. We agree that the TCFD framework would be appropriate for climate-related financial disclosures in New Zealand and it is important that the foundations of the regime are fit for the future given the increasing importance and focus on climate change.

We appreciate the opportunity to comment on behalf of our members and would be happy to discuss this submission with you.

Yours sincerely

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Appendix A – The TCFD

In 2015 the Financial Stability Board established the Taskforce on Climate-related Financial Disclosures and asked it to develop a set of voluntary climate-related financial disclosures that companies could use when providing information to stakeholders. The TCFD identified two types of risks:

- transition risks (policy risk, litigation risk, technology risk, market risk and reputational risk)
- physical risks (both event driven (eg extreme weather) and driven by long-term shifts in climate patterns).

The TCFD recommends 11 areas of disclosure within four thematic areas:

- **Governance** – disclosing the organisation's governance and management around climate-related risks and opportunities
- **Strategy** – disclosing the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material
- **Risk Management** – disclosing how the organisation identifies, assesses, and manages climate-related risks
- **Metrics and targets** – disclosing the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.