Investor Group on Climate Change (IGCC)

Submission to:

Climate-related financial disclosures: Understanding your business risks and opportunities related to climate change

December 2019

Erwin Jackson, Director, Policy
erwin.jackson@igcc.org.au
www.igcc.org.au

ABOUT US

The Investor Group on Climate Change (IGCC) is a collaboration of Australian and New Zealand investors focused on the impact that climate change has on the financial value of investments. The IGCC represents institutional investors with total funds under management of over $2 trillion, and others in the investment community interested in the impact of climate change. IGCC members cover over 7.5 million people in Australia and New Zealand.

Summary

The Investor Group on Climate Change (IGCC) welcomes the opportunity to comment on the New Zealand Government's discussion paper, *Climate-related financial disclosures: Understanding your business risks and opportunities related to climate change*. IGCC is a collaboration of New Zealand and Australian investors with total funds under management of more than $2 trillion.

Climate-related disclosures are:

- central to the long-term sustainability of New Zealand's companies and financial institutions;
- reducing the systemic risk climate change poses to the financial system, and;
- ultimately, increasing the prosperity of New Zealand's people and communities.

IGCC supports the broad direction of the Government's proposed mandatory climate-related disclosures proposals. Currently there is not enough decision useful information in the public domain about how companies and investors in New Zealand are identifying, managing, governing and reporting on climate-related financial risks and opportunities. Effective mandatory reporting would help to address potential financial stability risks, help support a managed transition to net zero emissions and build resilience to the impacts of climate change.

Specific comments on the Government's proposals

In providing this submission, IGCC has made the following recommendations:

1. Set managing the systemic risks of climate change to the New Zealand financial system and economy as a clear objective for implementing mandatory climate-related disclosures.
2. Climate-related disclosure requirements should be implemented through existing corporate and financial regulatory frameworks, and corporate and financial regulators must will have the central role of managing compliance. This will ensure actions in New Zealand align with global trends, build on the core competencies of these agencies, and ensure disclosures are perceived as material to financial performance and financial stability.
3. Ensure New Zealand is a fast-follower of other markets in integrating climate risk into the financial system and set a clear expectation that robust disclosures be in place by 2022 at the latest.
4. Financial and corporate regulators, and the government, should provide guidance on appropriate standards to support the TCFD in the New Zealand context. Without other layers of guidance, it is likely that companies will continue to underreport climate-related risks.
5. The scope of mandatory disclosures should be widened to include all companies, regardless of whether they are listed, where possible and practical.
6. The Council of Financial Regulators should examine the implications of exemptions of smaller entities for financial stability and make recommendations on whether and/or how they should be captured by TCFD disclosures.
7. The government should strongly support voluntary assurance to strengthen the quality of disclosures and set a deadline for mandatory assurance to be implemented by 2022.

The IGCC looks forward to working with the Government to implement and build upon the recommendations set out in the discussion paper and this submission to support a prosperous and resilient New Zealand.

Introduction

The Investor Group on Climate Change (IGCC) welcomes the opportunity to comment on the New Zealand Government's discussion paper, *Climate-related financial disclosures: Understanding your business risks and opportunities related to climate change*. The mainstreaming of climate- related disclosures is central to improving the climate risk management of New Zealand's companies and financial institutions, reducing the systemic risk climate change poses to the financial system, and ultimately, increasing the prosperity of New Zealand's people and communities.

IGCC's members have developed or are developing their own climate-related financial disclosures. As shareholders of many of New Zealand's largest companies they are a prime user of company climate-related disclosures. As global investors, IGCC members are also exposed to the actions of governments and financial regulators are taking to stimulate climate-related disclosures across a broad range of markets. Together, these characteristics give IGCC unique insights that will be valuable as the New Zealand Government further develops its climate-related disclosure framework.

This submission is broken into three sections. The first section provides important contextual information for IGCC's feedback, the second outlines IGCC's overall comments on the paper, and the third part addresses the specific questions set out in the discussion paper.

Framing New Zealand's response to climate-related disclosures

Institutional investors have systemic exposure to climate change

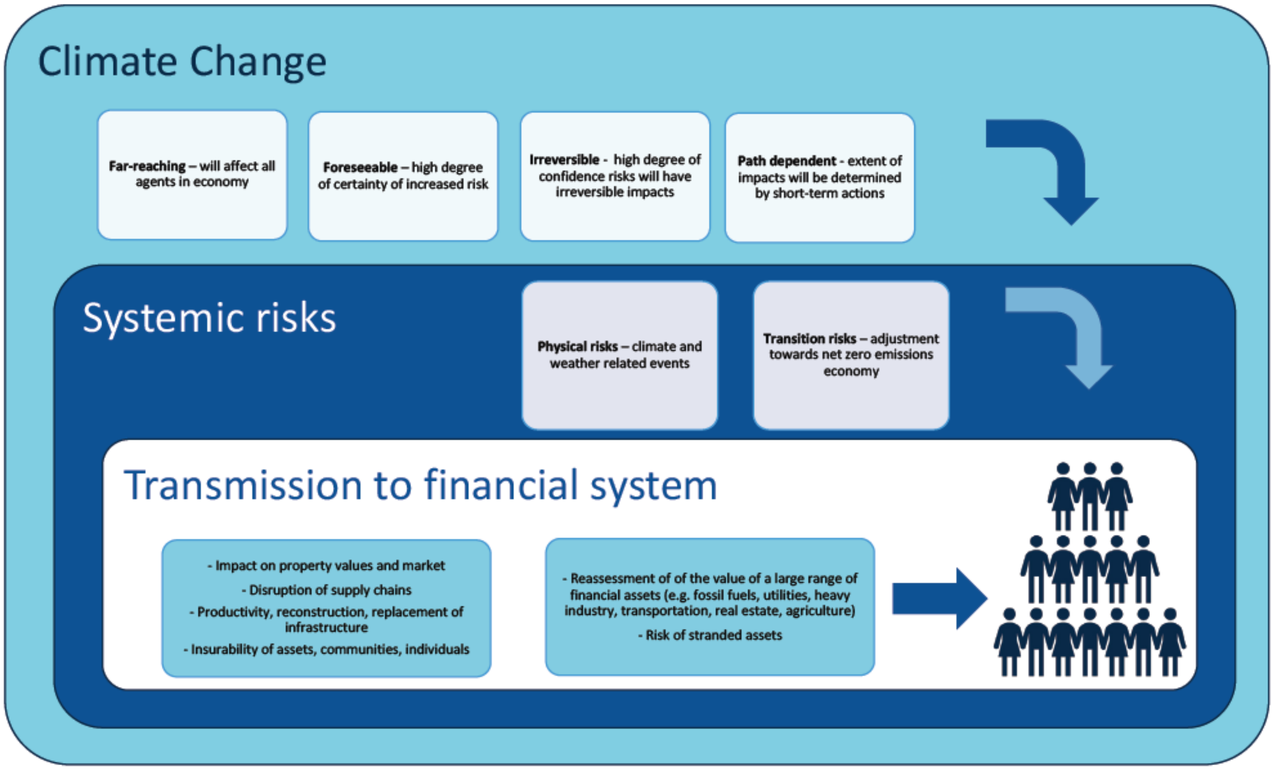
Investors are exposed to systemic, climate-related *physical*, *transition* and *litigation* risks (Figure 1).[1]

The systemic nature of these risks has been identified by financial regulators as requiring a strong and effective response. Reporting frameworks such as the G20 Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) recommendations are being embedded into the regulation of the financial system around the world.

Institutional investors invest across the economy for the long-term and are exposed to the growing impact of climate change on the companies, industries, property and infrastructure assets they own. Climate change risks will affect a broad range of asset classes and sectors. This means that investors cannot simply avoid climate risks by moving from one asset class to another and cannot diversify away from climate risk.

[1] https://www.ngfs.net/sites/default/files/medias/documents/ngfs-report-technical-supplement_final_v2.pdf

Figure 1: Climate change and macroeconomic and financial stability. Developed from Central Banks and Supervisors, Network for Greening the Financial System (2019) [2]



Climate-related financial disclosures are central to managing climate risks

Investors preside over financial risk for the long term and need to be managing climate-related transition, physical and litigation risks as part of their fiduciary duties. Regulators also need to have good visibility of the system-wide implications of decarbonisation and climate change itself. The community is increasingly engaging with pension funds to better understand the carbon footprint of and climate change risk in their retirement savings. Effective carbon risk disclosure integrated into routine financial reporting is the foundation of good risk management for all of these constituencies.

While existing emissions and financial reporting frameworks have proven to be useful building blocks in carbon disclosure, they no longer comprehensively serve the needs of investors who are seeking to understand and price the financial implications and effective management of systemic climate risks.

Investors are increasingly calling for greater take up of TCFD recommendations. At the same time, government policy coordination is critical to improving the quality of disclosures to ensure that material and investable information is delivered transparently to market.

Standardised reporting on material climate change risks and opportunities must be embedded in mainstream corporate and financial regulation. Overall, better collaboration between industry, investors

[2] https://www.ngfs.net/sites/default/files/medias/documents/ngfs-report-technical-supplement_final_v2.pdf

and financial policymakers on long-term carbon risk management will increase New Zealand's competitiveness and resilience to the economic impacts of climate change.

New Zealand is exposed to global market shifts

In October 2018, IGCC convened a workshop in Auckland to look at how to invest in climate solutions in New Zealand. In doing so, IGCC brought together investors, financiers, and other stakeholders to investigate key challenges and barriers for New Zealand, explore opportunities to scale up climate finance and discuss real-world examples of current best practice.[3]

Some of the key conclusions of this workshop included:

1. **There are strong expectations that global trends in investor practice will be reflected in New Zealand**: New Zealand will be impacted by shifts in global markets to low- and zero-emissions technologies, practices and investments. Capital is global and will be attracted to markets that are actively managing climate-related risks. Local legal experts have also indicated that they expect that New Zealand will follow global accountability trends, such as TCFD reporting, related to discharge of governance, fiduciary and stewardship duties.

2. **While there are some market leaders, overall, the New Zealand financial market is still at relatively early stages of responding to climate change risk and opportunity:** Compared to other markets there has been relatively less debate about transition and systemic risk from climate change in New Zealand. For example, insurance companies are on the "front lines" of climate change in terms of physical risk exposure, as well as exposure of their investment portfolios. There has not been the same level of leadership from New Zealand's insurance sector on climate change, compared to international counterparts. While the issue is climbing the agenda in New Zealand boardrooms, there has been a general disparity in response between large firms and SMEs (the latter, due to perceived relevance or limited resources).

3. **New Zealand faces ongoing challenges to climate-resilient investment, particularly for agriculture (still at early R&D stage), infrastructure and adaptation**: Issues of investment scale, general underfunding of infrastructure and a relatively weak innovation system have been highlighted. There has been limited public climate finance to date, and little experience and experimentation in the New Zealand market generally, with innovative climate finance instruments and approaches not yet widely adopted. The New Zealand Green Investment Fund Ltd is being established to address some of these gaps and weaknesses.

---

[3] https://igcc.org.au/wp-content/uploads/2016/04/IGCC-NZ-report-final.pdf

Overall comments on discussion document

IGCC supports the broad direction of the policy

IGCC agrees that currently there is not enough investment decision useful information in the public domain about how companies and investors in New Zealand are identifying, managing, governing and reporting on climate-related financial risks and opportunities.

While a good start, voluntary frameworks have not entirely succeeded in bringing the relevant information to the market. IGCC agrees that in New Zealand mandatory reporting would help to address potential financial stability risks, help support a managed transition to net zero emissions and build resilience to the impacts of climate change.

Greater clarity needed on policy objectives

IGCC would encourage the government to more clearly define the policy objectives of mandatory climate-related financial disclosures. The proposed objective in the discussion document focuses on investors and companies routinely considering climate-related risks and opportunities. This is an important but insufficient policy objective and may result in policy decisions that foreclose on the potential system-wide benefits of mandating high-quality climate-related financial disclosure.

Specifically, managing systemic risks to New Zealand's financial system should be central to government and financial regulator actions on climate-related disclosures. Global climate-related disclosure frameworks, such as the TCFD, emerged in response to governments recognising that climate change represents a systemic risk to financial stability. The routine consideration of climate-related risks is a pre-requisite for the ongoing management of such risks by companies, investors and regulators, which in turn is necessary to mitigate the risk to the financial system – and, importantly, the New Zealand economy.

Defining a core policy objective of climate-related disclosures as managing risks to the overall financial system risks underscores the importance of robust reporting frameworks across the economy and increases the scope and urgency of establishing a policy response to the systemic risks of climate change.

IGCC supports mainstreaming mandatory disclosures into investor and corporate governance frameworks

A guiding principle and objective of climate-related disclosures should be to mainstream climate action into the lifeblood of the financial system. All sectors of the economy will be impacted by climate change risks. This extends beyond the impact of climate change on a particular asset, to how climate change will impact supply chains, sectors, international trade and the overall economy. There are also emerging opportunities for key zero and low carbon industries. For investors, managing these risks requires at least the same levels of governance, oversight and active management as any other dimension of material financial performance.

Mainstreaming the assessment of climate-related risks into existing financial and corporate reporting requirements is appropriate given:

- the systemic materiality of the risk and the potential materiality of specific types of risk to specific organisations,
- the need to ensure the appropriate governance of climate risk,
- the need to make managing climate risks core to the functioning of the financial system, and,
- critically, to ensure financial regulators and supervisors are empowered to take responsibility for oversight of climate-related disclosures as part of their role in supporting financial stability.

The TCFD framework is central to delivering decision useful information to the market and investors. However, currently standards of reporting under the TCFD vary widely and many reports do not currently provide decision useful information to the market. For example, most TCFD-aligned disclosures are largely qualitative and fairly general, with limited disclosures of modelling assumptions and the financial impacts associated with specific climate-related risks. Another example is that disclosures often focus on operational exposure and not exposure aligned with financial reporting, e.g. equity-based emissions.

The TCFD's most recent status update report[4] noted that the framework is not yet driving the desired standard of disclosure and more detailed guidance is needed:

> *"The top area identified by users of climate-related financial disclosures as needing improvement is for companies to provide more clarity on the potential financial impact of climate-related issues on their businesses.*
>
> *"Three out of five companies responding to the TCFD survey that view climate-related risk as material and use scenario analysis to assess the resilience of their strategies do not disclose information on the resilience of their strategies."*

IGCC is currently working with its members to define clear investor expectations around decision useful TCFD reporting. There will also be an important role for financial and corporate regulators, and the government, to provide guidance on appropriate standards to support the TCFD in the New Zealand context. Without other layers of guidance, it is likely that companies will continue to underreport climate-related risks e.g. asset impairments due to strong climate policy responses or the physical impacts of climate change.

New Zealand needs to build capability for the inevitable

As outlined above, the New Zealand financial market is still at relatively early stages of responding to climate change risk and opportunity. Central to the Government's consideration should be to ensure New Zealand is a fast-follower of other markets in integrating climate risk into the financial system. This implies the government should recognise participants in the New Zealand market are starting from a point that is currently behind their international peers while at the same to signalling clear deadlines to bring climate related disclosures up to leading practice internationally.

[4] https://www.fsb-tcfd.org/publications/tcfd-2019-status-report/

Recommendations:

Based on the above, IGCC recommends:

- The Government sets managing the systemic risks of climate change to the New Zealand financial system and the economy as a clear objective for implementing mandatory climate-related disclosures.
- The Government defines two core principles to guide the development of disclosure frameworks:
    - Where possible, climate-related disclosure requirements should be implemented through existing corporate and financial regulatory frameworks, and corporate and financial regulators will have the central role of managing compliance.
    - Recognise that New Zealand reporting frameworks will, in the first years, go through a period of learning by doing and building market capacity, but that the Government clearly sets clear expectations that robust disclosures be in place by 2022 at the latest.

Response to questions in discussion paper

Question	IGCC Comments
Q1. Is the TCFD reporting framework the most appropriate framework for New Zealand?	TCFD is the appropriate framework. However, as outlined above, standards of reporting under the TCFD vary widely and many existing reports do not currently provide decision useful information to the market.
Q2. Do you agree with the conclusions we have drawn at the end of chapter 1?	Rationale outlined in the chapter is sound. However, it understates the financial stability and investment risks from climate change which are separate from, and additional to, company or asset level risks. For example, the comment, "Climate change is not material to every company of scale" underplays the systemic aspects of climate risk. The focus of the chapter is also very much on driving decarbonisation, not on building resilience to physical risks.
Q3. Do you agree with the objective as set out above? Q4. Should other objectives also be considered? Q5. Do you agree with the problem definition? Are there other aspects we should consider?	See overall comments on the discussion paper. The Government should clearly designate managing the systemic risks of climate change to the financial system and the economy as a clear objective for implementing mandatory climate related disclosures.

Q6. What are the implications of section 211 of the Companies Act 1993 for the disclosure of material climate-related information in annual reports?	The proposed implementation of the TCFD would remove ambiguity around whether a company is required to disclose under section 211 of the Company Act. For example, current requirements to disclose climate risks and opportunities only apply if this information will not be harmful to the company. This can lead to a situation where a company's board considers that disclosure may be harmful and it does not need to disclose the climate-risk, even if it is considered material for the company or represents a broader risk to the New Zealand economy. IGCC also recommends that as the proposed TCFD framework is implemented, guidance is provided that climate change-related information is not required in annual reports under section 211 to the extent that it is otherwise provided under the TCFD framework. Duplication of disclosure is not conducive to clear, concise and useful disclosure for investors.
Q7. What are the implications of the NZX listing rules for the disclosure of material climate related information b (a) equity issuers and (b) debt issuers?	As outlined in the response to the above question, duplication in reporting should be avoided. If an issuer has already disclosed a comprehensive non-TCFD framework that does address climate change risk, this may be a justifiable basis for it to "explain" non-compliance with the TCFD framework.
Q9. Do directors' legal obligations in New Zealand result in consideration, identification, management and disclosure of climate-related risks? Q10. Do you agree with the legal opinion prepared for the Aotearoa Circle?	New Zealand's legal opinions are consistent with the findings of a body of similar commentary in other markets globally which have found that management of climate-related risk is a core part of legal duties for company directors and institutional investors. However, these obligations are not currently resulting in appropriate climate-related risk management, implying further government guidance is needed.

Q11. Do you favour the status quo or new mandatory disclosures?	New guidance for mandatory disclosures. Voluntary disclosure within the context of current mandatory disclosure frameworks are currently not delivering decision useful information to the market in a timely fashion. This lack of transparency increases the risk of a lack of accurate market pricing, heightening financial stability and investment risks to New Zealand's financial system, companies and investors. Mandatory disclosures need to be embedded into the mainstream of the financial system and not positioned as just another compliance requirement. This will ensure credibility, durability and drive greater integration and innovation in New Zealand's financial markets.
Q12. If a mandatory approach is adopted, do you agree with the Productivity Commission that a mandatory (comply-or-explain) principles-based disclosure system should be adopted?	Yes
Q13. If the status quo is retained, how can government and investors be confident that risks would be routinely considered in business and investment decisions?	Ensure financial and corporate regulators set clearer expectations and guidance on climate-related financial disclosures within the context of existing reporting and disclosure frameworks.
Q14. Do you consider the TCFD framework to be best practice in relation to climate-related financial disclosures?	See response to Question 1. A clear example of where improved disclosures could be supported is through Reserve Bank of New Zealand (RBNZ) publishing baseline and integrated scenarios for both transition risk and physical risk.

Q15. What are your views about whether the TCFD's recommended disclosures will provide useful information to institutional investors and other users? Q16. Do you think the proposed disclosure system will encourage disclosing entities to make better business decisions?	IGCC supports the development of integrated global scenarios for stress testing financial systems to climate change through the global network of central banks and financial supervisors of which RBNZ is a member (the Network for Greening the Financial System or NGFS). RBNZ should take responsibility for downscaling these scenarios to the New Zealand context and requiring its regulated entities to stress-test their portfolios against these scenarios. This would provide a clear expectation on how investors and companies should be testing their reliance to climate related risks; support learning by doing between regulators and entities; and enhance RBNZ's analysis of financial stability risks from climate change. Note that guidance on disclosures should also clarify that scenario analysis is not forward guidance to remove barriers such as company directors being concerned about potential litigation on the basis of uncertain future projections.
Q18. What comments do you have on our proposal that non-disclosure would only be allowable on the basis of the entity's analysed and reported conclusion that they see themselves as not being materially affected by climate change, with an explanation as to why?	Broadly support with additional guidance from corporate and financial regulators on identifying material climate related risks (e.g. example above on RBNZ integrated physical and transition risk scenarios).

Q19. What are your views about providing a transition period where incomplete disclosures would be permissible?	The timing proposed in the discussion document seems appropriate to begin reporting, with a year to produce a fuller disclosure.
Q21. Should all of the following classes of entity be subject to mandatory (comply-or-explain) climate-related financial disclosures: listed issuers, registered banks, licensed insurers, asset owners and asset managers? Q22. Should any other classes of entity be required to disclose? Q23. Should there be an exemption for smaller entities? Q24. If there were to be an exemption: should it be temporary? Q25. What criterion or criteria should be used: annual revenue, total assets, a combination of the two, or some other measure or measures?	On first principles, disclosures should capture as many entities as practical and as required to ensure the management of systemic risks. However, if there should be a size exemption in the initial implementation of the policy, and we defer to the Financial Reporting Act which defines company sizing. The scope should also be widened to include all companies, regardless of whether they are listed. Investors and other regulated financial institutions provide capital to private companies making disclosure of material risks important in the private market. Climate change is a systemic, pervasive issue that requires the proper pricing of risk across all business sectors and good communication to stakeholders, including consumers. Not requiring private companies to disclose adds to the concern that reporting requirements disincentivise listing. IGCC is aware of the challenge for small fund managers in reporting in accordance with the TCFD, especially when there is reliance on or outsourcing to large global investment managers via managed funds. This should not be an excuse for inaction but may require additional support for government agencies in providing standardised reporting and disclosure tools and resources to assist. Finally, ensuring broad coverage of disclosures is central to supporting financial stability. Exclusion of economically or financially material entities is inconsistent with providing financial regulators information on system-wide climate-related risks.

Q26. Which dollar amount or amounts would be appropriate? Q27. Should there be a requirement to adjust for inflation from time-to-time?	IGCC would recommend that a clear timeline of work be undertaken by the Council of Financial Regulators to examine the implications of exemptions for financial stability and make recommendations on whether and/or how smaller entities should be captured by TCFD disclosures. In addition to this the Government should implement a program of education, training and guidance setting for smaller entities to make them market-ready for disclosures. Finally, IGCC's three-year strategy states that all of our members will report on TCFD by 2022.[5] This is in recognition of the need for the industry to 'walk the talk' and to develop comparable disclosure standards to companies in the real economy. IGCC is also developing tools and resources to assist our members in meeting this objective.
Q31. Should there be mandatory assurance in relation to climate-related financial disclosures? Q32. Which classes of information should be subject to assurance if it were to be mandatory? Q33. Do you consider that assurance should be required in relation to GHG emissions disclosures? Q34. Is limited assurance the only practicable approach in relation to	Assurance of Scope 1 and 2 emissions for companies is a mature practice. However, while the inclusion of climate-related financial disclosures within mainstream financial reporting (as required by TCFD) does potentially mean that reporting is already required by mandatory audit and disclosure provisions in certain circumstances, IGCC recognises that TCFD disclosures are at a relatively early stage of development. To support the acceleration of market practice, the government should strongly support voluntary assurance to strengthen the quality of disclosures and set a deadline for mandatory assurance to be implemented by 2022. The Council of Financial Regulators could establish a work program and consult with audits standards bodies, assurers, investors and companies to develop guidelines to support implementation in this timeframe.

[5] https://igcc.org.au/wp-content/uploads/2016/04/IGCC-in-2022-investing-for-climate-resilient-net-zero-emissions-economy.pdf

TCFD disclosures, or is reasonable assurance also feasible? Q35. If we do not introduce mandatory assurance when a disclosure system comes into effect, should it be reconsidered in the future?	
Q39. Do you consider that there is a role for government in relation to guidance, education, monitoring and reporting? Q40. Are there other activities that a government agency could usefully carry out? Q41. Which government agency or agencies will be best able to carry out these functions?	Existing corporate and financial regulators must have a central role in monitoring and reporting climate-related financial disclosures. This will ensure actions in New Zealand align with global trends, build on the core competencies of these agencies, and avoid disclosures being perceived as not being material to financial performance or financial stability. Additional specific actions that need to be undertaken include: - RBNZ downscaling global climate risk scenarios to New Zealand. Assessing financial stability, managing macroeconomic risks and economic modelling are part of the central bank's core competency and this task should not be left to the Climate Change Commission. - Council of Financial Regulators to examine the implications of exemptions for financial stability and make recommendations on whether and/or how smaller entities should be captured by TCFD disclosures by the end of 2020. It should also be charged with developing guidance for assurance of disclosures by 2022. - Government agencies should implement a program of education, training and guidance setting for smaller entities to make them market ready for disclosures.
Q43. What information do you have about the cost implications relating to these proposals?	Credible and sophisticated climate-related risk analysis and disclosures can require significant resources but can also provide major value to ensuring the long-term resilience of companies, boosting investor confidence in corporate governance and strategy, and ensuing the stability of New Zealand's financial system. In addition, although the first comprehensive climate-related disclosure is a resource-intensive exercise, the incremental costs of further iterations can be

	relatively low, particularly as organisational capabilities and skills in this area increase and as climate risk management processes permeate an organisation. The sooner companies and investors build internal skills and processes to undertake climate-related disclosures the sooner they will be prepared for the inevitable steps in this direction. In the interim period, there may be opportunities for government to mitigate some of the short-term implementation costs by working with key agencies to develop market guidance, tools and resources to assist in the implementation phase.

Conclusion

The implementation of mandatory climate-related financial disclosures is an important opportunity for New Zealand to build economic resilience and unlock investment opportunities in a world being reshaped by climate change. Market disclosures of climate related risks and opportunities is central to informing accurate market pricing, asset evaluations, and macroeconomic signalling, as well as being key to ensuring an orderly economic transition.

The IGCC looks forward to working with the Government and key agencies to implement and build upon the recommendations set out in the discussion paper and this submission to support a prosperous and resilient New Zealand.