In Confidence

Office of the Minister of Commerce and Consumer Affairs

Office of the Minister for Climate Change

Chair, Cabinet Economic Development Committee

Release of discussion document: Climate-related financial disclosures - Understanding your business risks and opportunities related to climate change

Proposal

1. This paper seeks agreement to release a discussion document relating to the design of a climate-related financial disclosure regime for entities that participate in New Zealand financial markets.

Executive summary

2. Climate change presents increasing financial risks to a large number of businesses, including through stranded assets in sunset industries, physical risks to plant and property from sea-level rise and availability through supply-chains. At the same time, those companies that are developing new low-emissions products and services may see significant opportunities from climate change.

3. Currently, the financial impacts of these risks and opportunities are not being adequately considered, valued and reported within the financial markets. There is therefore a risk to financial value that shareholders are not aware of.

4. As Mark Carney, the Governor of the Bank of England has stated "the challenge is that investors currently don't have the information they need [about climate risks and opportunities]. This must change if financial markets are going to do what they do best: allocate capital to manage risks and seize new opportunities. Without the necessary information, market adjustments to climate change will be incomplete, late and potentially destabilising. But with the right information, financial markets can smooth the transition to a two degree world."

5. The objective of this proposal is to move to a position where the effects of climate change become routinely considered in business and investment decisions. This requires businesses to measure and report clear, comparable, consistent, timely and decision-useful information about their risks and opportunities arising from climate change.

6. The business community is asking for greater clarity and certainty in relation to this type of disclosure. A number of industry members, including the Insurance Council of New Zealand, Meridian Energy, Contact Energy and the Sustainable Business

Network expressed their support for mandatory disclosures of climate change impacts.

7. This reflects an international trend. The Task Force on Climate-related Financial Disclosures (TCFD), chaired by Michael Bloomberg, provides a framework for companies to respond to demand for transparency on climate-related impacts. It is seen as the leading framework worldwide.

8. The Productivity Commission recommended in its final 2018 report *Low-emissions Economy* that the Government should endorse the recommendations of the TCFD and should implement "mandatory (on a comply-or-explain basis), principles-based, climate-related financial disclosures" to facilitate the markets in managing climate risk. The Government agreed to investigate this further.

9. The attached Ministry for Business, Innovation and Employment (MBIE)/Ministry for the Environment (MfE) discussion document is in response to those calls from the private sector to provide greater clarity and certainty, and to address the recommendation of the Productivity Commission.

10. The discussion document asks four key questions:

    10.1. **Whether reporting should be voluntary or mandatory** – we conclude in the discussion document that mandatory (comply-or-explain) reporting should be adopted to raise expectations and accelerate progress. Non-disclosure would only be permissible on the basis of a preparer's analysed and reported conclusion that they see themselves as not being materially affected by climate change, with an explanation as to why.

    10.2. **What should be disclosed** – we propose that the 'comply' element would be met through the principles-based disclosure framework recommended by the TCFD (see Appendix 1), which has been widely endorsed and is considered global best practice.

    10.3. **Which entities should disclose** – Consistent with the TCFD's recommendations, we propose that listed issuers, banks, general insurers, asset owners and asset managers would be disclosing entities. The discussion document also asks whether smaller entities within those categories should be exempt.

    10.4. **When the disclosure regime should come into force** – in order to provide certainty to the market in terms of what is expected, we propose that disclosures would come into force for financial years commencing six months on or after the date that the amending legislation is enacted. We are also seeking feedback from affected entities on the roles they will be looking for the government to play in to enable them to carry this analysis out.

11. We are also seeking agreement to release the discussion document for six weeks of consultation from the end of October to mid-December 2019. The release date will coincide with a likely heighted awareness of these issues due to the Sustainable Finance Forum's intention to release a legal opinion on the question of how professionals with fiduciary obligations are permitted or required to take account of climate change in their decision-making (this is the first project of the Aotearoa

Circle, a public-private partnership of Chief Executives committed to reversing the decline of New Zealand's natural resources). Therefore, the timing will enable the Government to respond to this issue in a timely manner.

Background

Markets need better information about financial risks and opportunities arising from climate change

12. The two key financial risks arising from climate change are physical risks and transition risks. Physical risks can include direct damage to assets due to extreme weather events, disruption to supply chains, changes in water availability and assets being 'stranded' due to rising sea levels. Transition risks can include technological advances, evolving policy actions by governments and regulators, changes in supply and demand, and reputational risks. Opportunities may include availability of new technologies, new markets or competitive advantage for firms developing resilient products.

13. These risks and opportunities are driving an international move towards disinvestment in high greenhouse gas (GHG) emitting products, processes and activities, and investment in new technologies, energy efficiency and clean energy sources. This is consistent with the spirit of Article 2(1)(c) of the Paris Agreement.

14. The Reserve Bank of New Zealand is contributing to this understanding, by reflecting climate risks within its core functions, and contributing to wider efforts to identify, monitor and manage climate risks within our economy and financial system, and as part of the global central banking and regulatory community.

15. However, few entities participating in financial markets in New Zealand (and worldwide) currently take a sufficiently long term view of the impact of climate change on their businesses, or report these risks. In addition, financial markets are not fully considering economic opportunities that could help accelerate the transition. Yet a well-defined and clearly understood solution to this does exist that we can draw on.

The Productivity Commission recommended a mandatory regime

16. The Productivity Commission's report *Low-emissions Economy* recommended (R7.4) that 'The Government should implement mandatory (on a comply-or-explain basis), principles-based, climate-related financial disclosures by way of a standard under the Financial Reporting Act 2013. These disclosures should be audited and accessible to the general public.'

17. The Government agreed to investigate R7.4. We are proposing to advance the work on R7.4 by seeking Cabinet approval to release a discussion document, as signalled in the Government's public response to the report [CAB-19-MIN-0296].

18. We propose adopting principles-based disclosures recommended by the TCFD. The TCFD was established by the Financial Stability Board in 2015 at the request of the G20 and their recommendations are now considered global best practice. Over two years on, some early adopters in New Zealand have already begun trialling disclosures in line with the TCFD approach.

There is a need for Government leadership on climate-related financial disclosures

19. A small number of New Zealand businesses have started disclosing in line with the TCFD framework, and the Investor Group on Climate Change, the Climate Leaders Coalition and the Aotearoa Circle are promoting climate-related financial disclosures. The Aotearoa Circle has also commissioned a legal opinion about fiduciary duties and climate change.

20. There is increasing international and domestic pressure from the private sector to increase climate-related financial disclosures and for governments to make this mandatory. Prominent investors, such as BlackRock and State Street, as well as many banks, pension funds, asset managers and insurers have put growing pressure on companies to disclose material climate-related financial information. There is growing pressure on investor organisations to disclose their risks. There is also growing demand from investors, such as NZ Super and several ethical KiwiSaver funds for better information about the companies within a portfolio. However, the status quo of reliance voluntary reporting is not resulting in the required pace of change.

This is the direction of travel internationally

21. Other countries are moving in the same direction as we propose. For example:

    21.1. The UK has set out an expectation for all listed companies and large asset owners to disclose in line with the TCFDs by 2022, and will examine progress on implementation by the end of 2020.

    21.2. France has strengthened mandatory carbon disclosure requirements for listed companies and introduced carbon reporting for asset owners and investment managers in 2016.

    21.3. Canada’s Expert Panel on Sustainable Finance includes a proposal for Canada to implement the TCFD recommendations on a ‘comply or explain’ basis.

    21.4. The European Union is considering reopening the EU Non-Financial Reporting Directive (NFRD), which would likely make TCFD disclosure mandatory.

22. Depending on our domestic policy timeframe compared to these other jurisdictions, other countries may be legislating in similar ways to New Zealand at the same time.

Key Issues

23. The commentary below sets out key issues being consulted on within the discussion document.

Voluntary versus mandatory reporting

24. There is a discussion of the advantages of (i) voluntary disclosure, relying on market pressures to drive greater disclosure, or (ii) moving to a mandatory (comply-or-explain) system, as recommended by the Productivity Commission.

25. The current obligations and pressures that enable a voluntary approach include recognition that climate risks are increasingly being seen as litigation risks, requirements on listed issuers under the NZX Listing Rules, fiduciary duties and

increasing market pressures from asset owners, insurers and banks internationally on investees to disclose climate risks. Despite these positive developments, due to disincentives to be an early-mover, unclear understanding of legal obligations, and confusion arising from different entities using different disclosure frameworks, the pace of change is too slow and *ad hoc* in nature.

26. Some stakeholders do not support mandatory disclosure, due to cost and resourcing implications. They support an awareness-raising, learning and experimentation phase. However, the alternative of largely or solely relying on market forces is too risky, given the urgent need for consistent, decision-useful information to support well informed decision-making.

27. We conclude that mandatory disclosure is the preferred option because it will promote business certainty, raise expectations, create a level playing field and should accelerate progress.

What should be disclosed

28. The discussion document states that the TCFD framework is regarded as international best practice and is sufficiently flexible to evolve because it is principles-based. Requiring disclosures in accordance with the TCFD framework will promote clear, consistent and comparable reporting between entities. We therefore suggest that the TCFD recommendations should form the 'comply' element of a mandatory (comply-or-explain) disclosure regime. What this looks like for businesses is included in Appendix 1.

29. Extended external reporting frameworks and sustainability frameworks that are aligned with the TCFD approach could also be used. Non-disclosure would only be allowable if an entity's reported analysis concludes that they are not materially affected by climate change, with an explanation as to why. Investors may then assess whether or not those explanations are adequate.

30. We do not consider that there are any viable alternatives to TCFD for the 'comply' element, as there are no alternative internationally recognised, principles-based frameworks for reporting climate-related financial information. Imposing unique requirements on New Zealand entities when it is clear that the rest of the world is increasingly adopting TCFD will add cost, complexity and risk for New Zealand businesses operating internationally.

Who this will apply to

31. The Productivity Commission did not express a view on which entities a mandatory (comply-or-explain) disclosure system should apply to. Consistent with the TCFD's recommendations, we propose that it should apply financial institutions and other entities that participate in financial markets. These are listed issuers, banks, general insurers, asset owners and asset managers.

32. Some entities that fall into the above categorisation are small entities for whom costs may be disproportionate. We have not formed a preliminary view about whether smaller entities within these categories should be required to comply. The discussion document asks whether there may be a need for an exemption based on total assets and/or annual revenue under which organisations would be exempt.

33. As this proposal is designed to use the levers available in financial markets to drive a change in investment patterns, large GHG emitters and other entities of scale would not be within scope unless they were listed issuers. However, private companies may receive indirect pressure from insurers and capital-providers to identify and manage climate-related risks and opportunities. It is important for all businesses, whether or not in scope of this regime, to consider the impact of climate change on their businesses.

When entities should start disclosing

34. We are proposing that mandatory (comply-or-explain) climate-related financial disclosures would come into force for financial years commencing six months on or after the date that the amending legislation is enacted. For example, enactment in mid-2021 means that a company with a balance date of 31 March would first need to include climate-related financial disclosures in its 2022/23 annual report.

35. Certain elements of the TCFD framework are complex, notably scenario analysis, and it will take some reporting entities time to be in a position to make a full set of TCFD-compliant disclosures. We propose that it would be permissible to not provide a full set of disclosures in year 1, subject to explaining why the disclosures are incomplete, to allow for a process of learning and experimentation.

Independent assurance

36. Although the Productivity Commission's recommendation stated that disclosures should be audited, we have concluded that independent assurance is not currently practicable for both demand and supply-side reasons.

37. The discussion document states that mandatory assurance should not be introduced until (a) it becomes clearer what users of the disclosed information might want from assurance providers, and (b) assurance standards setters have responded to user demand with new or amended standards and guidance material. There may, however, be a case for mandatory assurance of GHG emission disclosures as the International Auditing and Assurance Standards Board has already issued an assurance standard on greenhouse gas statements.

38. The issue of mandatory assurance could be reconsidered within three years of a mandatory disclosure regime coming into force, at which time there would be two years of data to draw upon.

The ongoing role for the Government

39. We have concluded that the Government has a crucial role in supporting reporting entities through the transition period and raising the quality of reporting over time. Guidance and education will be particularly important in relation to scenario analysis. Although there is rapidly growing TCFD guidance material internationally, New Zealand-specific guidance will be required to reflect the New Zealand-specific impacts of climate change nationally and regionally.

40. Monitoring disclosures will also be important in improving the quality of climate-related disclosures over time.

41. The discussion document does not express a view about which government agency should be responsible for these functions. MBIE, MfE and the Financial Markets Authority might perform those functions. The Climate Change Commission might have a limited role in relation to scenario analysis guidance. This will likely require a significant amount of agency resource.

Costs relating to climate-related financial disclosures

42. There are several challenges in determining the net costs of mandatory disclosure. The main challenge will be to assess what levels of disclosure in accordance with the TCFD recommendations might have taken place voluntarily absent mandatory disclosure. The discussion document seeks evidence about the cost implications of preparing TCFD reports.

Options

43. The potential policy options that the discussion document presents are as follows.

Option 1: Status quo – voluntary disclosures

44. The status quo is a voluntary approach which would rely on existing legal obligations and market pressures on companies and financial market participants to consider and in some cases disclose their climate-related risks. The evidence shows that the current approach is not driving adequate information disclosure on such a critical issue. Therefore, option 1 is not our preferred option.

Option 2: Mandatory (comply-or-explain) disclosures

45. The TCFD disclosure framework would provide the basis for the default 'comply' rule, but reporting entities would be able to use alternative sustainability and integrated reporting frameworks that are aligned with TCFD.

Implementation

46. MBIE and MfE propose that the disclosure requirements would be implemented by Order-in-Council on the recommendation of the responsible Minister. This detail will be further worked through by officials and as part of the consultation process to ensure that it is aligned with the preferred approach of stakeholders.

The discussion document

47. We propose to release the attached discussion document (**Appendix 2**). It is structured as follows:
    - Executive Summary
    - Chapter 1 – The context
    - Chapter 2 – Objectives and problem definition
    - Chapter 3 – Climate-related reporting obligations in New Zealand
    - Chapter 4 – Fiduciary duties and climate change
    - Chapter 5 – Designing a comply-or-explain disclosure system for New Zealand

48. Appendices A-G of the discussion document provide additional information about various matters.

Proposed process

49. We propose to release the discussion document on 31 October 2019 for a period of 6 weeks.

50. The Aotearoa Circle's Sustainable Finance Forum will be launching an interim report on 31 October 2019 outlining a roadmap to help New Zealand shift to a financial system that supports economic, social and environmental outcomes. Releasing the discussion document on the same date allows the government to be seen to be responding to private sector calls for government leadership in a timely manner.

51. Following consideration of submissions and advice from officials, we will report back to the Cabinet Economic Development Committee with proposals in February/March 2020.

Consultation (with other agencies, departments, interest groups etc)

52. Officials consulted with a number of stakeholders to gather information and help inform the preparation of the discussion document. This included members of the Big 4 accountancy firms, banks, legal professionals and a think tank.

53. The Treasury, Department of Prime Minister and Cabinet, Ministry of Foreign Affairs and Trade, Ministry for Primary Industries, Department of Internal Affairs, Financial Markets Authority, Reserve Bank of New Zealand, Energy Efficiency and Conservation Authority and External Reporting Board have been consulted on the discussion document.

54. We received feedback that this regime should be extended to also apply to non-listed large GHG emitters. Some agencies also noted that the TCFD was designed as a voluntary framework, and therefore may not be appropriate as a mandatory regime. There was also concern over the cost of making disclosures, and the resources needed for Government to fulfil monitoring, reporting and guidance functions. These concerns have been acknowledged and addressed in the discussion document, and above.

Financial implications

55. There are no financial implications arising from the recommendations in this paper.

Legislative implications

56. There are no immediate legislative implications arising from this paper. However, the consultation may result in policy recommendations being made to Cabinet which would require amendments to legislation.

Regulatory impact analysis

57. The Treasury's Regulatory Quality Team has determined that no separate Regulatory Impact Assessment is required in support of the proposal to issue the discussion document, since the analysis necessary at this stage is covered in the discussion document.

Treaty of Waitangi

58. We recognise that Māori/iwi businesses hold large asset bases that may be vulnerable to the impacts of climate change. However they are often unique in that they have many shareholders, but are not typically publicly listed companies. Because of this, the proposal will not impact Māori/iwi strongly as they largely fall out of scope of the entities we are targeting.

59. We are also aware that some iwi may have started to use the TCFD framework. Officials will engage with Māori/iwi on this issue, to better understand whether the Government can further support such analysis, such as through facilitating information sharing, capability building, or otherwise.

Human rights

60. The proposal in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Gender implications

61. There are no gender implications arising from the recommendations in this paper.

Disability perspective

62. There are no disability implications arising from the recommendations in this paper.

Publicity

63. We intend to issue a media statement accompanying the release of the discussion document. The document will be made publicly available on the MfE and MBIE websites and key stakeholders will be informed. We intend to hold targeted consultation events in the main cities. We expect the audience will be limited to those interested in this topic.

Proactive Release

64. MfE will publish a copy of this paper along with the discussion document on its website, subject to any necessary redactions.

Recommendations

The Minister of Commerce and Consumer Affairs and the Minister for Climate Change recommend that the Committee:

1. **note** that the discussion document outlines and seeks feedback on the key issues, objectives and potential options related to mandatory climate-related financial disclosures for listed issuers, banks, insurers asset owners and asset managers;

2. **agree** to release the attached discussion document entitled *'Climate-related financial disclosures – Understanding your business risks and opportunities related to climate change'*, subject to any minor or technical amendments that may be required;

3. **agree** to empower the Minister of Commerce and Consumer Affairs and the Minister for Climate Change to make minor amendments to the discussion document as required;

4. **note** that we are intending to release the discussion document on 31 October 2019 to coincide with the launch of the Sustainable Finance Forum's interim report, which will outline a roadmap to help New Zealand shift to a financial system that supports economic, social and environmental outcomes;

5. **note** that the discussion document will be released for public consultation for about six weeks;

6. **note** that a media statement will accompany the release of the discussion document; and

7. **invite** the Minister of Commerce and Consumer Affairs and the Minister for Climate Change to report back to Cabinet in April 2020 with policy proposals.

Authorised for lodgement.

Hon Kris Faafoi
Minister of Commerce and Consumer Affairs

Hon James Shaw
Minister for Climate Change

Appendix 1: The TCFD's recommended disclosures

The TCFD states that its recommendations "aim to be ambitious, but also practical for near-term adoption". They are structured around four thematic areas that represent the core elements of how organisations operate: governance, strategy, risk management, and metrics and targets. The TCFD recommended eleven sets of disclosures within the four thematic areas.

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.