

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Office of the Minister for Climate Change

Chair, Cabinet Economic Development Committee

Climate-related financial disclosures**Proposal**

- 1 This paper seeks agreement to introduce mandatory climate-related financial disclosure requirements for listed issuers, large registered banks, licensed insurers, and managers of registered investment schemes.

Relation to government priorities

- 2 These proposals link to the four Government priorities for building a productive, sustainable and inclusive economy, particularly priority 1.4: transitioning to a clean, green and carbon-neutral New Zealand [CAB-18-MIN-0111].

Executive Summary

- 3 Many businesses face significant physical and transitional risks (and potentially opportunities) relating to climate change. However, few are aware of, or are providing information to investors about how climate change may impact their business, strategies and financial position.
- 4 This information barrier is driving what the Productivity Commission termed “an ongoing and systemic overvaluation of emissions-intensive activities”, resulting in poor medium- to long-term decision-making, mispricing of assets and the misallocation of capital. This in turn creates macro-economic financial stability risks, and barriers to investment in low-emissions and resilient economic activities that are needed to meet New Zealand’s 2050 zero carbon target.
- 5 The Governor of the Reserve Bank of New Zealand (**Reserve Bank**), Adrian Orr, has recognised that,

the market failure is rife...disclosure is critically important. We know there are significant implications for the New Zealand society through climate change... [but] the awareness of climate change is... thin
- 6 Businesses and the financial sector have also recognised this problem. In a recent consultation, three quarters of business and industry respondents supported the introduction of mandatory climate-related financial disclosures, to improve information in the market in a consistent and comparable way.
- 7 Addressing these information gaps through better risk identification and disclosure can help businesses and investors make more informed and efficient decisions. While tools exist for businesses and investors to do this now, poor voluntary adoption and inconsistent approaches suggest that Government intervention is required.

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- 8 Our proposal is aimed at increasing the quantity and quality of disclosures and rapidly accelerating progress. The objective is to move to a position where climate change risks and opportunities become routinely considered in business and investment decisions in New Zealand, to contribute to the efficient operation of financial markets.
- 9 Mandating disclosure of clear, comparable, consistent, timely, and understandable information about those risks and opportunities can facilitate this objective.
- 10 Consistent with proposals outlined in a discussion document published by the Ministry for the Environment (**MfE**) and the Ministry for Business, Innovation and Employment (**MBIE**) in 2019, *Climate-related financial disclosures: understanding your business risks and opportunities*, and in light of the broad support received through the consultation process, we are proposing the introduction of a mandatory (comply-or-explain) disclosure regime for Financial Markets Conduct Act 2013 (**FMC Act**) reporting entities with higher levels of public accountability.
- 11 The disclosures will need to be aligned with the recommendations made by the Taskforce on Climate-related Financial Disclosures (**TCFD**) in 2017. Disclosures will focus on the impact that climate change may have upon a business, not the other way around.
- 12 We anticipate the disclosure regime would come into force for financial years commencing in 2022. We also envisage that this is a first step towards the more widespread adoption of climate-related financial disclosures in New Zealand.
- 13 The Government will play a significant role to make the disclosure regime fully effective, including:
 - 13.1 enacting legislation and making regulations to give effect to the proposals
 - 13.2 standard-setting by the External Reporting Board (**XRB**), to promote consistent, comparable, reliable and clear reporting
 - 13.3 the publication of guidance material, to assist entities to comply
 - 13.4 independent monitoring, reporting and enforcement by the Financial Markets Authority (**FMA**), to promote high quality disclosures.
- 14 The financial implications section seeks appropriations for the XRB and FMA for this new activity starting in 2020/21 for the XRB and 2021/22 for the FMA.

Background

- 15 The Intergovernmental Panel on Climate Change has stated that achieving the Paris Agreement goal of containing global warming to 1.5°C above pre-

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industrial levels will require an economic recalibration of scale and speed with no documented historic precedent. The International Energy Agency estimates that global investments of US\$75 trillion will be required to even have a 50-50 chance of limiting warming to 2°C. In addition, there are trillions of dollars of undisclosed, unquantified and therefore unmanaged risks related to climate change around the world.

- 16 Climate change presents financial risks to businesses in many ways: for example through stranded assets in sunset industries, risks to property, plant and equipment, disruption to supply chains, changing consumer preferences and reputational risks due to perceptions about whether a business is contributing to or detracting from the transition to a low-emissions economy. At the same time, businesses have significant opportunities in such areas as resource and energy efficiency and the development of low-emission goods and services.
- 17 In New Zealand, costs attributable to anthropogenic influences on the climate are already somewhere in the vicinity of \$120 million per decade for insured damages from floods, and \$720 million per decade for economic losses associated with droughts. For example, in 2015, 300 homes were flooded in South Dunedin from a high tide that coincided with an extreme rainfall event. This event gave rise to over \$28 million in insurance claims. These kinds of costs will almost certainly increase over time.
- 18 Some New Zealand entities, notably in the energy and banking sectors, are increasingly considering the impact of climate change on their businesses. However, it is clear that there is a long way to go before businesses and investors consider how climate change is likely to impact them in a robust and consistent way.
- 19 The Productivity Commission recommended in its 2018 report *Low-emissions Economy* that the Government should implement mandatory (on a comply-or-explain basis) principles-based, climate-related financial disclosures to facilitate the markets in managing climate risk. In 2019, the Government agreed to investigate this recommendation further.
- 20 The MfE-MBIE discussion document was released in 2019 proposing policy design features that were broadly consistent with the Productivity Commission's recommendations. Among other things, it included discussions on:
 - 20.1 the arguments for and against a new mandatory disclosure system
 - 20.2 what should be disclosed
 - 20.3 which entities should disclose
 - 20.4 when the disclosure regime should come into force
 - 20.5 the role of the Government.

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21 We are seeking agreement on these and other matters.

Analysis – Arguments for and against a new mandatory disclosure system

Arguments against a new mandatory disclosure system

22 The main argument for retaining the status quo is that government intervention is not needed because company directors, fund managers and listed issuers are required to consider and report on all financially material issues, including climate-related risks and opportunities.

22.1 Recent legal analyses carried out in New Zealand, Australia and other common law countries have concluded that company directors who overlook or disregard climate risk, risk failing to discharge their duty to act with due care, diligence and skill.

22.2 Investment scheme managers have fiduciary duties to take all material financial risks into account when making investment decisions and/or designing investment policies.

22.3 Listed issuers have comply-or-explain obligations to make material non-financial disclosures, including in relation to the environment, under the NZX's *Corporate Governance Code*. The FMA's *Corporate Governance Handbook* also includes disclosure recommendations to this effect.

Arguments for a new mandatory disclosure system

23 There are four main arguments for introducing a targeted mandatory disclosure system.

23.1 Investors, creditors and insurance underwriters do not have access to the information they need. Although it is already required for many entities to disclose material risks (implicitly including those arising from climate change), the great majority do not do so, or are not providing sufficient and credible information that will assist investors to make effective and efficient decisions.

23.2 The status quo is not driving change with sufficient urgency, given the pressing need for investment and business decisions to incorporate the destabilising physical and transitional impacts of climate change.

23.3 Businesses may worry about opening themselves up to competitive disadvantage by revealing climate-related risks and opportunities if their competitors are not doing the same.

23.4 It is very challenging for users to compare disclosures made by different entities because entities use a range of reporting approaches, meaning that the small amount of reporting that is currently taking place is inconsistent and incomplete.

Conclusions on a new mandatory reporting system

24 We are recommending the introduction of a new mandatory disclosure system for the reasons outlined above. It will promote business certainty, provide

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users with higher quality comparable information, raise expectations, accelerate progress and create a level playing field.

- 25 Other key issues, such as what should be disclosed, the classes of entity that it will apply to and how to exclude smaller entities for compliance costs reasons, are discussed below.

What should be disclosed

- 26 We are proposing the introduction of comply-or-explain annual reporting that would require certain entities to comply with standards issued by the XRB based on the TCFD framework. TCFD is structured around four thematic areas that represent the core elements of how entities operate: governance, strategy, risk management, and metrics and targets – see figure 1.
- 27 It is clear from diverse sources that TCFD is international best practice in relation to climate-related financial disclosures. It has been endorsed by governments, regulators, business associations, corporations, financial institutions, investors, professional accounting bodies and civil society organisations.
- 28 It is essential that New Zealand entities use the same disclosure framework as other countries, because modern economies rely on cross-border transactions and the free flow of international capital. Other countries are starting to move towards mandatory TCFD disclosures.
- 28.1 The UK Financial Conduct Authority (**FCA**) published a consultation paper in March 2020 on requiring the 480 or so issuers with a premium listing on the London Stock Exchange to make TCFD disclosures, commencing in 2021. The FCA envisages the proposed new rule would be a first step towards the more widespread adoption of TCFD within its rules, both as they apply to listed companies and to financial services companies. In addition, the UK Minister for Pensions and Financial Inclusion is proposing to use powers in the Pension Schemes Bill to require climate risk governance and TCFD reporting.
- 28.2 The European Commission is reviewing the EU Non-Financial Reporting Directive (**NFRD**). The consultation document, published earlier in 2020, asks whether the principles and content of TCFD should be brought within the scope of the NFRD.
- 28.3 In May 2020, the Canadian Federal Government announced that companies which receive COVID-19-related loans under the Large Employer Emergency Financing Facility will be required to publish annual climate-related disclosure reports consistent with TCFD.
- 29 Recognising that extended external reporting frameworks (e.g. Integrated Reporting) and sustainability frameworks are increasingly mapping their frameworks against TCFD, we recommend that aligned reporting frameworks, as identified in forthcoming guidance, could also be used.

Figure 1: TCFD recommended disclosures

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

The 'explain' element of comply-or-explain

- 30 'Comply-or-explain' is used in corporate governance regulation and financial supervision. It is based on the idea that one size does not fit all. Rather than imposing binding laws, regulators set out a recommended code, which entities may either comply with, or if they do not comply, explain why not. This provides regulated entities with the opportunity to use alternative disclosure approaches or not comply with some or all of the code, subject to explaining why. This approach can lower implementation costs, allow entities to progressively improve their disclosures over time, and allow entities to adapt their reporting to new trends and developments.
- 31 Feedback in submissions on the MfE-MBIE discussion document confirmed that comply-or-explain is needed in relation to TCFD, particularly in the early years. There will also be ongoing challenges in obtaining reliable data, particularly in relation to scenario analysis (i.e. see Recommended Disclosure (c) under Strategy in figure 1) and Metrics and Targets. We are proposing that it would be permissible for entities to explain why they cannot fully complete specific elements where information is not available, or disclosures are not practicable, following a best endeavours approach.
- 32 Where entities 'explain', this should include providing a roadmap to complete reporting, with an expected timeline and identifying any key barriers to disclosure.

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- 33 Entities could also 'explain' if their analysis finds there are no material financial impacts from climate change on their business. This should include explaining why this is the case, and the assumptions on which their analysis was based, such as the time horizons and expected regulatory settings.

The entities that the disclosure system would apply to

The entities initially consulted on

- 34 The MfE-MBIE discussion document proposed the disclosure regime would apply to financial institutions and other entities that participate in financial markets comprising listed issuers, asset owners, asset managers, banks and licensed insurers.
- 35 We recommended these classes be included for several reasons.
- 35.1 As the entities most likely to be affected by climate change in real terms, climate-related disclosures by listed issuers provides the core data that allows investors, lenders and insurance underwriters to meaningfully assess and price climate-related risks and opportunities.
- 35.2 Asset owners sit at the top of the investment chain and have the ultimate responsibility for asset allocation decisions. Asset owners invest in a range of asset classes, including bonds, wholesale funds and private equity. New Zealand examples include KiwiSaver Schemes, other Superannuation schemes, insurers and investing foundations.
- 35.3 Asset managers make investment decisions on behalf of their clients. They have an important role to play in influencing the entities in which they invest to provide high quality climate-related financial disclosures.
- 35.4 Banks are exposed to climate-related risks and opportunities through lending and other financial intermediary activities, and through their own operation.
- 35.5 Insurers underwriting and investment risks and opportunities are changing due to rising sea levels, changing climate patterns and the potential increase in the number and severity of weather-related natural catastrophes.
- 36 Submitters were largely supportive of the range of entities proposed for inclusion. However, some concerns were expressed about the ability of asset managers to comply. This is discussed below in paragraphs 60-61.

Defining the entities in existing financial markets legislation

- 37 These classes of entity are all regulated under financial markets legislation – notably part 7 of the Financial Markets Conduct (FMC) Act 2013.
- 38 We are therefore recommending that this disclosure regime applies to a subset of FMC reporting entities, namely:

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- 38.1 listed issuers in New Zealand
 - 38.2 managers of licensed Managed Investment Schemes
 - 38.3 registered banks
 - 38.4 licensed insurers
 - 38.5 credit unions
 - 38.6 building societies.
- 39 The objective of the regime is in keeping with the purpose of the FMC Act, to promote and facilitate the development of fair, efficient and transparent financial markets, and to promote the confident and informed participation of businesses, investors and consumers. This will facilitate implementation because it ensures consistency and allows leverage off existing, well-functioning systems, and because the general information-gathering and enforcement powers in the Financial Markets Authority Act 2011 will apply.
- 40 Disclosures will not be required of private, non-issuer companies or large greenhouse gas emitters unless they are included by one or more of the above categories.
- 41 The term 'Asset Owner' is not commonly used in New Zealand financial markets and therefore has caused confusion. By aligning both asset owners and asset managers with the existing definition of 'managers of registered schemes' in the Financial Markets Conduct Act 2013, we are able to provide more clarity on the scope of reporting entities.
- 42 Disclosure requirements under the FMC Act will not include, for example, large non-issuers and other large organisations like iwi, notwithstanding any activities currently regulated under the FMC Act. It will also not include wholesale funds that are not already captured as FMC reporting entities.
- 43 Wholesale funds may only be invested into by eligible wholesale investors, which either have significant investment activity; are a large investor; are a financial adviser; or invest in financial products as their principal business. The FMC Act requires publicly released financial reports from most wholesale funds, but not from unit trusts and private wealth (personalised investments).
- 44 We are not proposing to include personalised investments as the party with legal ownership of assets (i.e. the client) is able to directly influence investment strategies and request information about climate risks and opportunities. Public disclosure will not provide additional decision-useful information to the market and therefore does not fit with the purpose of the FMC Act.

Consulting on non-issuer disclosure

- 45 Several stakeholders provided feedback that materiality of climate change impacts is related to the size and impact of an organisation, rather than ownership. There are many unlisted companies in New Zealand. Restricting the scope of reporting entities to listed companies may leave significant risks to

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financial stability unmanaged, and create barriers for banks, insurers and investment managers to analyse their exposure. Moreover, this may create an uneven playing field between public and private companies.

- 46 However, this regime intends for disclosures to be read in the context of an entity's annual reporting, including their financial statements. Although non-listed issuers are required to prepare annual financial statements and distribute them to shareholders, they are not required to make them available to the public. Therefore, this regime cannot be simply extended to non-listed issuers.
- 47 Further analysis will be required to understand the value of and mechanism for extending this regime beyond listed issuers. We are seeking agreement to consult on whether non-listed companies should be required or encouraged to consider their climate-related financial impacts and how best to achieve this. We are recommending that this consultation should begin soon after this legislation is enacted.

Exempting smaller entities

- 48 Some banks, insurers, and investment scheme managers are relatively small, and the costs of preparing these disclosures will likely be disproportionate. We are proposing only the larger entities be included. Consideration could be given to including entities below the threshold at a later date, as part of a post-implementation review of the scheme.

Indexing the dollar thresholds

- 49 We are also recommending that there be a requirement for the dollar thresholds to be increased from time to time, to reflect movements in a suitable index maintained by Statistics New Zealand. This will ensure that smaller entities do not get unintentionally drawn into the disclosure regime.
- 50 Tables 1-3 outline exemption options using dollar thresholds as a proxy for economic significance. Note that 'assets' in the tables below refers to an entities' assets under management. Bolded rows indicate our recommended options.

Table 1: Registered banks (New Zealand incorporated & branches of overseas banks)

	Number of banks	Total assets (\$b)	Percentage of total assets
All registered banks	26	602.1	100%
Assets >\$1b	23	601.4	99.9%
Assets >\$3b	14	582.2	96.7%
Assets >\$5b	12	573.6	95.3%

Table 2: Investment scheme (asset) managers

	Number of scheme managers	Total assets (\$b)	Percentage of total assets
All scheme managers	105	146.4	100%
Assets >\$500m	34	139.4	95.2%
Assets >\$1b	23	132.6	90.5%
Assets >\$3b	12	114.5	78.2%
Assets >\$5b	5	70.5	48.4%

Note: The above table includes all investment schemes required to report under the FMC Act including retail funds, KiwiSaver, Superannuation and other retirement schemes.

Table 3: Licensed insurers – assets (>\$1b) and premium income

	Number of insurers	Total assets (\$b)	Percentage of total assets	Total premium (\$b)	Percentage of total premium
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

9(2)(ba)(i)

- 51 We propose to set these thresholds in primary legislation, to provide greater certainty for disclosing entities.
- 52 Acknowledging that the amount of assets under management by an entity may fluctuate regularly, this threshold would apply to the regulated entities who are within the threshold as at the last day of each of the 2 most recent financial years. This is consistent with the current approach of the FMC Act.
- 53 It is intended that the disclosure system will be reviewed 3-5 years after it comes into force by MfE and MBIE. This review will include, among other things, an assessment of the classes of entity covered by the regime and the exemption criteria.

Comment on listed issuers

- 54 For the avoidance of doubt, 'listed issuers' incorporates both equity and debt issuers.
- 55 Consistent with international comity principles, we are proposing that foreign exempt issuers listed on the NZX could be excluded from the disclosure system. These issuers' home exchanges are domiciled overseas, and they are deemed to meet the NZX Listing Rule requirements by complying with the requirements of their home exchange.

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- 56 Noting that climate-related financial disclosure is becoming more common internationally, we propose providing scope for a class exemption to be made for such issuers. Sixteen foreign exempt issuers are listed on the NZX at present.
- 57 We are not proposing to introduce any thresholds for listed issuers to disclose. As noted in paragraph 34.1, any climate-related risks and opportunities will affect 'real economy' companies first. As the underlying players of the financial markets, the analysis of other players further up the investment chain is reliant on as many companies disclosing as possible.

Comment on banks

- 58 We are recommending \$1 billion as the threshold for registered banks. Using this threshold, 99% of assets under management in New Zealand banks are included within the disclosure system.

Comment on building societies and credit unions

- 59 We propose that the same threshold of \$1 billion of total assets be used for building societies and credit unions that are regulated under the Non-bank Deposit Takers (NBDT) Act 2013. This will not have any short term consequences because:

- 59.1 no credit union is close to having total assets of more than \$1 billion
- 59.2 only one building society (Southland Building Society) is above this threshold, but it is also a registered bank.

- 60 We are making this proposal for two reasons. First, banks and NBDTs of the same size should be treated the same. Second, circumstances could change (e.g. by way of amalgamations).

Comment on insurers

- 61 In addition to using the same \$1 billion asset threshold, we also propose that an insurer be included if its annual premium income is greater than \$250 million. Assets under management alone do not provide an accurate picture of risk exposure for insurers. The inclusion of premium income as an alternative measure to total assets is needed to provide a proxy for liability-side risks for life, general and health insurers.

Comment on managers of registered schemes

- 62 We are recommending that managers of registered schemes with more than \$1 billion under management in aggregate would be subject to the disclosure system. However, they would be required to disclose in relation to each scheme they manage, on a comply-or-explain basis, rather than one aggregated report. This is because they manage numerous schemes, often with very different climate risk profiles. Investors in managed investment

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schemes need information to help them understand the impact of climate change on the future performance of the schemes they invest in.

- 63 Consultation with fund managers revealed costs of fund-by-fund disclosure would be approximately one percent of operating margin for an average fund manager, at \$1 billion total assets. We therefore consider \$1 billion to be an appropriate threshold.
- 64 In order to understand their climate risks, asset managers rely on information about climate risks faced by the entities in which they invest. It was suggested, therefore, that asset managers should be exempt, or their entry into the scheme should be delayed until after other entities have been disclosing for two or three years.
- 65 Although we acknowledge these concerns, we are recommending that managed investment schemes be included from the outset for the following reasons:
- 65.1 disclosures can provide important information to clients about the impact of climate change on long term returns
 - 65.2 it is important for asset managers to start the learning process sooner rather than later
 - 65.3 comply-or-explain will provide the flexibility to meet some of the asset managers' concerns
 - 65.4 managers of investment schemes can begin to consider where climate risk is likely to apply across their portfolios without granular data about investee companies. Firms can explore the use of reasonable proxies and assumptions to work around these issues, rather than leaving risks unrecognised. Imperfection is not an excuse for inaction.

Comment on multinational organisations

- 66 A number of banks, insurers and asset managers operating in New Zealand are subsidiaries or branches of multinational organisations. We are proposing that overseas incorporated organisations above the relevant thresholds should disclose in their New Zealand annual reporting, to ensure their New Zealand stakeholders' needs are met.

Comment on the scope of the regime

- 67 The regime as proposed would capture approximately 260 entities, including approximately 190 listed issuers. As of June 2020, fewer than 10 New Zealand entities have published reports aligned with the TCFD framework, and a small number are working towards doing so; 55% of NZX listed companies are not reporting any sustainability-related information. There will be significant additional effort required from regulated parties to undertake this analysis and understand their risks.

Future phases

68 We view the proposals within this Cabinet Paper as a first step towards more widespread adoption of the TCFD framework. Widespread adoption will increase the amount of decision-useful information in the market and better enable the objectives of the regime to be met, in facilitating a more efficient financial market. We therefore note that the scope of the regime may be expanded in future years, subject to adequate consultation.

Disclosure by public entities

69 Just as private sector entities face climate-related risks and opportunities, so do public sector actors.

70 The public sector makes up a large proportion of the New Zealand Economy: Government expenditure in 2019 was 29% of GDP. The Government also has a leadership role to play. Commercial entities receiving public funding should be held to a high standard of transparency to ensure their activities, strategies and financial planning take foreseeable risks into account, and to make the Crown aware of risks to public finance.

71 We are seeking agreement from Cabinet on the principle that it is important for public entities to consider and disclose their long-term climate-related risks and opportunities. A requirement to prepare and disclose will support transparency about whether government entities have sound processes for identifying and managing material climate-related risks.

72 However, we are recommending that public entities should not be captured under this regime. We consider that the inclusion of these entities is underpinned by a different intervention logic to that of reporting to increase the efficiency of financial markets. Instead we are recommending that this be achieved through regulations under section 5ZX or a written request under section 5ZW of the Climate Change Response Act 2002, which is already aligned with the language of the TCFD and captures a wide range of public entities, including government agencies and State-Owned Enterprises.

Comment on Crown financial institutions

73 Crown financial institutions are state-owned investment funds that invest in financial assets. There are a number of Crown financial institutions in New Zealand, most notably the New Zealand Superannuation Fund and the Accident Compensation Corporation, each of which has about \$45 billion of funds under management.

74 We are proposing that Crown financial institutions with assets under management of more than \$1 billion be required to publish TCFD reports. The reasons for including large Crown financial institutions are:

74.1 to promote better business decision-making; and

74.2 to promote accountability to Parliament and taxpayers.

Where the disclosures would be made

- 75 The main purpose of disclosing climate-related financial information is to provide information about material financial risks and opportunities to the users of their financial reports. Hence, it is important for the disclosures to appear in the same report in which they make their mainstream financial disclosures.
- 76 In addition, reporting entities should be able to publish detailed information (e.g. descriptions of climate scenarios) in other places, such as on their websites. However, the reporting entity should provide a 'roadmap' in their mainstream report so that users are able to readily find all of the more detailed information.

Independent assurance

- 77 The Productivity Commission stated in *Low-emissions economy* that disclosures should be subject to independent third-party assurance.
- 78 We agree in relation to greenhouse gas emission disclosures (see Metrics & Targets disclosure (b) in figure 1) as there are well established assurance standards in this area.
- 79 In addition, auditors of financial statements are already required to read and consider information presented in the annual report other than the financial statements under an existing International Standard on Auditing. Auditors need to respond appropriately if they identify material inconsistencies, or other information that appears to be materially misstated.
- 80 We are not recommending a separate comprehensive assurance requirement in relation to climate-related disclosures at this time. The International Auditing and Assurance Standards Board is currently considering wider issues around the assurance of forward-looking and qualitative information, including developing guidance material. However it would be premature to impose mandatory assurance now. This issue could be reconsidered as part of the policy review referred to in the attached regulatory impact analysis.

Implementation

The role of the government in supporting implementation

- 81 The Government will play a significant role to make the adoption of TCFD fully effective.
- 81.1 The TCFD's recommendations provide entities with wide discretion about what to report. It will be essential to have standards to make compliance easier and promote consistent, comparable, reliable and clear reporting. We propose that the XRB, which is the independent Crown entity that

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issues financial reporting standards, would carry out this function, subject to obtaining funding.

- 81.2 The Government will need to assist businesses by publishing guidance material and other information, such as climate models that will help them to carry out scenario analyses (see TCFD Strategy disclosure (c)). We propose that MfE will have the lead responsibility for coordinating this activity.
- 81.3 Independent monitoring, reporting and enforcement will be an essential part of promoting high quality reporting. The FMA is best placed to carry out this function because it is responsible for regulating most of the proposed reporting entities and has the necessary information-gathering, monitoring and enforcement powers, subject to obtaining funding.

A wider role for the XRB in relation to integrated reporting

- 82 Integrated reporting is about explaining how an entity creates value over the short, medium and long term using a combination of quantitative and qualitative information, much of it forward-looking. It is founded on the idea that an entity can best tell its value creation story in terms of six capitals – financial, manufactured, intellectual, human, social and relationship, and natural capital. An integrated report aims to explain how the entity draws on the six capital inputs and show how its activities transform them into outputs.
- 83 The XRB has advised us that investors and other users are increasingly stating that the financial statements alone do not provide them with sufficient information to make informed decisions. Preparers and users are increasingly asking the XRB to issue voluntary standards and guidance material that will assist reporting entities to produce high quality integrated reports.
- 84 The XRB sees the need for climate-related financial disclosures as the most urgent issue amongst a wider demand for reporting entities to publish integrated reports. Our proposals, including the legislative and financial recommendations, provide for the XRB to respond to increasing market demand for voluntary integrated reporting standards.

When entities should start disclosing

- 85 There are three main timing issues:
 - 85.1 The first implementation step is for the XRB to develop, consult on and issue new reporting standards and guidance material.
 - 85.2 The XRB does not have the resources to carry out this activity within existing baselines. Nor does it have the reserves to make a start on this work in 2020/21 – see the financial implications section below.
 - 85.3 Reporting entities will need to establish information-gathering systems to collect the information that will underpin their disclosures. Therefore, the

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XRB will need to issue the initial standard or standards several months before the disclosure regime comes into force.

86 For these reasons, we are proposing that:

86.1 the XRB commence work in 2020, once policy decisions have been made and enduring funding confirmed

86.2 subject to the legislation being enacted by mid-2021, we anticipate mandatory (comply-or-explain) climate-related financial disclosures would come into force for financial years commencing on or after 1 January 2022. This would mean, for example, that an entity with a 30 June balance date would first be required to comply or explain in relation to the financial year ending on 30 June 2023. Exact timing will be dependent on how long it takes the XRB to set standards.

87 These timing issues are interdependent. Delays in either securing enduring funding for the XRB or enacting the legislation will result in the implementation date being deferred.

Financial Implications

88 We are seeking appropriations for the XRB starting in Financial Year 2020/21 and the FMA starting in 2021/22.

89 The XRB will need to build capacity, employ specialist staff, establish a new Integrated Reporting Board under its auspices and start working on standards development in the 2020/21 financial year to avoid undue delay to the commencement of the regime. This will be essential for reporting entities. They need to know what they are required to report well before their financial year commences, so that they can put suitable information-gathering systems in place.

90 The FMA will also need to upskill and employ staff, prepare guidance material regarding implementation in 2021/22 & 2022/23, and monitor disclosures in 2023. It is likely that the FMA will also carry out some preparatory work in 2020/21. However, we are not seeking funding for that year because the work involved would be limited and the FMA obtained a substantial increase in its appropriation through Budget 2020.

91 We are seeking funding through the Crown, rather than through levies. This will be reviewed within three to five years.

Legislative Implications

92 There are two legislative implications.

93 First, primary legislation will be needed to specify the classes of entity that the climate-related standards issued by the XRB will apply to. [REDACTED]

94 The FMC Act provides for criminal penalties, pecuniary penalties, infringement notices and powers for the FMA to make orders. The Bill will extend existing enforcement provisions in the FMC Act to include provisions for offences relating to this legislation. Further work will be carried out as the Bill is developed on the relevant enforcement provisions needed.

95 Second, the XRB does not currently have the power to issue integrated reporting-related standards, including climate-related standards. However, section 17(2) of the Financial Reporting Act 2013 provides for the XRB's powers to be broadened in this way by Order in Council. Section 17(3) states that the responsible Minister:

...may make a recommendation only if he or she is satisfied that it is desirable for standards referred to in subsection (2)(a) to be issued in order to provide for the integrated reporting of an entity's performance or position in terms of both financial and non-financial information.

Impact analysis

Regulatory impact statement

96 A full Regulatory Impact Statement was prepared and is attached to this Cabinet paper. A joint Regulatory Impact Analysis Panel with members from the Ministry for the Environment and Ministry of Business, Innovation and Employment has reviewed the Regulatory Impact Statement and confirms that the analysis meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

Climate Implications of Policy Assessment

97 The CIPA requirements do not apply to this proposal as the potential emissions impact is indirect and unable to be accurately quantified.

98 Implementation of a climate-related financial disclosure system may contribute to an overall reduction in net emissions. This proposal is important in supporting the transition to a low-emissions economy by potentially redirecting investment away from emissions-intensive activities and towards low-emissions investments.

Population Implications

99 There are no material population group implications.

Te Tiriti o Waitangi Implications

- 100 We acknowledge the interest iwi/Māori have in the financial markets. Iwi/Māori participating in financial markets (through managed investment schemes, direct investments in listed debt and equity, and retail investment) will benefit from having more accurate, accessible and comparable data to inform investment decisions and engagement of scheme managers. Benefits will largely come from the more efficient operation of financial markets and greater macro-economic financial stability.
- 101 The proposals in the paper do not have immediate Te Tiriti implications. We note that some iwi KiwiSaver schemes would be in scope in principal, via existing FMC reporting obligations, although our recommended thresholds mean there are no immediate consequences for iwi KiwiSaver schemes. This will remain a live interest for iwi investors however.
- 102 Iwi/Māori were invited to participate in consultation on these proposals alongside other stakeholders and notice of the consultation was included in a regular Ministry for the Environment iwi newsletter. The scope of reporting entities was clarified in response to the feedback received, as per paragraphs 40 - 41.

Human rights

- 103 The proposals in this paper are not in any way inconsistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

Consultation within government

- 104 The following government departments and agencies have been consulted: Treasury, Reserve Bank, XRB, FMA, Legislation Design and Advisory Committee, Ministry of Justice, Ministry of Foreign Affairs and Trade, Ministry for Primary Industries, Statistics New Zealand, Department of the Prime Minister and Cabinet, Department of Internal Affairs and the Energy Efficiency & Conservation Authority.
- 105 **The XRB** supports these proposals, subject to being funded adequately (see the discussion of financial implications). The XRB agrees that climate reporting is urgent and needs to be prioritised. The XRB also considers that there will be growing user demand over the medium term for entities to publish extended external reports and a resulting need for it to issue reporting standards in relation to such matters as:
- 105.1 the reporting entity's governance, strategic direction and targets
- 105.2 the social, environmental and economic context in which the entity operates.
- 106 **The FMA** strongly supports the policy objectives behind this proposal and agrees that, subject to obtaining funding, the FMA is the appropriate agency

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to be responsible for monitoring and enforcement as well as reporting on the implementation of TCFD on a comply-or-explain basis.

- 107 However, the FMA has strong concerns that the proposed entity coverage is too broad, with potential adverse impacts for the overall success of the disclosure system. With that in mind, the FMA strongly advises that mandatory application be limited to NZX50 equity entities in the first instance to best support the successful implementation of the Government's policy objective. The FMA is also very concerned about the significant impact on managers of investment schemes, including the impracticality of preparing TCFD disclosures, on the basis that fund manager disclosures are dependent on investee disclosures.
- 108 The FMA strongly believes that TCFD requirements for registered banks and licensed insurers should be limited to their core banking and insurance operations as the same difficulties described for asset managers may arise for banks and insurers that have non-core subsidiary functions.
- 109 The FMA further notes that the unanticipated operational pressure of COVID-19, combined with an existing programme of significant regulatory change for the financial industry, should be considered in the timing proposed here. A fast pace for implementation may result in a failure to meet the timeline.
- 110 **The Reserve Bank** supports these proposals for mandatory disclosure of climate risk as a tool that would help inform monetary policy, supervision and financial stability. The Bank recognises that there are important challenges to making disclosure effective including establishing appropriate scenarios, managing uncertainty, data availability and capacity.
- 111 In overseas jurisdictions it has taken time for companies to develop expertise in climate risk reporting, and ongoing guidance from government has been needed. For these reasons, the Reserve Bank favours an approach that is collaborative with industry to identify and vet fit-for-purpose disclosure practices. The comply-or-explain approach is appropriate as a first step and would help address firm compliance risk and cost. Further, the Reserve Bank welcomes the role of the XRB in standard setting.
- 112 The Reserve Bank also agrees that thresholds for excluding smaller firms are appropriate and notes that, in order to deliver the intended benefits, the applicability of the TCFD requirements should not be unduly narrowed.
- 113 **The Department of Internal Affairs (DIA)** is supportive of greater disclosure of climate-related risks. DIA requested clarification on whether local government institutions would be included under the definition of 'asset owner' and recommended further narrative on the coverage of the regime.

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- 114 DIA also suggested exploring the use of section 5ZW of the Climate Change Response Act 2002 as a mechanism for requiring reporting.
- 115 The **Legislation Design and Advisory Committee** provided advice that the policy objective should clearly align with the legislation that is proposed to be amended, and asked Officials to consider the appropriate enforcement options.

Public consultation

- 116 MfE and MBIE issued a discussion document on 31 October 2019 outlining the proposals in this paper. Seventy-seven submissions were received and 59 submitters supported or strongly supported the proposals. Ten opposed or strongly opposed them. Three quarters of business and industry respondents (those impacted by the proposals) were supportive of the proposals.
- 117 Officials also held seminars in Auckland, Wellington and Christchurch, held a webinar and participated in roundtables and meetings with key stakeholder groups.
- 118 The consultation process has not led to any fundamental design changes for the proposed disclosure system. However, the proposals in the discussion document have been modified or developed in the following ways:
- 118.1 the dollar thresholds for excluding smaller entities and managed investment schemes have been added
 - 118.2 the 'explain' element of comply-of-explain has been made more flexible, particularly in response to feedback from investment scheme managers
 - 118.3 the proposal to provide scope for excluding foreign exempt issuers has been added
 - 118.4 the XRB will be the standard-setter for the regime, and will set timing for implementation
 - 118.5 we are seeking agreement to consult on whether and how non-listed companies may consider climate-related risks and opportunities
- 119 Consultation also reiterated that the Government will have a critical role in supporting reporting entities and promoting compliance.

Communications

- 120 If this proposal gains Cabinet approval, we intend to announce this via a media statement.

Proactive Release

121 MfE and MBIE will publish a copy of this paper, subject to any necessary redactions, within 30 business days of decisions being confirmed by Cabinet.

Recommendations

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

Context

- 1 **note** that, in general, inadequate information about risks can lead to mispricing of assets and the misallocation of capital;
- 2 **note** that many businesses face significant risks relating to climate change but few businesses are disclosing useful or complete information to investors, lenders and insurance underwriters;
- 3 **note** that the primary objective of these proposals is for the effects of climate change to become routinely considered in business and investment decisions to promote and facilitate the development of fair, efficient and transparent financial markets;

Mandatory (comply-or-explain) disclosure

- 4 **agree** to amend the Financial Markets Conduct Act 2013 to implement annual mandatory climate-related financial disclosures on a comply-or-explain basis;
- 5 **agree** that the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) will underpin the disclosure system;
- 6 **agree** that non-disclosure would be permissible where an entity analyses and reports that they see themselves as not being materially affected by climate change;
- 7 **agree** that non-disclosure of specific elements of the disclosure framework would be permissible where information is not available, or disclosures are not practicable, following a best endeavours approach;
- 8 **agree** that the following entities should be required to disclose their climate-related financial risks and opportunities in mainstream financial reports:
 - 8.1 listed issuers
 - 8.2 registered banks, credit unions and building societies with assets over \$1 billion
 - 8.3 licensed insurers with assets over \$1 billion or premium income of over \$250 million

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- 8.4 managers of registered schemes with assets under management over \$1 billion.
- 9 **agree** that officials should undertake further consultation on how non-listed companies consider climate change risk after this legislation is enacted and report back to DEV;
- 10 **agree** that the dollar threshold be increased from time to time in accordance with movements in a suitable Statistics New Zealand index;
- 11 **agree** that the regime will be reviewed within 3-5 years of commencement;
- 12 **note** that the scope of the regime may expand in future years, subject to appropriate consultation;
- 13 **agree** that it is important for public entities to consider and disclose their climate-related risks and opportunities;
- 14 **agree** that Crown financial institutions with assets under management of over \$1 billion should be required to disclose their climate-related financial risks and opportunities in annual reports;
- 15 **direct** officials to investigate the best way to effect recommendation 14 and report back to Ministers by the end of the year;
- 16 **agree** that climate-related financial disclosures should appear in the main document for communicating financially material information to an entity's relevant audience;
- 17 **agree** that independent assurance of greenhouse gas emission disclosures will be required;
- 18 **agree** that assurance will not be required in relation to other disclosures;

Power to act

- 19 **authorise** the Minister of Commerce and Consumer Affairs and the Minister for Climate Change to make minor or technical changes consistent with the policy intent;

Funding

- 20 **approve** the following changes to appropriations to give effect to the policy decision in the recommendations above, with a corresponding impact on the operating balance:

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	\$m – increase/(decrease)				
	2020/21	2021/22	2022/23	2023/24	2024/25 & Outyears
Vote Business, Science and innovation					
Minister of Commerce and Consumer Affairs					
Non-departmental Output Expense: Accounting and Assurance Standards Setting	1.100	-	-	-	-
Total Operating	1.100	-	-	-	-

- 21 **agree** that the proposed change to appropriations for 2020/21 above be included in the 2020/21 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply;
- 22 **agree** that the expenses incurred under recommendation 20 above be charged against the between-Budget contingency established as part of Budget 2020;
- 23 **note** that a Budget bid will be made next year for ongoing funding for both the External Reporting Board and the Financial Markets Authority to implement the above policy proposals;

Legislation

- 24 **note** that primary and secondary legislation will be needed to implement the mandatory (comply-or-explain) climate-related financial disclosure system;

25  s9(2)(f)(iv)

- 26 **agree** in principle to apply the existing offence, penalty and remedy provisions in the FMC Act for climate-related financial disclosures in the Bill;
- 27 **agree** to make an Order in Council under section 17 of the Financial Reporting Act 2013 authorising the External Reporting Board to issue financial reporting standards in relation to integrated reporting, including climate-related matters; and
- 28 **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office.

Authorised for lodgement

Hon Kris Faafoi
Minister of Commerce and Consumer Affairs

Hon James Shaw
Minister for Climate Change