CHAPMAN TRIPP

To: Ministry of Business, Innovation and Employment (*MBIE*) and Ministry for the Environment (*MfE)*

on the Discussion Document on Climate-Related Financial Disclosure

December 2019

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INTRODUCTION

Chapman Tripp welcomes the opportunity to submit on the Discussion Document on Climate-Related Financial Disclosure dated October 2019 (the *Discussion Document*).

We advise a number of clients on climate-related matters, including climate-related financial risk. The firm makes this submission in the interests of supporting and improving the proposed disclosure regime from the perspective of future users of the scheme. The views in this submission are the views of the firm, not of individual clients.

We are happy for our submission to be published.

CHAPMAN TRIPP'S ENGAGEMENT ON CLIMATE-RELATED FINANCIAL RISK

We routinely advise a broad range of entities on mandatory financial disclosures, including climate-related financial disclosures. We have also been at the forefront of advising on climate risk, including as a result of the Climate Change Response (Zero Carbon) Amendment Act 2019, the proposed Climate Change Response (Emissions Trading Scheme Reform) Amendment Bill and the Government's current proposal to introduce climate-related financial disclosure.

In October 2019, at the request of the Aotearoa Circle (a partnership of public and private sector leaders committed to sustainable prosperity in New Zealand), Chapman Tripp (Daniel Kalderimis and Nicola Swan) authored a legal opinion on the obligations of company directors and managers of retail managed investment schemes (fund managers) to consider climate change in their decision making (the *Legal Opinion*). As part of that work, we discussed the impact of the recommendations of the Task Force on Climate Related Financial Disclosure (*TCFD*) and their implementation in like-minded countries including the United Kingdom and Australia.

We were pleased to be invited to participate in the Government's consultation sessions in November 2019 on the Discussion Document in Wellington, Auckland and Christchurch.

As a result of the above, we welcome the opportunity to contribute further to the development of the Government's policy on climate-related financial disclosure through this submission.

SUBMISSIONS ON THE DISCUSSION DOCUMENT

Your name and organisation

Name	Penny Sheerin / Daniel Kalderimis / Nicola Swan
Organisation	Chapman Tripp

Summary of our submissions

We welcome the opportunity to submit on the Discussion Document on Climate-Related Financial Disclosure (the *Discussion Document*). Our submissions focus on three main themes:

- the importance of implementing a disclosure framework that is accessible and practical for entities required to make disclosures;
- the need to maintain a flexible approach to allow reporting entities to benefit from increasing industry guidance and international practice; and
- ensuring compatibility with existing disclosure requirements.

We set out our submissions in respect of certain questions from the Discussion Document below.

Responses to discussion document questions

6	What are the implications of 211 of the Companies Act 1993 for the disclosure of material climate-related information in annual reports?
	We think the Discussion Document overstates the scope of section 211(1) of the Companies Act 1993. It does not require all material information to be disclosed. Rather section 211(1)(a) has a backward focus on the financial statements for the last accounting period or business events arising in the last accounting period. Other elements of section 211(1) merely prescribe a list of specific items of information, several of which have fallen behind international comparative requirements (e.g. on remuneration disclosure).
	Strangely, the Companies Act 1993 contemplates regulations may specify content for a *concise* annual report (see the definition of **concise annual report**), which might provide a basis for regulation of climate risk financial disclosure in concise reports but not additional content for a full annual report.
	Accordingly we consider section 211 currently provides a poor basis for reporting of climate-related financial disclosure.
7	Question 7: What are the implications of the NZX Listing Rules for the disclosure of material climate-related information by (a) equity issuers and (b) debt issuers?
	While in theory NZX Listing Rule 3.1 might require disclosure by NZX listed equity issuers of very significant change in the financial risk profile arising from climate developments, that is unlikely to arise in practice. This will be because, at least for larger NZX listed issuers, the market price of quoted equity securities will unlikely change by 5% or more (in a positive or adverse manner) merely from climate related matters and/or climate matters will be readily observable, deductible or otherwise generally available to the market and therefore not constitute **material information** under the Financial Markets Conduct Act 2013 *(FMCA)*.

	While the NZX Corporate Governance Code, and associated ESG Guidance Note, requires NZX listed issuers of equity securities to consider providing some disclosure which could touch on material exposures to environmental risks, the NZX Code does not apply to debt only issuers. We think this is appropriate, given the characteristics of quoted debt securities. We agree that both the NZX Code and the ESG Guidance Note provide flexibility on how to present information about climate risk and certainly do not require the TCFD information to be disclosed. We think this flexibility is appropriate in a governance code.
8	How should the proposed adaptation reporting under the [Climate Change Response Act] and the climate-related financial reporting disclosures proposed in this discussion document best work together?
	It is currently unclear if TCFD-based reporting would satisfy the reporting obligations under sections 5ZV to 5ZW of the Climate Change Response Act 2002 (Act, as inserted by the Climate Change Response (Zero Carbon) Amendment Act 2019). Reporting under the Act focuses on adaptation reporting, as opposed to climate-related financial risk under TCFD-based reporting. That said, there are clear similarities between the type of information anticipated to be required under s5ZV of the Act and that anticipated by TCFD-based reporting. To avoid confusion, and in keeping with the requirement in section 5ZW(2)(c) of the Act to avoid unnecessary duplication of information, we suggest that any regulations issued pursuant to section 5ZW of the Act should be required to recognise that TCFD-based reporting will be acceptable for the purpose of reporting under the Act. We further suggest that such reporting should be subject to the same scrutiny as will be applied to other reporting entities.
9	Do directors' legal obligations in New Zealand result in consideration, identification, management and disclosure of climate-related risks?
	We concluded in our Legal Opinion that directors of New Zealand companies must assess and manage climate risk as they would any other financial risk. We concluded that directors of New Zealand companies are generally permitted, and will in many contexts be required, to take climate change into account when making business decisions. The requirement stems principally from the directors' duty to act with reasonable care. We concluded that directors of companies affected by climate-related financial risk must, at a minimum: identify that risk; periodically assess the nature and extent of the risk to the company, including by seeking and critically evaluating advice as necessary; and decide whether, and if so, how to take action in response, taking into account the likelihood of the risk occurring and possible resulting harm. We explained that directors can do so using conventional risk management strategies, and that the more material the risk, the more it would be reasonably expected to be considered. Importantly, the Legal Opinion notes that where the company has public disclosure obligations (i.e. listed issuers), directors also need to ensure they are disclosing material financial risk due to climate change as they would disclose other material business risks.

	Therefore, while directors' legal obligations require them to consider, identify and manage climate-related risks, disclosure is only currently required for listed issuers.
10	Do you agree with the Legal Opinion prepared for the Aotearoa Circle?
	Obviously, since members of our firm were the authors of the Legal Opinion prepared for the Aotearoa Circle, we agree with the Legal Opinion. During the Government's consultation on the Discussion Document, we appeared as panellists on the connections between the Legal Opinion and the proposed disclosure regime. There are two intersections with the Legal Opinion: • First, our conclusion that directors and fund managers must assess and manage climate risk as they would any other financial risk clarifies the expectations on directors and fund managers to take action internally. This conclusion becomes even more significant in a regulatory context where certain entities, including listed issuers and fund managers (asset managers), are required to publicly *disclose* certain aspects of their climate-related financial risk, as now proposed. • Second, the TCFD recommendations – given their wide-spread recognition and increasing adoption in like-minded countries – are a relevant part of the regulatory background for New Zealand companies, particularly listed issuers. This global trend towards greater disclosure of climate-related financial risk is one factor which supports the assessment in the Legal Opinion that a court would now expect company directors and fund managers to be identifying and assessing relevant climate-related financial risk. We would be interested in hearing any feedback on the Legal Opinion from other submitters, including any areas for future work.
12	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?
	We appreciate the Government's recognition of the speed at which climate-related financial disclosure is developing, including both technical understanding from industry and expectations of regulators. We believe it is important to retain flexibility to allow entities to respond in a manner that best fits their individual circumstances, while recognising the Government's stated goal of ensuring that the market has the information it needs, in a form that is useful for investors, creditors, insurers, and other users of annual reports, to allocate investments in a way that contributes to a low-emissions, climate-resilient economy (Discussion Document, p. 8). For this reason we support the Productivity Commission's proposal for a mandatory (comply-or-explain) principles-based disclosure system, as opposed to a more prescriptive regime (for instance through the introduction of new technical accounting standards).
19	What are your views about providing a transition period where incomplete disclosures would be permissible?
	We believe a transition period is a sensible option for all entities caught by the new regime. See further at question 21 below.

21	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?
	We think the application of the regime to classes of entity needs careful consideration. Under the Companies Act 1993, mandatory annual report disclosure is only required of "large" companies (with "large" being defined in section 45 of the Financial Reporting Act 2013). We are sympathetic to the caution expressed by the Capital Markets 2029 Steering Group about inconsistent disclosure and liability settings between public and private capital markets (see pages 35 -36 of the *Growing New Zealand's Capital Markets 2029* report). Accordingly, while we can see some logic for "large" publicly listed issuers of equity securities to report, to supplement the reporting required to be considered under the NZX Code and ESG Guidance Note, we do not think the TCFD framework should be mandatory for listed issuers that only have debt securities quoted, or for listed issuers of equity securities where the issuer is not "large" (as defined in section 45 of the of the Financial Reporting Act 2013). For the same reasons that we think the TCFD framework should only apply to "large" listed issuers, we think the framework should only apply to "large" licensed insurers. Regulation 9 of the Insurance (Prudential Supervision) Regulations 2012 already contains some license concessions for very small insurers (measured by gross written premium), although for the purposes of the TCFD framework we think a higher threshold should apply before an insurer is "large", more like the revenue threshold applying to "large" companies. We also see difficulties for asset managers, banks and insurers being expected to disclose detailed aspects of their own climate-related financial risk at the same time as listed issuers and asset owners begin to disclose their respective risk. For example, asset managers manage investors' participations in funds that might invest directly or indirectly in many individual companies, both in New Zealand and overseas. Asset managers are likely to need to rely on listed issuers' own disclosures in order to then properly assess their funds' climate-related financial risk. It might therefore be appropriate to delay the implementation of all types of mandatory disclosures for asset managers by an appropriate period. The same difficulties may also arise for banks and insurers, as the issues for them are of the same nature, albeit they are likely to have more ability to request risk-related information directly from the listed issuers they engage with. If a delayed implementation period were adopted for certain entities, this could be minimised so that certain disclosures were delayed (e.g. targets and metrics), while other disclosures were required immediately (e.g. governance, strategy, and/or risk management). We also suggest that asset managers are required to report for individual funds only, as opposed to at the manager level, as this is the information most relevant for investors. We suggest that consideration be given to acceptance of differentiated degrees of reporting depending on the extent of control the reporting entity has over its climate-related financial risk. For example, a company is likely to have much greater control over its specific climate-related financial risk than a bank, insurer or asset manager which must take into account the risk of multiple clients/insureds/investee companies.

	Climate-related financial reporting from companies would therefore be likely more granular than these other entities, at least in initial reporting years.
25	What are your views about our proposal to have a stand-alone climate-related financial disclosure report within the entity's annual report?
	For "large" listed issuers, banks and asset owners (institutional investors), the entity's annual report is often a key document used by potential and current investors to make investment decisions. We therefore support the proposal to have a climate-related financial disclosure report within the entity's annual report. We support there being at least an option for this to be provided in a stand-alone report within the annual report, to avoid the information getting lost). However, for asset managers and "large" insurers, the annual report is not the key document used by consumers or policy holders. Accordingly: • For asset managers of retail managed investment funds, we believe it would be more appropriate to require the approach to climate change risks to be covered in the relevant fund's Statement of Investment Policy and Objectives (*SIPO*) (required under the FMCA). In order to be most effective for investors, it would make sense for TCFD statements regarding Governance and Risk Management to be included in the SIPO (which contains high level strategic information, but is not necessarily updated annually). • For "large" insurers, disclosure would be best published on the insurer's website, for ease of reference for policyholders. We do not think it should be included in the policy document, as that content should be solely focussed on the terms of the insurance cover, so the suitability of the insurance policy for the policyholder's needs can be clearly assessed.
33	What comments do you have on the proposal to bring the disclosure system into force for financial years commencing six months on or after the date that the regulation is introduced?
	Given the existing strict disclosure requirements on listed entities, and potential adverse consequences for releasing inaccurate information to the market, we consider that a longer time period may be required to sign-post and prepare for incoming mandatory regulation than currently stated (six months from introduction of the regulations. We suggest 12 months.
35	Do you have any views on the legislative means for implementing new mandatory (comply-or-explain) disclosure requirements?
	Where the disclosures are to be required in annual reports, it would be most practical for an amendment to be made to enable regulations to be made to expand s 211 of the Companies Act to specify additional environmental, social or governance reporting, with the content of additional disclosure to be specified in regulations. As noted above, strangely the Companies Act already contemplates regulations may specific additional disclosure content for *concise* annual reports, but not full reports. We do not think the regulation making power should be limited to additional climate related disclosure; rather an amendment should contemplate a broader range of potential additional disclosures for additional environmental, social or governance reporting by "large" companies. However the regulation making power should require

	the relevant Minister to have consulted affected entities before the regulations can become effective. Where the disclosures are to be made in a SIPO for a retail managed investment fund, it would be most practical for an amendment to be made to section 164 of the FMCA, which provides for the matters to be addressed in SIPOs.
36	Do you believe there is a role for Government in relation to guidance, education, monitoring and reporting?
	We believe there is a significant need for guidance, education, monitoring and reporting. The TCFD recommendations were issued only in mid-2017, and the Discussion Document which proposes implementing these recommendations in New Zealand was published only on 30 October 2019. There has been very little time for the majority of entities affected by these proposals to come up-to-speed on the proposals, consider the specific implications for their entity, and to properly resource teams in order to be 'disclosure-ready' by FY2022-2023. Guidance (for example through early workshops with industry), examples of best practice, and statements as to expectations of regulators would be appreciated by entities required to comply with the proposals. In this regard, we support minimal regulatory overlap and/or conflict between existing reporting requirements and the new proposals. As we note in the Legal Opinion, pursuant to the NZX Listing Rules and the NZX Corporate Governance Code, listed companies must already disclose *material* climate change risk, or explain why they have decided not to do so. The present proposals would appear to be requiring much more granular information on these same material climate change risks than is currently provided. Accordingly, more specific guidance around the overlap between existing reporting requirements and the current proposals would be useful for future reporting entities. When assessing the standard of future disclosures, we would expect regulators to be pragmatic, to bench-mark disclosures against international trends, and to take into account the business cost of complying with the full TCFD recommendations against the relevance and benefit of those particular disclosures. For example, metrics and targets that might be appropriately disclosed in one industry may be less relevant for another. As for the overall tone of any new regulation, we believe a supported, non-punitive approach (at least for the initial years of any new regime) would deliver the best overall results.