Submission by

to the

Ministry for the Environment,

Ministry of Business, Innovation & Employment

on the

Climate-related financial disclosures Discussion Document

13 December 2019

PO Box 1925
Wellington
Ph: 04 496 6562
Mob: 021 375 061

CLIMATE-RELATED FINANCIAL DISCLOSURES –

SUBMISSION BY BUSINESSNZ,[1] AND BUSINESSNZ ENERGY COUNCIL

1.0 INTRODUCTION

1.1 BusinessNZ welcomes the opportunity to provide feedback on the 'Climate-related financial disclosures – Understanding your business risks and opportunities related to climate change: Discussion document' (referred to as 'the document').[2]

1.2 Specifically, BusinessNZ wishes to comment on the suitability of a comply-or-explain disclosure system as proposed in the document. We are of the view that business led collective action to engage with the Task Force on Climate-related Financial Disclosures (TCFD) framework would meet the goal of increased transparency of physical and transitional risk in New Zealand's capital markets. Furthermore, Government support would allow business led initiatives to gain the desired coverage and reduce the costs and uncertainties imposed on business.

RECOMMENDATIONS

It is recommended that:

a) **Government extend support to industry led initiatives rather than moving forward with legislation imposing unnecessary uncertainty and cost (p.4).**

Notwithstanding our primary recommendation above, on a without prejudice basis, if the Government introduced a mandatory comply-or-explain disclosure system:

b) **There is certainty given as to what entities would be included within the system (p.5);**

c) **That the catch 22 of 'comply-or-explain' is addressed (p.5);**

d) **Government departments and Crown entities and agencies are included (p.6);**

e) **MfE/MBIE undertakes its own research on the primary and secondary cost implications of a mandatory system, informing a reasonable size exemption and cost benefit analysis (p.7);**

f) **Government provides certainty on the support that will be offered to the private sector, particularly around the physical and transitional risks found in scenario analysis (p.7); and**

g) **Time is allowed for additional consultation periods (p.7).**

2.0 DEFINING THE PROBLEM

2.1 The nature of the problem should first be fully understood - who is affected by it, the cost of taking action, and who will bear that cost. Regulatory intervention is costly and should generally be a last resort engaged only when all other cost-effective approaches have been exhausted.

---

[1] Background information on BusinessNZ is attached as Appendix One.

[2] Given the BusinessNZ's broad membership, our members have a range of views on the proposed mandatory disclosures of climate-related financial information. Some may provide their own separate submissions on matters of concern or where the individual organisation has particular expertise.

2.2 While efforts of New Zealand based organisations such as Meridian Energy to engage with the TCFD framework should be lauded, forcing organisations who fall into broad categories such as 'listed issuers' and 'asset owners' to comply defies the intention and design of the TCFD framework. We suggest that the suggested coverage and indicators of the TCFD are broad by design and reflect its voluntary nature. This voluntary design makes it unsuitable for direct transplant into a legislated, mandatory comply-or-explain system, particularly when the net costs imposed on business are yet to be quantified or even guesstimated.

2.3 New Zealand's capital markets are relatively small, particularly when compared to the size of our economic competitors.3 BusinessNZ suggests that most actors in NZ's capital market lack the resources and expertise to carry out the detailed scenario analysis that may be reasonably asked of larger global players.

2.4 BusinessNZ strongly adheres to the idea of travelling up the regulatory pyramid, that is, considering non-regulatory options first, moving "up the pyramid" to generic light-handed options and introducing more stringent measures only if clearly warranted.

Existing evidence and measures

2.5 Business is increasingly eager to disclose climate related risk and mitigation strategies without compelled disclosures. Analysis from Barclays demonstrates that bonds with higher ESG scores have constantly outperformed their opaquer peers.[4] In effect, firms who fail to plan for and publicise their physical and transitional climate risks will be punished by investors via a risk premium assigned to their debt and equity issues.

2.6 Assets under management by signatories to the UN Principles of Responsible Investment (UN PRI) have leaped from US$22 trillion in 2010 to more than US$66 trillion in 2019. 480 PRI signatories with a combined US$42 trillion under management voluntarily opted to create TCFD reports in 2018.[5] There is a clear and growing demand for climate related disclosures from this massive investment bloc. Signatories to the PRI have done so on a voluntary basis, demonstrating the potential of industry led, voluntary initiatives to make significant inroads in increasing the demand for and publication of climate related disclosures.

2.7 The Australian Securities Exchange has made specific mention of the physical and transitional risks of climate change and appeals to listed firms to comply-or-explain in a TCFD framework. This can be found in recommendation 7.4 of the February 2019 update of its Corporate Governance Principles and Recommendations guidelines.[6]

2.8 Rule 3.1.1 of the NZX Listing Rules has been effective in stimulating fair disclosure of material risk. It should be noted that this already extends to climate risk. Government could play an educative role in supporting greater buy-in of recommendation 4.3 of the NZX Corporate Governance Code by listed entities. While the NZX controls the content of the Corporate Code with FMA oversight, changes to include specific recommendation of TCFD disclosures in recommendation 4.3 is an example of a more flexible, effective change supported broadly by BusinessNZ.

2.9 It should be noted that the directors of Government departments and Crown entities and agents have similar responsibilities to disclose material risks related to their operational models (climate change falls within this responsibility). Despite this, the

[3] The Reserve Bank of New Zealand. *A Primer on New Zealand's Capital Markets.* Bulletin, volume 78, no. 3. May 2015.

[4] Barclays. "The positive impact of ESG investing on bond performance." October 2016.

[5] NZX. *NZX ESG Guidance Note. January 2019.*

[6] ASX Corporate Governance Council. *Corporate Governance Principles and Recommendations. February 2019.*

McGuinness Institute found that 81.5% of Crown agents and Crown entities, as well as 62.1% of Government departments failed to include a single mention climate change information in their annual reports.[7]

2.10 While the Productivity Commission's Low-emissions Economy report that spurred this discussion document found that:

> *"Endorsement of the TCFD's recommendations by the New Zealand Government would send a strong signal to the investor community that the Government considers disclosure an important mechanism to help achieve the transition to a low-emissions economy."*[8]

Government Departments and Crown entities and agents appear not to be included within the proposed comply-or-explain system. BusinessNZ recommends that Government assistance to the suggested voluntary, industry-led system proposed by our organisation come in the form of guidance, support, and active participation via creation of TCFD reports by these Government entities. Support through scenario modelling and indications of transitional risk, coupled with role model reporting would reduce the private sector burden to create unique and expensive scenario modelling and provide clarity on regulatory pathways.

Primary recommendation: Government extend support to industry led initiatives rather than moving forward with legislation imposing unnecessary uncertainty and cost.

2.11 As indicated above, BusinessNZ strongly recommends that government support the private sector in making voluntary climate-related financial disclosures through the TCFD framework. The NZX Corporate Governance Code may provide an avenue for industry led change similar to recent actions taken by the ASX. A voluntary collective action agreement across the private sector provides another possible avenue for non-legislated innovation supported by Government.

2.12 As detailed in the Productivity Commission's Low-emissions Economy report, Government endorsement of the TCFD framework would send a strong signal to New Zealand's capital markets. If this endorsement is to be credible, Government bodies should be compelled to make disclosures aligned with the TCFD framework.

2.13 Adequately communicating what Government support will be offered to the private sector would provide certainty in spending decisions and reduce the costs for individual organisations carrying out the expensive scenario and scope 1, 2, and 3 emissions analysis suggested by the TCFD as best practice.

3.0 PARTICULARS OF THE PROPOSAL AS OUTLINED IN THE DISCUSSION DOCUMENT

3.1 Without prejudice to BusinessNZ's primary recommendation, we would like to address specific aspects of the discussion document relating to the introduction of a Government administered comply-or-explain system, <u>should the proposal proceed.</u>

[7] McGuinness Institute. *Analysis of Climate Change Reporting in the Public and Private Sectors.* Working paper 2018/03. July 2018. At 18, 20.

[8] New Zealand Productivity Commission. *Low Emissions Economy.* Final Report – August 2018. At 195.

4.0 PRIVATE SECTOR ENTITIES – IN OR OUT?

4.1 The broad list of entities identified by the TCFD as potential adopters of the disclosure framework (banks, asset owners etc.) works in a voluntary industry led system supported by BusinessNZ. However, direct translation of these groups from suggested categories of volunteer parties to mandatory groups in section 106 of the discussion document is inadequate if organisations are to have certainty regarding their inclusion in the mooted 'comply-or-explain' system.

4.2 The loose definitions of potential groups covered by a possible comply-or-explain system in section 106 makes it almost difficult to comment on the specifics of coverage, even in this early stage of consultation.

4.3 Again, the loosely defined suggested groupings of potential disclosers is reflective of the voluntary design of the TCFD framework. BusinessNZ contends that a large private family trust (i.e. a possible institutional investor in this model) does not have an ethical responsibility to pay for the creation and disclosure of a comprehensive climate strategy for public dissemination.

4.4 Officials in initial discussions have suggested that the total number of organisations captured in the proposed legislated comply-or-explain framework would most likely be in the low hundreds. Further clarification is needed to ensure coverage does not extend beyond these select groups.

Recommendation: There is certainty given as to what entities would be included in the mandatory comply-or-explain system.

5.0 A CATCH 22?

5.1 The proposal in paragraph 105.1 that *"non-disclosure would only be allowed if the entity analyses and reports that they see themselves as not being materially affected by climate change, with an explanation as to why,"* would force firms uncertain of their responsibilities to undertake extensive research as to their climate impact if they wish to seek an exemption from undertaking research as to their climate impact. This effectively eliminates any complete exemption.

5.2 It may be contended that firms might be able to seek long term exemptions or explanations allowing them not to disclose if it is proven that their operations are found to be materially unaffected. Unfortunately, this is also unrealistic in the proposed model. The expectation that climate disclosures become increasingly detailed over time would force firms who view their operations as relatively unaffected by the metrics and general coverage of TCFD best practice at present to constantly undertake assessments and determine if their responsibilities have changed.

5.3 If a Government administered comply-or-explain system is to go forward, there must be clarification as to what level of analysis is required to prove no 'material' impact, and what cost this is likely to impose on organisations who would otherwise not engage in significant climate analysis.

Recommendation: That the catch 22 of 'comply-or-explain' is addressed.

6.0 GOVERNMENT BODIES – IN OR OUT?

6.1 As detailed in subsections 2.9 and 2.10 above, despite having similar fiduciary responsibilities to disclose material climate risk, Government bodies are poor performers at present. If the proposed mandatory comply-or-explain system were to go ahead, these organisations should also participate.

6.2 While it may be contended that Government bodies already employ meaningful mechanisms of climate-related disclosure and management, this could also be said of the private sector. If the Government wishes to support the TCFD framework as a uniform and comparable system via a mandatory comply-or-explain system for the private sector, it should demonstrate its support through active participation.

6.3 This participation would spur an accelerated rate of improvement in disclosure quality, allow more effective guidance from government on emissions scenarios, and reduce net costs imposed on the private sector.

Recommendation: That Government departments and Crown entities and agencies are included.

7.0 UNFORESEEN COSTS?

7.1 BusinessNZ is extremely concerned that a lack of clarity in the potential costs to private organisations has allowed the discussion document to misrepresent the strength of a mandatory comply-or-explain model. Without an understanding of both primary and secondary costs, a cost-benefit analysis cannot take place.

7.2 BusinessNZ supports the use of net costs (highlighted in section 136 of the discussion document) as a cost measure for this proposal and primary subject of future investigation.

7.3 While seeking submissions on costs is a step in the right direction, there are only a small number of local organisations who are in the process of disclosing climate related information in the TCFD framework. Most organisations moving to voluntarily disclose in the status quo have significant pre-existing strategic and risk management interests in transitional and physical climate risks. It is likely that smaller, currently less involved organisations will be subject to significantly larger net costs relative to revenue or assets than these organisations already with heavy climate interests and expertise.

7.4 In effect, those organisations likely to be burdened with the highest proportional net costs probably lack the expertise and resources to engage with Government as to the exact size of these costs, further distorting the apparent cost/benefit ratio of this proposal.

<u>Secondary Effects/Costs</u>

7.5 BusinessNZ is also deeply concerned that the secondary effects of this proposal would disincentivise financial institutions from engaging with smaller, unique individuals and organisations. While the direct emissions of financial institutions are likely to be low relative to revenue or assets, evaluating indirect emissions will be incredibly complex and costly. Determining the transitional and physical risks to the operational models of each debtor and their assets to determine scope 3 emissions is likely to be prohibitively expensive. We are particularly concerned that this will disincentivise transactions between insurers/banks and smaller, niche entities holding unique assets such as start-up businesses.

7.6 Compelling listed companies to comply-or-explain while allowing a total exemption for private organisations creates another regulatory/cost barrier that would disincentivise public listing. This has the added risk of impacting the health of a domestic capital market already struggling with illiquidity.

<u>Smaller Entities?</u>

7.7 BusinessNZ suggests that without direct investigation by Government into the net costs of the comply-or-explain proposal across the myriad of different organisations possibly effected, determining a fair bar for exemption by size will be difficult. Direct investigation into net costs across different organisations is needed to determine what metric would best be used to set size exemptions, and the level that this bar would be set.

7.7 We are supportive of inflation adjustment as this would account for changes in the real value of an exemption threshold.

Recommendation: MfE/MBIE should undertake its own research on the primary and secondary cost implications of the proposal, informing a reasonable size exemption and cost benefit analysis

8.0 DEFINING GOVERNMENT SUPPORT

8.1 The TCFD framework is extensive. Best practice disclosures from multinationals such as Unilever have involved determining both direct and distant/indirect emissions from operations and designing a comprehensive strategy with unique metrics. Most organisations covered within the proposed comply-or-explain system will not have the resources and expertise to produce reports this comprehensive – at least in the short/medium term.

8.2 To avoid a reliance on individual organisations to produce isolated and expensive transitional and physical scenario risk analysis, we recommend that Government extend significant support, specifically in the creation of generic scenario modelling. The participation of Government bodies as disclosers would be of significant assistance through role modelling.

8.3 If there is an expectation that compelled reports are to incrementally improve in quality, Government should be clear about its pipeline of support so business can plan and engage for/with these more detailed disclosures.

Recommendation: Government provides certainty on the support that will be offered to the private sector, particularly around the physical and transitional risks found in scenario analysis.

9.0 FURTHER CONSULTATION

9.1 We would like to reiterate our appreciation for the opportunity to comment on the climate-related financial disclosures discussion document at this time.

9.2 BusinessNZ suggests that the preliminary nature of the document warrants further consultation as proposals for more detailed climate related financial reporting are further detailed and recommendations from submitters are noted.

Recommendation: Time is allowed for additional consultation periods.

Appendix One - Background information on BusinessNZ

BusinessNZ is New Zealand's largest business advocacy body, representing:

- Regional business groups EMA, Business Central, Canterbury Employers' Chamber of Commerce, and Employers Otago Southland
- Major Companies Group of New Zealand's largest businesses
- Gold Group of medium sized businesses
- Affiliated Industries Group of national industry associations
- ExportNZ representing New Zealand exporting enterprises
- ManufacturingNZ representing New Zealand manufacturing enterprises
- Sustainable Business Council of enterprises leading sustainable business practice
- BusinessNZ Energy Council of enterprises leading sustainable energy production and use
- Buy NZ Made representing producers, retailers and consumers of New Zealand-made goods

BusinessNZ is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy and services for enterprise, BusinessNZ contributes to Government, tripartite working parties and international bodies including the International Labour Organisation (ILO), the International Organisation of Employers (IOE) and the Business and Industry Advisory Council (BIAC) to the Organisation for Economic Cooperation and Development (OECD).

The BusinessNZ Energy Council (BEC) is a group of New Zealand's peak energy sector organisations taking a leading role in creating a sustainable energy future. BEC is a division of BusinessNZ, New Zealand's largest business advocacy group. BEC is a member of the World Energy Council (WEC). BEC members are a cross-section of leading energy sector businesses, government and research organisations. Together with its members BEC is shaping the energy agenda for New Zealand.

Our vision is to support New Zealand's economic wellbeing through the active promotion of the sustainable development and use of energy, domestically and globally. With that goal in mind, BEC is shaping the debate through leadership, influence and advocacy.