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Economic Development, Science and Innovation Committee
Parliament Buildings
Wellington

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Submission on the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill

The Institute of Directors (IoD) appreciates the opportunity to comment on the [Financial Sector \(Climate-related Disclosures and Other Matters\) Amendment Bill](#) (the Bill). The Bill proposes broadening non-financial reporting, by requiring and supporting the making of climate-related disclosures by certain Financial Market Conduct ('FMC') reporting entities.

The impacts of climate change are already being felt in many countries and urgent action is required. Boards have a critical role in confronting and responding to climate-related issues and risks to ensure the long-term sustainability of their organisations and to understand and alleviate their impact on the environment. Climate change is a key leadership theme and the IoD has identified it as one of our *Top Five Issues for Directors* each year since 2018.

The introduction of the proposed new climate reporting regime is a necessary and important development. However it also entails substantial change and associated complexities. It will take time to develop the standards, regulatory framework and crucially, professional capability and competence. These are critical foundations to ensure an effective and meaningful reporting regime that goes beyond compliance and helps drive strategic thinking and change.

About the Institute of Directors

The IoD is New Zealand's pre-eminent organisation for directors and is at the heart of the governance community. We believe in the power of governance to create a strong, fair and sustainable future for New Zealand.

Our role is to drive excellence and high standards in governance. We support and equip our members who lead a range of organisations from listed companies, large private organisations, state and public sector entities, small and medium enterprises, not-for-profit organisations and charities.

Our Chartered Membership pathway aims to raise the bar for director professionalism in New

Zealand, including through continuing professional development to support good governance.

Summary of IoD submission

We support the introduction of climate-related disclosures, and agree that disclosures aligned with the Task Force on Climate-related Financial Disclosure (TCFD framework), and in accordance with the development of climate standards by the External Reporting Board ('XRB'), are an appropriate means of reporting climate-related disclosures in New Zealand.

To help ensure an effective and successful reporting regime, we encourage the Committee to:

- introduce an exemption for small NZX entities
- allow a longer period for implementing the reporting regime, including phasing in assurance requirements, at least 3 years after reporting commences, to enable the development of both reporting and assurance professional capability, experience and expertise
- ensure the requirement for assurance for utilising the reporting exemption does not end up requiring undue reporting (and thereby defeat the purpose of the exemption)
- reassess the level of penalties and defer their introduction - focusing on education and continuous improvement as reporting evolves and matures in the initial years.

We strongly oppose the penalty of imprisonment for directors of an entity that fails to comply with the climate standards. Individual criminal liability and imprisonment are not appropriate in the circumstances and are inconsistent with the goals of the Bill.

We also suggest that the proposed timeframe for preparation and lodgement of climate statements with the Registrar (within 4 months of an entity's balance date) be extended to 5-6 months due to the timing, resourcing and practicalities of also having to produce audited financial statements.

Guidance, education and support will be essential to help organisations fulfil their reporting requirements.

Background and overview of the Bill

Current non-financial reporting is under a range of frameworks (eg Integrated Reporting) and there is a wide spectrum of maturity in terms of thinking, analysis and reporting.

In our 2020 [Director Sentiment Survey](#) 13% of directors (42% for publicly-listed companies) said their organisation had included disclosures on climate related risks and/or the impact of climate change on their organisation in their latest annual report.

In December 2019 we [submitted](#) on the discussion document [Climate-related financial disclosures – understanding your business risks and opportunities related to climate change](#) released by the Ministry for the Environment and the Ministry of Business, Innovation & Employment. In our submission, we recognised the importance of climate-related financial disclosure and agreed that the TCFD framework would be appropriate in New Zealand.

The Bill introduces reporting requirements for climate-related disclosures by certain FMC reporting entities and amends the Financial Markets Conduct Act 2013, the Financial Reporting Act 2013, and the Public Audit Act 2001. The disclosures are to be aligned with the TCFD framework and in accordance with standards developed by the XRB. The XRB can also issue guidance on a wider range of ESG and other non-financial matters that can be applied on a voluntary basis.

The specific purposes of the Bill are:

- to ensure that the effects of climate change are routinely considered in business, investment, lending, and insurance underwriting decisions
- to help reporting entities better demonstrate responsibility and foresight in their consideration of climate issues
- to lead to smarter, more efficient allocation of capital, and
- help smooth the transition to a more sustainable, low-emissions economy.

While this Bill is the first of its kind in the world many other countries, including the UK, are also considering climate-related disclosures. We agree with the XRB that it should take into account international developments as it develops its own standards to ensure our approach remains consistent and aligned with other countries.

The Bill requires climate reporting entities to:

- prepare climate statements in accordance with climate standards currently being developed by the XRB (to be completed within 4 months after the balance date of the entity and signed by two directors)
- obtain an assurance engagement from a qualified climate-related disclosure assurance practitioner in relation to those statements (but only to the extent those statements are required to disclose greenhouse gas emissions)
- lodge the statements with the Registrar of Financial Service Providers
- keep proper climate-related disclosure records, for at least 7 years
- provide access, eg cross-reference, in the annual report to where the climate statements and assurance practitioner's report can be found.

An exception is allowed for climate reporting entities who have reasonably determined they are not materially affected by climate change, although they need to obtain independent assurance of their determination from a qualified assurance practitioner.

Scope and application

The Bill introduces mandatory climate-related disclosure requirements (on a 'comply or explain' basis) for FMC entities (defined in the Bill as 'climate reporting entities'). These include:

- all equity and debt issuers listed on the NZX
- all registered banks, credit unions and building societies with total assets of more than \$1 billion
- all managers of registered investment schemes with greater than \$1 billion in total assets under management

- all licensed insurers with greater than \$1 billion in total assets under management or annual premium income greater than \$250 million.

In our 2019 submission on the discussion document we submitted that there should be exemptions for some smaller organisations below a certain size (eg assets/revenue) given the existing disclosure burden (particularly for listed companies) and costs associated with complying.

We are disappointed that the Bill does not provide an exemption for small NZX entities and we encourage the Committee to consider including this.

As noted above this form of reporting is complex and still evolving. Professional capability will take some time to develop for both the preparation, and assurance, of climate-related disclosures. The true costs of complying with the Bill are still unknown and some smaller organisations in particular may struggle to find the capability and/or resource required to meet reporting and assurance requirements.

It is also feasible that as the reporting regime evolves it will expand to include other entities and sectors. For example the government may include the public sector so that the same expectations apply to public and private entities alike. The potential for wider coverage heightens the importance of developing a framework with requirements that are effective and proportionate.

Timing and capability for effective implementation

XRB has indicated that it is expecting to publish its climate standards by the end of 2022, which means the first disclosures may be required in 2023. It is critical that organisations have notice/time to prepare/collect data and information especially for the base year's reporting.

It is essential that capability in climate-related reporting and assurance is developed and supported to enable an effective reporting regime.

Implementing new reporting and assurance standards usually takes years due to the technical nature and need to build understanding and capability to comply with new expectations. For example it is widely accepted that it took many years/decades to lift the quality of non-financial performance reporting in the New Zealand public sector. Legislative requirements were introduced during the late 1980s and refined in the early 2000s, and in 2008 the Auditor-General [reported](#) to Parliament on the 'poor quality of non-financial performance reporting'.

Sufficient time and support will be needed to raise awareness of the new regime and to build organisational capability, including identifying and maintaining records of the information required.

The XRB usually allows a 3-4 year period when introducing new standards, to allow entities time to implement the necessary systems and processes. A transition period should be provided in the Bill, with a phased approach, eg that focuses initially on entities disclosing qualitative information on governance, strategy and risk management and later on providing the scenario analysis

disclosures.

Boards and others charged with governance will also need to deepen their understanding of the new reporting regime to enable them to fulfil their responsibilities effectively.

We strongly encourage the Committee to consider a longer implementation time frame to allow organisations to build their reporting systems, controls and capability.

Assurance requirements

The Bill proposes mandatory assurance for greenhouse gas emission disclosures, or reliance on the exception clause. Assurance engagements will be:

- undertaken in accordance with the auditing and assurance standards issued by the XRB
- performed by CRD assurance practitioners, who:
 - will have the expertise, technical competence and qualifications specified in the standards, and
 - are members of an approved CRD assurance body (approved by the FMA).

Assurance standards are by their very nature highly technical and a high level of expertise will be needed to ensure that the assurance is conducted to the appropriate standards. It will take time to build assurance capability and competency following the development of reporting systems, controls and capability.

We strongly encourage the Committee to consider phasing in of assurance requirements to follow reporting, eg after at least 3 reporting cycles.

The Bill proposes assurance over reliance on the exception clause for climate reporting entities who have reasonably determined they are not materially affected by climate change. However, it is not clear what information would need to be provided by the organisation to enable a CRD assurance practitioner to provide assurance that the exemption could be relied upon.

We encourage the Committee to ensure that utilising the exemption does not end up requiring undue information/reporting, and thereby defeat the purpose of the exemption.

Enforcement, infringements and penalties

The Bill extends the ability of the Financial Markets Authority (FMA) who is responsible for monitoring and enforcement and can make stop orders, direction orders, and grant exemptions.

There are a number of significant infringement fines and penalties set out in the Bill, many of which mirror similar provisions in the Financial Markets Conduct Act 2013 and the Financial Reporting Act 2013.

There are proposed infringement fines of up to \$50,000 for any entity which fails to keep proper records, fails to have the records available for inspection, fails to lodge climate statements with the

Registrar within 4 months of balance date or fails to link to them in the annual report.

There are proposed civil pecuniary penalties of up to \$5million where an entity (or \$1million for individuals) fails to keep relevant records, fails to prepare or lodge climate statements at all, or fails to satisfy the relevant assurance requirements.

It is also proposed that directors be liable for other matters including up to 5 years in prison and/or a fine of up to \$500,000 for knowingly failing to comply with the climate standards.

As discussed, introducing a new reporting regime is complex and will take time to develop capability, competency and expertise. Much will depend on exactly what is in the XRB's climate standards.

The Bill should be focused on encouraging entities and their directors to consider the climate-related issues and risks associated with their organisation, rather than punishing them for making incorrect assessments.

Some of the proposed penalties are severe, particularly given the nature of the information being disclosed which is more future-focused, uncertain and speculative than the type of information normally disclosed in financial reports.

We highlight that there has been an increasing trend of laws and regulations extending director responsibilities and personal liability, which has potential unintended negative consequences. This includes discouraging well-qualified people from joining boards, distracting attention from long-term business goals, dampening innovation and ultimately diminishing corporate governance.

It is against this background that we strongly oppose the penalty of imprisonment for directors of an entity that fails to comply with the climate standards. Individual criminal liability and imprisonment are not appropriate in the circumstances and are inconsistent with the goals of the Bill. We also strongly encourage the Committee to reassess the level of penalties in places and defer their introduction - focusing on education and continuous improvement as reporting evolves and matures in the initial years.

We also suggest that the proposed timeframe for preparation and lodgement of climate statements with the Registrar (within 4 months of an entity's balance date) be extended to 5-6 months due to the timing, resourcing and practicalities of also having to produce audited financial statements.

Guidance, support and education

It is important that there is sufficient government guidance, education and support for entities to develop capability and competence and ensure they are in a position to make meaningful disclosure under a new reporting regime.

We encourage and support government assistance in developing consistent and clear tools to help

reduce the cost of disclosure, and provide further clarity.

Conclusion

Urgent action is required to address the effects of climate change and we support the introduction of climate-related disclosures.

A successful reporting regime should help drive strategic thinking and change. It is critical that New Zealand gets the settings right in establishing the new regime, which includes:

- ensuring requirements are not overly burdensome (eg exempting smaller entities),
- allowing time to build organisational capability, systems and controls, and also assurance capability, competency and expertise
- providing guidance, support and education
- enabling strong leadership, eg which is not deterred by harsh penalties.

We appreciate the opportunity to comment on behalf of our members.

Yours sincerely,



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