Climate-related financial disclosures - Understanding your business risks and opportunities related to climate change

Submission by Vector Limited

13th December 2019

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Introduction

Vector supports the move to improve clarity on climate-related non-financial disclosure requirements as one more step on the pathway to a low carbon and resilient future. We recognise the need to provide investors with comparable, consistent, timely and understandable information on climate-related risks and opportunities.

The purpose of this submission is to provide insights from our experience in following the framework established by the Task Force on Climate-Related Disclosures (TCFD) and in completing our response to the Carbon Disclosure Project (CDP) for the 2019 financial year, which was aligned to TCFD.

We consider ourselves relatively well advanced in our understanding of the risks and opportunities posed by climate change, having undertaken scenario analyses for both physical and transitional impacts. As a business we have positioned ourselves to enable decarbonisation while ensuring that our network is sufficiently resilient to cope with changing climate parameters.

The following submission follows the questions provided in the consultation document: *Climate-related financial disclosures - Understanding your business risks and opportunities related to climate change. Ministry for the Environment & Ministry of Business, Innovation and Employment. 2019.*

The Context

1. Is the TCFD reporting framework the most appropriate framework for New Zealand?

Yes.

2. Do you agree with the conclusions we have drawn at the end of chapter 1?

Yes

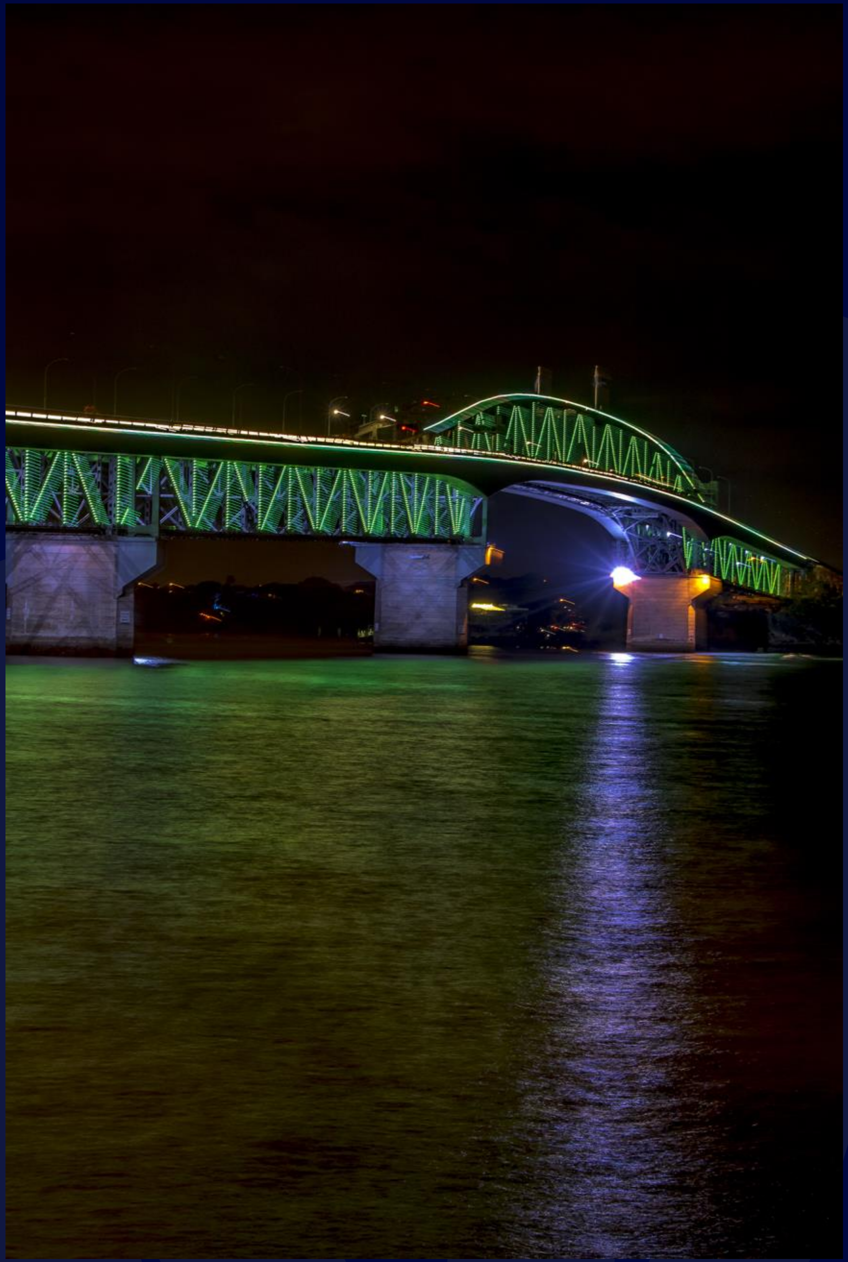
Objective and Problem Definition

3. Do you agree with the objective as set out above?

Yes

4. Should other objectives also be considered?

No



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Objective and Problem Definition (cont.)

5. Do you agree with the problem definition? Are there other aspects we should consider?

Agree there needs to be a level playing field to increase transparency and responsibility in relation to climate change risks and their management by listed issuers.

Agree that the broad range of approaches to non-financial reporting does make it difficult to compare companies. Some of these, such as TCFD, are more principle-based enabling an entity to interpret the information to be presented while others are very prescriptive with specific performance measures. More uniformity would allow investors and other stakeholders to compare companies on certain metrics.

Agree adopting TCFD early has some advantages in terms of improving business and investor understanding of climate-related risks and opportunities.

In respect to the point about seeing the full effect of the updated NZX Corporate Governance Code and the ESG note in January of this year, we agree that it is possibly too early to see the impact on non-financial reporting. However, the guidance, while referencing TCFD, does not specifically recommend TCFD and leaves it open to interpretation on how entities make climate-related disclosures. Therefore, waiting for the guidance to be fully adopted may still not lead to the widespread availability of comparable, consistent, timely and understandable information about the risks presented by climate change.

Agree the costs and resourcing can be significant for a business. We have provided an indication of various elements that will incur costs under Question 40.

Overall, in developing all financial disclosure obligations, we believe that the cost of regulatory compliance; commercial sensitivities and implications for reporting organisations intellectual property; as well as the need for effective regulatory coordination need to be central considerations.

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Climate-related reporting obligations in New Zealand

6. What are the implications of section 211 of the Companies Act 1993 for the disclosure of material climate-related information in annual reports?

Section 211 requires an annual report to include a “change in the nature of the business”. On a plain interpretation, a “change in the nature of the business” means a change in what the company *does* (ie change ‘undertaken by the company’), which might involve any plans to amend practices to manage climate change risk, but may not include how the company, in its passive state, is affected by climate change.

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?

The combination of recommendation 4.3 in the NZX Code, the ESG Guidance Note and the Continuous Disclosure Guidance Note sets a clear expectation for non-financial disclosures but does not provide sufficient guidance on the metrics and specifics of what and how climate change risks should be reported on in a meaningful way. Specific references to TCFD in the ESG Guidance Note provides an implication of the level of climate-related disclosure that is desired.

Climate-related reporting obligations in New Zealand (cont.)

8. How should proposed adaptation reporting under the Climate Change Response (Zero Carbon) Amendment Bill and the climate-related financial reporting disclosures proposed in this discussion document best work together?

At present there is very little detail available on the adaptation reporting requirements apart from what is contained in the Climate Change Response (Zero Carbon) Amendment Act ("Zero Carbon Act"). Clause 1 of section 5ZW contains requirements that mirror the high level TCFD recommendations in respect to governance, strategy, risk management and metrics and targets. Until there is more specific guidance on what is required to meet these reporting requirements it is difficult to ascertain how this will crossover with the climate-related financial disclosures as proposed.

We would expect that meeting the adaptation requirements of the Zero Carbon Act will require a more in-depth focus on the nature of physical risks an entity is facing with commensurate detail on how these are being managed. In particular it would need to provide a broader consideration of social impacts that may not necessarily have a financial implication (e.g. supply of electricity to vulnerable customers), as reflecting the considerations for the national climate change risk assessment and adaptation plan.

We expect that to comply with new climate-related financial disclosures, the adaptation information requested under the Zero Carbon Act would be summarised as part of a TCFD disclosure with a specific focus on the financial implications. This would sit alongside transition risks to provide an interested party a complete picture of climate risk.

Climate-related financial reporting disclosures would be an ongoing, or at a minimum annual requirement, whereas we would anticipate that for the purposes of informing the national climate change risk assessments and national adaptation plans referred in the Zero Carbon Act, the requirement to provide adaptation information would be less regular. However, we are still awaiting the detail on this.

As we noted in our submission responding to the Zero Carbon Act, the cost of compliance should be considered in the creation of information-gathering powers and we believe that duplication of existing requirements should be avoided as much as possible. We note that this consideration is provided for in section 5ZW of the Act, which provides for the creation of regulation which implements the Ministerial power to request information. As these reporting requirements are developed, we believe that the existing requirements under the TCFD framework should be considered, so as to not duplicate these requirements. As we also noted in our Zero Carbon Bill submission, we also believe that any new disclosure obligations or reporting requirements need to account for commercial sensitivities and implications for reporting organisations' intellectual property.

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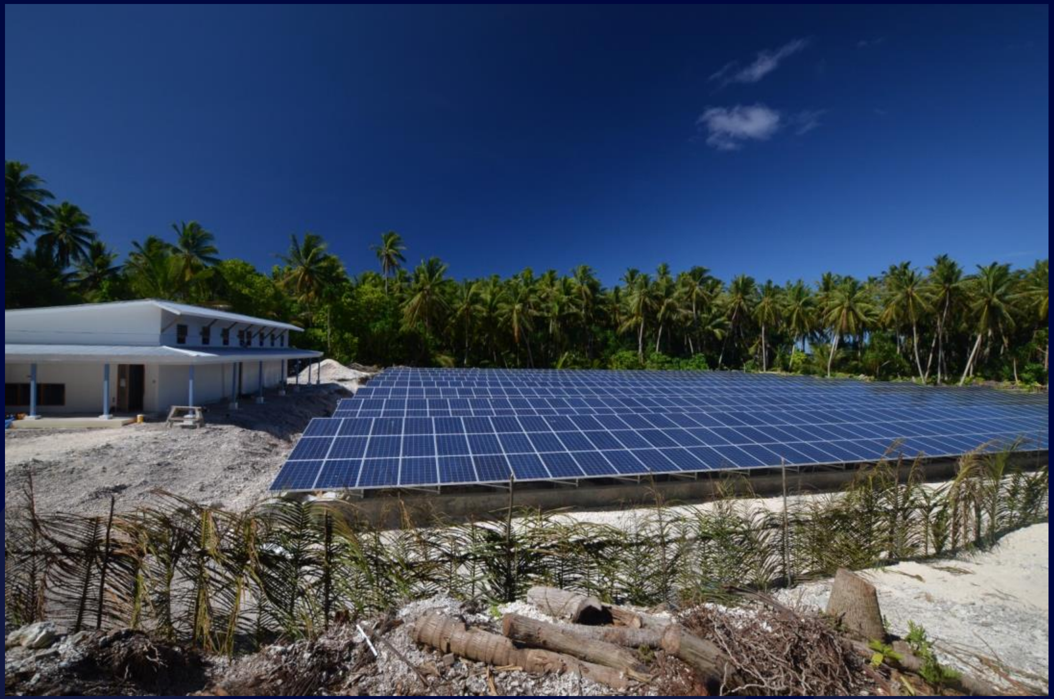
Directors’ legal obligations and climate change

9. Do directors’ legal obligations in New Zealand result in consideration, identification, management and disclosure of climate-related risks?

There are no explicit legal obligations in respect to climate-related disclosures, so those companies that choose to report are reliant on guidance such as the NZX Corporate Governance Code (“NZX Code”) and other guidance material such as FMA guidance and the NZ Institute of Directors “Four Pillars of Governance”. This leaves room for interpretation by individual entities on how they may consider, identify, manage and disclose climate-related risks.

10. Do you agree with the legal opinion prepared for the Aotearoa Circle?

We welcome the opinion in seeking to clarify the current state of the law in respect to climate-related disclosures but we do not have a view on whether the conclusions reached are correct or not.



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The status quo versus new mandatory reporting requirements

11. Do you favour the status quo or new mandatory disclosure requirements?

We are in favour of new mandatory disclosure requirements as we recognise the need for proactive action on climate change and the need for all actors to have the appropriate information to inform their decision making.

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?

Yes, a principle-based approach accommodates flexibility in the implementation of the requirements.

13. If the status quo is retained, how can government and investors be confident that risks would be routinely considered in business and investment decisions?

If the status quo is retained, they cannot be fully confident in this. The government and investors can rely to some extent on entities aligning themselves to the NZX Code and ESG Guidance.

Disclosures that would satisfy a comply requirement

14. Do you consider the TCFD framework to be best practice in relation to climate-related financial disclosures?

Yes

In our experience of completing a CDP response this year, which integrated the TCFD recommendations, we can see this framework is both comprehensive enough to elicit the right level of information but still provides an entity with the flexibility of how it presents this information to interested parties.

We are not aware of any equivalent frameworks.

15. What are your views about whether the TCFD's recommended disclosures will provide useful information to institutional investors and other users?

Disclosing in line with TCFD will demonstrate to investors:

- whether climate change is sufficiently embedded in the strategy of the organisation;
- an organisation has suitable governance structures in place to be overseeing climate risks;
- the quality of an organisation's risk assessment processes;
- there has been sufficient consideration of the key risks and opportunities and these are identified and being managed; and
- an organisation is measuring emissions and has plans in place to reduce these.

While we are not institutional investors ourselves we consider this level of detail would help them make an informed decision.

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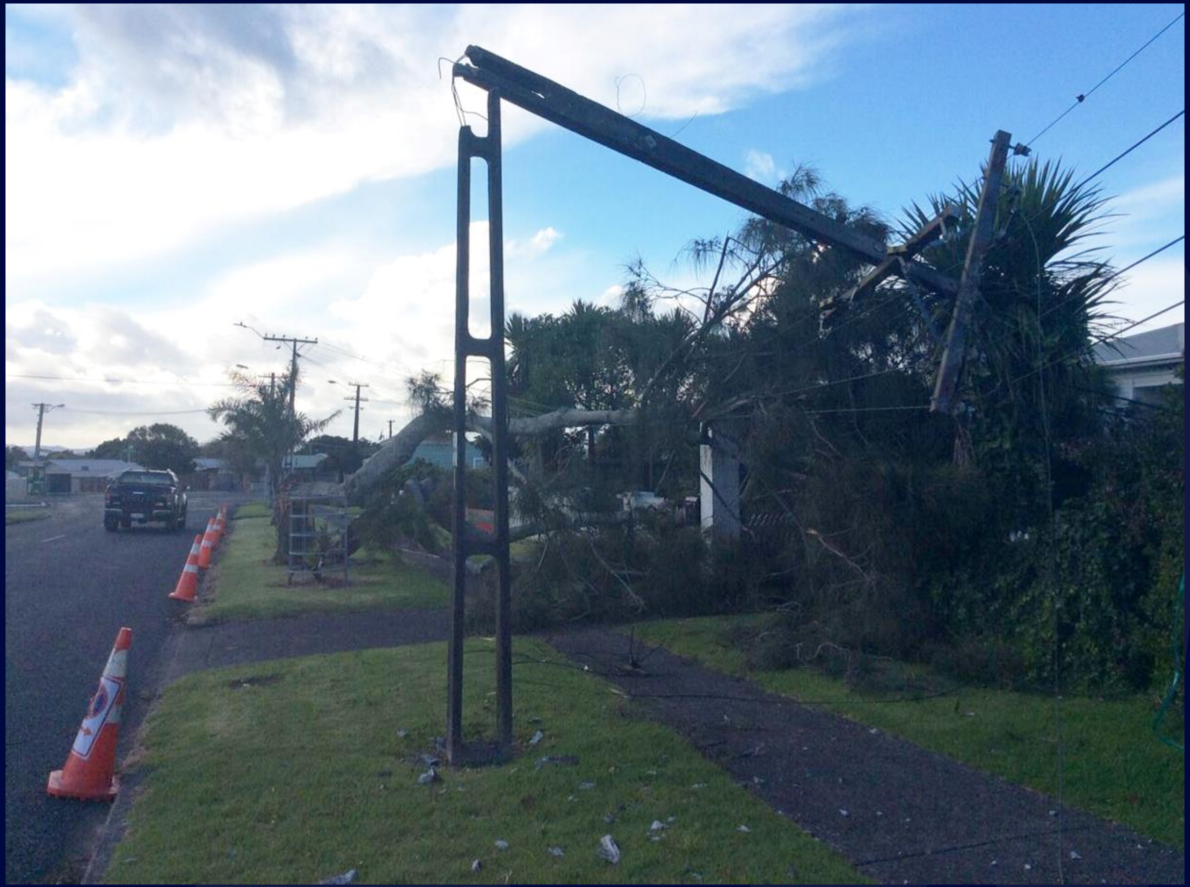
Disclosures that would satisfy a comply requirement (cont.)

16. Do you think the proposed disclosure system will encourage disclosing entities to make better business decisions?

Good businesses will already be actively considering climate change and incorporating this into their business decision making. For some businesses the requirement to disclose may in turn have the impact of ensuring they start to factor in climate change if they are not already doing so.

17. Is the definition of materiality in the IASB Conceptual Framework for Financial Reporting appropriate for this purpose?

Yes



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When it would be acceptable to explain

18. What comments do you have on our proposal that non-disclosure would only be allowable on the basis of the entity's analysed and reported conclusion that they see themselves as not being materially affected by climate change, with an explanation as to why?

This seems reasonable but we would also expect to see within that conclusion a description of their governance and approach to risk management generally, so there is assurance they have robust processes in place.

19. What are your views about providing a transition period where incomplete disclosures would be permissible?

This seems reasonable. In order to fully meet the requirements of the TCFD, entities may need to make a significant investment in modelling and scenarios to fully understand the potential risks or opportunities for their organisation. This will be difficult for some entities to meet and a transition period would help.

20. If there is to be a transition period, what are your views on it being for one financial year?

Our own experience from starting to understand and then assess climate risk and opportunity has been a two-year process. The transition and physical aspects of climate change while inter-related are quite different and do require separate assessments and often different expertise and different engagement within the business.

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Who it would apply to

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?

No

22. Should any other classes of entity be required to disclose?

There are other entities that should also be considered including state-owned enterprises, local authorities and all life-line utilities regardless of ownership structure.

Widening the coverage to include these public entities acknowledges that both tax payers and rate payers should be able to hold entities to account on their climate related exposure.

Given our own experience as a utility we acknowledge that a number of other businesses are dependent on us for the supply of key services. In order to prepare their own TCFD response they will want assurance that their upstream supplier, of which utilities are a key one, are also managing climate-related aspects. As currently proposed there would be a number of New Zealand utilities that would fall outside the classes of entity listed.

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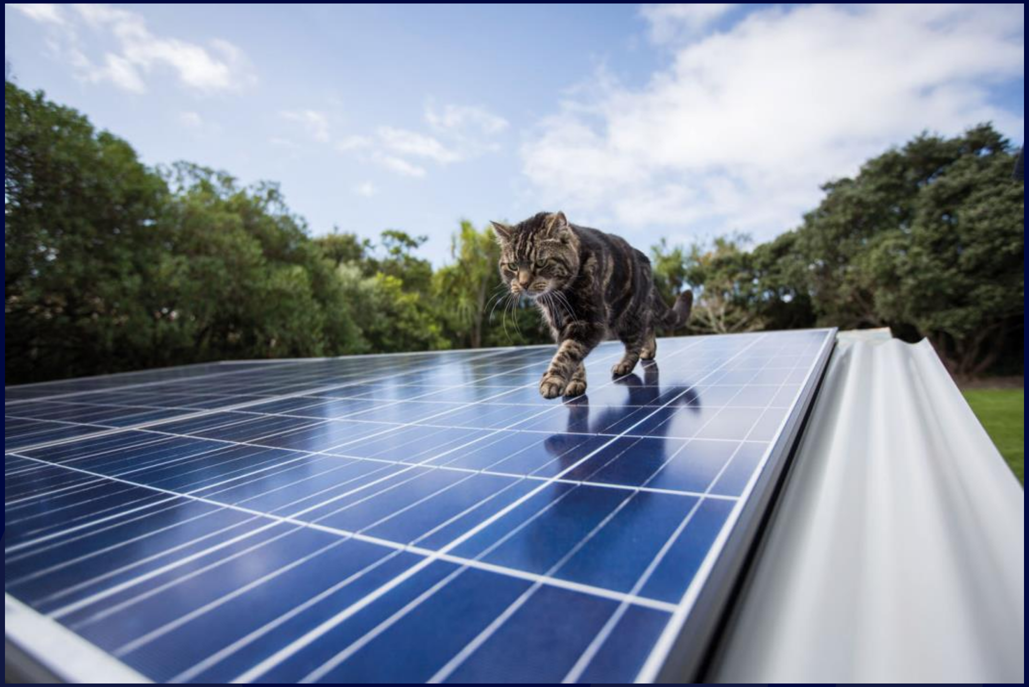
Whether there should be an exemption for smaller entities

23. Should there be an exemption for smaller entities?

No comment

24. If there were to be an exemption: (a) What criterion or criteria should be used: annual revenue, total assets, a combination of the two, or some other measure or measures? (b) Which dollar amount or amounts would be appropriate? (b) Should there be a requirement to adjust for inflation from time-to-time?

No comment



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Where the disclosures would be made

25. What are your views about our proposal to have a stand-alone climate-related financial disclosure report within the entity's annual report?

We agree that at least a summary of climate-related financial disclosure needs to be included within an annual report. It makes sense to view climate related risks/opportunities in the context of the other material topics a business is dealing with which would be addressed in an annual report. However, we are not certain that this needs to be stand-alone, or that with a focus on more concise annual reports, the full disclosure needs to be included.

To fully meet the TCFD recommendations requires some level of detailed explanation. We would consider that a climate-related financial disclosure is unlikely to be changing significantly each year and therefore a separate document that is updated every two to three years or where there is a material change would suffice. The annual report can include the summary of this document and any material changes within the reporting year.

Consideration should also be had to the growing shift to integrated reporting. An integrated reporting approach would expect a business to weave through climate change and its impact on the various capitals with consideration of how other material topics might also be impacting on these capitals. A separate section would lose this.

26. What are your views about providing for disclosing entities to include cross-references or mappings within that report to assist users to find relevant information?

Makes sense but as per the consultation document this should include references to information that is held outside of the report such as other reports or sections of the website.

27. What are your views about requiring explanations for non-compliance to be included in the annual report?

Agree

Independent assurance

28. Should there be mandatory assurance in relation to climate-related financial disclosures?

No but the option to introduce it in the future should be retained.

29. Which classes of information should be subject to assurance if it were to be mandatory?

No comment

30. Do you consider that assurance should be required in relation to GHG emissions disclosures?

For large emitters it is appropriate to expect assurance over the validity and accuracy of their GHG emissions disclosures.

For other emitters this may be a costly exercise with little value for users of the information. This money might be better spent by an organisation on scenario development for example which will better inform their strategies and in turn improve overall climate-related disclosures.

For a number of entities GHG emissions may not even be significant yet the cost of assurance will not necessarily reflect the volume of emissions but more the number of emission sources that need to be checked.

31. Is limited assurance the only practicable approach in relation to TCFD disclosures, or is reasonable assurance also feasible?

No comment

32. If we do not introduce mandatory assurance when a disclosure system comes into effect, should it be reconsidered in the future?

Yes

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Commencement and transition

33. What comments do you have on the proposal to bring the disclosure system into effect for financial years commencing six months on or after the date that the regulation is introduced?

This seems reasonable.

34. Do you consider that smaller entities should be provided with a longer transition if there were to be no exemption for them? If so, how long should that additional period be?

No comment

The legislative means for implementing reporting

35. Do you have any views about the legislative means for implementing new mandatory (comply-or-explain) disclosure requirements

We agree with paragraph 129 of the Discussion Document that it would be better for the Government to introduce legislation for new mandatory (comply-or-explain) disclosure requirements to be implemented by Order-in-Council on the recommendation of the responsible Minister, than give powers to the External Reporting Board.

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The role of the Government

36. Do you consider that there is a role for government in relation to guidance, education, monitoring and reporting?

Yes.

We believe there is a clear role for government to develop the New Zealand specific climate-related scenarios that entities can then apply to their own businesses. One of the challenges in deciding what impact climate change might have, and what to disclose, is the lack of agreed basis for assessing climate change. For TCFD reporting purposes government could have a role in defining the suitable range of scenarios. This would ensure all entities are considering comparable information when making decisions on whether to disclose and produce more consistent disclosure outputs.

This is particularly key for physical impacts as there are only a few regions in New Zealand that have undertaken the detailed analysis of future climate parameters. There is also a role for government in helping to connect entities to robust international information on how climate change might impact other countries that are both key markets and key suppliers to New Zealand.

More broadly education on how to apply TCFD will be important for all entities. A repository of best practice from international sources and opportunities to learn from those who have completed a TCFD disclosure would be beneficial.

We also believe that any new legislated disclosure obligation or requirement needs to be accompanied by clear guidelines from government around implementation and enforcement. Such guidelines ensure a consistent and transparent approach and strengthens business certainty. The government's role should focus on achieving compliance rather than penalising shortfalls, especially in the transition phase.

37. Are there other activities that a government agency could usefully carry out?

No comment

The role of the Government (cont.)

38. Which government agency or agencies will be best able to carry out these functions?

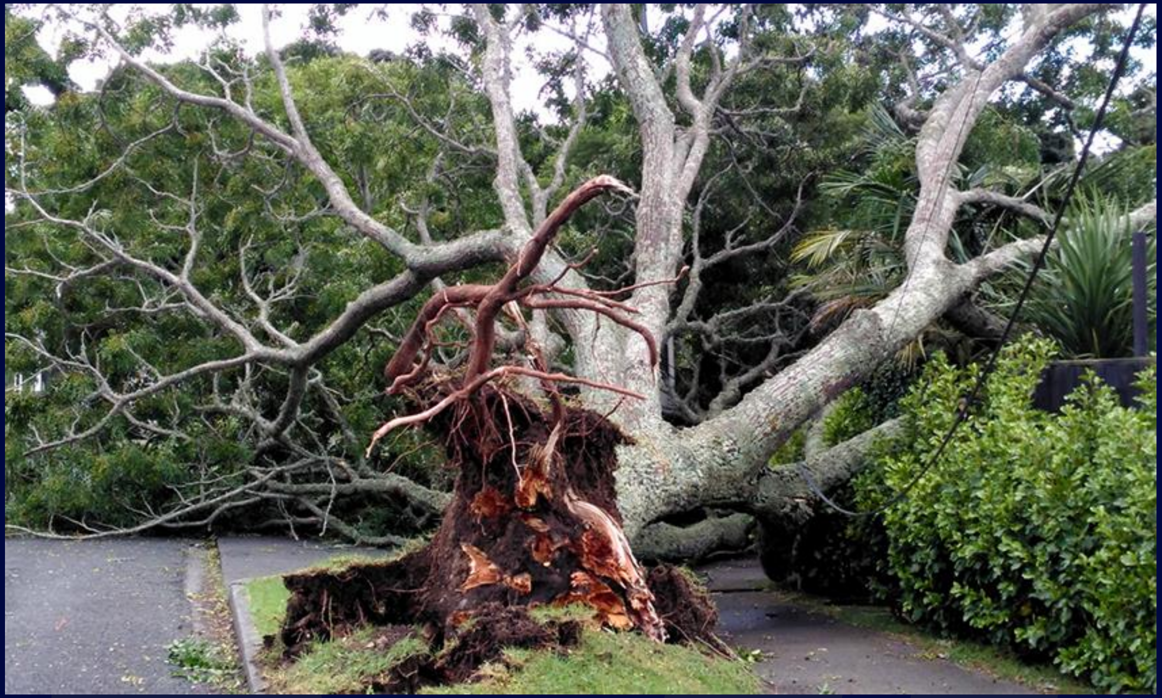
Ministry for the Environment in consultation with other relevant ministries (e.g. MBIE).

As we noted in our Zero Carbon Bill submission, the network components of Vector (both electricity and gas distribution) are already subject to regulation implemented by the Commerce Commission, the Electricity Authority and the Gas Industry Company. Given this existing regulatory oversight we recommend the development of regulation which is streamlined rather than fragmented.

Given that the Ministry for the Environment will be implementing the adaptation reporting requirements under the Zero Carbon Act we recommend that the Ministry also undertakes the functions referred to in question 36.

39. What would you need to assist you with a full set of TCFD disclosures

One of the key gaps that many businesses will face is sector and/or location specific scenario modelling for both physical and transition risks. Given that there is a lot of common information and analysis used in these scenarios it would make sense for a more co-ordinated approach to this.



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Costs relating to climate-related financial disclosures

40. What information do you have about the cost implications relating to these proposals?

Vector has information on the resource commitment required to be able to meet a CDP response having been acknowledged with an award for best first-time responder. A lot of the data collection, analysis and assessment included in the CDP response are also required for a TCFD disclosure. While we are not willing to make specific cost information publicly available we can acknowledge that the costs, in both staff time and consulting fees, are not insignificant.

These costs relate to the following items:

- Completion of a greenhouse gas inventory
- Greenhouse gas repository and reporting tool
- Data collection processes to take activity data and add to the greenhouse gas reporting tool
- External and internal technical advice to determine the appropriate emission factors for some of our industry specific emission sources
- External assurance of greenhouse gas data
- Completion of modelling and scenario analysis for both economic and physical impacts of climate change
- Internal assurance processes for all information that is being disclosed
- Engagement with international experts to better understand climate science and share this learning with key stakeholders

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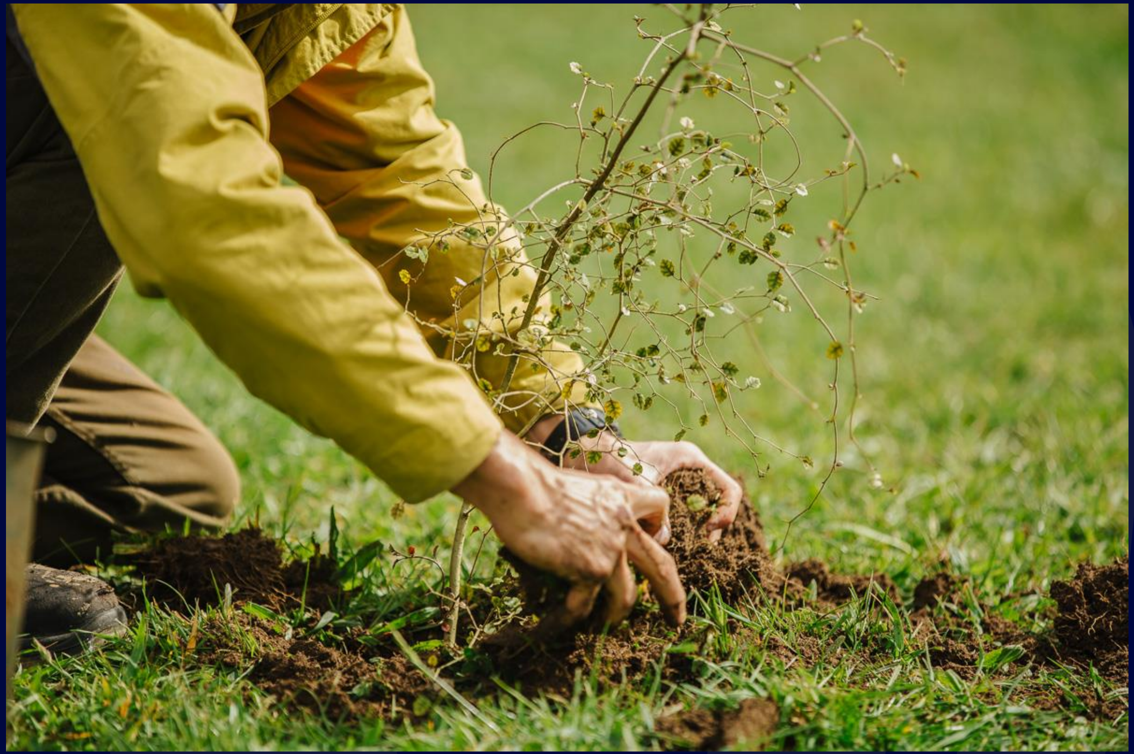
41. What information do you have about costs for specific types of reporting entities?

No comment

42. Do you have any other comments?

No



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