

## FINANCIAL SECTOR (CLIMATE-RELATED DISCLOSURES AND OTHER MATTERS) AMENDMENT BILL – VECTOR SUBMISSION

### Introduction

Vector welcomes the opportunity to submit to the Economic Development, Science and Innovation Committee (**the Committee**) on the Financial Sector (Climate-related Disclosures and other Matters) Amendment Bill (**the Bill**).

Vector supports the introduction of legislation requiring climate-related disclosures as an important step on the pathway to a low carbon future.

We take our role as a key enabler of Aotearoa New Zealand's decarbonisation goals seriously. Consistent, comparable, regular and reliable disclosures of climate-related risks and opportunities will assist corporates, financial institutions and investors to move towards a low-carbon and resilient economy.

### Executive Summary

As we noted in our [recent submission](#) to the Climate Change Commission, we consider there is a need for significant change in the electricity market to strengthen transparency, accountability, competition and growth to reach net zero. We support this Bill as one of a number of measures to improve corporate understanding and management of climate risks and opportunities.<sup>1</sup>

While we support the introduction of this Bill, the purpose of this submission is to identify a few areas that we consider would benefit from further clarity or consideration. Specifically:

- 1 **Express alignment with TCFD:** Vector considers that the Bill should expressly refer to the Taskforce for Climate Related Financial Disclosures (TCFD)'s recommendations. This will provide businesses with greater certainty that the incoming standards will be consistent with the TCFD and enable early reporting and analysis to commence within the TCFD framework, without fear that such work will be inconsistent with the XRB's final standard.
- 2 **Penalties:** The penalties contemplated by the Bill are significant. Given climate-related disclosures will be new to many reporting entities, it would be useful for the Financial Market Authority (FMA) to take an expressly supportive and flexible approach to enforcement in the initial compliance period, with express recognition that penalties will likely be reserved for only the most serious breaches, such as covered entities that intentionally fail to publish climate statements.
- 3 **Scenario analysis:** Vector asks that the Government publish climate scenarios for reporting entities to use as a baseline for undertaking climate related risk and opportunity assessments. Vector wishes to underline the importance of entities taking a comprehensive and consistent approach to scenario analysis. This will ensure that the disclosure regime is most effective and that resulting reports can be usefully compared between organisations

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<sup>1</sup> Frontier Economics *Whole Electricity System Costs: A report for Vector* (25 March 2021).

and over time. Government information sharing, models, and guidance support will be critical to ensuring consistency in the approach to scenario analysis.

- 4 **Overseas subsidiaries:** Vector proposes that the Bill clarify whether overseas subsidiaries are intended to be included in reporting requirements for listed issuers.
- 5 **Assurance:** Vector is committed to disclosing greenhouse gas (GHG) emissions and is supportive of the proposed assurance requirements in the Bill dependant on the disclosure requirements ultimately set in the Climate Standard(s). Vector highlights the need for proportionality and flexibility in the early years of application as the assurance profession matures.
- 6 **Materiality:** Vector suggests that materiality expectations under the Bill and/or climate standards align with materiality thresholds in other corporate reporting.

We expand on these points below. For ease of reference those clauses of the Bill referred to in this submission are set out in full in Schedule 1.

We would like to reiterate our commitment to engagement on this Bill and in the wider policy development process.

## 1. Vector's substantive comments on the Bill

### 2. *Standards aligned with TCFD*

Throughout the development of climate risk reporting policy in New Zealand since late 2019, Government has signalled that reporting will be aligned with TCFD. This is reflected in the Bill's explanatory note. However, there is no reference in the Bill to TCFD. This is in stark contrast to section 5ZW of the Climate Change Response Act 2002 which clearly provides for reporting under the four-part TCFD framework (regarding governance, strategy, risk management and metrics & targets).

Vector proposes that the Bill and the proposed climate standard(s) should identify and provide for synergies with the TCFD recommendations and other international guidance. This reflects the increasing harmonisation of many international reporting formats and also the practical experience of New Zealand businesses.

For example, since 2019 Vector has reported annually on climate change measures through the CDP (formerly the Carbon Disclosure Project). Our work in this regard was acknowledged in 2019, with an award from CDP for the best first-time performance across Australia and New Zealand. The CPD has been amended to align with TCFD disclosure recommendations, particularly with respect to data collection, analysis and assessment. Vector intends to publish its first voluntary TCFD report in late 2021 ahead of the mandatory requirement in the Bill.

To support businesses who have been early voluntary adopters of these measures, and to harness further voluntary action in the short-term (prior to the released of the external reporting board (XRB)'s climate standards), we suggest that the text of the Bill be amended to expressly provide that the standard will be based on or not be inconsistent with the TCFD recommendations. This could be done through more specific reference in the amendments to section 19 of the Financial Reporting Act 2013 (new subsections 19B, C and D are proposed already). This will provide businesses like ours with confidence to continue to take voluntary action in advance of mandatory obligations and final standards and to know that our work will remain relevant.

### 3. Penalties

The penalties proposed by the Bill are significant, with non-compliant entities and individuals subject to significant fines of up to \$5m and/or up to five years imprisonment for directors (section 461ZC(2)). Vector appreciates the importance of strong accountability mechanisms to ensure accurate and comprehensive climate reporting. However, given the lack of experience that most climate reporting entities have in the climate reporting context, we would be concerned by the inclusion of these penalties if they were not accompanied by clear signalling from the FMA regarding its likely approach to enforcement, particularly in the initial compliance years.

In [our submission](#) to MfE's 2019 discussion document (**the 2019 consultation**) we recognised that any new legislated disclosure obligation or requirement would need to be accompanied by clear guidelines from Government around implementation and enforcement. This would ensure a consistent and transparent approach. We suggested that the Government's role should focus on achieving compliance rather than penalising shortfalls, especially in the transition phase.

In particular, it was noted in the "Role of Government" section of the 2019 consultation that "*it is almost inevitable that the quality of reporting will initially be of widely varying quality*" and "*the overall standard of reporting will increase over time*" due to increasing experience and availability of guidance.<sup>2</sup> This inevitability is why we argued that the government should take a compliance focused approach rather than a penal one. Vector suggests that a focus on enforcement in the early years will not encourage climate reporting entities to realise the potential of climate reporting as a tool for business preparedness but rather will result in the new obligations being viewed as a technical compliance obligation.

Separately, Vector is concerned that section 461ZK makes *employees* of a climate reporting entity liable for fines of up to \$50,000 for failing to comply with a requirement to provide information to an assurance practitioner. No other provision in the FMCA makes an employee potentially liable for this level of penalty. The only other similar provision of which Vector is aware is section 39 of the Financial Reporting Act 2013, which imposes liability for failure to provide requirement information to an auditor. In light of the nascent state of the climate reporting regime, and the lower standard of review undertaken by an assurance practitioner as opposed to an auditor, we consider that this provision is unwarranted at this time. It places an unfair burden on employees who will need to be champions of this regime within their organisations for the reporting to succeed and for the disclosures to be valuable for external audiences.

### 4. Scenario analysis

In our submission to the 2019 consultation we noted that reporting entities will need to commit significant investment to the development of robust climate scenarios in order to conduct the necessary risk assessment for their organisation. It is widely accepted that this will be extremely challenging for the majority of New Zealand's listed issuers that do not have in-house expertise in climate science or modelling.

Climate scenario models have high mathematical sensitivity to the model assumptions and input data. A lack of standardisation will result in each organisation having different models of future

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<sup>2</sup> Ministry for the Environment and Ministry of Business, Innovation & Employment *Climate-related financial disclosures – Understanding your business risks and opportunities related to climate change: Summary of submissions* (March 2020).

scenarios, which in turn undermines the effectiveness of comparing different resilience strategies. Furthermore, organisations can exploit the lack of consistency to develop models that best suit their business strategy, creating the risk of ‘greenwashing’ and misleading claims. The Sustainable Finance Forum has defined the development of Standards and Pathways<sup>3</sup> as a key recommendation to mitigate this risk to investors, and has asked for ‘stronger regulatory oversight over sustainability standards’.

Business has repeatedly sought assistance from government to produce model climate scenarios for the New Zealand context in order to avoid organisations reinventing the wheel individually. We continue to hold the view that there is a clear role for Government to develop New Zealand specific climate-related scenarios that entities can apply to their own businesses. One of the main challenges entities face in this context is the lack of agreed basis for assessing climate change impacts (both physical and transitional). By taking a role in defining suitable scenarios, the government would ensure entities are relying on comparable information to produce consistent disclosure outputs.

We recognise that this is particularly important in relation to regions of New Zealand where analysis of future physical climate parameters has not been undertaken. We also see a role for Government in connecting entities to robust international information that will assist in understanding how climate change impacts in other countries may affect New Zealand climate reporting entities.

In some cases, companies that have already prepared voluntary disclosures in line with TCFD recommendations do not have the time, budget or resources to develop comprehensive scenarios. This has been reflected in insufficient scenario modelling or delay in engaging in that recommendation.

The Climate Change Commission’s Draft Advice is an example of a centralised transitional scenario analysis. The work is interpretable for business units with the intention of publicly disclosing models and data used in the analysis. This enables organisations that are not in agreement with the centralised scenarios, to develop their own variations with clear and documented explanations of what assumptions and/or input data was changed, and why. Vector suggests that such transitional scenario modelling, is supplemented with physical risk modelling, such as the National Climate Change Risk Assessment for New Zealand<sup>4</sup>, which must be conducted at least every 6 years as required by the Climate Change Response (Zero Carbon) Amendment Act 2019. Aligning these existing work streams to form TCFD specific guidance on scenario analysis would be of high value.

## **5. Overseas subsidiaries**

The references to “subsidiary” in the Bill are unclear as to whether or not they include overseas companies. Vector seeks clarity as to whether overseas subsidiaries, particularly those operating in Australia or the Pacific Islands, must be included in group climate statements.

The lack of clarity results from the definition of “*subsidiaries*” which is expressly amended by section 5(3) of the Bill to read “*in Parts 7 and 7A, includes any entity that is classified as a subsidiary in any applicable financial reporting standard*”.

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<sup>3</sup> The Aotearoa Circle *Sustainable Finance Forum: Roadmap for Action* (Final Report, November 2020).

<sup>4</sup> Ministry for the Environment *National Climate Change Risk Assessment for New Zealand – Arotakenga Tūraru mō te Huringa Āhuarangi o Āotearoa: Technical report – Pūrongo whaihanga* (August 2020).

It appears that the intention may be to allow the XRB the discretion to specify the scope of subsidiary reporting in its Climate Standards, including to require overseas subsidiaries. However technically “*financial reporting standard[s]*” (per the above mandate) do not extend to Climate Standards (see s 5(1) Financial Reporting Act 2013).

We also note that an “*entity*” under both the FMCA and the Financial Reporting Act may include a company or other body corporate, therefore taking into account overseas companies; and a “*company*” under the FMCA expressly includes overseas companies (s 6 FMCA).

## **6. Assurance**

In Vector’s submission to the 2019 consultation we noted that it is appropriate to expect assurance over the validity and accuracy of GHG disclosures for large emitters. Vector is committed to disclosing GHG emissions and is supportive of the proposed assurance requirements in the Bill, dependant on the disclosure requirements ultimately set in the Climate Standard(s). However, we are concerned that there is significant work to be done for the assurance profession to be ready to service assurance engagements that will be required under the Bill if the climate standards require disclosure of Scope 1, 2 and/or 3 emissions. In light of the penalties applicable to listed issuers that fail to obtain adequate assurance, we highlight the need for proportionality and flexibility in the early years of application if assurance is required.

## **7. Materiality**

In financial statements, materiality is both a qualitative and quantitative judgement to guide whether certain information is required to be included. Vector expects that materiality considerations in the climate risk disclosure context should align with materiality in other financial reporting. Vector welcomes guidance on materiality as it relates to climate reporting, whether appropriate in the Bill or in the forthcoming climate standards.

Vector welcomes the opportunity to engage on this submission with the Committee by way of oral submission if useful.

**SCHEDULE 1: Relevant provisions of the Bill – available here:**  
<https://legislation.govt.nz/bill/government/2021/0030/latest/LMS479740.html>

## **8. CLIMATE CHANGE RESPONSE ACT 2002**

### **5ZW Minister or Commission may request certain organisations to provide information on climate change adaptation**

- (1) The Minister or the Commission may, in writing, request that a reporting organisation provide all or any of the following information:
  - (a) a description of the organisation’s governance in relation to the risks of, and opportunities arising from, climate change:
  - (b) a description of the actual and potential effects of the risks and opportunities on the organisation’s business, strategy, and financial planning:
  - (c) a description of the processes that the organisation uses to identify, assess, and manage the risks:
  - (d) a description of the metrics and targets used to assess and manage the risks and opportunities, including, if relevant, time frames and progress: and
  - (e) any matters specified in regulations.

## **9. FINANCIAL SECTOR (CLIMATE-RELATED DISCLOSURES AND OTHER MATTERS) AMENDMENT BILL**

### **461ZC Offence to knowingly fail to comply with climate standards**

- (2) A person who commits an offence under **subsection (1)** is liable on conviction,—
  - (a) in the case of an individual, to imprisonment for a term not exceeding 5 years, a fine not exceeding \$500,000, or both; and
  - (b) in any other case, to a fine not exceeding \$2.5 million.

### **461ZK Assurance practitioner may require information and explanations from director or employee**

- (1) An assurance practitioner appointed for an assurance engagement under this Part is entitled to require from a director or an employee of the climate reporting entity the information and explanations that the assurance practitioner thinks necessary for the performance of their duties as assurance practitioner.

- (2) A director or an employee who fails to comply with a requirement to provide information or an explanation under **subsection (1)** commits an offence and is liable on conviction to a fine not exceeding \$50,000.
- (3) In any proceeding against an employee for failing to comply with a requirement to provide information or an explanation under **subsection (1)**, it is a defence if the employee proves that—
  - (a) the employee did not have the information required in their possession or under their control; or
  - (b) by reason of the position occupied by the employee or the duties assigned to them, they were unable to give the explanations required.

Compare: 2013 No 101 s 39

## **10. FINANCIAL REPORTING ACT 2013**

### **39 Auditor may require information and explanations from director or employee**

- (1) An auditor of a specified entity is entitled to require from a director or an employee of the specified entity the information and explanations that he or she thinks necessary for the performance of his or her duties as auditor.
- (2) A director or an employee who fails to comply with a requirement to provide information or an explanation under subsection (1) commits an offence and is liable on conviction to a fine not exceeding \$50,000.
- (3) It is a defence to an employee charged with an offence against subsection (2) if he or she proves that—
  - (a) he or she did not have the information required in his or her possession or under his or her control; or
  - (b) by reason of the position occupied by him or her or the duties assigned to him or her, he or she was unable to give the explanations required.

Compare: 1993 No 105 s 206(2), (4), (5)