ESPERANCE
Capital Ltd

6 June 2018

The Chair
New Zealand Productivity Commission
Wellington

Dear Sir

Low-emissions Economy – Draft Report

I write to make a submission on this draft report.

I wish to address one recommendation of the draft report, R6.2 "The Government should officially endorse the recommendation of the Taskforce on Climate-related Financial Disclosures".

In considering this recommendation I think it is worthwhile to give my view of the current investment environment in New Zealand. I would also state that I support the endeavours to make New Zealand a low-emission economy and I accept that there will be a high cost to achieve this.

I believe that we are witnessing a major change in the environment in which investment decisions are being made. I think we have seen, at least at the wholesale level and to some extent at the retail level, a broad acceptance of socially responsible investing. Indeed there now seems to be acceptance that restricting investments from companies, assets and economic activities that are detrimental to society and the environment does not entail any major impact upon investment returns and could actually be positive now that markets are pricing in the negatives of such activities and weight of money is moving away from those companies. This broad acceptance can be seen in the response by the kiwiSaver fund managers when taken to task about their investments in 2016.

However a greater movement is now occurring in New Zealand which is less about such negative filtering as adopted by the SRI aware managers and more about endeavouring to make positive investments. It is now undoubted that the Impact Investment industry and movement is well established in most major western economies. We are now beginning to see impact investment arise in New Zealand.

The recently established Impact Investment Network in New Zealand, the emergence of service providers focusing upon impact investing needs and now the establishment of New Zealand's first impact investing fund (Impact Enterprise Fund) show that New Zealand is joining in this new initiative.

Paul R S Hocking *(Director)* • **Phone** 021 362 545 • **Email** phocking@esperance.co.nz • **Mail Address** P O Box 10 305, Wellington 6143

Bruce McKay *(Consultant)* • **Phone** 027 489 5505 • **Email** bmckay@esperance.co.nz • **Mail Address** P O Box 25 746, St Heliers, Auckland

www.esperance.co.nz

It would also appear that the millennials and perhaps the cohort either side of them now adopt the need for positive social, economic and environmental outcomes much more so than their parent's generation and those still older. This appears to be also driving their investment thinking. My involvement in equity crowd funding has enabled me to observe the number of successful capital raises that have a social or environmental aspect to them.

That said, I don't believe we are yet seeing broad acceptance of such positive investment approaches across the wholesale fund managers yet.

The reason I make these comments is because I believe New Zealand is on the cusp of a broad change in investment considerations towards positive and impactful social and environmental expectations.

In moving towards a low-emissions economy I believe we are seeing acceptance of the issues.

I accept that recommendation R6.2 may be a useful mechanism in accelerating this broader acceptance of social and environmental issues in investment. However I think there is need for caution on two fronts.

1. The TCFD recommendations point to requiring early adoption by firms in the financial services industry such as banks, insurers, asset managers and asset owners. In New Zealand we have a number of small financial services firm that already bear high compliance costs and mandatory reporting under TCFD will cost much but not deliver clear benefit.

   In particular, the Financial Markets Conduct Act 2013 creates an entity know as a Reporting Entity which is essentially any entity that holds a financial markets licence issued by the Financial Markets Authority. The reporting requirements of these Reporting Entities is already very prescribed and quite onerous however some of these Reporting Entities are small and have little impact in and of themselves. An example is requiring all such entities to conform with AML/CFT requirements which is a high cost regime however the risk is often minimal. It is my concern that there will be a broad brush approach to having Reporting Entities adopt the TCFD recommendations even if they are small and almost inconsequential even though the activity for which they are licensed as value for users of the service.

2. My second concern is that adopting TCFD could have the impact of creating winners and losers in the low-emissions business environment without that being an intended consequence. If the market expects that all firms will identify their exposure to climate related risk and disclose their measures to mitigate or manage their risk then those entities that don't disclose measures that lessen the risk by lessening the climate impact will suffer in financial markets and reputationally. However it needs to be accepted that some firms will have little choice other than to accept that a move to a low-emissions economy means they will just have to accept higher costs. It is the same as for households where climate issues will merely result in higher living costs. In a modern economy some entities can only react by accepting a higher cost of being in business.

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The risk however for those firms is that although they will be contributing to the low-emissions economy by paying to support it they will be seen as pariahs but not actively lessening or mitigating their climate risk. Mitigating risk will be seen as a public good. Accepting the risk and paying for it will be seen as a negative. I don't see this as a fair outcome from a move to a low emissions economy therefore there is a need for caution.

I also believe that in adopting TCFD's recommendations we should support the use of reporting mechanisms that are already gaining broader uptake. Specifically I recommend that New Zealand use the International Integrated Reporting framework as the basis from which to mandate reporting requirements. Companies, investors and lenders are already seeing the benefits of this framework and are now using the framework. I specifically draw your attention to Sanford as an example.

I am more than happy to discuss this submission.

Yours faithfully

Paul R S Hocking

Paul R S Hocking *(Director)* • **Phone** 021 362 545 • **Email** phocking@esperance.co.nz • **Mail Address** P O Box 10 305, Wellington 6143

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