CADWALADER

New Zealand Exchange Announces Changes to Climate/ESG-Related Governance Requirements

April 18, 2023

By Jason Halper
Partner and Co-Chair | Global Litigation

By Jayshree Balakrishnan
Associate | Global Litigation

Effective April 1, 2023, the New Zealand Exchange (NZX) has updated the **NZX Corporate Governance Code** (Code) and the **NZX ESG Guidance Note** (ESG Note). There are eight principles that underlie the Code: (1) ethical standards; (2) board composition and performance; (3) board committees; (4) reporting and disclosure; (5) remuneration; (6) risk management; (7) auditors; and (8) shareholder rights and relations. The Code uses a "comply or explain" approach, encouraging issuers to adopt the Code, but requiring them to explain why not if they choose not to. The ESG Note is not a separate disclosure requirement or expectation, but rather, "outlines good ESG practices, and accepted frameworks for issuers to consider adopting when making their ESG disclosures" under the Code. Issuers with financial years that start on or after April 1, 2023 must use the updated version of the Code, while those with financial years that started prior to April 1, 2023 can continue to report for this year using the June 17, 2022 version of the Code or voluntarily use the updated Code, so long as they clarify which version they are using.

One of the biggest changes in the updated Code involves **Principle 4 (Reporting & Disclosure)**, with the addition of a new recommendation 4.4, which requires an issuer to provide non-financial ESG disclosure at least annually. Recognizing that it is impossible to provide an exhaustive list of ESG issues a company should consider, the ESG Note draws from the FTSE Russell ratings model and the United Nations Principles for Responsible Investment guidance to provide a non-exhaustive list of ESG reporting considerations. These include biodiversity, water security, land degradation, labor standards, safe development of medicines, tax transparency, and succession planning. The Code now encourages issuers to disclose "the process by which an issuer has ensured that its non-financial reporting disclosures are materially accurate," and provide the disclosures in an easily accessible and understandable format.

The Code addresses "Climate-related Disclosure," noting that: "NZX is a member of the Sustainable Stock Exchanges Initiative, and acknowledges the importance of disclosures relating to an issuer's climate change risks and opportunities" and "NZX considers that these disclosures will be informative for investors wishing to understand an issuer's environmental practices, risks and opportunities. NZX's ESG Guidance Note provides further guidance in relation to making climate-related disclosures."

Some of the other key changes to the Code and ESG Note are summarized below.

- **Principle 1 (Ethical Standards):** The Code now encourages issuers to "explain[] why ethical behaviour is important to an issuer's purpose." It also encourages issuers to consider adopting formal whistleblowing procedures "in light of the nature of the size and composition of its business" and whether "to provide access to employees to confidential third-party agencies for whistleblowing / speak-up purposes."
- **Principle 2 (Board Composition & Performance):** NZX has expanded disclosure requirements for directors, including by requiring information on the board's assessment of the director's independence, and stating that not only must the chair of the board be independent, the chair and CEO cannot be the same person to prevent conflicts of interest. Additionally, issuers in the S&P/NZX 20 Index "should have a measurable objective for achieving gender diversity in relation to the composition of its board, that is to have not less than 30% of its directors being male, and not less than 30% of its directors being female, within a specified period."
- **Principle 3 (Board Committees):** In order to prevent conflicts of interest, NZX now recommends that executive directors do not sit on remuneration committees. If an issuer does appoint an executive director to a remuneration committee, it should have "robust conflict management arrangements in place" and should not allow the executive director to participate in any consideration of his or her own remuneration.
- **Principle 5 (Remuneration):** The Code provides that an issuer should have publicly available remuneration policies for executive and non-executive directors. Further, an issuer "should disclose how its executive remuneration arrangements align with its strategy and performance objectives and should disclose generic eligibility and vesting hurdles for any long-term incentive scheme that forms part of its remuneration arrangements."
- **Principle 6 (Risk Management):** NZX now requires that a summary of an issuer's risk management framework be included in its annual report.
- **Principle 7 (Auditors):** Although the Code already required disclosure of an issuer's internal audit functions, NZX has added commentary to emphasize the importance of internal audits. According to NZX, "[i]nternal audit provides objective assurance about internal controls and risk management and may assist an issuer in evaluating and improving the effectiveness of its risk management, internal control and governance processes."
- **Principle 8 (Shareholder Rights & Relations):** Noting the importance of shareholder participation in meetings, the Code encourages issuers to facilitate participation by hosting

fully virtual or hybrid meetings based on the circumstances.

Taking The Temperature: New Zealand has been on the forefront of ESG and climate-related reporting. As explained in the ESG Note, issuers on the NZX must navigate requirements imposed by the Sustainable Stock Exchange, the UN Sustainable Development Goals, the Paris Agreement, the Climate Change Response (Zero Carbon) Amendment Act of 2019, the United Nations Universal Declaration on Human Rights, as well as the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021. Updates to the Code and the guidance provided in the ESG Note help companies model their corporate governance and disclosure practices to the various developing ESG reporting standards.

As we have previously discussed, in our view it is not possible to separate climate or other ESG issues from the obligations owed by companies' boards and management. Other regulators and organizations are similarly promoting the integration of ESG-related and corporate governance issues. The Task Force on Climate-Related Financial Disclosure's ("TCFD") governance pillar emphasizes the importance of board and management focus on climate-related issues. Earlier this year, the FCA published its discussion paper on sustainability-related governance, which considered whether regulated firms (banks, insurers, and asset managers) should be required to incorporate sustainability into their governance strategies. Last fall, the Institutional Shareholder Services (ISS) reported on the "different changes taking place in the corporate governance landscape in light of increasing awareness of sustainability issues," including a 60% increase of S&P 500 companies that had at least one director with ESG skills, and highlighted "the importance of traditional corporate governance dimensions such as shareholder rights and board attributes to address [environmental and social] issues." Similarly, we have also discussed the 2023 voting guidelines published by proxy advisory firms Glass Lewis and ISS, which included enhanced board accountability for climate-related issues and oversight of environmental and social issues. Boards looking to adopt or revise governance policies to better integrate ESG-related issues should look to these recommendations and other reports addressing this important issue.