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Climate-related disclosures regime and the use of third-party providers

The FMA's role in the CRD regime

The main statutory objective of the Financial Markets Authority – Te Mana Tātai Hokohoko (FMA) is to promote and facilitate the development of fair, efficient and transparent financial markets. The FMA is responsible for independent monitoring and enforcement of the climate-related disclosures (CRD) regime under the Financial Markets Conduct Act 2013 (FMC Act).

About this information sheet

This information sheet provides guidance to assist Climate Reporting Entities (CREs) in understanding what they should consider before engaging a third-party provider to deliver services for the CRD regime. It is structured around three key questions:

1. What is the purpose of engaging a third-party provider?
2. Does the third-party provider have the required skills, knowledge and experience, and will the third-party provider's services and outputs enable compliance with the CRD regime?
3. Has an appropriate due diligence process been followed?

This information sheet also highlights some important due diligence practices and risks of failing to follow proper process when engaging a third-party provider. The appendix provides additional questions CREs could ask before engaging a third-party provider.

For the purposes of this document, 'CRD regime' is inclusive of the requirements outlined in:

- [Part 7A](#) of the FMC Act;
- the [Climate-related disclosures framework](#) (CRD framework) as set out in Aotearoa New Zealand Climate Standards NZ CS 1, NZ CS 2, and NZ CS 3; and
- the [record keeping obligations](#)¹.

¹ The legislative record keeping obligations of CREs are set out in Part 7A of the FMC Act and the Ministry of Business, Innovation and Employment (MBIE) exposure draft of record keeping regulations (published on 21 June 2023). The FMA also published consultation on proposed guidance and expectations for keeping proper climate-related disclosure records on 23 June 2023 that includes our interpretation of these legislative requirements.

This information sheet is primarily intended for CREs and their directors, and third-party providers.

Responsibility for compliance with the CRD regime remains with the CRE, irrespective of whether or how third-party providers are involved. CREs must ensure that any providers they engage will enable them to meet their legal obligations.

1. What is the purpose of engaging a third-party provider?

When preparing climate statements, CREs may want to engage third-party providers to obtain access to expertise or data that is not otherwise available. In other instances, CREs may want an external opinion regarding the work prepared by management. When contemplating engaging a third-party provider, CREs should consider the following:

CREs should first understand what they require, and why, from a third-party provider

It is important to distinguish between services that are being provided to a CRE in relation to the CRD regime, and other climate-related services that do not fall within the requirements of the regime (e.g. relating to a CRE's wider strategic ambitions or sustainability practices). Services provided in relation to the CRD regime will need to comply with all the requirements for the mandatory disclosures, including the CRE's record-keeping obligations.

Before contacting potential third-party providers about supporting them with compliance with the CRD regime, CREs should:

- ensure they have a basic understanding of their obligations, to identify their reporting gaps. At a minimum we recommend considering:
 - Part 7A of the FMC Act, and their wider FMC Act obligations;
 - the CRD Framework; and
 - the record keeping obligations.
- seek to understand third-party providers' specific services and expertise, and whether these align with the areas identified as requiring external support. Factors CREs could consider include:
 - the complexity of what is involved – CREs may need to break requirements down into multiple issues so they can better understand them and define boundaries;
 - categorising problems by nature and/or subject matter, and identifying more complex issues that cover multiple areas and might require a range of specialist expertise to fully understand and address;
 - what industry best practice looks like, and the approach others in the sector are taking;
 - the information and underlying data that might be required; and
 - whether there is already internal capability and capacity (e.g. the CRE could upskill current staff, potentially with input from a third-party provider).

This information will help CREs understand more about any current reporting gaps, the data required, and limitations of their internal resource, to better identify the need for, and scope of services to be provided by,

third-party providers. If CREs determine that a third-party provider will provide the best outcome for their requirements, the following sections will provide further guidance.

Type of providers that could be engaged

CREs could require expertise from a diverse range of providers to meet the obligations of the CRD regime, and may need to consider engaging more than one provider for particularly complex matters. Areas where third-party input could be required include:

- climate science expertise for assessments of future physical risks;
- financial reporting and assurance expertise for compliance with the CRD framework and/or record-keeping requirements;
- risk advisory expertise for identifying, managing and responding to climate-related risks and/or opportunities;
- financial modelling expertise for climate-related financial impacts;
- legal expertise for understanding and applying legislation;
- strategy consulting expertise for assessing the resilience of strategy and potential opportunities;
- experience working within regulated regimes for understanding regulatory requirements; and
- data services or analytics expertise for provision of risk metrics and emissions data.

2. Does the third-party provider have the required skills, knowledge and experience, and will the third-party provider's services and outputs enable compliance with the CRD regime?

It is important that CREs obtain services from third-party providers that have the required skills, knowledge, and experience. CREs should review providers' skills, qualifications and certifications, and also their relevant experience in the specific subject matter area.

To ensure third-party providers' services and outputs will be compliant with the CRD regime, CREs should consider the following:

Does the provider understand the requirements of the CRD regime?

At a minimum, third-party providers should be able to demonstrate understanding of:

- the CRD regime, including the FMC Act, the record-keeping regulations, and the CRD framework;
- any limitations in being able to meet the CRD regime requirements as part of their services;
- any guidance or information sheets issued by the FMA or the External Reporting Board (XRB) relevant to the services they are providing; and
- the potential risk and legal liabilities for CREs (and their directors) in respect of the CRD regime.

Do the provider's outputs meet the requirements of the CRD regime?

CREs' climate statements need to:

- meet the disclosure requirements of the CRD framework; and
- be transparent and provide context, including in relation to the quality of underlying data and areas of complexity (e.g. estimations, models, uncertainties and judgements).

Therefore, third-party providers need to be able to articulate how their services and final outputs will support CREs to comply with the CRD regime.

CREs should consider:

- how the provider will give them the information they require (e.g. embedded in their workpapers, or provided as a summary document);
- how the provider has ensured their services will meet the requirements of the CRD regime (e.g. detailed reviews, quality control checks); and
- doing their own sense checks on the information to ensure they are comfortable with the services and outputs.

Example 1: Aligning third-party providers' work with CRD regime requirements

A third-party provider appointed to help develop a CRE's scenario analysis and its associated disclosures is required to understand how the terms 'scenario analysis' and 'climate-related scenario' are defined under the CRD regime. Both the provider and the CRE should ensure the services provided and the resulting disclosures satisfy these definitions.

Can the provider describe their data sources, uncertainties, limitations, methodologies and assumptions?

Disclosures relating to the quality and nature of information relied on by CREs to prepare their climate statements should be transparent. These disclosures are essential for users to understand the climate statements. We emphasise the importance of the disclosures relating to:

- the quality of underlying data, including the associated uncertainties, limitations and/or reporting gaps; and
- areas of complexity, including the methodologies and assumptions underlying any estimations, models or calculations.

CREs must ensure third-party providers can:

- identify and disclose their data sources;
- explain any limitations or uncertainties in relation to the data;
- provide information that can be used to describe the assumptions and methodologies used for any estimations, models, or calculations;
- effectively communicate their services and outputs; and

- provide or access (on behalf of the CRE) any supporting records that comply with the record keeping obligations for a period of seven years.

Example 2: Using data from external parties

A manager of investment schemes (the CRE) engages a third-party provider to support the drafting of disclosures of its schemes' scope 3 GHG emissions related to the underlying funds. The provider supplies a range of indicators, intensity ratios, activity and financial data for the MIS manager's funds. The provider also outlines its sources, calculation methods, assumptions, and the ratios and attribution factors applied.

The CRE works with the third-party provider to ensure that it understands and can appropriately identify and document the methodology and assumptions from the third-party provider's work for its GHG disclosures in its climate statements. The CRE also writes a file note about this process and how it concluded that all material information was disclosed and how this reconciles with the underlying investments in the fund.

Example 3: Climate risks associated with a mortgage portfolio

A bank (the CRE) engages a third-party provider to help review the exposure of its mortgage lending portfolio to climate-related risks. The provider uses a range of climate models and data, some drawn from global sources. Its analysis extrapolates trends from New Zealand-wide mortgage data based on assumptions about the risk profile of the underlying properties.

When finalising the scope of work, the CRE ensures the third-party provider can identify and describe any data and estimation uncertainties in its work, such as limitations in downscaling climate models, difficulties in accurately assessing risk for individual properties, and any subjectivity involved in the assumptions.

The provider agrees to document this information as part of the outputs it provides to the CRE. This information will comply with the CRD regime and can be used for disclosures in the climate statements.

3. Has an appropriate due diligence process been followed?

CREs should apply appropriate due diligence practices when selecting a provider, including considering the following questions:

Have internal procurement policies and procedures been followed?

CREs should follow their own internal procurement policies and procedures when selecting a potential provider.

This should be in conjunction with any other relevant policies, such as their Conflict of Interest Policy. CREs should require any third-party provider to declare any potential interests or conflicts (e.g. shares) before proceeding with their services. Conflicts will then need to be managed appropriately by the CRE.

Are contracts or letters of engagement with the provider fit for purpose?

CREs should ensure that any agreements with a provider are fit for purpose and cover the requirements of the CRD regime and FMC Act. In particular, the contract should clearly set out the agreed scope of work and any limitations, to help confirm that the provider can deliver what the CRE needs.

CREs should note any caveats or limitations in scope proposed by a provider and consider any impacts on their compliance before finalising the agreement. For example, CREs should ensure that the contract allows for access to, and use and publication of, data or outputs as required to produce compliant disclosures and fulfil the record-keeping obligations.

Can the provider ensure they can meet the requirements of the record keeping obligations?

CREs should ensure that a third-party provider understands and can meet the requirements of the record keeping obligations. In particular, this includes either:

- a provider retaining and providing access (on behalf of or to the CRE) to their supporting records for a period of at least seven years, with this requirement written into the agreement with them; or
- the CRE obtaining a copy of the provider's supporting records at the time the work is undertaken and retaining the records for a period of at least seven years.

In both cases, the CRE should ensure that its contractual arrangement with the provider allows it to access and make these records available, if required, to the FMA or other parties as required under Part 7A of the FMC Act. Furthermore, the contract should include a statement to the effect of ensuring these records will enable the CRE to meet the requirements of the FMC Act, CRD framework, and record keeping obligations.

Contracts with providers should include a provision for situations where a CRE's relationship with a provider ceases within the seven-year period. The CRE needs to be able to obtain copies of the records on expiry or termination of the contract, or ensure ongoing access for the required period.

Example 4: Third-party providers retaining their supporting records for seven years

A CRE uses a third-party provider to support and advise in relation to its climate risk management practices (Provider A). Some information from Provider A's services and outputs is incorporated into the disclosures in the CRE's climate statements. After two years of using this provider, the CRE decides to use a different third-party provider (Provider B).

Even though the CRE has stopped using Provider A's services, the CRE ensures that Provider A keeps any supporting records in relation to its historic services and outputs related to the CRD regime for a period of seven years. This includes any of Provider A's data, calculations, methods, assumptions and outputs that support the CRE's disclosures in the climate statements to enable compliance with the CRD framework.

The CRE's contractual agreements with Provider A and Provider B include provisions for access to their supporting records for a period of seven years.

Have you ensured the independence of your auditor and assurance provider for climate statements, including the required assurance over greenhouse gases from October 2024?

Ensuring investors have confidence in climate statements will be a key part of maintaining participation in New Zealand's financial markets. This confidence depends partly on the independent assurance provided by auditors of financial statements, and the assurance over the climate statements (including the mandatory assurance over greenhouse gases from October 2024). Before engaging an assurance provider, CREs should have an appropriate understanding of the assurance standards for auditors and assurance providers for greenhouse gases.

CREs should discuss with their auditor or assurance provider any other services these firms provide or may provide to the CRE, and whether the auditor or assurance provider can maintain their independence while providing these other services.

Risks of failing to follow a proper process to select a third-party provider

There is a risk that if CREs do not have enough understanding of the regime's requirements or follow a due process to select a provider, they may engage a third-party provider who:

- does not provide the support required (i.e. the wrong scope);
- does not retain their underlying records in accordance with the FMC Act and any associated regulations;
- provides information with missing or low-quality underlying data that lacks sufficient explanation of associated uncertainties;
- insufficiently explains methodologies and assumptions;
- has inappropriate caveats in their contract or letter of engagement;
- lacks quality control processes to ensure the quality of their work is maintained; and
- is not independent (for assurance-related services).

Appendix

To assist in the practical application of this information sheet, we have prepared some questions that CREs could ask prospective third-party providers.

Understanding of the CRD regime

- What is your understanding of the requirements of the CRD regime, including Part 7A of the FMC Act, and the Aotearoa New Zealand Climate Standards?
- What is your understanding of the impacts of non-compliance with the CRD regime (e.g. reputational, legal, enforcement, penalties)?

- How do you ensure that your services will be adequate and meet the requirements of the CRD regime?

Record-keeping

- How do you ensure your record-keeping processes comply with the legislated requirements?
- Can you describe your processes in relation to record-keeping and retaining data, work papers and outputs, including making sure supporting records are available for seven years, even if the contractual relationship has ended?
- How will you ensure prompt access is available to any records we might need in relation to our disclosures, in a form that we can use and if necessary, make available to the FMA?

Skills, knowledge and experience

- What are your qualifications and certifications?
- Are you subject to external oversight by a professional association or regulator?
- Can you describe your experience working in the relevant subject area (e.g. climate science, financial reporting, GHG accounting, assurance, legal, experience of regulated regimes, risk management, modelling, or data and analytics)?
- Can you provide examples of your experience in relation to other relevant projects in the same or similar subject areas?

Understanding the services needed (i.e. the required scope)

- Can you describe the services you provide and how that will support us?
Follow up with specific questions to ensure a deep understanding of their services.
- How do you think the nature of our sector and business will affect the work required?
- How would you approach this work?
- Can you provide examples of the specific services you have provided to other organisations?

Service and outputs

- Can you describe the process of delivering your services?
- Can you describe what your output will look like?
- How do you ensure your services and outputs comply with the requirements of the CRD regime?
- How do you explain your methodologies and assumptions used for estimates, calculations and models within your work or outputs?
- What data do you use for your services?
- How do you identify data uncertainties or limitations in your work or outputs?
- How will you provide detail about your methodologies and assumptions used for estimations, calculations and models that will enable us to comply with the Aotearoa NZ climate standard framework?

Quality control

- What are your internal quality control processes?
- How do you ensure your work is complete and accurate?
- In terms of assurance, what is your internal process to ensure independence?