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External Reporting Board Aotearoa New Zealand Climate Standard 1, Climate-related Disclosures, Governance and Risk Management Consultation Document

This submission on the External Reporting Board (XRB) Aotearoa New Zealand Climate Standard 1, Climate-related Disclosures, Governance and Risk Management Consultation Document, 20 October 2021 (NZ CS 1), is from the Financial Services Council of New Zealand Incorporated (FSC).

As the voice of the sector, the FSC is a non-profit member organisation with a vision to grow the financial confidence and wellbeing of New Zealanders. FSC members commit to delivering strong consumer outcomes from a professional and sustainable financial services sector. Our 98 members manage funds of more than \$95bn and pay out claims of \$2.8bn per year (life and health insurance). Members include the major insurers in life, health, disability and income insurance, fund managers, KiwiSaver and workplace savings schemes (including restricted schemes), professional service providers, and technology providers to the financial services sector.

Our submission has been developed through consultation with FSC members and represents the views of our members and our industry. We acknowledge the time and input of our members in contributing to this submission.

The FSC's guiding vision is to grow the financial confidence and wellbeing of New Zealanders and we strongly support initiatives that align with our strategic intent and deliver:

- strong and sustainable customer outcomes
- sustainability of the financial services sector
- increasing professionalism and trust of the industry.

We welcome the opportunity to provide feedback on the NZ CS 1 to ensure that the impacts of climate change are actively considered by our members, that climate is taken into account in business and investment decisions made across the industry and so our members can demonstrate accountability and foresight in relation to climate issues. We fully support alignment with international standards as significant deviation from these would only create additional work for entities reporting in more than one jurisdiction.

The key points of our submission are as follows:

- FSC members support the disclosure of climate-related information that meets the qualitative characteristics of useful information (noting that this has yet to be described in the proposed disclosure concepts authoritative notice).
- We support keeping the standard to concise principles as far as possible, leaving detail and sector specific information to future guidance.

- Whilst we support defining terms to aid understanding, we encourage aligning with the definitions used by the International Sustainability Standards Board (ISSB) and adopting existing definitions from New Zealand legislation as far as possible.
- We encourage consistency with the standards to be developed next year by the ISSB and factoring into the XRB consultation process in 2022 the ability for submitters to revisit their comments having had the opportunity to see the approaches being taken internationally. Building in future flexibility to align with the ISSB as necessary will be extremely important for New Zealand.

In relation to matters that have not been addressed in the NZ CS 1, we encourage consideration of how existing accounting concepts, such as going concern, are affected by the forward looking nature of climate standards. For example, if the risk management tools and methods (such as scenario analysis) used reveal plausible future outcomes, to what extent should they affect decision making regarding (or disclosure about) going concern.

We also note that the XRB will be developing a draft version of the related requirements for the application of materiality to climate disclosures which is to be the subject of a secondary consultation in March 2022. This will be an important aspect of the development of the standard framework, particularly as a number of the proposed disclosure requirements in NZ CS 1 do not specifically reference the concept of materiality.

We welcome continued discussions ahead of further XRB consultations planned for next year.

I can be contacted on 021 0233 5414 or richard.klipin@fsc.org.nz to discuss any element of our submission.

Yours sincerely

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WHAT IS THIS CONSULTATION DOCUMENT ABOUT?

Who is interested in climate-related disclosures?

1. Primary users have been identified as existing and potential investors, lenders and insurance underwriters. Do you think that all of these users should be included in the primary user category?

We agree that all of these users should be included in the primary user category and support the XRB approach of focusing on the entity (and on the primary users of its financial information). We acknowledge that in time, integrated reporting may extend to include a wider range of stakeholders. However, we consider that wider group of stakeholders is distinct from the identified primary users. This is because they are not allocating capital or making other similar decisions on the basis of the disclosures, as mentioned in the NZ CS 1. Accordingly, the FSC considers this distinction should be maintained.

PROPOSED SECTIONS OF NZ CS 1

Key decisions for Governance

2. Do you think the proposed Governance section of NZ CS 1 meets primary user needs?

We consider the proposed governance section meets primary user needs, however we refer to our response to Question 2a below.

2. a) Do you think that the information provided under this section of NZ CS 1 will provide information that is useful for decision making to primary users (existing and potential investors, lenders and insurance underwriters)? If not, please explain why not and identify any alternative proposals.

At a high level we agree that the information will be useful to primary users. However, we have some concerns and suggestions. We caution against use of the expression “climate-related issues”. For example, the verbs assessing and managing apply perfectly to “risks”, but they are less appropriate for “opportunities”. Combining “risks” and “opportunities” into “issues” might be appropriate for high level recommendations, however we consider it introduces definitional uncertainty when trying to achieve the precision needed in a mandatory standard. We consider it important to have the correct language in place at the outset. In support of this caution, we note the IFRS Technical Readiness Working Group’s (TRWG) recently released Climate-Related Disclosures Prototype¹, does not use the term “climate-related issues.”

There may be value in the standard distinguishing between opportunities that refer to “upside” uncertainties (such as potential outcomes that are outside business as usual ranges but in a positive sense) and genuine (for example new technology) opportunities which are likely to be difficult to disclose, more speculative (and often commercial in confidence). Climate-related opportunities will be changing and evolving and, as is the case for risks, it is as much about the processes and plans to work towards them and communicate this to the boards and senior leaders, than it is about the actual opportunities.

¹ [ifrs.org/sustainability](https://www.ifrs.org/sustainability) under “Resources”

2. b) Do you consider that this section of the standard is clear and unambiguous in terms of the information to be disclosed? If not, how could clarity be improved?

We agree that this section of the standard is clear on what information is required to be disclosed. However, in consideration of what the TRWG proposes for ISSB to consider, we emphasise the importance of allowing submitters to comment next year on specific differences between ISSB standards and XRB's proposals. For example, at the "objective" level, the XRB narrows management's role to "assessing and managing", whilst the TRWG uses broader "management's role" language, introducing "assessing and managing" only in the list of inclusions.

In addition to having a chance to properly align with ISSB, we consider that the XRB guidance that is yet to come will be critical in terms of understanding expectations, and we are keen to be involved in any discussions with XRB on what the guidance might look like.

2. c) Do you consider that this section of the standard is adequately comprehensive and achieves the right balance in terms of prescriptiveness and specificity? If not, what should be removed or added to achieve a better balance?

We are pleased that XRB has indicated that it is open to further public input over the coming months on matters canvassed in this consultation. For example, on this question, understanding how climate standards develop internationally is particularly relevant. It is important that we align internationally both on what must be disclosed and how (purposively or prescriptively) it must be disclosed.

We consider that out of caution, Climate Reporting Entities (CRE) may interpret some of the requirements in the NZ CS 1 very specifically, such as the proposal to include information regarding whether and how related performance metrics are incorporated into remuneration policies. A more purposive, principles based approach is suggested.

The disclosures should be more principles based in nature, for example an outline of where remuneration policies are being used for the purposes of management accountability rather than "whether and how". We understand that the use of the term "whether" would allow a CRE to comply by reporting that it had not incorporated the performance metrics into its remuneration policies, but that the proposed standard does not require an explanation as to why the entity has not done so. As a more general comment, it would be helpful if XRB could clarify in the standards regime that the use of the term "whether" does not require an explanation of "why" an entity has adopted an alternate practice.

Fundamentally, we agree with the XRB explicitly stating that the obligations and its disclosures should not be used as a "checklist". We note that the disclosures for the Governance and Risk Management sections are conveyed as a list of mandatory and very specific requirements.

Key decisions for Risk Management

3. Do you think the proposed Risk Management section of NZ CS 1 meets primary user needs?

Some FSC members are concerned that "tools and methods" and "value chain" introduce concepts that, notwithstanding a "materiality" override, may require the disclosure of substantial detail. We suggest a more purposive approach should be taken.

We note that to the extent suppliers and other members of a CRE's value chain are not themselves a CRE, the information required to make the NZ CS 1 disclosures will require a CRE to determine what is reasonable in terms of the standard of due diligence that is appropriate for it to apply. We suggest that this may be an area on which the XRB or the Financial Markets Authority could usefully provide additional guidance.

3. a) Do you think that the information provided under this section of the standard will provide information that is useful for decision making to primary users (existing and potential investors, lenders and insurance underwriters)? If not, please explain why not and identify any alternative proposals.

Refer to our response to Question 3 above.

3. b) Do you consider that this section of the standard is clear and unambiguous in terms of the information to be disclosed? If not, how could clarity be improved?

Refer to our response to Question 3 above.

3. c) Do you consider that this section of the standard is adequately comprehensive and achieves the right balance in terms of prescriptiveness and specificity? If not, what should be removed or added to achieve a better balance?

In addition to our response to Question 3 above, we support the XRB's proposal not to require specific disclosure of a director's skills in relating to assessing climate issues for the reasons noted in the NZ CS 1.

Proposed defined terms

4. The XRB has primarily drawn from the TCFD's definitions for its defined terms. Do you agree that we should align closely with the TCFD's definitions?

It is the view of some FSC members that where terms are defined, or are used in the definition of other terms, they should be aligned with other existing regulatory requirements, for example "senior management" and "board of directors". However, where a term is defined in TCFD, we consider that the XRB standards should align with the TCFD definitions, as this will support clarity and consistency within the sector, and internationally.

5. The XRB is particularly interested in feedback on the following defined terms as they are currently proposed: 'climate-related risk', 'climate-related opportunities', 'climate-related issues', 'physical risk', and 'transition risk'.

Refer to our response at 2a).

5. a) Do you consider that the XRB should align with the TCFD and use the terms ‘climate-related opportunities’ and ‘climate-related issues’, or should we only refer to ‘climate-related risks’?

We support aligning with international climate risk categorisation. Omitting the word “negative” from the definition of “climate-related risk” may help to avoid the need for the concept of “climate-related issues”. Risk management more broadly generally uses a definition of risk that focuses on uncertainty, rather than solely on negative consequences. Also see our response at Question 2. a) on addressing uncertainties related to climate (positive and negative).

We note that the TRWG has not used the term “climate-related issues” in its climate prototype, using opportunities and risks separately. As explained at Question 2.a), we support not using “climate-related issues”.

5. b) Do you consider that the proposed definitions for these terms are accurate, sufficiently clear and well-explained? Do they need further detail or explanation? If so, should that detail be included in the defined terms or in guidance?

We refer to our response at Question 4 above.

6. Do you have any other views on the defined terms as they are currently proposed?

We have no further comment on this Question.

PROPOSED NZ CS 2 and NZ CRDC

NZ CS 2: Adoption of Climate-related Disclosures

7. The XRB is currently of the view that adoption provisions for some of the specific disclosures in NZ CS 1 will be required. However, the XRB does not believe it is necessary to provide any adoption provisions for entities in relation to the Governance and Risk Management disclosures. Do you agree with this view? Why or why not?

Our response to this Question will depend on how purposively the requirements in the standard are drafted. If there are very prescriptive requirements, for example for “tools and methods” and “value chain” disclosures, adoption provisions may be required.

ACCOMPANYING GUIDANCE

8. The XRB currently intends NZ CS 1 to be concise and sector neutral, with sector-specific requirements to be contained in guidance. Do you agree with this approach?

Some of our members are of the view that sector specific guidance is not required for the Governance and Risk Management sections of the NZ CS 1. However, more broadly the FSC strongly supports this approach for the more technical aspects of the XRB standards around scenarios for example but would appreciate an early indication of when we could expect guidance information. As representative of several key sectors, we welcome the opportunity to assist with the development of sector guidance.

9. Do you have any other comments?

We have not further comments at this stage but reiterate the FSC's willingness to continue to work with the XRB to progress the CRD regime for New Zealand.