Bank of New Zealand's submission on the "Aotearoa New Zealand Climate Standard 1 - Climate-related Disclosures – Strategy, and Metrics and Targets Consultation Document (NZCS1)"

2 May 2022

1 Introduction

1.1 Bank of New Zealand ('BNZ') has prepared this submission in response to "Aotearoa New Zealand Climate Standard 1 - Climate-related Disclosures – Strategy, and Metrics and Targets Consultation Document (NZCS1)" ('Consultation Document').

1.2 BNZ fully supports the climate-related disclosure framework and the introduction of the standard to enable existing and potential investors, lenders, and other creditors to understand the potential impacts of climate change on reporting entities. BNZ is committed to transparently disclosing how it is managing exposure to climate change and issued its voluntary reporting in the form of a Climate Risk Disclosure Statement for the year ended 30 September 2021 - see Climate-Risk-Disclosure-Statement-2021.pdf (bnz.co.nz). BNZ's commitment to the role it has to play in addressing climate change is reflected in its membership of the Net Zero Banking Alliance, we are the first New Zealand based bank to have joined.

1.3 The focus of this submission is to call out factors that we believe will assist in developing a robust climate standard that will be comparable for existing and potential investors, lenders, and other creditors. One of our key themes is the need for effective climate disclosure to be much more than a compliance exercise. It must enable reporting entities and users to gain insights on opportunities as well as risks. BNZ considers that for the disclosure regime to be effective, users should be able to make comparisons between different reporting entities. In order to do so, BNZ's view is that the latest climate projections data should be made available on an open-source basis, and free of charge, to avoid inequities and to enable all New Zealand reporting entities (and the wider business and community sectors) to access it. In BNZ's view, this data set should be provided by the Government to ensure that reporting is comparable and not restricted by the inability of an entity to pay for the data. We are aware that the Government's draft national adaptation plan proposes to make national climate projection datasets available from June 2024. However, these datasets will be provided too late for some reporting entities required to report earlier. In addition, BNZ considers that the Government could support this disclosure regime by mandating the public release of emissions data held by government agencies, regulated sectors and other public sector entities. This is of particular relevance to the banking sector to enable the effective reporting of financed emissions in the early stages of this disclosure regime.

1.4 Given the current data challenges associated with financed emissions, BNZ's preferred approach is for an adoption provision to be added so that disclosure of financed emissions is not required until sufficient data is available to ensure that the disclosure is accurate and useful. If XRB does not proceed with an adoption provision on this basis, BNZ's next preferred option is an adoption provision that stages disclosure of financed emissions with the most GHG intensive/emitting sectors to be disclosed in Year 1 with others to follow in Year 2 and Year 3 based on intensity of emissions in specified sectors (e.g., oil and gas, agriculture, commercial real estate). If XRB does not proceed with any adoption provisions in relation to financed emissions, BNZ submits that reporting entities should only be required to provide financed emissions on a "reasonable endeavours" or "best endeavours" basis given data limitations apply.

1.5 One of the other issues BNZ submits XRB should carefully consider is the timing of disclosures of GHG emissions. BNZ is part of an Australian corporate group that is required (under the Australian National Greenhouse and Energy Reporting Act 2007) to report scope 1 and 2 emissions on a 1 July-30 June year but has a 1 Oct-30 September financial year. If required to report to its financial year under the standard, BNZ will have to reproduce scope 1 and 2 emissions on a different year to group reporting. This will likely be an issue for all NZ companies that are part of an Australian or other international group.

1.6 BNZ supports the New Zealand Bankers' Association's detailed submission on this consultation. BNZ has provided further high-level submissions below on specific key issues in the consultation.

2 Responses to Consultation Document questions

Q1: Do you think the proposed Strategy section of NZ CS 1 meets primary user needs?

Q1(a): Do you think that the information in this section of the standard will provide information that is useful to primary users for decision making? If not, please explain why not and identify any alternative proposals.

Q1(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?

Q1(c): Do you consider that this section of the standard is adequately comprehensive and achieves the right balance between prescriptiveness and principles-based disclosures? If not, what should be removed or added to achieve better balance?

2.1 BNZ submits that actual financial impacts of climate-related risks and opportunities on its financial position, financial performance and cashflows will be hard to quantify initially and agrees with the XRB's proposal to permit reporting entities to provide qualitative information only in their Strategy disclosures in the first year of reporting. BNZ also notes that, at this stage, climate-related methodologies focus on a subset of asset classes only. Any other income streams (e.g., foreign exchange trading) are unlikely to be able to be analysed until suitable methodologies become available.

Q2: Do you agree that a standalone disclosure describing the entity's business model and strategy is necessary? Why or why not?

2.2 BNZ's view is that it would be preferable if the standard required entities to signpost opportunities rather than disclose them at a detailed financial level, recognising that forward-looking financial data is based on a set of assumptions that are particularly difficult to forecast in relation to climate change, and also the commercial sensitivity of providing detailed financial forecasts. BNZ considers that this could be simply achieved by mirroring the approach to existing annual reports where entities signal, at a high level, the priority parts of the economy they are looking to support by putting capital into those areas.

Q3: Do you agree that we should not prescribe which global mean temperature increase scenario(s) should be used to explore higher physical risk scenarios (such as 2.7°C and or 3.3°C or by using Representative Concentration Pathways (RCP) such as RCP4.5 or 6), but rather leave this more open by requiring a 'greater than 2°C scenario'? Why or why not?

2.3 BNZ considers that, at a minimum, RCPs should be used as the basis so that there is a common methodology which will assist in comparability. As noted by the XRB and TCFD, climate scenarios are designed to be challenging but plausible. The latest IPCC report states that without deep emissions cuts a plausible future includes temperature increases well above 2°C. XRB could amend the wording to require "a scenario well above 2°C" and use the corresponding RCP to define "well above".

Q4: We do not require transition plans to be tied to any particular target such as net zero and/or 1.5°C, but that entities will be free to disclose this if they have done so. Do you agree? Why or why not?

2.4 BNZ considers, given the underlying ethos of transition plans, it is prudent that any target relevant to a transition plan is disclosed with that plan. This will aid primary users to assess the ambition of such plans and enable comparability across entities.

2.5 Further, New Zealand's target is to reduce net emissions of all greenhouse gases (except methane) to zero by 2050. BNZ's view is that it would be prudent to disclose how the transition plans align with that target to assist with an overall New Zealand climate view for Government and officials.

Q5: Do you have any views on the defined terms as they are currently proposed?

2.6 BNZ notes that neither the definition of transition plan nor adaptation plan explicitly incorporates a requirement to disclose how the reporting entity is planning to mitigate identified transition risk. We believe that this is a gap that should be filled through the extension of the transition plan definition to cover identified transition risks and how these will be mitigated (for example, see page 48 of the TCFD's (2021) Proposed Metrics Targets Transition Plans Guidance).

2.7 BNZ also submits that "vulnerability" should be defined separately in plain language as opposed to within other technical terminology (see paragraph 2.26 below). BNZ proposes that the XRB clarify whether vulnerability is intended to cover solely exposure (e.g., a residential property exposed to flood risk) or also the customer's adaptive capacity and sensitivity to respond (e.g., their ability to move house or the relevant characteristics of the house (such as being elevated from the ground in a flood zone)). BNZ notes that the TCFD examples are predominately exposure examples.

Q6: The XRB has identified adoption provisions for some of the specific disclosures in NZ CS 1:

Q6(a): Do you agree with the proposed first-time adoption provisions? Why or why not?

Q6(b): In your view, is first-time adoption relief needed for any of the other disclosure requirements? Please specify the disclosure and provide a reason.

Q6(c): If you are requesting further first-time adoption relief, what information would you be able to provide in the interim?

2.8 BNZ supports the proposed first-time adoption provisions.

Q7: Do you think the proposed Metrics and Targets section of NZ CS 1 meets primary user needs?

2.9 No. Primary users would want to ensure there is comparability. BNZ's view is that the lack of guidance around metrics and targets in relation to financed emissions does not enable this comparability, as explained below.

Q7(a): Do you think that the information in this section of the standard will provide information that is useful to primary users for decision making? If not, please explain why not and identify any alternative proposals.

2.10 Although this section refers to financed emissions, it underestimates the difficulties for financial institutions in accurately calculating such emissions and provides little guidance, other than referring to available methodologies. Although the calculation itself and methodologies followed (PCAF) are relatively simple, the accuracy of data and ability to readily source the data is difficult. Furthermore, methodologies used to report emissions should be prioritising emissions in the real economy rather than emissions that have been attributed to reporting entities based on attribution rules that dilute the view on actual emissions. There are risks of inaccuracy and inconsistency between financial institutions, meaning comparability will be very challenging, if not impossible. For example, if a financial institution is looking to set a 2030 emissions reduction target for a sector, having real emissions data on customers will be important otherwise it will be very difficult to track progress (if you were to take an economic approach). Sourcing this data from customers is not always possible as customers must have done their own emissions accounting and then agree to provide the data to BNZ. There is also the issue of customers following a multitude of methodologies or using different calculators and we must be able to capture, assess and disclose these differences. BNZ considers that there is a role for Government in terms of broader education for those companies/entities below the reporting entity level to understand that they need to provide this information to their bank to support the reporting of financed emissions in this regime.

Q7(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?

2.11 BNZ submits that this section underestimates the issues financial institutions are facing in accurately calculating customer emissions in a way that provides accuracy and usefulness to enable a bank to take meaningful action. BNZ submits that XRB should provide further guidance to help financial institutions to navigate these issues. First time adoption principles should also be reconsidered, as noted below, given the data constraints.

2.12 BNZ considers that "vulnerable to" requires definition. There are specific definitions used in relation to climate risk. This is discussed further in paragraph 2.26 below.

2.13 This section refers to "science-based" targets. We note that the definition and application of "science-based" has evolved over time and may be interpreted in different ways dependent on the context in which it is applied. BNZ submits that this term should be defined in accordance with the Science Based Targets Initiative to ensure consistency of application. The SBTi[1] define science-based targets as those that "require a company to reduce its emissions at a rate that is consistent with the level of decarbonisation required to limit warming to 1.5°C or well-below 2°C" (p.9). This definition implies a temperature goal consistent with that of the Paris Agreement and an emissions reductions pathway that is consistent with attaining this goal.

2.14 BNZ notes that the definition of "gross emissions" specifies that gross scope 2 emissions must be calculated using the location-based methodology. We note that the GHG Protocol Scope 2 Guidance defines two approaches for calculating the scope 2 emissions from purchases of renewable energy and other forms of energy:

- The "location-based" approach is designed to reflect the average emissions intensity of grids on which energy consumption occurs and mostly uses grid-average emission factors.
- In contrast, the "market-based" approach is intended to help companies reflect the emissions impacts of differentiated electricity products that companies have purposefully chosen (e.g., supplier-specific emissions rates and power purchasing agreements).

2.15 BNZ is concerned that the prescription of a locations-based methodology to Scope 2 emission calculations will be to the detriment of companies deliberately sourcing low-carbon power sources. We consider a more appropriate approach is to require the application of a location-based approach where a market-based one cannot be applied.

2.16 BNZ notes that accounting for scope 2 emissions using the location-based methodology is inconsistent with the GHG Protocol which states that both location and market-based scope should be reported. BNZ considers that using both is better because it continues to provide comparability and a basis for choosing either a location-based or market-based option for a scope 2 target. BNZ notes that some entities have already set their scope 2 SBTi target using market-based methodology.

Q7(b): Do you consider that this section of the standard is adequately comprehensive and achieves the right balance between prescriptiveness and principles-based disclosures? If not, what should be removed or added to achieve a better balance?

2.17 BNZ submits that this section is too light given the complexity of financed emissions. The issues and constraints in sourcing data and how methodology gaps are to be treated should be addressed by XRB more clearly.

Q8: We have not specified industry-specific metrics. The guidance will direct preparers where to look for industry-specific metrics. Do you believe this is reasonable or do you believe we should include a list of required metrics by industry? If so, do you believe we should use the TCFD recommendations or follow the TRWG prototype?

[1] SBTi (2020) Foundations for Science-based Net-zero Target Setting in the Corporate Sector

2.18 BNZ supports the adoption of financed emissions as a recommended industry-wide metric, and within this, supports banks having flexibility as to the disclosure of other industry metrics. Banks will be following set methodologies and will be required to disclose industry scope and assumptions. BNZ considers that this flexibility is beneficial as it enables banks to set metrics and targets that can be tracked and managed in the context of existing banking systems and identifiers and align to financial statements. If implemented correctly, this ought to align with bank risk management frameworks and allow them to manage the specific climate risks they will identify in their portfolios.

Q9: We will require disclosure of scope 3 value chain emissions as part of this standard. Are there areas (particularly in your scope 3 value chain) where there are impediments to measuring at present? If so, what are these areas and when do you think it **might be possible to measure these areas?**

2.19 The most material scope 3 emissions for BNZ are its financed emissions – the emissions associated with its lending and investment portfolios. There are methodologies (i.e., PCAF) available for calculating the emissions associated with lending to a business but the challenge is sourcing the input data required to complete accurate calculation – this is very much dependent on the information available from a bank's customers and their willingness to share this information with their bank. Ideally, banks would be able to source actual emissions data (where possible) and methodologies direct from customers – this increases the level of accuracy (subject to methodology applied) and allows for a targeted, customer engagement approach to emissions reduction. A top down, or economic approach may create issues with assumptions and inaccurate data inputs and makes setting and tracking emissions reductions difficult. In addition, BNZ notes that at this point, very little data exists (if at all) at an economic level of requisite granularity or detail to apportion emissions from regional or national levels to bank portfolios. BNZ is working hard to source emissions data direct from customers – our experience to date tells us this process will be slow and highly dependent on our customers' climate change maturity and the bank's ability to collect the data with available technology solutions.

2.20 As noted above, BNZ considers that Government educational support to businesses on the need to share this information with their banks would be beneficial. Further, there may be opportunities where the Government could support the establishment of industry wide frameworks to gather this information on a sector basis – for example, by enabling the provision of smart meter data from the electricity sector to assist in establishing emissions for residential housing. Further, if farmers are required to provide emissions data to Inland Revenue a dataset could be developed from that to support disclosures for the financing of farm emissions that are consistent and standardised. ETS input data would also be a useful data set to assist with understanding emissions from business customers.

2.21 BNZ considers that an adoption provision is necessary in relation to the disclosure of scope 3 financed emissions. BNZ's view is that the adoption provision should relate to the availability of the data as opposed to a specific time period, as it is difficult to assess when the data will be available. The New Zealand Government could support this data being made available through legislation or regulation as noted above.

2.22 Further, concerning methodologies, we note that the current PCAF methodology does not cover all asset classes and financial products and that these will be addressed over time (see page 44 of the PCAF Standard for details). It is imperative that beyond data, the Standard recognise the impracticalities of calculating Scope 3 emissions given such methodology constraints. BNZ submits that, if an adoption provision is not added, reporting entities should only be required to provide scope 3 financed emissions on a "reasonable endeavours" or "best endeavours" basis until sufficient data is available.

2.23 BNZ has committed to the Net Zero Banking Alliance. BNZ's view is that XRB should consider these industry methodologies for an appropriate approach when it comes to financed emissions. The Net Zero Banking Alliance for example notes the importance of prioritising efforts where we have, or can have, the most significant impact i.e., the most GHG intensive and GHG emitting sectors within our portfolios. Therefore, a full Scope 3 value chain inventory may be unrealistic when the guidance and methodologies being used by the bank recommend a staged process and a material impact-based approach first. BNZ will be able to disclose the financed emissions as it works through this in the priority sectors and submits that the adoption provisions could be structured to support progressive disclosure of financed emissions with the most GHG intensive/emitting sectors to be disclosed first on a staged basis.

2.24 In summary, in relation to financed emissions, BNZ's preferred approach would be for an adoption provision to be added so that disclosure of financed emissions is not required until sufficient data is available to ensure that the disclosure is accurate and useful. If XRB does not proceed with an adoption provision on this basis, BNZ's next preferred option is an adoption provision that stages disclosure of financed emissions with the most GHG intensive/emitting sectors to be disclosed in Year 1 with others to follow in Year 2 and Year 3 based on intensity of emissions in specified sectors (e.g., oil and gas, agriculture, commercial real estate). If XRB does not proceed with any adoption provisions in relation to financed emissions, BNZ submits that reporting entities should only be required to provide financed emissions on a "reasonable endeavours" or "best endeavours" basis where data limitations apply.

Q10: Paragraphs 8, 9 and 10 contain specific requirements relating to the disclosure of GHG emissions to facilitate the conduct of assurance engagements in line with the requirement of section 461ZH of the Financial Markets Conduct Act. Do you have any observations or concerns about these proposed requirements?

2.25 BNZ has no concerns with these requirements.

Q11: Do you have any views on the defined terms as they are currently proposed?

2.26 As noted above, BNZ is concerned that the concept of vulnerability and how it is to be applied in the context of this standard is not clear. We note that explaining a concept with other (unexplained) concepts is problematic. BNZ's view is that a plain language explanation would help reporting entities to interpret this term. BNZ is particularly concerned about this term due to its central application to both disclosure of transition and physical risk. We note that historically "vulnerability" has been a variously interpreted term in the climate change literature and guidance (and is also used in a wider sense within the banking sector). The components in this consultation document seem different to the components attributed in IPCC's AR5 where exposure is differentiated from vulnerability (which itself comprises adaptive capacity and sensitivity) as two explicit components of climate risk. In considering a definition it may be helpful to differentiate between "exposed to" and "vulnerable to". This is important from an implementation perspective as, where they are combined, a vulnerability assessment of adaptive capacity and sensitivity (i.e., vulnerability) and exposure requires access to significantly more, and types of, data that than required for a pure exposure only assessment. We note that the examples provided in the TCFD[2] appear to confuse this differentiation with the bulk of examples provided relevant to exposure only. We submit that the standard should allow either assessment with explicit disclosure to that effect, i.e., quantification of exposure or vulnerability would be tagged as such.

Q12: The XRB has proposed not providing first-time adoption provisions for the Metrics and Targets section of NZ CS 1. Do you agree? Why or why not?

2.27 BNZ does not agree with this proposal. As mentioned above, there are significant near term challenges with sourcing data for financed emissions. BNZ is following global best practice in line with the Net Zero Banking Alliance which recommends starting with the most material GHG emissions intensive sectors. Given this approach, data uncertainty and assurance requirements, it is unlikely to be possible and may not be helpful (for the sake of comparability) to report all scope 3 in year 1.

Q13: The XRB proposes that the minimum level of assurance for GHG emissions be set at limited assurance. Do you agree?

2.28 Yes, given data uncertainty, the lowest level of assurance should apply.

Q14: The XRB has proposed a definition of material (*Information is material if omitting, misstating, or obscuring it could reasonably be expected to influence decisions that primary users make on the basis of their assessments of an entity's enterprise value across all time horizons, including the long term).* Do you agree with this definition? Why or why not?

2.29 BNZ is generally supportive of the proposed definition of materiality.

Q15: Do you have any other comments on the proposed materiality section?

2.30 BNZ has no issue with the proposed definition of materiality *per se*. However, we are concerned that a lack of guidance relevant to determining materiality according to this definition (i.e., "any impacts that circle back" paragraph 9.3.1) may compromise both a bank's ability to do so and do so in a way that is consistent with other banks. We have a similar concern with the incorporation of temporal assessment (i.e., "including the long term"). If we interpret this correctly, this introduces the potential, for example, that climate-related drivers deemed immaterial now may become material later (i.e.,

[2] See Table CS1 (p.16) of TCFD (2021) Guidance on Metrics, Targets and Transition Plans

dynamic materiality). Guidance is required to ensure relevant and consistent interpretation of this requirement.

2.31 Consistent with other comments, we are concerned about the time that will be required by the financial sector to extend current systems to these broader systems and temporal boundaries of inquiry. In particular, and in the absence of adoption provisions, there is a risk that disclosures that are "forced" prior to system readiness, might increase the risk of misrepresentation and divert from a true and fair view of the implications of climate-related risk for bank operations and strategies.

Should the XRB have any questions in relation to this submission, please contact:

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