Climate-related Disclosures

Strategy, and Metrics and Targets Consultation Document

EY submission

April 2022

Building a better working world

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Climate-related Disclosures Strategy, and Metrics and Targets Consultation Document

Tēnā koe e te rangatira,

EY welcomes the opportunity to submit to the External Reporting Board (**XRB**) on the proposed Strategy, and Metrics and Targets sections as part of the Aotearoa New Zealand Climate Standard 1: Climate-related Disclosures (**NZ CS 1**).

At EY, we are committed to building a better working world — building trust and confidence in the capital markets and in economies the world over. Our multidisciplinary Climate Change and Sustainability Services team helps clients understand the risks and opportunities arising from climate change and sustainability issues. In January 2021, we announced our ambition to be carbon negative in 2021 by setting targets to significantly reduce our absolute emissions and removing and offsetting more carbon than we emit. We plan to not only become carbon negative but to also reduce our total emissions by 40% — consistent with a science-based target — and achieve net zero in 2025.

The EY commitment to sustainability is an integral part of our NextWave strategy and ambition to create long-term value for all stakeholders. We believe climate-related financial disclosures can contribute to a better working world. Our submission contains our views on NZ CS 1 and specific recommendations on the draft sections on Strategy, and Metrics and Targets. We believe these changes could further improve transparency and decision-making to stimulate and steer investment towards long-term sustainable options and support the allocation of capital to adaptable, efficient and climate-resilient entities.

We hope that our submission will provide a valuable point of view. Thank you for the opportunity to make this submission, and we look forward to continued engagement.

Ngā mihi nui,

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SUBMISSIONS

Background

Our working world is undergoing significant shifts. Investors, regulators and — more broadly — society are increasingly demanding greater transparency around both the financial and nonfinancial performance of organisations to assess their true long-term value.

EY's Climate Change and Sustainability Services (**CCaSS**) practice helps clients strategise for long-term value by understanding and evaluating nonfinancial outcomes and impacts (including climate change), identifying risks and opportunities, and supporting the reporting of nonfinancial performance disclosures to their stakeholders. EY is a member of the Task Force on Climate-related Financial Disclosures (**TCFD**) and issues regular Climate Risk Barometer publications which monitor the progress of reporting against the TCFD recommendations at a global and regional level. These publications have highlighted small incremental improvements in climate risk disclosures since the launch of the TCFD but also show a significant gap between the full set of recommended disclosures and current practice. In addition, our CCaSS practice in Aotearoa New Zealand has served as the Secretariat of The Aotearoa Circle's Sustainable Finance Forum (**SFF**) to develop the SFF Interim Report and 2030 Roadmap for Action, recognising the critical role of finance to scale up and re-direct capital to enable the transition to a sustainable economy. EY continues to support the work of Toitū Tahua — the Centre for Sustainable Finance, and the implementation of the 2030 Roadmap for Action.

Given our role in helping clients respond to climate change risks and the development of reporting frameworks such as the TCFD recommendations, we welcome the opportunity to make this submission on the draft Strategy, and Metrics and Targets sections as part of the proposed standard, **NZ CS 1**.

Executive Summary

EY strongly supports the draft sections on Strategy, and Metrics and Targets as part of NZ CS 1, outlined in the Consultation Document. In particular, EY supports XRB's decision to provide additional disclosure requirements, where necessary, to ensure that NZ CS 1 is ambitious and forward-looking.

Our submission makes specific recommendations that we believe could further improve transparency and decision-making to stimulate and steer investment towards long-term sustainable options and support the allocation of capital to well-prepared and climate-resilient entities.

On the basis that all sectors will face disruption from the physical and transition impacts of climate change, and that the climate-related disclosures regime should serve the needs of a broad range of stakeholders, and be linked to New Zealand's targets under the Climate Change Response Act 2002, we submit that the XRB should:

1. Commit to revisiting the proposed definition of materiality within three to five years, to reconsider adopting a double materiality lens, to cover not only the impact of climate change on the climate reporting entities (**CRE**) (as defined in the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill) but also the impact of the CREs on climate change.

2. Commit to revisiting the proposed updated definition of primary users within three years, to consider expanding beyond "existing and potential investors, lenders and other creditors" to cover a wider scope of stakeholders who have a legitimate interest in the disclosures made by CREs and other entities who choose to voluntarily disclose in line with the NZ CS 1.

3. Commit to revisiting the number of scenarios required to be used in scenario analysis within three years, to reconsider the requirement for a minimum of only two scenarios.

4. Require that transition plans be tied to a net zero/1.5°C target, and within three years, require that CREs explain how these pathways would be funded, paid for or financially supported from their business model.

In addition, EY wishes to express our strong support for the following proposals within the Consultation Document:

- The proposed requirement for CREs to disclose the transition and adaptation plan aspects of its strategy, including the extent to which financial plans are aligned with these plans.
- The proposed requirement that CREs must disclose the methodologies and assumptions underlying the climate-related scenarios used, and the scenario analysis process employed to support transparency and comparability.
- Setting the minimum level of assurance for GHG emissions at limited assurance (for now) and the proposal to revisit the level of assurance after a suitable period of time once the assurance regime has commenced (from 27 October 2024). In addition, we submit that assurance over other disclosures beyond GHG emissions should be encouraged by the XRB.
- The alignment of NZ CS 1 with the work of the International Sustainability Standards Board (ISSB), specifically the new ISSB climate-related disclosures standard, which is currently under consultation.
- The proposed requirement that CREs must disclose and assure material scope 3 (value chain) emissions as part of this standard, given their materiality to many entities' operations.

1 The Concept of Double Materiality

The XRB has proposed the following definition of materiality: "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". The XRB acknowledges: "that the enterprise value lens also includes any impacts that the entity may have on climate change that circle back to have a subsequent impact on the entity's enterprise value. For example, if an entity has a significant negative impact on climate change, this may negatively impact its enterprise value due to subsequent regulatory action or social pressure". The XRB also considers that "this approach sets a solid foundation that we can build upon, which may include double materiality in the future".

The flow-on effects of other international efforts to adopt a "double materiality" lens to sustainability reporting will ultimately impact many CREs in New Zealand. As recognised by the XRB, a key example of this is the European Union's (**EU**) proposed Corporate Sustainability Reporting Directive (**CSRD**) which aims to ensure that companies publicly disclose adequate information about the sustainability risks and opportunities they face, as well as the impacts they have on people and the environment ("double materiality"). The concept of double materiality has recently been incorporated into TCFD reporting requirements in Switzerland, which, from 2024, will require large Swiss companies to report on both their financial or investment risks linked to climate change, and on the impact that the company's commercial activity concretely has on the environment.

Our recommendation: With this in mind, and building on our prior submission, EY recommends that the XRB commit to revisiting the proposed definition of materiality within three to five years, to reconsider adopting a double materiality lens. In turn, the regime can help to better disclose the complete impact of climate change in Aotearoa New Zealand, by ensuring the CREs' impact on our climate, people and environment is not excluded from disclosures.

2 Definition of Primary Users

The XRB has noted that climate disclosures have primary users and other users, with primary users being "those to whom the disclosed information is targeted, to directly inform their decision making" and other users being "wider stakeholders who will likely also have an interest in the disclosed information".

The XRB has specifically defined primary users as: "existing and potential investors, lenders and other creditors", slightly updating the definition that was outlined in the first Consultation Document.

As outlined in our prior submission, in the context of climate change risks, shifting from a shareholder to stakeholder perspective is important given that TCFD-aligned climate-related disclosures are designed to be used by entities in providing information not only to investors but to "other stakeholders". All sectors will face disruption from the physical and transition impacts of climate change. We note that the TCFD recommendations refer to "investors, lenders, insurance underwriters *and other stakeholders*" as having a legitimate interest in the disclosures themselves or in the outcomes of the disclosures. It is important for all stakeholders, including civil society, government, regulators, customers and employees and the general public, to be able to assess the climate risks of CREs. "Existing and potential investors, lenders and other creditors" are not the only stakeholders who interact with CREs and make decisions based on the information provided in disclosures. EY also notes that an expanded definition of primary users will help to ensure that all types of entities, including Crown Financial Institutions and entities not captured by the definition of CREs, can make appropriate disclosures in line with NZ CS 1.

Our recommendation: With this in mind, and building on our prior submission, EY recommends that the XRB commit to revisiting the proposed updated definition of primary users within three years, to consider expanding beyond "existing and potential investors, lenders and other creditors" to cover a wider scope of stakeholders who have a legitimate interest in the disclosures made by CREs and other entities who choose to voluntarily disclose in line with the NZ CS 1.

3 Scenario Analysis

Investors, regulators and — more broadly — society are increasingly demanding greater transparency around the resilience of an organisation's business model and strategy to the potential impacts of climate-related risks and opportunities. EY strongly supports the XRB's proposal to require scenario analysis be undertaken, using a range of climate-related scenarios, including — at a minimum — a 1.5°C scenario and a greater than 2°C scenario. However, EY notes that increasingly, a minimum of at least *three* scenarios are used by leading TCFD reporting organisations internationally, particularly given that most scenario methodologies recommend the use of three or four scenarios. [1] In addition, the TCFD have noted that while the use of only two scenarios may be a practical way to start, the drawback to using only two scenarios includes a tendency to interpret one as "good" for the company and one as "bad", which may introduce a bias into the scenario analysis.[2] To improve the maturity of climate disclosures over time, EY believes the number of scenarios required to be used in scenario analysis should therefore be revisited after a suitable period of time.

Our recommendation: The XRB should commit to revisiting the number of scenarios required to be used in scenario analysis within three years, to reconsider the requirement for a minimum of only two scenarios.

4 Transition Plans

To ensure that organisations effectively address their climate-related risks and opportunities and plans to transition and adapt to a net-zero, climate-resilient future, both transition and adaptation plans should be components of an organisation's overall business strategy. We strongly support the XRB's proposed requirement for CREs to disclose the transition and adaptation plan aspects of its strategy, including the extent to which financial plans are aligned with these plans. However, EY notes that the XRB are not currently proposing to 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. In addition, while entities will need to disclose the *extent to which* financial plans are aligned with their transition and adaptation plans, the XRB is not currently proposing to require that they are in fact aligned.

As defined by the TCFD Guidance, a transition plan is an aspect of an organisation's overall business strategy that lays out a set of targets and actions supporting its transition to a *low-carbon economy*, including actions such as reducing its GHG emissions. The IPCC's Special Report on Global Warming of 1.5°C found that GHG emissions need to decline by about 45% by 2030 and reach net-zero around 2050 in order to achieve a 1.5°C temperature target. Reflecting the science, EY believes that credible transition plans should be linked to a net zero/1.5°C target and be costed to show their viability and financial impact on the organisation.

This is in line with the EU's proposed Corporate Sustainability Reporting Directive (CSRD), which among other disclosures, requires sustainability reporting contain in particular:[3]

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[1] Amer, Daim and Jetter, A review of scenario planning, 2013; Haigh, Scenario Planning for Climate Change: A Guide for Strategists, 2019; Ralston and Wilson, The Scenario Planning Handbook: Developing Strategies in Uncertain Times, 2006; Lindgren and Bandhold, Scenario Planning: The Link Between Future and Strategy, 2009; Van Der Heijden, Scenarios: The Art of Strategic Conversation, 2010.
[2] Task Force on Climate-related Financial Disclosures, Guidance on Scenario Analysis for Non-Financial Companies (October 2020). https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Scenario-Analysis-Guidance.pdf.
[3] Directive of the European Parliament and of the Council, Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, As Regards Corporate Sustainability Reporting (Page 43), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&from=EN.

> "(iii) the plans of the undertaking to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement;"

In addition, the Climate Change Response (Zero Carbon) Amendment Act 2019 (Zero Carbon Act) aims to provide a framework by which New Zealand can develop and implement clear and stable climate change policies that contribute to the global effort under the Paris Agreement to limit the global average temperature increase to 1.5° Celsius above pre-industrial levels. The XRB has outlined their desire to ensure comparative information and consistency of reporting. To align with New Zealand's legislated emissions reductions target and improve transparency and consistency of disclosures for users, transitions plans should align to a target net-zero future. This will support CREs in understanding how their future emissions trajectories will support New Zealand in reaching our legislated emissions reduction targets. Furthermore, a transition plan that is not aligned with an entity's financial plan will be difficult to turn into action. If transition plans are to be credible, they must be costed.

Our recommendation: The XRB should require that transition plans be tied to a net zero/1.5°C target and, within three years, require that CREs explain how these pathways would be funded, paid for or financially supported from their business model.

Further Support

EY wishes to express our strong support for the following proposals within the Consultation Document:

1. The proposed requirement for CREs to disclose the transition and adaptation plan aspects of its strategy, including the extent to which financial plans are aligned with these plans.
2. The proposed requirement that CREs must disclose the methodologies and assumptions underlying the climate-related scenarios used, and the scenario analysis process employed to support transparency and comparability.
3. Setting the minimum level of assurance for GHG emissions at limited assurance (for now) and the proposal to revisit the level of assurance after a suitable period of time, once the assurance regime has commenced (from 27 October 2024).
4. The alignment of NZ CS 1 with the work of the International Sustainability Standards Board (ISSB), specifically the new ISSB climate-related disclosures standard, which is currently under consultation.
5. The proposed requirement that CREs must disclose and assure scope 3 (value chain) emissions as part of this standard, given their materiality to many entities' operations.

Conclusion

Climate-related risks can have a detrimental impact on investors and other stakeholders, and managing these risks is critical for an entity to achieve long-term value creation. EY is committed to ensuring that the assurance and advisory professions are able to continue serving the evolving needs of investors, businesses, and the public interest.

We commend the XRB for utilising this opportunity to create a robust, fair and effective climate-related risks disclosure regime that supports Aotearoa New Zealand's pathway towards a more sustainable, low-emissions, climate-resilient economy. We wish to again express strong support for the draft sections on Strategy, and Metrics and Targets as part of NZ CS 1, that have been outlined in the Consultation Document. The recommendations we have outlined within our submission are intended to highlight areas where NZ CS 1 can be further strengthened to achieve a world leading climate-related disclosure framework for Aotearoa New Zealand to allow for better decision making on capital allocation and help smooth our transition.

We are happy to meet with the Climate-related Disclosures Project Steering Group to discuss any aspect of our submission. To discuss this further, please contact Pip Best at pip.best@nz.ey.com

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EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

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