RBNZ SUBMISSION ON THE

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

2 May 2022

Reserve Bank of New Zealand
Te Pūtea Matua

Introduction

Protecting and promoting the stability of New Zealand's financial system is one of our key objectives. Climate-related risks will have a significant effect on New Zealand's economy and financial system. Therefore, we are a strong supporter of increased disclosure of climate-related risks as a way to understand and mitigate financial risks while incentivising investment in a low emissions economy.

We congratulate the External Reporting Board (XRB) for its significant progress in developing the reporting regime.

We note that the ultimate responsibility for managing risks lies with the firms themselves, not with regulators, and we see disclosure as a key step to making that happen. Disclosure can facilitate:

- Changes to firms' behaviour by directing attention to climate-related risks – 'you manage what you measure'.
- Changes to investors' behaviour by reflecting the climate-related risks and opportunities of investment thus helping to avoid stranded assets and incentivise low-emission investment.

Therefore, disclosure can help ensure that climate change is routinely considered in business decisions and provide important information to investors for their allocation of capital.

We have a close interest in the reporting standards that the XRB is developing to implement the new requirements in line with the Task Force on Climate-Related Financial Disclosures (TCFD) guidance. These standards will apply to a number of the banks and insurers that we supervise and will incentivise them to make progress on robust long-term plans for responding to climate change and managing emerging risks.

We will also be publishing a guidance note for regulated entities on best practice management of climate-related risks which will cover the separate question of what firms should do, rather than what they should disclose.

Cross-agency collaboration is crucial to address the challenge that climate change poses for the financial system. We are liaising closely with XRB and will continue to engage closely to ensure that any guidance or expectations we issue are aligned with what the XRB covers in respect of the reporting of that risk management. Our goal is to see entities manage their own climate-related risks in a transparent manner that ensures these risks and opportunities are incorporated into business decisions.

We are aware that some of our comments and suggestions will be more appropriate to include in guidance. We look forward to discussing these with you.

Background

We place a significant emphasis on disclosure as part of our regulatory framework to support effective market discipline. More broadly, disclosure is an important part of how we assess financial stability and risks in the sectors we regulate. Adequate disclosure is critical to our financial stability mandate at the RBNZ.

In step with other regulators and central banks we are intensifying our supervision of climate-related risks and incorporating climate risks into our stress testing programme. We learn from and share best practice through the Central Banks and Supervisors Network for Greening the Financial

System (NGFS), a network of 108 central banks and supervisors working together on climate change.

A key output of the NGFS is the development of climate scenarios which may help advance a well-grounded basis for vulnerability assessments/stress testing. We are developing our stress testing programme, with an initial focus on coastal flooding. We plan to develop a scenario-based stress test in 2023. To help align our stress testing (where possible), with the scenarios developed as part of the mandatory climate-related disclosure regime, we are liaising closely with XRB and participating as an observer in the Aotearoa Circle's development of sector-based scenarios for the banking sector.

Our comments are based primarily on our role as prudential regulator. We also intend to lead by example and develop the building blocks for our own disclosure. We have disclosed our operational carbon footprint since 2019 and have taken initial steps to understand the impact of our investments. Some of our comments reflect our practical experience in emission reporting and the challenges we face particularly for financed emissions.

Response to the Questions Raised in the Consultation Document

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

Question 1a: 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.

We believe this information will be useful for primary users.

We note that for many firms this will be the first time they have gathered, managed and disclosed climate-related information and it will be challenging. Being as clear as possible is critical and will help make disclosure feasible.

The integration of climate change considerations across the economy and financial system will require significant capacity building for firms, boards, regulators, investors and other stakeholders. We note capacity building is underway through groups such as the Institute of Finance Professionals New Zealand, the Institute of Directors and Toitū Tahua, the Centre for Sustainable Finance and encourage entities to engage.

We agree broadly with the need to extend disclosure to cover both transition plans *and* adaptation plans. Adaptation plans should help keep companies focused on preparing for the impacts of climate change. As a regulator, this will help us assess, monitor and manage the exposure and preparedness/resilience of the firms we supervise who report under the regime. However, we suggest considering a single plan covering both transition and adaptation. In practice, these issues intertwine and overlap. Having a single plan may reduce the burden on entities of having to adjust multiple plans and make it easier for primary users to form a holistic view of an entity's resilience to climate-related risks.

At present we do not understand whether the inclusion and use of 'actual financial impacts' is feasible given data and methodology constraints, but this could be because we are not clear of the intent (perhaps further clarification is warranted). While we consider the internal logic and the TCFD alignment makes sense, input from entities will be critical to understand the feasibility of reporting 'actual financial impacts'. For example, does this require entities to ascribe actual financial impacts from a storm and then the degree to which that storm can be attributed to climate change? The first-time adoption provisions mean only qualitative information will be required for the first report, and ascribing financial impact in year two may be challenging. Both the TCFD and TRWG recognise that this will not be easy. For example, TCFD states: "These impacts may be described in qualitative, quantitative, or a combination of both qualitative and quantitative terms. The Task Force encourages organisations to include quantitative information, where data and methodologies allow."

Question 1b: 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 it is critical to cover methodologies and assumptions particularly given data issues and that methodologies are evolving or not well understood.

However, we also suggest that the standard (or guidance) should require firms to outline the consequences or limitations of these methodologies and assumptions (and the judgements that led to these assumptions).

Question 1c: 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?

Given the current context where standards and methodologies are rapidly evolving, the balance between prescription and principles makes sense. Entities will need time to embed new processes, including understanding current and future risks, opportunities and financial implications, while at the same time considering national and global developments.

However, over time as standards and methodologies develop, it may be worth considering being more prescriptive either in the standards or the guidance. Further, there will be a limit to the usefulness of the data for comparison under the principles-based approach. It is harder to compare across sectors, sub-sectors and firms with little or no prescribed disclosure. Sectoral guidance is one way to support consistency with the intended outcome of making it easier to compare firms within the same sector.

Question 2: Do you agree that a standalone disclosure describing the entity's business model and strategy is necessary? Why or why not?

We strongly support this provision. Having the description with the disclosure should improve understanding and accessibility by enabling primary users to reflect and assess the CRE's disclosure against its business model and strategy. As the transition and adaptation plans evolve, we would expect to see them incorporated into this standalone disclosure.

Question 3: 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?

We support a flexible approach given that scenarios will change over time with increased understanding. Going forward, we support incorporating a regular review to mitigate any risk of entities gravitating to scenarios with a low 'upper bound'.

One thing to note is that using a 1.5°C scenario for high transition risks implicitly assumes a trade-off between emissions pricing and global rising temperatures. While this holds globally or for large countries or blocs, it does not necessarily hold for a small country like New Zealand that could experience both high domestic emissions pricing and severe physical impacts from global warming simultaneously. It would be helpful if the guidance allowed for such a scenario, perhaps by specifying that a path for emissions pricing that would be consistent with 1.5°C if applied globally would meet the guidance and could be combined with physical risks from global warming in excess of 1.5C.

It may make sense to update the guidance periodically and have the standard reference the guidance.

Question 4: 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?

We agree. We note it is more important that entities develop and implement plans to transition to a low carbon economy that include concrete targets and actions in the short and medium term, than only generic targets such as net zero by 2050.

Question 5: Do you have any views on the defined terms as they are currently proposed?

We suggest considering the following:

- 'Adaptation plans' We note potential issues with the insurance industry use of the terms 'risk' and 'minimising'. The insurance industry prices and accepts risks (rather than minimising them). Asking insurers to 'minimise' risks associated with physical climate changes could be too prescriptive to their overall business models and could have unintended consequences such as insurance retreat from areas at risk from future flooding.
- It would be useful to define 'short-term', 'medium-term' and 'long- term'. Such terms vary between industries and within industries. For example, for a general insurer short-term is < 1 year, and long-term could be anything beyond the business plan, c. > 3-5 years. In contrast, a life insurer would have long-term products lasting 30+ years. For consistency, stipulating a range may be useful. For example, 'short-term <5 year', 'medium-term is 5-10 years', 'long-term > 10 years'. Given the different nature of industries, these definitions may need to be sector-based (but clearly defined in terms of the climate standards).
- It would be useful to define 'science-based target'.

Question 6: The XRB has identified adoption provisions for some of the specific disclosures in NZ CS 1:

Question 6a: Do you agree with the proposed first-time adoption provisions? Why or why not?

Given the urgency of preparing for and mitigating climate change, we support including scenario analysis in the first year of disclosure. Early scenario analysis will help entities get an early view of the resilience of their organisations to climate change. This in turn will help them integrate climate considerations through their organisations, for example setting aside budgets for further scenario analysis.

We stress the need to get started. Starting with qualitative disclosures and moving to quantitative disclosures means a lower threshold for getting started, and hopefully a smoother and more transparent pathway to fuller more meaningful disclosures. We agree that delays would may lead to broader risks for the financial system if this information was not disclosed until 2025–2030. We don't think it is necessary to have a longer adoption provision for adaptation plans and believe there should be a single adaptation/transition plan.

Question 7: Do you think the proposed Metrics and Targets section of NZ CS 1 meets primary user needs?

Question 7a: 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.

We believe this information will be useful for primary users.

We agree it is critical to find the right balance between disclosing clear information that meets the needs of users without diminishing clarity with excessive detail.

We agree with the focus on gross emission reduction, rather than offsets. We suggest further clarification is needed around science-based targets, for example, clarifying the distinction between specific operational targets (e.g. reducing business travel GHG emissions by 50% by 2030) and more generic targets (such as net zero by 2050).

Question 7b: 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 believe that clarity could be enhanced in the following areas:

- Disclosure requirements for cross-industry metrics. It is unclear from 4 whether CREs must disclose all cross-industry metrics listed in 4 or only those metrics used to manage climate related risks and opportunities (i.e. 3a). Note that Para 8a states that only 4a is mandatory.
    - Note also that the rest of the standard uses the word 'key' and 'must' is onerous if metrics are deemed as immaterial.
    - Including definitions for the three types of metric 'cross-industry', 'industry-specific', 'entity specific.

- Defining 'upstream' and 'downstream' outside of the 'value chain' definition.

Question 7c: 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?

On the balance of prescription vs principles, it might be useful to state that as standards and best practice becomes more defined, disclosures will become more prescriptive to allow for better comparability and accountability. The ability to self-define some metrics measures may create a lack of accountability, but given the data and resource limitations we don't see an alternative at the moment.

Question 8: 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?

Industry specific metrics are evolving and should be looked at as data, methodology and capacity develops.

It would be useful if the standards could be flexible enough to encompass this evolving landscape allowing for increased prescription in time to improve comparability and for us to benefit from international progression and consolidation. For example, although aligned, ISO standards require metrics to be presented in a different way to GHG Protocol and use different terminology - "Categories" instead of "Scope" which could cause inconsistency in reporting i.e. TCFD disclosure ("Scope") when referenced back to a CRE's inventory report ("Category").

Question 9: 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?

We support the inclusion of Scope 3 value chain emissions.

As acknowledged in the document, CREs may be limited by resource and expertise at the beginning, but unless it is mandated, CREs may have little incentive to dedicate resource and grow this area.

RBNZ currently reports operational scope 3 emissions with a limited assurance verification.

We note current limits on data availability for purchased goods and services. Domestically, these should improve with mandatory reporting and the Carbon Neutral Government Programme.

Several methods are available to calculate scope 3 emissions from purchased goods and services - supplier-specific, industry average, spend-based, and hybrid. We started with spend-based method with the intention of shifting to hybrid and then supplier-specific over time and therefore we agree it is important to disclose methodology and assumptions.

Regarding financed emissions, it is useful that the document references the Standard for GHG Accounting for the Financial Industry. It would be helpful to include key themes of this standard into the XRB guidance because for financial institutions, financed emissions will make up almost the entirety of scope 3 emissions. Guidance is also required on whether XRB expects CREs to report on asset classes not yet defined in the Standard for GHG Accounting for the Financial Industry Standard, or whether CREs can exclude them until standards are developed further. We note there are standards for only six asset classes, and many assets are not yet covered by a standard. For example, the RBNZ holds almost exclusively fixed income assets, which are not yet defined by the Standard, so we have used measures from Bloomberg and S&P to understand our emissions in this area.

Question 10: 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?

Other than providing clarity around mandatory disclosure requirement for cross-industry metrics (see Question 7b) we have no comments or concerns about the requirements proposed in 8, 9 and 10.

Question 11: Do you have any views on the defined terms as they are currently proposed?

See above.

Question 12: 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?

We agree. Early use of metrics will help entities understand the degree climate change may impact their operations. This in turn will help entities integrate climate considerations through their organisations, for example in setting targets for energy efficiency.

CREs need to start reporting metrics. This means accepting that Year 1 data won't be perfect and data quality will improve over time. Verification not required until Year 2 with two levels of verification standards (reasonable for Scopes 1 & 2 and limited for Scope 3). Overall there is sufficient flexibility for improvements in data quality without providing 1st time adoption.

Further clarity on required levels of comparative information would be helpful. The draft guidance states that CREs do not need to provide comparative information in Year 1 but need to provide at least two years' comparative information in Year 2.

Question 13: The XRB proposes that the minimum level of assurance for GHG emissions be set at limited assurance. Do you agree?

We agree with setting 'limited' assurance as the minimum level for greenhouse gases. 'Reasonable' assurance would be too much of a hurdle for many scope 3 emissions and the costs may outweigh the benefits.

It will be interesting how external financial auditors balance this 'limited' assurance with the requirement of 'reasonable assurance' for the balance of the financial statements. To help primary users make this distinction we support clear messaging/disclaimer noting that GHG emissions are subject to only 'limited assurance'.

Question 14: 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?

We agree with this definition of materiality, for the following reasons:

- We note that the definition, and some of the supporting material in Table 11, are fairly close parallels of key parts of the existing definition of materiality in the financial reporting standard NZ IAS 1 "Presentation of Financial Statements". We think it makes good sense to anchor the new definition to the existing accounting definition in this way, while the rest of the definition goes into more detail on climate-specific aspects.

We also support the ways in which the definition has been adapted from the NZ IAS 1 definition of materiality:

- First, the broad concept of enterprise value (as defined) seems the appropriate replacement for the focus on "financial statements" in the NZ IAS 1 context.
- Second, the emphasis on "all time horizons, including the long term" is important to include.
- Third, it makes sense to refer to users' decisions based on <u>their assessment of</u> enterprise value, rather than directly on enterprise value, given the subjective nature of the definition of "enterprise value".

We think it will be important for a CRE to discuss its materiality judgements in its climate report, and the context in which the judgement is made, which will need to be revisited for each report. This will be relevant for primary users.

Question 15: Do you have any other comments on the proposed materiality section?

We agree with the discussion in section 9.3.1 of the consultation which explains the use of the "enterprise value" focus for materiality. We understand that this means the focus is on "outside-in" risks and agree that this is a pragmatic approach at this stage, while also acknowledging the point that the impact an entity has on the climate can be material for enterprise value if that indicates that the entity faces material transition risk ("inside-out" risks). We agree with this latter point being included in paragraph 12 of the proposed materiality section. We agree with the point that a matter may not be material by magnitude but may be material by nature, for example if an entity does not have a process that would be good practice, that may indicate a lack of governance. We also support the inclusion of paragraph 14 in Table 11, making the point that a given class of risks may be material when taken in aggregate.

Conclusion

Thank you for this opportunity to comment on the proposed standards. We will continue to support the XRB as you work towards a full disclosure standard.