

16 September 2022

External Reporting Board
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By email: climate@xrb.govt.nz

ICNZ submission on XRB's Exposure Draft on NZCS1, NZCS2, NZCS3 and Guidance Document

Thank you for the opportunity to submit on the Exposure Draft and Guidance Document.

By way of background, ICNZ's members are general insurers and reinsurers that insure about 95 percent of the Aotearoa New Zealand general insurance market, including about a trillion dollars' worth of Aotearoa New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

ICNZ has made positive contributions and provided insights on climate change and its impacts to many forums. Its members have formed a specialist committee on climate change to draw upon a wide range of expertise and knowledge so that we can contribute to better understanding of the issues and play a constructive role in developing solutions to the challenges the topic presents.

ICNZ supports the climate-related disclosure regime. The disclosure standards are critical to enable the transition to a low-carbon economy as they will ensure investors have comparable, relevant and consistent data to inform their decisions. They also play a fundamental role in helping reporting entities to develop resilience to climate change by requiring the risks and opportunities presented to be integrated into strategy, including how

to transition to a low-carbon future, with appropriate governance and oversight of the measures to achieve that.

It is a new regime with reporting entities at various stages on their disclosure journey. This will present challenges for all, but the general insurance sector is up for the task. Indeed, we have the first financial sector to develop climate-related scenarios consistent with the requirements of the Exposure Draft. This will support our members as they draw on that to inform the impacts for their own organisations. We have also shared our work with other sector organisations so they may gain insights from the work we have done and in time we hope to gain insights from the work they have done.

ICNZ commends the XRB on its approach to developing the standards. Consultation has been exemplary throughout. The XRB has an extremely well-informed team that has kept itself informed of international developments that have been occurring in parallel to inform these standards. It has provided deep dive sessions to help reporting entities understand their proposals. Each standard is accompanied by a section that clearly explains the rationale for the XRB's position and there is comprehensive guidance to support the interpretation of the standards. I cannot recall a better approach.

The XRB's standards have steered a course toward principles rather than prescription. In our view, this is appropriate particularly given the nascent stage of reporting. Such an approach though does mean that standards are more open to interpretation by regulated entities as to how they interpret their obligations. Equally, for the regulator, the Financial Markets Authority (FMA), it leaves open how it will interpret the standards and the expectations it will set. As with all principles-based regulation, the devil is always in the detail.

We have been encouraged though by signals from the XRB and the FMA that they do not expect perfection from the beginning. This is the start of a new phase in financial reporting and almost all reporting entities have a long way to go to develop their capabilities to meet climate change disclosure obligations. The same would be true of regulators.

We have submitted to the draft Governance and Risk as well as the Strategy and Measures and Metrics consultation rounds that preceded the development of the exposure draft. In those submissions, we sought greater clarity and guidance to better understand the intent and implications of those drafts. The XRB has responded by acknowledging some of the challenges for first time reporting entities and has through NZSC2 provided broader adoption provisions. We support this. The XRB has also provided extensive explanations and guidance around the three standards which addresses many of our previous concerns. For this reason, our submission only raises a few points for consideration as we largely support the exposure draft.

We submit the following observations for the XRB to consider in either providing additional guidance or amendment to the standards as appropriate.

- (1) Reporting entities will need to interpret what they believe to be current impacts of climate change in relation to 'normal' weather events. For general insurers, the material impact of weather events is reflected in claims and given our access to historical claims data we are able to estimate to some extent the impact of climate change through trends in losses which indicate the growing impact of climate change. Without these trends and noting the guidance states climate attribution is not required (2.3.1 paragraph 3), it is doubtful whether reporting climate impacts will be useful to primary users. There is likely to be inconsistency in how reporting entities choose to report and how they interpret the data they see. Insurers are all generally aligned in terms of how they report on and measure claims relating to severe weather, but other sectors will not be. Even so primary users will be more interested in the attribution data, but it certainly not possible to report this. They will also look for comparability of reported data. Further guidance will be needed about the reporting of trends for all reporting entities.
- (2) It is still not sufficiently clear to us how useful it is to disclose to primary users all anticipated impacts that are reasonably expected if they do not also take into account the mitigation steps that can be taken to avoid these impacts. We acknowledge that the mitigation steps will be addressed in the disclosure of transition plans. However, the technical aspects of how this is presented in a disclosure and how the impacts are explained and quantified will still need to be worked through. More work is required to ensure this information is useful to primary users.
- (3) It would be helpful if the XRB in its guidance could clarify whether an assurance engagement at parent level is sufficient for the New Zealand entity. We believe that is the case as long as there is a standalone document relating to the New Zealand entity. Certainty about this interpretation would assist.
- (4) Following the initial consultation on Governance and Risk Management, the XRB decided to depart from the approach taken by the TCFD and removed insurers from being a primary user. Our understanding of the rationale was that insurers would be able to obtain the information they needed when underwriting, so their inclusion was not necessary. A consequence of this decision has meant that the Guidance document has focused on investor needs as a primary user. This may lead to some unintended consequences for investors.

As the XRB will be aware, the TCFD literature identifies physical, transition and liability risks associated with climate change. The XRB's approach considers liability risks, including litigation risk, to be part of transition and that transition planning will also incorporate adaptation to climate risks. This may create a potential problem due to the lack of clarity around the need to identify and disclose actions or lack of action to address climate change impacts which could harm third parties and lead to litigation. The extent of the financial exposure to such litigation may be hard to assess but would be highly relevant to investors. Under the XRB's proposal it is far from clear that investors would be able to see from the disclosures that are required to be made whether a reporting entity was insured for liability in this respect or even whether they were sufficiently insured. It is certainly not commonplace to disclose insurance liability cover for commercial reasons.

The standards which apply from 1 January 2023 appear to be forward looking from that date. Under 14 (b), reporting entities must disclose the anticipated financial impacts of climate-related risks and opportunities reasonable expected by an entity. It would be helpful to confirm that if a reporting entity has as yet a potential but unrealised liability for any actions prior to 1 January it would be required to disclose that potential. As we know, liability claims may manifest themselves many years later and result in very significant costs.

If the XRB is of the view that insurers should not be considered to be primary users, it would be important for it to expand its guidance in this area so reporting entities have a clear signal about what is expected to be covered.

Over-arching comments

ICNZ supports making climate-related disclosures. Disclosure informs primary investors about climate risks and supports the efficient allocation of capital to support a smooth transition to a net-zero carbon economy. The integration of climate risks into an organisation's overall strategy with supporting metrics and targets will help inform climate reporting entities (CREs) themselves about the risks and opportunities open to them, and how they are managing those risks or achieving the opportunities they have identified. It is noteworthy that insurers are significant investors and therefore are primary users too. From this dual perspective, we see a careful balance needs to be applied to determine how much information is both necessary and sufficient to inform a primary user's decisions, and what can reasonably be expected of CREs when starting on the journey of climate disclosure. ICNZ members in particular recognise the need to focus more on climate change and emissions reduction, given the effect we are already seeing through increasingly severe and frequent weather events. Our feedback here is not intended to detract from the level of

ambition, and our country's net zero goal, but to manage the technicalities around reporting of this information for CREs.

The draft Strategy and Targets & Metrics standard requires broad and detailed disclosures. We reference in particular the definition of materiality in terms of the breadth of disclosure, combined with TCFD guidance which suggests CREs should stray on the side of disclosure, to indicate that there is little that ought not be disclosed. At the same time, some of the XRB's specific requirements to disclose potential impacts on cash flows, financial statements and financial performance demand a lot of detail that will be extremely challenging to provide at the outset. It would be good to understand if the XRB has engaged with auditors on how they will treat this information when it forms part of an annual report and to reflect that in the Guidance.

Overall, the XRB's draft is weighted to requiring the maximum information to be disclosed from the outset in most instances. We question whether the XRB has fully anticipated how much work and resource this will require of CREs, many of whom will be starting from a reasonably immature base. We acknowledge that the XRB in its deep-dive sessions that supported the release of the draft have provided examples that reflect brief, high-level reporting and have stressed that perfection is not expected from day one. Even so, there is evidence from overseas that entities who are already reporting under the TCFD framework have struggled with some aspects, especially around articulating the financial impacts of climate risks. This ought to be a signal not to expect too much too soon from CREs and to stray on the side of providing more guidance and more time to implement some aspects.

These considerations lead us to submit that the XRB should remove the requirement to provide an explanation of why a reporting entity is not disclosing current or anticipated financial impacts in Year 1. We believe this is the first-time adoption provision that will be most utilised. We propose that the XRB need to set the expectation that while they welcome disclosure of this information in Year 1, if CREs are not ready to disclose it in Year 1 they do not have to explain why they are not doing so. This would help to remove some pressure, while still making clear that CREs need to meet the requirements in Year 2. We believe this is further justified when one considers the wording in the Guidance around this which says, 'an entity should provide a brief description of the process it has followed in attempting to quantify the financial effects of the anticipated climate-related impacts it faces.'

Consistency and comparability of reporting has been emphasised by the XRB. We agree. Indeed, it will also be important for government entities and financial sector regulators to utilise the same approach and terminology as outlined in the XRB requirements, when examining climate risk for relevant institutions. For instance, it would be most unhelpful if reporting entities were required to address the same topics in different ways for different

audiences, such as, for prudential supervision. The XRB's requirements, which have tried to align with emerging international standards, will be a basic standard for companies to meet going forward. As such, we would encourage the XRB to ensure other government bodies are also comfortable with the requirements, and willing to use them for their own purposes, prior to final publication of them in December.

Response to XRB's specific questions

Will draft Aotearoa New Zealand Climate Standards meet primary user needs?

- a) Do you think that the proposed disclosure requirements will provide information that is useful to primary users for decision making? If not, please explain why not and identify any alternative proposals.**

Yes, we think the proposed disclosure requirements will be useful to primary users for decision making.

- b) Do you consider that draft Aotearoa New Zealand Climate Standards are clear and unambiguous in terms of the information to be disclosed? If not, how could clarity be improved?**

Apart from the points we have noted above, we consider the draft standards to be clear and unambiguous.

- c) Do you consider that draft Aotearoa New Zealand Climate Standards are comprehensive enough and achieve the right balance between prescriptiveness and principles-based disclosures? If not, what should be removed or added to achieve a better balance? Please consider your answer to question 5 when responding to this question.**

Yes, but this is qualified by our other comments in this submission.

- 2) Do you have any views on the defined terms in draft Aotearoa New Zealand Climate Standards?**

These are clear.

- 3) Do you have any practical concerns about the feasibility of preparing the required disclosures in draft Aotearoa New Zealand Climate Standards? In responding to this question, please consider the proposed first-time adoption provisions in NZ CS 2 and your answer to question 4. Please also clearly explain what would make the specific disclosure unfeasible to disclose against either in the immediate term or the longer term.**

Our view is that this is heavily dependent on individual member's capability/capacity issues as well as the broader issues related to reporting Scope 3 GHG emissions for underwriting. More generally, the breadth and depth of disclosure requirements does raise questions about the resourcing required. It should not be underestimated how large the uplift required will be for most organisations, and also how broad the impact of these disclosure requirements will be on these entities.

4) Do you agree with the proposed first-time adoption provisions in NZ CS 2? Why or why not?

We support the new adoption provisions especially that around Scope 3, given the lack of an agreed methodology for underwriting emissions currently.

Reflecting our earlier comments, we also request the removal in Year 1 of the need to explain why a reporting entity is not disclosing current or anticipated financial impacts.

a) Are any additional first-time adoption provisions required? If so, please provide specific details regarding the adoption provision and the disclosure requirement to which it would apply, and the period of time it would apply for.

We have nothing further to add.

5) Do you think the draft staff guidance documents will support CREs when making their disclosures and support consistent application of the disclosure requirements? Why or why not?

The draft Guidance is helpful and supports the disclosure requirements. We have referred above to some areas where further guidance may assist and also the need not to underestimate the breadth of disclosure required.

As the Guidance is far more detailed than the requirements, there could be a risk of entities following the letter of the Guidance, but the regulator finding that they have not met the requirements. It would be useful for the Guidance to be clear about how such a situation will be avoided.

While the Guidance is a useful starting point, it may be that as entities engage in the specifics of producing the disclosures, they realise that they have more questions to ask. We recommend that the XRB – or the FMA - consider giving support in a real time way as entities produce their disclosures. Unless this is provided, there will be a need to accept a very high level of variability in the early years as entities make different assumptions about what requirements mean for them.

a) Do you think the guidance is under, adequately or overly specific and granular?

The draft Guidance generally hits the right balance, but we believe it would benefit from some refinement and we identify some specific areas for improvement.

- The Guidance is quite repetitive, in that it lists the disclosure requirements, then lists them again when giving guidance on each point. There is no need to list all the disclosure requirements up front as this can be obtained from NZCS1.
- Although some international examples are given, it would be helpful if the XRB updated the Guidance document after the first New Zealand reports have been published to include tangible examples of best practise by New Zealand entities.
- We acknowledge the need to provide a broad range of examples, but very few examples given in the Guidance are relevant to the insurance, or even financial, sector. Specific Guidance for insurers, keeping in mind the particular challenges we face, would be very helpful and improve consistency across disclosures. Table 4 on p19 is a good example of where it does not really help insurers or banks at all.
- One thing the Guidance does not do is integrate the NZCS3 requirements around materiality, principles etc, or give any additional detail on these. It would seem to make sense that when walking through each disclosure requirement that the XRB gives specific guidance on how to consider materiality etc, otherwise one has to refer back to NZCS3 at the same time.
- Also, in terms of integration, it would be useful to incorporate guidance from other bodies within the XRB guidance document, rather than expecting users to read multiple documents from different bodies. For example, on p36 XRB suggests that a reader reviews all the risk management guidance provided by TCFD, before reviewing this section of the XRB guidance. It is already challenging for a reader trying to read the guidance in light of the NZCS1-3 requirements, so adding a whole additional section to review makes it more challenging. It would be more helpful to provide a summary of the TCFD guidance within the Guidance document.
- The cross-Industry metrics guidance on p.49 does not provide any advice on how entities should deal with a lack of methodology available for specific sectors and emissions sources. This is the situation insurers face currently in with respect to guidance on reporting the exposure of underwriting to S3 emissions.

- It would also be helpful to provide a high-level overview document of the disclosures required and over what timeframes (Year 1, Year 2 etc).

b) Do you consider that anything in the guidance should be elevated into the standard? Should anything be demoted from the standard into guidance?

Further to our earlier comments about reporting climate trends in lieu of climate attribution, we believe it would be useful to elevate from the Guidance the reference to not having to report climate attribution data. In elevating this point, it would also be useful to clarify what the XRB expects to be reported with respect to climate trends.

Additionally, we note the definition of current financial impacts is now not included in the disclosure requirements but is in the definitions section. It would be much clearer to a primary user if it is part of the requirements (in terms of the reference to financial performance, financial position and cash flows).

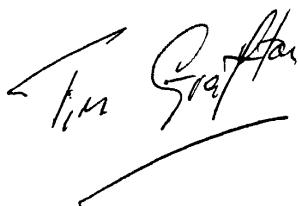
6) Paragraphs 13 to 19 of draft NZ CS 3 are the proposed location of disclosures requirements. Paragraphs BC14 to BC20 of the basis for conclusions on draft NZ CS 3 explain the XRB Board's intent regarding these proposed requirements. Do you agree with the proposed location of disclosures requirements? Why or why not?

What is proposed is reasonable. It provides flexibility as to where the climate disclosures are made such as in an annual report or in a stand-alone document. It makes it clear that wherever the disclosure is made it needs to meet accessibility and fair representation requirements and provide cross-referencing to assist both requirements.

Conclusion

Thank you again for the opportunity to submit on the draft Exposure Standards and the Guidance Document. If you have any questions, please contact me on tim@icnz.org.nz or by phoning 027-270-9084.

Yours sincerely,



Tim Grafton
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