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Tēnā koe April

### **Exposure Drafts Aotearoa New Zealand Climate Standards**

Thank you for the opportunity to comment on the External Reporting Board's (XRB's) Exposure Drafts:

- Aotearoa New Zealand Climate Standard 1: *Climate-related Disclosures* (NZ CS 1);
- Aotearoa New Zealand Climate Standard 2: *First-time Adoption of Aotearoa New Zealand Climate Standards* (NZ CS 2); and
- Aotearoa New Zealand Climate Standard 3: *General Requirements for Climate-related Disclosures* (NZ CS 3).

### **Our general comments and support for the proposed climate framework**

We commend the XRB and staff for working at great speed to issue the draft standards and for keeping them short, succinct and at a principles-based level. We also commend the XRB and staff for the level of engagement and communication undertaken in developing these draft standards. We recognise the enormity and complexity of the task that the XRB and staff have undertaken in a very short period of time.

It is important for users to have trust and confidence in the entities that produce climate statements that comply with the XRB's climate standards. Climate standards help ensure high-quality reporting by entities to their stakeholders and promote transparency and accountability for the entity's climate-related actions. It is therefore important that the climate standards are appropriate for all climate reporting entities.

We support the proposed climate-related framework and many of the proposals in the exposure drafts. We consider it important that the concepts and methodologies in the draft standards align, as appropriate, with international standards and frameworks. This gives credibility to the proposed standards and the climate-related information that entities report. We believe the proposals in the draft standards are generally suitable for the majority of the entities that are climate reporting entities. This includes the for-profit entities in the public sector that are climate reporting public entities (for example, Air New Zealand, the port companies and the mixed ownership model companies).

### **Our specific comments on public sector public benefit entities (PBEs)**

Climate-related information disclosed by an entity must be comprehensive and reflect the entity's operating model and activities. It is therefore important that the XRB's climate standards are also appropriate for the small number of public entities that are PBEs and are climate reporting entities (currently Auckland Council, Kāinga Ora – Homes and Communities and Accident Compensation Corporation). However, the draft standards being

for-profit focused are not sector-neutral or future-proofed and may result in climate statements that do not meet the information needs of the stakeholders of public entities that are PBEs.

Limiting the primary users of the climate statements of a public entity that is a PBE to a narrow group (the investors, lenders and creditors) and defining materiality for the disclosure of climate-related information in terms of “enterprise value” (a concept which is largely irrelevant to public entities that are PBEs) risks important aspects of public sector climate reporting being omitted or the reporting requirements that are drafted in for-profit terms being unclear in their application.

We raise the following key issues in relation to public entities that are PBEs for the XRB to consider:

- **NZ CS 1 – Definition of “primary users”** [See our response to Question 2]  
The definition is inappropriate for the climate reporting public entities that are PBEs (currently Auckland Council, Kāinga Ora – Homes and Communities and Accident Compensation Corporation). The definition focuses on the primary users of for-profit entities and is inconsistent with the statutory purpose for the climate standards and climate-related disclosures set out in the Financial Reporting Act 2013. Under the Act, the purpose of climate standards is not limited to enabling assessments by the “primary users” (as defined) but also includes enabling assessments by “other stakeholders”. (This applies to all climate reporting entities, not just those entities that are PBEs.)

We recommend the inclusion of “other stakeholders” in the definition of “primary users” and that the guidance encourages climate reporting entities to consider the needs and interests of their wider stakeholders in their climate reporting.

- **NZ CS 3 – Definition of “material” and linkage to “enterprise value”** [See our response to Question 2]  
The definition of “material” is linked to “enterprise value” with the relevant audience being the “primary user” as defined. The linkage is inappropriate for those public entities that are PBEs due to its focus on elements that are for-profit focused. The definition of “material” is inconsistent with the requirement in draft NZ CS 1 for entities to think more broadly about climate-related risks and opportunities. It is also not useful as a means of encouraging entities to think more specifically about its impact on climate.

We recommend that the definition of “material” not be linked to “enterprise value”.

- **Draft staff guidance – Public sector-specific guidance** [See our response to Question 5]  
Given the short comment period for the draft standards, we have not reviewed the draft staff guidance in detail. However, we note that, like the draft climate standards, NZ CS 1: *Guidance for all sectors* and NZ CS 1: *Guidance for MIS Managers* are focused on assisting for-profit entities to apply the climate standards.

We recommend that the XRB discuss with the climate reporting public entities that are PBEs to provide specific public sector guidance to assist those PBEs when applying the climate standards, including the need to think more broadly about their other stakeholders.

Our comments on the individual Questions and on matters specific to public entities are set out in Appendix 1: Responses to the Questions.

If you have any questions about our submission, please contact Lay Wee Ng, Technical Specialist, at [laywee.ng@oag.parliament.nz](mailto:laywee.ng@oag.parliament.nz).

Nāku noa, nā



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Controller and Auditor-General

## Appendix 1: Responses to the Questions

- 1) Do you think draft Aotearoa New Zealand Climate Standards will 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.
  - 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?
  - 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.

We support the principles-based disclosures in the draft standards with more detailed guidance being set out in supporting guidance documents. It is important that guidance material can be updated promptly in a fast-developing area. We also support the need for entities to consider climate-related risks and opportunities more broadly and the requirement to separately disclose offsets to the GHG emissions.

Subject to our comments in the cover letter and under Question 2 in relation to public entities that are PBEs, we consider that the draft climate standards will meet the needs of the for-profit entities' primary users (as defined).

We raise the following areas for the XRB's consideration.

### **NZ CS 1 Climate-related Disclosures**

#### **NZ CS 1 - Disclosure Objective for Strategy**

Paragraph 9 of draft NZ CS 1 proposes that the disclosure objective for Strategy as:

“To enable primary users to understand **how climate change is currently impacting an entity and how it may do so in the future**. This includes the scenario analysis an entity has undertaken, the climate-related risks and opportunities an entity has identified, the anticipated impacts and financial impacts of these, and how an entity will position itself as the global and domestic economy transitions towards a low-emissions, climate-resilient future.” [emphasis added]

We consider that the objective for Strategy should be about what the entity proposes to do and the actions it proposes to take to address current and future impacts of climate risks and opportunities. It is not just about how climate change impacts the entity. We suggest that the first sentence of the disclosure objective for Strategy in draft NZ CS 1 be reworded to:

“To enable primary users to understand how climate change is currently impacting an entity and how it may do so in the future and the entity's response.”

#### **NZ CS 1 - “Aligned with science”**

Draft NZ CS 1 requires, for each GHG emissions target, the disclosure of (among other matters) whether the target is “aligned with science” and if so, whether it has been validated by a third party (paragraph 22(e)(ii), draft NZ CS 1). The term “aligned with science” is not defined.

We consider it is more useful for entities to disclose the basis of the target and whether it has been validated by a third party rather than to determine whether it is “aligned with science”. It may not always be easy to determine (or have general agreement on) what is, or is not, “aligned with science” in a rapidly developing area, particularly in the absence of a clear definition.

## **NZ CS 1 - GHG emissions disclosures**

The initial consultation on Strategy and Metrics and Targets (SMT) proposed the disclosure of the source of GHG emissions factors, the global warming potential rates used and a summary of exclusions. These disclosures were proposed to enable primary users to understand how GHG emissions have been calculated. However, following consultation feedback, paragraph BC48 of draft NZ CS 1 states that the disclosure for the source of GHG emissions factors and global warming potential rates was removed as there was no specific support for this disclosure.

We disagree with the removal of these disclosures. We consider that the information is fundamental to an understanding of how GHG emissions have been calculated and to the credibility of the GHG information.

We recommend that these disclosures be required to be disclosed.

## **NZ CS 1 - “Limited assurance” over the three Scopes of GHG information**

In our submission to the XRB on consultation paper *Strategy and Metrics and Targets*, we stated that we consider that “reasonable assurance” should be expected for Scope 1 and Scope 2 emissions information to give greater assurance of the reliability of the information and that “limited assurance” is the most that should be expected for Scope 3 information until there is a better understanding of the feasibility and cost/benefit considerations for requiring reasonable assurance.

Draft NZ CS 1 continues to prescribe a minimum of “limited assurance” over the three Scopes of GHG information, albeit it provides an exemption for the disclosure of Scope 3 emissions in an entity’s first reporting period in draft NZ CS 2.

We question why the climate standards for preparers should set the level of assurance expected. This would seem better placed in the assurance standard for climate related disclosures.

If the XRB continues with the minimum of “limited assurance” then we recommend that the XRB reconsiders the level of assurance over the Scopes of GHG information, particularly in relation to Scope 1 and Scope 2, when it carries out its post-implementation review<sup>1</sup> of the climate-related disclosure framework.

## **NZ CS 1 - Definition of Scope 3 and GHG sources [*Public entity-specific issue*]**

The definition of Scope 3 includes categories of greenhouse gas emissions (GHG) sources that are taken from the GHG Protocol. Scope 3 is defined as:

“Other indirect GHG emissions not covered in scope 2 that occur in the value chain of the reporting entity, including upstream and downstream GHG emissions. Scope 3 categories are purchased goods and services, capital goods, fuel-related and energy-related activities, upstream transportation and distribution, waste generated in operations, business travel, employee commuting, upstream leased assets, downstream transportation and distribution, processing of sold products, use of sold products, end-of-life treatment of sold products, downstream leased assets, franchises, and investments.”  
(page 13, draft NZ CS 1)

This list of categories of GHG sources for Scope 3 may not be suitable, or complete, for a public entity that is a PBE. For example, not all goods and services and capital goods of a public entity that is a PBE are “purchased” (they may be acquired through non-exchange transactions”) and not all their products are “sold” (they may be provided free of charge). We note that the Glossary of the *GHG protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard* defines “Downstream emissions” as:

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<sup>1</sup> We note that the XRB has committed to begin a post-implementation review of the climate-related disclosure framework no later than December 2025.

“Indirect GHG emissions from sold goods and services. Downstream emissions also include emissions from products that are distributed but not sold (i.e., without receiving payment)”.

However, it is still not clear whether any of the above listed categories capture some of the services that a Council provides to residents or the use of Council provided goods or services by residents. For example, are emissions from vehicles using roads provided by a Council included within a Council's emissions?

We recommend that Scope 3 includes categories (and guidance) of GHG sources that are appropriate to public entities that are PBEs.

### **NZ CS 3 General Requirements for Climate-related Disclosures**

#### **NZ CS 3 - Aligning group GHG emissions disclosures with the financial reporting entity**

Draft NZ CS 3 requires an entity to prepare its climate-related disclosures for the same reporting entity as its financial statements. If the reporting entity is a group comprising a parent and its subsidiaries, the climate-related disclosures are reported in respect of that group. Given the availability of existing globally accepted and commonly used GHG emissions measurement and reporting standards, draft NZ CS 3 does not mandate a single approach or require a particular consolidation approach (for example, equity share, operational control or financial control). Instead, an entity is required to disclose the standard it uses to measure its GHG emissions, the GHG emissions consolidation approach used and a summary of specific exclusions of sources, facilities and/or operations with a justification for their exclusion (paragraph 23, draft NZ CS 1).

We agree that an entity's climate-related disclosures should be for the same reporting entity or group as its financial statements.

However, as the choice of consolidation approach can move emissions between Scopes, we recommend that, for clarity, paragraph 23 of draft NZ CS 1 also requires the disclosure of the extent to which the GHG emissions consolidation approach differs from the consolidation approach used in financial reporting. This is important, as financial information such as those required to be disclosed by paragraph 21 of draft NZ CS 1 (for example, total revenue for an intensity factor or capital expenditure under 21(f)) will differ from information reported in the financial statements.

#### **NZ CS 3 - Scenario analysis methodologies and assumptions**

Paragraph 50 of draft NZ CS 3 requires the disclosure of the methodologies and assumptions underlying the climate-related scenarios used, and the scenario analysis process employed. Among other disclosures, it requires, under paragraph 50(a)(iii):

“a description of the various emissions reduction pathways in each scenario and the key assumptions underlying pathway development over time, including the scope of operations covered, policy and socioeconomic assumptions, macroeconomic trends, energy pathways, carbon sequestration from afforestation and nature-based solutions and technology assumptions including negative emissions technology”.

Not all of the matters listed in paragraph 50(a)(iii) will be relevant for all climate reporting entities. We suggest that paragraph 50(a)(iii) be reworded to:

“a description of the various emissions reduction pathways in each scenario and the key assumptions. This may include the underlying pathway development over time, including the scope of operations covered, policy and socioeconomic assumptions, macroeconomic trends, energy pathways, carbon sequestration from afforestation and nature-based solutions and technology assumptions including negative emissions technology”.

## NZ CS 3 - Restatements

Paragraph 45 of draft NZ CS 3 requires an entity, when deciding whether to restate comparative information (for reasons other than for correcting material errors) to consider the needs of its primary users and should restate comparatives if this provides the most decision-useful information.

We consider that paragraph 45 should require an entity to restate the comparative information for any material changes (individually or cumulative) where practicable, such as changes in emission sources (for example, new Scope 3 sources added), revised emission factors (for example, where the entity has provisionally used a 2020 electricity factor for the 2022 year due to a time lag in available data) or changes in methodologies. This would be akin to a change in accounting policy which is required to be retrospectively applied unless impracticable, to enable comparability overtime. If the comparative information is not restated, the reasons for not restating should be required to be disclosed for each relevant subsequent year where the comparative information is disclosed.

Paragraphs 51 to 53 of draft NZ CS 3 includes a requirement to provide an explanation for any base year GHG emissions restatements.

We consider that there should be clear disclosure requirements for any material changes in the emissions sources included between the base year and current reporting period, including when the base year has not been restated. We recommend that entities be required to disclose, in subsequent years, that emission sources have changed but where the base year has not been restated.

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

As stated in our previous submission on consultation paper *Governance and Risk Management*, some of the proposed terminology and definitions in draft NZ CS 1 are not sector-neutral or future-proofed. We recommended that the XRB reconsidered the terminology, definitions and the language used to ensure they are sector-neutral and future-proofed. Sector-neutral definitions and terminology can be accompanied by guidance material that interprets the terminology for application in each sector.

Other than changing the term “Board” to “governing body” (which we support), the draft standards have generally retained the terminology, definitions and the language from the earlier drafts. We raise the following key terms for consideration.

### **NZ CS 1 - Narrow definition of “primary users” [Public entity-specific issue]**

Draft NZ CS 1 defines “primary users” as “existing and potential investors, lenders and other creditors”.

We note the XRB’s reasons for the narrow the definition<sup>2</sup>. However, we continue to disagree<sup>3</sup> with a definition of “primary users” that is focused on the primary users of for-profit entities. While appropriate for for-profit public entities, the definition is not suitable for those public entities that are PBEs and are climate reporting entities. The nature of these public entities, as public benefit entities, is not changed because it is a climate reporting entity by way of having listed debt securities (Auckland Council) or by Ministerial direction for Crown financial institutions (for example, Accident Compensation Corporation).

We consider that the narrow definition of “primary users” is inconsistent with the statutory purpose for the climate standards and climate-related disclosures set out in section 19B of the Financial Reporting Act 2013 (the Act)<sup>4</sup>. Under the Act, one of the purposes of climate standards is to “...enable investors and other

<sup>2</sup> As set out in paragraphs BC25 and BC26 of draft NZ CS 3.

<sup>3</sup> See our previous submissions to the XRB on consultation papers *Governance and Risk Management* dated 22 November 2021 (<https://www.xrb.govt.nz/dmsdocument/4217>) and *Strategy and Metrics and Targets* dated 2 May 2022 (<https://www.xrb.govt.nz/dmsdocument/4516>).

<sup>4</sup> Section 19B of the Financial Reporting Act 2013 states:

**“Purpose of climate standards and climate-related disclosures**

The purpose of climate standards is to provide for, or promote, climate-related disclosures, in order to —

stakeholders to assess the merits of how entities are considering those risks and opportunities”. Not including “other stakeholders” in the definition of primary users, in our opinion, does not meet the legislative purpose.

Unlike the International Sustainability Standards Board (ISSB) who issues standards for the for-profit sector, the climate standards issued by the XRB should be applicable to both for-profit entities and public benefit entities.

The definition of “primary users” is narrowly focused and not sector-neutral. It has the potential to limit the ability of the public entities that are PBEs to apply the climate standards appropriately and comprehensively to their operating model and activities. The impacts of climate, including the associated risks and opportunities on their operating model and strategies and the metrics and targets that are selected may not be as comprehensive when compared to having to report to broader stakeholders that are relevant to the public entities that are PBEs. This may affect the quality of reporting to their stakeholders and undermine trust and confidence in the climate-related information of those public entities.

### **NZ CS 3 - Narrow definitions of “material” and “climate related disclosures” [Public entity-specific issue]**

We note that draft NZ CS1 would require entities to think more broadly about the anticipated impacts of climate-related risks and opportunities, not just the financial impacts.

However, draft NZ CS 3 continues to define “material” in the context of “enterprise value”<sup>5</sup> with the relevant audience being the “primary user” (as defined):

“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.”

Similarly, draft NZ CS 3 contains a narrow definition of “climate related disclosures”:

“Disclosures about climate-related risks and opportunities that are useful to primary users when they assess, and make decisions about, an entity’s **enterprise value**, including information about its governance, strategy and risk management, and related metrics and targets.” [emphasis added].

We disagree with the definitions for “material” and “climate related disclosures”. Both definitions are for-profit-focused and based on, among other financial information, market capitalisation and the defined primary users’ assessment of future cash flows. While appropriate for for-profit public entities, these definitions are inappropriate for public entities that are PBEs:

- the definition of material and its basis on market capitalisation is not appropriate for entities that are PBEs;
- the elements contained within the definition of enterprise value are generally not relevant for public entities that are PBEs; and
- linking the climate related disclosures definition to assessing and making decisions about enterprise value does not work for public entities that are PBEs.

We recommend that the definition of “material” not be linked to enterprise value as we do not think it is necessary or appropriate.

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(a) encourage entities to routinely consider the short-, medium-, and long-term risks and opportunities that climate change presents **for the activities of the entity or the entity’s group**; and

(b) enable entities to show how they are considering those risks and opportunities; and

(c) enable **investors and other stakeholders** to assess the merits of how entities are considering those risks and opportunities.” [emphasis added]

<sup>5</sup> Draft NZ CS 3 defines “enterprise value” as: “Market capitalisation of an entity plus the market value of the entity’s net debt. It is determined by capital market participants, based on their estimation of the amount, timing and certainty of future cash flows spanning the short, medium and long term. Enterprise value reflects primary users’ assessments of future cash flows, including the value attributed to those cash flows by primary users. Essential inputs in determining enterprise value include corporate reporting in financial statements, as well as reporting on climate-related risks and climate-related opportunities that are reasonably likely to affect the entity’s business model over time (that is to say, affect revenue, costs, assets, liabilities, cost of capital and/or risk profile). The term captures the notion of expected value creation, preservation or erosion over time for an entity’s primary users.” [emphasis added]

Unlinking the two concepts is:

- More consistent with the requirement in draft NZ CS 1 for entities to think more broadly about climate-related risks and opportunities on its business model and activities;
- More appropriate for public entities and those entities that do not have share capital or a readily available share price; and
- More useful as a means to encourage entities to think more broadly and specifically about its impact on climate.

If the linkage to enterprise value is retained, we recommend that the definition of “enterprise value” be amended for public sector PBEs.

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.

Subject to our comments in the cover letter and under Questions 1 and 2 about the appropriateness of the draft standards for public entities that are PBEs, we make the following comments about practical challenges of preparing the required disclosures in draft Aotearoa New Zealand Climate Standards.

### **NZ CS 1 - Scenario analysis**

Draft NZ CS 1 proposes that an entity must describe the scenario analysis it has undertaken to help identify its climate-related risks and opportunities and better understand the resilience of its business model and strategy. It proposes that this must include a third climate-related scenario in addition to the, at a minimum, a 1.5 degrees Celsius climate-related scenario and a 3 degrees Celsius or greater climate-related scenario (paragraph 12 of draft NZ CS 1). The Basis for Conclusions states that the requirement for a third scenario was added to avoid two scenarios being seen as opposites or “good and bad”.

We do not consider that a third scenario should be mandatory. Scenario analysis is challenging and potentially costly to undertake and we do not consider that the cost-benefit of requiring a third scenario is justified, or has been justified in the Basis for Conclusions. We consider that the disclosure of two scenarios (a 1.5 degrees Celsius climate-related scenario and a 3-degrees Celsius or greater climate-related scenario) will, in most cases, be sufficient. The standard could encourage, rather than mandate, a third scenario where it is considered that third scenario will provide material information to stakeholders.

### **NZ CS 1 - Assurance over scope 3 value change emissions**

While we support the disclosure of Scope 3 value chain emissions as part of this standard, in our submission to the XRB on consultation paper *Strategy and Metrics and Targets*, we expressed our concern about the practical challenges of providing assurance over Scope 3 information. Much of the emissions information relies on external suppliers and it is unclear whether suppliers currently have the systems in place to provide this information.

We suggested that, as an alternative, to allow entities a longer transition period to comply with the Scope 3 disclosures and with any corresponding assurance requirements. As such, we support the exemption from Scope 3 disclosures for an entity’s first reporting period in draft NZ CS 2.

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



However, we consider that the requirements relating to comparative information and their assurance need to be clarified.

Draft NZ CS 2 provides a number of disclosure exemptions for an entity when it first applies the climate standards. However, it is silent on how initial application of the assurance requirements will work and whether the emissions information that was produced prior to the commencement of the assurance regime will need to be assured in future years when it is presented as comparative information.

We recommend that NZ CS 2:

- clarifies how initial application of the assurance requirements will work and whether the emissions information that was produced prior to the commencement of the assurance regime will need to be assured in future years when it is presented as comparative information. Alternatively, this could be addressed in the assurance standard; and
- requires the climate statement to make clear which comparative years presented have not been subject to an assurance engagement.

- 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?
- a) Do you think the guidance is under, adequately or overly specific and granular?
  - b) Do you consider that anything in the guidance should be elevated into the standard? Should anything be demoted from the standard into guidance?

Given the short comment period for the draft standards, we have not reviewed the draft staff guidance in detail. However, we note that, like the draft climate standards, NZ CS 1: *Guidance for all sectors* and NZ CS 1: *Guidance for MIS Managers* are focused on assisting for-profit entities to apply the climate standards.

We recommend that the status of the guidance material as non-mandatory material be clearly stated at the front of the guidance.

#### **Need for public sector-specific guidance [*Public entity-specific issue*]**

We consider the guidance can be useful to support for-profit climate reporting entities, including for-profit public entities, when making their disclosures. However, we do not consider that the draft staff guidance, by being for-profit focused, is likely to be useful for those public entities that are PBEs.

We recommend that the XRB consults with public entities and provide guidance that is specific to public sector in the staff guidance to assist public entities that are PBEs to apply the climate standards.

- 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?

We agree with the proposed location of disclosures requirements.