

November 22<sup>nd</sup> 2021

## NZSA response to NZCS1 – Governance and Risk Management

The NZ Shareholders' Association would like to thank the External Reporting Board for the opportunity to comment on their initial draft of *NZCS1 – Governance and Risk Management*, as part of the climate-related disclosure framework.

We also look forward to commenting on the *Strategy* and *Metrics and Targets* components of the framework as they are released in March 2022.

### Overall Commentary on NZCS1

- 1) **An enduring strategy:** NZSA recognises the significance of climate-related risks for investors. We believe that in the long-term, an organisation-wide focus on sustainability will be for the benefit of shareholders.
  - a) We support the XRB's approach to incorporate and relate climate-related risks to an organisation's strategy.
  - b) We would expect clear disclosure of the risks and opportunities associated with climate change on an organisation's business (although recognise this will be addressed in the *Strategy* section of the framework).
- 2) **Transition:** The XRB notes that an aim of CS1 is to ensure "*more informed capital allocation decisions, both within an entity and by investors into an entity*".
  - a) For organisations currently involved in carbon-intensive industries, NZSA will encourage organisations to prepare a transition roadmap, to provide assurance to investors that the organisation can sustain investor value.
- 3) **Long-term value:** NZSA is pleased that the XRB does not intend for CS1 to simply be a compliance exercise. We prefer a broad approach to the treatment of climate-related risks in organisations, that aims to support long-term value for investors.
- 4) **Scope:** We note the applicability of the proposed Bill to Climate Reporting Entities, including all listed entities with a market capitalisation greater than NZ\$60m and managed investment scheme (MIS) with assets greater than \$1 billion.

- a) We are concerned at the potential for unlisted MIS' to escape disclosure due to the relevant threshold.
  - b) NZSA feels this acts as a dis-incentive for companies to list on public markets and (for those already listed) increases costs relative to unlisted entities of a similar scale.
  - c) We feel that the consultation document had assumed an MIS dealing in financial securities. However, not all MIS' manage these types of assets. For example, there is scope for a listed property entity to be subject to mandatory climate change disclosures, while a larger *unlisted* property MIS will escape the requirement.
  - d) NZSA would prefer a **single, consistent threshold** (perhaps based on total assets) regardless of listing status.
- 5) **Global Alignment:** NZSA is pleased that the NZ Climate Change Disclosure framework will be based on the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).
- a) This forms an efficient mechanism to align NZ disclosures with an international standard.
  - b) We appreciate the XRB's comments on pg 13 of the consultation document that "*we are staying connected to these developments, both at an international level and at a jurisdictional level to ensure a degree of compatability as appropriate.*"
- 6) **Auditing and Verification:** NZSA believes that auditing of governance and risk management processes associated with Climate Change should be included within the scope of NZCS1
- a) NZSA will look for evidence of effective Governance and Risk Management processes associated with climate change outlined in a specific policy document available to primary users (in the same manner as an *Audit Policy* or *Whistleblowing Policy*).
- 7) **Governance and Risk Management Disclosures:** NZSA supports the proposed disclosures as outlined in section 7.2 –
- a) For listed entities, we recommend that the NZX Listing Rules require the public disclosure of climate-related governance and risk management policies by listed organisations.
- 8) **Board skills:** We do **not** support the 'laissez-faire' approach taken by the XRB in relation to the disclosure of Board skillsets appropriate for the management of climate change risks.
- a) NZSA believes that board skillsets need to cover a holistic and increasing group of stakeholder needs.
  - b) It is important that investors are provided with a degree of assurance that their Board can meet the needs of stakeholders, to fulfil their duty to act in the best interest of the company and its shareholders.
  - c) We do not believe a focus on how the Board accesses climate skills (pg 17) is an effective solution – the same could be said for other core Board functions, such as financial oversight (which is also a mandated skillset for any NZX-listed entity).

## Consultation Questions

***Primary users have been identified as existing and potential investors, lenders and insurance underwriters. Do you think that all of these users should be included in the primary user category?***

***NZSA Response:*** Yes, for the reasons outlined by the XRB in terms of informing the groups that make capital allocation decisions. We would also expect **regulators** to form part of the ‘primary user’ category, as disclosures made by a company may have a significant impact on regulatory decisions that may **enable** capital investment, and therefore affect capital allocation.

We also believe, however, that company reporting outputs are used by a wide range of stakeholders, well beyond the specific stakeholder categories identified above. Climate-related disclosures, as with any form of disclosure, needs to satisfy a wide variety of stakeholders to ensure that directors continue to act in the best interests of the company and to create value for shareholders.

***Do you think the proposed Governance section of NZ CS1 meets primary user needs?***

***NZSA Response:*** Yes, when taken in context of the future disclosure required under the (future) *Strategy and Targets and Metrics* sections. We agree with the scope, specificity and clarity.

NZSA believes that a definitive statement as the scope of governance in terms of emissions (Scope 1, 2 or 3) should form a key statement in any climate-change related governance policy.

NZSA believes that some verification of Climate change-related Governance processes and policies should be include within the scope of the annual Audit, to provide assurance to investors as to the quality of the process and disclosure.

***Do you think the proposed Risk Management section of NZ CS 1 meets primary user needs?***

***NZSA Response:*** Yes, when taken in context of the future disclosure required under the (future) *Strategy and Targets and Metrics* sections.

We do believe that under NZCS2, organisations in carbon-intensive industries have a requirement to prepare a transition roadmap, to provide assurance to investors that the organisation can sustain investor value into the long-term. This may create some ‘crossover’ with the governance and risk management processes required under NZCS1.

NZSA believes that some verification of Climate change-related risk management processes and policies should be include within the scope of the annual Audit, to provide assurance to investors as to the quality of the process and disclosure.

***The XRB has primarily drawn from the TCFD’s definitions for its defined terms. Do you agree that we should align closely with the TCFD’s definitions?***

***NZSA Response:*** Yes. NZSA believes that using more localised definitions will increase complexity for investors (in terms of understanding) and issuers (in terms of compliance).

***The XRB is particularly interested in feedback on the following defined terms as they are currently proposed: ‘climate-related risk’, ‘climate-related opportunities’, ‘climate-related issues’, ‘physical risk’, and ‘transition risk’.***

***a) Do you consider that the XRB should align with the TCFD and use the terms ‘climate-related opportunities’ and ‘climate-related issues’, or should we only refer to ‘climate-related risks’?***

NZSA Response: NZSA thinks there may be a small error in the question. Our understanding is that the TCFD framework uses the terms “climate-related opportunities” and “climate-related risks”. We are comfortable with this distinction. The use of “climate-related issues” as an umbrella term offers less clarity and may increase confusion.

***b) Do you consider that the proposed definitions for these terms are accurate, sufficiently clear and well-explained? Do they need further detail or explanation? If so, should that detail be included in the defined terms or in guidance?***

NZSA Response: We are comfortable with the proposed definitions.

***Do you have any other views on the defined terms as they are currently proposed?***

NZSA Response: No.

***The XRB is currently of the view that adoption provisions for some of the specific disclosures in NZ CS 1 will be required. However, the XRB does not believe it is necessary to provide any adoption provisions for entities in relation to the Governance and Risk Management disclosures. Do you agree with this view? Why or why not?***

NZSA Response: Yes. We do, however, believe that an appropriate **guidance note** may be helpful for organisations not as advanced in their climate-related disclosure journey.

***The XRB currently intends NZ CS 1 to be concise and sector neutral, with sector-specific requirements to be contained in guidance. Do you agree with this approach?***

NZSA Response: Yes.

## Appendix 1 – Draft NZSA Sustainability Policy Highlights

*This policy is still in development, and is expected to be released for consultation during December 2021/January 2022. The text below represents a summary position only.*

1. NZSA supports business initiatives that reduce global carbon emissions.
2. We will expect organisations to fully consider the risks and opportunities available to them as part of their capital investment decision-making processes.
3. NZSA encourages Board inclusion of environmental outcomes as part of their service in acting to support shareholder interests.
4. We expect the sustainability actions of a company to be supportive and complementary to an organisation's wider strategy.
5. NZSA supports a single 'climate reporting framework' approach, based on TCFD:
  - Governance
  - Risk Management
  - Strategy
  - Metrics/Targets
6. NZSA supports transition plans for companies migrating to a more sustainable future.
7. NZSA supports validation and verification of climate-related disclosures through a recognised emissions or other relevant audit processes.
8. NZSA supports efforts made by corporates to broaden the diversity of their skills to cope with emerging sustainability requirements.