May 2nd 2022

NZSA response to NZCS1 – Strategy, Metrics and Targets

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

Overall Commentary on NZCS1, Part 2-5

As per our Part 1 submission on NZCS1, 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.

1) **Transparency:** We support the XRB's approach to incorporate and relate climate-related risks and climate-related opportunities to an organisation's strategy.

   We note and appreciate the position outlined by the XRB on page 11 of the consultation document: "*Climate-related disclosures are a mechanism to increase transparency about the risks and opportunities arising from climate change.*"

2) **NZX Code of Corporate Governance:** Please note that NZSA has made a submission on the NZX Code of Corporate Governance (available here). As part of that submission, we have noted the following:

   a) that the contents of the current ESG Guidance Note are elevated to the NZX Code of Corporate Governance itself, within a new principle covering **non-financial reporting**.

   b) "*While NZSA recognises that an issuer's website may contain relevant ESG information, we would prefer to utilise a company's annual report or associated documents as the primary source of ESG information, with relevant links to external information sources as required.*"

   c) that the NZX and XRB ensure a consistent approach to avoid confusion for both listed entities and investors.

3) **Adoption Standards and Guidance Notes:** We support the intention of the XRB to provide both a first-time adoption standard and guidance notes for climate-related disclosures. NZSA feels

this is helpful in providing implementation leadership and education to organisations and investors alike.

4) **Investor and Primary User education and understanding:** While guidance notes may be helpful in educating organisations as to how they construct their climate-related disclosures, NZSA feels there is also a need to educate primary users on how to ***understand*** the disclosures. We look forward to supporting the XRB in developing appropriate materials.

5) **Broader environmental sustainability and disclosure:** While not directly relevant to the scope of this submission, NZSA believes that climate-related disclosure is only one element of a broader set of environmental sustainability disclosure requirements.

   We will continue to advocate for a clear roadmap of future regulatory development of environmental disclosures. We also continue to encourage entities to take a 'broad approach' to their environmental risks and opportunities, and the impact of those on their corporate strategies.

NZCS1, Governance and Risk Management Feedback

We appreciate the efforts made by the XRB to summarise the feedback received on Part One of the NZCS1 submissions process.

1) We support the update to the definitions of primary users; while this differs from our own submission, we appreciate the trade-off required between required disclosures meeting the needs of a broad set of stakeholders and compliance costs.

2) We wholly support the XRB's position to align the core disclosure requirements in NZCDS1 with those of TCFD.

While we appreciate that the scope of the Act is outside the XRB's control, NZSA will continue to advocate for the inclusion of unlisted entities, with an overall threshold based on total assets. The current exclusion of such entities from the Act may act as an unintended disincentive for a public exchange listing.

Consultation Questions – NZCS1, Strategy, Metrics and Targets

Part Two - Strategy

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

<u>NZSA Response</u>: Fundamentally, subject to feedback provided within this submission document, NZSA believes that the focus of the disclosure will meet the needs of investors and other primary users. Investors will be looking for assurance that the organisation has considered the key climate change-related risks and opportunities and that these have been considered within the organisation's strategy.

Scenario Analysis: NZSA supports the focus on the transparency of scenario analysis, allowing investors to understand the resilience of the organisation. As per the XRB proposal in section 6.1 (7), we would expect strong disclosure of the assumptions used to underpin each scenario.

Linkage to broader strategy: The proposed standard adopts a narrow focus, solely on climate change. While this is appropriate on the context of the scope of the standard, NZSA believes there should be some provision within the standard to reflect that climate-related factors are only one amongst many that inform an organisation's strategic outcomes. To this end, we would expect disclosures related to climate change to be well-integrated with other aspects of an organisation's disclosure around its strategy and level of achievement against it.

"Greenwashing": NZSA fully supports the XRB's statement in section 6.1 (2) that "*an entity must ensure that relevant information is not obscured by the inclusion of insignificant detail.*"

a) ***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.***

<u>NZSA Response</u>: We note the XRB's statement in section 6.1 (2) that "*If the disclosures provided in accordance with paragraphs 3–7, are not sufficient to meet the objective in paragraph 1, an entity must disclose additional information necessary to meet that objective.*" The statement implies that the disclosure requirements should be seen as a minimum requirement.

Transition Roadmap: NZSA notes that in its submission on Part 1 of NZCS1, we stated that:

> *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.*

NZSA notes section 6.1 (5) (e) of the proposed standard, requiring disclosure of "*the transition and adaptation plan aspects of its strategy, including the extent to which financial plans are aligned with these plans.*"

NZSA considers that this specific disclosure requirement is a key strategic element that will support the intentions expressed by the XRB in section 3.1 of the consultation document, particularly that climate-related disclosures will *"lead to a more informed market, a more efficient allocation of capital, and to smooth the transition to a more sustainable, low-emissions economy.*"

We support the inclusion of an *adaptation plan* and *transition plan* as specific disclosures within the standard and would encourage the XRB to improve the priority and prominence of this requirement by creating the disclosure requirement as a separate section.

This also allows organisations to differentiate between "one-off" transition-related risks and opportunities, and those that are ongoing.

NZSA does note that the development of an adaptation plan is a key feature of the first-time adoption provisions outlined in section 6.3.

b) ***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?***

<u>NZSA Response</u>: We consider that the disclosure objectives contained within Table 3 of 6.1 (1) could be worded more effectively, to focus on the difference between strategic and financial **outcomes** and how they are achieved (i.e., business model, strategic plan, financial resources as **inputs**). This would recognise that the same strategic outcome could be achieved if an organisation adapted its planning to mitigate climate-related risks and adapt to climate-related opportunities.

Should this feedback be adopted, this may require slight changes to sub-sections within Table 3.1.

We also consider the description of climate-related risks and opportunities within section 6.1 (4) (c) as requiring further specificity – while *physical* risks should be included, we would expect that risks include elements relating to *customer* risk / opportunity, *reputation* risk/opportunity and *stakeholder* risk/opportunity, amongst others. NZSA recognises that different factors may be defined for different businesses (not all of them solely transition risks) and would therefore prefer a broader approach to this statement, with examples contained within guidance notes.

c) ***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?***

<u>NZSA Response</u>: We refer to our feedback above – NZSA would prefer greater emphasis on the disclosure of a specific transition plan for the organisation's preferred (sustainable) outcome. NZSA believes that this can be created within the principles-based approach of the proposed standard.

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

<u>NZSA Response</u>: Yes. Investors, as a primary user, are looking for information that can help them assess strategic and financial outcomes in the short, medium, and long term. The impacts of climate-related risks and opportunities on an organisation's business model and strategy assist investors in making appropriate capital allocation decisions.

As per our comment above, however, NZSA believes that climate-related factors are one amongst many impacting an organisation's strategic outcomes. We would expect organisations to take a broad approach in describing risks and opportunities that impact their strategic outcomes and how they deliver against those.

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?

NZSA Response: NZSA prefers that organisations are free to determine their own scenarios, leaving scope for investors and other primary users to judge the credibility of those scenarios as part of their capital allocation decisions. NZSA also notes that as further climate-related research is completed, scenarios may be altered to reflect greater knowledge in future.

For example, recent research at Victoria University of Wellington, released on May 1st, has already evidenced differing timeframes and impacts of rising sea levels around New Zealand. This is not solely based on temperature movement, but also considers local ground movement factors.

If the standard is too specific, there is some likelihood that evidence provided by new research cannot be included in an organisation's scenario development.

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?

NZSA Response: NZSA supports this approach – again on the principle of leaving scope for investors and other primary users to judge the credibility of an organisation's targets as part of their capital allocation decisions.

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

NZSA Response: The definitions within section 6.2 are broadly clear and appropriate.

1) The nature of the wording in section 6.1 relating to 'business model' and 'strategy' (as defined) may require clarification to better separate business model inputs (which may include a strategic implementation activity/plan) and strategic outputs.

2) NZSA notes the proposed definitions of an *adaptation plan* and a *transition plan*. While there is a clear distinction based on 'low emissions' as compared with the broader set of risks or opportunities contained within an adaptation plan, this proposed differentiation is likely to cause confusion for investors and other primary users.

   While we support the alignment with TCFD implied in the definitions, more specificity around the adaptation plan being related to a 'company's strategic response and capability development' may provide a better distinction.

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

a) ***Do you agree with the proposed first-time adoption provisions? Why or why not?***

   NZSA Response: Yes. NZSA feels the proposal outlined by the XRB reflects a balanced approach that allows organisations the opportunity to develop climate-related capability and investors/other primary users the ability to develop their understanding.

b) ***In your view, is first-time adoption relief needed for any of the other disclosure requirements? Please specify the disclosure and provide a reason.***

NZSA Response: No. The 'pathway' approach implied within the first-time adoption provisions and the timeline set out in Figure 5 should be attainable by all in-scope organisations.

We note that the impacts of climate change are already being felt by organisations and their investors, so would be reluctant to provide any further relief beyond that proposed in the XRB proposal. For example, we note the recent (significant) loss announced by NZ King Salmon (NZX: NZK) and their associated capital raise.

Greater disclosure is required as early as possible to provide transparency for investors and increase knowledge of climate-related risks and opportunities.

Like the XRB, NZSA will continue to encourage organisations to understand the environmental scenarios that may impact them and how they should be described to investors.

c) ***If you are requesting further first-time adoption relief, what information would you be able to provide in the interim?***

NZSA Response: n/a – NZSA does not support first-time adoption relief beyond that proposed by the XRB.

Part Three – Metrics and Targets

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

NZSA Response: Fundamentally, NZSA believes that the disclosures proposed within the Metrics and Targets section meet the needs of investors and other primary users, subject to our submission feedback below. Investors will be seeking assurance that the specific actions and plans disclosed by the reporting organisation are translating to measurable improvement in related metrics.

a) ***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.***

NZSA Response: Broadly, yes.

Adaptation (one-off) vs 'ongoing': The standard as proposed does not differentiate delivery milestones associated with the "one-off" adaptation plans from metrics associated with the underlying, ongoing business operations of the entity. NZSA would prefer to see this distinction reflected in the standard, allowing primary users (including investors) to determine an organisation's progress on both aspects.

This may imply extending the standard to cover not just metrics and targets but including key adaptation **milestones** within both the standard (7.1) and the definitions (7.2).

b) ***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?***

<u>NZSA Response</u>:

Business Activities: NZSA notes that the term "*business activities*" is used in sections 7.1.4 (Table 6), in the context of providing a percentage amount exposed to transition risk or physical risk. The term is also not defined in section 7.2.

We consider that this term is ill-defined and would prefer more specific measures. From an investor's perspective, the percentage of **total assets**, **net profit after tax** or **revenue** (or a combination of all three) would create clarity as to the longer-term resilience of the underlying business.

Remuneration: We note that 7.1.4 (h) proposes that the portion of management remuneration dedicated to climate-related risks and opportunities is disclosed. NZSA considers this impractical for the following reasons:

- Executives will be required to apportion their time on climate-related activities to meet the requirements of the standard. At best, this will only represent an estimate and will add little value to investors or other primary users.
- The management of climate-related strategy, risks and opportunities should become an integrated part of an organisation's wider efforts to manage those functions (see our comments earlier in this submission), rather than wholly separate from the other risks and opportunities facing the organisation.

For these reasons, we do not believe that the disclosure will add meaningful value to primary users (including investors).

We note that there is no current requirement for organisations to disclose spend other internal management or assurance functions that are critical for investors (such as internal audit processes, finance and accounting or technology).

c) ***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?***

<u>NZSA Response</u>: NZSA is supportive of the balance of the standard between principle-based disclosure and proscribed requirements.

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?

<u>NZSA Response</u>: NZSA prefers that organisations are free to determine their own industry-specific metrics, leaving scope for investors and other primary users to judge the credibility of those metrics as part of their capital allocation decisions.

We appreciate the efforts planned by the XRB to include appropriate context within guidance notes.

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?

NZSA Response: NZSA support the inclusion of scope 3 measures within the metrics standard. However, we believe that this should be subject to first-time adoption relief, mainly due to the complexity for most organisations in measurement and reporting of scope 3 emissions.

NZSA also believes that scope 3 emissions data should be subject to independent assurance (see our submission feedback on *Part 4 – Assurance* below), as we would wish for all climate-related disclosures. Without appropriate first-time adoption relief, organisations are likely to have difficulty in independently verifying the climate-related data provided by other organisations in their supply chain. In many cases, organisations supplying scope 3 emissions data may not be subject to New Zealand law, making it difficult to compel them to provide high-quality scope 3 emissions data.

Given the potential inaccuracy of scope 3 reporting, under current measurement and verification conditions, it is unlikely that the metrics (and delivery of the organisation against target) will be trusted or relied on by primary users.

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?

NZSA Response: NZSA supports the nature of these disclosures, subject our feedback on first-time adoption relief for scope 3 emission reporting.

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

NZSA Response: We are broadly supportive of the defined terms in section 7.2.

We do believe that the definition of "metric" should include a reference to "**milestones**", allowing progress against adaptation plans to be reported to primary users.

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?

NZSA Response: As per our commentary above, NZSA believes that first-time adoption relief provisions should be created for the reporting of Scope 3 emissions.

Given the potential inaccuracy of scope 3 reporting, under current measurement and verification conditions, it is unlikely that the metrics (and delivery of the organisation against target) will be trusted or relied on by primary users.

Part Four – Assurance

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

NZSA response:

Scope of Assurance Engagement: NZSA supports the intent of the Act for climate-related disclosure to "*comply with applicable auditing and assurance standards issued by the XRB.*"

However, NZSA believes that independent assurance should apply to **sections 4-10** contained within Table 6. This would include all entity-specific, industry-specific and cross-industry metrics as well as associated targets.

NZSA feels this better reflects investor expectations, in a similar manner that financial disclosures are audited by an external auditor.

Limited vs Reasonable Assurance: NZSA supports the 'limited assurance' level as a minimum. This leaves the option open for primary users to advocate to an organisation's Board for a higher level of assurance if appropriate.

Part Five – NZCS3

NZSA agrees with the rationale behind the development of a separate standard for general requirements associated with climate-related disclosures.

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?

NZSA response: NZSA supports the definition of materiality as per the XRB proposed definition in Table 12.

- We agree with the XRB that New Zealand's climate-related disclosure regime should be based on the internationally recognised TCFD framework.
- The concept of materiality is well understood by investors and other primary users in audited financial accounts. The use of similar language reduces complexity and improves understanding for investors.
- We agree that the concept of materiality should be applied in the context of the organisation itself, rather than its impact on climate change. NZSA considers it likely that organisations without effective transition or adaptation plans will ultimately suffer significant loss of enterprise value due to perceived investment risk.