

### September 27<sup>th</sup> 2022

# NZSA response to NZ Climate Related Disclosure Framework (Exposure Draft)

The NZ Shareholders' Association (NZSA) would like to thank the External Reporting Board for the opportunity to comment on the exposure drafts comprising the initial Aotearoa New Zealand Climate Related Disclosure Framework ('CRD Exposure Draft')

We appreciate that this is the culmination of many months of work, starting with the initial consultation questions released in the latter half of 2021. NZSA acknowledges the effort that the XRB has undertaken to maximise the consultation input from stakeholders.

#### **NZSA Context**

NZSA assesses both the disclosure and methodology of various governance, ethical and financial factors for listed New Zealand companies, and summarises these for retail investors. Currently, we have issued a consultation draft of a new assessment policy related to *Environmental Sustainability*. We expect this to come into force from mid-October 2022, for application from January 2023 onwards.

We're pleased to note that the assessment approach we have adopted within our consultation draft has strong alignment with the XRB's CRD Exposure Draft. A key differentiator is that NZSA has adopted a broader approach, with an expectation that listed entities focus on governance, strategy, risk, opportunity and metrics/milestones associated with **all** environmental matters (incorporating, of course, climate change-related issues).

We note that NZSA's approach is in line with the draft IFRS S1 approach adopted by the International Sustainability Standards Board (ISSB).

We continue to assert that an organisation-wide focus on environmental sustainability will be for the benefit of shareholders in the long-term.

# Ongoing Advocacy

While we appreciate that the scope of the Climate-related Disclosures Framework 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.

We will also continue to monitor the degree of **alignment** with the requirements expressed by other domestic and international stakeholders, including the International Sustainability Standards Board (ISSB) and NZX Limited, with a view to minimising differences in disclosures required from different bodies. We are currently comfortable with the XRB's assessment of alignment with both TCFD and ISSB. NZSA notes there appears to be strong alignment across the different institutions supporting the investor landscape in New Zealand.

## Overall Commentary on the Exposure Drafts

- 1. We note and appreciate that the current Exposure Drafts for NZCS1, NZCS2 and NZCS3 have addressed many of the concerns raised in previous submissions by NZSA.
  - a. **Transition Plan Milestones:** We believe that further clarity is required into the disclosure of key milestones, and progress against them, contained within transition plans (see paragraph 8 below).
  - b. Governance Body Skills: We understand the XRB's approach to disclosure of the climate-related skills and competencies of a governance body, set out in BC22 of NZCS1. We feel that gaps in approach can be addressed by others for the listed sector. Nonetheless, our concern as to the ability of a governance body to manage climate-related expertise remains for non-listed entities (see paragraph 4 below).
- 2. We are supportive of the intention expressed by the XRB in NZCS1, paragraph BC18 (Basis for Conclusions) to conduct a post-implementation review (PIR) of the CRD Framework no later than December 2025. New Zealand is an early adopter of a climate-related disclosure framework. NZSA considers that a PIR within 3 years will form a good opportunity to maintain global alignment and ensure that practical lessons learned since December 2022 can be examined.
- 3. **Scope 3 Emissions**: NZSA notes that NZCS2 section 18 now contains a specific provision for first-time adoption relief for the reporting of Scope 3 emissions, allowing a one-year 'phase-in' period for quantitative reporting and disclosure.

NZSA is supportive of this addition, as outlined in its submission of May 2022.

a. **Capability-building**: Organisations face significant complexity in measuring and gaining assurance for Scope 3 emissions, particularly those with multi-national supply chains operating in jurisdictions that do not offer the same current commitment to climate

disclosures. The first-time adoption provision offers organisations a further 12 months in which to build their internal capability related to emissions reporting.

We concur with the XRB statements contained within NZCS2 section BC16 (Basis for Conclusion) encouraging organisations to begin building this capability now – regardless of first-time adoption provisions. NZSA will assess organisational readiness for Scope 3 emissions reporting as part of our interactions with listed organisations from January 2023.

- b. Reliance: Investors will have faith in emissions disclosures, in a similar manner to which they regard financial data, and use these disclosures as factors in their investment decision-making. In the same manner that investors do not generally welcome 'restatements' of prior year financial data due to material error, NZSA believes that a focus on ensuring the quality of Scope 3 emissions data will minimise the degree of prior year restatement required.
- c. **Credibility**: From the perspective of the CRD framework, we believe a bias towards accuracy will enhance the reputation of the regime amongst investors.
- 4. **Governance Body Skills**: NZSA submitted in November 2021 that 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. We note that section 7(b) of NZCS1 (Exposure Draft) places the onus on a governance body to "ensure(s) that the appropriate skills and competencies are available to provide oversight of climate-related risks and opportunities."
  - b. We accept that the XRB's approach in the CRD Exposure Draft has been to set principles rather than prescription. The XRB's approach implies that an assessment of "how governance is done" is left to others, including the NZX Code of Corporate Governance and the NZSA itself. Note that the draft section 7(b) is supported by the NZSA's own policy on <u>Independent Advice for the Board</u>, which provides practical guidelines for how a Board accesses appropriate expertise and discloses supporting processes.
  - c. Nonetheless, we note that NZCS1 does not require disclosure of appropriate skills and competencies in their own right. Note that NZSA's own exposure draft for Environmental Sustainability (a broader construct than climate change) contains the following statements:

- 1.5 → NZSA·supports·efforts·made·by·Boards·to·broaden·the·diversity·of·their·skills·and·thoseof· senior· executives· to· effectively· govern· and· manage· emerging· environmentalsustainability·requirements.¶
  - a) → NZSA-expects·Boards·to·have·sufficient·capability·to·assess·risks·and·
    opportunities·associated·with·environmental·sustainability,·as·
    evidenced·through·appropriate·experience·and·as·part·of·a·'skills·matrix'assessment·disclosed·in·the·annual·report.¶
  - b) → Where-Board·members·feel·that·they·require·additional·capability·toassess·proposals·related·to·specific·environmental·sustainability·issues,· NZSA·expects·the·Board·to·seek·independent,·external·advice·asrequired.¶
- d. In this context, we are comfortable with the approach adopted by the XRB insofar as it applies to the listed sector and retail investors, as we believe that there will be pressure from existing groups (including NZSA) for disclosure of relevant skills.
- e. However, we are less clear as to how transparent disclosure of skills and competencies, or access to them, is determined for climate reporting entities (CRE's) that are **not** publicly-listed entities.
- 5. Executive Remuneration disclosure: As with all matters affecting executive remuneration generally (and CEO remuneration specifically), NZSA encourages clear disclosure of the methodology used to support incentive awards. This includes metrics or 'measure groups', weightings and outcomes compared with targets for each component affecting an incentive award.
  - a. We are supportive of the disclosure requirement in NZCS1 7(d) and 21(h) as this
    encourages disclosures of incentive structures, assuring investors that the interests of
    management are aligned with their own interests
  - b. We note that the potential for confusion caused by the word "proportion" in table 6, section 4(h) of the prior consultation document (April 2022) has been removed. The use of the wording "management remuneration <u>linked</u>..." makes it clearer that this is related to specific incentive structures associated with management remuneration, rather than trying to account for a proportion of an executive's base remuneration.
- 6. **Strategy and Transition Planning:** In our submission of May 2022, NZSA expressed concern as to the structure of the 'Strategy' section contained within the April 2022 consultation document, as we felt it confused 'inputs' and 'outputs' in a manner that did not aid clarity.
  - a. Given our feedback, we appreciate the XRB's adoption of new sub-headings within the "Strategy" section of NZCS1 (paragraphs 9-15). This offers much greater clarity for primary users as to the disclosure of the 'inputs' that result in an impact (output) for the organisation.
  - b. NZSA appreciates the clearer focus contained within the disclosure objective (section 9) on how an entity is positioning itself as the economy transitions towards a low-emissions, climate-resilient future.

- c. NZSA offers wholehearted support for the XRB's approach to the 'Strategy' section as expressed in BC25 (Basis for Conclusion): "...an entity disclosing to primary users how climate change is impacting and may further impact an entity's ability to deliver on its core strategy. It is also about what an entity is doing, given those impacts and potential impacts, to put itself in a better strategic position and build resilience".
- d. Both section 10(e) and section 15(b), focusing on "how" a business can position itself in relation to climate-change related inputs will be key disclosures for investors in assessing the resilience of an organisation's business model and strategy.
- e. NZSA is agnostic towards the addition of a third required scenario analysis. We note the XRB's assessment that the original two scenarios specified in the April 2022 consultation document offered a 'good' or 'bad' interpretation and have no reason to dispute this logic.
- f. We believe that section 15 would benefit further by requiring disclosure of an organisation's progress against key milestones contained within its transition plan (see our commentary in paragraph 8(b) 8(d) below).
- 7. **Risk Description:** As per its submission of May 2022, NZSA is appreciative of the addition of a new description covering "transition risks" in Appendix A, providing greater clarity on the components relating to what may comprise such risks, including "policy, legal, technology, market and reputation risks".
- 8. **Transition Milestones:** NZSA continues to believe that milestones achieved as part of a climate change-related transition plan form an important disclosure for investors. Our May 2022 submission advocated that these should be included within the "metrics and targets" section.
  - a. We note that NZCS1 section 20 contains to requirement to disclose progress against transition plan milestones.
  - b. With the XRB's addition of NZCS1 section 15, however, NZSA now believes that a disclosure of progress against transition plan milestones would be better suited as disclosure within this section.
  - c. We note that none of the clauses in section 15 require disclosure of an organisation's progress against its transition plan. Investors are likely to value this information, as demonstrated evidence of credibility in an organisation creating greater resilience towards climate-related risks and opportunities.
  - d. NZSA therefore proposes the addition of a new clause as section 15(d), requiring disclosure of "the extent to which key milestones within the transition plan have been delivered or achieved"
- 9. **Fair Presentation and Principles:** NZSA is supportive of the content of NZCS3. In particular:

- a. We note the clear requirements contained within sections 5-8 relating to 'fair presentation'. We believe these are supportive of succinct, relevant disclosures that will support a reduction in 'greenwashing'.
- b. We are supportive of the disclosure principles expressed in Table 1 and Table 2, relating to *Information* and *Presentation*. We also accept and support the pragmatism expressed by the XRB in section 10, relating to any potential trade-off that may be required between disclosure principles.
- c. We support the principle expressed in Table 1 (Timeliness) that climate-related disclosures should be available at the same time as an entity's financial reporting.
- 10. **Data Source:** NZSA supports the pragmatism of the XRB in determining the disclosure source of climate-related disclosures. Nonetheless, we will continue to expect appropriate references within an entity's Annual Report and that such references are cross-referenced to further information sources if required.

#### 11. Materiality

- a. We note and support the XRB's clear statement in NZCS3 BC27 (Basis for Conclusion) that the definition of materiality is based on the "effects of climate-related risks and opportunities on an entity's enterprise value".
- b. We also note the potential impact of NZCS3 section 37 in positing that a company's impact on the environment may affect its enterprise value. NZSA believes this is a much more nuanced (and helpful) position than simply focusing on "single" or "double" materiality. Ultimately, enterprise value that affects investors.
- c. We do not support explicit disclosure of the impacts of the company on climate-change in its own right (unless there is an impact on the company itself) and are aligned with the logic expressed in NZCS3 BC30 BC35.
- d. The XRB's approach in NZCS3 is consistent with the position expressed by NZSA in its May 2022 submission: "...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."

# Consultation Questions – NZ Climate Standards (Exposure Draft)

1) Do you think draft Aotearoa New Zealand Climate Standards will meet primary user needs?

<u>NZSA Response</u>: Yes. We note the XRB's intention to undertake a post-implementation review by December 2025 – NZSA believes this will provide an excellent opportunity to incorporate

learning from the first years of the CRD Framework's operation and check alignment with global standards and other jurisdictions.

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.

<u>NZSA Response</u>: Yes. NZSA is aware of growing investor expectation in relation to better disclosure of environmental factors that may impact long-term investment performance.

We maintain that the impact of climate change is only one of these environmental factors. Depending on the specific organisation, investors may be concerned about environmental factors related to water use, waste management, ground contamination or loss of resources.

NZSA will continue to advocate for a broad approach towards the disclosure of risks and opportunities related to an organisation's environmental sustainability.

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?

<u>NZSA Response</u>: Yes – particularly following the clarification to the 'strategy' section following the April 2022 consultation document.

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.

<u>NZSA Response</u>: Yes, with the notable exception of the lack of specificity related to the disclosure of the skills and competencies of the governance body (see paragraph 4 above) and the lack of a disclosure requirement for progress against milestones associated with an organisation's transition plan (see paragraph 8 above).

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

<u>NZSA Response</u>: We appreciate the clear definition now provided in relation to 'transition risks'. We also note the nuanced approach to the definition of materiality, in terms of the impact of climate-related factors on an organisation's enterprise value.

NZSA is comfortable with the definitions provided.

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.

<u>NZSA Response</u>: NZSA believes that the required disclosures are achievable by in-scope organisations. We note the first-time adoption provision associated with scope 3 emissions disclosures and believe this will support organisations in building the required capability (people, processes) to create accurate reporting.

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

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.

NZSA Response: No.

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?

<u>NZSA Response</u>: We note that the Guidance Documents produced by the XRB are described as "working drafts". NZSA believes that is a fair summary of their status.

We note the presence of the occasional error within the document (such as the "Reference Source not Found" error on page 36).

More fundamentally, we note that not all disclosure requirements are supported by a practical guidance note. Given this is an 'emerging' topic for many, NZSA believes that each requirement should be supported by at least some context.

Last, we believe that in some cases the Basis for Conclusion statements made within each of NZCS1, NZCS2 and NZCS3 should be directly included within the guidance notes. They offer specific direction as to the approach taken by the XRB in determining the requirement, and therefore encourage greater compliance with the intention of the CRD Framework regulatory aims.

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

NZSA Response: See above.

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

<u>NZSA Response</u>: No – NZSA appreciates the succinct nature of NZCS1, NZCS2 and NZCS3 and does not believe this should be compromised.

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?

<u>NZSA Response</u>: Broadly, yes. A key proviso to our support is based on the need for 'timeliness' defined in Table 1 of NZCS3, which requires the alignment of CRD disclosures with a CRE's financial reporting period. This allows an annual 'toolkit' of documents to support investor decision-making. Some organisations already produce a separate 'Sustainability Report' that acts as a supporting document to their Annual Report.

NZSA respects the pragmatism of allowing disclosures in separate documents, with effective cross-referencing.

Nonetheless, we will continue to advocate for an entity's annual report to be the primary source for required disclosures, with effective cross-referencing to other documents.

Thank you for the opportunity to submit to the XRB's on the Exposure Drafts for the Climate Related Disclosure Framework. Please feel free to contact NZSA if you have any further questions or comments related to this submission.

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