NZSA Policy No 22 – Environmental Sustainability

Application: This policy applies to all NZX listed companies.

Purpose: NZSA maintains a range of policies to positively influence the behaviour of all participants in the NZX listed company sector. These policies should be read in the context of the NZSA Policy Framework Statement.

Statement No 22:

This policy document is a new policy recognising the greater role that environmental sustainability considerations play in investor decision-making and the emerging regulatory framework in New Zealand.

Recently, the External Reporting Board (XRB) has sought consultation as it develops New Zealand's Climate-Related Disclosures. The intent of this NZSA policy, however, is to reflect broader environmental criteria of interest to shareholders.

As with all of our policies, our key interest in the development of this policy is to ensure that listed entities operate in a manner that ensures their future sustainability. Existing NZSA policies focus heavily on governance sustainability – this policy intends to broaden the scope of our coverage to include environmental assessments.

NZSA believes that there is long-term alignment between corporate performance and environmental sustainability.

NZSA will review this Policy in mid 2023 as the topic continues to attract commentary and regulatory development during 2022.

We expect to begin application of indicative assessments to companies from January 2023.

1.0 Policy: Environmental Sustainability

1.1 NZSA supports the extension of the 'four pillar approach' to climate-related disclosure created by the Task Force on Climate-related Financial Disclosures (TCFD) as a framework to cover **all** environmental sustainability issues. This includes four types of disclosures:

a) Governance

b) Risk Management

c) Strategy
d) Metrics/Targets

1.2 NZSA will seek evidence that Boards have supported the allocation of resources within their organisation to identify, assess and manage environmental sustainability issues.

1.3 NZSA will look for Boards to self-identify and disclose key environmental sustainability risks and opportunities.

a) These will be specific to each company depending on its business activity. Some examples are provided in the Policy Appendix as guidance, however, this is not considered an exhaustive list and does not form part of this policy.

b) NZSA will look for disclosures either within an Annual Report or in a separate 'ESG Report' or similar, supported by appropriate cross-referencing within an Annual Report.

1.4 NZSA will seek evidence of **global** environmental benefit (such as emission reductions) through a company's environmental disclosures and actions, rather than a sole focus on local (New Zealand) environmental benefits or emissions reduction.

1.5 NZSA expects that environmental sustainability reporting by an organisation will be succinct and focus on **outcomes for shareholders**, as opposed to marketing content ('greenwashing').

1.6 NZSA supports the use of carbon offsets as a mitigation to emissions where there is no currently feasible alternative to the underlying activity.

a) We expect disclosure of adaptation roadmaps and associated milestones (see paragraph 1.17) in support of the future 'reset' of the business model.

b) Where offsets are utilised, NZSA will seek disclosure as to the **quality** of the carbon offset, to provide assurance for shareholders that the company has purchased an offset commensurate with its activities.

Governance

1.7 NZSA supports efforts made by Boards to broaden the diversity of their skills and those of senior executives to effectively govern and manage emerging environmental sustainability 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 to assess proposals related to specific environmental sustainability issues, NZSA expects the Board to seek independent, external advice as required.

1.8 NZSA will look for disclosure of Board processes that describe the role the Board and senior executives play in governing environmental sustainability issues.

1.9 NZSA expects organisations facing significant environmental sustainability risks or opportunities (including those operating in 'transition' industries) to include environmental sustainability matters within the scope of an appropriate Board Sub-Committee.

1.10 NZSA recognises that Boards have to manage relationships with multiple stakeholders, as part of their responsibility to serve shareholder interests. NZSA encourages Board inclusion of environmental outcomes as part of their obligation to shareholders.

1.11 Disclosure of Board governance processes related to environmental sustainability may include, but not be limited to:

a) Development and disclosure of specific environment-related policies.

b) How the Board holds management accountable for implementation of environmental sustainability policies, strategies and targets

Risk Management

1.12 NZSA recognises the significance of environmental sustainability risks for investors. To this end, similar to governance, we expect clear disclosure as to the processes used by an organisation in identifying and managing environmental risks.

1.13 NZSA believes that companies' risk management processes should allow quick and appropriate responses to environmental damage or breaches of environmental standards (including engagement with stakeholders). Note that NZSA can only assess the effectiveness of a process should such an event occur.

Strategy

1.14 We expect the environmental sustainability actions of a company to be supportive and complementary to an organisation's wider strategy – including business model and financial outcomes.

1.15 We expect climate-related risks and opportunities, and their impacts, to be disclosed to investors.

a) Where appropriate, this should include sensitivity analysis showing impacts on key operational and/or business outcomes.

b) Disclosures should cover both short and long-term impacts of climate-related risks and opportunities on an organisation's strategy.

1.16 We will expect organisations to fully consider the environmental risks and opportunities available to them as part of their capital investment decision-making processes.

1.17 NZSA supports adaptation roadmaps for companies migrating to a more environmentally sustainable future.

a) Where organisations operate in environmentally challenged industries, NZSA expects that an adaptation roadmap is disclosed as part of the annual report, to provide assurance to investors that the organisation can sustain investor value into the long-term.

b) We expect disclosure of progress against milestones

c) Specifically related to climate change, NZSA expects the disclosure of transition plan outcomes related to greenhouse gas emissions.

Metrics and Targets

1.18 NZSA supports business initiatives that reduce the negative impact of a business on the environment, including global carbon emissions.

1.19 We expect a disclosure of key environmental sustainability measures, their targets and the level of achievement in the relevant reporting period.

a) 'Measures' should include 'delivery milestones' where appropriate, for example, in the context of an adaptation plan.

b) NZSA believes that the disclosure of environmental milestones may be just as critical as metrics in enhancing environmental outcomes and investor disclosures.

1.20 Where environmental sustainability outcomes are recognised as supporting an incentive or remuneration payment to the CEO or other senior executives, the measures, targets, weighting and level of achievement should be clearly disclosed within the Remuneration disclosures.

1.21 NZSA expects companies to disclose their greenhouse gas emissions.

a) Disclosure should at a minimum cover scope 1 and 2 emissions measures.

b) NZSA expects an organisation to disclose its 'pathway' to achieving disclosure of scope 3 emissions.

1.22 Where relevant, NZSA expects at least prior period comparative information to support measures associated with environmental sustainability.

Assurance

1.23 NZSA expects governance and risk management processes, strategy and metrics associated with environmental sustainability disclosures to be included within the scope of the annual audit, or equivalent external audit and verification processes, to provide **limited assurance** to investors as to the quality of the process and disclosures associated with the governance and management of environmental sustainability outcomes.

a) NZSA notes that 'limited assurance' represents a lesser standard than that required of a company's financial statements' ('reasonable assurance').

b) We consider this an appropriate level of assurance at this time, until the quality, availability and accuracy of environmental data improves.

c) NZSA notes that the expectations contained in its Audit Independence Policy are relevant for the provision and quality of audit and assurance services.

Policy Appendix:
Examples of Environmental Risks and Opportunities

The examples provided below do **not** form part of the NZSA Policy in section 1.0. Their intention is to provide pragmatic examples to foster a broad approach for companies to self-identify their key environmental risks.

Ultimately, a company's directors and executive officers should be in the best position to understand environmental impacts on their organisation NZSA expects that risks and opportunities will be unique to each business.

Physical Risks	• Weather event affecting site services • Increasing risk of physical damage

	• Impact of drought / rainfall • Water supply impacts on site operations
Supply chain	• Direct supply disruptions through weather events • Disruption from ‘secondary’ impacts (e.g., electricity shortages) • Disease or other environmental factors impacting crops or vegetation • Transport disruptions caused by weather events
Labour	• Staff perceptions of company impacting recruitment or retention
Operations	• Waste minimisation requirements • Water use restrictions • Soil or Air pollution • Bio-diversity loss
Customers	• Customer boycotts • Reputational / market perceptions • Brand value impact
Political	• Impact of carbon tax or offset regime (political risk) • On-site emissions capture / treatment • Loss of asset value due to redundancy or substitution • End-of-life recycling requirements • Emission reduction
Funding or financial	• Impact of debt funder (bank) policies • Share price re-rating due to investor perception • Ability to secure insurance cover

2.0 Advocacy

2.1 NZSA will continue to provide meaningful and considered advocacy on behalf of retail investors as part of the submissions process associated with the Climate-Related Disclosures regulatory framework.

2.2 We believe that the scope of organisations required to make disclosures under the Bill should be determined by a single, consistent threshold – regardless of listing status. We do not wish to see NZ suffer an unintended consequence of a reduced incentive to list on an exchange as a result of climate disclosure requirements.

2.3 We will continue to advocate for the ESG Guidance Notes maintained by the NZX to be ‘elevated’ to form a section within the NZX Code of Corporate Governance.

2.4 We will continue to advocate for the development of effective guidance notes for organisations preparing their initial climate-related disclosures, together with support materials for investors in interpreting them.

2.5 We recognise that the current Climate-Related Disclosure (CRD) regime is likely to be a ‘start point’ for the External Reporting Board (XRB). Nonetheless, we will continue to advocate for a ‘broad’ approach to environmental disclosures, as we believe that this information would benefit investors and place environmental sustainability issues in the appropriate context in relation to an organisation's wider risk governance processes.

3.0 Commentary

3.1 NZSA has prepared this policy document in response to the changing legislative and regulatory context in New Zealand and also in response to evolving investor expectations that support transparency of environmental risks and opportunities and their impact on an organisation.

3.2 NZSA recognises the ongoing demand from society AND shareholders for greater focus on sustainable outcomes.

a) In some instances, NZSA believes that the 'externality' nature of environmental factors have encouraged a greater focus on short-term gain at the expense of long-term interests of investors.

b) NZSA believes that there is long-term alignment between corporate performance and environmental sustainability.

c) Achieving an environmentally-sustainable business does not represent 'trading-off' shareholder benefit with an environmental outcome in the long-term.

d) NZSA notes as evidence the outcomes of the Exxon (NYSE: XOM) shareholder meeting in 2021, that caused a change in board composition and saw shareholders demand greater environmental responsibility to be taken by the company.

3.3 NZSA notes that entire industry sectors (for example, oil exploration) now struggle to achieve debt funding and have been "re-rated" as a result of potential future environmental impacts affecting long-term returns.

a) This is supported at an institutional level by the increase in 'sustainable funds' and global ETF's focused on sustainability.

b) NZSA also notes the role of shareholder activism in banks to prevent debt funding to perceived unsustainable industries, a practice that has occurred in Australia and New Zealand.

3.4 NZSA also acknowledges the growing importance of environmental sustainability to investors.

a) We believe that we have a role in providing information to investors in relation to the environmental sustainability of New Zealand corporates, as a means of aiding investor decision-making.

b) Investors utilising NZSA topic-based information already have the option of placing a lower weighting on some of the information provided by NZSA as part of their decision-making.

c) An increasing proportion of investors are expecting greater disclosure relating to environmental impacts on their investment.

3.5 While NZSA recognises that New Zealand regulators have a current focus on climate-related disclosures, NZSA believes that there are other environmental-related risks and opportunities facing New Zealand organisations.

a) Examples in addition to climate change may include waste minimisation, recycling initiatives, soil remediation, water use and management, pollution and land use

b) We would encourage organisations to take a 'broad' approach in the development of their environmental strategies and disclosures.

3.6 Similarly, we would also encourage a broad consideration of environmental risks. While physical risk or transition risk is oft-discussed in commentary and regulatory frameworks, we would also consider that a discussion focused on customer or reputation risk is relevant.

3.7 We have attempted to use and support 'global' definitions – we will continue to support regulatory frameworks that minimise complexity both for investors and organisations.

3.8 NZSA recognises the broadening of stakeholder interest in private and public sector organisations.

a) We continue to believe that the current focus of the Companies Act in ensuring directors act in the "best interests of the company" is appropriate.

b) The management of *environmental sustainability* is a critical 'hygiene factor' in this context.

3.9 NZSA recognises the challenges facing the external audit profession in New Zealand relating to the broadening required capability (eg, data science, technology/IT, non-financial disclosures).

a) For environment-related disclosures, NZSA recognises that both the measures themselves and the capability required to review them are likely to be in their infancy.

b) While we expect a move to investment-grade assurance over time ('reasonable assurance'), NZSA feels that a 'limited disclosure' regime will serve current requirements, allowing the industry to develop capability – both in terms of capacity and capability – over time.

3.10 NZSA is wary of the unintended consequence of both disclosure expectations and the scope of future disclosure compliance. We prefer a consistent approach being applied to all relevant organisations, rather than an attempted differentiation between listed entities and unlisted companies.

3.11 We note that measurement of some environment-related disclosures may be difficult to achieve in the short-term. For example, the disclosure of verifiable 'scope 3' emissions requires certification of emission outputs from the input organisations associated with a company's supply chain.

a) NZSA considers a 'best efforts' or a 'phased-in' approach appropriate as a company's initial disclosure approach, for measures that require significant external or 'subjective' input.

b) We are conscious on the long-term impact on investor confidence in metrics or milestones should companies be forced into a position of inaccurate reporting.

3.12 NZSA is aware of the trade-off between local emissions (ie, New Zealand) as compared with total, global emissions. Notwithstanding our comments relating to scope 3 emissions, we will seek to understand the relationship between local and global environmental impacts in a company's actions. NZSA will support actions that result in a net reduction in **global** emissions.

3.13 Compliance costs for corporates are of concern to NZSA, as these costs are ultimately borne by shareholders and other funders. In support of this:

a) NZSA supports a 'concise' summary of environmental governance, risks, opportunities, strategies, metrics/milestones and targets.

b) We do not support the concept of 'greenwashing' and will discourage organisations from engaging in this practice.

c) NZSA will continue to look for evidence of synergy between global and New Zealand-focused disclosure requirements

3.14 NZSA believes that investor, funder and market sentiment plays a key role in incentivising private sector organisations to address environmental sustainability risks or issues.

3.15 Environmental risks are a subset of the multiple risks facing an organisation, and should be considered alongside strategic, business and operational risks and within the risk governance processes that support the Board in decision-making.

a) NZSA considers that environmental sustainability risks should be governed and managed within the content of the organisation's overall risk management framework.

b) Environmental Sustainability risks should be prioritised in the context of all risks facing a company.

3.16 NZSA notes the role of the Protected Disclosures Act in supporting individuals in 'whistleblowing' processes in relation to a company's activities. While not directly addressed in this policy, NZSA's Employee Engagement and Whistleblowing Policy sets clear expectations as to our expectations.

4.0 Key Regulatory Requirements

4.1 Climate-Related Disclosures regulatory framework, enabled by the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021.

References

XRB Consultation Document: Governance and Risk Management

NZSA Submission to XRB Governance and Risk Management (Part 1)

XRB Consultation Document: Strategy, Metrics and Targets

NZSA Submission to XRB Governance and Risk Management (Part 2)

XRB Exposure Drafts: Climate-related Disclosure Framework (CRD)

NZSA Submission on Exposure Drafts for CRD

'Values to Riches' Report

Forbes Magazine Article (Professor Robert Eccles) on XOM Shareholder vote in 2021

ESG Guidance Note, NZ RegCo

NZSA Submission on NZX Code of Corporate Governance

International Sustainability Standards Board – IFRS S1 Consultation Draft

Definitions

Transition Business	A business that will be required or expected to determine a adaptation or transition plan due to the impacts of climate change on its core business.
Adaptation Plan	A plan or roadmap detailing how a business intends to move from its current business model to a future business model that offers greater resilience to changing environmental factors.
Transition Plan	A plan detailing how an organisation intends to reduce its greenhouse gas emissions.
Scope 1	All direct greenhouse gas emissions.
Scope 2	Indirect greenhouse gas emissions from consumption of purchased electricity, heat, or steam.
Scope 3	Other indirect emissions not covered in scope 2 that occur in the value chain of the reporting entity, including both upstream and downstream emissions.
Reasonable Assurance	Similar to an audit standard; a positive expression of opinion that the disclosures are prepared and presented fairly in all material respects
Limited Assurance	A reduced standard of review; a negative expression of opinion that there is no matter that has come to light that causes the reviewer to believe that disclosures are incorrect.
Externality	An uncosted impact on a business

Related Policies

Policy 4 – Employee Engagement and Whistleblowing

Policy 5 – Executive Remuneration

Policy 10 – Audit Independence

Policy 17 – Board Composition

Policy 21 – Independent Advice to the Board

Document Control

This document was approved by the NZSA Board:	**Oct 2022**
This document is effective from:	**Jan 2023**
The next planned review date is:	**Dec 2023** (after year 1)