Axiom Advisory
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Submission on Climate-Related Disclosures (NZ CS1) Consultation Document

Kia ora April

Thank you for the opportunity to make submissions on the Consultation Document on NZ CS 1.

As we move forward to a mandatory disclosure regime, clearly thorough preparatory work is necessary to make it work better here in New Zealand. The document is a step in the right direction. It is well presented and raises some thoughtful issues and questions for discussion. I congratulate the team at XRB for their work.

I give below some general comments and suggestions on the proposed standard for your consideration. Specific responses to the individual questions raised in the document are given in the Appendix.

1. Financial sector participants as 'preparers' of disclosed information: the challenge of aggregation

Under the proposed legislation reporting entities ('preparers') includes institutions in both the financial sector (i.e., banks, insurers, fund managers) as well as publicly listed entities in the non-financial sector above a certain market cap threshold. The disclosure framework seems straightforward for non-financial sector participants as preparers: they will be required to disclose climate-related information (including governance and risk management arrangements) for their specific industry sectors.

For financial sector participants, the task of preparing disclosure information in a meaningful way is tricky, and I am not sure this has been reflected in the document. Apart from being 'primary users', financial sector participants will also have an obligatory *preparer* role, with respect to their portfolio of loans / investments. In the consultation document it is not very clear how this dual role will work. Their preparer role will present some conceptual challenges that need some further thought.

Financial sector participants sit at the top of the financing eco-system. Their lending or financing portfolio would typically include a wide variety of businesses or sectors, each with its own distinctive set of climate related governance and risk management arrangements, climate related challenges, strategies and metrics. Aggregating such diverse information streams obtained from their portfolio constituents and presenting a composite picture into their own publicly disclosed reports in a meaningful way will likely be conceptual minefield.

For instance, companies in the energy sector, construction sector, technology or media sector will arguably have different carbon footprints, face widely different climate challenges, and will need to adopt different risk management approaches, strategies and metrics to reduce their climate impact or protect their businesses from related risks. A bank that lends to, or a fund that invests in, a diverse portfolio of such companies will require some clear thinking on how to aggregate and present in its own disclosed reports cross all the mandatory disclosure elements. A bank may well disclose its own governance or risk management processes, but to be meaningful these must be grounded in the corresponding arrangements in the constituents of their portfolio. This issue will be particularly challenging when disclosing for the strategy, risk management and metrics pillars of TCFD recommendations.

2. Climate risks and opportunities: did we get the balance right?

Elsewhere in this document (footnote 20 on page 16) the term 'climate-related issues' has been defined to include both risks and opportunities. Yet disclosure objectives stated here relate only to climate related risks, without a specific mention of opportunities.

It seems more appropriate to also include a specific reference to climate related opportunities in the disclosure objective or explanatory paragraph. This would complete the objective and align it to the intent of the disclosure standards. From the perspective of primary users, we need to keep focus on both risks that arise from climate change on the invested / financed assets, and the pursuit of opportunities the businesses create or exploit for climate adaptation / mitigation, for the benefit of the business, industry sector, community, or society at large. The notion is that when businesses diligently work on climate risk mitigation, for instance to reduce the climate impact of their operations or through their business value chain, opportunities for mitigating climate impact across a wider footprint may arise. Primary users would have an interest in understanding how risk management processes systematically filter such opportunities and consider these for commercialization. The term climate-related opportunities are well defined in 7.4.

3. Financial sector participants as preparers – a different risk classification

As noted above, banks, investment funds and insurers will have to view climate-related risks differently from operating businesses. This is where a risk classification of physical and transition risks may fall short. Financial institutions as preparers likely already analyse and classify risks along sectoral groupings, such as by portfolio (for example, home loans, commercial loans, commercial insurance, personal insurance), by hazard (for example, tropical cyclones, floods, convective storms and hail, coastal inundation, bushfire, soil contraction) and by geographic region. It would seem appropriate to encourage them to disclose such exposures in aggregate as part of the mandatory disclosures. This can be done by accommodating these risk categories in the definitions and in the disclosure requirements for all TCFD pillars. These would certainly be of interest to primary users.

Secondly, financial institutions normally face a different of risks derived from their business operations, including credit risks and financial risks. Theis classification would be particularly relevant for risks derived from climate related issues. For instance:

- *Credit risk* is often defined as the potential reduction in value of on- and off-balance-sheet assets due to a deterioration in the credit profile of an institution’s clients or a financial counterparty. Both investment and treasury activities are at risk of climate change–induced degradation in creditworthiness
- *Financial risk* relates to reduced liquidity available to meet an institution’s obligations to disburse / invest funds because of a loss in the value of its investments or other assets, its potential inability to access funding at a reasonable cost, and the deterioration in value of financial instruments because of market changes.

I suggest that some clarity is provided in the disclosure standards to accommodate this risk classification.

4. Where and how to disclose?

There is currently a serious debate among professional accountants and corporate leaders about where TCFD information should be disclosed. This is not as mundane as it sounds. TCFD has recommended that all the recommended information be integrated into the annual financial filings that listed companies are required to make to market regulators. I am not sure how this matter will be addressed in our proposed mandatory disclosures. You may wish to open this aspect up for some debate and develop guidance going forward. This may present implementation challenges.

I trust you will find these comments helpful in this journey. Thank you for the opportunity once again, and best wishes.

Nga mihi

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Appendix 1

Questions	Comments
1. 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?	Yes. However, it will be helpful to clarify that investors include both institutional and individual investors. Retail investor community are a significant group in many financial markets, and their interest in climate-related information and disclosure should be protected. They can potentially play a role in influencing the climate responses of companies they invest directly in through stock exchanges.
2. Do you think the proposed Governance section of NZ CS 1 meets primary user needs? *a) Do you think that the information provided under this section of NZ CS 1 will provide information that is useful for decision making to primary users (existing and potential investors, lenders and insurance underwriters)? If not, please explain why not and identify any alternative proposals.* *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?* *c) Do you consider that this section of the standard is adequately comprehensive and achieves the right balance in terms of prescriptiveness and specificity? If not, what should be removed or added to achieve a better balance? (Para 7.2.1 Pg 17)*	Yes
3. Do you think the proposed Risk Management section of NZ CS 1 meets primary user needs? *a) Do you think that the information provided under this section of the standard will provide information that is useful for decision making to primary users (existing and potential investors, lenders and insurance underwriters)? If not, please explain why not and identify any alternative proposals.* *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?* *c) Do you consider that this section of the standard is adequately comprehensive and achieves the right balance*	a) and b) The proposed disclosure will be adequate in relation to governance at the non-financial sector participants who will prepare the information. It is not very clear how this will work for financial sector participants who also have a 'preparer' role and obligation to disclose. There may be some conceptual challenges here that needs further thinking and clarity- See notes 1 and 2 in cover letter. The balance between climate risks and opportunities needs some adjustment - See note 2 in cover letter.

Questions	Comments
in terms of prescriptiveness and specificity? If not, what should be removed or added to achieve a better balance? (para 7.3.1 Pg 19)	c) Yes. (We may need more specificity in the disclosures on Metrics and strategy!)
4. 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? *(Para 7.4 pg 22)*	Yes, with some qualifications, see note 2 and 3 in cover letter.
5. 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'?* *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?*	I understand the thinking behind requiring disclosure only for physical and transition risks. However, please note that financing institutions will typically cover a wide range of sectors, some of which may well have very distinct and wide-ranging risks that don't quite fit tightly in the physical and transition risk categories as defined. It would be better to leave in place for disclosure any other risks that are "not elsewhere specified", a kind of catch-all group where the entities could disclose other risks that are material for them. Please also see notes 2 and 3 in cover letter on 'opportunities'.
6. Do you have any other views on the defined terms as they are currently proposed?	See note 3 in cover letter.
7. 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? *(Para 8.1 pg 23)*	Yes, as stated in the document, adoption of these standards for Governance and Risk Management sections are unlikely to be onerous. Adoption standards will probably need to be considered for the Strategy and Metrics pillars.
8. 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? (Para 9 pg 24)	Yes
9. Any other comments	Guidance on where and how to disclose needs some debate. See note 4 in cover letter.