Climate-related Disclosures

Governance and Risk Management Consultation Document

EY submission

November 2021

Building a better working world

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Submitted to climate@xrb.govt.nz

Climate-related Disclosures Governance and Risk Management Consultation Document

Tēnā koe e te rangatira,

EY welcomes the opportunity to submit to the External Reporting Board (**XRB**) on the proposed Governance and Risk Management sections as part of the Aotearoa New Zealand Climate Standard 1: Climate-related Disclosures (**NZ CS 1**).

At EY, we are committed to building a better working world — building trust and confidence in the capital markets and in economies the world over. Our multidisciplinary Climate Change and Sustainability Services team helps clients understand the risks and opportunities arising from climate change and sustainability issues. In January 2021, we announced our ambition to be carbon negative in 2021 by setting targets to significantly reduce our absolute emissions and removing and offsetting more carbon than we emit. We plan to not only become carbon negative but to reduce our total emissions by 40% - consistent with a science-based target - and achieve net zero in 2025.

The EY commitment to sustainability is an integral part of our NextWave strategy and ambition to create long-term value for all stakeholders. We believe climate-related financial disclosures can contribute to a better working world. Our submission contains our views on NZ CS 1 and specific recommendations on the draft sections on Governance and Risk Management that we believe could further improve transparency and decision-making to stimulate and steer investment towards long-term sustainable options and support the allocation of capital to adaptable, efficient and climate-resilient entities.

We hope that our submission will provide a valuable point of view. Thank you for the opportunity to make this submission and we look forward to continued engagement.

Ngā mihi nui,

Pip Best, New Zealand Climate Change and Sustainability Services Partner

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SUBMISSIONS

1. Background

Our working world is undergoing significant shifts. Investors, regulators and — more broadly — society are increasingly demanding greater transparency around both the financial and nonfinancial performance of organisations to assess their true long-term value.

EY's Climate Change and Sustainability Services (**CCaSS**) practice helps clients strategise for long-term value by understanding and evaluating nonfinancial outcomes and impacts (including climate change), identifying risks and opportunities, and supporting the reporting of nonfinancial performance disclosures to their stakeholders. EY is a member of the Task Force on Climate-related Financial Disclosures (**TCFD**) and issues regular Climate Risk Barometer publications which monitor the progress of reporting against the TCFD recommendations at a global and regional level. These publications have highlighted small incremental improvements in climate risk disclosures since the launch of the TCFD but also show a significant gap between the full set of recommended disclosures and current practice. In addition, our CCaSS practice in Aotearoa New Zealand has served as the Secretariat of The Aotearoa Circle's Sustainable Finance Forum (**SFF**) to develop the SFF Interim Report and 2030 Roadmap for Action, recognising the critical role of finance to scale up and re-direct capital to enable the transition to a sustainable economy. EY continues to support the work of Toitū Tahua - the Centre for Sustainable Finance, and the implementation of the 2030 Roadmap for Action.

Given our role in helping clients respond to climate change risks and the development of reporting frameworks such as the TCFD recommendations, we welcome the opportunity to make this submission on the draft Governance and Risk Management sections as part of the proposed standard, **NZ CS 1**.

2. Executive Summary

EY strongly supports the draft sections on Governance and Risk Management as part of NZ CS 1, that have been outlined in the Consultation Document. In particular, EY supports XRB's decision to base NZ CS 1 on the TCFD recommendations, as the leading framework for climate-related disclosures internationally, and to provide additional disclosure requirements, where necessary, to ensure that NZ CS 1 is ambitious and forward-looking.

Our submission makes specific recommendations we believe could further improve transparency and decision-making to stimulate and steer investment towards long-term sustainable options and support the allocation of capital to well-prepared and climate-resilient entities. On the basis that all sectors will face disruption from the physical and transition impacts of climate change, and that the climate-related disclosures regime should serve the needs of a broad range of stakeholders, we submit that:

- the concept of materiality should be defined using a double materiality lens, to cover not only the impact of climate change on the climate reporting entities (**CRE**) (as defined in the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill), but also the impact of the CRE on climate change.
- the definition of primary users should be expanded beyond "existing and potential investors, lenders and insurance underwriters" to cover a wider scope of stakeholders who have a legitimate interest in the disclosures made by CREs and other entities who chose to voluntarily disclose in line with the NZ CS 1.
- the level of assurance required over GHG emissions is appropriate to be set at a limited assurance level, and that assurance over other disclosures beyond GHG emissions should be encouraged.

3. The Concept of Double Materiality

EY notes that the XRB are currently developing a definition of "material". The XRB has acknowledged "that the outward 'impacts of' an entity on climate change are also important to consider" and that future consultation (specifically in relation to Strategy and Metrics and Targets) will explore extending into this area. EY recommends that in order to allow NZ CS 1 to be future proofed as far as possible, the XRB should embrace the opportunity to incorporate the concept of double materiality into all aspects of NZ CS 1 from the outset.

International reporting obligations are increasingly adopting a "double materiality" lens to sustainability reporting, which requires an assessment of both inwards and outwards impacts (i.e. not only the material impact of climate change on the entity itself, but also the entity's material impact on climate change (beyond the disclosure of greenhouse gas emissions metrics). A key example of this is the European Union's (**EU**) proposed Corporate Sustainability Reporting Directive (**CSRD**) which will amend the existing Non-Financial Reporting Directive (**NFRD**). The CSRD aims to ensure that companies publicly disclose adequate information about the sustainability risks and opportunities they face, as well as the impacts they have on people and the environment ("double materiality").

When companies report under the directive, they will need to use a set of new sustainability reporting standards being developed by the European Financial Reporting Advisory Group (EFRAG). The proposed sustainability reporting standards by the EFRAG aim to meet the requirements of an inclusive range of stakeholders. They will adhere to the concept of "double materiality," with both "impact materiality" and "financial materiality" perspectives being applied in their own right. The concept of double materiality has recently been incorporated into TCFD reporting requirements in Switzerland, which, from 2024, will require large Swiss companies to report on both their financial or investment risks linked to climate change, and on the impact that the company's commercial activity concretely has on the environment. Although the TCFD recommendations are focussed on the financial risks inherent to individual entities, by adopting a double materiality lens the XRB can ensure that NZ CS 1 is better future proofed by reflecting emerging international best practice on climate-related materiality. In turn, the regime can help to better disclose the complete impact of climate change in Aotearoa New Zealand, by ensuring CRE's impact on our climate and environment is not excluded from disclosures.

We recommend that a double materiality lens should be applied to Governance and Risk Management as well as Strategy and Metrics and Targets disclosures, to ensure that entities publicly disclose adequate information about the risks and sustainability issues they face, as well as the impacts that they are having on people and the environment.

4. Definition of Primary Users

In the context of climate change risks, shifting from a shareholder to stakeholder perspective is important given that TCFD-aligned climate-related disclosures are designed to be used by entities in providing information not only to investors but to "other stakeholders". NZ CS 1 is based on the TCFD's recommended disclosures however it has identified the primary users of climate-related disclosures as only "existing and potential investors, lenders and insurance underwriters", on the basis that they are the ones making capital allocation and other decisions based on the information provided in the disclosures. While XRB acknowledges that climate-related disclosures may also be relevant to a wider group of stakeholders, "other stakeholders" are not considered primary users.

All sectors will face disruption from the physical and transition impacts of climate change. We note that the TCFD recommendations refers to "investors, lenders, insurance underwriters *and other stakeholders*" as having a legitimate interest in the disclosures themselves or in the outcomes of the disclosures. It is important for all stakeholders, including civil society, government, regulators, customers and employees and the general public, to be able to assess the climate risks of CREs. "Existing and potential investors, lenders and insurance underwriters" are not the only stakeholders that interact with CREs and who make decisions based on the information provided in disclosures. EY also notes that an expanded definition of primary users will help to ensure that that all types of entities, including Crown Financial Institutions and entities not captured by the definition of CREs, can make appropriate disclosures in line with NZ CS 1.

We recommend that definition of primary users should be expanded to cover a wider scope of stakeholders who have a legitimate interest in the disclosures made by CREs and other entities who disclose in line with the NZ CS 1.

5. Assurance requirements

Investors, regulators and — more broadly — society are increasingly demanding greater transparency around nonfinancial performance of organisations to assess their true long-term value. Assurance serves the public interest by promoting trust and confidence in business and the capital markets. We note that the XRB is working to determine whether the XRB will specify the level of assurance required over GHG emissions, and if so, what the level of assurance will be. Disclosures are of limited use if users cannot be confident in their accuracy.

We currently provide GHG assurance to a wide variety of organisations across a range of sectors. We have also provided limited assurance over disclosures in relation to the broader TCFD recommendations and the assumptions and approach supporting climate scenario analysis and portfolio analysis. Internationally, assurance of non-financial disclosures continues to steadily grow, helping to raise the quality of disclosures. For example, the proposed EU CSRD, which is expected to apply to approximately almost 49,000 companies, will require companies to provide external assurance of reported sustainability information.

We recommended that limited assurance should be adopted as the required assurance level over GHG emissions. We believe this is an appropriate level of assurance to provide transparency and accountability to stakeholders, as well as assurance to management and those charged with governance over the quality of the information provided. While reasonable assurance is feasible over GHG emissions metrics, limited assurance is a suitable starting level for mandatory assurance requirements, with an option to move towards reasonable assurance at a later stage once the regime has been in force for an appropriate period of time. In addition, we submit that limited assurance is also an appropriate level of assurance over other disclosures beyond GHG emissions.

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6. Conclusion

Climate-related risks can pose serious risks for investors and other stakeholders, and the management of these risks can underpin the ability of an entity to achieve long-term success. EY is committed to ensuring that the assurance and advisory professions are able to continue serving the evolving needs of investors, business, and the public interest.

We commend the XRB for utilising this opportunity to create a strong, fair and effective climate-related risks disclosure regime which supports Aotearoa New Zealand's pathway towards to a more sustainable, low-emissions, climate resilient economy. We wish to again express strong support for the draft sections on Governance and Risk Management as part of NZ CS 1, that have been outlined in the Consultation Document. The recommendations we have outlined within our submission are intended to highlight areas where NZ CS 1 can be further strengthened to achieve a world leading climate-related disclosure framework for Aotearoa New Zealand to allow for better decision making on capital allocation and help smooth our transition.

We are happy to meet with the Climate-related Disclosures Project Steering Group to discuss any aspect of our submission. To discuss this further, please contact Pip Best at pip.best@nz.ey.com

option B
option A
global
Growth
idea
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