

22 November 2021

External Reporting Board

By email: climate@xrb.govt.nz

Submission on Aotearoa New Zealand Climate Standard 1 – Governance and Risk Management Consultation Document – Climate-related Disclosures

- 1 This is a submission by Dentons Kensington Swan on the External Reporting Board's – Te Kāwai Ārahi Pūrongo Mōwaho ('XRB') *Proposed Aotearoa New Zealand Climate Standard 1 – Climate-related Disclosures* ('Climate Standards') Governance and Risk Management Consultation Document of October 2021 ('Consultation Document').

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- 2 Dentons Kensington Swan is one of New Zealand's premier law firms with a legal team comprising over 100 lawyers acting on government, commercial, and financial markets projects from our offices in Wellington and Auckland. We are part of Dentons, the world's largest law firm, we have unparalleled access to the legal expertise of over 12,000 lawyers in more than 80 jurisdictions.
- 3 We act for a wide range of financial markets participants, including a number of providers of KiwiSaver schemes and other managed funds. We frequently assist managers, trustees, supervisors, and custodians of schemes in meeting their regulatory compliance obligations under the Financial Markets Conduct Act 2013, including their financial market licensee obligations.
- 4 Our submission below has been drafted to include:
 - a general comments on the proposed Climate Standards;
 - b more specific comments in relation to the Governance Section and Risk Management Sections of the proposed Climate Standards; and
 - c some specific issues faced by KiwiSave schemes and other managed funds.

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General Comments

- 5 We strongly agree that climate change is an increasingly important issue, and that climate change considerations must be at the forefront of any future-thinking governance body. However, in the context of climate-related disclosures, climate reporting entities ('CREs') need to be able to take into account how climate change affects them and tailor their disclosures appropriately.
- 6 While the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021 ('Act') requires CREs to comply with climate-related disclosure standards, those standards must also reflect that climate-related issues will be more prevalent for some CREs than others and, accordingly, the climate statement prepared by each CRE should be able to be tailored to reflect the climate related issues that they face and consider important.
- 7 This need for differential reporting by CREs was highlighted by the Economic Development, Science and Innovation Committee ('Committee') in their final recommendations prior the Act being passed. In recommending the removal of the "explain" part of the "comply-or-explain" regime, the Committee noted that the need for differential reporting could be achieved through the development and application of the Climate Standards.
- 8 The proposition that different CREs will have different reporting requirements in relation to climate related issues is also supported by the Task Force on Climate-related Financial Disclosures ('TCFD') who stated in their *Fundamental Principles for Disclosure* that "Disclosures should be eliminated if they are immaterial or redundant to avoid obscuring relevant information" and "Organizations should avoid generic or boilerplate disclosures that do not add value to users' understanding of issues".
- 9 As currently drafted, the Climate Standards do not adequately provide for differential reporting and do not provide sufficient flexibility to allow CREs to tailor their climate-related disclosures, and their governance and risk management frameworks to the climate risks that they face.
- 10 While we agree with the Committee and the TCFD that CREs should be required to provide a climate statement, we also agree with the Committee that differential reporting is important and that the Climate Standards should provide for this. In particular, we consider that differential reporting should:
- a allow CREs to develop governance and compliance processes that are right-sized for the climate-related risks they face, and provide disclosures which are fit for purposes;
 - b result in a better overall analysis of climate-related matters and disclosures;
 - c avoid a 'tick the box' exercise, which ultimately would result in less meaningful disclosures; and
 - d ensure that the costs associated with providing more detailed climate-related disclosures will be borne by those to which CREs that the matters are most relevant.
- 11 This response will focus on the two draft sections of the Climate Standard released – Governance and Risk Management. We appreciate the opportunity to respond to the XRB's proposed framework at this time.

Governance Section

- 12 The stated aim of the Governance Section of the Climate Standards is to enable primary users to understand the role of the board and management of a CRE in overseeing, assessing, and managing climate-related issues.
- 13 In its current form, we hold concerns that the requirements will result in:
- a CREs needing to develop governance processes that are not right-sized for the CRE's characteristics;
 - b CREs needing to provide information that is not fit for purpose based on the climate change risks that are faced by the CRE; and
 - c CREs adopting a 'tick the box' approach.

What disclosures should be made?

- 14 Although the Consultation Document states 'Climate-related disclosures are not intended to be a compliance exercise' and that disclosures 'should not be used as a checklist', the use of '*must include*' with respect to information disclosures under sections 7.2(4) and 7.2(5) of the proposed Governance Section strongly contradicts that stance. In our view, the statement in Annex 2 of the Consultation Paper that the XRB proposed guidance on governance disclosures represents 'no substantive change' from the TCPD's recommendations is disingenuous. The change in wording will have a material impact on CREs
- 15 It is difficult to reconcile the XRB's view that CREs are to "*apply judgement to determine what information is material and whether the information provided satisfies the disclosure objective*", with its use of the words '*must include*' for the broad list of mandatory disclosures.
- 16 The inclusion of the words "*must include*" means that the Climate Standards:
- a do not allow for differential reporting as per the Committee's recommendation; and
 - b are not aligned with the TCFD's Fundamental Principles for Disclosure nor the recommendations provided by the TCFD, which are drafted on the basis that the relevant CRE "*should consider including the following information.....*".
- 17 For these reasons, we **recommend** that the reference to '*must include*' in sections 7.2(4) and 7.2(5) of the proposed Governance Section be replaced with "*should consider including*", to align with TCFD's recommended approach. This recommendation would still require a CRE to provide a climate change statement that includes:
- a a description of the board's oversight of climate-related risks and climate-related opportunities; and
 - b a description of management's role in assessing and managing climate-related risks and climate-related opportunities,

and where appropriate, the CRE would need to include the information set out in sections 7.2(4) and 7.2(5) of the proposed Governance Section.

- 18 This approach would provide a CRE with the ability to tailor its disclosure to include information which is most relevant to it and the climate risks that it faces – noting that where a CRE fails to comply with an applicable climate standard, the CRE and its directors commit an offence and are liable to imprisonment or a fine, in the case of an individual, or a fine in other cases. This would avoid CREs needing to adopt governance processes that are disproportionate to the impact of climate change on their business.

Additional information

- 19 The explanatory paragraph to the proposed Governance Section provides that:

“If the disclosures provided, applying paragraphs 3– 5, are not sufficient to meet the objective in paragraph 1, an entity must disclose additional information necessary to meet that objective. However, an entity must ensure that relevant information is not obscured by the inclusion of insignificant detail.”

- 20 While this statement provides that the CRE must ensure that the relevant information is not obscured by the inclusion of insignificant detail, given the inclusion of the new offence provision we are of the view that CREs are likely to take an overcautious approach to what is ‘relevant’ and what is ‘necessary’ to meet the objectives, to ensure there is no question of compliance with the Climate Standards. These concerns are exacerbated by the requirement in the guidance notes that disclosures ‘must include’ certain items.
- 21 In such cases, the ability for primary users to have access to *consistent* and *comparable* information that will generate genuine understanding of climate related risks and opportunities a business carries will likely be jeopardised where too much information is disclosed.
- 22 The disclosures required may also distort the extent of a CRE’s focus on the impact of climate change compared with other areas of the CRE’s business, for those CREs where the impact of climate change is negligible. This is particularly the case for fund manager CREs required to disclose governance arrangements for funds that are largely unaffected by climate issues.

Cost v benefit

- 23 The provision of the information required by the disclosures, and the new governance processes that will need to be put in place to support those disclosures, will come at a cost – both in time and money. To the extent that the information required is relevant and appropriate for a CRE, however, that is certainly worthwhile. There will be significant upfront, and ongoing, investment made by all CREs in order to comply, and it must be ensured that the cost of providing such information does not *exceed* the benefit to primary users in each case.
- 24 We believe our recommendation above is an appropriate trade-off between ensuring that appropriate climate disclosures are made and the costs involved in supporting and providing such disclosures.

Risk Management

What disclosures should be made?

- 25 Consistent with our comments above, we consider that the inclusion of the words ‘*must include*’ in sections 7.3(4) and 7.3(5) of the proposed Risk Management Section means that the Climate Standards:
- a do not allow for differential reporting as per the Committee’s recommendation; and
 - b are not aligned with the recommendations provided by the TCFD, which are drafted on the basis that the relevant CRE “*should consider including the following information.....*”.
- 26 For the same reasons listed above, we **recommend** that the reference to “*must include*” in sections 7.4 and 7.5 of the proposed Risk Management Section should be replaced with ‘*should consider including*’. This recommendation would still require a CRE to provide a climate change statement that includes:
- a a description of its processes for identifying and assessing climate-related risks
 - b a description of its processes for managing climate-related risks; and
 - c a description of how its processes for identifying, assessing, and managing climate-related risks are integrated into its overall risk management,
- and where appropriate, the CRE could include the additional information set out in in sections 7.3(4) and 7.3(5) of the proposed Risk Management Section.

Additional information

- 27 Also consistent with our comments above, we consider that the inclusion of the statement:
- “If the disclosures provided, applying paragraphs 3–5, are not sufficient to meet the objective in paragraph 1, an entity must disclose additional information necessary to meet that objective. However, an entity must ensure that relevant information is not obscured by the inclusion of insignificant detail.”*

will likely mean that CREs take an overcautious approach to what is ‘relevant’ to ensure there is no question of compliance with the Climate Standards. As above, this will jeopardise the effectiveness of the regime for primary users.

Specific issues faced by KiwiSaver schemes and managed funds

- 28 Consistent with our comments above:
- a the proposed Climate Standards do not adequately allow for climate-related disclosures to be tailored to address the climate-related risks faced by different KiwiSaver schemes and other managed funds; and
 - b the costs (both time and money) associated with compliance with the Climate Standards will outweigh the benefit of the regime.

- 29 As a starting point, while we understand that it may be appropriate for KiwiSaver providers and other fund managers to provide disclosures at both an entity and underlying fund level, the proposed Climate Standards do not adequately provide for this. In our view, the climate-related disclosures at an entity level will relate mostly to governance and oversight while at the underlying scheme / fund level the disclosures will relate to the actual investments themselves (which are likely to be more detailed).
- 30 While it is important for investors to understand how climate-related risks are dealt with at a governance / board level, we **recommend** that the Climate Standards need to include mechanisms to reflect that the climate-related disclosure required at the entity level will be different from the climate-related disclosures required at the underlying scheme / fund level.
- 31 Second, the Climate Standards do not recognise that the climate-related risks faced by some schemes or funds are greater than others. For example, a scheme or fund that invests in a number of companies (who have significant climate impacts) will be exposed to substantially higher climate-related risks than a scheme or fund that solely invests in green bonds or ESG funds.
- 32 Last, the Climate Standards are unclear as to the extent of the obligations that will apply where a CRE fund manager invests on a “fund of funds” basis. Classification of the XRB’s expectations in this regard would be helpful.
- 33 As currently drafted, the Climate Standards do not adequately allow CREs who are fund managers to tailor their climate-related disclosures, and contradict the TCFD’s fundamental principles for effective disclosure. We consider that an effective solution to this issue is covered by our recommendations above.

Further information

- 34 We thank the XRB for the opportunity to submit of the draft Climate Standards through the Consultation Document.
- 35 With the recommendations that we have proposed above, we consider that the Climate Standards will be market leading in terms of the TCFD’s recommendations and will provide a shining example of climate-related disclosures that can be adopted by other jurisdictions.
- 36 We are happy to discuss any aspect of our feedback on the Consultation Document. Thank you for the opportunity to submit.

Yours faithfully



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