

Aotearoa New Zealand Climate Standard 1: Governance and Risk Management

November 22, 2021

Submission by the Responsible Investment Association Australasia

The Responsible Investment Association Australasia (RIAA) welcomes the opportunity to make a submission to the External Reporting Board (XRB) on its consultation into a standard for governance and risk management (NZ CS 1).

About RIAA and our members

RIAA champions responsible investing and a sustainable financial system in New Zealand and Australia and is dedicated to ensuring capital is aligned with achieving a healthy society, environment, and economy.

With over 450 members managing more than NZ\$39 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across New Zealand and Australia. RIAA's membership includes superannuation funds, KiwiSaver default providers, fund managers, banks, consultants, researchers, brokers, property managers, community trusts, foundations, faith-based groups, financial advisers, financial advisory groups, and others involved in the finance industry, across the full value chain of institutional to retail investors.

The importance of XRB's NZ CS 1 to the global investment community

Aotearoa New Zealand may be the first jurisdiction globally to require mandatory climate risk disclosures for large public companies and their investors. Disclosure of climate risk will be essential to achieving more accurate risk management and valuations. This should lead to faster, meaningful global decarbonisation efforts, which will help achieve the commitments of both the Paris Agreement and the Glasgow Climate Pact. Accordingly, by benchmarking what good mandatory climate risk disclosure standards look like, the XRB's regulation of NX CS 1 will have global implications.

Summary

RIAA supports the overall approach taken to drafting the Standard for governance and risk management for climate related financial disclosures.

At the highest-level RIAA's key recommendations to improve the comparability and completeness of data as well as the supervision and regulation of disclosures are:

- a. Escalate *supervisors and regulators* to primary users
- b. More consistently align with the TCFD recommendations, including scope of disclosures and terms, for example, board management disclosures including processes *and frequency* by which management is informed
- c. Consider IGCC's recommendation that board climate change expertise is disclosed by way of a published matrix, with climate change a skill that directors are assessed against

- d. Issue supporting guidance that specifically addresses and guides reporters with respect to:
- identifying and considering the different types of risks that may or may not be material to respective entities (i.e. chronic and acute physical risks)
 - Prioritisation of risks (section 5)
 - Issues related to the Strategy (which includes scenario analysis) and Targets & Metrics sections
 - how unlisted companies and other uncovered entities may voluntarily report against the Standard
- e. Provide a timeline for when the XRB shall review the Standard.

Responses to consultation questions

1a. 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?

Recommendation 1: Consider adding ‘supervisors’ to the definition of the term ‘regulators’ and escalating the revised user group to primary users. *Supervisors* may include independent verifiers of extra-financial data.

Rationale: The reason for recommending the escalation of *supervisors and regulators* to primary users is so that they have both the scope and presentation of data in a way that enables adequate supervision and enforcement in the roll out of the forthcoming disclosure standard. Independent verifiers will have a key role in ensuring the reporting against the standard is complete and reliable.

2a. Do you think the proposed Governance section of NZ CS 1 meets primary user needs?

Recommendation 2a: Amend Clause 5c to read “processes *and frequency* by which management is informed about, makes decisions on, and monitors, climate-related issues.”

Rationale: to align with Clause 4a for the Board (i.e. Clause 4a notes “processes and frequency by which the board and/or board committees are informed about climate-related issues”) and provide completeness in data reported.

Recommendation 2b: Review and consider references contained in the Investor Group on Climate Change’s (IGCC) submission to board skills disclosure through a published matrix, with climate change being a skill that directors are assessed against.

2b. 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?

Comment: some aspects of the TCFD recommendations are not reflected in the draft Standard, particularly with respect to Clause 4a Board duties. Respecting the XRB is adopting a qualitative and less prescriptive approach to guide reporting, it may be worth considering providing guidance (separate to the Standard) that suggests reporters also consider and disclose how climate change has been factored into strategy, business plans and budgets.

3. Do you think the proposed Risk Management section of NZ CS 1 meets user needs?

Discussion: If the XRB is deviating from the prescriptive nature of TCFD recommendations with respect to specifying the types of risks against which entities should report, then the Standard risks

reducing completeness and comparability. Should the XRB choose a method of reporting different to TCFD recommendations, it will be important that clear guidance is provided that enables reporting entities to see, identify and consider the different types of risks that may or may not be material to their respective entities (i.e. chronic and acute physical risks). Particularly during the first few reporting cycles, the provision of education by way of guidance notes (around the consideration and disclosure of certain risk types for example) may in some cases lead to a 'tick the boxes exercise', but this outweighs the risk of reporting entities not including certain aspects because they simply have not had exposure to or understand the scope and nature of climate risks in their business operations and strategies.

Recommendation 3a. Guidance be provided that enables reporting entities to see, identify and consider the different types of risks that may or may not be material to their respective entities (i.e. chronic and acute physical risks).

Recommendation 3b. Consider adding a requirement for liable reporting entities to report:

- the types of climate-related risks that were assessed alongside the process for identifying the risks. This would be separate to setting out the identified material risks for a reporting entity in Strategy section reporting.
- how a reporting entity *prioritises* different risks (section 5).

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?

Comment: RIAA agrees that the XRB should align closely with international frameworks and definitions, especially those set out by the TCFD.

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'

Comment: RIAA supports the IGCC's proposal to establish a definition for "climate change skills" as it relates to boards and management based on the *World Economic Forum Climate Governance Principles, Changing Climate*, Cluster 4 of the European Financial Reporting Advisory Group's sustainability reporting standards roadmap, and other relevant sources.

6. Do you have any other views on the defined terms as they are currently proposed?

Recommendation 6a: To assist with clarity of responsibility, personalise terms to the largest extent possible (i.e. 'board members' or 'board members acting as the board', rather than 'the board').

Recommendation 6b: Consider adding *investment committee* to key terms. These committees are essential decision-making forums and are not always a sub-committee of the board, so should be listed alongside the other important governance aspects of the entity.

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?

Comment: Due to the structure of the industry and the sequencing of reporting obligations, the XRB will need to accommodate some incompleteness of data during the first and second reporting phase. Underlying companies and their fund managers will take at least the full first cycle to be able to

report in a way that enables an asset owner (at the end of the value chain) to report completely and reliably. Having said this, RIAA agrees with the XRB that it is not necessary to provide any adoption provisions for entities in relation to NZ CS 1 as this is the overarching aspect of the disclosures. Entities such as asset owners should address the potential incompleteness of their data in the initial periods with a commentary around why this exists.

Recommendation 7: accommodate some incompleteness of data from those entities at the end of the investment value chain during the first and second reporting phases.

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?

Comment: With regards to the Governance and Risk Management elements, sector-neutral requirements are appropriate. For the remaining two elements, Strategy (which includes scenario analysis) and Targets & Metrics, sector-specific guidance may be required to guide reporters.

9. Do you have any other comments?

Recommendation 9a: Provide a timeline for when the XRB shall review the Standard and a menu of likely associated guidance.

Recommendation 9b: Consider providing guidance on how unlisted companies and other uncovered entities may voluntarily report against the Standard.

Recommendation 9c. Because the XRB is taking a principle rather than prescriptive approach to supporting mandatory climate risk disclosures it is critical that in referencing the Paris Agreement, the *full phrasing* is used to reflect the context in which the Agreement was negotiated and struck and give relevance to the aspects of disclosure selected by reporting entities.

The Consultation’s commentary	The Paris Agreement text for Article 2(a)
“holding the increasing in the global average temperature to well below 2° C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5° C above pre-industrial levels.”	”holding the increase in the global average temperature to well below 2° C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5° C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change. ”