RBNZ SUBMISSION ON THE

XRB Climate-related Disclosures Consultation Document

26 November 2021

Reserve Bank of New Zealand
Te Pūtea Matua

Introduction

Protecting and promoting the stability of New Zealand's financial system is one of our key objectives. Climate-related risks will have a significant effect on New Zealand's economy and financial system. Therefore, we are a strong supporter of increased disclosure of climate-related risks as a way to understand and mitigate financial risks while incentivising investment in a low-emissions economy. We note that the ultimate responsibility for managing risks lies with the firms themselves, not with regulators, and see disclosure as a key step to making that happen.

Disclosure can facilitate:

- Changes to firms' behaviour by directing attention to climate-related risks – 'you manage what you measure'.
- Changes to investors' behaviour by reflecting the climate-related risks and opportunities of investment thus helping to avoid stranded assets and incentivise low-emission investment.

Therefore, disclosure can help ensure that climate change is considered in business decisions.

The Taskforce for Climate-related Financial Disclosure (TCFD) has led the way globally with its guidance promoting disclosure that is decision-useful, comparable, and forward-looking. We welcome the new requirements for mandatory climate-related disclosure under the recently enacted Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021, and have a close interest in the reporting standards that the XRB is developing to implement the new requirements in line with the TCFD guidance.

These requirements will apply to a number of the banks and insurers that we supervise and will incentivise them to make progress on robust long-term plans for responding to climate change and managing the emerging risks. We aim to support regulated entities in achieving climate-related disclosure that meets the objectives of the XRB standards, by helping to develop a common understanding of what is needed and sharing best practice. We will be publishing a guidance note for regulated entities on best practice management of climate-related risks which will cover the separate question of what firms should do, rather than what they should disclose.

Cross-agency collaboration is crucial to address the challenge that climate change poses for the financial system and we are working proactively to help ensure that it happens. We have already been liaising closely with XRB as you work on developing your climate-related disclosure standards, and we will continue to do so. We will continue to engage closely with the XRB as you further develop your standards (and associated guidance), to ensure that any guidance or expectations we issue are consistent with what the XRB covers in respect of the reporting of that risk management.

We are very supportive of the work of the XRB in implementing climate-related disclosures. We believe regulators are primary users of the reporting standards, and our submission is driven by our desire to see alignment in climate-related risk reporting. Our goal is to see entities manage their own climate-related risks in a transparent manner that ensures these risks and opportunities are incorporated into business decisions.

We are aware that some of our comments and suggestions below will be more appropriate to include in guidance. We are happy to discuss this further.

Questions for Response

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?

We agree with the primary users identified. In addition, customers and target markets should be primary users. This is to ensure that entities consider climate-related risks, not just in respect of their finances, but also how the risks impact their dealings with customers, for example, on provisions of services.

We also think that regulatory bodies, such as RBNZ and the FMA, could be considered to be primary users.

We place a significant emphasis on disclosure as part of our regulatory framework, to support effective market discipline. Adequate disclosure is critical to our financial stability mandate at the RBNZ. We believe we are a primary user, because our interest as prudential regulator is closely aligned with investors and with financial disclosures as they relate to financial risks. By considering regulators as primary users we hope to avoid doubling up on reporting requirements while making sure regulated entities are disclosing on climate-related risks as fits with our prudential regulation requirements. These disclosures will be a helpful discussion point in our conversations with regulated entities on climate-related risks.

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.

We believe this information will be useful for primary users.

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?

We believe this section is clear and unambiguous.

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?

We think consideration needs to be given to the following factors to ensure this section of the standards on governance are adequately comprehensive and balanced.

Balance is very important and we recommend not being too prescriptive in the standards. We think this avoids making the standards difficult to follow or making them a box-ticking exercise. Having more generalised standards, with details contained in guidance, also allows for the standards to be flexible and to evolve to match the fast moving international and domestic context. Finally, we think the ultimate goal is a framework under which entities are comprehensively managing their own climate-related risks.

We agree with the XRB's stated intention to be ambitious and forward looking, and future proofed as far as possible.

Boards should give appropriate consideration to climate-related issues from a New Zealand perspective as well as from a Group perspective, where it applies to multinational firms.

- Where firms are part of a multinational business, it should not be acceptable for them to use the parent's climate-related risk reporting for their NZCS reporting without appropriate consideration of how it applies to the climate issues coming from New Zealand.
- Conversely, it may be acceptable for firms which are part of multinationals to report on their contribution to climate-related risks or opportunities as it is reported across a Group. However, the New Zealand part of the assessment must be clearly distinguished from the whole.
- Further, it will be important for entities to highlight how risks in other regions may affect their operations in New Zealand. For example, an entity may face risks from Group level activities, while entities may have branches or subsidiaries subject to significant exposures in different jurisdictions e.g. the Pacific Islands.

The requirement for the disclosure of governance processes and frequency should include reference to the policies that are in place to govern climate-related issues, and where policies are required, an expectation that they indicate frequency of review, e.g. a risk committee might have climate-related risk included in its terms of reference, which are reviewed by the Board yearly [Governance Disclosure 4 (a), 5 (c)].

Boards should disclose how they consider risks outside their standard operating or business model timelines, e.g. show an awareness or assessment of the risks that may exist outside their current view such as the 'unknown unknowns' or long-term horizon risks.

We agree that there is an interconnection between financial statements information and climate-related disclosures. Boards should ensure consistency between, or consider in tandem, climate-related risk disclosures and financial statements, to ensure that it is clear how the material financial impacts of such risks, as well as achieving any climate targets, highlighted in disclosure statements, are factored into the financial statements. The European Securities and Markets Authority (ESMA) recently stated the following in highlighting its enforcement priorities for 2021 annual financial reports:

- "ESMA also reminds issuers that, in addition to information required by individual IFRS Standards, pursuant to paragraph 112(c) of IAS 1 Presentation of Financial Statements, information on climate-related matters needs to be provided in the notes if not presented elsewhere in the financial statements when such information is relevant to an understanding of any of them."[1]

Opportunities should be included alongside risks. We support naming them as opportunities (rather than as 'upside risk' or other variations on risk).

We strongly support XRB's proposal to include remuneration policies as part of the required disclosure on governance.

[1] https://www.esma.europa.eu/sites/default/files/library/esma32-63-1186_public_statement_on_the_european_common_enforcement_priorities_2021.pdf

Boards need to have the skill and capacity to oversee climate-related risks and an understanding of how considerations for these risks/opportunities need to be embedded in the organisation. Given the economy-wide, collective nature of climate change, the XRB may wish to highlight in its guidance that collectively Boards need to discuss how they will (either themselves or with external expertise) use a big picture, strategic view that encompasses risks across appropriate timelines, spatial scales (local, national, global), all sectors, and is multidisciplinary (able to account for risks from physical impacts and transition risks e.g. policy/market risk). This will be critical to Boards being able to oversee climate-related risks. Note that this is a recommendation of the Investor Group on Climate Change. [2]

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.

We agree with the high-level objective of the standard and note that it should be consistent with TCFD recommendations. We believe a high-level approach in the standards allows for more specificity within guidance, which is easier to evolve. We feel that flexibility in the standards is important to match the speed at which climate issues are evolving.

We support public disclosure of climate-related risk and note that the new legislation requires a climate reporting entity to include its annual climate statement either within its annual report, or via an internet link from the annual report. So we believe that it is important for annual reports to be as easily accessible as possible to the general public. We also recommend that the disclosures should be communicated in a way that is accessible to a broad audience.

We recommend adding 'data sources and assumptions' as information included in Risk Management Disclosures 4 (a).

Risk management disclosure should cover short, medium and long-term time horizons and we recommend that this language should be consistent with the requirements for governance in 4 (a). Risk assessment should stretch to cover risks that may intertwine with other climate-related or non-climate related risks, intensify and snowball. For example, the possibility of agriculture facing a risk of drought, market access, regulation and price input increases all at the same time.

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?

We agree that this section is clear. We support making the overarching ambitions as flexible as possible, and putting more details in the guidance.

[2] IGCC-Climate-Change-Board-Report.pdf

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?**

In comparison to 3 (a) and 3 (b) there are no further details to cover 3 (c). We are not sure if this is because you feel it is not required.

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?

Yes, noting that as New Zealand will be one of the first countries with mandatory climate-related disclosures, we need to stay in step with international developments from the perspectives of firms, investors and regulators.

With respect to your comparisons with TCFD, specifically recommendations for Boards as noted on page 33, we recommend you consider including some examples so firms can think about interlinkages with strategies before next consultation in March 2022.

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'.

We agree with the terms you have defined and support using risks and opportunities. We prefer to see 'opportunities' used rather than alternatives such as 'upside 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'?**

Yes. As above we support using 'opportunities' as being useful and more easily understood.

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?**

Yes.

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

We ask that you keep technical terms to a minimum. We feel the terms defined here are sufficient for use in the standards.

It may also be useful to define the following terms: 'comparative information' and 'consistency of reporting'.

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?

We feel that standards around metrics, targets and scenarios may require adoption provisions but we agree that adoption provisions are not necessary for governance and risk management disclosures. However, we recommend that there is clear messaging to entities on this through 2022.

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?

Yes, we agree NZ CS 1 should be concise to make it as simple as possible.

While we think sector neutrality is achievable for the governance and risk management standards, we think this may not be the case for standards relating to metrics and targets. There are likely to be significant reporting differences for climate-related risk among insurers, banks and non-bank deposit takers.

9. Do you have any other comments?

New Zealand, like other jurisdictions, needs to build capacity in this area. There are few experts both in developing the disclosures, and in using them. For this reason disclosures should be clear and accessible and at a level appropriate for the user. We would expect practices to grow and evolve and it is important the standard is flexible enough to allow this. Guidance and messaging can support this and we should be clear it will be an expectation of regulators.

It is important to note that this disclosure framework will involve a number of regulators and firms, so it will be important for the XRB to align final decisions across existing reporting and regulatory requirements.

Thank you for this opportunity to comment on the proposed standards. We will continue to support the XRB as you work towards a full disclosure standard.

Conclusion

We place a significant emphasis on disclosure as part of our regulatory framework, to support effective market discipline. Market discipline works best if it is based on the disclosure of robust, reliable and comparable information. Although the mandatory climate-related disclosure regime will not specifically be part of our framework, we are committed to working with our regulated entities and other agencies to ensure that the new disclosure requirements deliver the best outcomes for New Zealand.