Submission to the External Reporting Board (XRB)

Aotearoa New Zealand Climate Standard 1 Climate-related Disclosures: Strategy, and Metrics and Targets Consultation Document

Submission details[1]

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Response

The Guardians of New Zealand Superannuation ('Guardians') is pleased to have the opportunity to comment on the *Climate-Related Disclosures (CS1: Strategy, and Metrics and Targets)* Consultation Document published by the NZ External Reporting Board ('XRB').

As a Crown entity, the Guardians manages the New Zealand Superannuation Fund to help pay for the increased cost of universal superannuation entitlements in the future. Information with respect to our approach to investing is available *here.*

As a long-term investor, we are committed to active ownership and the promotion of good governance for the overall health of the capital markets. In our view, good governance is an indispensable prerequisite for successful company performance over the long-term. We expect that Boards and executive teams are active in considering how to account for the changing risk profiles of the companies they are responsible for, including sustainability-related risk.

In our management of the NZ Super Fund we have long acknowledged the material risks that climate change presents to the returns of long-horizon investors like ourselves. We have worked to reduce the Fund's exposure to these risks, build up its resiliency, and position our portfolio to aid in the transition to a net zero emissions economy. We have set Fund-wide carbon reduction goals, measured our progress against these and been transparent about how we are tracking. We have also disclosed extensive information about our approach to climate change.

Under our Climate Change Investment Strategy, we aim to ensure that the risks and opportunities stemming from climate change are factored into our investment strategies and ownership practices.

[1] www.nzsuperfund.nz/publications/submissions; RI > Communications > Submissions

To do this successfully, we require credible climate-related disclosures made by the companies we invest in.

The NZ Super Fund is a signatory to the *Paris Aligned Investment Initiative*, reflecting global good practice in pursuing net zero carbon emissions by 2050. To transition a large and complex portfolio like that of the Fund's to net zero, without compromising long-term investment returns, is a challenging task. It is in large part because we have been collecting the type of data required by climate-related disclosures that we have gained the confidence required to make this commitment; it is only through comprehensive, consistent and ongoing disclosure of climate data by our investee companies that we will be able to fulfil our commitments under this initiative.

As such, the Guardians is highly supportive of the development and implementation of the mandatory climate-related disclosure regime in Aotearoa New Zealand, both for investment funds such as the NZ Super Fund, and for the companies we invest in. Specifically, from a NZ Super Fund perspective, undertaking climate-related disclosures has many benefits:

- allowing us to test our Climate Change Investment Strategy and identify improvements;
- better enabling us to make comparisons between companies and sectors in how they are responding to climate change;
- serving as a single source, setting out our approach to climate change for both internal and external audiences; and
- allowing us to walk the talk with the investee companies with which we engage on ESG disclosure matters.

Rather than reiterate the Document's salient points, the Guardians' response to the consultation on draft Climate Standard 1 (CS1) includes a series of general observations and specific suggestions in relation to each of the consultation questions.

In **summary**, the Guardians:

1. supports the need for consistent and comparable standards for climate-related disclosures in our belief that ESG considerations, including climate change, are material to long-term risk and return.
2. endorses the balanced approach taken with respect to the Strategy and the Metrics/Targets sections of the standard. We view CS1 as ambitious enough to ensure that disclosures are ultimately meaningful and comparable, while ensuring requirements are responsive to relevant context - and acknowledge the inherent complexities and capability building required on the road to reporting.
3. commends the XRB's team on the quality of the CS1 drafting, collaboration and consultation process, whilst also suggesting areas for further improving the clarity
4. sees opportunities for improving the clarity of CS1 by better differentiating between definitions and disclosure requirements for corporate and investor CREs, as discussed below. The principal area for distinction is in the consideration of Scope 1 and 2 emissions from investee companies (i.e. portfolio emissions) as Scope 3 emissions for relevant investors.
5. identifies opportunities for CS1 to be more explicit around the source, application and interpretation of climate change scenarios prescribed, and to mandate disclosures in

relation to an additional, higher-emissions scenario. See Q3/4.

6. acknowledges the astute inclusion of first-time adoption provisions around (i) quantifying financial impacts and (ii) detailed transition and adaptation planning, that together, recognise the inherent complexities and the sequential nature of understanding, addressing and valuing climate-related risk.
7. proposes a further refinement by phasing the implementation of mandatory risk and impact disclosures; with quantitative *transition* risk/impact reporting leading equivalent *physical* climate risk/impact reporting by 1-2 years. This approach reflects the urgency of addressing emissions and the relative maturity of GHG assessment protocols and global/national climate mitigation policies, whilst acknowledging the greater complexity in identifying and addressing the challenges presented by physical climate risk. The phasing could mirror that prescribed for transition and adaptation plan disclosure.
8. supports a narrative approach to structured climate-related reporting, with the required disclosures additionally cross-referenced in an index or reconciliation table to aid in the clarity, logic and flow of the information. This approach would also facilitate the adoption of future sustainability-related disclosures in support of Integrated Reporting.
9. notes the concurrent emergence of international climate-related reporting requirements under the International Sustainability Standards Board (ISSB) and others, creating the potential for NZ entities to be exposed to multiple, overlapping and conflicting and/or rapidly evolving mandatory reporting requirements. We recognise the XRB's efforts to coordinate and align the CS1 principles, structure and content with relevant international bodies to ensure consistency and mitigate the risk of diverging disclosure protocols.

Response to consultation questions – Strategy

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

a) Do you think that the information in this section of the standard will provide information that is useful to primary users for decision making? If not, please explain why not and identify any alternative proposals.

Yes, for the most part.

However, the Guardians sees opportunities for improving the clarity of CS1 by better differentiating between definitions and disclosure requirements for corporate and investor CREs. There are several areas we believe could be clarified in this respect, as discussed below.

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?

Clarity of CS-1 Strategy could be improved in some respects:

- Some of the current wording in Table 3 is better suited to corporate reporting entities, rather than investor reporting entities such as the Guardians. Although CREs are encouraged to apply judgement, the XRB should consider opportunities for clearer differentiation between disclosure requirements for corporates and investors. This might include:
    - shifting to more generic terminology in relevant paragraphs of the main

disclosures table. For example, replacing references to *'business model and strategy'* with reference to *'integrating climate-related factors into wider business/investment strategy', 'commercial approach'*, or similar. This would be supplemented by accompanying guidance for (i) corporates (business model and strategy, cashflow, etc.) and (ii) investors (investment strategy, portfolio performance, etc.). Or;

- including separate sub-paragraphs for two (or more) broad categories of entity.

- Shifting 3(d) 'climate scenarios' to 3(a) to reflect the fundamental nature of scenarios informing subsequent risk/impact/implications analyses. Para 3 then becomes: a) Scenarios/scope; b) Risks and opportunities; c) Impacts; d) Implications/response.
- Integrating 6(d) *'a description of the scenario analysis…'* to 3(a). The climate change scenarios will frame and drive the subsequent analyses and discussion of risks, opportunities (4.), impacts (5.), etc. and associated commercial implications (6.).
- Para 5. and 6. are somewhat intermingled. It might be clearer to disclose <u>Impacts</u> (on <u>current</u> business model, strategy and finances) under 5., then <u>Implications</u> (in the form of amended business model, strategy, etc. as expressed in terms of Transition and Adaptation Plans – see next point).
- Separating reference to Transition (4.c) and Physical (4.d) climate-related risks/opportunities would add clarity by acknowledging the often very different drivers/implications/timeframes around each – and the varying degrees of agency of CREs in managing emissions/transition risk versus their physical hazard exposure.
- Thereafter, retaining a clear distinction between Transition (5.e) and Adaption (5.f) plans, where CREs can describe the resilience of their commercial approach/activities to the respective risks/impacts.
- Para 7. could be simplified for the sake of the clarity by replacing *'…energy pathways, carbon sequestration from afforestation and nature-based solutions and technology assumptions including negative emissions technology;'* with simply: *'technology pathways and assumptions';* leaving further detail for accompanying guidance documents. This would allow CREs to apply judgement and further future-proof the standard against other, unspecified emerging technologies.

c) Do you consider that this section of the standard is adequately comprehensive and achieves the right balance between prescriptiveness and principles-based disclosures? If not, what should be removed or added to achieve a better balance?

Overall, yes, although there are opportunities to be more explicit around appropriate sources and applications of prescribed scenarios, as discussed in 3. below.

2. Do you agree that a standalone disclosure describing the entity's business model and strategy is necessary? Why or why not?

Yes, it is helpful to understand the broader commercial context of the reported risks, opportunities and potential impacts. The XRB should consider opportunities for clearer differentiation between disclosure requirements for corporates and investors (see Q1.b).

This disclosure could be further clarified by requesting Impacts and Implications be presented in a more holistic manner – covering amended ‘*commercial approach’* - business models, investment strategy, finances, etc. - directly in terms of Transition and Adaptation Plans.

3. Do you agree that we should not prescribe which global mean temperature increase scenario(s) should be used to explore higher physical risk scenarios (such as 2.7°C and/or 3.3°C or by using Representative Concentration Pathways (RCP) such as RCP4.5 or 6), but rather leave this more open by requiring a ‘greater than 2°C scenario’? Why or why not?

The Guardians supports the prescription of three scenarios as standard:

- 1.5°C scenario. This would help effectively identify more extreme transition risk, link to national emissions reduction goals and ensure consistency of CRE’s analyses by assessing/encouraging progress towards Net Zero.
- 2°C scenario. The IPCC’s Special Report (2018) illustrated the significant additional impact that an extra half-degree is projected to have, the material shift in transition pathway – and how close we are to the 1.5°C window of opportunity closing.[2] Most leading climate scenarios now offer a 2-degrees scenario to help contrast with 1.5°C
- Greater than 2°C scenario. This would help identify more extreme physical climate hazard exposures and associated risks and/or more moderate transition risk.

We further support CS1’s current flexibility for CREs to report on a wider range of *additional* possible scenarios, as appropriate for their entity/sector. For example, *‘Current/Stated Policies’* scenarios assume that only currently implemented global laws/policies (in any given reporting year) be considered. Most major scenario sources include such a scenario to reflect current policy settings announced by governments (currently reflecting implied temperature rise of 2.8-4°C).[3] Advocating for this higher-emissions scenario would:

- reduce year-on-year comparability (covered by other two scenarios), in favour of more sector-focused comparative analyses of the relative risks, impacts and implications of specific policies in place during any given reporting period.
- be of great insight to preparers and users in terms of identifying more extreme, yet plausible, physical climate hazard exposures and associated risks - some of which are progressively 'locked-in'.
- better account for prior experience of deferred action on non-binding global climate commitments and enduring geopolitical complexity in Paris-aligned climate negotiations/actions.

[2] (IPCC, 2018: Global Warming of 1.5°C. [Masson-Delmotte, V., et al.). IPCC’s Special Report contrasted two scenarios, finding that: 1.5ºC equates to 45% CO_2 emissions reduction from 2010 to 2030; NZ by 2050, whilst; 2ºC equates to 25% CO_2 emissions reduction from 2010 to 2030; NZ by 2070

[3] Network for Greening the Financial System (NGFS) ‘Current Policies Scenario’; IEA Stated Policies Scenario (STEPS), etc.

4. We do not require transition plans to be tied to any particular target such as net zero and/or 1.5°C, but that entities will be free to disclose this if they have done so. Do you agree? Why or why not?

We agree in the short-term.

Whilst the Guardians supports the prescription of a 1.5°C scenario as standard for *risk and impact analyses*, to help effectively identify transition risk, more time may be needed by CREs to fully understand, embark and publish a binding *Transition Plan* explicitly targeting a 1.5°C outcome.

The XRB may consider including this matter as a first-time adoption provision so as not to de-facto force this initial Net Zero commitment on CREs in year 1.

In the second or third year, we would encourage CS1 and/or accompanying guidance to:

- Prescribe such a Net Zero/1.5oC transition target to align with NZ's Zero Carbon Act[4], Climate Change Commission (CCC) and the National Climate Change Risk Assessment (2020),[5] along with established local and global initiatives such as the Climate Leaders Coalition NZ[9] and Net Zero Asset Owners Commitment.
- require/reflect good practice in transition and adaptation planning, by specifying the identification of material shared socioeconomic signposts, climate tipping points and thresholds, along with dynamic adaptive pathway planning (DAPP) approaches.

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

The terms are well defined. Many of the defined terms appear to largely focus on operational businesses and are not practically applicable to investment funds.

6. The XRB has identified adoption provisions for some of the specific disclosures in NZ CS 1:

a) Do you agree with the proposed first-time adoption provisions? Why or why not?

We broadly agree with the proposed first-time adoption provisions, which individually and collectively provide a rational degree of relief for immature CREs in respect to some of the more complex and confronting aspects of mandatory CRD.

We agree with provision for deferring disclosure of quantitative financial impacts in year one, due to the general immaturity of global and local standards, and inconsistency of many off-the-shelf climate risk quantification/valuation solutions at present.

We believe other provisions may benefit from refining, primarily to further distinguish between transition and physical CRD - and phase their relative adoption. See below.

b) In your view, is first-time adoption relief needed for any of the other disclosure requirements? Please specify the disclosure and provide a reason.

[4] *Climate Change Response (Zero Carbon) Amendment Act 2019* aims to limit warming to 1.5 degrees above pre-industrial levels

[5] https://environment.govt.nz/publications/national-climate-change-risk-assessment-for-new-zealand-main-report/

We propose a further refinement by phasing the implementation of mandatory risk and impact disclosures; with *quantitative* transition risk/impact reporting leading equivalent physical climate risk/impact reporting by 1-2 years.

The timeframes for disclosure of quantitative physical climate risk/impact/adaptation timeframes should be aligned.

This approach reflects the urgency of addressing emissions and relative maturity of GHG assessment protocols and global/national climate mitigation policies. At the same time, this acknowledges the greater complexity and ambiguity in identifying and addressing the challenges presented by physical climate risk.

Specifically, we recommend the first-time adoption provisions relating to para 4 and 5 should be amended to better distinguish between transition risk and physical risks/planning. This phasing could mirror that prescribed for full transition and adaptation plan disclosure in relation to Para 5(e)b.

Our rationale here is based on our belief that:

- Early and frank disclosure on GHG emissions and action on decarbonisation is a top global and national priority, as reflected in the CCC recommendations, NZ government transition policies and Nationally Determined Contributions (NDCs).
- Robust GHG protocols are well established (at least for Scope 1 and 2), and local support and service providers are readily available – in comparison to physical climate risk analysis protocols.
- Greater complexity/nuance remains in identifying, understanding and addressing the challenges presented by physical climate risks, analysis of which are subject to a wider range of approaches, methodologies, assumptions and limitations.
- deferral enables further engagement, understanding and action in response to NZ's National Climate Change Risk Assessment (2021), National Climate Adaptation Plan (2022) and Climate Change Adaptation Act (est. Q4 2023).
- deferral avoids preparers having to report on physical climate risks/impacts before having had a chance to develop robust adaptation/resilience plans which might mitigate some of the associated value erosion. Disclosure of quantitative physical climate risk/impact should be aligned with adaption plans.

c) If you are requesting further first-time adoption relief, what information would you be able to provide in the interim?

N/A

Response to consultation questions – Metrics and Targets

7. Do you think the proposed Metrics and Targets section of NZ CS 1 meets primary user needs?

a) Do you think that the information in this section of the standard will provide information that is useful to primary users for decision making? If not, please explain why not and identify any alternative proposals.

Mostly. These metrics and targets will give end users additional transparency they currently lack when evaluating a CRE's climate risk and opportunity exposure.

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?

The Guardians sees opportunities for improving the clarity of CS1 by better differentiating between emissions definitions and disclosure requirements for corporate and investor CREs.

Whilst companies can directly decarbonise, investors can only reduce exposure to high-emitting companies and/or encourage (to lesser/greater degree) the transition efforts of companies in their portfolio. To reflect this, the GHG Protocol considers Scope 1 and 2 emissions from investee companies/holdings (i.e. portfolio emissions) as Scope 3 emissions for their relevant investors. It would be helpful for the mandatory reporting requirements and associated definitions to reflect this important distinction

Secondly, the document specifies *location-based Scope 2* reporting but does not specify what to use for *target setting*. It is left as an assumption of being similarly location-based. This could be made clearer. Would market-based target setting be an option? E.g. SBTi allows companies to disclose whether they are using a location- or market-based accounting approach to calculate base year emissions and to track performance against a science-based target (as per GHG Protocol Scope 2 Guidance). TCFD recommends indicating if scope 2 emissions calculations are location- or market-based.

c) Do you consider that this section of the standard is adequately comprehensive and achieves the right balance between prescriptiveness and principles-based disclosures? If not, what should be removed or added to achieve a better balance?

Mostly. However, we encourage the XRB to consider some of the issues discussed below.

8. We have not specified industry-specific metrics. The guidance will direct preparers where to look for industry-specific metrics. Do you believe this is reasonable or do you believe we should include a list of required metrics by industry? If so, do you believe we should use the TCFD recommendations or follow the TRWG prototype?

We believe it is reasonable to not specify industry-specific metrics at this stage, pending finalisation of the ISSB reporting standards based on the TRWG prototypes. This can best be referenced in the accompanying guidance, as updated from time to time.

9. We will require disclosure of scope 3 value chain emissions as part of this standard. Are there areas (particularly in your scope 3 value chain) where there are impediments to measuring at present? If so, what are these areas and when do you think it might be possible to measure these areas?

There are many barriers to measuring scope 3 value chain emissions but a broader shift by industry to measure their individual Scope 1 and 2 emissions at scale will help to address many. Including Scope 3 disclosures in CS1 will drive increased reporting of all emissions by a range of sub-entities across the value chain, and progressively improve the cumulative impact of these Standards.

The global shift towards widespread assessment/reporting of GHG emissions is still relatively new and, as such, the quality of available data/information remains limited. It's challenging for a CRE to gather porous data and be required to report Scope 3 emissions with a potentially large margin of error. These challenges should be resolved in time but in the meantime, CS1 should require a best-efforts approach to measuring Scope 3 emissions, supported by detailed accompanying guidance.

Finally, CREs should be required to identify and disclose the most material *sources* of Scope 3 emissions in their value chain and ensure that potential areas for reduction/transition are specified in their business/investment strategy (transition plan).

10. Paragraphs 8, 9 and 10 contain specific requirements relating to the disclosure of GHG emissions to facilitate the conduct of assurance engagements in line with the requirement of section 461ZH of the Financial Markets Conduct Act. Do you have any observations or concerns about these proposed requirements?

No.

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

It would be useful to reference/source a definition for a 'science based target' e.g. SBTi

12. The XRB has proposed not providing first-time adoption provisions for the Metrics and Targets section of NZ CS 1. Do you agree? Why or why not?

The Guardians would support a first-time adoption provision to permit only qualitative disclosure of identified source/scale of Scope 3 emissions in the value chain. Quantitative Scope 3 emissions assessments would commence thereafter. See Q9 for further comments.

XRB has embedded an adoption provision in section 7.3, from the provision in section 5.4, by not requiring comparative information to be disclosed. For end users this would decrease the usability of disclosures given that one of the key challenges for asset owners will be getting emissions data from private, non-CRE companies across multiple sectors.

Whilst reporting on all climate-related metrics outlined for CREs may not be feasible, guidance and/or minimum-acceptable comparative information might offer an effective compromise.

13. The XRB proposes that the minimum level of assurance for GHG emissions be set at limited assurance. Do you agree?

Yes, we agree.

We note the work of the International Auditing and Assurance Standards Board (IAASB) on their Extended External Reporting (EER) Assurance project as a key input to this discussion.

14. The XRB has proposed a definition of material (information is material if omitting, misstating, or obscuring it could reasonably be expected to influence decisions that primary users make on the basis of their assessments of an entity's enterprise value across all time horizons, including the long term). Do you agree with this definition? Why or why not?

We agree with the XRB's current definition of single (or 'enterprise value') materiality in line with the ISSB and others. However, we encourage the XRB to set a general intention/timeline for broadening this materiality definition and adopting a more comprehensive approach as standard.

Significant negative ESG impacts are becoming increasingly material to companies' operations and long-term performance, at the same time as positive impacts are being reflected in company/investment strategies.

The Guardians' investment belief holds that ESG considerations, including climate change, are fundamental to long-term risk and return. We see the materiality of ESG considerations as embedded in the long-term value of a company. Investors are increasingly interested in multiple dimensions of materiality to guide investment decision-making, engagement and voting.

Good practice recognises that the global decarbonisation, resilience and adaptation agenda risks additional adverse impacts, most critically on nature and vulnerable people. The Guardians supports CS1's broader definition of impact and recognises the wider environmental and social impacts of transition/adaptation planning and actions as highly relevant to materiality. We advocate for ongoing development of integrated sustainability-related standards/guidance reflecting the need for a just transition.

We note that the IFRS Foundation and Global Reporting Initiative (GRI) have teamed up to coordinate the activities of their standard-setting boards to reduce the reporting burden for companies and to harmonise the sustainability reporting landscape. We trust that the XRB will participate in this collaborative approach, with the aim of integrating the two 'pillars' of sustainability reporting.

15. Do you have any other comments on the proposed materiality section?

The Guardians supports a narrative approach to structured climate-related reporting, with the required, material disclosures additionally cross-referenced in an index or reconciliation table to aid in the clarity, logic and flow of the information. This approach would also facilitate the adoption of future sustainability-related disclosures in support of Integrated Reporting.

CREs should be required to disclose their full reasoning and supporting evidence for deeming omitted requirements 'immaterial' to end users.