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**ICNZ submission on XRB's Climate-related Disclosures Strategy and Targets & Metrics Consultation Document**

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Thank you for the opportunity to submit on the Climate-related Strategy and Targets & Metrics Consultation Document.

By way of background, ICNZ's members are general insurers and reinsurers that insure about 95 percent of the Aotearoa New Zealand general insurance market, including about a trillion dollars' worth of Aotearoa New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

ICNZ has made positive contributions and provided insights on climate change and its impacts to many forums. Its members have formed a specialist committee on climate change to draw upon a wide range of expertise and knowledge so that we can contribute to better understanding of the issues and play a constructive role in developing solutions to the challenges the topic presents.

ICNZ supports the overall ambition of the draft standard and note that the XRB and the Financial Markets Authority have said that they do not expect perfection from the beginning. We support that sentiment given that this is the start of a new phase in financial reporting and some reporting entities have a way to go to develop their capabilities to meet climate change disclosure obligations. For this reason, our submission focuses on areas where we believe more clarity and time will be required to provide more meaningful reporting and higher quality data for primary users. Please contact Tim Grafton (tim@icnz.org.nz) if you have any questions on our submission or require further information.

We highlight five key areas where we seek change or greater clarity and guidance.

1. Clarity around the meaning of climate-related impacts as to whether this relates to all climate impacts or only climate change impacts and if the latter, recognition of the challenge and complexity this presents for meeting reporting obligations and the implications for financial audits in areas where assurance is not required by the standard.
2. A more graduated approach to reporting the impacts of climate change on financials. We propose that year one would permit qualitative reporting, year two would require *actual* quantitative impacts and year three would require *actual* and *potential* quantitative impacts. Greater guidance and clarity around 'actual' and 'materiality' may mitigate the need for this approach.
3. An adoption provision for the disclosure of Category 15 Scope 3 emissions with respect to underwriting portfolios in recognition of the lack of an accepted methodology and the complexity inherent in gathering data in the timeframes expected.
4. Materiality –A shorter and more precise definition of materiality with a balance between meeting primary users' needs and what CREs can reasonably be expected to consider as material given the information available to them at the time of disclosure. More guidance with examples would assist.
5. Broaden the definition of "capital" to "capital deployment and operational investment" to better capture the full range of activity deployed on climate change impacts.

**Over-arching comments**

ICNZ supports making climate-related disclosures. Disclosure informs primary investors about climate risks and supports the efficient allocation of capital to support a smooth transition to a net-zero carbon economy. The integration of climate risks into an organisation's overall strategy with supporting metrics and targets will help inform climate reporting entities (CREs) themselves about the risks and opportunities open to them, and how they are managing those risks or achieving the opportunities they have identified. It is noteworthy that insurers are significant investors and therefore are primary users too. From this dual perspective, we see a careful balance needs to be applied to determine how much information is both necessary and sufficient to inform a primary user's decisions, and what can reasonably be expected of CREs when starting on the journey of climate disclosure. ICNZ members in particular recognise the need to focus more on climate change and emissions reduction, given the effect we are already seeing through increasingly severe and frequent weather events. Our feedback here is not intended to detract from the level of ambition, and our country's net zero goal, but to manage the technicalities around reporting of this information for CREs.

The draft Strategy and Targets & Metrics standard requires broad and detailed disclosures. We reference in particular the definition of materiality in terms of the breadth of disclosure, combined with TCFD guidance which suggests CREs should stray on the side of disclosure, to indicate that there is little that ought not be disclosed. At the same time, some of the XRB's specific requirements to disclose potential impacts on cash flows, financial statements and financial performance demand a lot of detail that will be extremely challenging to provide at the outset. Overall, the XRB's draft is weighted to requiring the maximum information to be disclosed from the outset in most instances. We question whether the XRB has fully anticipated how much work and resource this will require of CREs, many of whom will be starting from a reasonably immature base. We acknowledge that XRB in its deep-dive sessions that have supported the release of the draft have provided examples that reflect brief, high-level reporting and have stressed that perfection is not expected from day one. Even so, there is evidence from overseas that where entities who are already reporting under the TCFD framework have struggled with some aspects. This ought to be a signal not to expect too much too soon from CREs and to stray on the side of providing more guidance and more time to implement some aspects.

One of the consequences of the expected level of disclosure will be to create tensions between what is commercially sensitive to support a competitive market and what is needed to inform primary users. While there is guidance from the TCFD on managing such tensions, the broader, more detailed requirements that the XRB has outlined especially with regards to actual and potential financial impacts, will bring this to the fore from the outset of reporting. We would also recommend more guidance and examples to assist CREs to get the balance right between confidentiality and disclosure.

We note where the XRB's approach departs from international approaches adopted by either the TCFD or TRWG frameworks. New Zealand's insurance market is supported by offshore parent companies who play a vital role in supplying sufficient capital to support the higher levels of risk that New Zealand faces. We recognise that the XRB are aiming to future proof disclosure requirements as much as possible, but we would recommend this be done in a way that aligns as far as possible with current international best practice. We believe it will be important to ensure that any standard also meets the new global baseline which will be created by the ISSB's current consultation on climate and sustainability-related disclosure standards.

To alleviate the challenges outlined above, we recommend amendments to the adoption provisions to permit a graduated disclosure of quantitative financial data over three climate statements. The second climate statement would require actual quantitative data with actual and potential quantitative data required from the third year. This is discussed in more detail below.

As noted, the insurance sector in its role as an investor is a primary user as well as an underwriter. ICNZ acknowledges that Scope 3 emissions, particularly underwriting and investment emissions will make up the largest portion of our emission sources across general insurers. We are committed to understanding these emissions across the insurance sector, but guidance and taxonomy for carbon foot-printing of these portfolios (absolute and carbon intensity) is still under-developed. We acknowledge the contribution by the Partnership for Carbon Accounting Financials (PCAF), the GHG Protocol and the CRO Forum and others which provide assistance in calculating GHG Scope 3 emissions. However, insurers are also underwriters of risk, including climate-related risk, and we note there is very limited[1] international guidance on how to calculate Greenhous Gas (GHG) Scope 3 emissions for underwriters. The general insurance sector underwrites over $1 trillion of New Zealand's assets and liabilities. Accurate calculation of full value chain emissions from the outset will likely not be possible. Disclosing only some of the value chain emissions may mislead primary users and reduce comparability. The fact that an assurance regime does not apply in the first year offers limited relief from this. While we recognise the standard allows for omissions when explained, we also recommend a graduated approach in regard to underwriting within Category 15 of Scope 3 in particular through a specific adoption provision which we address below.

**Response to specific XRB Questions**

Our responses to the questions posed in the Issues Paper are set out below.

**Q1. Do you think the proposed Strategy section in NZCS1 meets primary user needs?**

As noted, we question whether there has been an assessment of whether the breadth and depth of disclosure goes beyond meeting primary user needs particularly with respect to the infancy of this regime, the absence of forthcoming XRB guidance, and evidence that offshore those who are reporting under the TCFD framework are struggling to meet all aspects. So, while we believe that the draft will meet the usefulness test for primary users, we believe it exceeds what is required at this stage of the reporting regime in particular areas. We identify these areas in response to subsequent questions.

[1] PCAF has just released (March 2022) a scoping document that identified the significant challenges insurers face in calculating Scope 3 emissions for underwriters though it plans to release some guidance later in 2022. The Chief Risk Officers (CRO) forum has released high-level guidance https://www.thecroforum.org/wp-content/uploads/2020/05/CRO-Carbon-Foot-Printing-Methodology.pdf but it too identified significant limitations and challenges for insurers.

With respect to Q1 a, b and c in relation to the clarity and lack of ambiguity of this section of the standard and whether it is adequately comprehensive and strikes the right balance between prescriptiveness and principles-based disclosure we offer the following observations:

We note an entity must include the following information when describing its climate-related risks and opportunities (see paragraph 3(a)): (a) how it defines short, medium and long term and how the definitions are linked to its strategic planning horizons and capital deployment plans).

From an accounting viewpoint, “capital” spending is defined by quite narrow criteria while a lot of an insurer’s spending on climate change is likely to be operational spending, for instance, if an insurer were to support customers by spending on flood mitigation, this would be regarded as capital for the customer, but operational spending for the insurer. In this instance, insurers would not be able to accurately describe this operational spending as “capital deployment”. The same would apply to a lot of actions an insurer may undertake, such as, undertaking research or acquiring data in connection with climate risks. We recommend that a more helpful definition would be “capital deployment and operational investment” or similar to capture the activity more completely. The same comment applies to 5d as well as 4f in metrics/targets.

We note the requirement to disclose the actual impacts of climate-related risks and opportunities on an entity’s business model, strategy and financial planning. It would be helpful if there were guidance on timeframes here, such as, whether ‘actual impacts’ are limited to the reporting year.

We note 5 (c) requires disclosure of the actual financial impacts of climate-related risks and opportunities on its financial position, financial performance and cash flows. Even though this part of the standard is not required to be assured, the fact that the disclosure appears in an annual report and may disclose financial figures, would require auditors of the accounts to comply with ISA (NZ) 720 (Revised). This raises questions about the amount of work and assurance auditors, who are not specialists in the area of climate-related risks, will be able to apply to this part of the annual report. It may also raise questions about the consistency of audits and comparability between CREs. Further guidance on the expectations of auditors in this area would be helpful.

We also recommend a more graduated approach to stepping into quantitative reporting of climate change impacts on financials. We propose that year one require qualitative reporting as a minimum, year two quantitative data on actual impacts (and qualitative reporting as appropriate) with year three requiring both *actual* and *potential* quantitative impacts. The need for this approach would be mitigated by greater guidance and clarity from the XRB around its expectations of ‘actual’ and ‘materiality’. Absent this clarification, we assume more onerous expectations that require a more graduated approach.

We seek further clarity on the definition of ‘actual.’ In particular, it needs to be clear whether the XRB expects reporting on the actual impact of climate-related events or the actual impacts due to climate change. For an insurer, it is easy to measure the impact of climate-related events, say on claims, but very challenging to measure the impacts of climate change, particularly on financial measures. The latter requires significant research into what losses can be attributed to climate change versus normal climate patterns. Similarly, challenges arise with respect to investments in trying to distinguish between changes in value arising from climate-related impacts and other market fluctuations. We believe more meaningful information could be provided such as requirements to provide information about climate-related investment exclusions, divestment decisions and climate friendly investments that have already been made. For these reasons, we recommend further targeted consultation with the insurance sector on climate-related disclosure followed by clear guidance.

In 7 a (iii) XRB is far more prescriptive than the TCFD in requiring scenario analysis to specifically address “policy assumptions, macroeconomic trends, energy pathways, carbon sequestration from afforestation and nature-based solutions and technology assumptions including negative emissions technology.” We note the XRB sees this as important to their role in New Zealand’s mitigation and adaptation planning as a heavily agriculture-based economy with significant land-use related emissions and sequestration. While XRB’s rationale for this level of prescription is understandable, we recommend that the standard should remain high-level requiring CREs to identify what is material to their disclosure and to include in guidance the types of disclosure XRB expects to be included. This approach would enable XRB to add factors over time that it felt were particularly important to New Zealand without requiring a change to the standard.

In 7 a (iv), unlike either TCFD or TRWG, XRB wants disclosure of what modelling was used and why. XRB says that it included this to provide transparency to primary users on whether entities are making use of existing models. It also says this will help to ensure that entities are being driven by what is most appropriate for the particular analysis being undertaken in this context rather than using existing modelling that was designed for another purpose in a way it was not intended. Apart from the departure from TCFD and TRWG, we seek clarity from the XRB on how this disclosure should be managed. Often the models that are used are either proprietorial or used under a license agreement with commercial confidentiality provisions attached. It may be that the expectation is only a very high-level reference to the use of a particular model and if that is the case clarification of this point would be helpful. In any event, there should be sufficient information provided in the other disclosure requirements to inform primary users without the need to access the models themselves. We recommend the XRB provide guidance here to assist CREs to navigate the confidentiality issues.

**Q2. Do you agree that a standalone disclosure describing an enterprise's business model and strategy is necessary?**

We agree that it is important for primary users to understand a CRE's business model as it provides context for the disclosures it is making. We note that in its deep dive consultation sessions the XRB said saw little difference between disclosure of businesses as used by the TCFD and XRB's requirement to disclose an enterprise's business model. XRB's expectation is that standards will likely shift to business model terminology. We also note that the XRB said its expectations of disclosure were that CREs would be succinct and high-level. We support this approach.

**Q3. 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'?**

ICNZ supports a flexible approach to the use of global mean temperature increases. ICNZ has adopted a sectoral approach to developing climate change scenarios and impact pathways and we believe other sectors should be able to adopt what is appropriate for their sector in providing meaningful short, medium and long-term scenarios. This balances primary users' needs for comparability across a sector and CREs' need to determine the scenarios that make most sense to them. We therefore support leaving the 2+ scenario open rather than prescriptive, as the XRB have proposed. If anything, we would suggest that the XRB ensures that scenarios are linked to the latest climate science. The recent release of the IPCC 6th Assessment Report is noteworthy as current trajectories suggest we could be at 1.5 degrees before the end of the current decade.

**Q4. 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 or disagree?**

Comparability of transition plans is more achievable than comparability of scenario analysis and as such it is appropriate to facilitate this. In our view, transition plans should be in line with the government's policy of 1.5C, but the requirements do not need to stipulate this. In order to improve comparability, we recommend that if entities align their transition plan to a target, they disclose what target they have used.

**Q5. Defined terms as currently described?**

We identify issues with the following defined terms in so far as these definitions when applied to the draft standard create more onerous reporting requirements which may not be necessary to meet primary users' needs.

**Actual** – as discussed above, it is critical greater clarity is provided on what XRB is requiring when it uses this term with respect to *actual impacts of climate-related risk* on strategy, financial planning and cash flows among other matters. It is not clear whether the XRB is asking CREs to report on all climate-related impacts or those associated with climate change. If it is the latter, then without requiring extensive scientific investigation, CREs will have to make assumptions about the extent they can attribute actual climate impacts to climate change. These points should be borne in mind also in the context of a CRE providing quantitative data which, when included in an annual report, must be capable of being evaluated for consistency by an external auditor as they must consider all information in a financial report. A further point of clarification is whether 'actual' refers to impacts that only occurred in the reporting year and not from previous years.

**Cash flows** – the definition used here requires CREs to report actual and <u>potential impact</u>s on cash flows as reflected in its statement of cash flows. Cash flows are explicitly quantitative measures. If the XRB's expectation is that quantitative data be disclosed on cash flows, then we suggest a graduated approach be taken to reporting financials (year one qualitative at a minimum, year two actual quantitative at a minimum and year three actual and potential quantitative).

**Q6. First time adoption plans and relief for other disclosure requirements**

ICNZ supports the use of first-time adoption plans to assist CREs to step into this new reporting regime as capability and capacity is built up. The areas where adoption plans are proposed to apply are appropriate in our view because these are challenging areas for disclosure. We recommend however that first-time adoption provisions for transition plans and adaptation plans be aligned, so full disclosure of both be required in Year 2. Delaying adaptation by a year suggests it is less important than transition, and insurers know that the two must go hand in hand.

We refer to specific Scope 3 adoption provisions in question nine below.

**Q7. Do the proposed metrics and targets meet primary user needs?**

We agree that the metrics and targets that are required to be disclosed in this section will meet primary users' needs where they are material. With respects to parts b) and c) relating to clarity, lack of ambiguity and comprehensiveness, we offer these comments.

We note an entity must present comparative information regarding the previous period for all amounts including metrics reported in the current period. When relevant to understanding the current period's climate-related disclosures an entity must also disclose comparative information for narrative and descriptive information.

For each metric reported in the current period an entity must disclose at least two years of comparative information to provide a basis for tracking progress. The requirement for two years of historical data could discourage the introduction of new metrics and the enrichment of key metrics. In addition, the requirement to have this audited could also be a barrier to changing key metrics. We recommend that the XRB considers using a 'where possible' rather than 'must' requirement.

**Q8. 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 TCFD recommendations or the TRWG Prototype?**

We believe it is preferable for industry sectors to develop the metrics that are appropriate for them. The general insurance sector is currently developing its scenario analysis and impact pathways and in undertaking this work recognise that a sector is far better equipped to determine the best metrics than for these to be determined by a standard setting body or other external organisation. We also acknowledge that each CRE will need to determine what it needs to disclose and can draw on the industry specific metrics as appropriate. So, we support the XRB's use of guidance to identify where industry specific metrics can be found as a reference point for primary users.

On reporting on emissions intensity, our understanding from the deep dive sessions the XRB hosted that there will be no prescription on how to measure emissions intensity. The general insurance sector would be free to determine what measure would be most appropriate for the sector. If this is the case, then it would allay our initial concerns around reporting on emissions intensity.

**Q9. 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?**

We support the aim of disclosing Scope 3, but request it is highlighted very clearly the need for users and CREs to understand the uncertainty, and by necessity the incomplete picture, in various categories of Scope 3 reporting until such time as good practice matures.

As noted, we have identified above impediments to reporting Scope 3 underwriting emissions. No accepted methodology exists yet on measuring underwriting emissions. This opens the door to wide interpretation and variability that would not be useful for primary users. So, guidance is required as a starting point, and a first-time adoption provision is suggested above.

Scope 3 emissions reporting is still maturing, and the methodologies for Category 15 are immature or in the case of underwriting are not yet available. We note a thorough methodology is in development by the Partnership for Carbon Accounting Financials, but it is currently limited to only general insurance commercial lines. This is due in late 2022 but until that point it will be difficult to understand the burden involved in estimating emissions.

A limited amount of extra time to develop meaningful data collection and methodology approaches would lead to a more beneficial outcome.

For those with international parents, the requirement for full value chain emissions reporting presents additional risks and challenges around accuracy and consistency of reporting across jurisdictions.

That said, it is important to note that a number of our members have been reporting GHG Scope 1 and 2, and aspects of scope 3, for many years now – with well-established data collection and methodologies. Supply Chain emissions have been on the radar for a while, and methodologies exist for their calculation - though there is still significant work for CREs to do to calculate and report on this category of Scope 3.

We propose a first-time adoption provision to be taken to disclosing Scope 3 emissions for underwriting until an appropriate standard has been released and sufficient time is allowed to adopt it. We would envisage a description in the first climate statement of the measures being taken to report on Scope 3 emissions, the limitations to being able to report and how these challenges will be addressed. This would be followed by qualitative reporting and quantitative measures being required in subsequent years as a standard becomes available. Unless an adoption provision is provided, there will be insufficient value to primary users because if insurers are just providing a best guess in year one, it will be impossible to compare one entity with another, or to rely on the accuracy of the data in any meaningful way.

**Q10. 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?**

Our concerns relate to reporting GHG Scope 3 emissions for insurance underwriting are as noted above. In addition, it would be helpful if XRB could clarify its requirements for inventory reporting. XRB have implied that a new report may not be required to be created if GHG emissions for the NZ entities and methodology/assumptions are already captured in an existing document. This should be made clearer, as a reading of the requirements implies that a completely standalone GHG inventory report is required.

**Q11. Views on defined terms**

**Interim target** – should read “Refers to a short-term or medium-term milestone between the organization’s long-term target and current period”

**Scope 1 - All direct GHG emissions**. The TCFD further defines scope 1 as 'Scope 1 GHG emissions are direct emissions from owned or controlled sources.'. Ownership and control are an important part of the Scope 1 definition, especially in relation to accounting for the emissions of subsidiary businesses. We recommend that XRB aligns with the TCFD definition of scope 1 emissions.

**Q12. The XRB has proposed not providing first-time adoption provisions for the Metrics and Targets section of NZ CS 1?**

As noted, we recommend a first-time adoption provision as described above be provided for insurance underwriting with respect to Category 15 Scope 3 emissions reporting.

**Q13. The XRB proposes that the minimum level of assurance for GHG emissions be set at limited assurance. Do you agree?**

We support Limited Assurance. This is necessary to inform primary users of the disclosure being presented to them so they can exercise appropriate judgement. The XRB should clarify whether assurance over a group's GHG data, for instance, its Australian and New Zealand entities assured together is sufficient, or whether the New Zealand entity has to have separate assurance.

**Q14. 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 note the question actually summarises quite briefly what the XRB actually says about materiality. We take this opportunity to address the totality of what the XRB says on the subject as it does raise questions about the breadth and detail of what is expected to be disclosed and creates a tension around the disclosure of confidential information. Also, as XRB notes, all disclosures - and there are many to make in relation to the standard and assessing a CRE's enterprise value – require materiality judgements to be made. Equally, these are judgements primary users will have to make which begs the question whether the approach XRB has taken will assist them to do that. We recommend that XRB review its definition of materiality with a view to simplifying the guidance language.

Alternatively, or in addition, the XRB could consider providing more specific definitions of materiality in relation to the Strategy and separately the Metrics & Targets section.

To the question asked, exercising judgement about what is omitted across all time horizons when some of those time horizons are long-term is problematic. Primary users who specialise in long-term investments may have a quite different view of what should reasonably be expected to be disclosed. Yet CREs are expected to have a view on the characteristics of primary users. How does the CRE make a judgement about which primary users' needs to satisfy? Further, would omitting information create a liability on a CRE either now or at a future date?

It is not clear either whether a CRE must provide an explanation for every judgement it makes not to disclose because it judges it to be immaterial. Nor is it clear with respect to this obligation how the CREs realises it has not met a primary users' expectations of disclosure nor how the primary user would know there is non-disclosure. We note the XRB's observation that what is material could include matters that are nil or close to zero.

We also note the breadth of materiality which includes "the full range of possible outcomes and the likelihood of the possible outcomes within that range" on an entity's enterprise value including over the long-term. The words underlined go to our contention that the demands being placed on CREs go much further than what would be necessary and sufficient to meet primary users/ needs.

If no changes are made to the XRB's current approach, then we recommend more balance with respect to the disclosure expectations. The reasonable expectations of primary users' needs must be balanced by only requiring CREs to disclose what they can be "reasonably expected to disclose given the information available to them". With all the good will in the world an omission could be made that could open a CRE to regulatory sanction or even litigation for instance, by omitting some information because it did not consider all the possible outcomes over the long-term. This creates a risk for CREs, which is counter to the culture that the disclosure regime aspires to create. Uncertainty will breed caution. Adding a test of what a CRE could reasonably be expected to disclose would assist CREs.

**Q15. Do you have any other comments on the proposed materiality section?**

Addressed in the previous question.

**Conclusion**

Thank you again for the opportunity to submit on the draft governance and risk standards. If you have any questions, please contact me on tim@icnz.org.nz or by phoning 027-270-9084.

Yours sincerely,

**Tim Grafton**
Chief Executive