

RBNZ SUBMISSION ON THE

*Climate Change
Commission's
Draft Advice*

26 March 2021

Overview

We welcome the Climate Change Commission's draft advice as a considered and substantial contribution to shifting New Zealand towards a more climate-resilient future. The draft advice makes a strong start at exploring linkages between investment and climate resilience, and we appreciate that it recognises the interplay between the environment, economics, finance and wellbeing. We agree that interventions in all areas need to be properly considered and coherent.

At the end of this submission, we have included a table summarising our response.

We acknowledge that addressing climate change is a shared responsibility that requires a collective response. All New Zealanders will need to contribute. Many of the primary levers are with Government. Others are with iwi, businesses, communities and families.

Importantly, these actions feed into, and rely on, the economy and financial markets for their efficacy. The same efficiencies of markets and commerce that could enable action at scale may also serve to dilute the impact of isolated initiatives.

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On one hand, climate change provides a direct challenge to financial stability. Climate financial risks include physical risks (e.g. droughts or increased flooding) and transitional risks (e.g. carbon pricing or legal challenges). Foremost, our interest is the exposure of the financial sector, such as banks and insurers, to climate-related risks. Global understanding of climate risks is evolving along with the understanding of how they impact financial stability. Markets move quickly once a critical mass of information is available.

On the other hand, the Reserve Bank's activities in the climate space, both in its own role as kaitiaki of the financial system and in collaboration with others, can enhance transparency and reduce market failures such as information asymmetry.

Our submission is therefore limited to five areas of particular relevance to our remit:

1. Climate change and financial stability – the nature of risks and pace of change required.
2. The role of finance – recommending greater emphasis on finance/investment to more fully acknowledge the role of finance as an enabler and a potential blocker of climate resilience (barriers, interlinkages, levers).
3. Disclosure as a mechanism to improve the systemic management of climate risks – risk management and transparency.
4. The importance of Investment
 - Investing at scale: leveraging private investment – recognising carbon bias and unwinding this, improving information.
 - The need for a ‘green’ recovery.
5. A Te Ao Māori lens, and the need for a considered and aligned approach.

Our approach to climate change

We see financial stability being best maintained when all relevant risks are adequately identified, priced, and allocated to those best able to manage them.¹ Climate change and its associated risks provide a direct challenge to financial stability. The risks are material but extremely difficult to identify, price, allocate, and manage with accuracy.

Many of the material costs of our economic decisions are 'externalised' to others, including future generations.

Compounding these issues, market participants often take a short-term view in their decision making. Starting now to

get on the path to a low emission, climate-resilient economy as part of the global effort will help reduce the risks to the stability of the financial system and macro-economy.

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The Reserve Bank continues to build capacity to play our part. Like many other central banks, we take our role in a collective response to climate change seriously. We have joined 83 other central banks and supervisors to strengthen the global response to climate change through the Network for Greening the Financial System (NGFS). The NGFS aims to exchange experiences, share best practices, contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy.²

One of the benefits of international linkages like this is that they can lead to aligned efforts, potentially avoiding loss of ground due to conflicting approaches.

At the local level, we adopted our Climate Strategy in 2018.³

1 <https://www.rbnz.govt.nz/research-and-publications/speeches/2020/speech2020-05-28>

2 https://www.ngfs.net/sites/default/files/media/2020/09/03/ngfs_charter_final.pdf

3 <https://www.rbnz.govt.nz/financial-stability/climate-change/strategy>

Climate change and financial stability

We have previously highlighted how climate change can affect financial stability in our published *Financial Stability Reports*. The financial sector is mainly exposed through the sectors that it lends to and insures. Both physical risks and transition risks feed through conventional financial risks, especially credit risk and underwriting risk. Our May 2019 *Financial Stability Report*⁴ provided the results from a survey that showed that most banks and insurers expect a significant impact on their businesses, although many are still at an early stage in terms of developing their strategies and risk management systems to respond to those exposures.

Physical risks

We recognise that a steady increase in physical risks is largely baked in for the next few decades. For general insurers this will mean more frequent extreme weather events leading to increasing claims and more large spikes in claims. Over time, it could mean non-insurable assets. For banks this will mean increased risks to the property they rely on as collateral, and an increased risk of default by agricultural borrowers from the impacts of more erratic weather. As a central bank we are interested in the manifestation of these risks and working collaboratively to mitigate them. While both the mean and variance of risks are likely to increase, there is an element of predictability to this. This increase in physical risks should plateau over the longer term, provided that the transition to a low-carbon economy is achieved globally.

Transition risks

The impact of transition risks for financial stability is likely to depend on the pace and timing of the measures taken to move to a low emissions economy. All else being equal, in terms of pace, a coherent, well signalled, sustained economy-wide approach to managing the path to a low-carbon economy should be much better for financial stability than a disorderly, jarring transition. As the Commission's draft advice spells out very clearly, deferring necessary actions now, especially those marked as most urgent, will lead to the need for more drastic and disruptive action later.

The Reserve Bank's remit includes the promotion of financial stability, and we recognise that banks and insurers can play an important role in supporting the transition to a climate resilient economy. There is interconnectedness between the soundness of the financial system as a whole, and the management of increasing climate risks across the economy. For example, general insurers typically renew property insurance contracts annually, so withdrawal of cover from properties facing increased risk (of flooding for example) would be a rational market response once premium increases have gone beyond the point the market can bear.⁵ This could result in a step-change in banks' credit risk on mortgage lending in any areas of insurance withdrawal.

⁴ <https://www.rbnz.govt.nz/financial-stability/financial-stability-report/fsr-may-2019>

⁵ <https://deepsouthchallenge.co.nz/insurance-retreat-and-climate-change-much-anticipated-research-released/>

The role of finance as an enabler of change

Access to finance and retuning the economy to account for climate risks is critical to an orderly, smooth transition to a climate resilient economy. It is also critical to meeting the targets of reaching net-zero long-lived gases by 2050 and to reduce biogenic methane emissions by between 24-47% by 2050 in the Climate Change Response (Zero Carbon) Amendment Act.⁶ The purpose of the Act is to provide a framework for New Zealand to develop and implement clear and stable climate change policies that contribute to the global effort under the Paris Agreement to limit the global average temperature increase to 1.5° Celsius above pre-industrial levels; and allow New Zealand to prepare for and adapt to the effects of climate change.⁷

As the Commission notes, the counterfactual, business-as-usual investment in long-lived assets and infrastructure, risks 'locking in' a high emissions trajectory and putting additional assets at risk of the physical and transition risks from climate change.

The importance of finance as an enabler is highlighted in Article 2.i.c of the 2015 Paris Agreement: "Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development".⁸

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The role of finance in addressing climate change is increasingly recognised internationally. For example, finance is one of the key themes at this year's UN Climate Change Conference of the Parties (COP26).

The Commission's draft advice already highlights the need for investment (see, for example, section 'Align investments for climate outcomes' p. 129) and in different sections of the report (e.g. Enabling recommendations 2.c and 4.b) and in Chapter 12.

6 <https://www.legislation.govt.nz/act/public/2019/0061/latest/LMS183741.html>

7 <https://www.legislation.govt.nz/act/public/2019/0061/latest/LMS183741.html>

8 UNFCCC Paris Agreement Text (Article 2.1c)

Recommended greater emphasis on ‘Investment/finance’

Given the importance of finance and investment as an enabler of change, and the interlinked nature of policy and investment flows, it may be beneficial to draw together these threads in a discrete chapter (or expand the current section 6).

This could include the quantum of investment required, the environment required to facilitate these investments and the interplay between the economy,

investment/finance and policy (mutually reinforcing or at odds). It could review the efficacy/efficiency/equity of different investment/financial instruments (e.g. subsidies, government bonds, ETS) in particular contexts. It could also highlight the risks to the broader economy/finance system should finance flows fail to be redirected in a timely manner or New Zealand fail to meet its international targets.

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Investment/finance merits a stronger presence in the draft advice because it underpins every other sector. Such a chapter would make it clear that without investment at an appropriate scale and timeframe, many of the transitions highlighted in the draft advice will not be possible.

Other tools to enrich the consideration of markets and finance

There are some tools which may aid in bringing a greater consideration of markets and finance into the core of the report. For example, to support this analysis, we suggest extending the current economic analysis from its focus on the impact on GDP, to include an estimate of the required investment in different sectors and the trajectory of investment over the emission budget periods, including when this investment needs to peak. It could also highlight savings in terms of operating costs and co-benefits/costs.

We note that similar analysis has been prepared to inform the UK’s Climate Change Committee’s advice.⁹ The UK analysis estimates that achieving net zero would require capital investments to scale up from around £10bn/year to nearly £60bn/year at its peak. It indicates key areas for investment include surface transport, electricity supply and residential buildings. Given New Zealand’s already high proportion of renewables, our key investment areas may differ, but this type of analysis is useful in focusing investors’ minds on key areas to build capacity and highlighting the importance of early action.

⁹ See for example *The Road to Net-Zero Finance: A report prepared by the Advisory Group on Finance for the UK’s Climate Change Committee* <https://www.theccc.org.uk/publication/the-road-to-net-zero-finance-sixth-carbon-budget-advisory-group/>

Another tool that may aid efforts at consistent disclosure and reporting is a taxonomy or definitions around what is meant by green or brown. Without a definition of what 'counts' as 'green' there is a risk of greenwashing and a lack of additionality. This would build on recommendations made by the Sustainable Finance Forum and the Productivity Commission. The Productivity Commission noted:

The Government should align its project and programme funding so that it discourages high-emissions, path-dependent activities, and encourages low-emissions, path-dependent activities. This alignment should be supplemented by work to define what constitutes low-emissions investment, with the aim of identifying a clear taxonomy.¹⁰ (Rec 7.5)

We suggest that it would be useful for New Zealand policy makers to engage with work under way to further develop and harmonise the taxonomies developed in Europe and China. Further it may be useful for New Zealand to build capacity in understanding of the scope and scale of investment flows, for example by joining the OECD Research Collaborative Tracking Finance for Climate Action. Other countries are building capability. In France, the Institute for Climate Economics conducts an annual assessment and its latest data from 2019 shows climate finance rising from €35.8bn to €45.7bn from 2011 to 2018.¹¹ In the current global environment of rapidly allocating capital driven by low interest rates and COVID-19 economic recovery, this metric becomes all the more important.

¹⁰ https://www.productivity.govt.nz/assets/Documents/4e01d69a83/Productivity-Commission_Low-emissions-economy_Final-Report.pdf

¹¹ <https://www.i4ce.org/download/landscape-of-climate-finance-in-france-2019-edition/>

Disclosure as a mechanism to improve the systemic management of climate risks

The Reserve Bank supports the Government's plans for the mandatory disclosure of climate-related financial risks using the Task Force on Climate-related Financial Disclosures (TCFD) framework. This is already being developed by the Ministry for the Environment (MfE) and the Ministry of Business, Innovation and Employment (MBIE). Disclosure is an important instrument to both manage risks and incentivise investments in a climate-resilient economy and is consistent with the Reserve Bank's approach to prudential regulation. As noted above, the Reserve Bank is a member of the NGFS, which has pledged its support for the TCFD on the basis that it provides a framework for consistent, comparable and decision-useful disclosure.

Disclosure is an important instrument to both manage risks and incentivise investments in a climate-resilient economy and is consistent with the Reserve Bank's approach to prudential regulation.

The Commission's draft advice makes the recommendation to:

“Implement the proposed mandatory financial disclosures regime and explore the creation of a similar regime that covers public entities at the national and local level.”

We support the recommendation to explore public sector climate disclosure. We agree that public entities need to understand, assess and manage climate-related risks at the local and central level.

Public entities hold significant financial assets, and act as catalysts for the investments and actions of others. At the local level this includes long-lived, high value assets (such as storm water systems) that will be at risk from climate change,

while councils' role in allowing/preventing development on low-lying coastal land will impact the amount of residential mortgages at risk. At the central government level, this includes infrastructure assets such as buildings and roads, and policies that will either support or curtail an orderly climate transition. Public sector expenditure represents a significant proportion of the economy as a whole and the analysis of the risks it is subject to should align with that undertaken in the private sector.

As awareness of the role of finance in climate change increases, there is likely to be increased pressure on public institutions. Taxpayers and ratepayers could increasingly want to know about such risks, while similar demand for such disclosures could come from investors.

Internationally and in New Zealand, some public entities are already beginning to use the TCFD framework to understand and report climate-related risks. Central banks in the UK and France have used the TCFD framework to make the first steps towards disclosing their climate-related risks, while Canada has tied some of its recovery spending to align with the TCFD.¹² In New Zealand, the NZ Super Fund¹³ and Auckland Council¹⁴ have disclosed using TCFD, while the Ministry for the Environment (MfE) is preparing its own TCFD report.

The Reserve Bank has been involved as an observer to MfE's TCFD process. Our observations are that, although the process is challenging, MfE has reported key benefits including identifying and increasing awareness of risks particularly in the longer term. Given that most organisations are at the beginning of their journeys on climate risks, and that climate may only currently be perceived as a peripheral issue for some of them, the TCFD framework is a way to mainstream and integrate the consideration of climate-related risks across organisations.

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However, we note that the TCFD-aligned disclosure was developed by the Financial Stability Board for the private sector and further study would be required to identify any limits to the suitability of this approach for the public sector. For example, modifications may be required in areas such as governance.

The Commission's draft advice makes the recommendation to:

“Evaluate the potential benefits of mandatory disclosure by financial institutions of the emissions enabled by loans over a specified threshold.”

We support this recommendation and agree that evaluation is needed. Consideration needs to be given to growing momentum to expand from initial set of TCFD disclosures to 'forward metrics' that align portfolios to the Paris Agreement. We encourage New Zealand banks to engage with this work.

Capital markets are critical for us to enjoy the benefits of the development of our built environment and the support of our standard of living. As we collectively address the challenges of climate change, understanding how investments impact on our natural environment is key. Developing reporting measures of emissions enabled by investments could be useful in providing such information and would also serve to enable public or investor scrutiny of investment objectives.

¹² <https://www.bankofengland.co.uk/prudential-regulation/publication/2020/climate-related-financial-disclosure-2019-20>;
https://www.banque-france.fr/sites/default/files/media/2020/06/26/rapport-annuel-investissement-responsable_2019_en.pdf;
<https://pm.gc.ca/en/news/news-releases/2020/05/11/prime-minister-announces-additional-support-businesses-help-save>

¹³ <https://www.nzsuperfund.nz/news-and-media/nz-super-fund-releases-climate-change-report/>

¹⁴ <https://www.aucklandcouncil.govt.nz/plans-projects-policies-reports-bylaws/our-annual-reports/Pages/current-annual-report.aspx>

However, as a regulator, we note that there will be disparities in size, resources and capacity amongst institutions in relation to disclosure. Our expectations are that maturity and sophistication in relation to climate-related disclosure would differ by organisation and it may be challenging to develop consistently useful measures. In this regard, we would encourage industry to collaborate, bringing smaller institutions along so they can move to a common standard. We also acknowledge that banks are unlikely to have this information currently. This will also take time to develop as many of the firms that banks invest in do not disclose their emissions. Therefore we support a staged approach. Until applicable standards are developed, differences in methodologies can lead to different reporting for the same emissions.

Despite these challenges, in our view further disclosure regarding financed emissions makes sense. It would help identify transition risks in the economy and is in step with demands from investors who increasingly see climate risk as investment risk.¹⁵ For example, Climate Action 100+, a group of over 500 institutional investors controlling over \$47 trillion of assets, is demanding that the world's 161 highest emitting companies (representing 80% of industrial emissions) publish strategies to reduce emissions by 45% by 2030 and to reach net zero by 2050. Internationally, there is significant momentum in large financial institutions pledging to reach net-zero financed emissions by 2050¹⁶ including Barclays, Morgan Stanley, HSBC and JPMorgan Chase.¹⁷

Further, we suggest reviewing international efforts to identify and disclose financed emissions. As highlighted above, the focus internationally for banks is expanding from the initial set of TCFD disclosures to aligning portfolios with net zero in line with the Paris Agreement (or other forward looking metrics). Any moves in New Zealand need to be cognisant of this shift. The TCFD's recent consultation on such forward looking metrics highlighted they could be useful, but noted challenges around the assumptions, future uncertainty or opaque methodologies.¹⁸ The TCFD is considering these findings and will issue draft guidance this year.¹⁹ We note that in March 2021 the European Banking Authority launched consultation on the draft technical standards on Pillar 3 disclosures of Environmental, Social and Governance risk. This included the proposal that institutions disclose their green asset ratio on exposures financing taxonomy-aligned activities, such as those consistent with the Paris Agreement goals.²⁰

15 See: <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

16 https://igcc.org.au/wp-content/uploads/2020/09/140920_Media-Release_Climate-Action-100-Net-Zero-Company-Benchmark-announcement.pdf

17 <https://home.barclays/society/our-position-on-climate-change/>; <https://www.morganstanley.com/ideas/climate-change-net-zero-financed-emissions>; <https://www.hsbc.com/news-and-media/hsbc-news/hsbc-sets-out-net-zero-ambition>; <https://www.jpmorganchase.com/news-stories/jpmorgan-chase-adopts-paris-aligned-financing-commitment>

18 <https://assets.bbhub.io/company/sites/60/2021/03/Summary-of-Forward-Looking-Financial-Metrics-Consultation.pdf>

19 <https://www.fsb-tcf.org/publications/>

20 <https://www.eba.europa.eu/eba-launches-public-consultation-draft-technical-standards-pillar-3-disclosures-esg-risks>

Importance of Investment

The OECD has estimated that US\$6.9 trillion is required globally every year up to 2030 to meet climate and development objectives.²¹

In New Zealand, the Commission's draft advice highlights areas in key sectors that will require significant, timely investment such as in public transport and the electricity sector, to meet demand growth from electrifying transport and heat.

The Commission's draft advice makes recommendations to:

“Investigate and develop plans to mobilise private sector finance for low emissions and climate-resilient investments.” AND

“Ensure that economic stimulus to support post-COVID-19 recovery helps to bring forward the transformational investment that needs to happen anyway to reach our joint climate and economic goals”

The Reserve Bank supports these recommendations. As stated previously, starting now to get on the path to a low emission, climate-resilient economy as part of the global effort will help reduce the risks to the stability of the financial system and macro-economy.

Private investment is desirable for its scale and benefits as part of an efficient capital market. To promote private investment, we see information, credit and liquidity as a critical enablers.

Barriers associated with climate investments include their long-term, capital-intensive nature, and a high learning curve for

investors in new industries. Furthermore, associated technologies may feature a higher risk of failure or accelerated obsolescence. Attempts to draw in private-sector investment need to directly lower these barriers by providing a 'demonstration effect' and/or transferring or mitigating perceived 'pioneer risk'. In addition, any efforts need to be of sufficient scale and timeframes. There may also be a need for complementary policy measures as markets respond best when there are strong, consistent signals.

Efforts to mobilise private sector finance may be further hindered by New Zealand's small scale capital market, which is growing but not yet of sufficient size to continuously attract investment. This market is divided between banks or large firms, such as telecommunications or energy companies (that need to raise capital for a specific project) and small scale niche issuers. Generally, investors consider two risks when making investments: liquidity (the ability to buy/sell) and credit (the soundness of the investment) – and the trade-off between liquidity and credit generates price/yield (to compensate for risk). Generally, given these trade-offs, the smaller the entity, the more expensive the funding – a bias toward status quo investment. In short, the challenges to enticing private capital could be viewed as a 'chicken and egg' situation.

New Zealand's market for green bonds may continue to grow organically but it is difficult to see how this would happen at the scale or pace required.

²¹ <https://www.oecd.org/environment/cc/climate-futures/policy-highlights-financing-climate-futures.pdf>

New Zealand's market for green bonds may continue to grow organically but it is difficult to see how this would happen at the scale or pace required. Some form of intervention may be required to grow capital markets to attract green investment, beyond investor preference. This could be in various forms of incentives or disincentives such as tax breaks, guaranteed backing or liquidity provisions. However, any intervention would need to be weighed carefully to avoid

unintended consequences such as the risk of crowding out other investments or fund raising capabilities. We note the work of New Zealand Green Investment Finance (NZGIF), however this is limited by its scale (\$100 million) and investment mandate.²²

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For example, the German sovereign green bond €6.5 billion was oversubscribed €33 billion while the Netherlands first sovereign green bond €6 billion was oversubscribed €20 billion.²³

A similar approach could be a catalyst for action in New Zealand and help to overcome the twin tragedies of the 'commons' and the 'horizons' as outlined by former Bank of England Governor Mark Carney in a landmark speech in 2015.²⁴

²² Mandate excludes large scale renewable electricity generation, forestry, state sector investment, carbon capture and storage and adaptation https://static1.squarespace.com/static/5cc8bb6fab1a623acbf93b1f/t/5dd4896e7d21622586c610c5/1574209902893/NZGIF+Guide_1.pdf

²³ <https://english.dsta.nl/subjects/green-bonds/news/2019/05/21/%E2%82%AC-5.98-billion-issued-in-new-20-year-green-dsl-2040>; <https://www.ft.com/content/39bd3613-2843-459c-bd6b-c625b6843fef>; https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1657; <https://www.ft.com/content/61195ec8-2488-4f6d-9806-efaaecc6c2b5>; <https://www.dmo.gov.uk/data/gilt-market/green-gilt-issuance>

²⁴ <https://www.bis.org/review/r151009a.pdf>

Drawing in private capital may also deliver the co-benefit of helping to build capacity in the public sector by injecting further commercial rigour and experience. Pairing investments with investor performance requirements will develop a growing cadre of New Zealanders skilled in these investments to further drive accelerated capacity building across sectors such as local and central government.

Finally, there is a significant opportunity to invest in a climate-resilient recovery from the COVID-19 pandemic. The NGFS has called for a 'green' recovery that lays the groundwork for a smoother, more orderly transition.²⁵ We endorse this approach. As our Governor has stated publicly, the current economic regeneration must be used and invested in a way that increases climate resilience and reduces physical and transition risks.

“The current economic regeneration must be used and invested in a way that increases climate resilience and reduces physical and transition risks.”²⁶

²⁵ <https://www.ngfs.net/en/statement-need-green-recovery-out-covid-19-crisis>

The economic response to the pandemic should therefore not be to re-build the old economy with the climate risks it presents, but to act now to lay the groundwork for an orderly transition to a more sustainable economy and climate-resilient financial system – a 'green' recovery.

²⁶ <https://www.rbnz.govt.nz/research-and-publications/speeches/2020/speech2020-05-28>

Te Ao Māori lens and the need for a considered and aligned approach

Te Ao Māori lens is essential. We support the Commission's desire for a 'Genuine, active and enduring partnership with iwi / Māori' [Enabling recommendation 3].

We note that as tangata whenua and Te Tiriti o Waitangi partners, it is essential that iwi Māori voices, and mātauranga Māori is embedded into this work. Mātauranga Māori is a form of knowledge regarded as both 'traditional' but also contemporary, and as representative of the experiences of generations of Māori in Aotearoa New Zealand. Because it goes back centuries, mātauranga can reveal richer things about Aotearoa – including what its climate was like before Europeans arrived – that science alone cannot. It is inseparable from Māori culture, values and beliefs; Māori consider themselves part of nature and within it, and mātauranga Māori reflects this.

As we are increasingly seeing globally, climate scientists are turning to indigenous communities, partly because they have often been in the same place for centuries. Science, in the traditional Western sense, and Mātauranga Māori knowledge can work in synergy to create more effective solutions.

As noted in the Te Ōhanga Māori – Māori Economy Report released in January this year:²⁷

“Through iwi, collectives, and businesses, Māori support the mauri of land, ecosystems, water, air, waterways, and oceans, providing crucial support for natural capital, and ultimately enabling wellbeing for future generations. Land and water are fundamental to Māori identity and culture through whakapapa. As such, we recognise that in Te Ao Māori, their true value cannot be reflected on a balance sheet or in numerical values.”

Māori are particularly vulnerable to physical and transition risks of climate change. They are disproportionately represented among lower socioeconomic statistics and exposed to physical impacts such as rising sea levels, coastal erosion, storm surges and flooding. The economic impacts of such events can be long lasting, such as reduced access to, and bounty of, traditional resources such as fisheries. There are also large areas of Māori land which hold much of the biodiversity in Aotearoa.

From engagement with iwi we can see that there is an appetite for climate resilient and sustainable related investments. Further research could identify these opportunities. Such research could be led in partnership with iwi and crown agencies.

²⁷ <https://www.rbnz.govt.nz/research-and-publications/research-programme/te-ohanga-maori-2018>

A considered and aligned approach is needed

The carbon footprint and climate change risk profile of our economy is governed by a number of factors. Theoretically a price on carbon would drive most emission reduction. However, given the scale of our economy, the nature of investment barriers

and the potential impacts for financial stability, we strongly support the advice of the Commission that a cohesive policy response is required including a carbon price, regulation and public and private investment.

We strongly support the advice of the Commission that a cohesive policy response is required

The Reserve Bank has experience as a regulator from its role in the prudential regulation of banks and insurers. The Reserve Bank's "three pillars" approach to banking supervision from the mid-1990s placed a heavy reliance on market discipline, to such an extent that New Zealand was an outlier from conventional, more intrusive approaches to banking supervision internationally. Even so, a key feature of our approach was the need for regulation to ensure that banks disclosed the key information to enable the market to provide the right price signals about banks. As noted above, we fully support further regulation now to ensure that stakeholders are well informed about the way that climate risks impact on conventional financial risks.

Also, the Reserve Bank has become increasingly convinced in recent years of the need to strengthen the "regulatory discipline" pillar of our supervisory approach. There are various aspects of the way that financial systems work that show the need for regulatory action. One example is a "race to the bottom" situation or "herding" behaviour, where no single player wants to pull out of a market where all their competitors are still making money in the short term. The Global Financial Crisis provides a prime example of how a very complex system with many interacting factors can lead to very damaging outcomes, and the need for appropriate regulation. The GFC is also a reminder of the need for well-considered regulation and policy that thoroughly explores trade-offs and unintended consequences.

The draft advice spells out very convincingly the complexity of the interactions between the actions of individuals, firms and the government, and the number of market failures and barriers to action that can prevent the achievement of a low-carbon, climate resilient future. The long-term intergenerational nature of the problem, and the way it affects all aspects of our lives, creates whole extra layers of complexity compared to the pre-existing challenges of maintaining the stability of the financial system.

So while most of the recommended necessary actions in Chapter 6 are outside the Reserve Bank's direct areas of interest, we fully support the fact that many of them fall into the second and third of the three types of intervention listed on page 104: we view the first type of intervention, namely "emissions pricing and other market incentives to influence choices", as a necessary but not sufficient response. Given the amount that needs to be done, it is very helpful for the report to single out the necessary actions that are time-critical. This highlights a first problem in relying on market pricing, since the ETS does not yet appear to be functioning effectively, and a number of choices that are relevant to a long-term low-carbon economy could be made poorly now, relying on current market signals. The point is well made that "Policy decisions and investments made now must not lock New Zealand into a high emissions path" (page 18 of the Report).

Finally we note the need for aligned, coherent approach across Government and support the Commission's emphasis on partnership between central and local government.

We emphasise the need for an approach that draws together both emission reduction and climate adaptation. These two interlinked challenges cannot be approached in a siloed manner without risking disjointed analysis and policy development or an inadequate/unbalanced assessment of climate risks to financial stability and the economy more broadly. This may be particularly relevant in New Zealand given the potential tipping point nature of cumulative risk, the cost of action and the highly concentrated nature of our export economy e.g. tourism, agriculture. The need for joined-up thinking is a key theme in climate finance literature and noted by the Bank for International Settlements.²⁸ Inadequate alignment may serve to increase risks embedded within the economy and ultimately delay progress towards a more financially stable, resilient future.

28 The green swan Central banking and financial stability in the age of climate change. <https://www.bis.org/publ/othp31.htm>

Conclusion

Thank you for the opportunity to comment on this draft advice. We look forward to engaging with you further on the points raised in this submission. We also welcome the opportunity to meet your modellers to further understand the assumptions underlying the quantitative implications of your modelling. While much of our own analysis of the New Zealand economy is aimed at understanding how Reserve Bank policy instruments can best serve our mandate over the short to medium term, we are currently also engaged with longer term scenarios produced by the NGFS. The NGFS is developing four scenarios:

- **Orderly:** Early, ambitious action to a net zero CO2 emissions economy.
- **Disorderly:** Action that is late, disruptive, sudden and/or unanticipated.
- **Hot house world:** Limited action leads to a hot house world with significant global warming and, as a result, strongly increased exposure to physical risks.
- **Too little, too late:** with both high transition and physical risk.

In the future we will be interested in linking such frameworks to key financial and macroeconomic quantities, to better understand the implications of physical and transition risks due to climate change for a sound and dynamic monetary and financial system and consequently the prosperity and wellbeing of New Zealanders.

We acknowledge the comprehensive nature of the draft advice and have focused our attention on several key areas. It's important to take a collective approach and we look forward to working with you on these and other areas relevant to our remit.

Summary of our Response

Commission's Draft Recommendation	RBNZ Response
Implement the proposed mandatory financial disclosures regime and explore the creation of a similar regime that covers public entities at the national and local level [Necessary action 17.a].	Support. Evaluation is needed.
Evaluate the potential benefits of mandatory disclosure by financial institutions of the emissions enabled by loans over a specified threshold [Necessary action 17.b].	Support. Evaluation is needed.
Investigate and develop plans to mobilise private sector finance for low emissions and climate-resilient investments [Time critical necessary action 6.f].	Support.
Ensure that economic stimulus to support post-COVID-19 recovery helps to bring forward the transformational investment that needs to happen anyway to reach our joint climate and economic goals [Time critical necessary action 6.c].	Support.
Genuine, active and enduring partnership with iwi / Māori [Enabling recommendation 3].	Support.
RBNZ Additional feedback	
Include new chapter on investment/finance or expand Chapter 6.	Given the interlinkages and interdependencies across the economy, investment/finance merits its own chapter/ section. Happy to provide further input in a meeting.
A considered and aligned approach is needed.	<p>We support the Commission's advice that a carbon price alone is insufficient.</p> <p>We support the Commission's advice that central and local government work in partnership and consider adaptation with mitigation.</p>