

RBNZ SUBMISSION ON THE
MfE Emissions
Reduction Plan
Discussion Document

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**Reserve Bank
of New Zealand**
Te Pūtea Matua

Introduction

We welcome the Emissions Reduction Plan Discussion Document and are pleased to contribute to this step in New Zealand's path to a low-carbon, climate-resilient economy.

Like many other central banks we are moving to understand and integrate climate change considerations into our core functions.

We join 100 other central banks and supervisors in collaborating internationally on climate change through the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). Internationally, central banks are shifting to integrate climate change into their operations and the delivery of their financial stability and monetary policy mandates. Last week the Basel Committee on Banking Supervision (BCBS) issued its draft principles for the management and supervision of climate-related financial risks. The BCBS is the primary global standard setter for the prudential regulation of banks. Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability.

At the Reserve Bank of New Zealand – Te Pūtea Matua, we are kaitiaki (guardians) of New Zealand's financial ecosystem, tasked with maintaining and enhancing financial stability. We act collectively to promote the prosperity and wellbeing of all New Zealanders. We do this in large part by promoting a sound and dynamic monetary and financial system – a necessary platform for a sustainable and productive economy. We have begun working towards embedding climate considerations into our core functions relating to financial stability and monetary policy. In conducting these core activities, we must have regard to all relevant risks and operate according to appropriate time horizons.

Our vision is that climate change considerations are incorporated into the Reserve Bank and the financial system.

Finance underpins the shift to a climate-resilient economy. Much of the work to prepare for and prevent climate change depends on access to finance. The role 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".

While central bankers have the responsibility to play a critical role within their mandates, we recognise it is primarily the Government's role to lead emission reduction as part of a collective response including Māori, the private sector, communities, local government and individuals. In such a response, the role of the private sector is critical given that business touches points in all aspects of production and consumption, and the financial sector plays a key role in providing financing and pools the risk for business. The collective response needs to be aligned and at a scale and pace appropriate to the risks.

The longer the delay, the greater the potential for natural, social and financial disruption. The Bank for International Settlements' Green Swan book highlighted the potential financial stability risks that stem from climate-related risks. We support an urgent, but orderly, transition to a climate-resilient economy as part of a collective, global effort. We note the importance of New Zealand's reputation and its ability to continue to have access to markets as global consumers and investors' preferences evolve. Beginning 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 the macro economy.

Background

Global developments

Internationally there is strong and growing momentum on climate change from across the financial sector, including financial regulators, the private sector and standard setters. This month's United Nations Climate Change Conference COP26 put an unprecedented focus on the financial sector role in relation to climate change. Key developments included:

- The Network for Greening the Financial System (NGFS), of which RBNZ is a proud member, announced that 100 central banks have now joined their network. It published three new reports: "Scenarios in Action: a progress report on global supervisory and central bank climate scenario exercises"; "Progress report on the Guide for supervisors"; "Climate-related litigation: raising awareness about a growing source of risk".¹
- Launch of the Climate Training Alliance portal to enhance the availability of training resources for authorities responding to climate risk. The Alliance is a collaboration between the Bank for International Settlements, the International Association of Insurance Supervisors, the NGFS, and the UN-convened Sustainable Insurance Forum.
- The Glasgow Financial Alliance for Net Zero (GFANZ) announced that more than 450 firms in the financial services sector across 45 countries that represent more than \$130 trillion of financial assets have committed to align their activities to transitioning to net zero and to work to deliver the \$100 trillion investment needed to achieve net zero over the next three decades.²
- The International Financial Reporting Standards Foundation announced the formation of a new International Sustainability Standards Board (ISSB), which seeks to develop a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors' information needs — building further upon the work of the Task Force for Climate-Related Financial Disclosures (TCFD), which will continue to be taken forwards in 2022.³
- The UK announced the intention to become the world's first net zero aligned financial centre, with a proposed new requirement for mandatory net zero transition plans for UK financial institutions and companies.⁴

New Zealand developments

Recent domestic developments include:

- The announcement of the Crown Responsible Investment Framework issued to the NZ Super Fund, the Accident Compensation Corporation, the Government Superannuation Fund and the National Provident Fund.
- New requirements for mandatory climate-related disclosure under the recently enacted Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021. Related to this:

¹ Available at <https://www.ngfs.net/en/liste-chronologique/ngfs-publications>

² Glasgow Financial Alliance for Net Zero announced

³ International Financial Reporting Standards Foundation announced

⁴ Chancellor: UK will be the world's first net zero financial centre - GOV.UK (www.gov.uk)

- The External Reporting Board's Climate-related Disclosures Governance and Risk Management Consultation Document
- The Financial Markets Authority's Climate-related Disclosures regime implementation approach
- The announcement that New Zealand would issue a Sovereign Green Bond to fund low carbon projects.

Climate change and the RBNZ's balance sheet

Like other central banks we are looking closely at ways we can use our balance sheet to incorporate sustainability goals to support the transition to a low emission, climate resilient economy and the development of a sustainable finance market in New Zealand.

Our balance sheet is primarily used for two purposes: implementing monetary policy; and holding foreign reserves to support conditions in the New Zealand dollar market in the event of market stress, if required. To implement monetary policy, we are active in domestic financial markets with operations such as the Large Scale Asset Purchase Programme (LSAP), the Funding for Lending Programme (FLP) and Open Market Operations. Meanwhile, our foreign reserves holdings need to meet strict liquidity and credit quality criteria to ensure they are available in short order in the event that the New Zealand dollar markets requires support.

Our ability to operate over a long time horizon will support the steady approach required to incorporate our climate goals in how we implement monetary policy. Our journey in this area is in its early stages, but as seen globally, efforts are under way to investigate how to give effect to this goal.

We have begun looking in more depth at the climate-related risks that arise from our government bond holdings. Possible actions include taking a more holistic approach when making asset allocation decisions in our foreign reserves portfolio, by considering the expanding universe of sustainability-linked investment opportunities. This would allow us to optimally combine our policy objectives with our sustainability goals. We are conscious that the range of investment options will widen over time and we will look to support the development of such markets.

Domestically, we intend to review the types of collateral (e.g. bonds) that we accept in exchange for cash in our operations, and the pricing of these bonds. That said, our journey along this path is in the early stages, but we remain committed to researching options so we can best contribute to a low-emission, climate-resilient economy and support the development of a climate-friendly Debt Capital market in New Zealand.

Response to the four questions highlighted in the Discussion Document

Our submission is focused on the four questions in the funding and financing section of the discussion document (page 36).

1. What are the main barriers or gaps that affect the flow of private capital into low-emissions investment in Aotearoa?

As noted above, investors have signalled significant changes to the flow of capital.

This shift in the flow of capital will bring opportunities and risks to New Zealand's current economy as the transition gathers pace. The Investor Group on Climate Change noted this month that New Zealand "needs to get on top of stubborn emissions rates and help create more investment-grade opportunities in green infrastructure and industries..." and "better prepare the entire economy for a more structural shift over the coming decades backed by private capital."

New Zealand, like other countries, faces barriers to increasing the flow of private capital into low-emissions investment. There are three main overarching barriers:

1. **A leadership/coordination gap** across private and public service (e.g. private sector first movers are often disadvantaged and the public sector comes up against its own mandates) may mean investment lacks sufficient pace/scale. There is a tendency to focus on short term costs rather than long term value. Better and credible information will expedite the process of various markets pricing in climate-related risks over time. An example of this is the development of robust project pipelines for low-carbon infrastructure investment within a country. These pipelines require co-ordination across the public and private sectors and should look to be resilient to external shocks where possible, and involve the right institutions.
2. **A lack of data and information** makes it difficult for investors to incorporate climate considerations into their investment decisions. The scope and the quality of climate reporting can vary significantly and the evidence with regards to the direct climate impact of various green investments is not always clear. These create barriers that lead to investors choosing to sit on the side-lines as they wait for unified market standards to develop. In part, this is because historic data is of limited use for assessing future risks and it is also why developing scenarios on future risks is so important. As the Climate-related Disclosure regime is embedded there will be a need for further publicly available data to enable better decision making around the risks and opportunities associated with investments.

At the same time, as our *Climate Changed 2021 and Beyond* report highlighted, while tools like disclosure and scenario analysis are critical in helping us understand and prepare for climate-related risks, we cannot let a desire to perfect such analysis paralyse us. We will never have perfect information on climate change, yet the direction is clear and this should not prevent us from taking action while simultaneously improving data, capacity and methodology.

3. **Capacity:** climate change presents new financial risks for investors that will require organisations to upskill their staff and/or hire new staff in order to embed climate considerations into investment decisions and risk management processes. This will need to take place across the public and private sectors. These changes will take time.

The barriers highlighted above lead to additional, more specific barriers:

- a) Barriers associated with the nature of low-emission investment (e.g. long term, capital intensive, learning curve for investors, regulatory uncertainty and increasing cost of capital intensive investment in time of inflation and rising funding costs).
 - i. Current barriers to private investment include perceived risks arising from a lack of understanding or track record for a technology, business model, team, and investment strategy or asset class. Climate investment is particularly disadvantaged given that the required finance is often long term, capital intensive and involves a learning curve for investors.

- ii. The development of green fixed income markets globally faces barriers related to taxonomies and costs of entering the market. While there has been progress in taxonomies (e.g. in Europe, China and the International Capital Markets Association) there remains no globally unified definition of green bonds. Leading bond standards for green bonds also suggest that issuers complete impact reporting to show how the funds they have raised are generating environmental benefits. The scope and quality of this reporting varies significantly, making it difficult for investors to discern the true environmental impact of a green bond issuance. This also creates additional costs for issuers as these impact reports are typically either completed or reviewed by third parties. There may also be issues around ongoing compliance related to ensuring that the funds raised continue to go towards green projects throughout the duration of the bond.
 - iii. The demand for sustainable investment in equities has increased significantly in recent years. Specialist organisation provide ESG ratings which look to assess how well companies are addressing ESG concerns. These ratings can play a key role in determining where fund managers or exchange-traded funds invest. However, ESG ratings across providers are not well correlated, due to different weightings and data being applied across the methodologies to produce these ratings. This makes it difficult for investors to discern whether their investment is sustainable or not. Where some measures are less credible than others, investors may lose faith in the ratings overall. The shift towards climate-related reporting should improve access to information on climate-related risks and opportunities.
- b) Barriers associated with the nature of New Zealand’s capital market.
- i. Efforts to mobilise private sector finance may be further hindered by New Zealand’s small scale debt 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, ports 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 without impacting the price) 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.
 - ii. 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 debt capital markets to attract green investment at pace and scale, beyond investor preference. This could be in various forms of incentives or disincentives such as tax breaks for green issuers, 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 (\$400 million).

2. What constraints have Māori and Māori collectives experienced in accessing finance for climate change response activities?

There are many parallels between the barriers affecting the flow of capital into low-emissions investment and those of Māori capital seekers more generally.

- A leadership/coordination gap makes an already complex ecosystem difficult for capital seekers to navigate
- There is a lack of available data and information to assist capital allocation decisions.
- There is an identified need to upskill capital seekers through financial, business and governance training. Greater investment can support the transition from public to private capital.

More specific barriers related to the nature of kaupapa Māori entities and their investment philosophy. Often there is greater alignment with investors of long-term patient capital who have environment, social, governance and cultural factors embedded in their investment approach. The slowness to acknowledge the developing Māori economy and need for a different response has meant Māori capital seekers have been disadvantaged by a lack of suitable capital solutions.

Primary Sector – Low-emissions Economy

Agriculture, forestry and fishing makes up \$23bn⁵ of the Māori asset base. We note that the impact of climate change may be disproportionate on Māori. The known barriers to accessing capital combined with emerging climate change risks mean that Māori may need to be supported to develop climate change mitigation strategies. Such support may require a collective response.

3. What else should the Government prioritise in directing public and private finance into low-emissions investment and activity?

The table below aligns the barriers identified above with identified requirements to drive the transition to a low carbon economy.

Barrier	Identified requirements
Leadership/Coordination gap to address multiple market failures (e.g. externalities, missing markets, information asymmetry) and secure transition at required scale and pace	<p>A coordination mechanism to crowd-in private sector capital (such as a specialised/dedicated fund) for commercial investment to increase the likelihood and pace of transition to climate resilience.</p> <p>A mechanism to align and clearly articulate the activities of different public agencies (including subsidies, grants, innovation funding and policy etc...) to make it easier for private investors to prepare their transition plans.</p> <p>Durable policy settings, including emission pricing with sufficient efficacy, to incentivise investment over long time horizons towards a low carbon, climate resilient economy.</p>
Data and information availability	Data and information on the impact of green investments, and reporting across sectors of the climate risks on firms' balance sheets.

⁵ Source: BERL/RBNZ Te Ōhanga Māori 2018 *The Māori Economy 2018*

Barrier	Identified requirements
	<p>Disclosure used as a critical component to help channel the flow of capital for resilience to climate-related risks.</p> <p>An understanding that while critical data and methodologies (such as scenario analysis) need to improve, we will never have perfect information on climate risks/impact on which to make decisions.</p> <p>A commitment to developing data and making it widely available.</p>
<p>Upskilling/capacity building</p>	<p>Investors and asset managers understand the climate-related opportunities/risks associated with investment.</p> <p>Investors, asset managers and others are able to make decisions under uncertainty in an investment context.</p>
<p>Nature of climate-related investments (long term, lack of track record, capital intensive, learning curve for investments)</p>	<p>A mechanism to provide demonstrator effect/reduce pioneer risk (to reduce information asymmetry to help build markets).</p> <p>Development of investment assessment practices and information sets.</p> <p>Coordination globally on the development of definitions/taxonomies to reduce greenwashing with a focus on transparency. Recognition of the need to get started and refine as we go.</p>
<p>Nature of New Zealand's capital market</p>	<p>Market signal of long term liquidity.</p> <p>Market signal of scale and pace.</p>

Summary of barriers and identified priority requirements

While there have been significant shifts in investor momentum on climate change in recent years, multiple barriers exist at both the global and national levels.

These barriers occur in a context of multiple market and regulatory failures, globally and domestically. Given that energy and food are life-giving and ubiquitous to today's economies, the challenge of required investment stretches across all sectors of our economy with multiple policy actors including the private, public and non-profit sectors, Iwi/Māori and individuals.

In the context of this complexity, we stress two points:

1. First, the need for leadership to drive a coherent response with clear policy and market signals.
 - 1.1. The Government's role is critical to enable the largest ongoing impact for all agents of change – public, private, NGO and individual efforts.

- 1.2. In part, this is because there are multiple market failures at play. These include market failures such as challenges around the tragedy of the commons and the horizon, the interplay of property rights and decision making, pricing and access to capital and investments (including institutional structures).
 - 1.3. The goal should be seeking to maximise climate resilience without undue risk. This lens will need to be applied across all investment pathways and actions and climate risks will need to be integrated into decision making across the financial system.
2. Second, the need for a clear focus on a long term investment.
 - 2.1. We are good at focusing on short term cost but not so good at identifying long term value. Policies and interventions need to focus on the highest net expected risk-adjusted return.
 - 2.2. This will incorporate multi-party analysis of expected benefit (opportunity cost), ownership of the measures (i.e. crown balance sheet or other), frameworks for setting standards and prices, and how these strategies can be flexible and evolve over time.

4. Is there anything else you wish to share in relation to funding and financing?

Analysis to inform the UK's Climate Change Committee's advice estimates that capital investment in net zero technologies will need to scale up from around £10bn/year currently, to around £55bn/year at its peak in the year 2035⁶. As we highlighted in our Climate Change Commission submission, it would be useful to have a similar analysis to inform New Zealand's approach to investment. Given New Zealand's already high proportion of renewables and agricultural economy, our key investment areas will differ. However, a simple scaling of the UK analysis to the size of the New Zealand economy and converting to New Zealand dollars, would indicate a figure that would reach around \$8bn/year in required capital. Then, further investments will be required in adaptation. The biggest hurdle is the courage to invest at scale in the future of Aotearoa New Zealand.

Considering the barriers highlighted in sections 1, 2, and 3, an approach is needed that secures sufficient scale, pace and breadth of investment and alignment across the financial system. To best ensure an intergenerational view is taken when investing, some degree of independence from the government of the day is required.

An option available is to develop a fund to invest on a commercial basis for purposes consistent with New Zealand's domestic and international climate change obligations. An intention of the financing and management of the Fund would be to unlock private capital which would otherwise not flow to the projects considered. This could be in terms of co-investment with the fund manager in specific projects and/or through the removal of market failure inhibiting other private endeavours - for example by moving at scale to derive network effects or by extensions of scope to gain from whole of system solutions.

The fund could hence be 'goal dependent' as determined by Government via an investment mandate, and 'operationally independent' to deliver on the mandate, with success measured by the appropriate third party experts. These could include stewards such as the Climate

⁶ <https://www.theccc.org.uk/publication/the-road-to-net-zero-finance-sixth-carbon-budget-advisory-group/>

Commission, Ministry for the Environment and appropriate iwi and Treaty partner representation.

The fund could complement the existing \$400 million GIF although at a scale that would send a strong market signal, and derive stronger scale benefits as highlighted above, and crowd-in private investment at multiple levels.

Conclusion

Securing investment at an appropriate scale and pace is critical to shifting New Zealand's Emission Reduction Plan beyond a policy framework to actual emission reduction.

As we highlighted in our recent *Climate Changed 2021 and Beyond* report, we consider that beginning 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 financial system and the macro economy. An orderly transition will be better for financial stability than one that is deferred then abrupt, or too late.

While there is significant momentum in climate investment internationally, there remain significant barriers to the flow of private capital into New Zealand-based low emission investment at scale and pace. In particular, there is a need for leadership to drive a coherent response with a clear market signal and a clear focus on long term investment.

We welcome the opportunity to discuss this submission with you.