Investor Group on Climate Change

Investor Group on Climate Change (IGCC)

Submission to:

Climate Change Response (Zero Carbon) Amendment Bill

July 2019

Contact details:
Erwin Jackson, Director, Policy
erwin.jackson@igcc.org.au
www.igcc.org.au

ABOUT US

The Investor Group on Climate Change (IGCC) is a collaboration of Australian and New Zealand investors focused on the impact that climate change has on the financial value of investments. The IGCC represents institutional investors with total funds under management of over $2 trillion, and others in the investment community interested in the impact of climate change. IGCC members cover over 7.5 million people in Australia and New Zealand.

The $42 billion NZ Super Fund has been a member of IGCC for over a decade and supports initiatives that provide for a safe and stable climate. It has been consulted regarding this submission.

SUMMARY

Zero Carbon Bill is a step towards a prosperous zero carbon economy

Climate change presents a systematic risk to investment returns, financial stability, communities and economies. The decisions governments, investors, companies and individuals make today will have a material impact on the retirement savings of all New Zealanders.

Long-term investors have a critical role in delivering a more prosperous future and are increasingly changing their investment practices to align with a net zero emissions economy. Many are engaging with governments and companies they invest in to ensure they have strategies aligned with the objectives of the Paris Agreement.

While there are some market leaders, overall, the New Zealand financial market is still at relatively early stages of responding to climate change risk and opportunity. However, there are strong expectations that global trends in investor practice will be reflected in New Zealand over time. New Zealand will be impacted by shifts in global markets to low and zero emissions technologies, practices and investments. Capital is global and will be attracted to markets that are actively managing climate-related risks.

In this context, IGCC welcomes the fact that the New Zealand government is also undertaking a range of very positive measures to reduce emissions and unlock investment opportunities. These are broadly in line with the policy priorities of the investment community.

Investors strongly support the passage of the Zero Carbon Bill

Institutional investors have to make long-term returns on their investments. Lack of credible, durable and predictable policy frameworks mean investors will either choose not to invest, invest in other countries where policy is more predictable, or charge higher risk premiums on investments to hedge against policy risk.

Policies, such as the Zero Carbon Bill, can provide the private sector with greater certainty as to the rate and pace of change. A clear pathway to transition will improve investors' ability to:

- assess climate-related risks and opportunities
- measure and disclose portfolio exposure to the low carbon transition, and
- further invest in opportunities to support the transition to a zero carbon, climate resilient world.

Building on the strong foundations in the Zero Carbon Bill

IGCC would like to encourage four further improvements to the Bill to facilitate investment in emissions reductions and building resilience to the impacts of climate change.

1. **Targets aligned with the objectives and rules of the Paris Agreement:** Meeting the objectives of the Paris Agreement would substantially reduce the financial damage caused by climate change and limit the cost of climate change adaptation measures. IGCC strongly supports the purpose of the Bill to provide a framework for New Zealand to contribute to limiting global warming to 1.5°C.

   IGCC prefers, in line with international accounting rules, the setting of a net zero greenhouse gas emissions target for 2050 instead of separate targets for biogenic methane and other greenhouse gases.

   New Zealand is a small country located in a region extremely vulnerable to the impacts of climate change. The nation's ability to influence and hold other nations to account for their own commitments is in part dependent on New Zealand implementing policy that is consistent with the international rules-based system.

   At a minimum, the government should translate and communicate the proposed targets in the Net Zero Bill into an overall national target using currently agreed emissions accounting frameworks.

2. **Adaptation and resilience to the physical effects of climate change critical to long term prosperity:** With the right government policies in place, investors are well placed to provide the capital needed to support a national adaptation plan. IGCC therefore supports the adaptation elements of the Zero Carbon Bill. Given the emerging impacts of climate change in New Zealand and around the world, IGCC would encourage the government to provide the resources required to expedite the development of a robust national adaptation plan by 2021.

3. **Mainstreaming just transition:** Global markets are starting to irreversibly shift from high carbon to low carbon modes of production and consumption and climate change itself is disrupting industries like agriculture and tourism and impacting their economic viability. Governments, investors, companies and communities all have a role to play to ensure a just and orderly transition for regions impacted by the transition from emissions intensive activities and physical climate change itself.

   IGCC would however encourage the government to more strongly represent the need for a 'just transition' in the Zero Carbon Bill. This could provide a stronger legislative basis for the ongoing consideration of just transition in New Zealand's policy processes.

4. **Climate-related financial disclosures to build economic resilience:** IGCC welcomes that the New Zealand government's approach to climate related financial disclosures will be progressed outside of the Zero Carbon Bill. These disclosures are critical for climate risk management. However, to be as effective as they can be, standardised reporting on material climate change risks and opportunities should be embedded in mainstream corporate regulation, not separate climate change legislation.

INTRODUCTION

Institutional investors have systemic exposure to climate change.

Investors are exposed to systemic, climate-related *physical*, *transition* and *litigation* risks.

The systemic nature of these risks has been identified by financial regulators as requiring a strong and effective response. Reporting frameworks such as the G20 Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) are being embedded into the regulation of the financial system around the world, including in New Zealand.[1]

Institutional investors invest across the economy for the long-term and are exposed to the growing impact of climate change on the companies, industries, property and infrastructure assets they own.

Climate change risks can come directly through the impact of extreme weather on the airports, roads or electricity transmission assets they own or indirectly as climate change impacts the property market or wider economic conditions. This is called 'physical risk'.

Other risks and opportunities come from the steps taken to reduce emissions. This is called 'transition risk'. This includes regulatory shifts, technology disruption and changes in market demand for carbon intensive goods and services. For example, as the world continues to shift away from carbon intensive energy sources like thermal coal or high emissions agriculture, resource and agriculture companies need strategies to manage this transition. As major investors in infrastructure and property, long-term investors also see opportunities to deliver returns to their members by ensuring these assets are zero emissions, support the growth of clean energy across the economy, and are resilient to climate change impacts.

Finally, climate change is now widely regarded as essential expertise for boards and directors of both financial and non-financial corporates. Understanding and managing climate change related risks and opportunities is seen as central to the discharge of governance, fiduciary and stewardship duties, with the spectre of directors' personal liability in the future, for failure to properly consider and disclose.

Companies need to consider both the physical and transition impacts, in relation to their products and services, operations and supply chain, and implications for financial performance as well as legal and social licence to operate. Investors need to consider the implications for asset values and the discharge of their investment mandates and duties, as well as reputational and competitiveness impacts as they come under direct scrutiny from their own stakeholders. Both need to consider the systemic risk dimension (i.e. risks to economic and financial system stability, as well as social and environmental system constraints), in addition to company/portfolio-specific impacts.

Climate change has recently been identified as one of five leading 'top of mind' issues for New Zealand company directors.[2]

[1] https://www.rbnz.govt.nz/financial-stability/climate-change/strategy and https://www.rbnz.govt.nz/research-and-publications/speeches/2019/speech2019-07-11
[2] http://www.scoop.co.nz/stories/BU1901/S00277/top-five-issues-for-directors-in-2019.htm

All of this means responsible investors need to act on climate change.

Globally, institutional investors are responding to the risks from climate change in a range of ways[3]:

1. **Investment practice**: Institutional investors are addressing climate change in their day-to-day investment practices. This includes integrating climate change into their investment mandates, reporting, portfolio analysis and decision-making; making investments in low carbon and climate resilient portfolios, funds and assets; and, phasing out investments in thermal coal. For example, a global survey carried out by the bank HSBC in 2017 showed that two thirds of investors were planning to increase their investments related to tackling climate change. This includes 97 percent of European investors, 85 percent of US investors and nearly 70 percent of Asian investors.[4] In 2018, 90 percent of New Zealand and Australian investors were implementing low carbon strategies, up from just over 50 percent in 2017.[5]

2. **Corporate engagement**: Institutional investors are significant investors in, and owners of, many of the world's largest companies. Investors are increasing engagement with these companies to secure commitments from boards and senior management to take action to reduce emissions, and disclose to investors their plans to thrive in a resilient, net zero emissions economy. Through a global initiative called Climate Action 100+, over 340 investors with US $33 trillion in assets are now engaging actively as shareholders with the world's highest emitting companies.[6]

3. **Public policy engagement**: Government policy provides the signals and incentives that direct the flow of capital across the global economy. Policy engagement by long-term investors is occurring because it is a necessary extension of their responsibilities and duties to deliver strong returns for their members. Credible, investable and durable policy frameworks put in place today can support strong investor and super fund holders' returns into the future. In 2017, IGCC undertook member surveys where around 80 percent of respondents said that policy or regulatory uncertainty remained major challenges for investment.[7] In particular, investors cited the need for clarity around how governments intend to transition to a low-carbon economy and meet the goals of the Paris Agreement.

New Zealand is exposed to global market shifts

In October 2018, IGCC convened a workshop in Auckland to look at how to invest in climate solutions in New Zealand. In doing so, we sought to bring together investors, financiers, and other stakeholders to investigate key challenges and barriers for New Zealand, explore opportunities to scale up climate finance and discuss real world examples of current best practice.[8]

[3] https://theinvestoragenda.org
[4] https://www.gbm.hsbc.com/insights/sustainable-financing/attitudes-to-sustainable-finance
[5] https://igcc.org.au/wp-content/uploads/2018/08/IGCC_Report-low-carbon-solutions_Aug2018.pdf
[6] http://www.climateaction100.org
[7] https://igcc.org.au/wp-content/up- loads/2017/09/IGCC-road-to-return-final-final.pdf
[8] https://igcc.org.au/wp-content/uploads/2016/04/IGCC-NZ-report-final.pdf

Some of the key conclusions of this workshop included:

1. **There are strong expectations that global trends in investor practice will be reflected in New Zealand**: New Zealand will be impacted shifts in global markets to low and zero emissions technologies, practices and investments. Capital is global and will be attracted to markets that are actively managing climate-related risks. Local legal experts have also indicated that they expect that New Zealand will follow global accountability trends related to discharge of governance, fiduciary and stewardship duties. This is currently implicit in existing investor, director and trustee duties (under the Companies Act 1993, Financial Markets Conduct Act 2003 and Trustee Act 1956), and explicit in NZX corporate governance guidance. There is a case for financial regulators to step in, to clarify or make this explicit, and to send a strong signal to the market as other regulators have in other jurisdictions such as Australia, Europe, and the UK.

2. **While there are some market leaders, overall, the New Zealand financial market is still at relatively early stages of responding to climate change risk and opportunity:** Compared to other markets there has been relatively less debate about transition and systemic risk from climate change in New Zealand. For example, insurance companies are "on the front lines" of climate change in terms of physical risk exposure, as well as exposure of their investment portfolios. There has not been the same level of leadership from New Zealand's insurance sector on climate change, compared to international counterparts. However, the issue is climbing the agenda in New Zealand boardrooms, although there has been a general disparity in response between large firms and SMEs (the latter, due to perceived relevance or limited resources).

3. **New Zealand faces ongoing investment challenges, particularly for agriculture (much still at early R&D stage), infrastructure and adaptation**: Issues of investment scale, general underfunding of infrastructure and a relatively weak innovation system have been highlighted. There has been limited public climate finance to date, and little experience and experimentation in the New Zealand market generally, with innovative climate finance instruments and approaches not yet widely adopted. Importantly, the New Zealand Green Investment Fund Ltd is being established to address some of these gaps and weaknesses.

The New Zealand government is also undertaking a range of very positive measures to reduce emissions and unlock investment opportunities. These are broadly in line with the policy priorities of the investment community[9] and, in addition to the development of the Net Zero Carbon Bill include:

- an inter-agency Transition Hub to develop, analyse and advise on transition pathways, a 'just transition' and economic impacts
- post-2020 NZ Emission Trading Scheme (NZ ETS) reforms to strengthen and improve its operation

[9] https://igcc.org.au/investors-set-out-policy-priorities-to-limit-systemic-climate-risks/

- the launch of the New Zealand Green Investment Finance Fund Ltd to stimulate low-carbon innovation and investment
- consideration of the role of the Reserve Bank of New Zealand in monitoring and managing climate change related financial system risks, as part of Phase 2 of the Reserve Bank Act review, and
- the Sustainable Finance Forum under The Aotearoa Circle to design a roadmap to help New Zealand shift to a financial system that supports economic, social and environmental outcomes.

Paris Agreement-aligned strategies and durable policy frameworks can unlock investment

Institutional investors have to make long-term returns on their investments. Lack of credible, durable and predictable policy frameworks mean investors will either choose not to invest, invest in other countries where policy is more predictable, or charge higher risk premiums on investments to hedge against policy risk.

Policies that credibly support achieving the Paris Agreement's goals will provide the private sector with greater certainty as to the rate and pace of change. A clear pathway to transition will, in turn, improve investors' ability to assess climate-related risks and opportunities, to measure and disclose portfolio exposure to the low carbon transition, and to further invest in opportunities to support the transition to a zero carbon, climate resilient world.

Critical to the investment decisions needed to limit warming to 1.5^{o}C and well below 2^{o}C is policy that is long-term, durable and includes market-based carbon pricing.

- **Long-term**: The setting of ambitious, long-term emissions reduction targets and strategies is crucial for both creating investor confidence and allowing for a carefully planned and lowest cost transition.

- **Durable**: Investors are seeking an integrated policy framework able to deliver a level of investment stability. With stable policy settings, that endure past one election cycle, investors will be better able to make long-term, low carbon investment allocations.

- **Market-based carbon pricing**: A suite of policy responses will be required to transition the economy. To ensure companies and investors are managing the emissions in an efficient way this needs to include a price on carbon. Pricing carbon embeds climate risk into the lifeblood of investment decisions. If carbon is priced, the cost of pollution can't be ignored. Development of a carbon market that is transparent, liquid (many participants and free flowing trade) and focused on achieving net zero emissions will enable investors to better anticipate and plan for future carbon risks.

Zero Carbon Bill – an Investors Perspective

Implementing a long-term and durable policy framework

IGCC strongly supports the passage of the Zero Carbon Bill with bipartisan support.

Investors also support the establishment of the Climate Change Commission, and process of setting of interim carbon budgets, as this should provide sufficient flexibility for the New Zealand Government to set an emissions reduction trajectory that is mindful of national, and global, circumstances. By allowing the emissions trajectory to be adjusted in this way, New Zealand's emissions reduction trajectory can be both responsive to issues including changes in economic conditions and the costs of technologies without losing sight of the overall long-term goal of net zero emissions.

A long-term signal, complemented with short to medium term targets that are reviewed regularly, is more likely to drive investment into the cost-effective emissions reductions while allowing for a flexible approach to managing economic impacts and changed market conditions.

Proposed emissions reductions targets

There is currently a gap between the objectives of the Paris Agreement and the domestic action governments, including New Zealand, are taking. This is of concern to long-term investors because climate change poses unprecedented threats to the economy and the financial system. Recent economic analysis suggests that, conservatively, warming of 2.5-3°C could reduce global economic output by 15 per cent to 25 per cent and more than 30 per cent for 4°C warming.[10] These economic impacts are material to the investment returns of long-term asset owners and their underlying unit holders.

Meeting the objectives of the Paris Agreement would substantially reduce the financial damage caused by climate change and reduce the cost of climate change adaptation measures. This requires credible emission reduction targets and policies to achieve them. Recently, 77 investors with US $34 trillion in assets reiterated their call on governments to implement policies to limit average global temperature rise to no more than 1.5°C.[11] These investors represent around half of global assets under management.

In this context, IGCC prefers the setting of a net zero greenhouse gas emissions target for 2050 instead of separate targets for biogenic methane and other greenhouse gases. New Zealand's international commitments cover all emissions and the government should seek to be consistent across both its domestic and international commitments.

National targets that are consistent with the international rules-based system developed under the United Nation's Framework on Climate Change (UNFCCC) and its Paris Agreement

---

[10] Burke, M, W. Matthew Davis, N. Diffenbaugh (2018), **Large potential reduction in economic damages under UN mitigation targets** https://doi.org/10.1038/s41586-018-0071-9
[11] https://theinvestoragenda.org/wp-content/uploads/2019/06/G20-Global-Investor-Statement-on-Climate-Change.pdf

are in New Zealand's national interest. New Zealand is a small country located in a region extremely vulnerable to the impacts of climate change. Supporting agreed international rules for the accounting of national targets and action in line with the objectives of the Paris Agreement is therefore important to New Zealand's economic and social wellbeing. The nation's ability to influence and hold other nations to account for their own commitments is in part dependent on the nation implementing policy that is consistent with the international rules-based system.

To avoid backsliding on existing commitments, developed country targets under the Paris Agreement should be economy-wide and presented using existing accounting frameworks under the UNFCCC. This means overall national targets should be economy-wide and in line with agreed methodologies for the treatment of different greenhouse gases.

The separation of biogenic methane and other greenhouses into different targets risks being inconsistent with the international rules-based system for the accounting of national targets. This would be of additional concern to investors as the comparability and assessment of national targets, will through time, impact on how investors assess the zero carbon competitiveness of the New Zealand market, how exposed the nation is to transition risks from global action on climate change, the integration of climate change factors into credit ratings, and what investment opportunities might exist in New Zealand.

IGCC notes that all countries have unique challenges in achieving net zero emissions. The agricultural sector plays a significant role within the New Zealand economy, being both the largest contributor to overseas exports by value, as well as the largest sectorial contributor to greenhouse gas emissions. However, the agricultural sector and land- use management also provide significant opportunities for the management of national emissions.

Starting from a relatively low base, the investment market in forest conservation, sustainable forestry, and sustainable agriculture is growing rapidly. Doubling in the last decade, the market is attracting more and more mainstream investors. There is every reason to believe that the opportunity for sustainable finance in the agricultural sector will continue to grow, including through investments from pension funds.

New Zealand is well placed to be a global leader in delivering land-based solutions to climate change and to export this knowledge and technology to other nations as they themselves grapple with address the emissions from their agricultural and land sectors.

At a minimum, the government should translate and communicate internationally the targets in the Net Zero Bill as an overall target national target using currently agreed emissions accounting frameworks. This would reduce potential investment uncertainty, enhance transparency and comparability, enable better assessment of the nation's contribution to limit warming to 1.5^{o}C, and support the international rules-based system.

Adaptation and resilience to the physical effects of climate change is critical to long term prosperity

The physical effect of climate change is increasingly recognised as a financial risk for investors, requiring the same levels of governance, oversight and active management as any other dimension of material financial performance. Investors are developing tools and frameworks to help investors assess and manage physical climate risk at both the portfolio and the asset level.

Financial regulators around the world are also increasingly focused ensuring the financial system is resilient to climate change impacts. As an example, the table below outlines the scenarios that the Bank of England recently outlined for the stress testing of the insurance industry.[12]

Table 1: Stress testing impacts on investments from physical risk for Life and General Insurers. 1.5-2°C world refers to the Bank of England's orderly transition scenario. 4°C world refers to their scenario where governments fail to address climate change.

			1.5-2°C world	4°C world
Agriculture and Food Security	Change in equity value for sections of the investment portfolio comprising material exposure to agriculture and food security sector		-10%	-20%
	Proportion of the portfolio with income heavily reliant on transporting/trading/supplying products based on food (eg super- market chains.)		-5%	-10%
Real Estate Assets	Change in property value for assets materially affected by physical climate change risk	Global Average (inc. other regions) North America Europe Asia and Pacific	-15% -15% -8% -30%	-30% -30% -15% -60%

However, there are a number of practical barriers to investing in and supporting climate change adaptation. Governments have a clear role in helping overcome these barriers to build more resilient communities and economies.[13] These barriers include a lack of funding for basic climate science, coordination and clear accountabilities among the various levels of government on adaptation, no up-to-date national assessment of infrastructure, sectors and regions at risk to the effects of climate change, no indicative quantification of the investment required for adaptation, and no mandate for public finance vehicles to support investment structures to adaptation projects.

IGCC therefore supports the adaptation elements of the Zero Carbon Bill, specifically the development of the national climate change risk assessment, the preparation of national adaptation plans, progress reports and the powers to request the provision of information on the impacts of climate change from government organisations, local governments and "lifeline utility" providers (see comments on mandatory reporting below).

These elements provide key elements of the basic infrastructure required to build resilience of the New Zealand economy to impacts of climate change. However, given the emerging impacts of climate change in New Zealand and around the world, IGCC would encourage the government to provide the resources required to expedite the development of a robust

[12] https://www.bankofengland.co.uk/prudential-regulation/letter/2019/insurance-stress-test-2019
[13] https://www.mfe.govt.nz/sites/default/files/media/Climate%20Change/ccatwg-report-web.pdf

national adaptation plan by 2021. With the right government policies in place, investors are well placed to provide the capital needed to support a national adaptation plan.[14]

Climate-related financial disclosures to build economic resilience

IGCC welcomes that the New Zealand government's approach to climate related financial disclosures, outside those under the adaptation information gather provisions, will be progressed alongside the Zero Carbon Bill.

These disclosures are critical, but to be as effective as they can be, standardised reporting on material climate change risks and opportunities should be embedded in mainstream corporate regulation, not separate climate change legislation.

Investors who are managing financial risk for the long term, need to be managing transition, physical and litigation climate risks. Regulators also need to have good visibility of the system-wide implications of decarbonisation and climate change itself. The community is increasingly engaging with pension funds to better understand the carbon footprint of and climate change risk in their super. Effective carbon risk disclosure integrated into business-as-usual financial reporting is the foundation of good risk management for all of these constituencies.

Mainstreaming just transition

Global markets are starting to irreversibly shift from high carbon to low carbon. Climate change itself will disrupt industries like agriculture and tourism and impact on their economic viability. These changes will create challenges for individuals, communities, and the future economic development of regions in which investors invest and on the superannuation holders who live there.

Investors could be key to the revitalisation of impacted regional economies, providing the capital to support new industries, resulting in new jobs. But for investors to support regional transformation, there needs to be investable opportunities that will deliver both jobs and returns. This requires careful planning and the right bodies to implement the required policies.

IGCC encourages governments to implement independent statutory economic transition authorities to plan for an orderly transition, including community transition planning and the development of labour adjustment packages for communities impacted by the transition from emissions intensive activities and physical climate change itself.

The establishment of the Government's Just Transition Unit, the undertaking of the Just Transition Summit and the partnering with Taranaki to assist with the region's transition is welcome. IGCC would also encourage the government to more strongly represent just transition in the Zero Carbon Bill. This could provide a stronger legislative basis for the ongoing consideration of just transition in New Zealand's policy processes. This could include:

[14] https://igcc.org.au/wp-content/uploads/2017/03/Adaptation_FINAL.pdf

- Inclusion of monitoring and review progress on the Government's just transition goals in the purpose of the Climate Change Commission,
- The explicit inclusion of just transition in the matters the Commission must consider when providing advice; and
- Just transition being explicitly included in the responsibilities that the Minister has in the development of emissions reductions plans and national adaptation strategies.

CONCLUSIONS

Investors strongly support the passage of the Zero Carbon Bill. The Zero Carbon Bill can provide the private sector with greater certainty as to the rate and pace of change. This will improve investors' ability to assess climate-related risks and opportunities, to measure and disclose portfolio exposure to the low carbon transition, and to further invest in opportunities to support the transition to a zero carbon, climate resilient world.

There are a number of weasures that could strengthen the Bill. These include the following:

- IGCC continues to prefer the setting of a net zero greenhouse gas emissions target for 2050 instead of separate targets for biogenic methane and other greenhouse gases. At a minimum, the government should translate and communicate internationally the targets in the Net Zero Bill as an overall target national target using currently agreed emissions accounting frameworks.
- Alongside the implementation of the Zero Carbon Bill continue to advance the government's approach to climate related financial disclosures.
- More strongly represent just transition in the Zero Carbon Bill. This could provide a stronger legislative basis for the ongoing consideration of just transition in New Zealand's policy processes.

IGCC looks forward to working with the government to advance a climate change response that delivers a resilient and prosperous economy to support the pensions for future generations of New Zealanders.