

# The Treasury

## Reserve Bank Act Review Phase 2 Submission Information Release

October 2019

This document has been proactively released by the Treasury on the Treasury website at

<https://treasury.govt.nz/publications/information-release/reserve-bank-act-review-phase-2-proactive-release>

### Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 9(2)(a).

### Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

## **Consultation: Safeguarding the future of our financial system**

### **Follow-up questions on the role of the Reserve Bank: Phase 2 of Reserve Bank Act Review June 2019**

#### **Response from the Guardians of New Zealand Superannuation**

##### **Background**

The regulation of the financial markets is influential in incentivising market participants to adopt more sustainable approaches to investment, banking, insurance and corporate practice. The Guardians of New Zealand Superannuation (the Guardians) considers it prudent to address the impact of climate change and other environmental, social and governance factors on its investment portfolio.

The world must limit global warming to a 1.5 degree Celsius increase to avoid the dramatic impacts of climate change. The systemic nature of the problem requires a system-wide response to manage financial stability and enhance resilience. The financial system has an important role to drive alignment with a low-carbon pathway (at both system and institution levels) through proper pricing of risks, incentives and regulation. The insurance sector in New Zealand needs to prepare for the physical climate risks that are now unavoidable. Regulatory measures and pricing mechanisms will play a role in encouraging adaptation to these risks by the public and private sectors.

Beyond climate change, New Zealand faces other sustainable development challenges including protection of natural resources and addressing socio-economic challenges around equality.

Matt Whineray, the Guardians' Chief Executive Officer, is Co-Chair of the NZ Sustainable Finance Forum. The Forum is tasked with designing a roadmap to help New Zealand shift to a financial system that supports positive long-term economic, social and environmental outcomes. The Forum will identify opportunities and make recommendations to help align New Zealand's financial system with 21st century sustainability challenges including meeting New Zealand's commitments

to greenhouse gas emissions reductions and to achieving the United Nations Sustainable Development Goals. The Forum will deliver its roadmap and recommendations in 2020.

In the Guardians' response to this consultation, we focus on climate change resilience and on the goals of the Sustainable Finance Forum which are pertinent to the Reserve Bank's purpose to contribute to a sustainable economy.

### **Answers to specific questions:**

## **Consultation Document 2A. The Role of the Reserve Bank**

### **Chapter 2. What financial policy objectives should the Reserve Bank have?**

#### **2.B Should the Reserve Bank be given a more explicit climate change objective?**

Central banks and financial regulators, as well as other financial actors, should be anticipating emerging climate risks and acting now in order to mitigate long-run impacts which could have an impact on financial stability. Globally, central banks are exploring how to integrate climate risk into stress testing processes. It is widely seen to be within the mandate of central banks to play their part in ensuring financial systems are resilient to climate change risks.

Climate change has a number of characteristics that require a separate approach<sup>1</sup>:

1. **Far-reaching in breadth and magnitude:** Climate change will affect all actors in the economy, all sectors and asset classes across all geographies. This means the impact could be much larger and more diverse than those of other structural changes
2. **Irreversibility:** there is currently no mature process for reversing the concentration of greenhouse gases in the atmosphere. Above a certain threshold, scientists have shown that climate change will likely have irreversible consequences for the planet.

---

<sup>1</sup> UK Green Finance Strategy p.19 <https://www.gov.uk/government/publications/green-finance-strategy>

3. **It is foreseeable.** While the end point, pathways and time horizons are uncertain, there is a high degree of certainty that some combination of physical and transition risk will manifest in the future
4. **Dependency on short-term actions:** The magnitude and nature of the impacts will be determined by actions taken today, which requires a credible and forward-looking policy path.

It is for these reasons that central banks and prudential regulators around the world have explicitly recognised climate change risk as a material risk to the stability of the financial system.

We support explicit reference to climate change in the hierarchy of objectives and considerations for the Reserve Bank. Because of the long-term intergenerational nature of this risk to the financial system, the Reserve Bank Act should ensure climate change is included in its remit over these future time-frames.

Ideally, primary legislation should allow for the Reserve Bank to act flexibly, have the capacity to respond to climate risks and to use its powers to promote the low-carbon transition. In particular, the Reserve Bank Act should not predicate *against* the Reserve Bank integrating responses to climate change as part of its regulatory and supervisory remit.

### **Other aspects of the Reserve Bank's role:**

#### **Sustainable Finance System**

The Reserve Bank Act's purpose statement requires the Reserve Bank to set monetary and financial policy in a way that "promotes the prosperity and wellbeing of New Zealanders and contributes to a sustainable and productive economy".

This purpose aligns well with the objectives of the Sustainable Finance Forum.

The New Zealand financial system should contribute to, and not undermine, New Zealand's sustainable development goals. There should be sufficient flexibility in

the objectives set in the Reserve Bank Act to allow the Reserve Bank to take account of the future recommendations of the Sustainable Finance Forum and of other financial sector work including the Capital Markets Workforce.

The Reserve Bank Act should encourage the Reserve Bank to give consideration to unsustainable environmental, social and governance practices that present a systemic risk to the financial system, or demonstrate imprudent behaviour by the financial sector. The Reserve Bank should be able to work with other actors to achieve improvements in the financial system's contribution to sustainable development.

Beyond monitoring and identifying barriers, the Bank could explore other options to promote low-carbon investment, from both the supply and demand side – and be involved in monetary policy evolving internationally to support allocation towards sustainable finance.

#### **Consultation Doc 2B – Financial policy tools powers and approach.**

#### **3B. The Reserve Bank's planned approach to climate change. Do you think that the Reserve Bank's planned approach to climate change-related risks is appropriate and adequate?**

The Reserve Bank's climate strategy has already made progress, including adopting relevant recommendations from the Network for Greening the Financial System (NGFS). We are supportive of central banks working together through the Network for Greening the Financial System – which seeks to address financial stability risks from climate change and the transition to a low-carbon economy. Only a global response will be sufficient to turn the tide on the worst impacts of climate change on financial stability and to incentivize allocation of capital to achieving the low-carbon transition.

The Reserve Bank's climate change strategy includes consideration of the impacts of climate risk on inflation, labour markets, capital and immigration flows, house

prices, insurance firms, and New Zealand farms and the long-term economic implications of climate change.

There are a number of different scenarios at play in the way climate risks and the transition to a low-carbon economy develop. The Reserve Bank's strategy therefore has to be able to evolve. This points to a less prescriptive approach to how policy tools are used providing there is a strong approach to governance of climate change at the Reserve Bank and that this is seen to align with its purpose.

We support interaction between financial regulators in New Zealand on the low-carbon transition. There are some specific areas of work which our financial regulators can work on together. These include overcoming barriers to green bond issuance, pricing climate risk into lending and insurance, information flows to market participants, and promoting adaptation to future physical climate risks.

**Would it be different if it was given a more explicit Climate Change objective, as considered in Q2B of the Consultation Document 2A.?**

We believe it would make a difference to have a more explicit objective to ensure climate risk is a consideration over the long-term timeframes necessary (as outlined in our response to Q2B above).

Climate change (and other sustainable development goals) could already be interpreted to be part of the Reserve Bank's purpose of contributing to a sustainable and productive economy. However, including climate resilience in the hierarchy of objectives and considerations will ensure clarity on this point with current and future Boards and Governors.

The Reserve Bank plays a role in encouraging the banking and insurance sectors to take good strategic decisions and action now in order to mitigate the long-run impacts of climate risks, as opposed to current short-term incentives to maintain the status quo. By way of example, the mismatch between short-term (annual) insurance and long-term mortgage contracts in the NZ housing market is of significant importance with regards to the physical impacts of climate change.

**6D. Do you think a high level coordination objective would be an appropriate way to ensure that the Reserve Bank is coordinating non-financial agencies (for example on climate change).**

We encourage cross-organisational work but would not see a prescriptive objective as the best way to achieve this. In addition to other Financial Regulatory bodies in New Zealand, other forums will evolve for the Reserve Bank to work with, including the NGFS and the Sustainable Finance Forum.

**Contacts:**

Conor Roberts, Senior Communication Strategist: <sup>[1]</sup>

Anne-Maree O'Connor, Head of Responsible Investment: <sup>[1]</sup>