

The Treasury

Release of DEV-21-SUB-0191 - Establishing a Crown Responsible Investment Framework Information Release

January 2022

This document has been proactively released by **Minister of Finance (Hon Grant Robertson)** on the Treasury website at

<https://treasury.govt.nz/publications/information-release/finance-portfolio-cabinet-material>

Cabinet Document Details

Title: **Cabinet Paper: DEV-21-SUB-0191: Establishing a Crown Responsible Investment Framework**

Date: **16 September 2021**

Creator: Office of the Minister of Finance
Office of the Minister for ACC

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:

[36] 9(2)(h) - to maintain legal professional privilege

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [36] appearing where information has been withheld in a release document refers to section 9(2)(h).

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.

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Office of the Minister of Finance

Office of the Minister for ACC

Chair, Cabinet Economic Development Committee

Establishing a Crown Responsible Investment Framework

Proposal

- 1 This paper seeks agreement to issue a Crown Responsible Investment Framework (the Framework) specific to the largest Crown Financial Institutions (CFIs), with a first iteration targeting carbon emissions of investment portfolios.

Relation to government priorities

- 2 This Framework will give effect to the Labour 2020 Election Manifesto commitment to develop an ethical investment framework for all government-controlled investments so New Zealanders know that all the public's shared investments are into things we can stand proudly behind.
- 3 It will initially focus on setting climate change expectations, aligning with the Government's priority for laying the foundations for a better future with a focus on sustainability, and pursuing carbon neutrality.

Executive Summary

- 4 All parts of the Crown's economic apparatus have a role to play in the transition to a low carbon economy. The CFIs have to varying degrees implemented this mission into their investment strategies, but this is inconsistent and opaque across the portfolio. We recommend that Cabinet endorse the development of a Crown Responsible Investment Framework for the CFIs.
- 5 The Framework is intended to compliment the Carbon Neutral Government Programme (CNGP), setting enduring expectations for the CFIs to measure and reduce the carbon¹ emissions of investment portfolios and exposure to fossil fuel reserves. Offsetting the remaining carbon emissions is not feasible for investment portfolios and we instead challenge the CFIs to show leadership through engaging businesses on carbon transition strategies and considering positive investments into carbon solutions.
- 6 Carbon is a narrow focus of possible Environment, Social and Governance (ESG) factors. However, we consider that starting with this Government priority now enables evolution to other factors in time. We have engaged the CFIs throughout

¹ Throughout this Cabinet paper, carbon emissions represent all greenhouse gas emissions, with carbon dioxide (CO₂) being the predominate gas. The CFIs use CO₂ equivalent, which captures the greenhouse gases which contribute to climate change (CO₂, CH₄, N₂O, HFCs, PFCs, SF₆, and NF₃). CO₂ equivalent or "CO₂e" means the number of metric tons of CO₂ emissions with the same global warming potential as one metric ton of another greenhouse gas.

development of the Framework and recognise that implementation requires careful consideration of how fiscal and non-fiscal objectives can be jointly achieved.

- 7 For this reason, we intend to issue a principles-based framework through an enduring letter of expectations to the CFIs. This allows for the CFIs to respond with how they will give effect to the expectations, enabling Ministerial and public scrutiny on the ambition to support the transition. We are satisfied that the initial response from the CFIs will create the required transparency and is consistent with the Paris Agreement and Zero Carbon Act requirements.

Background

- 8 This Government is committed to responsible actions, to optimise the wellbeing of both current and future generations. The CFIs play a crucial role in managing New Zealand's financial wealth to promote intergenerational equity. We consider this to be analogous to the role of responsible investment across all financial and social capitals, to ensure investments today are made into things we can stand proudly behind and contribute to the society we will hand down to future generations.
- 9 The CFIs in scope are the Guardians of New Zealand Superannuation (Guardians), the Accident Compensation Corporation (ACC), the Government Superannuation Fund Authority (GSFA) and the National Provident Fund (NPF). The CFIs are fiscal policy tools, and collectively manage over \$100 billion of public funds in financial market investments.
- 10 In August 2020 the Cabinet Economic Development Committee agreed that the CFIs, being funds with assets under management of over \$1 billion, should be required to disclose their climate-related financial risk and opportunities in annual reports [DEV-20-MIN-0151]. We now propose that the implementation of the Framework will require action as well transparency, to commit to a pathway to carbon neutrality by 2050.
- 11 Legislation for three of the four CFIs requires that Boards maintain an ethical investment policy.² There is already a high degree of collaboration to give effect to ethical or responsible investment, particularly for negative screening or exclusions. However, the individual investment strategies of the CFIs can result in quite different approaches to positive screening.
- 12 The Guardians has, since 2016, taken the investment decision to significantly reduce its carbon exposure. Other CFIs have only acted in light of new legislation (the Climate Change Response (Zero Carbon) Amendment Act 2019) or are yet to begin the journey to reduce carbon exposure in earnest.
- 13 A Government issued Framework is intended to bring about consistency of action where there is an overarching policy ambition. The Framework will enable clear communication of the Government's expectations which should be considered by the CFIs when implementing their ethical investment policies.

² Legislation frames this as 'ethical investment' but the modern parlance of 'responsible investment' captures a wider array of positive as well as negative screening of Environmental, Social and Governance factors.

Analysis

Climate Change Expectations

- 14 Climate change is one of the greatest challenges of our time. The recently published Sixth Assessment Report from the Intergovernmental Panel on Climate Change (IPCC)³ found unequivocal evidence that the global economy's reliance on fossil fuel consumption is causing temperatures to rise, leading to drastic changes in the atmosphere, ocean and land.
- 15 Our national wellbeing is vulnerable to the economic and environmental impacts of climate change, both locally in our communities and internationally through ensuring New Zealand's reputation on the world stage and our national commitments are met.
- 16 New Zealand has committed to taking urgent action on greenhouse gas mitigation and climate change adaptation through the Paris Agreement's article 2(1)(c) which commits the government to "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development", the Nationally Determined Contributions and the Climate Change Response (Zero Carbon) Amendment Act 2019.
- 17 The Government has committed to reduce emissions in its own activities in order to demonstrate what is possible for other sectors in the economy and showcase positive action to the rest of the world.
- 18 In December 2020, the Government announced a climate change emergency and the establishment of the CNGP⁴. This aims to accelerate the reduction of emissions within the public sector, and to be carbon neutral from 2025.

What is the Framework?

- 19 The Framework shown in Appendix One is designed to be complimentary to the CNGP. While the public sector is required to measure, reduce and offset emissions we recognise that company level emissions are not directly controlled by the CFIs. Therefore, instead of offsetting carbon exposure we are asking the CFIs to provide leadership to 'Influence' the transition.
- 20 The CFIs, as investment managers, hold minority stakes in a large number of underlying companies. The Framework sets the expectation that the CFIs will divest from the worst emitters, but the investment portfolios still need to get exposure to a diverse portfolio of companies. These companies are obligated to achieve carbon neutrality by 2050, which sets the target date for the Framework.
- 21 We considered requiring the remaining carbon exposure to be offset but this is not best practice for investors. Requiring investors to bear the financial burden of the transition would move the burden of responsibility from the underlying companies to

³ https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_SPM.pdf

⁴ The CNGP does not currently extend to autonomous Crown Entities (Guardians and GSFA), nor body corporates (NPF). ACC is a Crown Agent, so its operational emissions are captured by the CNGP.

investors and it would introduce double counting and double paying for carbon credits.

- 22 At this time, the Framework is focused on the Government's pledge to deliver a carbon neutral New Zealand by 2050, aligned with the Paris Agreement. However, we reserve the right to evolve the Framework to other aspects of ESG factors where Government policy sets the basis of society's expectations of responsible investment practice.
- 23 While this Framework is specific to the CFIs, it will create a signal to all public investment institutions to consider the principles of the Framework and how these can be applied consistently with mandates.
- 24 The Framework is intentionally principles-based to enable flexibility of individual CFI investment strategies while moving towards the overarching policy objective of carbon neutral investment portfolios. Committing to interim targets will enable public scrutiny of progress, starting at 2025 but providing assurance that this path leads to successful achievement of this objective by 2050.
- 25 Equally important as the action to reduce allocation to carbon intensive assets is the role of CFIs to champion and invest in the solutions that can support the carbon transition. This could be investment into existing, productive assets or can be additive to the transition by aiding the development of new assets with a climate focus. Engagement with existing businesses to consider how carbon can be seen as a future liability is crucial to the transition and the CFIs are well placed to play this role.
- 26 Stability of the Government's expectations is important, it will enable the CFIs to develop long-term responsible investment strategies to measure, reduce and influence the transition to zero carbon investment portfolios by 2050.
- 27 We recognise the importance of CFI Board accountability to manage dual financial and responsible investment objectives over time. The principles are a minimum standard to be consistent with global best practice investment standards and commitments of the Paris Agreement. The CFIs are encouraged to go above and beyond the minimum standard where this is not expected to have a negative impact on the investment return profile.

Implementation Approach

- 28 A range of implementation options were considered to provide certainty that the CFIs will adopt the Framework. These options presented trade-offs between the ease of implementation and the strength of enforcement:
 - 28.1 Legislative change,
 - 28.2 Ministerial directions, and
 - 28.3 Ministerial expectations.
- 29 Legislative change would be a fundamental change to governance settings of the CFIs and would not meet the ambition to publish or amend the Framework in a timely manner. It could undermine the investment independence of the CFIs, and erode

performance accountability, which are strong features of the existing legislative settings.

30 [36]

31 Ministerial expectations are highly visible and can be applied consistently to the CFIs, however they lack the certainty of enforcement. To mitigate this, we have engaged extensively with the CFIs. This has generated assurance of buy-in on the overall goals for the Framework and has elicited a draft CFI proposed response that aligns with our expectations.

32 We therefore recommend that the Framework is implemented via an enduring letter of expectations to the CFIs. We do not expect to update the principles frequently but do expect the CFIs to refresh their commitments to the principles periodically.

33 Expectations will also articulate that CFI leadership on responsible investment will avoid the need for Ministers to be more directive. Voluntary action from the CFIs, to implement investment strategies that can deliver positive investment returns, has a greater signalling effect to investment market participants than forced compulsion.

34 If CFI leadership does not meet the level of ambition of the Framework, the Government reserves the right to initiate legislative change to strengthen the enforcement of the Framework.

35 There has been significant discussion with CFIs about the development of the Framework, but we are yet to undertake formal consultation on this draft. We therefore recommend that the Minister of Finance and the Minister for ACC have delegated authority to make technical amendments to the Framework following consultation with the CFIs.

36 Should any significant changes be required as a result of CFI consultation, or a shift to the New Zealand policy position, we will come back to this Committee to seek agreement to update the Framework principles.

CFIs' Response

37 The CFIs will be required to formally respond to the Framework with how it will meet the expectations of the Framework now and into the future. At a minimum, they will set out how they will give effect to the Framework over the following five years, to 2025 initially, and explain how they expect to transition on the pathway from 2025 to achieving carbon neutrality by 2050.

38 The CFIs will be required to refresh these commitments regularly, initially prior to 1 January 2025 and within five years after that date. The intention of regularly updating the commitments is to remain current with evolving expectations of global best practice commitments.

- 39 Our engagement to date has confirmed that the CFIs will respond with reduction commitments that are consistent with the 1.5 degree warming scenario advised by the Paris Agreement. We are also encouraged by the leadership and engagement approach of the CFIs to aid the transition at company level.
- 40 Our one concern is that the CFIs are not unified on the measurement standard they will use to target reductions of both carbon emissions and fossil fuel reserves. To mitigate the risk of inconsistency and a lack of comparison across the CFI portfolio, all CFIs will report on two metrics that are being utilised. This meets the requirement for transparency but will need careful communication of why two metrics are reported.
- 41 We expect measurement standards to evolve rapidly and have set the expectations for the CFIs to strive for consistency as this takes place.

Financial Implications

- 42 There are no financial implications from the proposal in this Cabinet paper.

Legislative Implications

- 43 There are no legislative implications from the proposal in this Cabinet paper.

Impact Analysis

Regulatory Impact Statement

- 44 The proposal in this Cabinet paper does not require new legislation so a Regulatory Impact Statement (RIS) is not required.

Climate Implications of Policy Assessment

- 45 The CIPA team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the impact on emissions is indirect.
- 46 A key outcome of the Framework will be for CFIs to reduce the carbon emissions of the investment portfolios on a pathway that aligns with carbon neutrality by 2050. However, given the indirect nature of the carbon emissions exposure (i.e. via minority shareholdings in underlying companies), this reduction does not directly impact on overall greenhouse gas emissions, so cannot be assessed in-line with the CIPA requirements.

Population Implications

- 47 There are no meaningful population implications expected at this stage.

Human Rights

- 48 The proposals in this paper are not in any way inconsistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

- 49 The following government departments, agencies and Ministers have been consulted on this Cabinet paper:
- 49.1 The Minister for Climate Change
 - 49.2 The Ministry for the Environment
- 50 The feedback has been incorporated.
- 51 The Crown Financial Institutions have been consulted during the policy development for the Framework and will be consulted ahead of the launch of the Framework.
- 52 The Department of the Prime Minister and Cabinet has been informed of this Cabinet paper.

Communications

- 53 The Framework will be issued via a Ministerial enduring letter of expectations from the Minister of Finance and the Minister for ACC in October 2021.
- 54 Communications will be coordinated with the CFIs and an appropriate event will be identified to announce the Framework and the subsequent CFI response.

Proactive Release

- 55 This paper will be proactively released within 30 business days of decisions being confirmed by Cabinet, with redactions as appropriate under the Official Information Act 1982.

Recommendations

The Minister of Finance and the Minister for ACC recommends that the Committee:

Relation to government priorities

- 1 **note** that the Labour 2020 Election Manifesto committed to develop an ethical investment framework for all government-controlled investments so New Zealanders know that all the public's shared investments are into things we can stand proudly behind.
- 2 **agree** to establish a Crown Responsible Investment Framework (the Framework) that gives effect to this commitment.
- 3 **agree** that the first iteration of the Framework will set climate change expectations to align with the Government's priority for laying the foundations for a better future with a focus on sustainability, and pursuing carbon neutrality.
- 4 **agree** that the Framework will apply to the four largest Crown Financial Institutions, the Guardians of New Zealand Superannuation, the Accident Compensation Corporation, the Government Superannuation Fund Authority and the National Provident Fund.

Framework principles and implementation

- 5 **note** that the first iteration of the Framework is designed to be complimentary to the Government's carbon neutral commitments but recognises that company level emissions are not directly influenced by investment managers.
- 6 **agree** with the Framework principles for Measure, Reduce and Influence.
- 7 **agree** to delegate authority to the Minister of Finance and the Minister for ACC, in consultation with the Minister for Climate Change, to make technical amendments to the Framework should this be required following further consultation with stakeholders
- 8 **agree** to the Framework being implemented via Ministerial expectations

Authorised for lodgement

Hon Grant Robertson
Minister of Finance

Hon Carmel Sepuloni
Minister for ACC

Appendix One

Crown Responsible Investment Framework for Crown Financial Institutions

Measure

1. Your investment portfolio exposure to carbon emissions and fossil fuel reserves should be reported transparently, on a consistent basis, enabling public scrutiny over progress towards carbon neutral portfolios by 2050;
2. Reporting should align with the Taskforce for Climate-related Financial Disclosure recommendations, until the External Reporting Board's (XRB) climate-related disclosure framework has been issued, at which point it should apply, and should continue to evolve in line with global best practice standards;
3. You should strive for consistency of measurement standards across the Crown Financial Institutions so that relative performance on carbon emissions reduction can easily be interpreted.

Reduce

4. Crown Financial Institution investment portfolios must be carbon neutral by 2050;
5. You should set challenging minimum reduction targets for carbon emissions and fossil fuel reserves at interim periods to provide assurance that investment portfolios are on track to be carbon neutral by 2050;
6. Interim targets should be aligned with global best practice standards to maintain a 1.5 degree global warming outcome;
7. Your first interim target should be for 2025 and should be refreshed prior to the start of that year for 2030. This process is to be repeated every five years thereafter.
8. Where investment strategies allow, you should take a leadership position ahead of minimum reduction expectations to demonstrate how return on investments can be achieved through low carbon strategies;

Influence

9. You should utilise your long-term risk and return strategies to actively identify positive investments that generate additionality to the transition to a low carbon economy; and
10. Recognising that success in reducing carbon exposure for investment portfolios relies on investee companies to transition to low carbon solutions, you should utilise your position as significant investors to engage with New Zealand and global companies on developing transition strategies.