Climate Change Risk Disclosure – a New Zealand First

The issue of climate change has been analysed and debated by politicians and scientists for decades. During that time, though, little has been done to concretely prepare either people or the country itself for the impacts that climate change is already having. To ensure that New Zealand's economy does a better job of adapting to and mitigating the coming climate impacts, the government is now turning to the financial sector.

Climate Change Minister James Shaw announced this week that New Zealand will be the first country in the world to require large financial institutions such as banks, insurers, credit unions, and others to report on climate risks, as well as what they're doing to mitigate those risks. All told, this disclosure will reveal the climate risks faced by approximately 90% of New Zealand's total assets.

We at Trustees Executors welcome this policy change as an encouraging and proactive step to preserving New Zealand's unique natural environment, tackling global climate change, and achieving a sustainable economy and financial system. By tracking the economic risks posed by climate impacts, the business sector can develop a better understanding of the cost of inaction. Moreover, they'll be able to take appropriate action to protect economic interests proactively, rather than waiting to see what happens.

The largest institutions will be responsible for disclosure
According to Shaw, all banks, credit unions, insurers, building societies, investment schemes, or crown financial institutions with more than $1b in total assets will be forced to report on their climate change risk starting in 2023, or provide an explanation why they haven't. As a result, approximately 200 of New Zealand's largest firms and organisations will need to report on about 90 per cent of New Zealand's total assets.

This approach allows the government to develop a comprehensive overview of the country's climate change risk, without directly burdening SMEs with the task of assessing their risks and preparing reports. More importantly, this will allow the entire economy, as well as individual loans and investments to be viewed through the lens of impending climate change. The act of preparing the report will allow the affected businesses and organisations themselves to understand their climate change risks, and to take them into account when making decisions.

Risk assessment will help facilitate controlled changes
In order to adapt to a changing climate, and to minimise potential economic damage, it's essential to understand the climate-related risks faced by individual businesses and their communities. Specifically, governments, investors and lenders need to be able to make financial and policy decisions that take climate change into account. This ensures that funds aren't invested poorly going forward, and that critical economic assets are protected.

This can and will have adverse impacts on some communities over others, which is why this type of disclosure policy isn't popular with everyone. However, it allows precisely those communities to adapt to the changing climate early—under financial pressure—rather than dealing with it reactively after the effects of climate change force change in an uncontrolled manner.

Disclosure will curb greenwashing and promote real change
Greenwashing is the practice of misrepresenting a business or fund as being more sustainable or environmentally friendly than it actually is in order to attract investors or customers. The new disclosure policy aims to crack down on this.

Climate change risks to businesses include economic risks, such as the risk of increased costs due to the implementation of more stringent emissions regulations. This means that fund managers will be forced to disclose to what extent they are exposed. This, in turn, will increase their overall risk as perceived by investors, providing an incentive to divest themselves of environmentally unfriendly assets. Effectively, this will shift investment away from risky emitters and toward sustainable businesses.

Mandatory disclosure has faced stiff resistance worldwide
New Zealand will be the first country in the world with this type of initiative. Several other countries are working on similar kinds of disclosure policies, however many are faced with stiff resistance from businesses and political leaders. That is not because they are unconcerned about climate change. Rather, the issue is about acknowledging and quantifying climate risks. Once potential climate impacts are identified and quantified, they will be used to inform decisions by lenders, investors and insurers. As a result, businesses, individuals, and political entities with higher risks will face higher interest rates and insurance premiums.

Disclosure impacts some communities adversely
Disclosing climate change risks will have immediate negative consequences for some communities. As severe weather and droughts become more common and sea levels

rise, some communities will face much greater risks than others, based purely on their location. For example, towns facing increased flood risks may suddenly find themselves unable to attract the investment they need to keep businesses growing. This will ultimately force them to either invest in flood mitigation infrastructure, or to relocate to safer areas.

Additionally, some industries have reason to be concerned about secondary effects. Faced with the real costs of climate change, future steps to curb greenhouse emissions by the government are likely to be more aggressive than in the past. High-emission industries like the dairy industry may be forced to greatly reduce their impact on the climate, likely at great expense. This is unavoidable, because driving these changes is ultimately the point of risk disclosure. However, it's unsurprising that the affected communities and businesses aren't eager to face increased costs. To protect these vulnerable elements, it's tempting for governments to hold back on implementing similar mandatory disclosure policies. Unfortunately, it's far too late to ignore climate impacts.

It's too late to wait

Over the past several years, the global economy has faced one major challenge after another. While New Zealand fared relatively well until the onset of the COVID-19 pandemic, its businesses, particularly those operating internationally, faced the impacts of rising trade global barriers, political tensions between major trading partners, drought, and natural disasters even before the coronavirus sent the global economy into freefall. The problem is, however, that things are unlikely to get better soon.

Climate change impacts are only getting started

New Zealand is already being affected by climate change, from devastating droughts, to ocean acidification, to rising flood risk. Similarly, global trade and political tensions are, in part, being driven by climate change issues abroad. This means that the difficulties faced by New Zealand's economy are only just beginning, and that they will intensify over time. The best time to prepare for and limit climate change was last century, but the next best time is now. By investigating, acknowledging, and managing climate risks as soon as possible, we can better adapt for what is to come, and prevent potential future economic disasters.

What disclosure means for financial services

Banks, investment funds, and other financial institutions have a responsibility to act in the best interests of their clients and investors. As the reality of climate change has come into focus, though, it's become increasingly difficult for them to do so. Currently, the models that the global financial system is built on don't reflect the real costs that businesses face due to climate change. Those models drive financial decisions that are sometimes at odds with the long term interests of both their investors and society at large.

The direct result of the new disclosure policy will be to rectify this issue by clarifying how risky various loans and investments actually are in light of a changing climate. In order to adapt, financial services providers are necessarily going to change strategies in terms of what kinds of assets they'll be willing to hold. For example, fund managers will likely be less willing to hold equity in businesses that have a lot of climate risk—whether that's because they're vulnerable to the changing climate, or to changing greenhouse emissions regulations. Banks, for their part, will need to consider climate risk when issuing business loans.

This will naturally drive funds toward low-risk, sustainable businesses while defunding those who rely on climate change risks remaining externalised. They know that, as the effects of climate change continue to manifest and the government tightens regulations, this latter strategy will become untenable.

COVID-19 is an important opportunity

Because of the coronavirus pandemic, a lot of investments have moved from equities to cash and other liquid assets. Now, all that capital is looking for a home. By drawing attention to climate change risks today, the government is sending a message about where those funds would best be invested. If investors take the suggestion to heart, it will go a long way toward preparing New Zealand's economy to weather the changing climate more effectively.

At Trustees Executors, we welcome any initiative or policy change that will meaningfully facilitate the shift toward a sustainable economy and financial system. Investigating and disclosing climate change risks is a fundamentally positive step for financial institutions and businesses in general, as it will provide everyone with more accurate information, allowing us to make better decisions to become stronger and more resilient in the years to come.