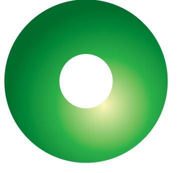


The Aotearoa Circle

Mā te Kaitiakitanga ko te Tōnuitanga
Prosperity Through Guardianship

Sustainable Finance Forum Interim Report 2019

The Aotearoa Circle

The Aotearoa Circle is a unique partnership of public and private sector leaders, unified and committed to the pursuit of sustainable prosperity for Aotearoa New Zealand ('New Zealand'). They aim to achieve this by reversing the decline of our natural resources. Collectively, this partnership has been formed to promote transformational change.

Sustainable Finance Forum (SFF) by numbers

12

Members of the Leadership Group

33

Members of the Technical Working Group

50+

Stakeholders interviewed

50

Stakeholders completed on-line surveys

95%

Stakeholders felt the current financial system is not sustainable

About the SFF

The financial system is the engine of the economy; we need to scale up and re-direct capital to enable the transition to a sustainable economy.

The SFF is the first project launched by The Aotearoa Circle, recognising the critical role of finance to achieve, and accelerate, the transition to a sustainable economy, and the need for a financial system that is fit for that purpose.

“We need to systematically align the New Zealand financial system with the task of meeting our 21st century sustainability challenges, and in the process produce better outcomes for all New Zealanders.”
(Karen Silk, Westpac)

The SFF brings together key players in New Zealand’s financial system - including Māori leadership, representatives from banks, insurance companies, industry, professional services, civil society, academia, and government - to explore how to re-design our current financial system to meet the challenges as well as capture the opportunities.

The aim of the project is to produce a Roadmap for Action on how to shift New Zealand to a sustainable financial system – from one which focuses primarily on (often short-term) financial wealth creation, to one that supports long-term social, environmental, and economic

wellbeing and prosperity for all New Zealanders, protecting natural resources for future generations. At the same time, this will strategically position New Zealand for continued access to international markets. The Roadmap for Action will include specific recommendations on re-shaping the current financial policy, regulatory and market framework.

Kaitiakitanga is the overarching theme – considering the role the financial sector plays in the guardianship of people and the natural environment, recognising the past, present and future generations.

About this Report:

This document is the Interim Report (Report) of the SFF. It represents the collective, and voluntary, efforts of the SFF undertaken from January 2019 to October 2019.

The report sets out why we need to shift, urgently, to a sustainable economy. It proposes the principles and characteristics of a sustainable economy and financial system - drawing upon a Māori world view of Kaitiakitanga. The forum has reviewed much of the latest local and international thinking and best practice, along with a 'future state' vision for New Zealand's financial system. It assesses how well our current financial system performs against that benchmark and poses some initial ideas and questions on Potential Pathways for change.

Feedback on this Report:

From November 2019 to the end of February 2020 this Interim Report will be tested with civil society, Māori and Iwi, public, and private sectors. Your feedback is welcomed.

The feedback survey can be accessed here.

Based upon feedback, the SFF aims to finalise this Report and a Roadmap for Action by the end of July 2020. This will further set out how to implement the final recommendations of the SFF.

Letter from the Chairs

In writing this report, we met and talked with dozens of people, businesses, banks and investment organisations and their message was stark: our current financial system is neither sustainable, nor fair.

Issues such as market short-termism, the failure to properly price social and environmental costs and a lack of information and awareness mean capital is misallocated. Our financial system is facing the same issues as other business sectors and society more broadly – how do we properly consider and account for the long-term impacts of our activities on our climate, our waterways and our social fabric?

Put simply, we all need to better manage the resources we use to create wealth. Businesses ultimately draw from social and environmental capital – our people and our land – to create financial capital. If we deplete these natural capitals now then we will reduce our ability to create financial value for future generations. This is a threat to our collective wealth and wellbeing and a major long-term threat to business.

We need to reorient the allocation of capital to produce better social and environmental outcomes. The financial system has a clear role to play and the imperative for business is clear: healthy businesses depend on a healthy economy and society.

These are long-term challenges, but there is an urgent need to act now. Business leaders need to lead – we can't wait for legislation or regulation to solely drive the change.

At the same time this process will create business opportunities as we need to innovate, adapt and change and ultimately find new technologies and new ways to manage resources more efficiently.

This Interim Report is the first step in creating a roadmap to a more sustainable financial system – a system where we create value today while also valuing the natural and social resources that will provide value for future generations.

For over 150 years, the full costs of investment decisions have not been properly felt by those making the decisions – the cost of pollution, the loss of biodiversity, or increases in inequality have not been properly accounted for. In the language of economics, these are called 'externalities' – negative impacts felt and paid for by society, rather than those responsible for the actions.

In Te Ao Māori, there are no such things – nothing is 'external' to the system, and this is a useful way of thinking about a New Zealand response to this problem.

Our vision for a sustainable financial system is one where:

- The system serves the long-term needs of society, the environment and the economy.
- The system plays its role in the transition to a low-emissions, resource efficient, just and inclusive economy.
- Decision making is well-informed, transparent and facilitates sustainable development.
- The system is resilient, robust and agile through the incorporation of environmental, social and economic risks.
- Society has trust and confidence in the system.

In developing the requirements for a roadmap we have started by looking at the current state of the New Zealand system, reviewing what others have done, here and overseas, and drawing on the input of the experts in the Technical Working Group and input from interviews with financial sector participants and other stakeholders.

We asked: What is stopping New Zealand's financial system from being sustainable? What is preventing participants from making decisions that positively contribute to desired outcomes?

We have organised the Interim Report around the three key themes flowing from our investigation:

1. Changing mindset – embedding within organisations the imperative for aligning investment, lending and risk allocation decisions with long term societal goals.
2. Aligning the financial system – or: Greening Finance – adapting financial models and providing the tools and capabilities to incorporate sustainability into the financial system.
3. Mobilising Capital – or: Financing Green – promoting opportunities to allocate capital towards investments that target these outcomes.

In the first half of this report we explain the concept of sustainable finance, outline the current state of the financial system, and set-out what we see as some of the challenges and barriers to it operating in a sustainable way. In the second half we pose a series of questions for further consideration and suggest a number of potential pathways we might consider. We want this to create further conversations on possible solutions and the merits of the potential pathways.

We see three areas arising out of those themes which promise the greatest impact:

- Leadership to drive the vision of the SFF.
- Improving the availability and quality of environmental and social data.
- Pricing natural and social capital impacts.

As a first step in changing mindset, The Aotearoa Circle has also released a legal opinion (prepared by Chapman Tripp) that considers the obligations of directors, investment managers, professional trustees and other professionals with fiduciary obligations, to consider climate change risk in their decision making. This is a ground-breaking development for New Zealand, consistent with international views and we hope it encourages increased urgency in addressing climate change risks throughout the financial system.

We will be engaging broadly with financial system participants, with Māori and Iwi leadership on kaitiakitanga principles and with stakeholders as we work to develop the Roadmap for Action in 2020, which will outline practical steps we can take to tilt the financial system to better support our country's critical sustainability agenda.

We look forward to your input and welcome your leadership.

MATT WHINERAY
Co-Chair

KAREN SILK
Co-Chair

Secretariat services provided by

The vision of the SFF

Collectively, we need to acknowledge that we operate within an economic system that depends on continued availability of largely unpriced environmental and social inputs. We need to align with the principles of Kaitiakitanga and value, protect, and preserve these natural and social resources because we need them to provide for future generations.

The SFF vision is a sustainable financial system which delivers the following outcomes by 2030:

- Recognition that the real purpose of a financial system is to serve the long-term needs of people, planet, profit – with capital flows aligned accordingly.
- A financial system that plays its role in delivering on the critical sustainability agenda and the transition to a low-emissions, resource efficient, just, and inclusive economy.
- Financial decision making that is well informed, transparent, and facilitates long-term wellbeing and sustainable development.
- A financial system that is more resilient, robust, and agile through the incorporation of environmental, social, and economic considerations.
- A society that has trust and confidence in our financial system and its actors (organisations and individuals) to understand its real purpose and their role and responsibilities within it.

Given the urgency of the task created by our current use of environmental and social resources and the need to align to international commitments such as the United Nations Sustainable Development Goals (SDGs) and the ambition of the Paris Agreement, this transformational shift needs to occur in the next decade.

Our approach

To develop this document, the SFF adopted the following approach:

- **Theory of change:** To understand what a sustainable financial system meant to the SFF and how it differed from the current state, the SFF developed and used a Theory of Change.
- **Literature review on international practice:** The SFF conducted a literature review to collate evidence to understand why the outcomes identified in the Theory of Change weren't occurring and where changes have been implemented elsewhere, leading to improved sustainable outcomes.
- **Stakeholder Engagement:** To ensure local context, we conducted a series of direct interviews with over 50 people. An additional 50 people responded to on-line surveys. These leaders came from the various actor groups and included Māori business leaders, social enterprises, investors, financial advisers, banks, and other financial institutions, corporate leaders, regulators, Government, and academia.
- **Interim Report:** Our analysis from the literature review and interviews was then consolidated and forms the basis of this Report. It is envisaged this Report will form the basis for further industry engagement, before being finalised.

2030

SFF is ultimately seeking a sustainable financial system which delivers the sustainable outcomes

July

2020, this Report will be finalised, and supported by a Roadmap for Action

100+

stakeholders provided input

Why we need to rethink our current use of natural capital

A large part of our economic success has been created using natural and social capital, such as water, energy, and labour. Historically, this has created substantial benefits for society with few side-effects. However, these side-effects are growing, as is the realisation that there are constraints on natural and human capital. We now understand that our current use of natural and social resources is not sustainable, and we need to rethink the way we define economic success to ensure that it delivers sustainable intergenerational development and wellbeing.

The imminent and transformative effects of climate change

99%

of coral reefs lost at a temperature rise of two degrees

13%

of all land will undergo an ecosystem transformation at two degrees

The ambition of the Paris agreement is to limit climate change to 1.5 degrees of global warming above pre-industrial levels. The 2018 Special Report from the Intergovernmental Panel on Climate Change (IPCC) on Global Warming of 1.5 degrees states that achieving this will require an economic change with "no documented historic precedent" in terms of speed and scale. We need to reduce global emissions by 45% by 2030, and be net zero by at least 2050, ideally sooner. The IPCC estimate that this will require a 600% increase in capital for low-carbon technologies and energy efficiency by 2050. Even with 1.5 degrees of warming it's estimated that the implications of climate change to the natural environmental are material, for example:

- 4% of all land will undergo a transformation from one ecosystem to another, with 13% transforming at 2 degrees (primary industries account for approximately 8% of New Zealand's GDP)
- We will lose 70-90% of coral reefs, with 99% lost at a temperature rise of two degrees (an important source of food and income in the Oceania region)
- Global annual fishery catch will decrease by 1.5 million tonnes, with a decrease of 3 million tonnes at 2 degrees (accounting for 0.7% of New Zealand's GDP and 3.2% of export in 2015[5])
- An ice-free arctic summer will occur once per century at 1.5 degrees compared to once per decade at 2 degrees

At two degrees, sea level rise is estimated to hit approximately 1m by 2100, with 68,000 buildings in New Zealand located on land below this level with a replacement value of $19 billion.[6] An estimated 170,000 buildings sit within 3m of current sea-level and would be impacted by storm tides and wave floods, with a replacement value of $52 billion.[7] This is approximately 10% of all private dwellings in New Zealand.[8] These estimates don't include the costs of adapting other infrastructure such as transport. It also only considers the impacts of sea-level rise. Climate change will also cause changes in rainfall, extreme weather events, heatwaves, and a significant number of other climate hazards. It will impact health, food and water supply, tourism, migration, domestic security, and significantly alter life as we know it, even at 1.5 or 2 degrees. Co-dependencies within our economy will lead to further impacts that cannot yet be understood. The banking sector alone lends around $190 billion in home mortgages, which cannot be withdrawn as risks change like insurance.[9] There are also emerging risks from not setting out realistic decarbonisation plans aligning to a two-degree future. These include increasing risk of litigation or exclusion from international trade as a penalty for slow action. In other words, there is a very significant cost to inaction – the base case is not the status quo.

These are the impacts of a 2 degree world. Current global proposed mitigation plans have us on track to 3 degrees of warming or higher. Potential damage is not linear with an increase in temperature – 2 degrees is significantly worse than 1.5 degrees. At 3 degrees, things get exponentially worse and we reach the point of no return.

Water – the lifeblood of Aotearoa

70% of New Zealand's export earnings directly rely on natural capital.[10] Freshwater is a crucial resource for New Zealand's key exporting industries, but water quality has degraded across the country. Water is taonga for Māori, meaning it is a culturally valued resource. New Zealand's key economic sectors including the primary sector and tourism are dependent on freshwater resources. Global change is needed to protect both freshwater and our oceans.

Around 75% of consumptive freshwater is used for irrigation, particularly in regions with low rainfall and high temperatures, where farming would naturally be limited.[11] In these regions, water demand is exceeding what is available and sustainable, which will likely continue as the climate warms.[12] That puts our key economic sectors at risk of an increasingly insecure and unsustainable resource.

The key pollutants causing the most damage are nutrients, pathogens, and sediments. Between 2000 and 2010, the nitrogen levels in our waters increased more than in any other Organisation for Economic Co-operation and Development (OECD) member country.[13] Figures released by the Ministry for the Environment in 2017 showed that between 1994 and 2013 nitrogen levels were worsening at 55% of monitored sites.[14] Water contamination from the agricultural industry and urban stormwater run-off are a concern for both environmental and public health reasons, as well as impacting the cultural significance of water to Māori, and providing safe habitats for our native species.

The 2019 Environment Aotearoa Report[15] estimated that:

- 90% of original wetlands have now been drained
- 82% of the river length in pastoral farming areas was not suitable for activities such as swimming
- 71% of river length in pastoral farming areas had modelled nitrogen levels that could affect the growth of sensitive aquatic species during the period 2013–17

Water pollution is also impacting urban areas and drinking water. In some regions, urban rivers are more polluted than rivers in pastoral areas. Contaminants entering old and leaking storm and wastewater systems are causing pollution to enter our waterways, contaminating drinking water, degrading food, and making water un-swimmable. Between 2010 and 2014, 59% of groundwater sites failed to meet drinking water standards on at least one occasion due to E. coli being detected and 34% had median nitrate-nitrogen concentration above those expected from natural conditions.[16] In 2017, the OECD described New Zealand's economic growth model as largely relying on "exploiting natural resources", with environmental resources beginning to show "environmental limits", meaning our future growth which depends on these resources is at risk.[17] External factors which exacerbate this decline in quality and availability such as climate change will also play a factor in our growth potential. For a country that relies on a pure New Zealand reputation for tourism and primary industries, we are risking not just our reputation but our future financial wellbeing.

70%

of New Zealand's export earnings directly rely on natural capital

2017

OECD describe New Zealand's economic growth model as exploiting natural resources

90%

of original wetlands have now been drained

Why we need to rethink our current use of social capital

33

out of 35, New Zealand gender equality ranking for the number of women in senior management roles

2018

Global Director Survey showed inequality and poverty ranked among the top concerns of New Zealand directors

Accelerating action to address inequality

Inequality has been recognised in New Zealand, and internationally, including by the world's major economic bodies — the World Bank, International Monetary Fund (IMF) and OECD — as a significant and growing issue.

The distribution of wealth in New Zealand is largely concentrated in the top 20 percent of households who collectively hold about 70 percent of total household net worth.[18] These households experienced an average net worth increase of $394,000 from June 2015 to June 2018, while the net worth of the bottom 40 percent did not increase.[19]

At work, the average hourly wage of Māori and Pacific employees was 82% and 77%, respectively, of the average wage earned by Pākeha.[20] The unemployment rate for Māori, while decreasing over the last 10 years, remains double the national average in New Zealand at 9%.[21]

In terms of gender equality, New Zealand ranked 33rd out of 35 countries surveyed regarding the number of women in senior management roles.[22] Although the gender pay gap has reached an all-time low of 9.4%, if progress on gender pay discrimination continues at the same pace, it will take 40 years before a gender pay gap of zero is reached.[23] Women in New Zealand report a lack of financial products, services, advice and education as barriers to full participation in our economy.

These statistics highlight a challenge for New Zealand, particularly given high levels of inequality are linked to health issues, criminality, declining social trust, and economic instability. Conversely there is compelling evidence that positive equality factors, such as diversity in leadership, are linked with commercial success. They also highlight that the current pace of progress to address inequality needs to be accelerated. OECD research suggests that in recent decades New Zealand's income inequality gap has impacted GDP by more than 15%, which is largely due to flow on effects of inequality in the New Zealand educational system.[24]

Concerns around inequality have not gone unnoticed by boards — the results of a Global Director Survey conducted in 2018, showed inequality and poverty ranked among the top concerns of New Zealand directors. The challenge is transforming concern into tangible action. Currently, gender statistics are increasingly being reported but other important inequality and diversity information, such as ethnic diversity in publicly listed or state sector boards, is not being reported.[25] Change is difficult to achieve without transparency over the current state of inequality, in all its forms, and the active tracking of progress.

Bridging wealth, race, education and genders gaps in the New Zealand is not only a matter of fairness, but also central to sustainable and inclusive economic growth. We cannot afford to wait decades to achieve incremental progress when a comprehensive response to inequality can help New Zealand switch to a higher value, more productive, and fairer economy today.

“A financial system cannot be sustainable if it undermines the basic human rights we all hold dear”

Financial sector’s role in supporting the eradication of labour exploitation.

Slavery is illegal – at all times, anywhere. Despite this unalienable human right, the scourge of slavery is estimated to still entrap 40 million people today.[25] An estimated $150 billion each year is generated globally from illegal labour slavery, making it the third most profitable criminal activity.[26]

The prevalence of slavery is a systemic failure not only in protecting human rights but of economic proportions. The profits from illegal exploitation are privatized by a few, whilst the costs are socialised to the most vulnerable, and the ethical compromise is borne by us all - often unknowingly as financiers and consumers we become complicit in supporting these practices. Exploitation can look like anything from underpaying minimum wages, to debt bondage, to people controlled by threat to themselves or their family.

No country is free of it.

The New Zealand Labour Inspectorate has credible reports of illegal wage levels pegged to source countries amongst the migrant community in New Zealand. The inspectorate also found routine underpayment or cases of exploitation across many sectors including horticulture, viticulture, dairy, forestry, and construction. Business models with franchising arrangements or significant labour outsourcing increase both complexity and a commensurate need for oversight.

When investors and banks misprice unlawful labour costs (that is, when they are endemic yet hidden in the system), it has knock on impacts to valuations, profit forecasts, and share price expectations that can reinforce or exacerbate exploitation.

The Finance Commission on Modern Slavery and Human Trafficking was formed to consider the role the finance sector can play in countering this illegal trade and recently launched the outcome of that enquiry - a Blueprint for Mobilising Finance Against Slavery and Trafficking (Blueprint).[28] The Blueprint focuses on 5 streams of actions across the banking, investment and insurance sectors which are:

- Compliance with law
- Knowing and showing slavery
- Using influence through contracts
- Due diligence and financing decisions
- Supporting remedy
- Using innovation and technology.[29]

Using the tools in the Blueprint, New Zealand financial sector firms can map their risk exposure across businesses they finance or invest in. It can help them assess the governance and compliance measures these companies have in place to protect their brand, employ migrant workers, maintain access to markets, and provide guarantees to customers, such as those reporting under the Australian Modern Slavery Act.

There are significant brand risks to New Zealand in exploitative practices. As financiers, we should support a sustainable workforce that protects people. Our national reputation as a “good place” to work and do business depends on it.

Mō tātou, ā, mō kā uri ā muri ake nei

"for us and our children after us"

Ngāi Tahu

A sustainable financial system in the New Zealand context

Acting in the interests of our community means building a legacy of enhanced social, cultural, and environmental capital over the long term, on an intergenerational timescale. Our role is to take something finite and make it infinite for future generations.

Financial capital is a necessary vehicle to deliver that legacy, but it is not the overall objective. Framing the function of land, resources, finance and other economic units as generative and not extractive is also much more closely aligned to a Māori worldview: we don't own it, we look after it, we are a caretaker for the future. In financial terms we might describe sustainable as living off the interest and growing the principal, which aligns with our goal to leave the world in a better state than when it was handed to us.

Weaving in Māori worldview as a sustainable model

Within Te Ao Māori, a number of special relationships exist that resemble duty of care – one is the connection with and obligation to look after ancestral lands, mountains, rivers, and other physical and cultural assets. Another is to our children and future generations.

These special relationships exist because it is believed that neither the natural world, nor the generations to come, can influence the day to day decisions that affect everyday life. They place trust and confidence in the present generation who are in control whilst learning from those that have passed or are elderly.

Sharing knowledge by passing down through generations ensures that current and future generations can survive and prosper.

Many of the values or operating principles that we associate with a Māori worldview, such as kaitiakitanga, form the toolkit to meet those obligations. These values and principles also guide how Iwi/Māori approach business and finance, as well as guide the formation of business partnerships when investment, and/or economic decisions are made.

Such values and principles could also form a toolkit for transforming the financial system to a more sustainable model, interdependent and connected, by taking an intergenerational long-term view.

Sustainable Financial System

One system

From a Māori perspective, everyone, including the business community, is viewed as belonging to one ecosystem – the economic concept of externalities doesn't exist. All aspects of the physical world are connected to one another, to the spiritual and metaphysical realms and to us the people. Recent Tiriti/Treaty settlements indicate new thinking with the Whanganui River and Te Urewera now having legal personality, thereby increasing their rights of protection.

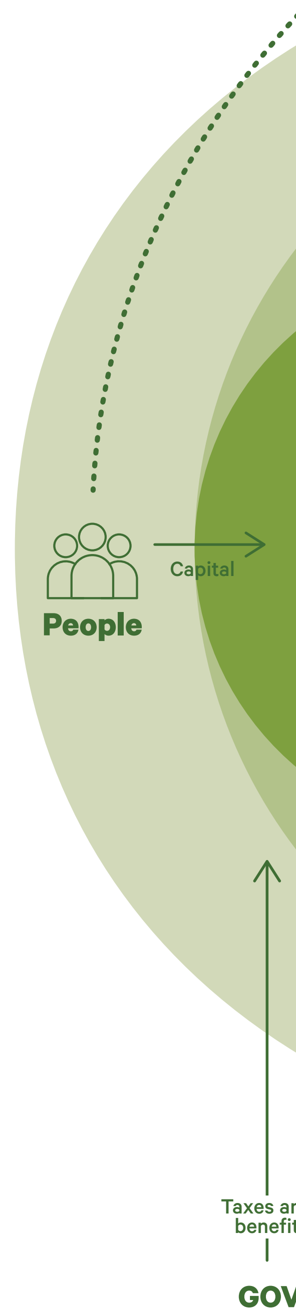
In traditional economic theory we have learnt that impacts to the environment, community and culture are classified as external to economic activity and excluded from measures such as GDP. In a Māori world-view these are core to social and fiduciary responsibilities, which require us to be custodians or guardians of the system as a whole. They are not externalities but central to building long term sustainable "wealth" whilst the creation of pūtea, or money, is the output which allows the environment, community and culture to be cared for.

Another key element to this system is diversity. We thrive on diversity within the economy and supply chain rather than consolidation. This provides opportunities to partner and help one another at a community and economic level.

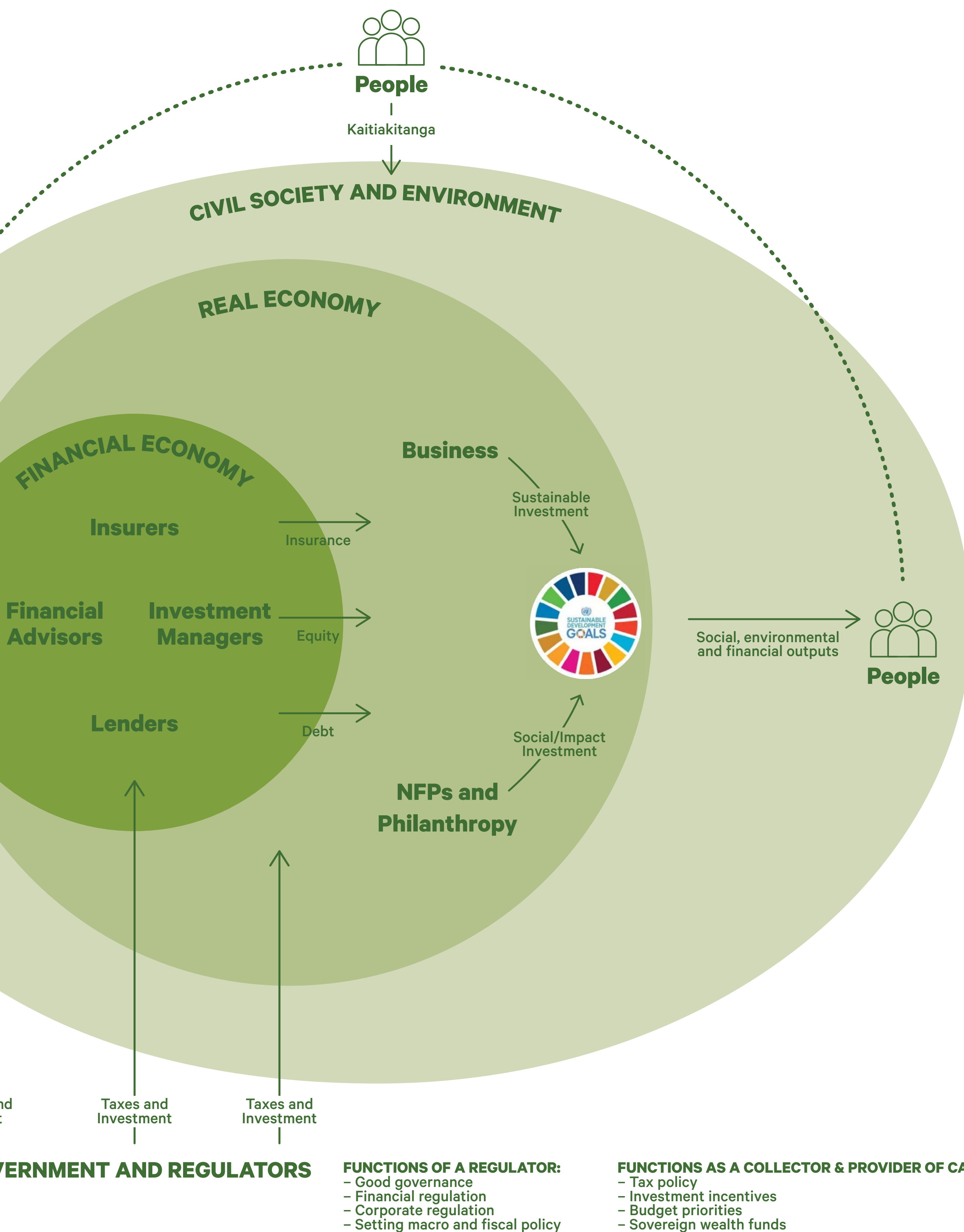
We are traders and business owners where we value our own people but are inclusive with others yet protective of our values and operating principles. We like to partner with those of shared values and long time horizons. A partner needs to demonstrate that they are also there for the long term.

The SFF's vision of a sustainable financial system is built around the one system model and the SDGs. The one system concept is also reflected in the "universal ownership" approach increasingly adopted by institutional investors where passive index tracking means they are long-term holders of the whole market, so the impact of good and poor practices by companies are all absorbed within the portfolio.

SFF's vision of a susta



inable financial system



Purpose of business and finance

In designing a sustainable financial system, the starting point must be to collectively agree upon the purpose, the role, and the responsibilities of business and finance in society.

US$2t

assets under management of member of the Net Zero Asset Owner Alliance

2050

member of the Net Zero Asset Owner Alliance achieve net zero emissions portfolios

The SFF's vision of a sustainable financial system in New Zealand is anchored in a Māori world-view, where business and finance are understood to operate within natural, human and social constraints and dependencies. The economy serves the needs and long-term wellbeing of society, while protecting and enhancing natural and human capital. Financial wealth creation is not the overriding goal of business and finance, but an outcome of, and wholly contingent upon, the creation of whole system prosperity.

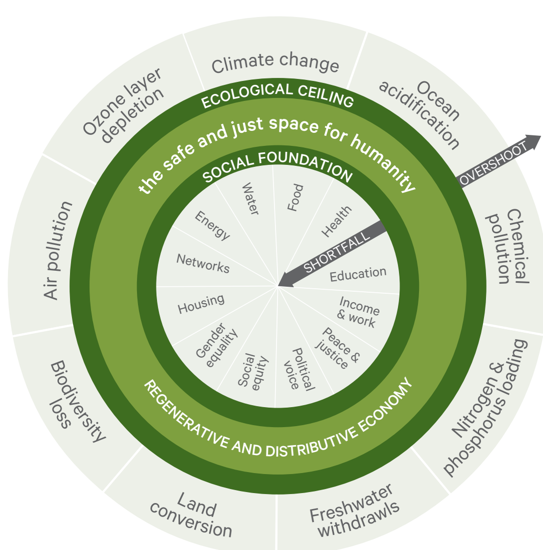
The SFF vision is consistent with latest international developments on the characteristics of a sustainable economy and sustainable financial system. It is also reflected in the next generation of business sustainability and responsible investment thinking: i.e. shifting to a purpose-driven, 'whole system value creation' business and investment models; striving not only to avoid significant harm to people and the planet but ideally also make a positive contribution to the achievement of national and international societal goals and corresponding science-based targets where possible. This is highlighted through emerging initiatives such as the Net Zero Asset Owners Alliance, which collectively pledges to align US$2 trillion of assets under management with a 1.5 degree future and achieve net zero emissions portfolios by 2050.[30]

Realigning the financial sector's purpose, is driven by collective recognition that there can be no more 'business-as-usual' and responding to the global values shift among consumers, society and emerging voice of younger generations. Stakeholders are increasingly concerned about the sustainability of the products and services they consume, the organisations they work for, the companies operating in their communities and how their money is spent or invested on their behalf. This is both a driver of policy and regulation and an independent source of risk and opportunity for companies and investors. Armed with technology and fuelled by a loss of trust, stakeholders are emerging as a powerful disruptive force in their own right. The recent move to activism (e.g. Extinction Rebellion, Greta Thunberg-inspired global climate strikes) underscores the urgent need for change and at the same time, presents an enormous opportunity for the financial sector to embrace clean and inclusive prosperity.

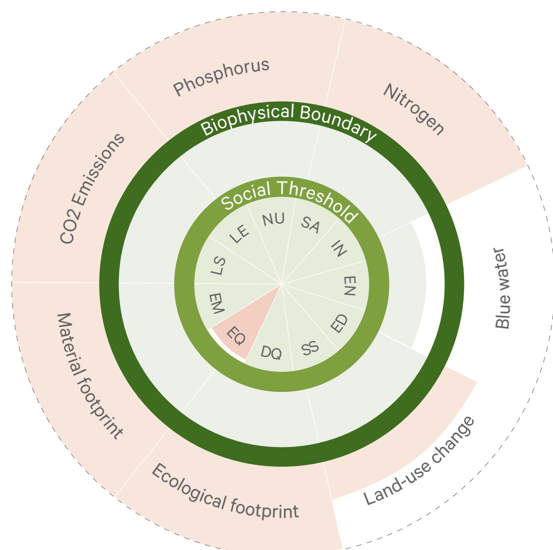
What is a sustainable economy?

A sustainable economy provides environmental, social, and economic prosperity. To visualise what this means, Kate Raworth's 'doughnut economics' – placing the economy within social and planetary boundaries - provides a simple yet powerful conceptual model, encapsulating decades of thinking on economic sustainability and 'limits to growth' theory.[31]

The Doughnut of social and planetary boundaries (Kate Raworth, 2017)[33]



New Zealand's Doughnut
(Goodlife - Country Comparisons, University of Leeds 2019)[34]



Raworth advocates the need to re-frame the current economic model of endless growth at any cost: "The aim of economic activity should be meeting the needs of all within the means of the planet... Instead of economies that need to grow, whether or not they make us thrive, we need economies that make us thrive, whether or not they grow. This means changing our picture of what the economy is and how it works".[32]

Under this model, the economy should serve society and deliver wellbeing and prosperity in a holistic sense (i.e. applying a long-term horizon and multi stakeholder lens); respecting environmental and social system boundaries (putting people and planet first). Recognising that business and investment performance, and financial system stability and prosperity, ultimately depends on the functioning and prosperity of social and environmental systems, which are increasingly under threat. Addressing systemic issues requires a collaborative, systems approach. It follows that we all have a shared interest, and arguably moral responsibility, to contribute towards protecting and enhancing environmental and social prosperity. According to Leeds University, New Zealand's doughnut model shows we are exceeding all planetary boundaries, except blue water, and are not meeting the social threshold for equality.

According to Raworth, '21st century economics' will involve the shift from "extractive enterprises" to "regenerative enterprises" (the circular economy) and to more equitable wealth distribution.[35] We cannot overcome social and ecological resource constraints through innovation alone; transformation in culture and leadership decisions will be required too. Traditional economic and financial models are built on theories (such as the 'trickle-down effect' and 'efficient market theory') that are arguably outmoded and metrics that are incomplete. GDP has become the proxy purpose of the economy, but it is not a good metric for wellbeing; we need to move to metrics that capture human and ecological outcomes – something the Living Standards Framework is seeking to do. Similarly, maximising financial profits and returns of business and investors, needs to be constrained by planetary and societal boundaries, not the sole purpose of the financial sector.

Raworth's model provides a vision for an equitable and sustainable economy but does not prescribe the pathway for getting there. Along with other countries in the world, New Zealand has committed to the UN SDGs and the Paris Agreement, representing a global consensus on the path that the world must take to survive and thrive. This provides a macro-level roadmap, that is being translated into local priorities and measures.

How does the financial system support a sustainable economy?

A sustainable financial system considers material sustainability risks on the sector but also considers the impact the sector has on planet and people.

Such a sustainable economic transformation will require financial system transformation, involving the redirection of public and private capital on a massive scale over a relatively short period of time. Harnessing the power and potential of financial markets – through allocation of risk and capital to shape the economy and to drive the necessary transition to a sustainable economy.

In essence, a sustainable financial system should serve and deliver upon the vision of a sustainable economy and be assessed in terms of both financial and non-financial performance and outcomes. It should be aligned with climate and sustainability goals and imperatives (which is ultimately the enduring path to financial system stability and resilience). Although a significant change, for those that see the direction of travel and lead the transition, this will create significant opportunities.

This will require both 'greening finance' (integrating consideration of sustainability risks, opportunities, and 'real-world' impacts into business and investment decision-making, ownership and disclosure) and 'financing green' (mobilising and accelerating capital to sustainability solutions and positive impact investments). It will also require identifying the interventions that will deliver the biggest impact (i.e. really 'shift the dial' in terms of whole system change). It will necessarily require a transformation in leadership style and culture across public and private sectors.

Greening Finance

This describes integrating the consideration of sustainability risks, opportunities, and 'real-world' impacts into business and investment decision-making, ownership and disclosure

Financing Green

This describes mobilising and accelerating capital to sustainability solutions and positive impact investments

Financial materiality lens (impact ON business and investors)

To date, the focus has been on the implications of climate change and other sustainability issues for investors and the financial system, in particular from a downside risk perspective, and how to measure and price this. This is driven by recognition of the financial materiality of sustainability factors to fiduciary and governance duties and financial system stability management. This is the approach of the framework developed by the Task Force on Climate-related Financial Disclosure (TCFD), for example.[36]

There is growing awareness that sustainability is a key driver of long-term economic and financial value creation, or destruction, at the macro and micro level. Degradation of social and environmental systems, and the transition to a sustainable economy, creates material business and investment risks and opportunities. Understanding and managing these risks and opportunities is now seen as central to the discharge of governance, fiduciary and stewardship duties, with the prospect of legal (corporate and even personal) liability in the future for failure to properly consider and disclose. At the financial system level, there is the (potentially 'unhedgeable') risk of sudden asset re-pricing, due to a market sentiment shift, causing economic shocks.[36] Also, international competitiveness risks (and opportunities) – e.g. countries or sectors being disadvantaged or penalised in global trade and financial markets if judged to be a laggard on climate or sustainability.

Real world impact lens (impact OF business and investors)

While an extremely important development, decision-makers should also consider the impact of investments and financial system management on the climate, social and environmental systems, and the real economy, and contributing positively to a sustainable economic transition (which, in turn, presents financial value-adding opportunities).

The two are closely interrelated (for example, the risk exposure of a company to the transition to a low-emissions economy is a function of its environmental impacts and contribution). Companies with strong governance and sustainable products, services, or business conduct, are more likely to be rewarded by markets and stakeholders. Conversely, companies with poor governance and unsustainable products, services or business conduct are negatively exposed to policy and regulatory interventions, market disruption, and consumer or societal backlash. At a macro-level, countries with sustainable economies and financial systems are more like to be stable, resilient and competitive in international markets.

Recent EU guidance on non-financial reporting and climate change (June 2019) addresses this "double materiality perspective", covering both 'financial materiality' (the financial impact on the company' of climate change physical and transition risks and opportunities) and 'environmental and social materiality' (how the company's activities impact the climate).[38] Going further, the French 'Energy Transition Law' makes climate change related disclosure mandatory, and as part of that, requires institutional investors to explain how their policies align with the country's climate goals and national strategy for a low-emissions economy.[39] Beyond disclosure requirements, the UN Principles of Responsible Investment (PRI) has launched project looking at how to make sustainability impact a core part of investment decision-making, through a broader interpretation of fiduciary duty or additional legal duties.[40]

Internationally, various frameworks and tools are available or under development to assist the market and regulators in determining what is compatible with or contributes to a sustainable economy. Markets are already responding with the development of new financial products and services.

The current state of the financial system

While there are some individual leaders, currently, financial markets in New Zealand – and globally – are still largely misaligned with climate change and other sustainability imperatives.

95%

of stakeholders surveyed by the SFF stated the current system was not sustainable, equitable and/or fair.

<1%

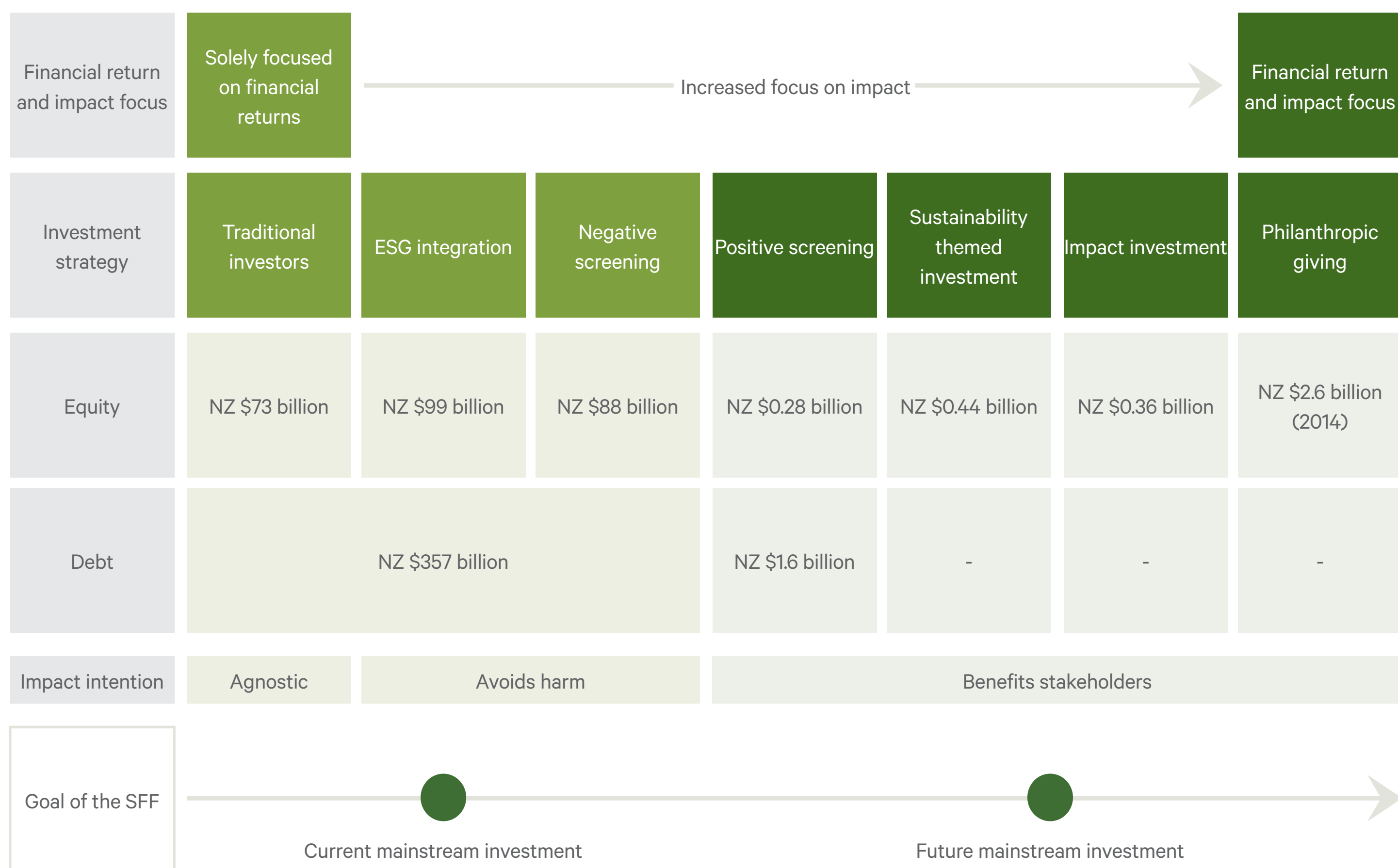
of estimated funds under management are being invested in strategies that set-out to achieve positive social or environment impact

From this perspective, there is a capital misallocation, due to issues ranging from market short-termism, linking of pricing and performance to financial outcomes only (maximising risk-adjusted, generally short-term financial returns is still the paramount objective), asset mispricing, lack of information and awareness across financial markets, and a number of other systemic issues and barriers.

Aligning the financial system will encompass both a shifting capital away from 'unsustainable' products and services and business practices and related infrastructure; and moving capital towards sustainable products and services and business practices, and related infrastructure – including mobilising and scaling-up capital for sustainability solutions and other positive impact investments. It will also require significant capital to remedy, or increase resilience to, the consequences of damage already done to social and environmental systems, including inevitable climate change impacts due to greenhouse gas (GHG) levels already in the atmosphere.[41]

Responsible investment strategies and sustainable finance products are being used to different extents in New Zealand. Responsible Investment Association Australasia's (RIAA) Responsible and Ethical Investment Spectrum sets out a range of different responsible investment strategies based on a primary focus on financial returns to a primary focus on positive environmental or social outcomes ("impact").[42] Using RIAA's 2019 benchmark data on responsible investment in New Zealand and lending disclosures from the major banks, there has been a clear shift over the years for Environmental, Social and Governance (ESG) issues to be incorporated either as a risk management or quality of management measure, and more recently for exclusionary screening. However, there are still parts of the market without any integration of ESG considerations and at the other end, less than 1% of assets are being invested in strategies that set out to achieve positive environmental or social outcomes[43], even though evidence shows financial returns are equal or can actually be improved through these types of strategies.[44] The goal of the SFF is to move mainstream investment from its current position to further along the spectrum, with a focus on both the avoidance of harm and the generation positive environmental and social outcomes.

Sustainable Investment Spectrum



New Zealand's capital markets form a central part of the domestic financial system and affect the wider economy.

The nuance of New Zealand's economy and financial system

In recent years, New Zealand's equity and bond markets have grown but overall the size of New Zealand's capital markets remains small and relatively underdeveloped when compared to international standards.[45]

Currently, the New Zealand banking system is the predominant funding source for New Zealand firms and other options for investment capital, including private capital and wholesale bond market, remain limited. New Zealand's public market is struggling to attract new listings due to a reluctance amongst New Zealand companies to list, with concerns including compliance, continuous disclosure standards and the mixed performance of IPOs.[46] New Zealand's capital market also remains highly dependent on international investment and foreign ownership in New Zealand equity markets is currently at 39%, the highest level since 2007.[47] Private markets in New Zealand are growing but not necessarily serving the full range of investors or investment stages.[48] A pathway to grow New Zealand's capital markets is outlined in the Growing New Zealand's Capital Markets 2029 Report, commissioned by the Financial Market Authority (FMA) and NZX.[49]

When developing a roadmap for a sustainable economy, the nuances of New Zealand's financial system need to be considered. In particular, consideration of the following aspects will be incorporated into the recommendations of the SFF's Roadmap for Action.

Large SME market

New Zealand's commercial sector is dominated by SMEs. In 2016, 97% of enterprises had fewer than 20 employees.[50] This means many organisations do not have dedicated full-time or part-time sustainability staff and compliance costs of increased reporting requirements can be significant. At the same time, increasing the regulatory or disclosure burden only on publicly-listed entities; means a large part of the corporate sector is not captured by the disclosure requirement, and it may drive a preference for organisations to favour private markets over public to reduce compliance costs.

Attractive destination for capital

New Zealand markets are reliant on international capital, where there is a growing demand for sustainable investments.[51] For New Zealand to remain an attractive destination for investors, supply of sustainable investments will need to increase in importance and any new regulation or sustainable standard introduced in New Zealand will need to align to international best practice.

The reliance on international capital is also true in the insurance sector, where domestic insurers rely on large global reinsurers to hedge risks. Without global reinsurers we would not have full earthquake cover. This means any pricing change in the domestic insurance sector needs to follow the pricing of reinsurers, otherwise a pricing mismatch will occur, squeezing margins or changing insurers' risk profile, if other hedging options are sought.

Small pools of capital

New Zealand's capital markets are relatively small in size. The KiwiSaver market grew to $46.2 billion in size in 2018. In comparison, this is approximately 2% of the Australian Superannuation market.[52] New Zealand is yet to enable a choice of tax efficient products, such as the UK's Individual Savings Accounts, which would help to grow the market and broaden options. Given its smaller size there is a lack of ability to have significant product differentiation, such as "deep green" funds, as demand is believed to be too niche to attract significant scale. There is also an increasing trend towards passive investment due to its low-fee structure and high demand for liquid assets. Both these attributes also reduce the market for active, long-term investment strategies, targeting positive environmental and social outcomes.

Trust structures

Trusts are important to the New Zealand economy and financial sector, with a sizeable pool of funds managed through these structures. The new Trusts Act 2019 clarifies core trust concepts and aims to modernise outdated language and concepts. For example, the new Act requires trustees to consider the objectives of the trust when carrying out their duties. To the extent that a trust is "large" or an "investment business", for the purpose of the Financial Market Conduct Act (FMCA), it is treated as a wholesale investor. This could include Iwi trusts, community trusts, charitable trusts, family trusts and other special purpose trusts. From a financial advice perspective, being a wholesale investor means the trust does not have the benefit of the full range of regulatory and competency protections available to retail investors.

Potential Pathways

Defining focus areas

Through the stakeholder engagement carried out by the SFF, 95% of interviewees told us the current financial system was not sustainable, equitable, and/or fair. Clearly, we need to change the status-quo to provide future generations with the same benefits past generations have experienced. The is our role as leaders and guardians.

Through the Theory of Change process, we identified key areas of focus for achieving a sustainable financial system. We have grouped these into three themes: changing the mindset, aligning the financial system and mobilising capital.

Changing mindset

- Leaders committing to sustainability as core to the organisation's purpose and long-term vision, championing sustainability as a strategic priority and driving a cultural shift.
- Redefining roles and responsibilities of financial system participants through clarification that fiduciary duty is broader than financial returns
- Linking performance management and remuneration to long-term outcomes
- Developing a clear blueprint for a sustainable economy in New Zealand, supported by long-term policy certainty and alignment of public finance and investment
- Embedding sustainability within financial market policy and regulation and the mandates of financial market regulators

Aligning the financial system ("greening finance")

- Raising awareness and capability of financial system participants, including consumers, on finance generally and specifically in relation to sustainable finance – through education and professional qualifications
- Pricing social and environmental impacts, and including their value in financial accounting, asset valuation, credit rating models, and banks' capital requirements
- Improving access to accurate and comparable environmental and social data and product information to underpin analysis and decision-making, through disclosure requirements, standards and verification

Mobilising capital ("financing green")

- Redirecting existing capital, and mobilising new capital, for projects and enterprises that deliver on global sustainability goals, such as the Paris Agreement and the SDGs – and on New Zealand's identified priority issues and economic sectors
- Identifying additional measures to stimulate supply and demand for sustainable finance products and services and promote financial inclusion

Potential pathways

Drawing from research and the insights and expertise of more than 100 stakeholders, the table below sets out Potential Pathways for achieving a sustainable financial system in New Zealand.

THEME	PRIORITY AREA	GETTING TO THE POINT	POTENTIAL PATHWAYS
Changing mindset	Long-term purpose and leadership	Currently decision-making is largely driven by short-term financial performance – often at the expense of social and environmental outcomes. A fundamental change to the business leadership and culture is needed to focus on long-term value creation for all stakeholders.	Reward organisations that lead through long-term purpose
	Legal obligations	Existing fiduciary duties do not explicitly require environmental and social factors to be considered and are sometimes interpreted as prohibiting this. The scope of fiduciary duty needs to be reviewed and clarified, along with a move from shareholder focus to stakeholder focus.	Clarify fiduciary duties
	Performance management and remuneration	Heavily linking remuneration to annual financial performance and targets has historically driven a culture of short-termism at the expense of long-term value creation. Performance management needs to support the long-term strategy of an organisation to drive behaviour change.	Link performance management and sustainable outcomes
	System Architecture	Sustainability is not well integrated across New Zealand's financial market regulation and it is not explicit in the mandates of most government-backed funds and regulators. Better strategic coordination, oversight, and incorporation in mandates and regulation will provide supportive regulatory structure as well as alignment of public finance and publically funded investment.	Develop a coordinated whole-of-government and whole-of-market strategy on sustainable finance with long-term policy certainty
Aligning the financial system ("greening finance")	Sustainability education	Low levels of awareness on sustainability and capability exist across all financial system participants, from consumers to directors. Providing all New Zealanders with education on sustainability concepts, such as ESG risk management, and responsible or impact investment will be a key enabler for shifting behaviour, and capital, toward positive social and environmental outcomes.	Integrate sustainability into all levels of education within society and the financial system
	Data and reporting	Having accurate and comparable data and reporting is a key element in valuing assets and investments. Environmental and social data and reporting needs improved accuracy, comparability and availability to become integral to financial decision making.	Improve accuracy, comparability and access to environmental and social data and reporting
	Pricing environmental and social outcomes	The global financial system is built on models, norms, and rules that do not reflect the full cost of business or respond to changing societal expectations. Valuing environmental and social impacts would improve the accuracy of valuations, accounting and capital adequacy models and reduce externalities.	Price externalities and expand financial models to incorporate environmental and social outcomes
	Market Stability	Environmental and social risks have the potential to cause – or be a lead indicator - of market disruption. By monitoring these risks closely, and thoughtfully implementing transition plans, regulators and the private sector can increase the resilience of the financial system and reduce economic shocks.	Move towards risk-based insurance pricing and monitor climate change and other sustainability risk in the financial sector
Mobilising capital ("financing green")	Defining sustainability	'Greenwashing' is a concern shared by all financial system actors. Developing a credible and objective sustainability 'language', which links to international standards, is necessary to facilitate the effective and genuine flow of capital to positive outcomes. This includes by defining 'green' and 'sustainable' investment.	Endorse an internationally aligned, Aotearoa fit-for-purpose set of definitions for sustainable investments
	Scaling positive impact	Currently, only a small percentage of capital is allocated to positive impact investments in New Zealand. We need to scale up, and diversify, the supply of positive impact investment products and services, and improve investibility and access, including through the use of innovative financing models.	Scale-up investment in positive impact projects and assets
	Inclusiveness	Our current financial system is contributing to growing inequality. Scaling up services targeting under-served groups and improving diversity and consumer protection will improve inclusion.	Scale-up micro-finance and social enterprise, adopt measures to address inequality and increase diversity, improve customer protection measures

DESIRED OUTCOMES

The purpose and culture of business supports intergenerational wellbeing and sustainable development and decision-making reflects this.

Fiduciary duty is understood to require consideration and management of environmental and social risks, opportunities, and 'real-world' impacts.

People are incentivised and rewarded according to demonstrable progress toward the organisation's long-term purpose, including sustainable outcomes and material issues facing organisations.

Sustainability is integrated into financial market regulation and central to the mandates and functions of all financial market policy-makers and regulators, as well as Crown or government-backed funds and financial entities. They promote and contribute to a sustainable economy and financial system.

Society and the financial sector have the knowledge to understand sustainability concepts and the frameworks to understand how financial decisions can impact environmental and social outcomes.

Environmental and social data and disclosures are as robust and accessible as financial disclosures, meet international standards and are integrated into financial decision making.

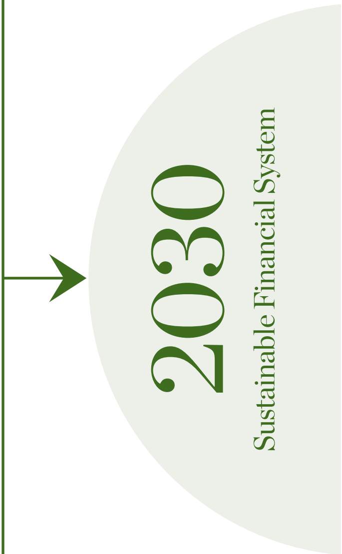
Environmental and social impacts are priced and included in our accounting, valuation and capital adequacy models and provide a price signal to realign the allocation of capital.

Pricing structures reduce exposure to systemic risks (such as climate change) and the potential impact of these risks on the financial sector are closely monitored and transition plans are in place.

An internationally recognised and locally applicable sustainability standard which reduces greenwashing and accelerates capital into genuine environmental and social purpose projects.

Investment is scaled into projects and enterprises which deliver positive social and environmental outcomes (including addressing climate change)

Suitable and accessible financial products are available to all. Consumers are better protected against unethical behaviour.



CURRENT STATE

For each of the three themes we have defined priority areas that emerged from our work.

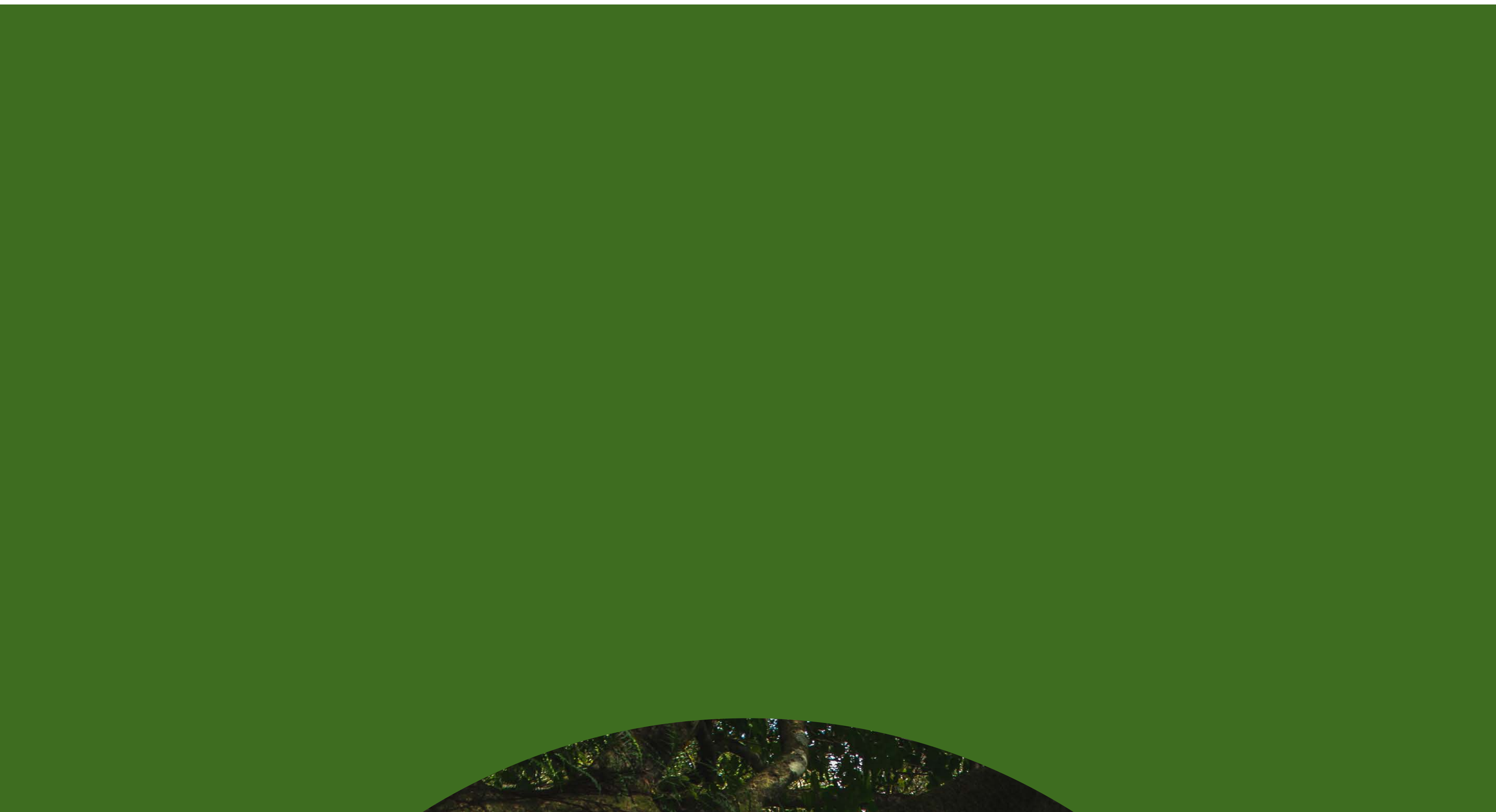
For each priority area we have framed the key issue, set out the Potential Pathways and identified the desired outcome from overcoming this challenge.

We are looking for feedback on how to further refine and implement these Potential Pathways.

We have set out a list of questions for each pathway to assist the development of our Final Report and Roadmap for Action.

Further information on each priority area and feedback questions are provided in the following sections of this Report.

Theme 1: Changing mindset



Long-term purpose and leadership

Currently decision-making is largely driven by short-term financial performance — often at the expense of social and environmental outcomes. A fundamental change to the business leadership and culture is needed to focus on long-term value creation for all stakeholders.

DESIRED OUTCOME

The purpose and culture of business supports intergenerational wellbeing and sustainable development and decision-making reflects this.

Key findings

- The expectations of business and finance sectors are changing rapidly – globally and in New Zealand, as negative social and environmental impacts become increasingly visible. Pressure is growing for organisations to deliver not only financial returns, but also to maintain a social licence to operate and serve a social purpose over the long-term. This is supported by research, which shows purpose-led companies have better employee retention[54], attract customers[55] and financially outperform[56].
- Directors and investment managers, along with senior management, are in a unique position to either create this change or be a barrier to this. Larry Fink, CEO of Blackrock, the world's largest investor, wrote a letter in 2016 to the CEO's of the US S&P500 and large European corporates that stated: "We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation. Additionally, because Boards have a critical role to play in strategic planning, we believe CEOs should explicitly affirm that their Boards have reviewed those plans".[57] This has been backed-up by the Business Roundtable's announcement to move away from shareholder primacy to commitments which consider all stakeholders though a social purpose. This commitment was signed by 181 CEOs of the world's largest organisations and showed a move towards a purpose-led approach.[58] Our stakeholder interviews showed there is some scepticism around these types of announcements until they are followed through with action.
- Financial authorities and business leaders around the world have begun to address the role of governance in driving a sustainable economy and financial system. In New Zealand, directors are currently encouraged by the FMA's Corporate Governance Principles and Guidelines to check that conduct towards stakeholders aligns with current accepted social, environmental, and ethical norms.[59] This would drive further action if this standard was raised from accepted norms to requiring leadership.
- Leadership has seen a recent wave of voluntary commitments made with respect to climate change in particular, such as the Climate Leaders Coalition in New Zealand. Globally, broader sustainability initiatives targeting the financial sector, such as the UN's Principles for Responsible Investment (PRI), Principles for Sustainable Insurance, the Principles for Responsible Banking and regional alliances (e.g. RIAA and the Investor Group on Climate Change) have had some take-up in New Zealand.
- Recent research found that, apart from market leaders and despite increasing awareness of the issues, there has been no significant or demonstrable shift in behaviour. The CFA Institute highlights the importance of values in investment organisations if the industry is to regain the trust of society.[60] The research showed that only 11% of investment leaders described the impact of the investment industry as very positive for society, and that of seven job factors studied, 'ability to help clients' and 'alignment to your organisation's vision and values' provided among the lowest levels of motivation for investment professionals.[61] Business and investment decision-making is still primarily made in favour of short-term financial returns and our stakeholder interviews supported this view and identified that many Boards are not leading — often requiring significant drive from management to embrace sustainability.

- There were different views on the right mix of regulation versus voluntary action to drive the necessary change in leadership style and culture. Regulatory interventions on governance and fiduciary duties will play a role but will not suffice. Regulation generally lags leadership and sets a compliance mindset, rather than focusing on the opportunities.
- There was consensus on the critical importance of a values shift and culture change, alongside 'technical' solutions, to achieve a sustainable economy and financial system. The CFA Institute argues that "making a consistent ... contribution to societal wealth and well-being is not just a nice goal for the investment management profession – it is quite possibly a matter of existential importance".[62] The Institute suggests ways to achieve a future state that "provides the best possible outcomes, by fulfilling client objectives, serving end investors, and contributing to societal wealth and well-being".[63] It calls upon leaders to: "Cultivate stronger culture".[64] The view that a company can take specific actions that both increase profits and improve the economic and social conditions in the communities where it operates is a new societal norm that is likely to progress further in the next 5–10 years. Managing culture involves deliberate strategy and leadership action to establish cultural signatures that are particularly motivational and sustainable".[65]

Potential pathways

REWARD ORGANISATIONS THAT LEAD THROUGH LONG-TERM PURPOSE

Feedback questions:

- Should business and investment sectors be expected to serve a broader social purpose and to deliver positive environmental and social outcomes? Should this be through leadership or regulation or both? If through leadership, how can this be promoted and rewarded? How can regulation be enabling rather than compliance-driven?
- What does this mean for Board composition, skills, accountability, and incentives?
- How can we achieve the necessary cultural shift across the corporate and financial sector and within organisations?

7.6%

the improvement in the annual risk-adjusted stock return of a portfolio of high "Purpose-clarity" firms.[66]

2018

Blackrock's annual letter quoted "without a sense of purpose, no company, either public or private, can achieve its full potential"

"ability to help your client" and "alignment with your organisation's vision and purpose" provided among the lowest levels of motivation for investment professionals"

Cultivate culture

CFA Institute calls on leaders

Legal obligations

Existing fiduciary duties do not explicitly require environmental and social factors to be considered and are sometimes interpreted as prohibiting this. The scope of fiduciary duty needs to be reviewed and clarified, along with a move from shareholder focus to stakeholder focus.

DESIRED OUTCOME

Fiduciary duty is understood to require consideration and management of environmental and social risks, opportunities, and 'real-world' impacts.

Key findings:

Fiduciary duties are imposed upon a person who exercises discretionary power in the interests of another, in circumstances that give rise to a relationship of trust and confidence – including those making investment decisions on behalf of others, providing investment advice or directors of companies.[67] Broadly speaking, fiduciary duty encompasses a requirement to act in good faith and in the best interests of shareholders, clients, members, or beneficiaries ('proper purpose' test). This is aligned in practice with the obligation to exercise due care, diligence, and skill, in line with professional norms and standards of behaviour ('prudent person' test).

In the New Zealand context, while there is variation in specific provisions across applicable legislation[68], fiduciary duty applies to actors across the financial system including:

- Directors of non-financial companies (i.e. producers of non-financial goods and services)
- Directors of banks and insurance companies
- Supervisors and managers of KiwiSaver and other FMA-regulated 'managed investments schemes'
- Supervisors of debt security issuers
- Trustees of other wholesale investment entities (e.g. iwi trusts or asset holding companies, charitable trusts and foundations, family trusts)
- Directors and trustees of Crown Financial Institutions (CFIs) and other government-backed funds
- Financial advisers (including providers of 'discretionary management services')

Internationally, it is becoming widely accepted that understanding and managing environmental and social risks and opportunities is central to the discharge of fiduciary duty, particularly in the context of climate change. In Australia, an influential legal opinion on "Climate Change and Directors' Duties" provided by Mr Noel Hutley SC of Minter Ellison, has provided greater certainty for directors and trustees.

The current New Zealand legal framework does not explicitly require consideration of environmental and social factors as part of fiduciary duty. Further, the recent review of legislation governing Trusts and financial services as well as the new Code of Conduct for Financial Advisers did not address this. Local legal experts have expressed informal opinion that this is implicit (in the context of climate change) and The Aotearoa Circle has commissioned a formal legal opinion on the topic of fiduciary duties and climate change as part of the work of the SFF.[69] ESG is explicit in best practice corporate governance guidance issued by the NZX and FMA.[70]

The research found that there is a lack of awareness or understanding of fiduciary duties, generally and in terms of the relevance of environmental and social factors, across corporate and financial sectors in New Zealand – especially among SMEs, non-institutional investors and financial advisers – as well as different levels of capability or resource to meet them. This is compounded by the current lack of clarity on scope from regulators and lack of a dedicated regulator in the case of trustees. The majority (approximately 60%) of financial advisers consulted considered that discharge of fiduciary duty required accounting for responsible investment issues. There were mixed views on whether this needs to be clarified in legislation, as opposed to regulator guidance or left to the market.

Where ESG factors are considered, the focus tends to be on the financial materiality for the company, shareholders, clients or beneficiaries – often over the short-term. There is a growing recognition that managing these issues well is better for the long-term value of a company. However, it is true that impacts on the environment, community, and society are typically still not considered or valued in their own right.

Sustainable finance roadmaps and action plans in the EU, UK, and Canada (with others underway) recommended clarifying the scope of fiduciary duties in relation to climate change and/or broader ESG issues. In 2018, the UK Department for Work and Pensions (DWP) clarified trustees' fiduciary duties in relation to ESG factors, requiring trust-based pension schemes to have a policy on how they consider financially material ESG matters, including climate change.

Global Context

UN PRI 'Fiduciary Duty in the 21st Century' and 'A Legal Framework for Impact' projects

The UN PRI has done extensive work on the scope of fiduciary duty for institutional investors, and issued a global statement concluding that investors (and other organisations in the investment system) must "integrate financially-material factors, including ESG factors, in their investment decisions, encourage high standards of ESG performance in the companies or other entities in which they are invested, and support the stability and resilience of the financial system".[71] It has also developed roadmaps for more than ten countries on the policy and regulatory changes required to embed ESG into fiduciary duties. The PRI is now turning its attention to the future evolution of investor duties, proposing that fiduciary duty should extend beyond financial impacts for stakeholders and encompass a requirement to measure and account for the 'real world' sustainability impact of their investments.[72]

Potential pathways

CLARIFYING FIDUCIARY DUTIES

Feedback questions:

- Does fiduciary duty in New Zealand legislation require consideration and management of environmental and social factors? Over what timeframe? If not, should it?
- Does/should it encompass a duty to deliver positive 'real world' impacts?
- In the case of financial advisers, should it be required to proactively enquire about and take into account their clients' sustainability-related values and goals? Should this be clarified in legislation and/or regulator guidance?
- Does there need to be differential treatment, phasing in or targeted support for SMEs and non-institutional investors?

Performance management and remuneration

Heavily linking remuneration to annual financial performance and targets has historically driven a culture of short-termism at the expense of long-term value creation. Performance management needs to support the long-term strategy of an organisation to drive behaviour change.

DESIRED OUTCOME

People are incentivised and rewarded according to demonstrable progress toward the organisation's long-term purpose, including sustainable outcomes and material issues facing organisations.

Key findings

- The rewards given to directors and employees, whether in salary, bonuses, or other types of remuneration, offer a tool to incentivise improvements beyond financial performance and towards positive long-term stakeholder outcomes and support the purpose and values of an organisation.
- Incentives and Key Performance Indicators (KPIs) drive conduct and behaviour. Instances of unethical behaviour within the financial sector have in part been driven by short-term incentives where KPIs are set to align with annual revenue plans and sales targets (e.g. sales leader boards).
- Misconduct issues within the banking and finance sector have unfolded in a number of jurisdictions. The Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (ARC), provided evidence of the link between unethical behaviour by the financial services industry and incentive, bonus and commission schemes which measure sales and profit but not compliance with the law and proper standards.[73] The systemic behaviour highlighted through these reviews has contributed to declining societal trust and confidence in the financial sector.
- In New Zealand, the Banking Conduct and Culture Report published by the FMA and the RBNZ in November 2018 found that where incentives were linked only to short-term outcomes this likely to lead to short-term financial goals being prioritised over long-term outcomes for customers.[74] Even in cases when CEO remuneration was linked to long-term outcomes, the measures still mainly related to financial performance or parent bank considerations. This has flow on effects for managers and front-line sales staff who have had performance disproportionately measured on sales through the use of financial incentives. The FMA and RBNZ have required changes in the retail facing segments of banks, to reduce the link with sales and increase the connection to good customer outcomes.[75]
- The FMA and RBNZ also published a review of conduct and culture in New Zealand life insurers in January 2019. The report highlighted the conflict of interest that is created by sales incentives which tell staff and intermediaries that a sale is a 'good outcome', when it may not in fact be in the best interests of customers and good customer outcomes.[77]
- Since these reviews, the Government has announced a proposed conduct licencing regime for banks, insurers and non-bank deposit takers, which includes banning target-based sales incentives.[78] The regime would, among other things, outline what obligations financial institutions have in relation to remuneration and any other sales incentives, and how they must manage the risks those incentives create.
- To date, the move away from sales metrics to customer outcomes has largely occurred in the customer facing parts of the banking and insurance sector. The focus has not yet been on other parts of the financial sector such as intermediaries. Other stakeholder outcomes (beyond customer outcomes) are not generally widely considered. This adds to the perception that environmental and social factors are 'externalities' and 'compliance costs' separate from profit maximisation goals, rather than integral to an organisation's long-term success. This means that where sustainability measures are reported (e.g. through sustainability reports), they are commonly not seen a core to business but viewed as a marketing tool or a compliance requirement. This perspective was reinforced through our stakeholder interviews.
- Creating broader remuneration practices which reflect long-term strategic plans and sustainability outcomes will send a signal to employees of what type of behaviour and outcomes are valued, which in turn will help to improve the conduct and performance within organisations. In the long-term, this creates an opportunity to foster a sustainable culture of good conduct, compliance with the law and proper standards, and as a result, improve public trust and confidence in the finance sector.

Global Context: Unilever

Unilever has placed the 'Unilever Sustainable Living Plan' at the heart of its business model, with a primary business strategy to create long-term growth and value in a sustainable way[79]. Performance measures at Unilever are selected to align with Unilever's short-term performance targets and long-term business strategy objectives, including delivering sustainable value for stakeholders. Unilever links sustainability to remuneration for management employees (up to and including the CEO and Unilever Leadership Executive) and encourages these employees to invest the whole or a proportion of their annual bonuses into Unilever shares to give managers an 'owners mind-set'. This initiative is making long term share ownership commitments the principal driver for reward at Unilever. Remuneration plans and value creation models such as Unilever's offer an example of how remuneration and share-based incentives can be designed to drive long-term thinking and progress on sustainability targets.

Potential pathways

LINK PERFORMANCE MANAGEMENT AND SUSTAINABLE OUTCOMES

Feedback questions:

- What is the right mix of criteria, payments and timeframes for remuneration and performance management metrics? How can remuneration pathways best be linked to longer term strategic plans? What is the appropriate timeframe and what evidence would be needed to monitor performance against long-term outcomes?
- Should a broader set of sustainability metrics be included in remuneration and performance management, beyond customer outcomes? What should the selection of appropriate metrics be based on? (e.g. sustainability materiality assessments)? What sectors of the financial system should these broader outcomes cover (beyond the current progress in the customer-facing parts of banks and life insurers)?
- What disclosure is required to enable stakeholders and members of the public to understand the approach being used for performance management?
- How should remuneration standards and performance management outcomes be enforced and who should be covered (e.g. best practice guidance, legislation, the proposed conduct licencing regime)?

67%

Approximate percentage of CEO pay linked to the performance of a bank, including financial performance[80]

The risk of poor customer outcomes was increased by the incentives offered to staff, which are typically highly focused on sales performance.[81]

100%

All banks assess sales performance when determining variable pay.[82]

High

Incentives that are highly sales focused means that the risk of inappropriate sales practices occurring is high.[83]

System architecture

Sustainability is not well integrated across New Zealand's financial market regulation and it is not explicit in the mandates of most government-backed funds and regulators. Better strategic coordination, oversight, and incorporation in mandates and regulation will provide supportive regulatory structure as well as alignment of public finance and publically funded investment.

DESIRED OUTCOME

Sustainability is integrated into financial market regulation and central to the mandates and functions of all financial market policy-makers and regulators, as well as Crown or government-backed funds and financial entities. They promote and contribute to a sustainable economy and financial system.

Key findings

- The concept of 'wellbeing', a broader and inter-generational notion of prosperity, underpins the Government's economic and sustainability agenda. However, this is not yet well reflected in New Zealand's financial market policy and regulatory framework, public finance system and public financial institutions (with some exceptions). There is also a lack of strategic coordination and some gaps in regulatory oversight (e.g. private markets and trustees).

Financial market regulation and regulator mandates:

- New Zealand's financial markets are highly regulated, in part responding to international developments such as Basel III, anti-money laundering initiatives, and IMF reviews of New Zealand's financial sector.[85] This has increased compliance requirements across most financial organisations and focused minds on the stability of the overall banking and financial system, but without much consideration of environmental and social impacts until recently.
- Current regulation can also inhibit growth in sustainable investment and asset class diversification. For example, the conservative mandates of KiwiSaver default fund providers, liquidity requirements to meet scheme redemption and transfer rules, and limiting KiwiSaver members to one scheme, makes investing in long-term projects and assets difficult. Similarly, under the Financial Markets Conduct Act, green bonds cannot currently use same class exclusions in respect to vanilla bonds, increasing issuances costs (unlike regulation in other jurisdictions). Current focus on fee minimisation and limited environmental and social disclosure requirements can also constrain responsible investment ambition.
- Treasury is leading a comprehensive review of the RBNZ's governing legislation currently, which includes consideration of whether the Bank should be given a specific climate change objective as part of its mandate. The purpose of the Reserve Bank Act is "to promote the prosperity and wellbeing of New Zealanders and contribute to a sustainable and productive economy". Currently, the Bank's specific responsibilities are defined in terms of financial and economic objectives (financial stability, price stability, employment etc), and historically, the Bank has not considered sustainability as part of monetary policy decision-making, balance sheet management or in determining risk weightings of assets and capital requirements of the banking system.
- The Bank has shown leadership, within the scope of its current mandate, with the development of a Climate Change Strategy, plus participation in the global Network for Greening the Financial System. This initiative brings together international central banks and supervisor, looking at promoting a sustainable financial system through monetary policy, macro and micro prudential regulation and its own asset purchasing and lending decisions.[86] The financial system stability risks from climate change physical and transition impacts are addressed in the Bank's recent Financial Stability reports.
- By comparison, the purpose of the FMA's governing legislation is "to promote and facilitate the development of fair, efficient and transparent financial markets", so there is less accountability regarding sustainability outcomes.[87] This is starting to change with the FMA publishing a proposed guidance on 'good conduct and good disclosure' for green bonds and other responsible investment products and membership of the International Organisation of Securities Commissions' (IOSCO) Sustainable Finance Network. In addition, the Ministry of Business, Innovation and Employment (MBIE) is conducting a review of KiwiSaver default provider arrangements, which includes questions on whether, and if so how, default provider schemes should be used to promote responsible investment.[88]

Public finance and procurement:

- The Government has announced its intention to transform the Public Finance System and the underlying legislation to enable a public service that positively assists and improves intergenerational wellbeing.[89] It released its first 'Wellbeing Budget' in 2019, which for the first time included a ''Wellbeing Outlook' — in addition to Economic and Fiscal Outlooks. It proposes to amend the Public Finance Act 1989 to embed this new approach to Budget development and fiscal policy. Treasury would be required to report on current and future wellbeing outcomes at least every four years. Future governments will have flexibility to decide on their own wellbeing objectives but would be required to explain how each Budget will contribute to those objectives.
- Historically, many Government spending decisions have been based upon lowest cost options at the expense of environmental or social outcomes. However, the Government has improved sustainability integration into its own procurement, which accounts for around $41 billion in spending per year. This amounts to 18% of New Zealand's GDP.[90] The latest edition of the Government Procurement Rules came into effect 1st October 2019, providing for contracts to be designated to achieve a "Priority Outcome" and in some cases requiring the consideration of "broader outcomes", looking at driving positive environmental and social outcomes. This could be further enhanced by setting minimum standards on environmental and social performance for certain sectors. For example, the Australian Government requires all Government owned and leased office buildings to receive at least 4.5-star ratings, through the NABER rating system.

Government-backed funds:

- Sustainability is not explicitly included in the mandates of the CFIs or key government-back funds such as the NZ Venture Investment Fund. However, the CFI mandates do require best practice portfolio management, with ethical and reputational elements. The Guardians of New Zealand Superannuation has shown leadership on responsible investment, within the bounds of its current mandate, and considers it best practice to integrate responsible investment. Its policy does include an intention to make investments which have positive social or environmental impacts but does not forgo financial returns for these. The Guardians of New Zealand Superannuation was itself formed for the purpose of easing the financial burden on future generations of funding the country's universal superannuation system. The new, government-backed Green Investment Finance Ltd has an explicit climate change mitigation mandate, but limited size and no ability to borrow to scale up its impact (unlike similar funds overseas) which might undermine its effectiveness.

Global context

- The UK Green Finance Institute (a key recommendation of the UK Green Finance Taskforce) is an independent, commercially-focused organisation, funded by the UK Government and City of London Corporation, to champion sustainable finance domestically and abroad and help secure UK leadership in green financial markets. It is intended to be the primary forum for public and private sector collaboration on green finance, to accelerate the transition to a zero-carbon and climate-resilient economy through the mobilisation of capital. It will convene and lead mission-led coalitions, to identify and unlock barriers to deploy capital at pace and scale towards impactful, real-economy outcomes.

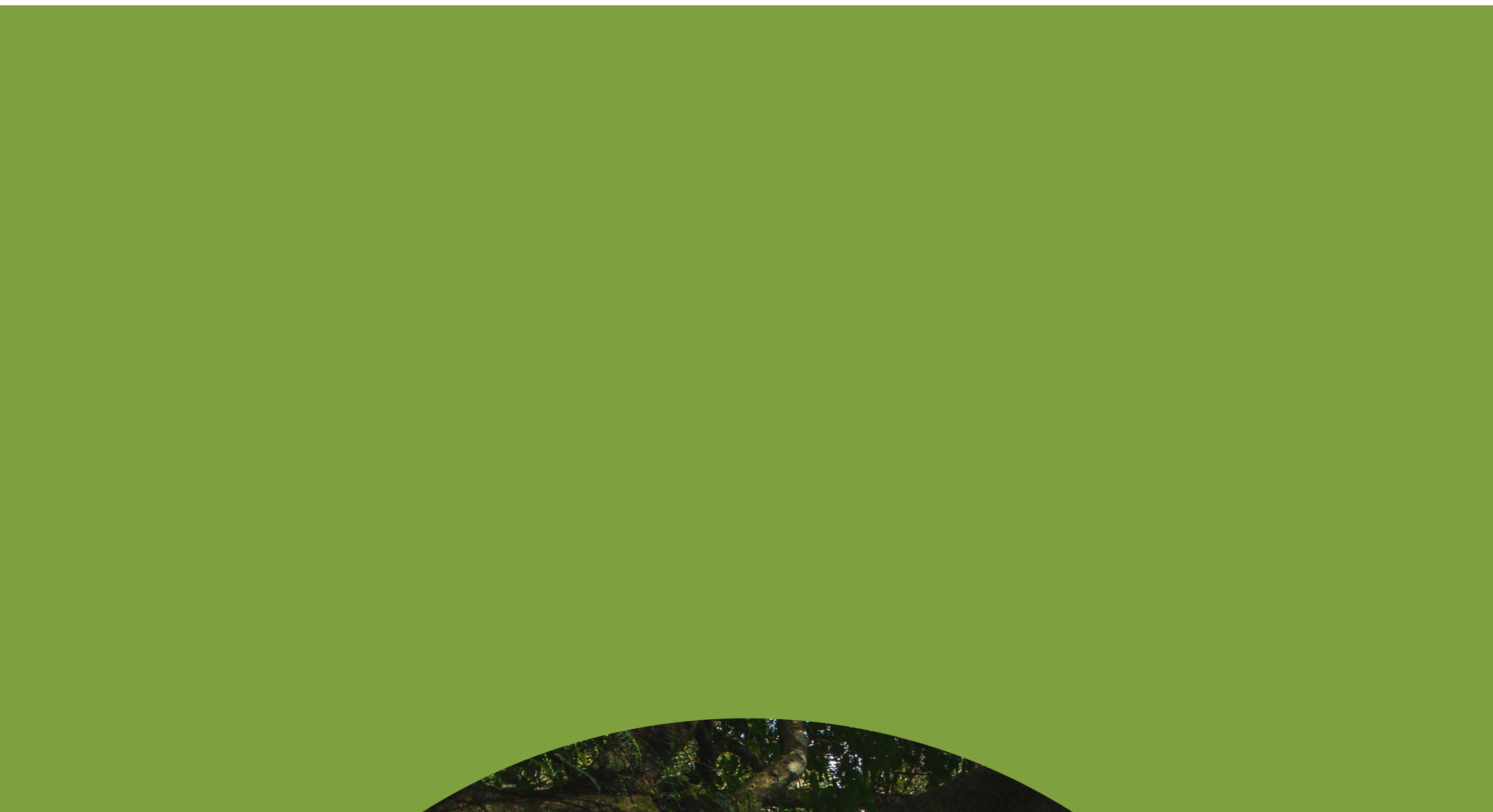
Potential pathways

DEVELOP A COORDINATED WHOLE-OF-GOVERNMENT AND WHOLE-OF-MARKET STRATEGY ON SUSTAINABLE FINANCE WITH LONG-TERM POLICY CERTAINTY

Feedback questions:

- Should the mandates of financial market policy makers and regulators and public financial entities (such as the CFIs) be revised to make sustainability outcomes explicitly part of their purpose and function and require them to promote and contribute to a sustainable economy and sustainable financial system?
- Should public financial entities be required to align their spending and investment decisions with New Zealand's climate and sustainability goals?
- Should sustainability be embedded in New Zealand's public finance system? Should private markets be regulated and supported in re-directing to sustainable finance? If so, how?
- How do we ensure strategic coordination and oversight (e.g. through a dedicated Ministerial portfolio, the Council of Financial Regulators, in consultation with other relevant government agencies and stakeholders, a new stakeholder institution similar to the UK Green Finance Institute)?

Theme 2: Aligning the financial system



Sustainability education

Low levels of awareness on sustainability and capability exist across all financial system participants, from consumers to directors. Providing all New Zealanders with education on sustainability concepts, such as ESG risk management, and responsible or impact investment will be a key enabler for shifting behaviour, and capital, toward positive social and environmental outcomes.

DESIRED OUTCOME

Society and the financial sector have the knowledge to understand sustainability concepts and the frameworks to understand how financial decisions can impact environmental and social outcomes.

Key findings

Levels of applied knowledge, by all financial system participants, on sustainability, sustainable finance and responsible investment needs to be a key priority. Through our stakeholder interviews, the capability gap was most frequently referenced within the retail, financial advisor, lenders, trustees, company director and c-suite levels. Notable exceptions include ESG specialists, trustees within the Māori sector and leaders within purpose driven organisations.

Whilst there are existing sources of education, awareness of these and adoption rates are low. These sources include:

- For consumers, responsible investment options are included in the Sorted website.[94] There are also the Mindful Money[95] initiative and Responsible Returns[96] websites from the RIAA.
- For financial advisers and fund managers, education is provided by the PRI Academy[97], the CFA Institute[98], and RIAA. RIAA has a Guide to Responsible Investment for financial advisers[99], and also provides a financial adviser certification program as well as ongoing education initiatives for its members.
- The Sustainable Business Council (SBC) provides guides and practical resources on sustainable governance and sustainability leadership.[100]

Education is a cross cutting issue. All financial system participants should be aware of the environmental and social risks, opportunities and impacts of their investment decisions.

- Financial literacy should start young and engage with issues such as sustainability and sustainable finance (e.g. investments have impacts).
- Consumers would benefit from improved financial literacy and responsible investment knowledge to enable them to make informed financial decisions.
- Investors need to be able to make informed decisions that consider the environmental and social impacts of their investments.
- Directors and senior management require insight and understanding to drive change. Our stakeholder interviews revealed the need for learning on a range of topics, including: setting a clear social and environmental purpose; board duties related to sustainability and climate change; ESG risk management; materiality and its link to risk management; stakeholder engagement; circular economy; impact measurement and valuation; sustainable procurement; and corporate environmental and social disclosures.

Whilst awareness and knowledge are necessary to achieve change, they are not sufficient in isolation. This is because we all have 'immunities to change' in which 'big assumptions' stop us taking action despite us having acquired that knowledge.[101] There has been significant information and awareness about sustainability and sustainable finance for several decades, yet most people do not change their behaviour.

Potential pathways

INTEGRATE SUSTAINABILITY INTO ALL LEVELS OF EDUCATION WITHIN SOCIETY AND THE FINANCIAL SYSTEM

Feedback questions:

- Within business, who should provide sustainable finance learning? What should this training cover (e.g. sustainability, sustainable finance, circular economy)? How should awareness of existing industry guidance and standards on responsible investment be increased?
- Should sustainable finance concepts be a part of the Financial Adviser Course and Financial Advice Provider (FAP) license process? Should advisers explicitly ask their clients about their responsible investment preferences (e.g. as part of Know Your Client (KYC)) and act accordingly?
- Should we require default KiwiSaver providers to provide a minimum standard of responsible investment information (e.g. supply information on their responsible investment strategy, impacts, stewardship activities)?
- Should responsible investment be built explicitly into the mandate of the Commission for Financial Capability (CFFC)?
- What are the best avenues to improve financial literacy and sustainable finance education for youth (e.g. national curriculum, tertiary level courses)?

Start young

Financial literacy should start young and engage with issues such as sustainability and sustainable finance

of secondary students want to learn about how to manage their money

Data and reporting

Having accurate and comparable data and reporting is a key element in valuing assets and investments. Environmental and social data and reporting needs improved accuracy, comparability and availability to become integral to financial decision making.

DESIRED OUTCOME

Environmental and social data and disclosures are as robust and accessible as financial disclosures meet international standards and are integrated into financial decision making.

Key findings

Having accurate environmental and social data is a vital starting point for measurement. Outside of New Zealand's Emissions Trading Scheme (NZ ETS) and Resource Consents there are few mandatory reporting requirements for environmental or social data. Leading organisations do publish either a stand-alone sustainability report or an 'integrated report'. However, in the absence of standards, organisations can 'cherry-pick' their ESG disclosures, thus biasing their reports. This means that companies who disclose environmental and social performance do so by self-selecting their reporting indicators. This ability to self-report and self-select data (including the way indicators are calculated), means environmental and social disclosures are generally incomparable and subjective, a point raised consistently in our stakeholder interviews.

Current mandatory corporate reporting requirements are focused on financial performance. The FMA's Corporate Governance Guide and the NZX's Listing Rules of 2017 recommend corporates report on their materially significant ESG issues on a 'comply or explain' basis. Whilst NZX recommends the use of the Global Reporting Initiative (GRI) Standards and/or the International Integrated Reporting Framework (<IR>), these are not mandatory. The application of these rules remains overly flexible, open to interpretation. One interviewee noted "too much power is afforded to the company to choose what it discloses, thus providing an overly generous view of performance".

Without comparability, environmental and social disclosures are difficult to use for (financial) decision making, resulting in a loss of importance and data integrity. This can in-turn make environmental and social disclosures a marketing exercise or a tick-box exercise. Again, this point was raised consistently in our stakeholder interviews, including from within the investment community and the corporate sector itself.

There are certain measurable and consistent environmental and social indicators that could be thought of as 'compliance level' indicators (e.g. health and safety incidents, GHG emissions). Requiring reporting and standards for these indicators (such as those afforded by the GRI Standards) would provide that comparability. More complex social data is hard to standardise, such as measurements of wellbeing, which vary depending on the outcomes experienced by individuals. Although these metrics are hard to standardise, the process used to develop them can be consistent. Leading practice in these types of "impact" metrics focus on providing evidence-based approaches for measurement, such as the Impact Management Project.[102]

28

out of the S&P/NZX 50 Index companies reported on climate change risk[104]

17

of 50 S&P/NZX 50 Index companies acknowledge the use of GRI[105]

95%

of Kiwisaver investors thinks ESG factors should be considered when investing[106]

Similarly, the TCFD provides a flexible framework for reporting on climate risks and opportunities. The current challenges for integrating climate change disclosures into current financial reporting is around the timeframe for climate risks to materialise. Asset impairment and/or revenue impacts happen over the medium to long-term, making it difficult to integrate into current disclosures. However, many strategies to manage climate risks of an organisation require long lead times, so early identification is critical. Internationally, regulators are providing guidance on their expectations of how to integrate climate risk into current reporting and accounting requirements, such as the Australian Securities & Investments Commission's (ASIC) recent updated guidance on climate risk related disclosures.[103]

Mandating the collection and reporting of environmental and social data is a highly effective method of improving data availability and consistency. A significant factor impacting the availability of evidence-based environmental and social data is cost. For example, acquiring useful climate data for climate hazards modelling requires specialist modelling capabilities. Similarly, ESG rating agencies and research houses will provide ESG assessments of individual companies at a cost, making access difficult for small financial advisers and fund managers.

There are opportunities to leverage existing data sets and make them open source. For example, the Ministry for the Environment is currently undertaking a National Climate Change Risk Assessment which will provide regional and sectoral level data. This is a hugely valuable data source for New Zealand. Making the outputs of the assessment open source for the use of corporates, the financial sector and to wider society will improve climate risk data availability at minimal cost.

Given the low level of compulsory ESG disclosure there is a low level of assurance (compared to financial statements). There are also limited examples of enforcement over poor ESG disclosures.

In the fund manager and financial adviser sectors there are limited reporting requirements. There are no mandatory reporting requirements, for a KiwiSaver fund or a fund manager, for example, to report on the outputs and outcomes of its responsible investment initiatives. There are also no requirements for reporting on the environmental and social impacts of investments or required verification relating to responsible investment claims. This lack of rigour around responsible investment claims has created mistrust, with 'greenwashing' eroding the credibility of genuine responsibly invested funds. The recent FMA consultation on labelling and disclosure for green bonds and other responsible investment products is looking to address this concern.

Potential pathways

IMPROVE ACCURACY, COMPARABILITY AND ACCESS TO ENVIRONMENTAL AND SOCIAL DATA AND REPORTING

Feedback questions:

- Should we develop a set of mandatory "compliance level" disclosures? What should this set of disclosures include (e.g. measurable indicators such as GHG emissions, water usage, diversity and H&S measures etc)? Should these disclosures apply to listed and non-listed entities? Should these disclosures align with a certain standard (e.g. GHG Protocol, GRI, SDGs, Living Standards Framework)?
- Should climate risk disclosures, aligned with the TCFD Framework, be mandatory? Should this apply to both listed and non-listed entities?
- Should the reporting of impact metrics be compulsory in certain sectors (e.g. charities, non-for-profits, issuers or managers of sustainable finance products)? If so, should the process used to report impact follow a prescribed framework (e.g. Impact Management Project)?
- What other measures should be taken to improve quality and comparability of data? Should ESG data be integrated into existing accounting standards?
- Should we mandate verification over environmental and social disclosures, including climate-related financial disclosures? Or what other methods should be used to |build confidence in data and disclosures (e.g. regulator powers, certification)?
- Could the Ministry for the Environment be required (and adequately resourced) to provide consistent and reliable data on climate hazards to the public?

Pricing environmental and social outcomes

The global financial system is built on models, norms and rules that do not reflect the full cost of business or respond to changing societal expectations. Valuing environmental and social impacts would improve the accuracy of valuations, accounting and capital adequacy models and reduce externalities.

DESIRED OUTCOME

Environmental and social impacts are priced and included in our accounting, valuation and capital adequacy models and provide a price signal to realign capital.

Key findings

Environmental and social impacts are often referred to as 'externalities'. Externalities are consequences created by one party (generally for free) which affect other parties (generally society and Government). Common examples of externalities include GHG emissions, pollution and under-paying employees (which causes financial hardship and wellbeing issues, a cost borne by families and the Government). Common barriers for pricing externalities include the lack of consistent frameworks for valuing environmental and social factors and the commercial impacts for businesses. Because externalities are currently unpriced they are not included in mainstream financial models:

- **Valuation models:** Mainstream techniques used for investment analysis, such as Net Present Value analysis, weight short-term performance more heavily through the use of discount rates, with longer term cashflows being more heavily discounted the further out they are. Given uncertainty around whether environmental or social costs will actually be recognised or incurred by companies (as opposed to society at large), they are typically not included in cash flow models. They also generally fail to recognise long term environmental and social related risks (i.e. costs of transition to a low carbon economy) through the use of terminal values that assume returns into perpetuity. Similarly, common investment management strategies rely on economic theories that downplay or ignore environmental and social impacts. For example, the efficient market hypothesis (which states that asset prices reflect all available information, making it difficult to beat the market), is commonly used by investment managers as a rationale not to consider environmental and social impacts on mistaken assumption that these are already incorporated in the market value.

- **Capital adequacy models:** 'Basel III' is the regulatory framework that sets banks' capital adequacy standards, stress testing, and market liquidity risk requirements. Its overarching objective is to guarantee the stability of the banking sector, but it doesn't explicitly address the environmental and social risks proven to both indirectly and directly affect stability. For example, capital adequacy rules favour short-term investments through requiring a high capital ratio against longer-term investments, due to their perceived high risk. RBNZ effectively oversee the implementation of Basel III and set rules for lenders on the amount of capital required to be held against risk weighted assets. The rules vary based on industry, tenor of the debt product and a range of other factors, such as credit risk ratings, which quantify the risk of future losses from borrowers' failure to repay debt. Although there are parameters in the regulations to incorporate operational, market and credit risk, there is currently no robust or commonly used method to factor in environmental and social outcomes in the framework.

The Tax Working Group's Future of Tax Report suggested prices could be placed on certain measurable externalities such as GHG emissions, waste, water quality, water abstraction, road transport through taxes or other policies.[108] Besides increasing GHG pricing through the Zero Carbon Bill, limited action has been taken to price these externalities to-date. In the absence of a price on externalities, regulators and business groups around the world have begun to address how to measure and value environmental and social impacts. An internal carbon price is increasingly factoring into their analysis. Internal carbon pricing allows companies to place a monetary value on emitting GHG emissions, regardless of whether their operations are subject to external carbon-pricing regulations. This allows companies to inform investment decisions, measure and manage the existing and potential financial and regulatory risks associated with different potential carbon pricing regimes, identify risks and opportunities and adjust strategy accordingly.[109] Externality pricing can be reasonably easily applied to other environmental factors, where reliable data can be monitored, but currently this is rarely done.

Better measurement and valuation of system impacts, to inform determination of company-specific priorities and goals and enable capital markets to price into asset valuations, is a major focus area of stakeholder collaboration currently, for example, the Natural Capital Protocol, Social Capital Protocol and Impact Valuation Roundtable.

Prudential regulators are also looking at how to use capital adequacy rules to provide a price signal to help with the transition to a low-emissions economy and reduce the likelihood of stranded assets. Mechanisms could include:

- A 'green' supporting capital factor to (parties being required to hold less capital against 'green' products/investments), reflecting an average the lower forward-looking risk of default.
- A 'brown' penalising factor (parties being required to hold more capital against brown products/ investments), given the increased forward-looking risk of default.
- Integrating sustainability-related factors into mainstream credit rating systems and stress testing (RBNZ expects to integrate climate change into its stress tests as part of its climate change strategy).
- Disclosing sustainability-related financial risks, including RBNZ disclosing its own risks and opportunities.
- Quantitative caps on debt-financing of firms heavily dependent on 'brown' assets.

Example

Accounting rules related to the value of assets are determined through estimated useful life and rates of depreciation and currently do not often reflect climate-related risks. Companies facing current or future climate-related risks can therefore be recording higher net book values of assets in the short-term. Later in an asset's life, when it is unlikely to be supported by relevant future revenues, it may ultimately become a stranded asset requiring large write-offs in value. An asset can become stranded as a result of factors such as new government regulations that limit the use of fossil fuels (e.g. carbon pricing), a change in demand (e.g. further shifts towards renewable energy), or even legal action.[111]

Potential pathways

PRICE EXTERNALITIES AND EXPAND FINANCIAL MODELS TO INCORPORATE ENVIRONMENTAL AND SOCIAL OUTCOMES

Feedback questions:

- Should measurable externalities (e.g. GHG emissions, water, waste) be priced? What is the best policy for incorporating a price on externalities (e.g. tax, trading schemes, incentive schemes for positive outcomes)?
- In the absence of externality pricing, what methods can be used by actors in the financial system to increase the incorporation of environmental and social values into accounting and valuation models?
- Should macro-prudential policy tools be used to provide a price signal for addressing climate change? If so, which tools (e.g. green/brown capital factors, climate change stress-testing, climate risk disclosures, quantitative caps)?

+50%

of New Zealand's GHG emissions are currently covered by the NZ ETS

+ $2b

the estimated social cost of air pollution (from humans) in New Zealand per annum[113]

TWG

Tax Working Group recommended the pricing of certain measurable externalities

100%

of New Zealanders pay for certain externalities, such as climate change

Market Stability

Environmental and social risks have the potential to cause – or be a lead indicator – of market disruption. By monitoring these risks closely, and thoughtfully implementing transition plans, regulators and the private sector can increase the resilience of the financial system and reduce economic shocks.

DESIRED OUTCOME

Pricing structures reduce exposure to systemic risks (such as climate change) and the potential impact of these risks on the financial sector are closely monitored and transition plans are in place.

Key findings

The magnitude and likelihood of destabilising risks are increasing as we push environmental and social boundaries. We are seeing global tensions and social uprisings increase in frequency, which many argue are caused by the current system settings and the "trickle-down" effect not reaching the middle class. It is estimated that in OECD countries, the increase in inequality between 1985 and 2005 reduced cumulative growth by 4.7%.[114]

We are also undertaking one of the largest economic transformations since the industrial age as we work to rapidly decarbonise the global economy to combat climate change. Climate change will cause significant disruption to many aspects of the financial system. A clear example of this is insurance pricing. As climate hazards such as sea-level rise increase so will significant damage to infrastructure and communities. There are two pricing approaches to pricing in the insurance sector:

- Risk-based pricing for insurance results in increased premiums for high-risk assets and promotes low risk behaviour, including avoidance of new building in high risk areas (e.g. inundation from coastal flooding, erosion from sea level rise). This approach has recently spread across Wellington and other high seismic regions. In Wellington some apartment dwellings have seen insurance premiums surge by 300%[115] due to better understanding of seismic risk. In the extreme, insurance might be unavailable as global reinsurers allocate risk to other areas, which in turn will prevent lending by banks on property assets.
- Community-based pricing is where pricing is spread evenly across a group. This approach means no particular sub-group is significantly better or worse off in terms of insurance cost but people in low risk areas pay higher premiums to subsidise people in high risk areas who have no premium incentive to reduce their risk. The EQC scheme is a pure community-based pricing scheme where everyone pays the same levy regardless of the location or value of their property.

As some insurance providers move to risk-based pricing, those that don't move will end up holding a higher risk portfolio which is commercially unsustainable, so will feel the need to follow. Global reinsurers also influence insurance pricing in New Zealand and use risk-based pricing models also pushing the domestic market towards this form of pricing.

In the context of climate change and other risks, it is critical for price to reflect the risk. This sends the right price signal to adapt to climate change and reduce risks. However, a rapid shift to risk-based pricing will cause affordability issues and rapidly alter the value of land and property across New Zealand. This type of dislocation in asset values has the potential to cause a substantial financial risk to some lenders. There are a range of measures to address this situation, commonly referred to as providing a "Just Transition". These measures provide assistance to certain impacted groups,

Global Context:

In the UK, the Prudential Regulation Authority (PRA) has established a Climate Financial Risk Forum (CFRF) to build intellectual capacity and share best practice, co-chaired with the Financial Conduct Authority (FCA). The CFRF brings together senior representatives from across the financial sector, including banks, insurers, and asset managers. The forum has set up four working groups to produce practical guidance on four specific topic areas: risk management, scenario analysis, disclosure, and innovation. The final outputs will be shared with industry more widely.[120]

such as the current focus on Taranaki through MBIE's Just Transition Unit.[116]

Monitoring the financial sector's exposure to potential systemic risks (such as climate change) is another important defence mechanism. The Productivity Commission observed that New Zealand currently has no whole-of-economy understanding of the level of financial exposure to climate risk. The Adaptation TWG[117] concluded that the country needs to confront the issue of allocation of risk, costs and benefits (between public and private sectors, and within and between generations) - who pays for what and what the funding mechanisms should be. It noted that risk-based insurance is likely to become increasingly expensive and/or harder to obtain in high-risk locations, placing pressure on public agencies (and in turn taxpayers and ratepayers) to fill the gap. There is also a concentration of risk in a small number of banks and insurance companies in New Zealand.[118]

The RBNZ has acknowledged the increasing risks to financial stability as a key component of their mandate. The Bank is moving towards a more intensive use of regulation and supervision to ensure the financial system is resilient in the face of increasingly severe and probable shocks.[119] Central Banks in other regions take a leading role in assessing the risk climate change poses to the economy and assisting the financial sector in understanding the potential impacts to their business and to implement risk management strategies.

The Bank of England has also committed to disclose an assessment of how it manages climate-related financial risks in its annual reporting, starting in 2020. This disclosure will align with the TCFD framework, setting out how the Bank integrates climate-related financial risks across its balance sheet and processes.

Potential pathways

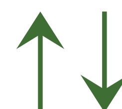
MOVE TOWARDS RISK-BASED INSURANCE PRICING AND MONITOR CLIMATE CHANGE AND OTHER SUSTAINABILITY RISK IN THE FINANCIAL SECTOR

Feedback questions:

- As the financial sector moves to risk-based pricing and factors in climate change, how should society be made aware of the impacts on prices?
- Would actors' value greater pricing transparency, including the impact of mitigation activity?
- What types of support should be put in place to ensure a just and stable transition?
- What is the most appropriate mix of regulation and pricing mechanisms to achieve a higher level of resilience to climate risk, while supporting those who are vulnerable?
- What sort of monitoring processes should be implemented to assess the scale of the risk climate change poses to the economy (e.g. regulator stress-testing and reporting, public climate change risk (TCFD) reporting)?

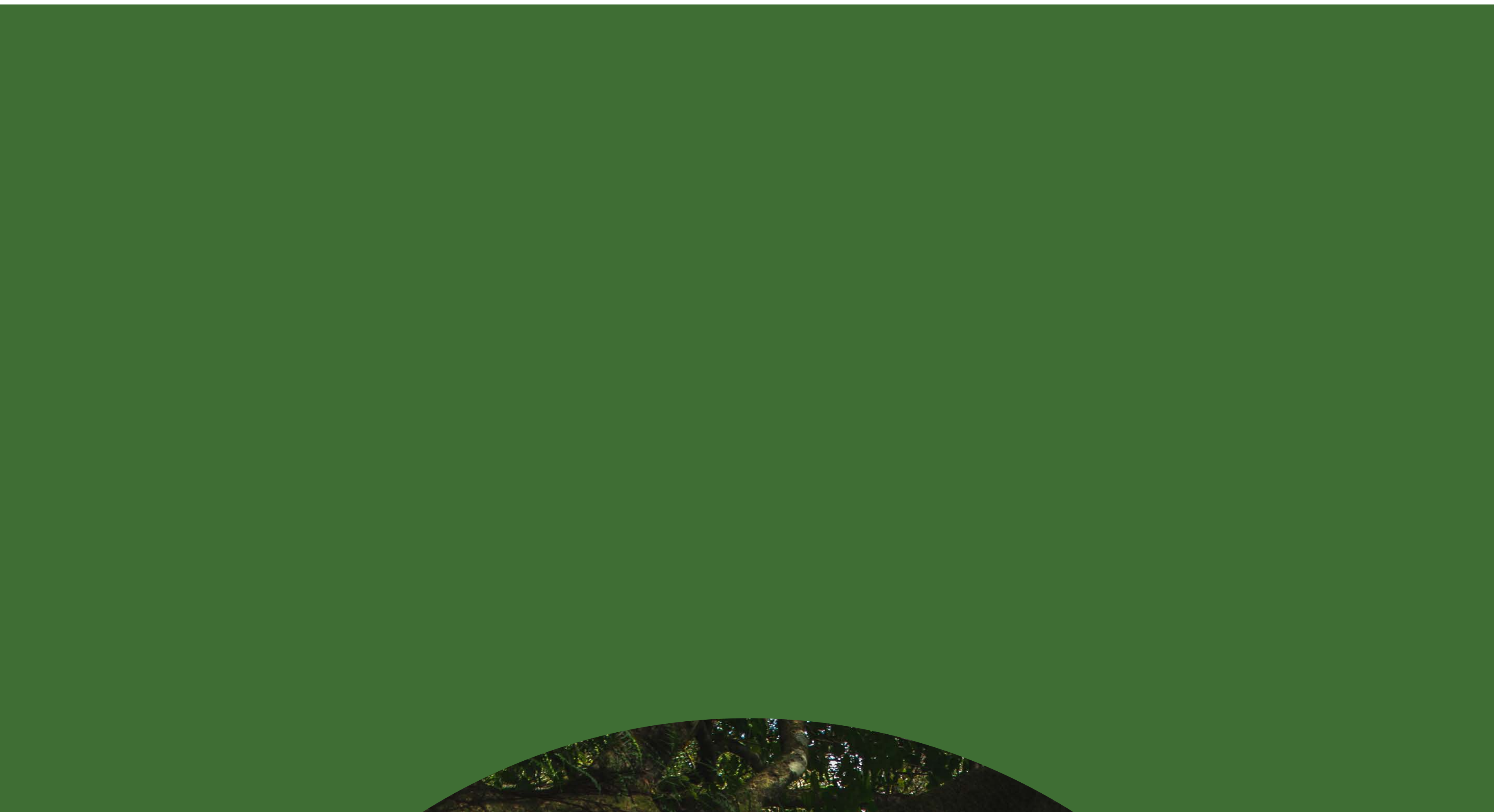
4.7%

reduced cumulative growth estimated in OECD countries, the increase in inequality between 1985 and 2005



people in low risk areas pay higher premiums to subsidise people in high risk areas who have no premium incentive to reduce their risk

Theme 3: Mobilising capital



Defining sustainability

'Greenwashing' is a concern shared by all financial system actors. Developing a credible and objective sustainability 'language', which links to international standards, is necessary to facilitate the effective and genuine flow of capital to positive outcomes. This includes by defining 'green' and 'sustainable' investment.

DESIRED OUTCOME

An internationally recognised and locally applicable sustainability standard which reduces greenwashing and accelerates capital into genuine environmental and social purpose projects.

Key findings

A key challenge for accelerating capital towards sustainable investment is a concern around 'greenwashing'. Greenwashing describes products and assets with claimed green credentials that in reality have little positive environmental (or social) benefit. To reduce this risk, standards are developed and supported by independent verification schemes.

Green and sustainable standards and taxonomies (classifications of what is 'sustainable') have emerged in debt markets. The most established standards relate to the green bond market where two international frameworks have been adopted globally:

- The Green Bond Principles sets out broad categories for green investments, such as energy efficiency, pollution prevention, clean transport and green buildings.[121]
- The Climate Bonds Initiative sets out prescriptive technical criteria (standards) for each sector that aligns with their view of a two-degree economy and leading resilience and ESG design.[122] More recently the EU's Technical Expert Group on Sustainable Finance developed an EU specific Standard and Taxonomy for financing a sustainable EU economy.[123] This has marked a recent move to develop regional based taxonomies that are fit-for-purpose and support the key transition sectors of the region.

These standards and taxonomies provide a green label and are not an indication of 'additionality' (funding projects that go beyond business-as-usual). The labelling aspect is important for investors looking to align their risk profile with sustainable asset classes, but it does not provide a clear signal to philanthropic or impact investors, if the key criteria is additionality.

New Zealand does not currently have a regional view on a preferred standard or a fit-for-purpose taxonomy defining what is 'sustainable'. Currently issuances of green products in the debt markets align to the Green Bond Principles or the Climate Bonds Initiative's Standard. These approaches both have pros and cons. The Green Bond Principles allow flexibility on what is 'green', and verification is optional, meaning the standard is subjective and can increase concerns around greenwashing. The Climate Bonds Initiative's Standard has a set of defined technical criteria and requires verification which provide objectivity and quality assurance. However, the technical criteria do not always align to New Zealand and Te Ao Māori priorities. For example, there are definitions of "green agriculture" emerging through the EU Taxonomy and the Climate Bonds Initiative's Standard. In general, these set out GHG emissions reduction targets over time and specify sustainable farm management practices. Given the regional specification of the sector (e.g. GHG emissions intensity of productivity, water sensitive basins), a global standard may not be the most appropriate for New Zealand and there is an opportunity for New Zealand to lead or influence international taxonomy development in this area.

New Zealand is heavily reliant on international investment and to mobilise the volumes of capital required to address the SDGs, significant additional domestic and international investment is needed. Global investors seeking sustainable investments currently rely on international standards, such as the Green Bond Principles and the Climate Bond Initiative's Standard, to identify potential investments. No corresponding standards are so far available for equity investment. This means it is extremely important that any taxonomy developed or used in New Zealand aligns with international standards to ensure the definition of sustainable is globally recognised. The emergence of the EU Taxonomy is likely to raise the bar on green definitions and over time and the requirements of international investors seeking sustainable investments.

Developing a robust and credible sustainable taxonomy covering environmental and social outcomes, is a complex task. . It also raises questions about striking the right balance in terms of level of detail and measurement required (keeping sight of the big picture). The EU Taxonomy that covers only climate change outcomes in seven sectors spans 414 pages.[124] To scale this across all sectors and all environmental and social outcomes is a monumental undertaking. An effective interim measure could be to develop a "brown" (or high ESG) risk taxonomy. This type of taxonomy can be easier to define and not need to be used to dictate investment. Subject to independent verification, it can then also be used to publicly report against (such as the RIAA certification scheme)[125]. This approach provides public awareness over the types of investments decisions organisations are making and improves internal data and reporting processes. For example, this use of public reporting is mandatory in the UK and Australia where organisations are required to report on the risk of Modern Slavery in their supply chains.[126]

Global Context: EU Taxonomy

The EU Technical Expert Group (HEG) on Sustainable Finance developed the EU Taxonomy in 2019. The purpose of the taxonomy is to accelerate capital into sustainable markets by providing an objective view on 'green'. Projects or organisations that meet the definition of the taxonomy must show a substantial contribution to at least one environmental objective along with no significant harm to other environmental objectives. The taxonomy currently covers climate change mitigation and adaptation, includes seven sectors and can be voluntarily used in both debt and equity markets. The HEG believes the benefits of the taxonomy include: Providing a creditable definition that can be used in investment decision, supporting companies and project looking to raise finance, avoiding greenwashing, translating commitments to the Paris Agreement and the SDG's for investors and rewarding companies undertaking environmentally sustainable activities.[127]

Potential pathways

ENDORSE AN INTERNATIONALLY ALIGNED, AOTEAROA FIT-FOR-PURPOSE SET OF DEFINITIONS FOR SUSTAINABLE INVESTMENTS

Feedback questions:

- Should New Zealand develop a national sustainable taxonomy that would set an objective view of 'green' and 'sustainable' across different sectors to increase investor confidence and accelerate capital? If so, what attributes should this taxonomy have? (e.g. align to other international standards, align to a two-degree future, require independent verification and impact reporting?).
- Should New Zealand develop a brown or high ESG risk taxonomy? If so, should it be voluntary or mandatory to report against it? Should it be just new investments or existing investments? What types of activities should be included (e.g. controversial weapons, brown/black thermal coal mining and electricity generation, high-irrigation agricultural projects in water sensitive basins)?

Scaling positive impact

Currently, only a small percentage of capital is allocated to positive impact investments in New Zealand. We need to scale up, and diversify, the supply of positive impact investment products and services, and improve investibility and access, including through the use of innovative financing models.

DESIRED OUTCOME

Investment is scaled into projects and enterprises which deliver positive social and environmental outcomes (including addressing climate change).

Key findings

Globally, impact investing' is still a niche market but gaining momentum with potential for mainstreaming.[128] The key features of impact investing are: the intent to generate positive, measurable social and environmental impact alongside a financial return and ideally also 'additionality' (e.g. delivery of benefits beyond what would have otherwise occurred). Additional projects generally overcome a characteristic that would otherwise make the investment commercially unattractive (e.g. long-term, small-scale, targeting vulnerable groups, or a new enterprise with limited credit history).[129]

A recent study by the RIAA found that there is a solid foundation of impact investing activity in New Zealand and an increasing number of dedicated funds with strong demand across investor groups, presenting a significant opportunity for the financial sector. To date, the majority of impact investments in New Zealand have been unlisted, illiquid and small in scale and there has been limited focus on 'additionality'. Impact measurement frameworks and methodologies (open source and proprietary) applied vary widely in their sophistication and complexity.

Building scale in positive impact investments is imperative to achieving New Zealand targets, such as the SDGs and the Paris Agreement. Growing the deal pipeline and track record will take time. Currently, deals can be slow and complex and there is a shortage of experience in structuring deals. This can be addressed though building up the ecosystem, including collaboration and sharing of insights. The development of larger deal sizes and increased pipeline will be crucial to achieving growth from institutional investors and retail product issuers. Currently, there is global wholesale product and local small-scale product available to enabling institutional and retail investors to at least tilt their portfolios in a more sustainable direction, by applying positive screens in their investment selection.

To increase the focus on additionality, Government will need to play a significant role, including championing innovative financing structures and introducing fiscal measures, which will improve the risk/return profile and provide grounds for leveraging private funds.

Other measures being explored or applied, in New Zealand or internationally. In the private sector, these include:

- **Social enterprise:** Social enterprises are often profit-making businesses, but they invest the majority of their profit and expenditure in positive outcomes.[130] The social enterprise sector in New Zealand is diverse and growing, with more than 3,500 social enterprises at present.[131] However, currently no defined legal structure exists in legislation, making it difficult for social enterprises to access mainstream capital.
- **Microfinance:** Microfinance is an emerging sector that provides financial services to small businesses and households. This generally involves providing small scale loans at low rates to groups that have issues accessing traditional financial services and is often accompanied by support services to borrowers such as budgeting and business advice.
- **Positive impact funds**: There is scope to increase scale through managed fund settings and sustainable lending requirements (e.g. KiwiSaver default providers could be required to have some focus on positive impact funds) and relaxing liquidity and fee restrictions and allowing multi-provider options would enable greater product choice, including allocation to private markets. Given the predominance of passive investment strategies currently, measures to promote and monitor the quality of 'enhanced passive' index products would assist.

- **Innovative platforms:** Financial sector innovation and technology will also assist in addressing sustainability challenges. New Zealand has benefited from recent innovations including crowdfunding and peer-to-peer lending which extend finance to traditionally uncommercial areas.[132] Online-only investment platforms are another financial sector innovation which provide investment opportunities to a wider audience.[133] These types of products will address some environmental and social issues but could cause their own issues.

Government measures to increase the investibility of additional project being used or explored internationally, include:

- Public Private Partnerships: These are projects which are jointly funded by the public and private sectors. They are typically long-term projects and are commonly used for large infrastructure projects. These types of arrangements reduce public expenditure by leveraging private sector capital and expertise and transferring risk to the private sector. In return, the private sector will invest capital beyond traditional financing horizons with a return based on the operation of asset once built.
- Outcomes payment contracts: Outcomes payment models (also referred to as Payment by Results) are structures used by the public sector to fund projects aimed at reducing a social problem. These arrangements are increasingly structured as outcomes payments contracts, so the service provider's return is based on the evidence-based impact achieved, similarly to social impact bonds.
- Guarantees and credit enhancements (fiscal measures): These are financing structures where Governments, private sector or NGOs provide some form of capital protection to de-risk an investment or provide a tax incentive to improve the return to make it appealing to commercial investors. These are commonly used by international developmental organisations.[134]
- Government funded investment vehicles: Government backed green funds are increasingly used to catalyse finance for untraditional sustainable projects. New Zealand has recently established the Green Investment Fund with $100 million to invest in commercial projects and the newly formed $241 million Endeavour Fund to fund research projects aimed at tackling long term issues. However, the scale of these vehicles is relatively small compared to international comparisons, such as the Australian Government's Clean Energy Finance Corporation (CEFC) which has $10 billion in total funding.[135]
- Using central banks' balance sheets: Innovative ideas are emerging to use central bank balance sheets and asset purchasing programs to drive demand for sustainable investments. The RBNZ's recent purchase of US$100 million in green bonds[136] supports this move and other opportunities exist in this area, including: applying a sustainability screen to liquidity borrowing, credit quotas[137] or interest rate ceilings (which influence the quantity or price of credit from a bank), incorporating sustainability factors into crisis management[138]; and considering how sustainability factors impact on inflation and labour market outcomes.[139]

Potential pathways

SCALE-UP INVESTMENT IN POSITIVE IMPACT PROJECTS AND ASSETS

Feedback questions:

- How can we scale-up businesses and investment funds focusing on delivering positive environmental and social outcomes (e.g. provide a legal structure for social enterprise, provide supportive regulation for micro-finance, remove barriers for positive impact funds)?
- What avenues should be used to scale-up Government investment in sustainable projects (e.g. public private partnerships, credit enhancements, fiscal measures, outcome payment contracts, scaling green investment vehicles, central bank balance sheet)?
- What additional measures can be taken to scale-up investment in positive impact projects and assets?

+3,500

social enterprises in New Zealand

$100m

in funding for the Green Investment Fund

$241m

in funding for solving long term issues (Endeavour Fund)

$100m

RBNZ's recent purchase of green bonds in USD

Inclusiveness

Our current financial system is contributing to growing inequality. Scaling up services targeting under-served groups and improving diversity and consumer protection will improve inclusion.

DESIRED OUTCOME

Suitable and accessible financial products are available to all. Consumers are better protected against unethical behaviour.

Findings

New Zealand has followed international trends of growing wealth inequality. In 2017, 28% of wealth created in New Zealand went to the richest 1% of Kiwis.[140] Between 2013 and 2017, the New Zealand economy grew by 14% per-capita, but average weekly incomes grew by just 6%[141], while rents rose by an average 15-20%.[142] This has been compounded by declining home ownership rates, relatively high youth unemployment, and high baseline child poverty rates — with approximately one in ten Kiwi children living in households experiencing material hardship[143] and one in 100 New Zealanders reported as homeless.[144] Factors adding to inequality include low financial literacy and the lack of suitable financial services for certain groups.

Providing financial products to parts of society that have limited ability to pay or with non-commercial structures is challenging. For example, owners of collectively held Māori land find it difficult to use the land as collateral to raise capital, as commercial banks will not generally lend against shared assets unless specialised structures are created. Historically, commercial service providers targeting underserved sectors have found it difficult to meet increased financial regulatory requirements.[145] To provide financial products to meet the needs of groups underserved by the current system, at the scale required, will require flexibility around organisational structures to blend commercial, micro-finance, philanthropy, and Government funding and support. Several pilot programs are created to target inclusion, but additional support is required to serve a wider audience and gain traction.

Some groups of vulnerable people are further exploited by the financial sector through high interest products, such as payday loans. They can also be provided with poor financial advice. According to FinCap, the interest and fees from high cost loans take $120 million a year out of the household incomes of New Zealanders, disproportionately affecting low-income families and leading to financial hardship and mental and physical health issues.[146] The government is working to update consumer credit laws to provide greater protection, including introducing a daily interest rate cap on loans and total amount repayable limit of twice the amount initially borrowed.[147] If passed this year, the Credit Contracts Legislation Amendment Bill will come into effect from March 2020. Pathways for customers to report the current unethical behaviour of financial service providers exist through the Commerce Commission but it cannot provide legal advice to individuals or act on their behalf to resolve specific issues with a business or person. This is a lower level of customer protection than other regions provide, such as Australia.

Some well understood approaches for reducing inequality have proven to be effective, such as compulsory saving schemes. The annual Global Wealth Report released by Credit Suisse shows strong links between mandatory saving schemes and reduced inequality.[148] For example, Australia's mandatory superannuation system was credited in the report for generating strong pension wealth and a high percentage of financial assets.[149] The current total number of KiwiSaver scheme members is now more than 2.8 million, creating approximately $48 billion in KiwiSaver assets, but active engagement and continued contributions have been issues and voluntary saving contributions are lower than some other regions.[150]

A living wage is an increasingly popular initiative targeted at increasing inclusiveness. New Zealand's incomes are in the bottom half of the OECD (as measured by per capita Gross Domestic Product) but should be in the top.[151] Income level disparities demonstrate social disparities with Māori and Pacific people having lower income levels, on average, than other groups.[152] A living wage is an idea that may provide income necessary to provide workers and their families with the basic necessities of life.[153] The Living Wage in New Zealand has been calculated to be $21.15 per hour for 2019, $3.45 more than the minimum wage currently set by the Government.[154] Since 2012, more than 60 New Zealand businesses have become accredited Living Wage Employers. Other jurisdictions have also led the way. For example, the Scottish Government became an accredited Living Wage Employer in 2011 and has since paid all staff within their pay scheme, including National Health Service staff, a Living Wage.

Case study: Financial products improving inclusiveness

Ngāi Tahu's Incentive Saving scheme Whai Rawa is helping the Ngāi Tahu whānau generate greater wealth and wellbeing.[155] The Whai Rawa managed investment scheme has the goals of improving participation in tertiary education, the levels of home ownership and the levels retirement savings. Since being established in June 2006, Whai Rawa has accumulated more than $88 million in funds from 27,000 members. The scheme offers a range of incentives to encourage savings contributions and limit barriers to access, including:

- Matched savings to encourage members to save for the long term by providing an incentive of 'matching' the amount members save
- Flexible withdrawals for key life events
- Early enrolment incentives for newborns
- Fee reductions

Potential pathways

SCALE-UP MICRO-FINANCE AND SOCIAL ENTERPRISE, ADOPT MEASURES TO ADDRESS INEQUALITY AND INCREASE DIVERSITY, IMPROVE CUSTOMER PROTECTION MEASURES

Feedback questions:

- What types of financial products and services are required to meet the needs of those current underserved by the current financial system (e.g. micro-finance schemes, Māori specific products such as a Māori Bank). What is the best avenue to expand these services (e.g. Government funded schemes, social enterprises public private partnerships)?
- What resources be provided to raise the level of financial capability (e.g. additional resources for the Commission for Financial Capability (CFFC))?
- Are larger structural changes needed to address inequality (e.g. a mandatory Living Wage, increased compulsory saving requirements)?
- Are consumer protection requirements adequate? If not, what additional resources and/or are required?

“We need your feedback and your leadership. We can not afford to wait until compulsion. The opportunity is to start now.”

Next Steps

A period of feedback and consultation will occur between November 2019 and February 2020. This is your opportunity to provide us with your ideas on potential pathways and other ideas to deliver a sustainable financial system.

The feedback survey can be accessed here.

And a link to the on-line feedback form can also be accessed from The Aotearoa Circle website.

Using feedback we receive, the SFF will perform the following activities before providing a Final Report and Roadmap for Action July 2020:

- Continue to engage with Māori and Iwi to consult on how kaitiakitanga and Te Ao Māori aligns with the vision of a sustainable financial system
- Further develop and clarify the potential pathways through:
  - Analysis of the merits and impacts of the potential pathways and the balance between the two
  - Clarification of what the Roadmap for Action map will look like in practice
  - Identification of the mechanisms for implementation, including allocation of accountability and timeframes
  - Engage with key sectors to obtain further insights into sectoral pathways
- Develop measures to monitor the progress (outputs) and success (outcomes) of the SFF, through tracking and evaluation of progress and effectiveness of the implementation of the Roadmap for Action and New Zealand's progress towards the Paris Agreement and the SDGs.
- Develop a governance structure for overseeing the implementation of the Roadmap for Action after the time-bound initiative of the SFF ends.

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