THE BIG PICTURE: CLIMATE CHANGE

What lies ahead in 2021?

May 2021

BELL GULLY

Contents

Introduction — the tipping point

The changing climate and how the world responds to it is the defining issue of this generation. Despite a global pandemic that has resulted in countries closing their borders, an almost complete cessation of international travel, domestic lockdowns and significant business and economic pressures, climate change has continued to be a key concern for governments and businesses alike across the globe.

In the sixth year after the Paris Agreement was adopted in 2015, it is clear the transition to a lower-carbon economy has begun. Since New Zealand declared its net-zero carbon target at the end of 2019, through reform of the Climate Change Response Act 2002, many others have announced net-zero carbon targets for 2050, including the European Union, Japan, Canada, South Africa, and South Korea. China has announced it is aiming for carbon neutrality by 2060. The United States of America, one of the world's three biggest emitters[1], has re-joined the Paris Agreement. Germany and Mexico, along with Japan and Canada, have developed long term plans to decarbonise their economies.

Government declarations are laudable. But global emissions are still high and there is a significant lag time between emissions and the point at which the impacts arising from those emissions are experienced by the global population. Transition action is now what is urgently needed.

Will it come? In New Zealand, at least, the conditions are finally emerging. We believe upcoming mandatory financial reporting on climate-related risks, in conjunction with recommended emissions budgets from He Pou a Rangi - the Climate Change Commission, will prove the tipping point.

The New Zealand framework

In New Zealand, the Government has been pushing through a multi-faceted framework aimed at targeting the transition to a lower-carbon economy. By the end of 2020:

He Waka Eke Noa – the Primary Sector Climate Action Partnership – released its first edition of its *Greenhouse Gases: Farm Planning Guidance* providing a guide for farmers and growers to help them measure, manage and reduce greenhouse gas emissions.

The NZ ETS was reformed, with changes introduced to the Climate Change Response Act 2002 (**CCRA**) to provide for the auctioning of NZUs, a cap on emissions, reform to the forestry-related regimes under the NZ ETS, and the removal of a fixed-price option for meeting one's compliance obligations.

The first National Climate Change Risk Report was released with work underway on the nation's first National Climate Change Adaptation Plan.

The Government established the independent Climate Change Commission, with seven appointed commissioners led by Dr Rod Carr.

The Minister for Climate Change asked the Climate Change Commission to proceed with recommendations on the first three emissions budgets, on the policy direction for the Government's first emissions reduction plan, reviewing New Zealand's first nationally determined contribution and advising on the eventual reductions needed in biogenic methane emissions.

The Government announced its intention to introduce a mandatory financial disclosure regime on climate-related risks to be in effect from 2023 (at the earliest) to capture 90% of assets under management in New Zealand.

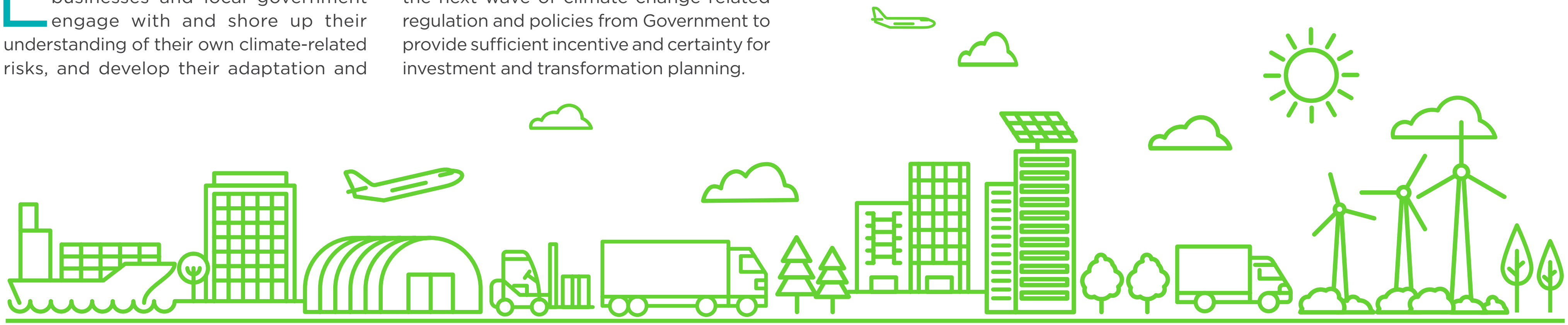
The Government considered the Resource Management's Review Panel's report on resource management reforms and proposed to implement a Climate Change Adaptation Act (**CCA**).

At this point in time the New Zealand Emissions Trading Scheme remains the central tool for mitigation, but the combination of mandatory reporting and national emission budgets should prove a potent addition.

In its draft report, the Climate Change Commission has said that now is the time for action if New Zealand is to play its part under the Paris Agreement. Consultation on the report has seen the pace and manner in which the transition is achieved hotly contested by commentators. But there seems to be little debate that a transition to a lower-carbon economy is needed. This, in itself, is a significant shift in a relatively small number of years.

What's coming this year?

Expect 2021 to be a year in which businesses and local government engage with and shore up their understanding of their own climate-related risks, and develop their adaptation and action plans. This will take place amid the next wave of climate change-related regulation and policies from Government to provide sufficient incentive and certainty for investment and transformation planning.



NOV 2019
Zero Carbon Act passed into law

JUN 2020
NZ ETS reforms passed by Parliament (including enabling a cap on emissions)

AUG 2020
First National Climate Change Risk Assessment released

SEP 2020
Government announces plans for mandatory climate-related risk reporting

JAN 2021
Climate Change Commission releases its draft advice report on reducing emissions and first proposed three 5-yearly emissions budgets

FEB 2021
Government announces plans for RMA reforms, including a new Climate Change Adaptation Act

MAR 2021
Consultation on Climate Change Commission's draft advice closed.

First auction of NZUs held

MAY 2021
Climate Change Commission provides final advice to Minister on 5-yearly emissions budgets, and on change needed to nationally determined contribution (NDC) under Paris Agreement

END-2021
Minister sets first three 5-yearly emissions budgets.

COP-26 held – potential that New Zealand will propose a new NDC

2022
First National Adaptation Plan to be published by August 2022

2023
Earliest date at which mandatory climate-related risk reporting would be required

BELL GULLY

The Climate Change Commission — Aotearoa is not on track

The Climate Change Commission released its **Draft Advice to the Government** for public consultation on 31 January 2021. By the close of its consultation period at the end of March, the commission had received more than 15,500 submissions. It is now working its way through this wave of feedback in order to prepare and present its final advice to Government by the end of May.

All eyes will be on that final advice, and the Government's reaction, because the Commission's draft advice came with a warning.

> "Current government policies do not put Aotearoa on track to meet our recommended emissions budgets and the 2050 targets."
>
> **He Pou a Rangi - the Climate Change Commission**
>
> 2021 Draft Advice

New Zealand's international commitment

If Aotearoa is to play its part to limit global warming to 1.5°C above pre-industrialised levels, our commitment to reduce emissions needs to change from 30%, to more than 35% below 2005 levels by 2030. This goes further than the reduction to New Zealand's domestic emissions budgets proposed by the Commission.

In the meantime, the Government already appears to be proceeding with a number of climate actions consistent with the Draft Advice, with its recent **Climate Action Announcement** on 8 April 2021 banning new low and medium temperature coal-fired boilers, the provision of a Decarbonising Industry Fund to help the private sector to transition away from fossil fuels, and funding the transition of several public sector organisations (schools, district health boards and tertiary education institutes) from fossil-fuel options for the generation of process heat.

The clock is ticking: The CCRA sets out the process for considering and responding to the Climate Change Commission's advice and recommendations on emissions budgets, imposing a number of deadlines.

31 May 2021
Final package of advice due to the Government

Within 10 working days
Minister of Climate Change must table the advice in Parliament

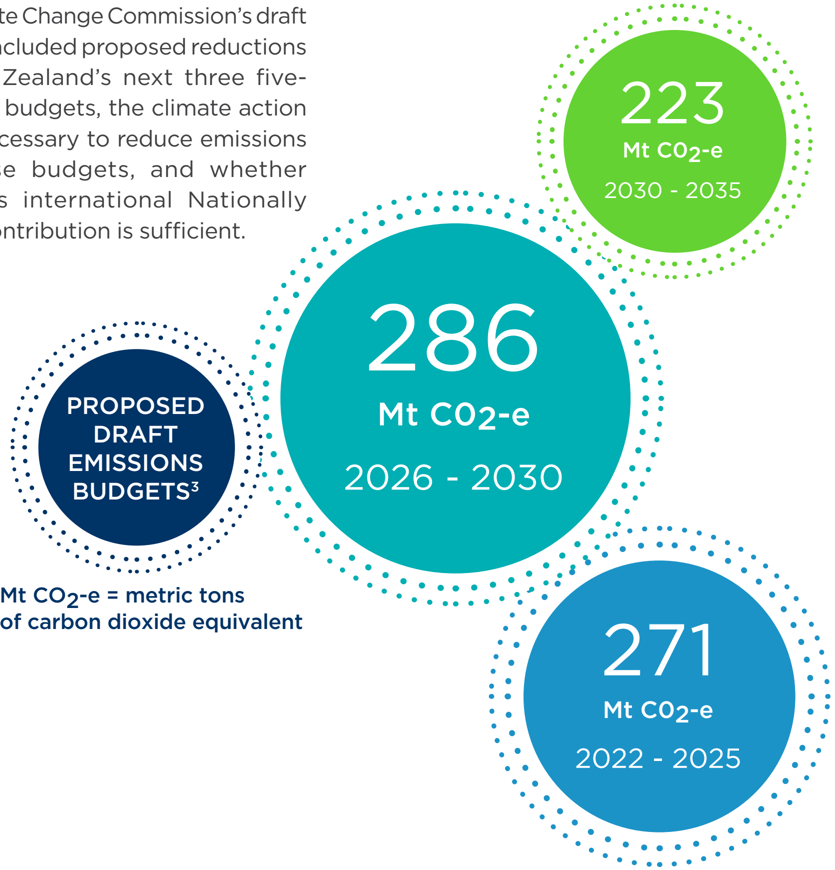
28 June 2021
Climate Change Commission must release the advice publicly

31 Dec 2021
The Government must have set the first three emissions budgets (to 2035) and release its first emissions reduction plan[2]

From 2022
The Commission to begin a new work programme to monitor implementation of its advice, including tracking against the 2050 net zero target

The Climate Change Commission — what transition looks like

The Climate Change Commission's draft advice included proposed reductions to New Zealand's next three five-year emissions budgets, the climate action it considers necessary to reduce emissions to meet those budgets, and whether New Zealand's international Nationally Determined Contribution is sufficient.



Mt CO_2-e = metric tons of carbon dioxide equivalent

> "Aotearoa will not meet its targets without strong and decisive action now to drive low emissions technologies and behaviour change across all sectors."
>
> **He Pou a Rangi - the Climate Change Commission**
>
> 2021 Draft Advice

TRANSITION BY SECTOR[4]

TRANSPORT

- An integrated national transport network to reduce private vehicle travel
- EVs widely adopted with Government support and incentives
- Freight moved to rail and shipping
- Use of low carbon fuels – hydrogen and biofuels – for heavy trucks, trains, planes and ships

HEAT, INDUSTRY & POWER

- End coal use
- Maximise the use of electricity, including for EVs and process heat
- More solar, wind and geothermal required
- Use low emissions technologies and prioritise energy efficiency when building homes
- Over the longer-term, reduce natural gas use in homes and businesses

LAND USE

- Government needs a cohesive strategy that includes water, biodiversity and climate
- Farmers need to make changes to lower emissions, while maintaining or improving productivity
- Policy support for greater farming efficiency – reduced animal numbers and better animal, pasture and feed management, plus adapted and improved land use (lower emissions practices and technologies)
- Forestry plays a role but is not the sole solution
- Pine has an important role to reach the 2050 target, provides material for bioenergy and building
- Incentivise native forests for long-term carbon sinks and wider biodiversity and erosion control benefits
- Government to better understand potential of existing forests, small tree blocks, wetlands and soils in storing carbon

WASTE

- Strengthened product stewardship
- Commitment to resource recovery and reuse
- Capture methane from remaining landfill waste

BELL GULLY

NZ ETS: regular evolution and refinement

The New Zealand Emissions Trading Scheme remains one of the Government's key policy responses to climate change. Recent amendments to the CCRA, and pending regulatory change, demonstrate the Government's desire to continue to evolve and refine the NZ ETS settings, to ensure emissions pricing plays its critical part within a complementary set of policies and measures to drive the move to a low-emissions economy.

Material amendments

The Government is currently consulting on what it refers to as technical changes to the emissions trading scheme and synthetic gas levy regulations. However, while these changes may be technical in nature, the Ministry for the Environment's **Consultation on the 2021 Proposed NZ ETS Changes** points out that a number of the changes are significant indeed for those involved in the NZ ETS.

Under 2019 and 2020 amendments to the CCRA, the Government is required to consider and update the unit limit and auction price control settings on an annual basis. This is the first year these settings will be updated. The challenge is this regulatory process is being carried out in parallel to the finalisation of the Climate Change Commission's Advice and the Government's consideration and response to the recommended emissions budget settings and other policy recommendations in that Advice.

For now, the Government is proposing to continue the zero limit on the importation and use of international emissions units in the NZ ETS. It is also seeking feedback, based on the Climate Change Commission's draft recommendations, on changes to the price and NZU volume settings for auctioning, highlighted in the table.

These proposed options seek to marginally reduce the volume of NZUs released into the market by the Government and to retain strong emissions pricing for such auctions. Combined, the options related to the Climate Change Commission's draft recommendations more strongly encourage transition to a low-carbon economy.

ANNUAL AUCTION VOLUMES UPDATE FOR EACH OPTION

Two options for reduced annual auction NZU volumes[5]

OPTION	2021	2022	2023	2024	2025	2026	22-26 TOTAL
STATUS QUO	19.0	19.3	18.6	17.2	15.5		
OPTION 1		19.3	18.6	16.4	16.4	14.0	84.7
OPTION 2		19.5	18.3	16.4	16.4	14.0	84.6

PRICE FLOOR[6]

Materially increasing the price floor for nzus in the government's auctions

SETTING	2021	2022	2023	2024	2025	2026
STATUS QUO	$20.00	$20.40	$20.81	$21.22	$21.65	$22.08
COMMISSION DRAFT ADVICE		$30.00	$32.10	$34.35	$36.75	$39.32

CCR TRIGGER PRICE[7]

Materially increasing the cost containment reserve trigger price

TRIGGER PRICE	2021	2022	2023	2024	2025	2026
CURRENT	$50.00	$51.00	$52.02	$53.06	$54.12	$55.20
COMMISSION DRAFT ADVICE		$70.00	$78.40	$87.81	$98.34	$110.15

NZ ETS: regular evolution and refinement

A number of the other proposed amendments or options being considered will directly affect (and likely increase) some organisations' compliance liability under the NZ ETS and for the importation of synthetic gas.[8]

SGG LEVY

Update the schedule of goods covered by the SGG levy to capture imported goods containing currently unlevied SGG blends.

INDUSTRIAL ALLOCATION

Update the electricity allocation factor used in industrial allocation to more accurately reflect wholesale electricity pricing.

WASTE

Improve the methodology that accounts for waste in the NZ ETS – these amendments present options to manage the increasing risks to closed landfills from flooding and erosion and the need for some such landfills to be excavated and waste disposed of elsewhere to address these risks.

DEFs

Update default emissions factors (DEFs) for waste and natural gas fields, and update other DEFs and reference data to reflect new global warming potentials.

New rules will impact the NZUs a forester can earn

Significant evolution of the post-1989 forestry regime was agreed with the passing of the Climate Change (Emissions Trading Scheme Reform) Amendment Act 2020. The new averaging accounting and permanent forestry regimes are due to come into effect on 1 January 2023. The Government expects this will lead to around 78,000 hectares of new commercial forests being planted between 2019 and 2027 – critical to enable New Zealand to meet its international emission reduction targets for 2030 and 2050.

The forestry regulations containing much of the detail underpinning the carbon benefits and risks are currently being developed, with a number of the proposed settings being the subject of consultation – see the Ministry for Primary Industry's **Additional proposed amendments to the Climate Change Forestry Sector Regulations 2008** which closed on 9 April.

The pending regulations will set out the proposed age band, average forest age and multiple rotation frameworks which directly affect the amount of NZUs a forest will earn – or alternatively, will have to be surrendered. They also set out the rules around when a party will be eligible for relief from surrender liability, for land subject to a temporary adverse event. The Government expects these settings will, over time, impact the operational management of such forests. The working theory is that the increasing carbon price and proposed settings around age, age band and rotations will on one hand disincentivise short rotations for plantation forests, and on the other, encourage the establishment of long-term carbon sinks under the permanent forestry regime.

NZU auctions

The NZU auction system is up and running, with the full quantum of NZUs selling in the first auction at a relatively modest price.

The Government marked another significant milestone in the history of New Zealand's Emissions Trading Scheme (**NZ ETS**) on the morning of 17 March with the first auction of New Zealand units (**NZUs**). At 9am, Minister for Climate Change James Shaw rang the "NZX bell" in Wellington, to formally open the bidding window for the highly anticipated auction.

The auction results saw a strong uptake from key sectors of the New Zealand economy, with all 4.75 million NZUs offered sold at a clearing price of NZ$36. The NZ$36 clearing price sits below the Carbon Market's last pre-auction trade at NZ$38.70, but higher than the Government's fixed price option of NZ$35, foreshadowing a strong appetite for exercising the fixed price option among those able to do so while it remains available.

There were a total of 40 participants in the auction with 30 of those bidders successful on the day. Feedback on the first auction for NZUs highlighted the high level of interest and involvement from major sectors of New Zealand including manufacturing, transport and forestry. It was considered a success.

Auctioning of NZUs makes up one of a suite of reforms to the ETS introduced in June 2020 under the Climate Change Response (Emissions Trading Reform) Amendment Act. Auctions have been introduced to align the supply of emissions units in the NZ ETS with New Zealand's emissions targets and five-yearly budgets. The supply of NZUs up for auction is intended to reduce over time to assist in achieving the budgeted levels.

For more information on foundation and operation of NZU auctions see: **Planning to purchase auction NZUs? Simulated test auctions to run this month.**

Mandatory climate-related disclosure

New Zealand has become the first country in the world to introduce legislation requiring mandatory climate-risk reporting for the financial sector. The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill was introduced to Parliament in April, and is now subject to Select Committee consultation. The Financial Climate-related Disclosures Bill outlines the reporting required by 'climate reporting entities', which represent the majority of assets under management in New Zealand. They include:

- **All registered banks, credit unions, and building societies with total assets of more than NZ$1 billion**
- **All managers of registered investment schemes with greater than NZ$1 billion in total assets under management**
- **All licensed insurers with greater than NZ$1 billion in total assets under management or annual premium income greater than NZ$250 million**
- **All equity and debt issuers listed on the NZX**

Overseas incorporated organisations will also be required to make disclosures if their New Zealand business exceeds these thresholds

DISCLOSE

Ensure the climate reporting entities disclose clear, comparable, and consistent information about the risks and opportunities presented by climate change

DEMONSTRATE

Help climate reporting entities better demonstrate responsibility and foresight in their consideration of climate issues

CONSIDER

Ensure that the effects of climate change are routinely considered in business, investment, lending and insurance underwriting decisions

TRANSITION

Lead to more efficient allocation of capital, and help smooth the transition to a more sustainable, low emissions economy

The new legislation is framed as a disclosure regime. But its ultimate purpose is to promote a more efficient allocation of capital in light of the potential impacts of climate change, to help with the transition to a sustainable and low-emissions economy, and to ensure that companies consider and understand the financial impacts of climate-related risks and opportunities. This reflects the Taskforce on Climate Related Financial Disclosures (TCFD's) view that climate-related disclosures will promote a greater understanding of the financial implications associated with climate change and potential climate-resilient solutions, opportunities and business models for companies.

Mandatory disclosures — picking up the pace

The new mandatory climate-related disclosure regime is one of a trio of developments that, taken together, are expected to drive real change towards a low-emissions economy. The others are the **draft advice issued by the Climate Change Commission** which urges the Government to pick up the pace to comply with the Zero Carbon Act's target of achieving net zero emissions by 2050, and the proposed changes to the resource management legislation, which will involve the introduction of a new Climate Change Adaptation Act.

Mandatory reporting of climate-related risks will be carried out through climate statements consistent with yet-to-be-developed climate standards, and audited by approved climate-related disclosure assurance bodies.

The reporting standards will be issued by the XRB, which will align with the recommendations made by the TCFD (widely accepted as international best practice for climate-related financial reporting). In line with the TCFD's recommendations, the mandatory climate-related disclosures are likely to focus on **four core areas of business operations for climate reporting entities.**

If the Financial Climate-related Disclosures Bill is passed by Parliament, climate reporting entities will be required to make disclosures for their financial years beginning in 2022, with the first climate statements expected to be delivered in 2023. As a result, from early next year, climate reporting entities may need to maintain records of the information required to be disclosed.

The Financial Climate-related Disclosures Bill takes a comply-or-explain approach to disclosures. Climate reporting entities must either comply with the applicable reporting standards, or if not, explain why not. Failure to comply could attract a range of penalties, ranging from fines of up to NZ$50,000 for infringement offences, to NZ$500,000 for individuals or NZ$2.5 million for reporting entities for more serious breaches. Individuals also face the possibility of imprisonment for a term not exceeding five years.

REGULATORS OFFER GUIDANCE

Both the NZX and the FMA released guidance on climate-related reporting and disclosure before the release of the Financial Climate-related Disclosures Bill. This guidance continues to apply.

NZX GUIDANCE

The NZX Corporate Governance Code, updated in December 2020, recommends that issuers should provide non-financial disclosures at least annually, including considering environmental, economic and social sustainability factors and prices.

The NZX also has a specific guidance note on ESG reporting that addresses the significance of climate change reporting for issuers, and notes that such reporting informs the over-arching long-term strategic view of business.

FMA GUIDANCE

The FMA states, in guidance updated in December 2020, that in line with its role as a financial markets conduct regulator, it supports the transition to an integrated financial system that considers non-financial risks (including climate-related risks). The FMA notes that it has a focus on encouraging boards and directors to identify, consider and adequately disclose climate risk (including through TCFD / mandatory climate-related disclosure).

In a speech in February this year, FMA CEO Rob Everett stated that the FMA is working together with XRB and other government agencies to prepare for the new regime on climate-related financial disclosures, as the relevant regulator for that area.

International pressure

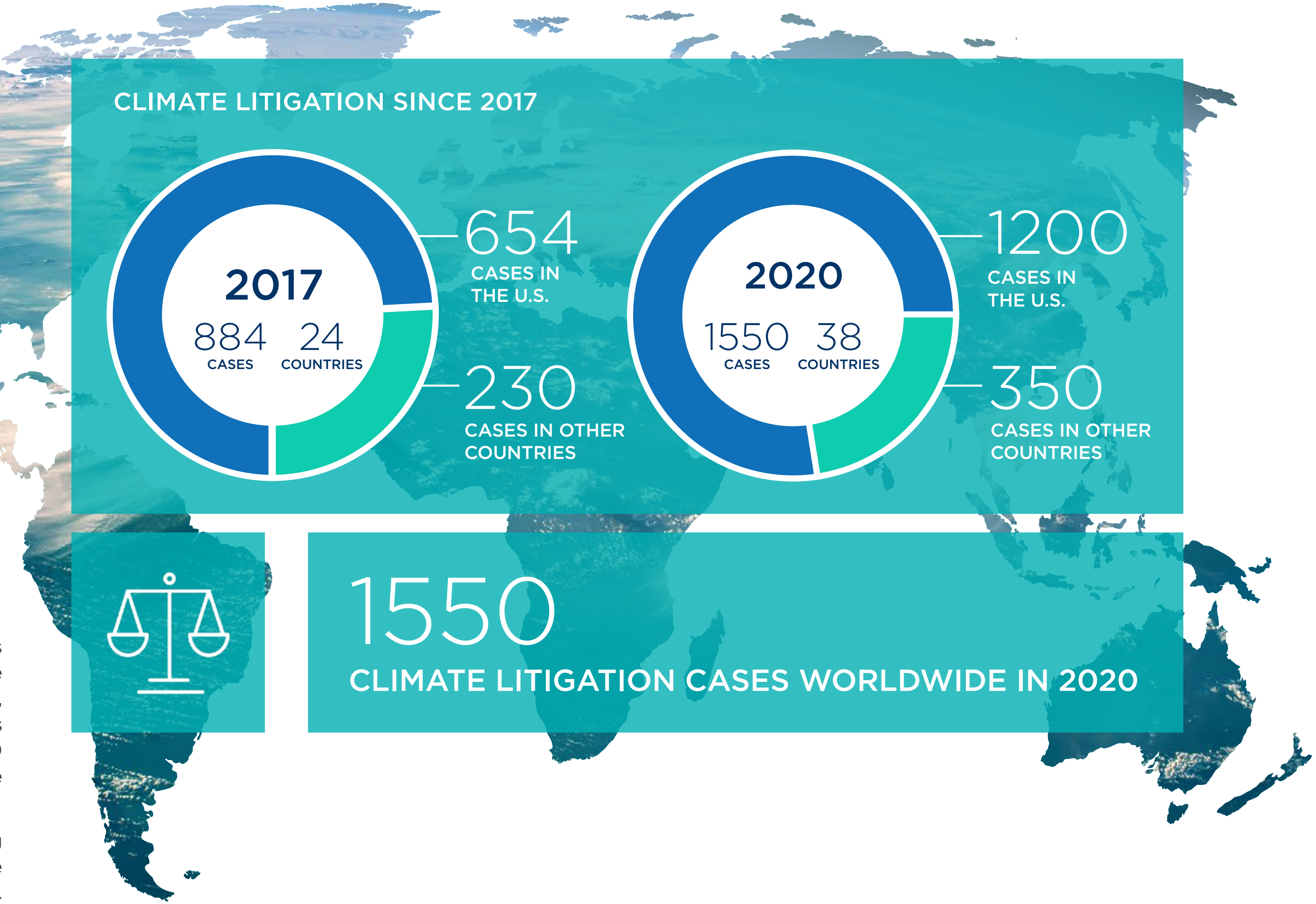
Globally we are seeing an increase in shareholder, investor and funder pressure for businesses to disclose their climate-related risks, along with climate action or transition plans to reduce or remove their business exposure to those risks. In March, Bloomberg Green reported on four key developments across the EU in just one week[9] as businesses acted to reduce exposure to climate risk and regulation was introduced to increase transparency on climate risk. On the face of it, none of these decisions reduce greenhouse-gas emissions. But together, they demonstrate that Europe's largest financial institutions appear to be serious about fighting climate change.

- The biggest Nordic bank, Nordea AB, said in March that 140 of its funds would tighten requirements around fossil fuel companies[10] and would only invest in companies on a "green transition path". Most of Nordea's funds – over 200 in total, representing 120 billion euros of investment – are now aligned with the stricter fossil-related restrictions.
- The largest French insurer, Axa SA, set a precedent for the global insurance industry. Axa SA has dropped RWE AG, one of Europe's biggest coal mine operators, as its client because of RWE's reliance on coal[11]. Globally coal use for generating electricity must fall significantly to help achieve Paris Agreement targets.
- HSBC Holdings Plc tabled a resolution on climate change[12] at its annual shareholder meeting after a number of shareholders proposed to table their own climate change resolution. HSBC had already set out a goal last year to reduce emissions in its operations and supply chain to net zero by 2030, and align its financed emissions at a portfolio level to net zero by 2050 or sooner. The resolution set out the next phase, including working with customers to support their transition – and publishing a policy by the end of the year to phase out financing of coal-fired power and thermal coal mining in the EU and OECD markets by 2030, and in all other markets by 2040.
- The EU introduced new rules to counter 'greenwashing' with its Sustainable Finance Disclosure Regulation taking effect on March 10[13]. It said the regulation is aimed at triggering changes in behaviour in the financial sector, discouraging greenwashing, and promoting responsible and sustainable investments.

Closer to home 2020 saw stakeholder-initiated climate change litigation in New Zealand seeking court-orders against a number of New Zealand businesses to reduce emissions activity. While the court didn't support the primary action in this case, similar cases in neighbouring Australia resulted in settlements that have seen the adoption of more transparent climate-related risk reporting and climate action plans.

As we head into COP26 in November in Glasgow, Scotland, with a key focus on climate finance, there is an expectation more governments, corporates and investors around the world will announce new initiatives to address climate risks and responding to climate change. Whether these announcements are merely rhetoric or give rise to real emission reductions is yet to be seen. It will likely depend on the level of regulatory requirements and associated stakeholder pressure for emissions transparency and compliance, risk disclosures, adaptation, and carbon retreat. Real reduction will also hinge on the climate finance, carbon and insurance price signals necessary for the balance sheet decisions that will enable the change required.

Climate litigation on the rise



Across the media and academia, it's being described as 'climate change lawfare'. In the past three years, the number of climate litigation cases has nearly doubled worldwide, to reach 1,550 cases across 38 countries, according to the United Nations Environment Programme[14].

Globally, the courts are increasingly grappling with plaintiffs seeking faster action on climate change or rulings on particular local impacts.

Climate litigation — key New Zealand cases

In New Zealand, a trio of recent cases stand out for their implications for government and businesses.

Smith v Fonterra Co-operative Group Limited and others (2020)

Seven large domestic emitters faced a claim they had been negligent or breached other legal duties by emitting greenhouse gases, and seeking orders requiring them to achieve net zero carbon emissions by 2030. In the High Court, two of the three causes of action were struck out, but the Court was unwilling to strike out the prospect of a novel tortious duty of care (though noting such a claim faced significant hurdles). An appeal was heard in February and judgment is awaited.

Hauraki Coromandel Climate Action Inc v Thames-Coromandel District Council (2020)

The High Court quashed a decision by the Thames-Coromandel District Council not to approve the mayor signing the Local Government Leaders' Climate Change Declaration - which she viewed as a potentially binding document, although its originator Local Government New Zealand did not. The case demonstrates that decisions by public bodies regarding climate change are likely to be considered significant decisions and, in certain contexts, can be the subject of close judicial scrutiny. The case also makes clear that decisions based on misinformation or a blanket denial of climate change may well be considered unreasonable by the Courts.

All Aboard Aotearoa Inc v Waka Kotahi (2021)

A coalition of climate and transport advocacy groups applied in the High Court for the judicial review of decisions by Waka Kotahi/NZ Transport Agency and the Government to fund and build the Mill Road roading project. The group, incorporated under the name All Aboard Aotearoa, is made up of Generation Zero, Lawyers for Climate Action, Bike Auckland, Women in Urbanism, Movement and Greenpeace and seeks to decarbonise transport in Aotearoa by 2030.

BELL GULLY

Climate litigation — key Australian cases

Internationally, while the acceleration in cases is most evident in the U.S., there have been two significant decisions for New Zealand businesses and directors out of Australia.

Abrahams v Commonwealth Bank of Australia (2017)

Two shareholders brought a claim against CBA for failing to address climate change risks in its 2016 annual report. They alleged CBA breached obligations under the Corporations Act to give a true and fair view of the financial position and performance of the company. They dropped the case after CBA changed its 2017 annual report to include an acknowledgement that climate change posed a significant risk to the bank's operations, and promised to undertake climate change scenario analysis on its business.

McVeigh v Retail Employees Superannuation Trust Pty (2020)

This claim was brought by a beneficiary (McVeigh) against a superannuation scheme trustee (REST), alleging that REST breached its duties to act with care, skill and diligence, act in the best interests of the beneficiaries, and exercise due diligence, because it had not carried out an assessment of climate change risks for the superannuation fund. It was settled in November 2020, at which time REST acknowledged the position of the Task Force on Climate-related Financial Disclosures (TCFD) that climate change is a material, direct and current financial risk to the superannuation fund across many risk categories. REST committed to taking further steps to manage and disclose climate-related risks.

CORPORATE GOVERNANCE THE NEXT FOCUS?

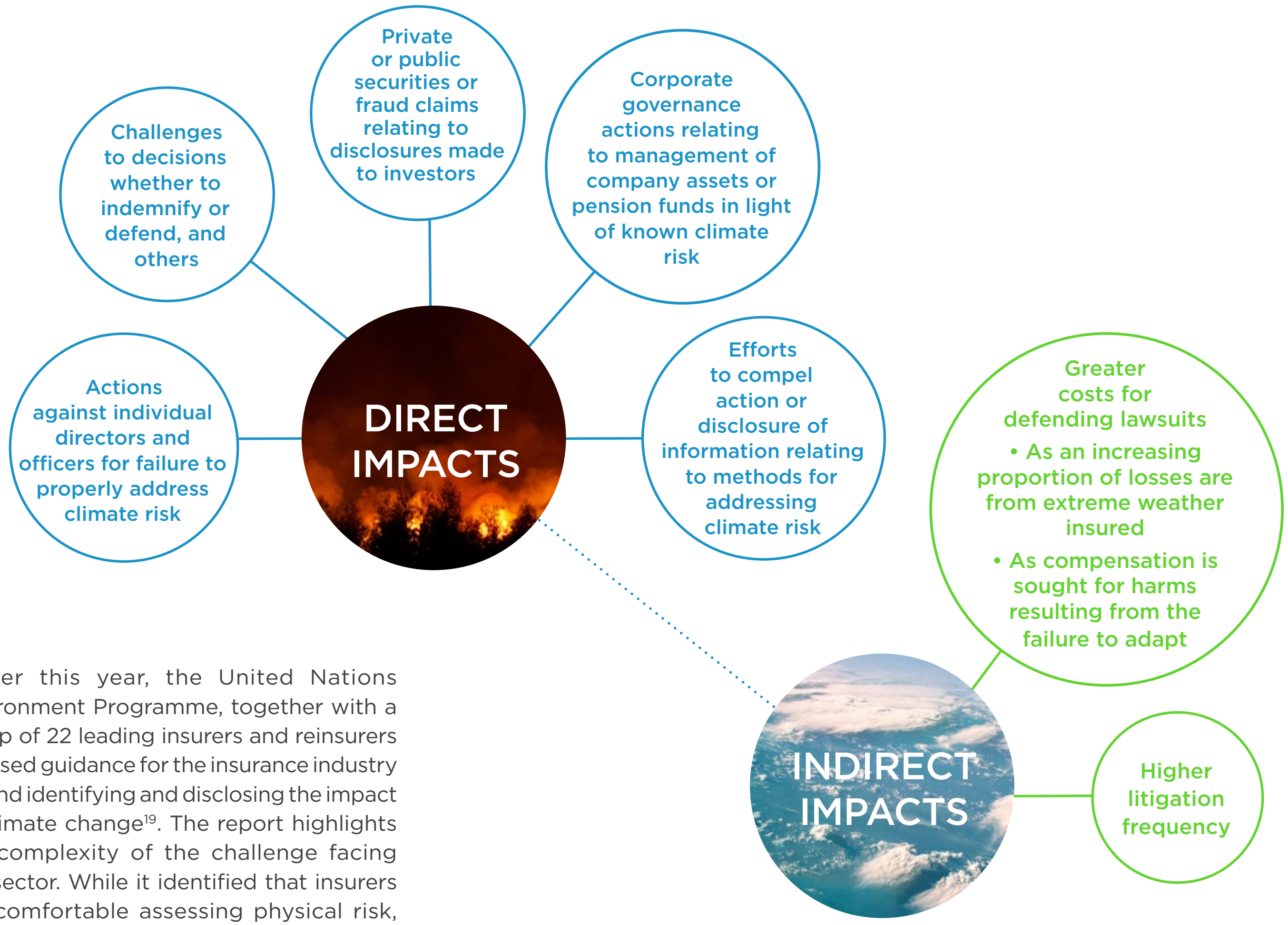
Local directors eyeing international climate cases that seek to hold companies to account through corporate governance and company law should note a thorough exploration of the key concepts in a 2019 paper[15] by Chief Justice Helen Winkelmann and two judges of the Supreme Court of New Zealand, Susan Glazebrook and Ellen France. That paper, Climate Change and the Law, highlights corporate governance as an area of potential development in which directors' duties may become a pathway through which companies are required to consider and address climate change.

Fire and flood — the insurance risk

Insuring climate-related risks is becoming harder and more expensive. As a group, insurers already have a sharp focus on the increased risks arising from climate change. The Insurance Council of New Zealand has been reported as welcoming the pending mandatory climate change reporting on the basis that is it very important for insurers to be able to identify the extent of their climate risk exposures[16]. In New Zealand and Australia, insurers are influenced by recent experience with the impact of changing weather patterns, ranging from bushfires to flooding. Reinsurers' appetite for risk in this part of the world will also play a material part in the availability, and cost, of cover for those exposed to climate risks.

A particular focus in New Zealand, with over 15,000 kilometres of coastline, is sea level rise. A research report released late last year for the Deep South National Science Challenge, Insurance Retreat, found homes with a 1% probability of coastal inundation could face a partial insurance retreat from 2030, with full retreat for at least 10,000 properties in Auckland, Wellington, Christchurch and Dunedin considered likely by 2050[17]. In response, the Insurance Council of New Zealand told media it expected companies would keep covering existing customers – at higher premiums and excesses – but might decline new customers in risky places[18].

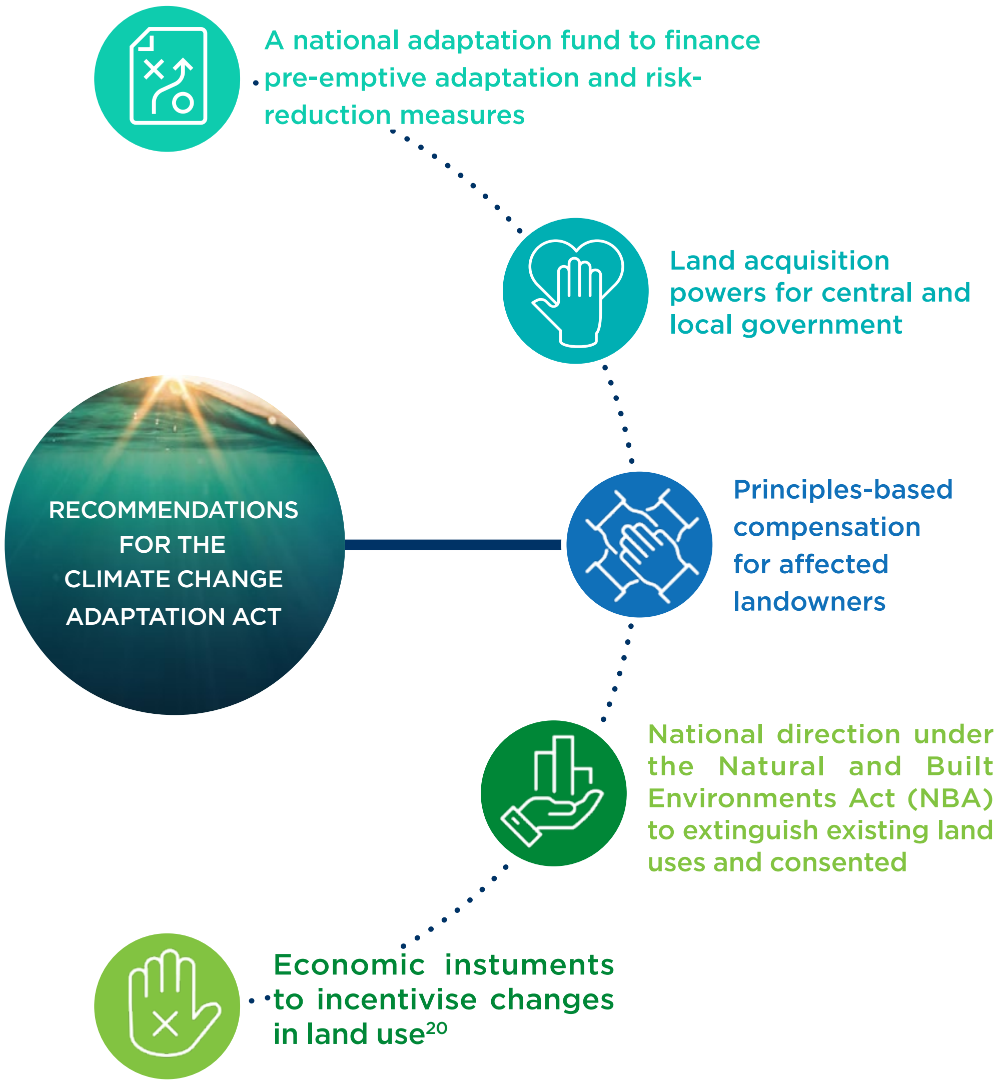
Earlier this year, the United Nations Environment Programme, together with a group of 22 leading insurers and reinsurers released guidance for the insurance industry around identifying and disclosing the impact of climate change[19]. The report highlights the complexity of the challenge facing the sector. While it identified that insurers are comfortable assessing physical risk, the report found they had not yet placed significant focus on litigation risks. Those risks may impact the companies themselves, their products and their insured clients.



Source: United Nations Environment Programme - Insuring the Climate Transition

BELL GULLY

Managed retreat — waiting and watching



New legislation to address managed retreat and climate change adaptation is in development. While the legislation's structure can be anticipated, little is known about how it could be implemented as yet. With significant policy work still needed and the Government keeping its cards close, we look at what can be learned from real-world examples for an indication of what might lie ahead.

A national approach

The Government will introduce the new legislation as part of a wider package of resource management reforms announced in February 2021 following the release of the Resource Management Review Panel's report last year.

If the Panel's recommendations are implemented, the new Climate Change Adaptation Act (CCA) will provide a national-level approach to managed retreat.

High stakes

A robust approach to managing climate-related inundation is necessary. With 75% of the New Zealand population living within 10km of the coast[21], over 10,000 coastal properties in Auckland, Wellington, Christchurch and Dunedin are at risk of full insurance retreat by 2050[22].

Some NZ$14 billion of local government assets alone are at risk from estimated sea level rise[23].

But managed retreat is a complex and often fraught area. There will be many differences of opinion on how risk is best managed – and who should pay the cost.

For a definitive answer on how the Government proposes to implement the Panel's recommendations in practice, we will have to wait until the CCA and NBA are introduced into Parliament. Climate Change Minister James Shaw has acknowledged that significant policy work is still required before that can happen[24], and has been reluctant to give any indication on a preferred view for fear of influencing market and landowner behaviour[25].

But with managed retreat already occurring, it is possible to draw on local and international examples to anticipate how the CCA might take shape. Real-world managed retreat suggests a potential package of mechanisms ranging from targeted rates to fund adaptation solutions[26], to rolling easements to roll-back coastal access in line with sea level rise[27]. Overseas, local authorities have been given the power to convert private coastal land from freehold to leasehold – essentially giving owners an end date to their legal right to remain on the coast[28]. In Matatā on New Zealand's east coast, a local council is using existing planning rules to extinguish existing use rights, as envisaged in the proposed NBA.

Managed retreat — high stakes

Case study: Matatā — Bay of Plenty[29]

In May 2005, heavy rainfall flooded the Awatarariki Stream causing 300,000m^2 of rock, wooden debris and mud to flow through the Matatā peninsula township in the western Bay of Plenty. An estimated NZ$20 million of losses resulted, with 27 homes destroyed and 87 other properties damaged.

The Whakatāne District Council calculated that the return period for a similar debris flow was 40-80 years, and that the only viable option to prevent an unacceptable fatality risk was to implement rapid managed retreat from the most affected area.

As a result, the Council introduced two plan changes to extinguish the existing use rights of 21 homeowners by the end of March 2021, and to prohibit all future residential development for an additional 24 properties. A $15 million compensation fund was separately established to purchase the 21 properties at current market value, with no discount for the known hazard risk.

Despite opposition from residents, the plan changes were approved by an independent hearings panel and all but one of 21 homeowners settled with the Council before their appeal in the Environment Court. The Court ruled that the last family could remain in their home for one more year, until March 2022, subject to strict conditions to protect their health and safety.

Next steps

The CCA is expected to be developed in parallel with the NBA and the Strategic Planning Act (SPA) throughout the course of this year[30]. Engagement with iwi/Māori and local government will occur in early 2021 and public consultation at the end of 2021[31]. A bill will then be introduced alongside the NBA and SPA by December 2021, and will go through a full select committee process.

BELL GULLY

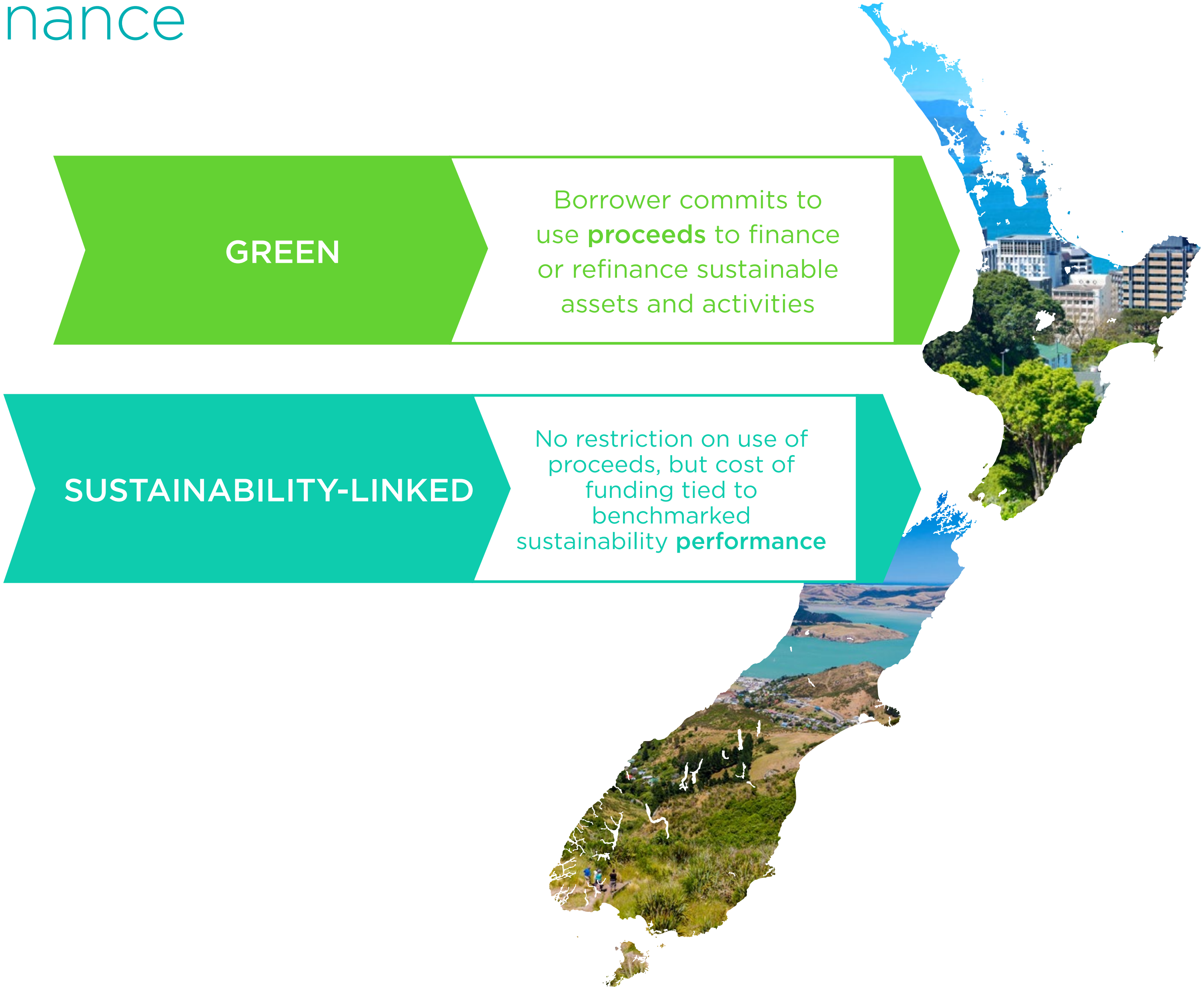
Sustainable finance

Sustainable financing is on the rise in New Zealand's loan and bond markets. As at March 2021 NZ$2.4 billion of green bonds are listed on the NZX[32] - but with global cumulative green bond issuance tipping over US$1 trillion in December 2020[33], there's clear scope for growth.

Climate change is of course a key driver of this trend, but there are also other forces in operation, including corporate sustainability strategies reflecting social and reputational pressures. Sustainable finance allows corporates to align their financing with those strategies and pressures, and meet demands from investors with environmental social governance (ESG) mandates.

A range of sustainable financing products have developed in New Zealand, the most prominent being "green" bonds and "sustainability-linked" loans.

The dramatic rise in issuance of green and sustainability-linked debt products both in New Zealand and globally has attracted attention, and there have been some notable developments in New Zealand and internationally over the past year.



Sustainable finance — the guidance

REGULATORY & INDUSTRY GUIDANCE

A good range has been published internationally and in New Zealand

Sustainability Linked Loan Principles

The APLMA, LMA and LSTA together published Sustainability Linked Loan Principles (together with guidance), which are voluntary guidelines designed to preserve the integrity of the sustainability-linked loan market

MAY 2020

Green Loan Principles

The APLMA, LMA and LSTA updated their Green Loan Principles (together with guidance), which provides a voluntary framework of market standards to promote consistency in the green loan market.

FEBRUARY 2021

Sustainability-Linked Bond Principles and Social Bond Principles

The ICMA issued this publication, setting a similar standard for the sustainability-linked and social bond markets.

JUNE 2020

Disclosure framework for integrated financial products

This publication by the FMA is for issuers of financial products that incorporate non-financial factors, including environmental, social and human capital impacts.

Its aim is to ensure investors can be confident products deliver what they promise and are not "greenwashed", which is relevant for issuers of green bonds in New Zealand.

DECEMBER 2020

The FMA has also announced its view that green bond issuances are not within the "same class" as existing vanilla corporate bonds for the purposes of the "same class exclusion" which provides relief from disclosure requirements under the Financial Markets Conduct Act 2013. Accordingly, additional disclosures are required in relation to new issuances of retail green bonds in New Zealand (other than in certain circumstances).

The guidance should help to ensure consistency and transparency are maintained in the green and sustainability-linked loan and bond markets as they develop in New Zealand

Trends

A developing European trend is the incorporation of sustainability features into the leveraged loan market, most notably the incorporation of pricing ratchets that are tied to the ability to meet (or failure to meet) prescribed targets and bespoke reporting requirements to audit that performance. With pressure on both financial institutions and private equity sponsors to incorporate green and sustainability based processes into credit and investment analysis, along with the increasing demand from investors for ESG linked products (both debt and equity), we expect local private equity sponsors will draw upon the European experience and look to the sustainability-linked loan market as a way to align pricing incentives and ESG considerations of both their investors and credit providers.

Another trend developing across the Tasman is an increase in complex structured financial products that integrate green elements. In August 2020 BNP issued Australia's first climate-linked bond (an AU$140m 8-year bond that paid a fixed coupon plus a return tied to the performance of a "forward-looking" climate transition index). Our expectation is that we will start to see more of this type of product here, particularly with New Zealand emissions budgets and targets seeking to drive transition climate action and the pending mandatory obligation for financial climate-related risk disclosures.

Looking ahead

With demand for ESG linked products continuing to grow, and increased scrutiny from regulators and investors to quantify and disclose ESG risks, we expect the green and sustainability-linked bond and loan market to play an increasingly mainstream role in the New Zealand loan and bond markets. The guidance published by regulators and industry bodies provides a helpful platform from which the market can develop.

Bell Gully's climate change practice

Our firm has been at the forefront of climate change action in New Zealand for more than 20 years. We helped to develop core climate change legislation in New Zealand and have had long-standing involvement with New Zealand's emissions trading initiatives, including advising the New Zealand Government on the design of the New Zealand Emissions Trading Scheme. Internationally, we worked on the world's first carbon trade for avoided deforestation and on pioneering emissions trading activity.

We act for an array of individuals and organisations, ranging from leaders in the emissions trading market and global investment banks to regional governments or government groups in New Zealand and overseas. This has included some of the nations that will be among those most affected by climate change.

That consistency in providing market-leading climate change advice is recognised by international legal directories. Bell Gully's environment practice is ranked in the top tier for environmental law in New Zealand by the Legal 500 Asia Pacific 2020.

Practice leader Simon Watt has also featured in the world-wide climate change rankings of the international legal directory Chambers Global since 2008 – the only New Zealand lawyer to be ranked in the last seven years.

We can provide you with:

- Specialist advice on all areas of law involving the regulation and reduction of greenhouse gas emissions.
- Advice on the regulatory and commercial opportunities and barriers in all sectors (including energy, transport, forestry, agriculture, manufacturing, and mining) transitioning to meet New Zealand's net zero carbon target.
- Advice on the implications of climate change adaptation for your business or community.
- Identifying carbon risks, as well as advice on carbon pass-through and trading.
- Robust due diligence around the sale or acquisition of emissions-exposed businesses or assets.
- Advice on activity and the financing of activity to implement carbon reductions and addressing regulatory barriers to a lower-carbon operation.
- High-level interpretation of New Zealand's climate change legislation and the implications of international agreements including the Paris Agreement.
- Advice on governance, risk and reporting associated with climate change.
- Advice on potential climate change litigation, and acting on actual climate change litigation matters

Our team

If you have any questions about this report, please contact one of the team listed or your usual Bell Gully adviser:

CLIMATE CHANGE

Simon Watt
PARTNER

DDI +64 4 915 6854 MOB +64 21 605 384
simon.watt@bellgully.com

CLIMATE CHANGE

Kate Redgewell
CONSULTANT

DDI +64 4 915 6868 MOB +64 21 570 945
kate.redgewell@bellgully.com

FORESTRY

Karl Anderson
PARTNER

DDI +64 9 916 8845 MOB +64 21 661 726
karl.anderson@bellgully.com

DERIVATIVES, BANKING AND FINANCE

David Craig
PARTNER

DDI +64 4 915 6839 MOB +64 21 674 851
david.craig@bellgully.com

ENERGY

David Coull
PARTNER

DDI +64 4 915 6863 MOB +64 21 800 308
david.coull@bellgully.com

FORESTRY

Andrew Petersen
PARTNER

DDI +64 9 916 8622 MOB +64 21 684 533
andrew.petersen@bellgully.com

LITIGATION

Blair Keown
PARTNER

DDI +64 9 916 8796 MOB +64 21 185 0409
blair.keown@bellgully.com

RESOURCE MANAGEMENT

Andrew Beatson
PARTNER

DDI +64 9 916 8754 MOB +64 21 223 9170
andrew.beatson@bellgully.com

RESOURCE MANAGEMENT

Natasha Garvan
PARTNER

DDI +64 9 916 8956 MOB +64 27 420 0561
natasha.garvan@bellgully.com

ENERGY

Angela Harford
PARTNER

DDI +64 4 915 6764 MOB +64 21 875 905
angela.harford@bellgully.com

LITIGATION

Simon Ladd
PARTNER

DDI +64 9 916 8934 MOB +64 21 920 508
simon.ladd@bellgully.com

SUSTAINABLE FINANCE

Jennifer Gunser
PARTNER

DDI +64 9 916 8757 MOB +64 21 704 923
jennifer.gunser@bellgully.com

BELL GULLY

Our team

If you have any questions about this report, please contact one of the team listed or your usual Bell Gully adviser:

PROJECTS AND REAL ESTATE

David Chisnall

PARTNER

DDI +64 4 915 6966 MOB +64 27 594 8505

david.chisnall@bellgully.com

PROJECTS AND REAL ESTATE

Toni Forrest

PARTNER

DDI +64 4 915 6524 MOB +64 27 5055 910

toni.forrest@bellgully.com

CORPORATE

Haydn Wong

PARTNER

DDI +64 9 916 8918 MOB +64 21 606 267

haydn.wong@bellgully.com

SUSTAINABLE FINANCE

Zac Kedgley-Foot

SENIOR ASSOCIATE

DDI +64 4 915 6820

zac.kedgley-foot@bellgully.com

CORPORATE GOVERNANCE

Amon Nunns

PARTNER

DDI +64 4 915 6741 MOB +64 21 687 368

amon.nunns@bellgully.com

CORPORATE GOVERNANCE

James Cooney

PARTNER

DDI +64 9 916 8620 MOB +64 21 190 6145

james.cooney@bellgully.com

CORPORATE

Renata Davis

SENIOR SOLICITOR

DDI +64 4 915 6798 MOB +64 21 537 174

renata.davis@bellgully.com

Acknowledgements

Our thanks to Bell Gully lawyers Simon Watt, Simon Ladd, Natasha Garvan, Jennifer Gunser, Kate Redgewell, Zac Kedgley-Foot, Rachel Gowing, Tasha Lea, Simone Cooper, Hannah Watson and Naushyn Janah for their assistance in preparing this report.

Endnotes

1 https://www.wri.org/blog/2020/12/interactive-chart-top-emitters

2 https://www.climatecommission.govt.nz/get-involved/faq/looking-ahead/

3 Ministry for the Environment. 2021. Proposed changes to the NZETS and SGG levy regulations 2021: Consultation document. Wellington: Ministry for the Environment.

4 Summarised from He Pou a Rangi – the Climate Change Commission 2021 *Draft Advice for Consultation.*

5 Ministry for the Environment. 2021. Proposed changes to the NZETS and SGG levy regulations 2021: Consultation document. Wellington: Ministry for the Environment – Table 7.

6 Ministry for the Environment. 2021. Proposed changes to the NZETS and SGG levy regulations 2021: Consultation document. Wellington: Ministry for the Environment – Table 9.

7 Ministry for the Environment. 2021. Proposed changes to the NZETS and SGG levy regulations 2021: Consultation document. Wellington: Ministry for the Environment – Table 10.

8 Ministry for the Environment. 2021. Proposed changes to the NZETS and SGG levy regulations 2021: Consultation document. Wellington: Ministry for the Environment.

9 https://www.bloomberg.com/news/articles/2021-03-17/eu-rules-bank-pledges-signal-new-day-for-europe-green-insight

10 https://www.nordea.com/en/press-and-news/news-and-press-releases/news-en/2021/140-funds-tighten-requirements-on-investments-in-fossil-fuel%20.html

11 https://www.bloomberg.com/news/articles/2021-03-17/eu-rules-bank-pledges-signal-new-day-for-europe-green-insight

12 https://www.hsbc.com/-/files/hsbc/investors/results-and-announcements/stock-exchange-announcements/2021/march/sea-210311-e-hsbc-announces-resolution-on-climate-change.pdf

13 https://ec.europa.eu/commission/presscorner/detail/en/mex_21_1106

14 https://www.unep.org/resources/report/global-climate-litigation-report-2020-status-review

15 https://www.courtsofnz.govt.nz/assets/speechpapers/ccw.pdf pages 45-47.

16 How has the insurance sector reacted to mandatory climate change reporting? (2021, April 28). *Insurance Business NZ.* https://www.insurancebusinessmag.com/nz/news/breaking-news/how-has-the-insurance-sector-reacted-to-mandatory-climate-change-reporting-253400.aspx

17 https://deepsouthchallenge.co.nz/wp-content/uploads/2021/01/Insurance-Retreat-December-2020-Final-Report.pdf

18 Homes to start losing access to insurance within 15 years – report. (2020, December 2) *Stuff.* https://www.stuff.co.nz/environment/climate-news/123560377/homes-to-start-losing-access-to-insurance-within-15-years---report

19 https://www.unepfi.org/psi/wp-content/uploads/2021/01/PSI-TCFD-final-report.pdf

20 Review Panel Report page 189 para [96] and page 186 para [84].

21 Review Panel Report page 176 fn 223 citing Climate Change Adaptation Technical Working Group. 2017. Adapting to Climate Change in New Zealand: Stocktake Report from the Climate Change Adaptation Technical Working Group. Wellington: Climate Change Adaptation Technical Working Group at 31. Retrieved from https://www.mfe.govt.nz/sites/default/files/media/Climate%20Change/adapting-to-climate-change-stocktake-tag-report.pdf

22 https://deepsouthchallenge.co.nz/resource/insurance-retreat-december-2020-final-report/ at 3.

23 Tom Simonson and Grace Hall *Vulnerable: The quantum of local government infrastructure exposed to sea level rise* LGNZ January 2019 at 12. Retrieved from https://www.lgnz.co.nz/assets/Uploads/d566cc5291/47716-LGNZ-Sea-Level-Rise-Report-3-Proof-FINAL-compressed.pdf

24 Cabinet Paper 'Adaptation legislation – proposed timelines and process' para [28]

25 Sea level rise: insurance and retreat – James Shaw. (2020, December 7). *Radio New Zealand.* https://www.rnz.co.nz/national/programmes/ninetonoon/audio/2018775996/sea-level-rise-insurance-and-retreat-james-shaw

26 Review Panel Report page 189 para [95].

27 Defend or retreat — the struggle to save our beachside paths and reserves from rising sea levels. (2020, September 30). *Stuff* https://www.stuff.co.nz/environment/climate-news/122733616/defend-or-retreat--the-struggle-to-save-our-beachside-paths-and-reserves-from-rising-sea-levels

28 Climate hazard property - from freehold to leasehold. (2021, February). *Radio New Zealand.* https://www.rnz.co.nz/national/programmes/ninetonoon/audio/2018781916/climate-hazard-property-from-freehold-to-leasehold

29 https://www.whakatane.govt.nz/residents/awatarariki-managed-retreat-programme

30 https://environment.govt.nz/assets/Publications/Cabinet-papers-briefings-and-minutes/cabinet-paper-adaptation-legislation-proposed-timelines-and-process.pdf at [9] and [31].

31 https://environment.govt.nz/assets/Publications/Cabinet-papers-briefings-and-minutes/cabinet-paper-adaptation-legislation-proposed-timelines-and-process.pdf at [45], [46].

32 https://www.nzx.com/markets/NZDX

33 https://www.climatebonds.net/2020/12/1trillion-mark-reached-global-cumulative-green-issuance-climate-bonds-data-intelligence

AUCKLAND

VERO CENTRE
48 SHORTLAND STREET
NEW ZEALAND

WELLINGTON

ANZ CENTRE
171 FEATHERSTON STREET
NEW ZEALAND