

10. Financing the transformation: Resiliency

What:

Improve prudential regulation over environmental risks.

Why change is needed:

The financial system is facing catastrophic risks from climate change and declining biodiversity. These risks are characterised by non-linearity and fat-tail distributions, which means that financial regulation needs new tools it uses to address this systemic risk.

Counterfactual:

Significant environmental risks are not monitored or regulated across the financial sector. This leads to risks propagating unabated, increasing the potential of catastrophic impacts to our economy and society.

Desired outcomes:

- Systemic environmental risks, such as climate change and biodiversity loss, are assessed and incorporated into capital adequacy requirements.
- Climate, and other environmental risks, are incorporated within Capital Providers risk management practices and disclosures.
- The RBNZ and Capital Providers recognise and factor in the financial impacts of biodiversity loss, ultimately leading to a reverse of current trends.

Recommendations in action:

Bank of England – Mandatory climate change stress testing

Bank of England has proposed a novel framework for gathering information on the size of the potential impact to the financial sector from climate change, in its mandatory biennial exploratory scenario (BES). This will require counterparty-level analysis of physical and transition risks, across three different climate scenarios and over a 30 year timeframe.

To read more about this case study and the detail behind this recommendation, read the Technical Chapter [here](#).

Chapter 10:
Resiliency

Resiliency: Detailed recommendations

What:	Topics	Recommendation
<p>Improve prudential regulation over environmental risks.</p>	<p>Monitor systemic climate risks.</p>	<ul style="list-style-type: none"> a) The RBNZ sets expectations for banks and insurers to assess firm-specific climate and environmental risks through introduction of stress testing which incorporates climate-risk, longer time horizons, and multiple scenarios; encourage developing novel modelling approaches and that RBNZ uses similar approaches to assess its own balance sheet risk. b) The RBNZ sets expectations for incorporating climate risk assessment into bank and insurer risk management practices and disclosures, following the Government’s proposed mandatory climate-risk (TCFD) reporting regime, which will apply to all registered banks and licensed insurers.
	<p>Reflect long-term risk in capital adequacy requirements.</p>	<ul style="list-style-type: none"> a) Researchers and the RBNZ investigate the relationship between sustainable lending practices and longer-term risk reduction. If needed, the RBNZ should consider: encouraging industry to build any new evidence into their internal risk models; the issuance of new guidance; and alignment with international capital adequacy recommendations should explicit changes be required.
	<p>Prepare for uninsurable markets.</p>	<ul style="list-style-type: none"> a) Treasury monitors the availability and uptake of insurance to identify locations and assets at risk of becoming uninsured and works with the sector to develop solutions (including public/private models) to maintain insurance cover while exposure and vulnerability is reduced. b) That the recommendations of the Resource Management Review be enacted in legislation, so the Government takes a long-term view, regulates and supports the reduction of risks to property and businesses arising from climate change, including banning new developments in locations facing high risks from climate change (with appropriate adaptation/resilience design).
	<p>Investigate financial impacts of other systemic risks beyond climate change, commencing with biodiversity loss.</p>	<ul style="list-style-type: none"> a) The RBNZ analyses the exposure of Aotearoa New Zealand’s financial system to biodiversity loss, and provides guidance similar to the DNB report. This should draw on connections with DNB and experts from iwi/Māori, DOC, MfE, the BioHeritage National Science Challenge, WWF. The immediate priority should be to draw attention to the relevance of biodiversity loss to financial institutions and corporates in Aotearoa New Zealand, a nation with strong reliance on agricultural systems, tourism and with very strong cultural connections to native biodiversity.