ICNZ Insurance Council of New Zealand

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Dear Steven,

LOW EMISSIONS ECONOMY

Introduction

The Insurance Council of New Zealand (ICNZ) is pleased to provide a submission to the Productivity Commission (the Commission) on this issues paper. This captures briefly some of the points made when I met with you on 1 October 2017.

ICNZ represents the interests of insurers and reinsurers who underwrite General Insurance policies, that is, we currently do not represent Life or Health insurers. Our members underwrite approximately $600 billion of New Zealand's assets and liabilities.

ICNZ does not have expertise in emissions nor in the dynamics of sectors like agriculture or transport that between them contribute the most greenhouse gas emissions (GGE). We do not profess to have any expertise into emissions trading schemes or forestation. We also note New Zealand's unusual emissions profile with most of our emissions being in the form of methane and nitrous oxide, rather than carbon dioxide due to the significant contribution from agricultural livestock.

However, we accept the findings of the Intergovernmental Panel on Climate Change (IPCC) and we are supportive of the targets set at COP21 in Paris in December 2015 which was signed by 196 countries. So, we agree there is an urgent need for countries to transition their economies to a low-emissions pathway and that progressively ambitious reduction measures will be needed globally to achieve the Paris targets.

Adaptation

ICNZ acknowledges the terms of reference for this inquiry require it to focus on mitigation, that is, the reduction of GGE and that adaptation measures are out of scope. Even so, it is important to note that adaptation measures to reduce the adverse impacts of climate change are fundamental to ensuring the affordability and availability of insurance. If insurance is not available to segments of the population to manage their risk, it will create a political economy problem for future Governments. This is because there will be more losses if adaptation measures are not taken. The IPCC's probabilistic scenarios broadly indicate that this will arise because of more frequent, extreme weather conditions. For New Zealand, this points to more inundation in the west, drier conditions in the east and sea-level rise. The Parliamentary Commissioner for the Environment and work it commissioned from NIWA has reported on the potential sea-level rise impacts for New Zealand in two reports.

The extent of adaptation required will depend on how successful measures taken to reduce GGE are. So, while out of scope, there is a direct causal link flowing from mitigation to the adaptation problem which is not insignificant and will have direct economic and social impacts.

Financial markets

In a prescient address at Lloyd's of London in September 2015, the Governor of the Bank of England, Mark Carney, the prudential supervisor of insurers, presented three significant risks that faced insurers due to climate change in the context of financial stability. These were:

Physical risks – the impacts today on insurance liabilities and the value of financial assets that arise from climate and weather-related events, such as storms and floods that damage property and disrupt trade

Liability risks – the impacts that could arise tomorrow if parties who have suffered loss or damage from the effects of climate change seek compensation from those they hold responsible. Such claims could come decades into the future, but have the potential to hit carbon extractors and emitters, and if they have liability cover, their insurers – hardest.

Transition risks – these are the financial risks which could result from the process of adjustment towards a lower-carbon economy. Changes in policy, technology, and physical risks prompt a re-assessment of the value investors place in a large range of assets as costs and opportunities become apparent. The speed of repricing is uncertain and could adversely impact financial stability. Critically, Carney noted that the risks to financial stability will be minimised if the transition begins early and follows a predictable path.

ICNZ therefore supports a pathway that starts early and is predictable.

Signs of an accelerating transition

There are sign that suggest the speed of transition to a low carbon economy may become more rapid than might have been expected. If this is so, then it will be important for the New Zealand economy to remain open to signals that this is occurring and agile enough to respond to re-pricing of assets. It is also important that the transition pathway maintains financial stability. It is important for policymakers to be alert to offshore changes in setting policy pathways to a low emissions economy for New Zealand. This suggests that regulatory

instruments should avoid building in rigidities and avoid constraining innovative responses while encouraging a predictable, low emission pathway consistent with the Paris targets.

The platform for a speedier transition starts with the commitment that now 195 countries (the United States withdrew its commitment in 2017 though many US States remain committed) have made to the Paris target. This level of global commitment establishes a fundamental platform for change.

The commitment by all countries except for the United States and Syria to the Paris targets is matched by the level of concern about what business identifies as the top risks facing the world. In 2016, at the World Economic Forum in Davos, global business leaders identified the failure of climate change mitigation and adaptation as their number one risk. Other risks in the top ten included issues associated with climate change like water crises (No 3), large-scale involuntary migration (No 4), energy price shock (No 5), and biodiversity loss (No 6). All those issues relate directly to climate change consequences. The prominence business leaders assign to climate change as a risk to the world strongly suggests that business strategies and investment will adapt quickly, particularly if price signals remain transparent and reflect climate change risk.

Sarah Barker, a special counsel with Minter Ellison in Australia, has identified signs that investment markets are beginning to change. She points to US$92 billion of Green Bonds being issued in 2016, a 90% growth year on year.

Another example she cites is Blackrock, the world's largest asset manager with about US$5.7 trillion invested, which has signaled it will act against independent company directors it invests in if they do not exhibit "demonstrable fluency" in climate change risks.

The United Nations Environmental Programme's (UNEP) Portfolio Decarbonisation Coalition (PDC) is charged with mobilising institutional investors to move to decarbonised portfolios. Since its inception in 2014, it has achieved US$600 billion in decarbonised investments. Although this is a small proportion of total global investments, its targets are well ahead of expectations.

Another influence on the pace at which investment will transition to decarbonised or low carbon assets is the risk of stranded carbon assets. Estimates of the size of the carbon bank available before the planet loses the ability to achieve the Paris target suggest there is about 500 Gigatonnes of C02 left to avoid exceeding the Paris 2-degree target. The world's proven oil, coal and gas reserves exceed this by at least five times. This poses a significant risk of stranded carbon assets as investors shift to low carbon assets. At the same time, significant change is occurring the requires that investors be better advised about the risks to equities exposed to climate change consequences.

Two years ago, France became the first country in the world to introduce mandatory carbon reporting obligations on publicly traded companies, banks, asset managers and institutional investors under Article 173 of its Energy Transition Law. While there is flexibility in the reporting methodology, there must be justification for the reporting methodology used and the underlying assumptions applied.

Several major institutions have taken steps to provide guidance on disclosure of climate change risks. The Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TFCD) has set out recommendations for governance, strategy, risk management

and targets to address climate change risks. This reporting framework has been adopted by the G20 and signals an inevitable move to increasing requirements globally to identify and report on climate change risks. Barker notes that Blackrock has said it will be seeking disclosure from investees consistent with TFCD recommendations. Greater transparency will enable markets to respond most efficiently in the transition to a low carbon economy.

New Zealand directors have a fiduciary duty to take due care and to be diligent in assessing the risks their companies face. Annual reports need to provide for litigation contingencies, asset valuations and bad debts that can all be influenced by climate change. Directors need to show they have applied a due process in achieving their judgments and will likely turn to the type of authoritative guidance set out by the FSB and G20. They may be personally liable if they do not do so.

In February 2017, across the Tasman, the financial regulator, the Australian Prudential Regulation Authority (APRA) announced at a forum hosted by the Insurance Council of Australia that it wanted companies to incorporate climate change risk and scenario-testing into their business planning. It has made it clear that directors can be held accountable for failing in their duties when assessing climate change risks.

Climate change litigation is also emerging most notably and unsurprisingly in the United States. These variously involve regulators taking cases against corporates for failing to adequately disclose climate change risks, infrastructure owners taking cases against carbon emitters to meet the additional costs they have incurred due to climate change and insurers have considered liability action against infrastructure owners for not protecting communities from climate change consequences.

Transparency in reporting

These developments are not ones that New Zealand can or should remain immune from. Indeed, ICNZ proposes that the Commission consider what, if any, climate change disclosure obligations should be considered for companies in New Zealand as a part of its recommendations. Such obligations will require identification and assessment of climate change risk to business. It will lead to strategic decisions to reduce that risk. It will lead to transparent reporting of risks which will inform investors. In turn, this will lead to the re-pricing of assets and equities with high carbon exposure and market incentives to shift to a low carbon economy. If the market is allowed to price those risks, it will avoid the distortion of other regulatory interventions that could suppress or distort the signals required to adjust. In turn, this will lead to a more stable transition to a low carbon economy. This approach would require somewhat light regulatory intervention which would be consistent with international change. It would remain essentially market-led and would provide an efficient response to climate change risk.

Reporting requirements would still need measures that are consistent, comparable, reliable, clear and efficient, that is, they should seek to minimise the costs of reporting. This short submission has referred to examples that the Commission could review to see whether they can be adapted for New Zealand.

Although it could be argued that such measures are not necessary because Boards already have a fiduciary duty to report to their shareholders about liability, impaired assets and bad debts, all of which can be adversely affected by climate change impacts. Even if this is the case, it is evident that few companies do report these risks or take a sufficiently long view, and certainly there is no consistent, clear and comparable reporting.

At the very least, more education and the greater awareness of directors to climate change risks is required. Directors are responsible for taking the lead in setting the strategy and setting the culture of the entities they govern. Leadership from the top will ensure that business adapts effectively to climate change risk. These steps need to be taken now because early adjustment is a least costly adjustment, and it will help contribute to a stable and predictable investment environment. It is critical that the transition to a low carbon economy does not destabilise financial markets.

Yours sincerely

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Chief Executive