ICNZ Insurance Council of New Zealand

Divestment, Reinvestment and Insurance

Australia-New Zealand
Climate Change Business Conference

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Why sustainable investment matters to insurers

Our business model depends on:

- matching long-term liabilities to policyholders with long-term investments

So, we have a natural interest in:

- long-term performance of our investments

Sustainability:

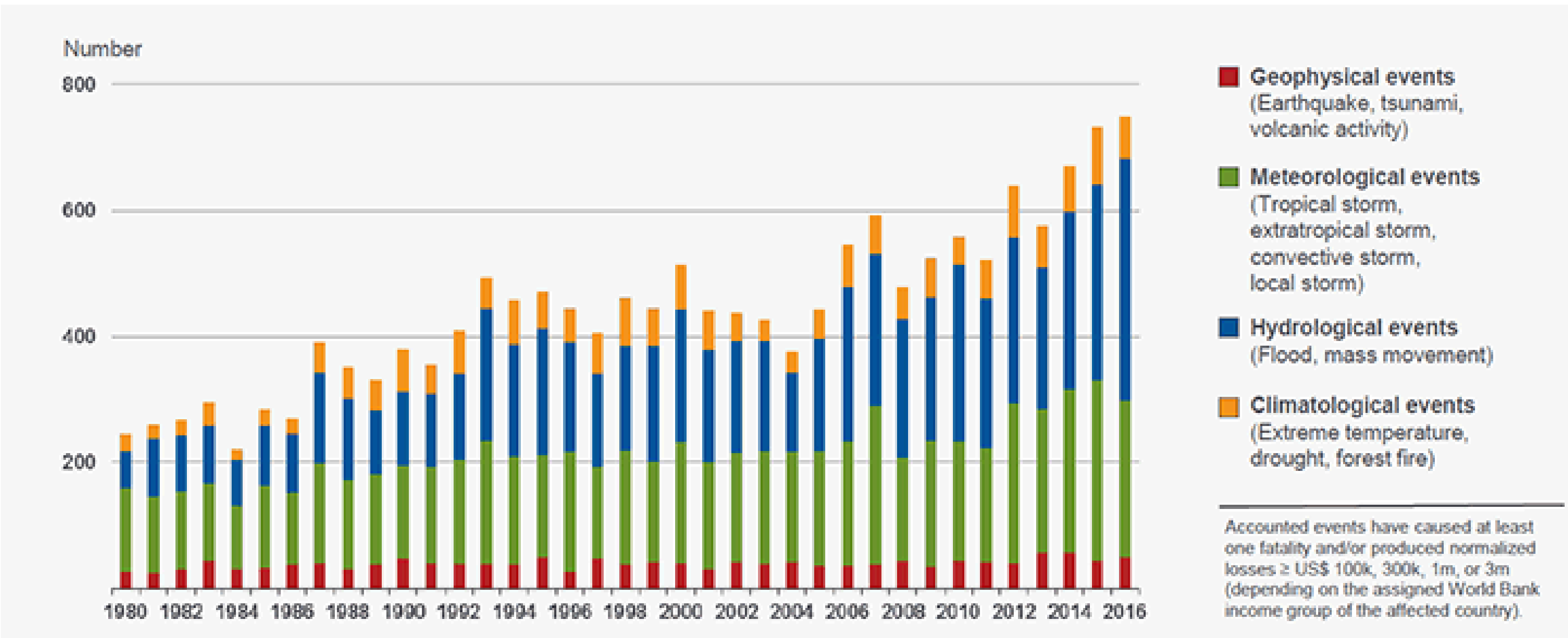
- by definition is targeted at long-term performance

So, we also have a natural interest in:

- sustainable businesses
- ESG factors as they tend to be more important for medium-long-term investment
- ESG as a way to align investment practices with insurers' long-term interests

Historical look back on global natural hazard losses

Risk 1: we underwrite physical assets, so accept climate change risks

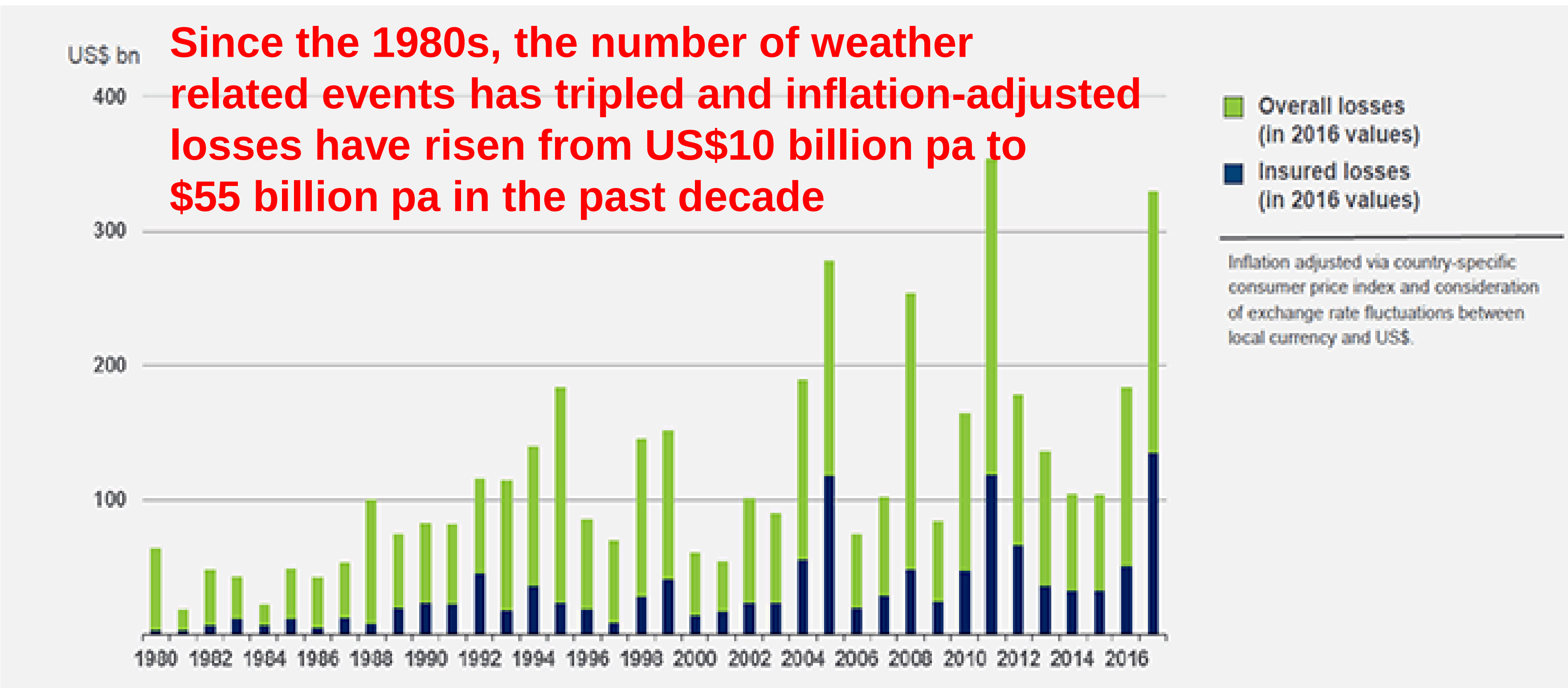


Source: Munich Re

Putting it another way: Insurers' 3 Risks

Risk 1: **we underwrite physical assets, so accept climate change risks**

Since the 1980s, the number of weather related events has tripled and inflation-adjusted losses have risen from US$10 billion pa to $55 billion pa in the past decade



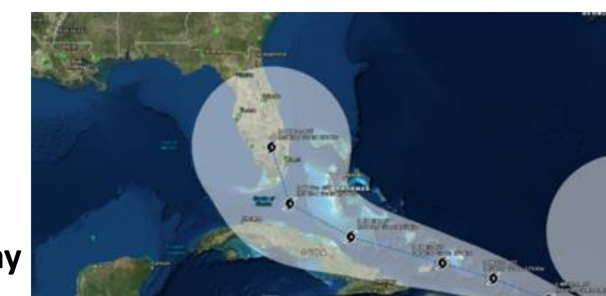
Source: Munich Re

Drivers of increasing losses

- global **population increase** from 4 billion (1975) to 7.6 billion (2018)
- improved living standards, so **higher value assets**
- **aggregation** of people/assets in urban areas 37% (1975), 50% (2010) and 57% (2025)
- settlement and **investment in vulnerable areas** specially coastal areas and areas close to rivers
- increasing complexity of **interdependencies** of value chains – exponential rise of IoT
- **Climate Change** – intensification and accumulation of extreme weather events; 70% of the infrastructure in cities in 2050 have not been built yet

2017, Hurricane Harvey, Houston

2017, Hurricane Irma's pathway



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Insurers' 3 Risks

Risk 1:

We underwrite physical assets, so we accept climate change risks

Risk 2:

We underwrite liability risks arising from those who have suffered loss from the effects of climate change seeking compensation from those they hold responsible e.g. fossil fuel emitters

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Insurers' 3 Risks

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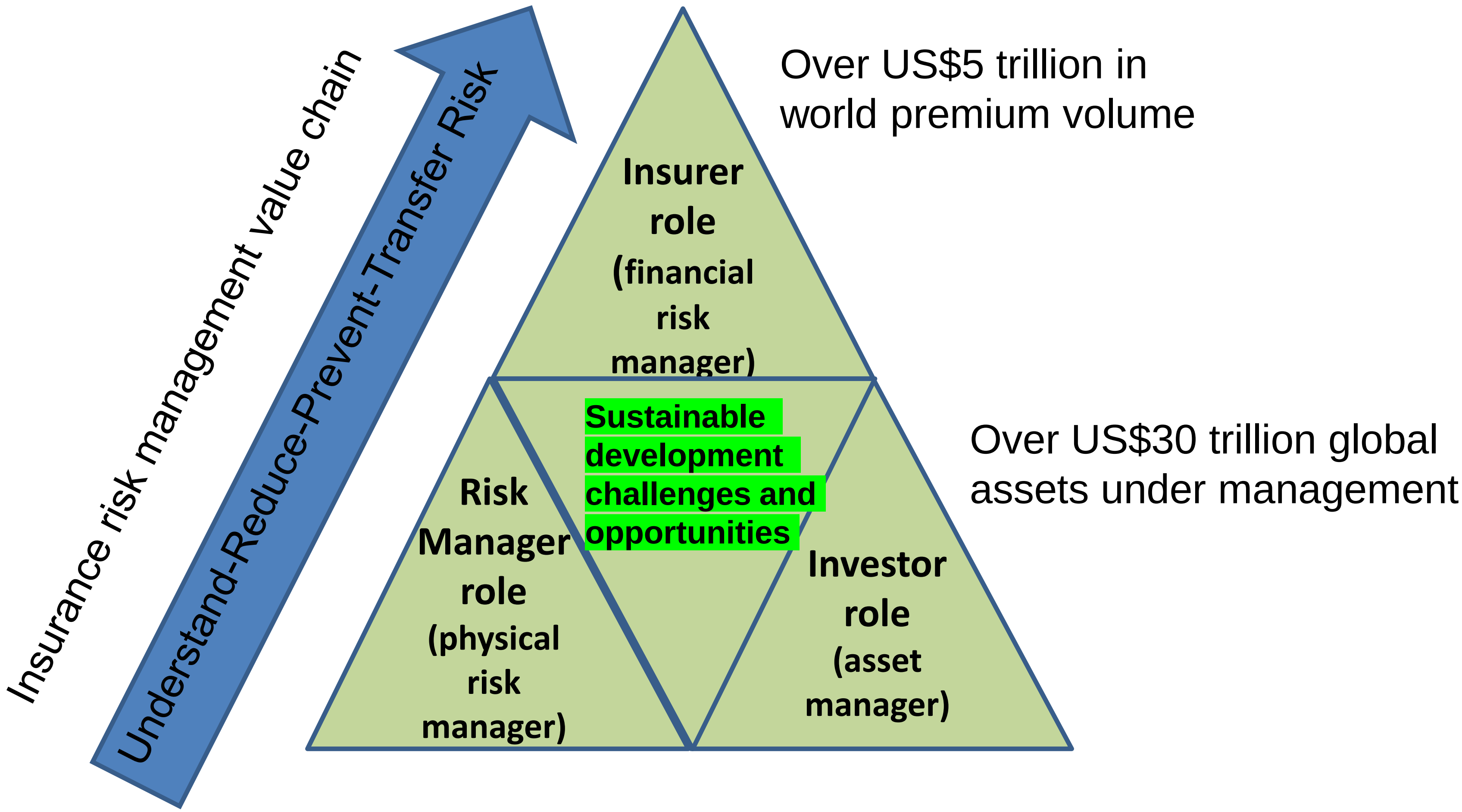
Risk 3:

We have transition risks as investors arsing from a sudden and disorderly adjustment to a low carbon economy

- elevated risk because both sides of the balance sheet vulnerable – underwriting and investing in assets exposed to climate change
- de-carbonising portfolios avoids stranded asset risk and provides more long-term sustainable return

The triple role of insurance in sustainable development



Source: UNEP Principles of Sustainable Insurance, Bacani

Disclosure to inform investment

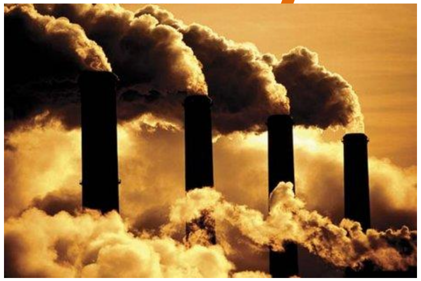
*"**We have no choice: a 2 degree world might be insurable, 4 degree world certainly would not be**."* Henri de Castries, Chairman and CEO of AXA, 22 May 2015, Climate Finance Day.

Founding members of the UNEP's Principles of Sustainable Insurance
Axa, Aviva, SwissRe, and Tokio Marine and Nichido Fire Insurance were members of the Taskforce for Climate-related Disclosures (**TCFD**) that recommended a framework for companies to disclose their climate change related exposures

TCFD framework:

- describe how climate risks/opportunities influence a firm's strategy
- discuss how the firm could be impacted and what it means for strategy
- disclose how to measure changes the firm is making
- consider a range of scenarios

Decarbonising - coal case study



Divesting US$2.8 billion by 2020 from those with >30% of revenue revenue from coal or >30% coal-based energy mix, actively builds new coal plants or produces more than $20 million tonnes of coal pa
Not insuring any new coal construction

Divesting from those >30% of revenues from coal mining and utilities generating >30% from coal sources reducing to zero by 2040
Not insuring construction or operation of mines and power plants

Divesting from coal
NB – Lloyd's not an underwriter itself, but a market of 90 international syndicates

Divesting its own assets and from companies generating >30% revenue from coal
Not insuring new coal-fired plants or mines in industrialised countries

Divesting from those with >30% of revenue from coal or >30% coal-based energy mix
Not insuring re/insurance to businesses >30% thermal coal exposure

Divesting its own and 3rd party assets from companies deriving >50% revenue from coal mining and utilities generating >50% electricity from coal
Not insuring on the same basis with 2 yr transition for existing clients, due diligence on ESG basis for those in 30-50% range

What critics say… and emerging issues

Critics say	Response
Get out completely and now, not gone far enough quickly enough	Is that possible e.g. 74% of world's steel dependent on coal? What about a 'just transition'? Isn't our action sending a very clear incentive to coal-miners to start changing their activity? Sudden change creates financial instability
Some still invest in 3rd parties with coal exposure	As a TCFD disclosure framework is adapted all investors will be able to identify these risks
Some big insurers have not moved	True, but those that have include some of the largest financial institutions in the world; it's just a matter of time

Emerging mining issues

- transition to a low carbon economy relies heavily on rare earth elements
- demand for lithium, cobalt + rare earths requires massive increase in mining
- Ultra Deep and Deep Sea mining will be inevitable, energy intensive to operate and carry environmental risks
- insurance support will be essential

Investment next steps: (1) Conditions

Remove barriers like…

- poor quality information about ESG risks
- the view social/environmental issues can be financial not consistently held
- sustainability mandates are not well expressed to asset managers
- regulatory perversely disincentive act against riskier renewable investment
- Short-term V Long-term financial return challenge

Promote disclosure metrics

- TCFD framework and ESG principles adopted
- UNEP FI framework developing metrics to inform investment e.g.
  - ❑ **Agriculture** and **Energy** sectors measuring incremental impact of climate change and extreme events on borrower revenues, cost of goods sold and probability of default
  - ❑ **Real Estate** measuring potential changes to property values and LVRs due to extreme weather

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Investing next steps: (2) Innovating for Adaptation

Insurance-linked loan packages – concessional loans with integrated resilience conditions e.g. favourable premiums and loan terms for resilience measures

Resilience Impact Bonds – a bond with outcome-based repayments linked to resilience; upfront financing so critical services requiring infrastructure (health, power) are more resilient. Returns greater for investors if there is greater resilience

Resilience Bond – a catastrophe bond (investors lose all on a given event) where interest (coupon) payments are reduced when resilience measures are implemented reflecting the lower risk bond investors bear

Resilience Service Companies – would pay for and implement resilience measures up-front, re-couping their investment from risk-based insurance premiums by reducing premium volatility

Source: Centre for Global Disaster Protection and Lloyd's

Insurance, catastrophe financing and small nation investments

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Ex-Post funding options

Increase taxes
Potentially unviable

Foreign Aid
Uncertainty, how much and when

Raise Debt
Limits to debt raising ability

Re-allocate Budget
Risk to current investment in development programmes

Ex Ante funding options

Risk Transfer to insurance via parametric cover — Large, low frequency events

Contingent Credit Financing
Dependent on debt — More severe, less frequent events

Reserve Funding
High opportunity cost — Small, high Frequency events

A 1:100 year event can destroy 20-40% of a Pacific nation's GDP

Advantages of Reinsurance Solutions

Efficient response to large-scale natural disaster

Guaranteed, speedy access to required recovery funds

Immediate post-disaster liquidity for Governments

Pre-determined premium gives budget planning certainty

No pay-back obligation Vs loans

Reduces Govt contingent liabilities – positive for sovereign rating

Limits pressure to divert investment funds from development projects