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15 February 2019

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ICNZ submission: Local government funding and financing - Issues Paper

The Insurance Council of New Zealand (ICNZ) welcomes the opportunity to submit on *Local government funding and financing - Issues paper* ('Issues Paper'), which was released by the Productivity Commission in November 2018.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, motor vehicle insurance and travel insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

Our submission is focussed on the section concerning climate change and other natural hazards and on responding to Question 8. ICNZ would be happy to meet with the review team to discuss our submission.

Submission

The Issues Paper sets out some of the key funding issues facing local government as a consequence of climate change and natural hazards such as earthquakes and we agree local government will face significant costs associated with adapting to and responding to these.

ICNZ supports the discussion on page 35 of the Issues Paper and in particular we agree that:

- billions of dollars of local government infrastructure and assets are at risk from sea-level rise¹, noting that the full cost of exposure (including central government and private sector property) will be in the tens of billions of dollars;
- there is often a mismatch between the resources and capabilities available to local authorities and the scale of their adaptation challenges;
- the central government approach to providing financial assistance to communities affected by natural disasters tends to be ad-hoc, providing little certainty in advance while also risking moral hazard; and
- there is no centrally managed mechanism for funding the costs of climate change adaptation.

It is important to remember that New Zealand is one of the most vulnerable countries in the world to the impact of natural disasters for an economy of our size, with a recent Lloyd's report rating our exposure as having the second highest level of annual expected losses as a percentage of GDP.²

The insurance industry (insurers and re-insurers) has provided more than \$30 billion to New Zealand people and organisations to help recover from the Canterbury and Kaikōura earthquakes, which has represented a significant proportion of the overall financial costs of these events.³ We remain at risk from further earthquakes, volcanoes and tsunami and from weather events, with 2017 and 2018 being New Zealand's most expensive years for weather-related events.

Climate change will increase the risk of flooding in parts of the country and drought in other areas. Coastal areas will be more vulnerable as sea levels rise, we can also expect more severe windstorms in the west and it is also expected to increase the frequency and type of biosecurity incursions. Seismic risks will however remain New Zealand's biggest exposure, given the ability for individual events to cause national level impacts and involve multi-year recoveries.

While we cannot control the forces of nature, we can reduce their impact significantly by building our capacity to withstand and recover from natural disasters. This is achieved by identifying and planning ahead on how to adapt or mitigate, in order to reduce the risks we face. Numerous studies show that investment in those measures before disaster strikes saves much more than trying to pick up the cost afterwards.

Reducing risks also helps to keep insurance available and affordable and high levels of insurance cover in turn benefits society by sharing the risk and reducing the cost individuals, businesses, and local and central government would otherwise have to meet as well as improving an economy's ability to recover after a disaster. Given New Zealand's exposure to natural disasters it is critical that New Zealand maintains access to international risk-capital to support both private insurers and the Earthquake Commission and proactive efforts to reduce risks and increase the swiftness of response and recovery are a welcome step in this regard.

¹ The recent LGNZ report 'Vulnerable: The quantum of local government infrastructure exposed to sea level rise' found \$2.7 billion of roading, three waters, and building infrastructure is at risk from as little as a 0.5 metre rise in sea level, with \$5.1 billion at risk at 1 metre, \$7.8 billion at 1.5 metre, and \$14.1 billion at 3 metre of sea level rise.

² A world at risk, Closing the insurance gap, October 2018, available from <https://www.lloyds.com/news-and-risk-insight/risk-reports/library/understanding-risk/a-world-at-risk>.

³ This includes funds that have been provided by private insurers to their personal and business customers and by re-insurers to EQC.

While these risks and issues extend beyond local government's infrastructure and financial strategies, how these matters are approached by local government is critical to wider outcomes. Amongst other things local government infrastructure underpins the activities and assets of communities and businesses. Where local government locates infrastructure, if and how it maintains it over time and how it charges for it will drive community and business behaviour in relevant areas. It is positive that local authorities are required to have a 30-year infrastructure strategy, which is relevant in terms of anticipating the impacts of climate change, though a further outlook for long term infrastructure is warranted, and equally geological risk (i.e. volcanic and earthquakes). Central and local authorities also need to be mindful of taking actions, particularly after a disaster, that increase moral hazard and potentially dis-incentivise the uptake of insurance in future.

Any approach by local government needs to be underpinned by the following:

1. A risk-based approach to climate change and geohazards and cascading/compounding hazards.
2. To answer the question of funding adaptation or risk-reduction as relevant requires analysis to determine what risk exists, noting Risk = Probable frequency of an event occurring X severity of impact (i.e. Risk should be quantified as a cost).
3. An assessment of appetite/tolerance for risk. Certain losses are tolerable and can be borne by property owners, some losses will have greater impact and justify a local government response to risk-reduction measures.
4. The relative merits (short/medium and long-term measures) of risk-reduction or adaptation options can be assessed and costs allocated to individual property owners, local government or central government as appropriate depending on the extent to which public good benefits exist.

The establishment of a Risk Management Agency focused on local government could perform a valuable advisory role for councils in adopting and applying such a framework. It is also critical that decision making is underpinned by good quality information at both a community and individual property level. It should be a goal to ensure that all properties have their risks identified in a transparent manner to inform risk management and market-led responses to the risks presented.

The Government has proposed, and ICNZ strongly supports, the enactment of a Zero Carbon Act that establishes a Climate Change Commission that amongst other functions undertakes National Climate Change Risk Assessments and requires government to develop and maintain a National Adaptation Plan. It is however also important that the Government carefully considers and formalises a principle-based approach to the role for central government in supporting funding of climate change adaptation measures, including where relevant for example coastal retreat.

The aim of this would be to reduce risky investments and moral hazard, allow for as orderly a transition as practicable, and ensuring that the costs of climate change are shared equitably across the existing population and intergenerationally. The absence of this creates uncertainty for local government and others and may prevent or limit sensible adaptation measures being taken now and increase moral hazard in some situations. History also shows that central government often ends up funding the response to disasters and so the absence of an upfront approach in this area does not necessarily reduce the long-term risks to taxpayers associated with the effects of climate change.

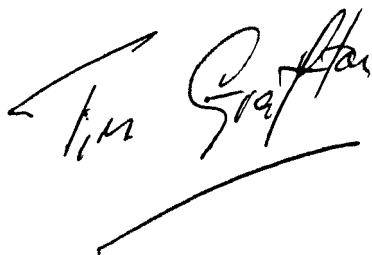
In making these comments we note there are a range of reasons for central government to consider these issues carefully and to develop a clear approach that amongst other things clearly addresses the role of local government:

- Central government has a direct role to play, not just because it is the funder of last resort, but because its infrastructure is also at risk and its infrastructure can have a compounding or ameliorating the impact on local government assets (e.g. the location and management of state highways).
- Central government should be taking a view of the total and social risks to New Zealand from natural catastrophes and assuring itself and New Zealanders that it is taking an appropriate approach to addressing risk reduction and management. We note the 2019 Budget's focus on wellbeing will include reporting on the four capitals⁴ and risks to them.
- Central government sets requirements for local government to follow through the Resource Management Act and supporting instruments (National Policy Statements, guidelines etc).

Conclusion

Thank you again for the opportunity to submit on the Issues Paper. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing andrew@icnz.org.nz.

Yours sincerely,



Tim Grafton
Chief Executive



Andrew Saunders
Regulatory Affairs Manager

⁴ Natural, human, social and financial/physical capital, as outlined in Treasury's Living Standards Framework.