

Hon Nicola Willis

Minister of Finance
Minister for the Public Service
Minister for Social Investment
Associate Minister of Climate Change



13 August 2024

Paul Shelton
fyi-request-27361-6fff7554@requests.fyi.org.nz

Dear Paul

Thank you for your Official Information Act request, received on 24 June 2024. You requested:

Please send me any official information that Minister Willis has received on the topic of uninsurability, insurance retreat, and rising insurance costs.

The request was extended by 15 working days on 16 July 2024 in order to undertake consultations.

Information being released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	28 February 2024	Aide Memoire T2024/433 29 Feb Meeting with IAG	Release in part
2.	7 March 2024	Aide Memoire T2024/593 Meeting with Insurance Council of New Zealand	Release in part
3.	15 March 2024	Treasury Report T2024/77 Climate Adaptation - Priorities for Future Work	Release in part
4.	29 April 2024	Cover briefing to RBNZ Report #6102 Reserve Bank Financial Stability Report May 2024	Release excerpt

I have decided to release the relevant parts of the documents listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- names and contact details of officials, under section 9(2)(g)(ii) – to maintain the effective conduct of public affairs through protecting Ministers, members of government organisations, officers and employees from improper pressure or harassment,
- advice still under consideration, under section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials,
- commercially sensitive information, under section 9(2)(b)(ii) – to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information,

- information provided in confidence, under section 9(2)(ba)(i) – to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied,
- direct dial phone numbers of officials, under section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage, and
- Section 18(c)(i) – that the making available of the information requested would be contrary to the provisions of a specified enactment.

Direct dial phone numbers of officials have been redacted under section 9(2)(k) in order to reduce the possibility of staff being exposed to phishing, social engineering and other scams. This is because information released under the OIA may end up in the public domain, for example, on websites including Treasury’s website.

Information publicly available

The following information is also covered by your request and is or will soon be publicly available on the websites listed:

Item	Date	Document Description	Excerpts	Links
5.	22 February 2024	RBNZ Report #6079 Bulletin article on the use of credit risk weights for climate-related purposes	Page 13 – “Standardised Approach” – First three paragraphs	https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2024/rbb-2024-87-02.pdf
6.	7 March 2024	RBNZ Report #6080 Guidance for prudentially regulated entities on managing climate-related risks	Pages 9-11: Paragraph 35 and Figure 3	https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/climate/guidance-managing-climate-related-risks.pdf
			Page 17: Paragraphs 68, 70	
			Page 18: Paragraphs 75-76, 79	
			Page 19: Paragraph 82	
7.	20 April 2024	RBNZ Report #6096 Draft RBNZ Statement of Intent 2024 – 2028 and Statement of Performance Expectations 2024-25	Sol Page 13	https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/statements-of-intent/statement-of-intent-2024---2028.pdf https://www.rbnz.govt.nz/hub/publications/corporate-publications/statement-of-performance-expectations/statement-of-performance-expectations-2024-to-2025

Item	Date	Document Description	Excerpts	Links
8.	29 April 2024	RBNZ Report #6102 Reserve Bank Financial Stability Report May 2024	Cover Report Page 2: Paragraph 6 Financial Stability Report Page 20 – 26	Not publicly available – relevant excerpt from this Cover Briefing has been released as item 4 in the table above. https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/financial-stability-reports/2024/may-2024/fsr-may-24.pdf
9.	20 March 2024	Treasury Report T2023/1934 Emerging Insurance challenges		Soon to be published at https://www.treasury.govt.nz/publications/search

Accordingly, I have refused your request for the documents listed in the above table under section 18(d) of the Official Information Act:

- the information requested is or will soon be publicly available.

In addition, some relevant information has been removed from documents listed in the above table and should continue to be withheld under the Official Information Act, on the grounds described in the documents.

Information to be withheld

There are additional documents covered by your request that I have decided to withhold in full under the following section of the Official Information Act, as applicable:

- advice still under consideration, section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials.

Item	Date	Document Description	Proposed Action
10.	27 June 2024	Treasury Report T2023/2206 Insurance update	Withhold in full

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Hon Nicola Willis
Minister of Finance

Table of Contents

1.	<u>Aide Memoire T2024/433: 29 Feb Meeting with IAG</u>	1
2.	<u>Aide Memoire T2024/593: Meeting with ICNZ</u>	7
3.	<u>Treasury Report T2024/77: Climate Adaptation - Priorities for Future Work</u>	13
4.	<u>Excerpt - Cover Briefing to RBNZ Report 6102 Reserve Bank Financial Stability Report May 2024</u>	39

Reference: T2024/433

Date: 28 February 2024

To: Minister of Finance
(Hon Nicola Willis)

Minister for Infrastructure
(Hon Chris Bishop)

Minister Responsible for EQC
(Hon David Seymour)

Deadline: Thursday 29 February

(if any)

Meetings with IAG

IAG New Zealand (IAG) has sought separate introductory meetings with each of you. The meetings with Minister Willis and Minister Bishop are on Thursday 29 February 2024, and the meeting date with Minister Seymour is yet to be confirmed.

These representatives you will be meeting from IAG include:

- Simon Allen, Chair
- Amanda Whiting, Chief Executive
- Bryce Davies, General Manager Corporate Relations

The objectives of these meetings are to:

- establish relationships with IAG, and
- discuss IAG's framework for reducing natural hazard risk in New Zealand.

This briefing provides you with talking points and background information on:

- IAG's framework and climate change adaptation, and
- insurance in New Zealand and Treasury's current work.

We have also included some talking points on lessons from the response to the North Island Weather events in case this is raised.

Talking Points

IAG framework and climate change adaptation

- Thank you for sharing with us the natural hazards risk reduction framework you have developed, along with your earlier briefings. These are valuable inputs as we progress our policy thinking.
- The unprecedented scale of economic and fiscal impacts from the North Island Weather Events reinforces the importance of New Zealand becoming more resilient to similar future events.
- Our Government is seeking advice on establishing a policy framework for climate change adaptation. This framework seeks to build upon existing systems to share the risks and costs of natural hazards and long-term environmental change.
- Risks and costs will need to be shared between central and local government, property owners and insurers. Building a consensus will be important for ensuring policy settings endure. Ministers will receive briefing on adaptation priorities ahead of the planned Climate Priorities Ministerial Group meeting in early March.
- We see insurance as a key part of an adaptation system in transferring risk and creating market signals to reduce risk. We also recognise that one of the main opportunities to adapt is through reducing underlying risk in a cost-effective way.
- One priority for us is ensuring that high-quality information about risk is available for decision makers to enable people to adapt effectively and efficiently. What specific gaps do you see in the availability and quality of risk information for individuals, communities and councils?
- I am expecting to be briefed by my officials on climate change adaptation in the next few weeks.
- s9(2)(f)(iv) [Redacted]
- s9(2)(f)(iv) [Redacted]
- s9(2)(f)(iv) [Redacted]
- s9(2)(f)(iv) [Redacted]

Insurance in New Zealand

- Uptake of residential insurance remains relatively high in New Zealand, despite significant increases in premiums in recent years. What challenges do you foresee to affordability and accessibility in the future?
- I understand IAG is introducing greater risk-based pricing for the flood component of its residential premiums. What impact will this approach have on the affordability and availability of insurance in New Zealand?
- What is IAG hearing from international reinsurers - do you expect pressure on reinsurance to reduce in the near future, and what would help give reinsurers confidence in the New Zealand reinsurance market?
- What do you think are the most promising innovations in the residential (or other) insurance market?

Lessons learned from the North Island Weather Events

- We are interested to hear IAG's views on the response to and recovery from the North Island Weather Events.
- Initial lessons from the Treasury's perspective are that:
 - Usable, high-quality information on natural hazard risk is important to support cost-effective and consistent decision making about the response and recovery, as well as how best to manage risk prior to events taking place.
 - A locally-led approach has benefits as well as trade-offs. The NIWE response was primarily locally-led and centrally supported. While this approach meant that responses could be tailored to the unique circumstances of affected regions, it did risk inconsistency in approaches.
 - There are opportunities to make future recoveries faster and more effective for the highest risk areas e.g. through clarifying ahead of time the roles, responsibilities and powers of central and local government.
- Work is underway to identify lessons learned from the North Island Weather Events for future recoveries. It is being led by the Cyclone Recovery Unit.

Background

IAG's framework and climate change adaptation


At a high-level, we (officials) support what is proposed in IAG's framework. We outline a brief selection of our reactions below which you may wish to raise. We do not comment here on each individual action suggested, given there are a large number.

We support:

- the focus on cost-effective, targeted actions made by those in the best position to reduce risk
- the emphasis on decision-makers being well-informed and incentivised to reduce risk
- the focus on actors having access to data and models needed to reduce risk, and
- the suggestions to improve council powers to limit development in at-risk areas and to improve national guidance.

We would be interested to understand from IAG what specific gaps they see in the availability and quality of risk information for individuals, communities, and councils.

s9(2)(f)(iv)



Insurance in New Zealand and Treasury's current work

The Treasury is responsible for advice on the functioning of insurance markets, administers the Natural Hazards Insurance Act, and monitors ACC, EQC - Toka Tū Ake (EQC), and Southern Response (the government-owned company responsible for settling claims by AMI policyholders for Canterbury earthquake damage).

In our role advising on the functioning of insurance markets we have tended to focus on **residential insurance**. This is because of the importance of housing to New Zealanders (including as a place to live and that in New Zealand a significant amount of household wealth is tied up in people's homes), meaning the benefits of residential insurance are particularly pronounced.

Characteristics of the residential insurance market in New Zealand include:

- **High uptake** while uptake data is relatively limited, the most recent available surveys suggest it is high: initial analysis of the Household Economic Survey reports 84%, while the Insurance Council of New Zealand annual survey reports 95%. This implies residential insurance remains affordable for and available to most people. It also reflects the fact that a residential insurance policy is required for mortgage lending and that many insured risks have been ‘community-rated’ (i.e. the costs are shared evenly rather than reflecting individual or localised risk profiles).
- **Increasing premiums:** s9(2)(f)(iv) [REDACTED] These increases have been driven by a range of factors including increasing construction costs (due in part to COVID-related supply chain disruptions) and higher reinsurance costs. Looking ahead, premiums may also face pressure from the shift to greater risk-based pricing and increases in underlying risk caused by climate change. Over time, pricing pressures may result in lower uptake.
- **High market concentration:** New Zealand’s residential insurance market is concentrated s18(c)(i) [REDACTED]
- **Use of all perils policies:** residential insurance policies in New Zealand generally cover all key risk/perils (e.g. fire, flood, storm, earthquake, tsunami, and volcanic) rather than offering cover for these separately. New Zealand is unusual in having this approach. In other markets (e.g. Australia and USA), insurers unbundle perils as an alternative to ceasing to underwrite high-risk locations.
- **Annual contracts:** insurance contracts are generally for 1-year periods, meaning that insurers can adjust terms (including price) or cease offering insurance annually.
- **Government involvement:** the government directly supports residential insurance through the EQC scheme, a key rationale for which is to encourage the uptake of insurance for residential buildings given the potential for non-insurance to create a material implicit fiscal risk. EQC cover is attached to the purchase of residential insurance, meaning if insurance becomes unavailable for some reason, an individual generally no longer has standard earthquake cover from EQC.

¹ s9(2)(f)(iv) [REDACTED]

Treasury's current work on residential insurance:

- **Market monitoring:** as part of our insurance policy work we carry out insurance price and availability monitoring. We do this mainly through a contract with Finity Consulting which provides quarterly updates by gathering online quotes for a static set of addresses. We are also currently running a survey on apartment insurance pricing and availability as apartments are not captured in the Finity monitoring. We are currently preparing advice for the Minister of Finance on the findings from this monitoring work.
- **Risk-based pricing:** insurers in New Zealand are adopting greater risk-based pricing for some risks (e.g. flood risk), enabled by an improved understanding of risk and better systems. While positive from a risk management and climate change adaptation perspective, greater use of risk-based pricing may pose insurability challenges for homeowners in high-risk areas. We are currently preparing advice for the Minister of Finance on this topic.

Lisa Davies, Senior Analyst, Financial Markets, s9(2)(k)

Mary Llewellyn-Fowler, Team Leader, Financial Markets, s9(2)(k)

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Reference: T2024/593

Date: 7 March 2024

To: Minister of Finance
(Hon Nicola Willis)

Deadline: 2pm, Tuesday 12 March
(if any)

Meeting with Insurance Council of New Zealand

This briefing supports your upcoming meeting with the Insurance Council of New Zealand (ICNZ) at 2pm on Tuesday 12 March 2024.

The main objectives of this meeting are to establish a relationship with ICNZ and to hear what is top of mind for the insurance sector.

ICNZ was established in 1895 to represent fire and general insurance companies. Its members underwrite around 95% of New Zealand's general insurance market, accepting the risks of over \$1 trillion of New Zealand's assets and liabilities. The Council also performs an important role in informing and educating consumers about key insurance issues and risks and is often in the media.

The representatives you will be meeting from ICNZ include:

- Tim Grafton, the outgoing Chief Executive (finishing this month after almost 12 years in the role), and
- Kris Faafoi, the incoming Chief Executive.

We understand from ICNZ that they may raise issues covered in their Briefing to the Incoming Minister (attached), particularly those relating to improving resilience (BIM pp. 11-14). In light of this, this briefing provides you with talking points on:

- Adaptation and resilience
- Affordability, availability and innovation
- Lessons learned from the North Island Weather Events (NIWE)
- Capital requirements (if raised)

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- Progress with the Natural Hazards Insurance (NHI) Act (if raised – noting ICNZ have already shared their concerns about progress with Minister Seymour who as Associate Minister for Finance has delegated responsibility for this work).

It also provides background information on insurance matters.

Talking Points

Adaptation and resilience

- The unprecedented scale of economic and fiscal impacts from the North Island Weather Events reinforces the importance of New Zealand becoming more resilient to similar future events.
- We see insurance as a key part of an adaptation system in transferring risk and creating market signals to reduce risk.
- Beyond insurance, the government has a key role in ensuring that people have the incentives and the ability to manage underlying risk - for example, through building flood resilience, land-use planning and retreating.
- We are currently working on an adaptation framework. As such, we welcome the suggestions in your BIM for how government and insurers can work together to prepare for the impact of climate change and look forward to engaging further on these.
- In particular, we agree that it is important for decision-makers to have good information about risk and are interested in your ideas about better collaboration between government and insurers on this. What specific gaps do you see in the availability and quality of risk information for individuals, communities and councils?
- *[If central government investment in local flood resilience is raised, you may wish to note that]:*
 - The government sees local government as having primary responsibility for managing natural hazard risk at a community level.
 - However, we also appreciate that some councils face both acute climate risk and financial capacity pressures.
 - As part of developing an adaptation framework, we will consider the cost sharing arrangements between central and local government.

Affordability, availability and innovation

- Uptake of residential insurance remains relatively high in New Zealand, despite significant increases in premiums in recent years. What challenges do you foresee to affordability and accessibility in the future?

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- I understand insurers are introducing greater risk-based pricing for the flood component of its residential premiums. What impact will this approach have on the affordability and availability of insurance in New Zealand?
- What are insurers hearing from international reinsurers - do you expect pressure on reinsurance to ease in the near future, and what would help give reinsurers confidence in the New Zealand reinsurance market?
- What do you think are the most promising innovations in the residential (or other) insurance market and are there any barriers to adopting these in the New Zealand context?

Lessons learned from the North Island Weather Events

- We are interested to hear ICNZ's views on the response to and recovery from the North Island Weather Events.
- Initial lessons from the Treasury's perspective are that:
 - Usable, high-quality information on natural hazard risk is important to support cost-effective and consistent decision making about the response and recovery, as well as how best to manage risk prior to events taking place.
 - A locally-led approach has benefits as well as trade-offs. The NIWE response was primarily locally-led and centrally supported. While this approach meant that responses could be tailored to the unique circumstances of affected regions, it did risk inconsistency in approaches.
 - There are opportunities to make future recoveries faster and more effective for the highest risk areas e.g. through clarifying ahead of time the roles, responsibilities and powers of central and local government.
- Work is underway to identify lessons learned from the North Island Weather Events for future recoveries. This is being led by the Cyclone Recovery Unit.

Capital and reinsurance requirements [if raised]

[ICNZ may bring up the capital/reinsurance requirements that insurers are regulated to hold. Insurers are regulated to hold sufficient capital or reinsurance to meet claims from a 1:1000 year earthquake occurring anywhere in the country. This requirement is higher than other countries and the ICNZ would like it to be reviewed].

- I note the point in your BIM that the RBNZ's capital requirements impact the cost of insurance premiums.
- The purpose of the 1-in-1000 seismic risk capital requirement is to contribute to NZ's financial stability by ensuring that the insurance industry is able to pay claims in the aftermath of a major earthquake.

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- The RBNZ will be reviewing and consulting on this over the next two years, as part of the review of its solvency standards.

Implementation of the NHI Act regulations [if raised]

- I understand that finalising the NHI Act regulations and instruments as quickly as possible is an important priority in order to provide certainty for the insurance industry ahead of commencement on 1 July 2024.
- When you met Minister Seymour on 14 February 2024, he undertook to do what he could to expedite the regulation-making. He has also expedited the proactive release of the latest Cabinet policy paper on the regulations. This was recently published on the Treasury website and will hopefully assist insurers as they plan for implementation.

Background on insurance matters

Responsibility for advising on and regulating insurance is shared across the public sector:

- The **Reserve Bank of New Zealand** provides advice on financial stability and is the prudential regulator.
- The **Ministry of Business, Innovation and Employment** provides advice on conduct and competition policy, and monitors the conduct and competition regulators (the **Financial Markets Authority** and **Commerce Commission**).
- The **Treasury** provides advice on the functioning of insurance markets, administers the Natural Hazards Insurance Act, and monitors ACC, EQC - Toka Tū Ake (EQC), and Southern Response (the government-owned company responsible for settling claims by AMI policyholders for Canterbury earthquake damage).


These agencies coordinate activity at the working level as well as via the Council of Financial Regulators which holds regular meetings to discuss regulatory issues, risks and priorities for financial markets, as well as quarterly fora with representatives of the insurance sector.

Residential insurance in New Zealand

In our role advising on the functioning of insurance markets, the Treasury has tended to focus on residential insurance. This is because of the importance of housing to New Zealanders (including as a place to live and that in New Zealand a significant amount of household wealth is tied up in people's homes²), meaning the benefits of residential insurance are particularly pronounced.

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Characteristics of the residential insurance market in New Zealand include:

- **High uptake:** while uptake data is relatively limited, the most recent available surveys suggest it is high: the Household Economic Survey reports 84% while the Insurance Council of New Zealand annual survey reports 95%. High uptake implies residential insurance remains affordable for and available to most people. It also reflects the fact that a residential insurance policy is required for mortgage lending and there is relatively high 'community-rating'/cross-subsidisation (i.e. the costs are shared evenly rather than reflecting individual or localised risk profiles) for key risks – for example EQC premiums do not differ across the country despite earthquake risk varying. Nevertheless, uptake may be lower in some communities and locations, including those subject to high flood risk.
- **High market concentration:** New Zealand's residential insurance market is concentrated in three insurers ^{s18(c)(i)} 
- **Use of all perils policies:** residential insurance policies in New Zealand generally cover all key risk/perils (e.g. fire, flood, storm, earthquake, tsunami, and volcanic) rather than offering cover for these separately. Unbundling of perils as an alternative to ceasing to underwrite high-risk locations is more common in other market (e.g. USA).
- **Annual contracts:** insurance contracts are generally for 1-year periods, meaning that insurers can adjust terms (including price) or cease offering insurance annually.
- **Government involvement:** the government directly supports residential insurance through the EQC scheme, a key rationale for which is to encourage the uptake of insurance for residential buildings given the potential for non-insurance to create a material implicit fiscal risk. EQC cover is attached to the purchase of residential insurance that includes fire insurance, meaning if insurance becomes unavailable for some reason, an individual generally no longer has standard earthquake cover from EQC.

Treasury's current work on residential insurance

Market monitoring

As part of our insurance policy work we carry out insurance price and availability monitoring. We do this mainly through a contract with Finity Consulting which provides quarterly updates by gathering online quotes for a static set of addresses. We are also currently running a survey on apartment insurance pricing and availability as apartments are not captured in the Finity monitoring. We are currently preparing advice for you on the findings from this work.

IN-CONFIDENCE*Emerging insurance challenges: risk-based pricing*

Globally, reinsurance has become more expensive and harder to access over recent years. This is a result of considerable losses from a range of hurricanes, typhoons, floods, storms, and wildfires, alongside the COVID-19 pandemic and the war in Ukraine. In New Zealand, insurers are needing to pay more for cover and retain more risk for non-earthquake perils.

Against this backdrop, insurers in New Zealand are adopting greater risk-based pricing for some risks, supported by an improved understanding of risk (due to better flood data and modelling) and better systems (including IT systems). While positive from a risk management and climate change adaptation perspective, greater use of risk-based pricing may pose insurability challenges for homeowners in high-risk areas. We are currently preparing advice for you on this topic.

Lisa Davies, Senior Analyst, Financial Markets, s9(2)(k)

Mary Llewellyn-Fowler, Team Leader, Financial Markets, s9(2)(k)

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Treasury Report: Climate Adaptation: Priorities for Future Work

Date:	15 March 2024	Report No:	T2024/77
		File Number:	SH-10-8

Action sought

	Action sought	Deadline
Hon Nicola Willis Minister of Finance	<p>Provide feedback to the Minister of Climate Change on the draft Cabinet Paper on an adaptation framework, (draft feedback is provided in Appendix One).</p> <p>Refer this report to Minister of Climate Change</p>	21 March 2024

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Tom Wilson	Senior Analyst, Climate Change	s9(2)(k)	s9(2)(g)(ii) ✓
Nicky Lynch	Manager, Climate Change		

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

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Treasury Report: Climate Adaptation: Priorities for Future Work

Executive Summary

The Minister of Climate Change will shortly seek your feedback on a draft Cabinet Paper proposing an adaptation work programme. This report provides our general advice on adaptation priorities and then draws on those views to suggest feedback on the draft Cabinet Paper.

Adaptation needs to be lifted in the policy agenda. We think this is necessary because climate change is likely to present a unique and serious challenge.

- While the scale of impact is uncertain and will depend on global emissions, the trend is clear. Climate change will exacerbate costs from climate extremes such as floods and droughts and will drive long term change such as sea level rise or economic adjustment costs in sectors such as agriculture, fisheries, or tourism.
- Because New Zealand's contribution to global emissions is very small, the main way we can manage these costs is by adapting.
- Costs are likely to be pervasive across the economy and society, and the scale of fiscal costs could threaten our long-term fiscal sustainability.
- Existing systems to manage natural hazard risks face regulatory and market failures that limit their effectiveness in enabling adaptation.
- To date, central government has made limited progress on core policy choices. In our view this reflects the complexity of the issues and the greater effort directed at mitigation policy than adaptation. Yet, central government's choices can make a major difference to economic, fiscal, and social costs to New Zealand.

We suggest a set of principles and priorities. s9(2)(f)(iv)



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s9(2)(f)(iv)

Recommended Action

We recommend that you:

- a **provide** feedback to the Minister of Climate Change on the draft Cabinet Paper on an adaptation work programme, as outlined in Appendix One.
- b **note** that Treasury is currently focussed on monitoring insurance markets, managing the capital investment system at Budget, supporting your participation in cross-government adaptation discussions, and integrating adaptation into wider fiscal and economic advice.
- c **indicate** if you would like the Treasury to focus on additional or different areas.
- d **refer** to the Minister of Climate Change

Refer/not referred.



Nicky Lynch
Manager, Climate Change

Hon Nicola Willis
Minister of Finance

_____/_____/_____

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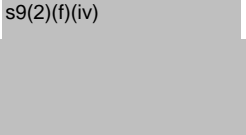
Treasury Report: Climate Adaptation: Priorities for future work

Purpose of Report

1. The Minister of Climate Change will shortly share a draft Cabinet Paper with you on an adaptation work programme. This report supports you to respond to the draft paper and engage on this work. This report covers:
 - a context, including the proposed adaptation work programme and the adaptation policy problem
 - b an explanation of why, in our view, adaptation needs stronger focus within central government
 - c our first-best advice on principles and priorities for progressing adaptation
 - d suggested feedback on the draft Cabinet Paper, focussed on where the paper could be more aligned with our advice (our feedback is in **Appendix One**).

Context

The Minister of Climate Change is seeking agreement to an adaptation work programme.

2. We prepared this report on the understanding that the draft Cabinet Paper on the adaptation work programme would be circulated to Ministers for consultation on Tuesday 12 March, with the aim of lodging the paper in time for ECO on March 27th.
3. We understand the draft Cabinet Paper has not yet been circulated for consultation but will be soon.
4. We are providing this advice now to give you an overview of adaptation issues from a Finance Portfolio perspective, and because the feedback may be helpful for the Minister of Climate Change to be aware of (if referred).
5. If the draft Cabinet Paper changes further, we can provide updated short briefing to you as required.
6. The draft Cabinet Paper proposes an 'adaptation framework', which is essentially a work programme for the following seven months. It proposes four workstreams for officials, a Ministerial Advisory Group, and a Select Committee inquiry.
7. The inquiry would deliver a final report in September 2024 ^{s9(2)(f)(iv)} 
8. The purpose is *"to initiate work to develop an adaptation framework to provide stable and predictable policy settings so that markets and individuals have the incentives and ability to manage risk"*.
9. The ongoing work is to be guided by the following objectives:
 - a minimise total cost
 - b improve climate risk and response information flows

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- c support market efficiency
- d uphold the principles of Te Tiriti o Waitangi
- e enable a fair transition.

What is the adaptation policy problem?

10. Climate change adaptation ('adaptation') is a process of adjustment to future climate conditions, to moderate harm or take advantage of opportunities¹. Climate change is:
 - a increasing the risk of acute extreme weather such as floods and droughts beyond what they otherwise would have been
 - b changing long-run climate environmental conditions, disrupting human economic and social activity (e.g. higher sea levels, or economic adjustment costs in sectors such as agriculture, fisheries or tourism).
11. It may not be possible or cost-effective to fully avoid all costs. But insufficient action to reduce risk will have considerable impacts.
 - a Fiscal costs are likely to be big enough to challenge long-term fiscal sustainability.
 - b Negative economic impacts are likely to significantly exceed any economic benefits.
 - c Financial and non-financial impacts for individuals are likely to be significant.
12. The size and distribution of these costs will depend on the extent of international emissions reductions and New Zealand's own adaptation policy choices.
13. Not all climate change impacts will be negative, for example, some crop yields may increase. However, this report focusses on the negative physical impacts of climate change, because they are expected to exceed benefits².
14. Adaptation can take many forms (Figure 1), but not all adaptation benefits exceed costs. Adaptation will be effective and efficient where the costs of action in the short term are outweighed by avoided costs later. The objective is not to eliminate risk, but to reduce it to a level considered acceptable³.
15. Adaptation is challenging for multiple reasons.
 - a Underlying risk is increasing over time. This means assets originally built in a lower risk environment can later face higher risk, disrupting land and insurance markets.
 - b In addition to increased risk due to climate change, risk increases as the number and value of assets increases over time.
 - c Adaptation lacks clearly quantifiable targets, unlike mitigation⁴.

¹ As defined in the New Zealand National Adaptation Plan 2022.

² OECD (2015). Swiss Re (2021) estimates global GDP 11-18% lower by 2050 due to climate physical impacts.

³ We use the term 'acceptable' to refer the perception of tolerable risk. What is considered tolerable will vary from person to person and will also vary over time. For example, risk tolerance often decreases after major disasters.

⁴ IAG has suggested that adaptation is sufficient when post-event recovery costs do not grow faster than the economy.

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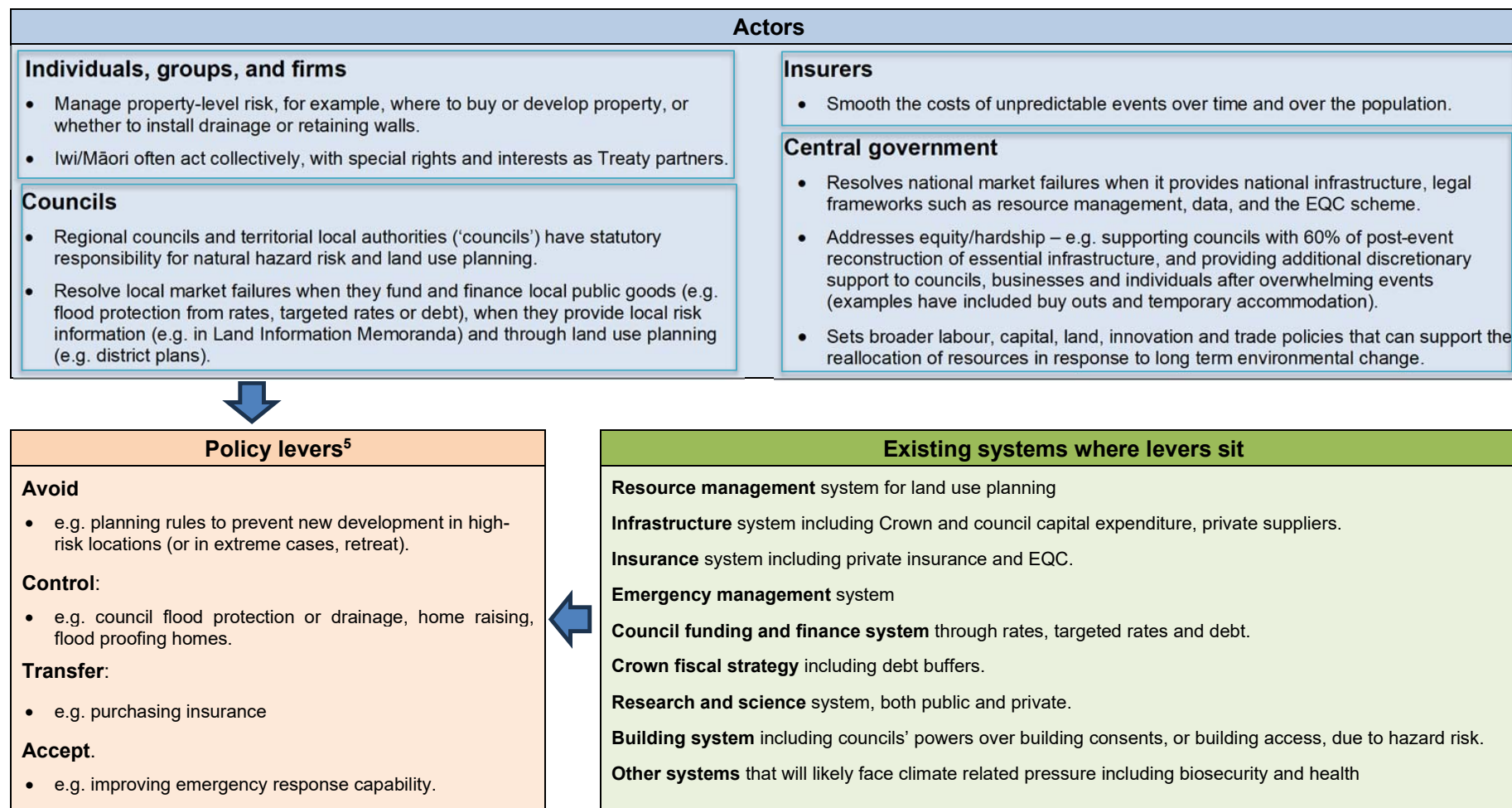
- d Uncertainty over the size of impacts across long time scales (to 2100 and beyond) can make cost-benefit judgements difficult. Waiting for more information (option value) can sometimes be a cost-effective option.
- e Adaptation costs compete with other financial pressures facing councils, firms, Iwi and individuals, and the Crown (including other long-term risks to fiscal sustainability such as health and superannuation costs).

Who is responsible for adaptation?

16. Central government, councils, insurers, and individuals all have an interest in adaptation. Many of the levers sit within existing systems. Figure 1 summarises the main actors, policy levers and existing systems where adaptation occurs.
17. The Climate Change Response Act 2002 requires the Minister of Climate Change to prepare a National Adaptation Plan (NAP) every six years. The first NAP was published in 2022. The Climate Change Commission (CCC) is responsible for six-yearly National Climate Change Risk Assessments. The CCC also evaluates the implementation of the NAP every two years, with the first review in mid-2024.
18. Within central government, responsibility for adaptation actions sits within multiple portfolios, limiting the value of a 'lead agency' approach. However, an effective coordination function is important (the Ministry for the Environment performs this function).
19. The Treasury is currently focussed on the adaptation-related areas of monitoring insurance markets and managing the capital investment system at Budget. We also support your participation in cross-government discussions, and we have integrated adaptation into fiscal and economic analysis such as the 2021 Long Term Fiscal Statement and 2023 Climate Economic and Fiscal Assessment.

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Figure 1: Summary of actors, policy levers, and existing systems responsible for managing the physical impacts of climate change.



⁵ The insurance industry and NZIER use the 'ACTA' framework above while some councils and government agencies use a similar Protect-Avoid-Retreat-Accommodate 'PARA'. We prefer ACTA because it includes insurance (transfer) and acceptance, however we will work with other agencies to agree a common framing for future advice.

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Why adaptation needs a stronger focus within central government

Climate change presents a unique challenge.

20. While the scale of impact is uncertain and will depend on global emissions, the trend is clear. Climate change will exacerbate costs from climate extremes such as floods and droughts and will drive long term change such as sea level rise or the economic adjustment costs in sectors such as agriculture, fisheries and tourism. Because New Zealand's contribution to global emissions is very small⁶, the main way we can manage these impacts is by adapting.
21. Climate change impacts are likely to be pervasive across the economy and society and the scale of fiscal costs could threaten our long-term fiscal sustainability.
22. While we cannot avoid physical climate change, there are many choices central government and other actors can take to adapt effectively. This has the potential to make a major difference to economic, fiscal and social costs to New Zealand.

The Government's fiscal position has been resilient to natural hazard events in the past, but future costs will be more difficult to manage due to more frequent climate extremes, greater use of retreat, and insurance market changes.

23. In this section we focus on fiscal costs following disaster events because those costs can be most easily isolated. **Appendix Two** describes the broader range of costs, both pre-event and post event, and recent examples. **Appendix Three** provides examples of economic and fiscal costs from the 2023 North Island Weather Events (NIWE).
24. In most years New Zealand has experienced multiple natural hazard events but with a modest fiscal impact in aggregate. For example, the average yearly cost of meeting the Crown's standing cost sharing commitments for state of emergency events between 2017 and 2022 (excluding for roading) was about \$3.7m.
25. Occasionally, overwhelming events have seen the Crown use its discretion to provide significant additional support to councils, and asset owners. These costs are met through borrowing using the Crown's debt buffer. Examples in recent history include:
 - a 2010/11 Canterbury earthquakes (approx. \$20b direct net cost to the Crown)⁷
 - b 2016 Kaikoura earthquakes (approx. \$2 - 3b direct net cost to the Crown)⁸
 - c 2023 NIWE (\$4.7b allocated to date), unprecedented for extreme weather events in terms of fiscal impact.
26. These major events have been large enough to influence fiscal indicators (OBEGAL and net debt) and economic indicators (GDP) but not large or frequent enough to challenge long term fiscal sustainability⁹. Successive governments'

⁶ New Zealand accounts for about 0.17% of global gross emissions.

⁷ Based on 2017 Treasury analysis of total net costs to the Crown from the earthquakes combined with updated estimates of EQC costs as at December 2021.

⁸ Treasury HYEPU 2016

⁹ We use the term fiscal sustainability to mean that existing policy settings are fiscally sustainable into the foreseeable future. That is, under existing policy settings, the government's fiscal position is not imposing a deteriorating debt or net worth trajectory that will at some future point force a fiscal correction.

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commitment to medium-term sustainability, through building fiscal buffers, has enabled resilience to fiscal shocks.

More frequent climate extremes

27. Based on our 2021 modelling, summarised in Box 1, we consider that larger and more frequent extreme weather events will contribute significantly to long term challenges to fiscal sustainability.

Box 1: Treasury modelling of fiscal impacts of increasing risk from weather events

The median simulation from our 2021 illustrative modelling of more severe and frequent storms/floods and droughts¹⁰ showed the fiscal pressure¹¹ from central government contributions increasing by 0.54 percentage points of GDP by 2061 (from an assumed baseline of 0% in 2021).

To put this number into context, over the same period the modelled fiscal pressure from superannuation costs would increase by 2.7 percentage points of GDP and health would increase by 3.7 percentage points of GDP.

The modelling also included estimates of impacts on net debt and GDP based on further assumptions about the mix of debt and tax that future governments would use in response to climate change costs. The median simulation saw net debt increase by 3.77% of GDP and GDP reduce by 1.9% by 2061.

We emphasise that the above figures are scenarios only and are not forecasts. Our judgement is that the scenario costs are likely to be an underestimate because they exclude the impacts of sea level rise or temperature change.

28. New Zealand also faces other large hazard risks. Earthquakes have historically caused far greater fiscal and economic costs than climate extremes and will continue to present a significant risk. **Appendix Four** compares climate related risks to non-climate hazard risks.

Greater use of retreat as a policy lever

29. Analysis by the National Institute of Water and Atmosphere (NIWA) suggests that sea level rise of 30 cm (expected between 2045 and 2070) would expose an additional 20,000 buildings, with a replacement value of \$6 billion, to risk of coastal flooding¹². If land values and other hazards are included, then this figure will increase. We note that these values represent value-at-risk rather than actual properties where retreat is deemed necessary, and do not account for routine infrastructure renewal.
30. Insurability could itself become a trigger for retreat. One study estimates that 10,000 coastal properties in Auckland, Wellington, Christchurch and Dunedin could become uninsurable by 2050 due to coastal flooding¹³. If acquisition was the policy response, then the cost would be in the order of \$10 billion at current capital values. The cost would be higher if river flood risk was included.

¹⁰ The return period of severe droughts was increased from 20 years to 7 years, and the impact of 10-year storms and floods was increased from 0.2% capital stock destroyed to 2% of capital stock destroyed, the latter approximately equivalent to the impact of the 2010-11 Christchurch earthquakes.

¹¹ We use the term fiscal pressure to mean the size of costs (e.g. capital damage) assumed to fall to Crown, separate from other parts of the model that made further assumptions on how the Crown would respond through borrowing, tax, or reduced spending elsewhere.

¹² This is additional to the estimated \$12.5 billion replacement value of buildings already exposed.

¹³ Storey et al (2020), based on an assessment that insurers will cease cover when coastal flood magnitudes that previously had a 1-in-100-year frequency increase to a 1-in-20-year frequency.


IN-CONFIDENCE

31. Ultimately, the fiscal implications for the Crown from retreat will depend on the speed of climate change and future policy choices on who pays, but the costs could be challenging in the context of wider fiscal pressures.

Changes to insurance markets and associated implicit fiscal risk

32. Insurers have shifted or will soon be shifting to greater risk-based pricing, particularly for the flood risk component of residential insurance premiums. This will result in premium increases in the highest risk locations and possibly the withdrawal of cover. The shift to greater risk-based pricing will be exacerbated by climate change unless natural hazard risk is reduced or managed.
33. Our separate forthcoming advice will cover this issue in more detail. In short, however, while the shift to greater risk-based-pricing can send a helpful price signal on the risk facing policy holders – and therefore help support adaptation – it may reduce living standards for homeowners in high-risk areas. In turn, this could cause pressure on the Crown to support insurability or to assist uninsured people following weather events. This pressure could materialise before the government has confirmed its approach to adaptation policy more broadly.
34. The fiscal implications for the Crown will depend on future policy choices. However, we note that policy responses in other jurisdictions have led to significant fiscal impacts (e.g. Cyclone Re-insurance Pool in Australia, which is supported by an annually-reinstated AUS \$10 billion government guarantee).

s9(2)(f)(iv)


Existing systems to manage natural hazard risk face significant regulatory and market failures.

38. As described in Figure 1, the natural hazards systems seek to resolve local and national market failures, balancing efficiency and equity.
39. However, several residual regulatory¹⁵ and market failures are creating sub-optimal outcomes within this system. We briefly summarise these below.

¹⁴ The overall cost of buyouts to the Crown is larger than this share, since achieving an agreed negotiated package with councils involved the Crown committing to co-fund other activities that it may not otherwise have supported. The Crown contributed approximately \$500 million toward the buyouts but in addition provided an additional \$495 million for transport projects and \$647.5 million for flood resilience projects.

¹⁵ We use the term regulatory failure to mean public actions, intended to correct market failures, that fail to recognise other market failures or fail to achieve their goals.

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Regulatory failures

- **Development in high-risk areas.** There is increasing anecdotal evidence that councils have permitted some new development or intensification in very high-risk areas, leading to poor outcomes for asset owners and increased implicit fiscal risk to the Crown. In other cases, new development has worsened flood risk downstream (unaddressed externality). We understand councils' attempts to restrict development are easily challenged under the Resource Management Act by developers or other groups. We do not have information on the scale of this problem nation-wide.
- **Uncertainty over who will decide and pay for retreat.** Councils have some powers to enact retreat in response to natural hazard risk via changes to land use under the Resource Management Act but these are not well set up for retreat, particularly post-event. Councils can also use the Local Government Act, or purchase property under Public Works Act (e.g. to build a stop bank). However, these three avenues rely on acquisition (taking ownership) for which councils lack resources. Councils also lack administrative tools and capacity to carry out retreat.
- **Council affordability.** Some councils say they cannot afford to build, maintain or upgrade local risk management infrastructure such as flood protection from their rates, targeted rates and debt. We do not have good information on the scale of this issue. s9(2)(f)(iv)
- **Moral hazard from central government's discretionary support.** See above section on the increasing case for a clearer split of post-event recovery costs.

Market failures

- **Equity, hardship from moves to risk-based insurance pricing.** As noted above, risk-based pricing could reduce insurance uptake, with possible hardship or other equity impacts.
- **Information failure from lack of data or myopia.** Councils' data on future natural hazard risks at the local level appears to be patchy and does not always account for increasing risk from climate change. Insurance contracts typically reflect short-term risk (within the 12-month period of the policy) based on backward looking data, rather than the longer-term risks presented by climate change data and information may also be overly discounted by property market participants for example due to wider housing supply constraints (myopia).
Recent actions to improve information includes legislation to ensure Land Information Memoranda (LIMs) provide nationally consistent and easily understood natural hazard information to property buyers¹⁶.

Central government has made limited progress on core policy choices.

40. Central government has undertaken work on adaptation in recent years, including the release of the National Adaptation Plan 2022 (NAP). This includes new legislation on climate related financial disclosures and the improved hazard information in LIMs. A new Cabinet circular requires agencies to consider resilience in asset management and capital investment (CO (23) 9). In 2023 public consultation took place on retreat and on national direction to target development at lower risk locations.
41. s9(2)(f)(iv)
- It has been difficult to make progress on core questions like the role of central versus local government, and who will decide and pay for retreat, because the levers for change sit across multiple portfolios that each face other priorities (Figure 1).

¹⁶ The Local Government Official Information and Meetings Amendment Bill 2022. Led by the Department of Internal Affairs.

IN-CONFIDENCE

- 42. Within the wider climate policy agenda, the strong legislative requirements that now exist under the Climate Change Response Act have created a clear incentive for government to ensure adequate plans are in place on mitigation. Adaptation as a problem does not lend itself so well to a targets-based approach, and consequently the incentive to prioritise adaptation is less strong.
- 43. Central government should retain option value in the face of uncertain future climate impacts. ^{s9(2)(f)(iv)}



Making progress on adaptation


Our first-best advice on adaptation principles and priorities

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Appendix Two: Sources and channels of cost from the physical impacts of climate change

Table 1: Sources and channels of cost from the physical impacts of climate change¹⁷

Sources	Channels
<p><u>Acute natural hazard costs</u>: the costs of adaptation actions before acute events ('pre-event') or the costs of repairing or recovering after acute events ('post-event'). Noting that pre-event costs can reduce post-event costs.</p>	<p><u>Fiscal channels</u>. Direct impacts on revenue and expenses such as repair of Crown infrastructure, or indirect impacts such as increased borrowing costs. We provide examples below.</p> <p><u>Economic channels</u>. Demand side costs such as reduced consumption, or supply side costs such as loss of capital stock. We provide examples below.</p> <p><u>Non-financial channels</u>. Many costs will fall outside fiscal and economic measures, including aspects of cultural harm, anxiety, uncertainty, injury or death, changes to social cohesion, or biodiversity change.</p>
<p><u>Chronic environmental change costs</u>. The costs of adjustment before long run changes occur, or the costs of adjustment afterwards. Noting that pre-change costs can reduce post-change costs. We currently have limited information on the scale of these costs.</p>	
<p><u>International costs</u>. Costs arising from relative changes in New Zealand competitiveness, or from possible disruption to global patterns of trade, migration, or reinsurance. These costs are highly uncertain.</p>	

Table 2: Examples of post-event costs from acute natural hazards

Fiscal channels	<ul style="list-style-type: none"> • Relief and recovery costs. For example, the direct fiscal costs to the Crown such as temporary accommodation, support to firms. For example, NIWE included \$318m fiscal cost for temporary accommodation.
Economic channels	<ul style="list-style-type: none"> • Output loss refers to the economic cost of lost production or consumption, for example from interruptions to the operation of farms. While rebuild activity will increase GDP, there is no increase in wellbeing if assets are only returned to their pre-event state. NIWE output loss was estimated to be \$0.4 – \$0.6b over the first half of 2023. (Note: output loss may also indirectly affect Crown revenue). • Inflationary effects. Rising prices are an economic impact resulting from reduced supply of goods and services, for example due to lost crops. These may be transitory or more long lasting, depending on the event. NIWE's inflationary impact was estimated at around a 0.4% price rise over the March and June 2023 quarters.
Combined fiscal and economic channels	<ul style="list-style-type: none"> • Capital loss refers to the cost of repairing or replacing damaged physical assets, which can be economic (private asset damage) or fiscal (public asset damage). Capital costs are typically moderated by insurance. Capital loss from the 2023 North Island Weather Events is estimated at \$9 – 14.5b across both public and private spheres.

¹⁷ Based on the framework published by the Treasury in the Climate Economic and Fiscal Update 2023.

IN-CONFIDENCE

Appendix Three: 2023 North Island Weather Events: Impact on OBEGAL and net debt

The NIWE response is expected to add \$1.7b to core Crown expenses in 2023/24 out of total expenses of \$140b¹⁸ and \$4.7b has been allocated over the forecast period to date. This is material when considering the forecast OBEGAL deficit of \$9.4b in 2023/24, and the target of returning to surplus in 2026/27; a surplus currently forecast at \$0.1b. This implies that were further such events to occur in the forecast period, with a similar costs, there would be an impact on the OBEGAL surplus date objectives all else being equal.

We estimate the NIWE response is increased net debt as a proportion of GDP by approximately 0.4 percentage points. Though less material than the impact on OBEGAL, it adds to net debt which is yet to peak (at 23.3% of GDP in 2024/25 against a policy ceiling of 30%.)

The table below breaks down the Crown's \$4.7b of allocated new spending.

Future of severely affected locations (Cost sharing for buyouts, flood resilience and additional transport projects)	\$1.73 billion
Transport (e.g. State Highway, local road, and rail repairs)	\$1.68 billion
Temporary accommodation	\$318.8 million
Managing silt, sediment and debris	\$250.2 million
Business support (excluding loan schemes)	\$161.0 million
Social sector support (e.g. provision of basic needs, mental health and employment services, other community supports)	\$138.0 million
Education (e.g. school repairs)	\$118.2 million
Recovery support structures (e.g. additional funding for NEMA, establishing the CRU)	\$87.9 million
Support for affected Māori	\$34 million
Other	\$198.2 million
Total operating expenditure	\$3.96 billion
Total capital expenditure	\$738.2 million
Total	\$4.70 billion

In addition to this allocated funding.

- The Crown reimburses councils for eligible response and recovery costs, based on standing civil defence commitments. This is funded through a permanent legislative authority. DPMC estimates costs for 2022/23 will be \$17.053 million. Costs for later years cannot be estimated at this stage.

¹⁸ HYEFU 2023 page 33

IN-CONFIDENCE

- The Government provided a package of up to \$2.24 billion to support businesses via the North Island Weather Events Loan Guarantee Scheme (supported loans up to \$2b) and Primary Producer Finance Scheme (funded up to \$240m).
- The Earthquake Commission scheme provides cover for residential *land* (not buildings) damage, including for climate related risks such as floods and storms. As of June 30, 2023, the estimated total cost of claims for the NIWE is \$486 million, with \$8 million already paid. Claims are paid out from the levy-based Natural Hazard Fund.

IN-CONFIDENCE**Appendix Four: Likelihood and consequence of selected natural hazard events in New Zealand**

Earthquakes have historically caused far greater fiscal and economic costs than climate extremes and will continue to present a significant risk. For context, the National Emergency Management Agency estimates the following likelihood of climate and seismic disaster events¹⁹:

Event	Likelihood over next 50 years	Potential capital damage
Cyclone Gabrielle equivalent	80%	\$9-14.5b (based on NIWE)
Alpine Fault earthquake	75%	\$10b
Hikurangi subduction zone earthquake	25%	\$10-20b
Wellington fault earthquake	5%	\$16b

¹⁹ <https://www.dPMC.govt.nz/sites/default/files/2024-02/bim-2023-nema.pdf>

Excerpt from Cover Briefing to RBNZ Report #6102 Reserve Bank Financial Stability Report May 2024

Page 2:

Paragraph 6

“Special Topic 2 has an assessment of insurance availability and risk-based pricing. There is a clear trend of insurers moving towards greater use of risk-based pricing for residential dwelling insurance. This means insurance premiums are more tailored to the risks that individual properties face (e.g. seismic or flood risk). Granular risk-based pricing provides a strong signal for all affected parties to proactively manage these risks. However, it may result in insurance becoming increasingly unaffordable or unavailable for high-risk properties. As a result, it is important that impacted stakeholders improve their understanding of natural hazards.”