Investor briefing

QBE Insurance Group Limited (ASX:QBE)

Re: Resolution 5(b) on the 2020 Notice of Annual General Meeting

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"*Gaining an understanding of the risks [from climate change] is an important first step for entities, but APRA wants to see continuous improvement in how organisations disclose and manage these risks over coming years.*"
- APRA Executive Board Member Geoff Summerhayes (emphasis added)

Introduction

Next month the following resolution will be put to QBE shareholders:

Shareholders request that the company disclose short, medium and long-term targets to reduce investment and underwriting exposure to oil and gas assets, along with plans and progress to achieve the targets set. The targets should be consistent with the climate goals of the Paris Agreement. This information should be published annually, starting with the 2021 annual report.

QBE has said it will set 'portfolio-wide' targets to measure and monitor climate-related risks. Market Forces has asked QBE to commit publicly that it intends to release, in 2020, targets specifically in relation to its oil and gas exposure in line with the Paris Agreement. Market Forces has made it clear that such a commitment would result in this shareholder resolution being withdrawn. QBE has refused to make this commitment.

We can only conclude that QBE does not intend to set Paris-aligned targets for its oil and gas exposure. Shareholder support for this resolution is therefore necessary to clearly set the expectation that QBE should produce these targets.
The oil and gas sectors are major contributors to global warming. Combined they produce more greenhouse gas emissions than coal. These sectors are major contributors to QBE's exposure to climate risk and therefore, this resolution is proposed in order to protect the long-term interests of the company, noting that:

- As recognised by the QBE Board, climate change is already impacting QBE's profitability and any rise in global warming increases the risk profile of climate change impacts to its financial health;
- a primary driver of global warming is the oil and gas industry, which QBE is exposed to through investments and underwriting;
- while QBE is working on disclosures of climate risks and opportunities and has said targets will be set regarding these risks, there are no specific plans for those targets to include a phase-out of oil and gas exposure through investments and underwriting, or even address those activities, which present a fundamental threat to our bottom line;
- QBE has admitted that it is basing its current energy policies on 1.7°C warming scenarios, rather than 1.5°C. Investors need to ensure QBE understands it is expected to align its activities to the ultimate Paris Agreement goal of limiting warming to 1.5°C;
- at the QBE 2019 AGM, QBE described its energy policy as a "living document" that would be constantly reviewed and updated. However, it is now one year old and despite the increasing clarity around the physical and transitional risks that climate change poses, the policy remains unchanged; and
- to be a credible public proponent for action that mitigates and builds resilience to climate change impacts, QBE should have its own house in order. Its current support for oil and gas expansion puts it out of line with the Paris Agreement.

To limit warming to 1.5°C oil and gas must not expand

"*If we built no more fossil fuel infrastructure and instead replaced existing infrastructure at the end of its productive life with a zero carbon alternative we could limit peak temperature rise to 1.5°C – as long as we start now.*"

- Chris Smith, Research Fellow in Physical Climate Change, University of Leeds.

Like coal, expansion of the oil and gas industry will undermine global efforts to limit global warming to 1.5°C.

In the 2018 IPCC report on 1.5°C, model pathways with no or limited overshoot of 1.5°C of warming showed that global net anthropogenic CO2 emissions must decline by about 45% from 2010 levels by 2030, reaching net zero around 2050 (page 95).

The IPCC report shows that the use of oil for primary energy must be reduced between 2020 and 2030 in all pathways that do not result in high overshoot of the 1.5°C target. Gas use for both primary energy and electricity generation decreases between 2020 and 2030 in the majority of these scenarios (page 132). The scenarios that show an increase in gas use require “widespread deployment of CCS” (carbon capture and storage) (page 97), a technology that has failed to demonstrate viability, as QBE acknowledges in its Energy Policy.

Any support QBE provides, either through underwriting or investment, to an oil or gas expansion project directly or companies expanding the scale of these sectors, is inconsistent with the 1.5°C goal.

More gas is a detour, not a transition

In its Energy Policy QBE describes natural gas as a “transitional fuel” which will “accelerate the curtailment of thermal coal”. This claim doesn’t stand up to the most basic scrutiny. QBE’s Board has failed to explain how this “gas transition” takes effect, given the claim would need to be supported by specific energy and economic modelling.

The current data actually shows that gas is a detour away from renewable energy and climate safety, rather than a “bridge” or “transition” towards it. As the IPCC modelling discussed above shows, to keep warming below 1.5°C, as coal electricity generation comes to the end of its life, it must be replaced with renewable energy (and storage) rather than polluting natural gas. While oil and gas will continue to play a role in the energy mix going forward, this role must also be viewed as limited and declining over time to adhere to the 1.5°C limit.

Building new natural gas electricity generation, which locks in carbon emissions for decades to come, when renewable energy technology is not only available, but cheaper, does not make climate or economic sense. It is in fact more likely that new gas power capacity is preventing opportunities that would otherwise have been available to renewable energy, "as once capital has been sunk, operators can keep running a [gas] plant as long as it can sell power for more than the marginal cost of producing it, even if it incurs a loss on the invested capital". There are significant barriers to closing down infrastructure ahead of its economic lifespan, so new gas developments should be avoided.

QBE is justifying increasing gas use by using 1.7°C warming scenarios

In a meeting with Market Forces on 12 March 2020, QBE informed Market Forces that its view regarding gas use increasing until 2030 was based on IPCC 1.7 degree warming scenarios. This is concerning as it goes against the clearly stated Paris Agreement goal of "pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels". In the meeting QBE promised to provide Market Forces with the specific scenarios it is basing its target development on, however, despite a follow-up request from Market Forces, these were never provided.

The difference between 1.5 and 1.7°C of warming could be significant in determining QBE's financial performance. And of course it should be noted that with around 1°C of warming currently, QBE's profits and revenues are already being hit hard due to increasing extreme weather like storms, bushfire and flood as well as other weather-related losses such as crop failures.

To illustrate, compared with 1.5°C, 2°C of warming will expose 2.6 times more people to extreme heat every five years, cause 6cm more sea level rise exposing 10 million more people to coastal flooding by 2100, and lead to a greater reduction in crop yields globally, including 2.3 times greater reduction for maize harvests in the tropics. There's also an increased risk of drought, heavy rainfall and 2-3 times greater destruction of vertebrate, plant and insect habitat.

To be aiming for anything other than 1.5°C of warming means QBE will be contributing to more severe revenue-destroying extreme weather, and increasing the risk that the world hits tipping points which set in motion runaway climate change.

Every fraction of a degree of warming that occurs will further exacerbate the financial impact of climate change on our company's bottom line. It is irresponsible to be linking corporate policy to scenarios that lock in more dangerous warming.

Energy Policy has not evolved

At the 2019 QBE AGM, QBE's CEO insisted the company's Energy Policy was a "living document". Chairman Marty Becker said "we'll continue to assess them [QBE's climate and energy policies] for tar sands, for natural gas, for oil, etc." and insisted that the policy could change as soon as "tomorrow".

Almost one year later nothing has changed.

In that time, other insurers, namely Swiss Re, AXIS Capital and AXA, have adopted restrictions on some oil and gas underwriting/investments, in particular those with extremely high life-cycle carbon emissions, like tar sands. More insurers are developing similar policies.

QBE has stated that it will set metrics and targets to measure and monitor climate-related risks across its entire portfolio this year. However, there is no guarantee that oil and gas exposure phase-out targets will be part of this, or, if they are, that they will be consistent with 1.5°C warming scenarios. It is in the interest of investors that QBE matches its words with actions and includes oil and gas phase out plans in any climate risk targets. That is why this resolution is so important.

Financial impact

QBE announced in February that once again earnings had been hit by climate-related disasters including bushfires, storms, floods and crop damage. This is despite increasing its budget for large individual risk and catastrophe claims from $1.2 billion to $1.4 billion for the 2019 year.

For QBE's Australia Pacific business, the net cost of catastrophe claims increased significantly in 2019 to US$193 million or 5.4% of net earned premium compared with $106 million or 2.8% in the prior year, mainly due to the Townsville floods and widespread bushfires.

The losses incurred by QBE on catastrophes, exacerbated by global warming, are a direct hit to the shareholder capital invested in this company, and present fundamental risks to the insurance industry's ability to operate. According to Tom Herbstein of Cambridge University, "climate change fundamentally challenges the existing insurance business model because it is rendering actuary analysis in many places obsolete."

QBE CEO Patrick Regan warned in February extreme weather risk was increasing across "swathes of Australia" and customers could be priced out. According to Munich Re, global warming is on track to make insurance unaffordable for low and average income earners in some regions, causing serious economic and social disruption.

The trend is clear. Without significant and urgent action in both climate change mitigation and adaptation, QBE faces shrinking markets and growing and less predictable natural catastrophe claims.

Special resolution 5(a)

The proposed ordinary resolution 5(b) is accompanied by special resolution 5(a). Australian corporate law does not by default permit shareholders to propose ordinary advisory resolutions unless such a power is explicitly granted by a company's constitution. This approach is out of step with similar jurisdictions including the UK, USA, New Zealand and Canada, where shareholder resolutions are a healthy part of corporate democracy. In the UK shareholders can consider resolutions seeking to explicitly direct the conduct of the board. In the US, New Zealand and Canada shareholders can consider resolutions seeking to advise their board as to how it should act.

QBE's constitution is not conducive to the right of shareholders to place resolutions on the agenda of a shareholder meeting. In our view, this is contrary to the long-term interests of the company, its board and shareholders. Passage of this special resolution will simply put our company and its shareholders in a similar position as listed companies in the UK, US, Canada or New Zealand.

Regardless of the special resolution’s outcome, votes lodged on both resolutions prior to the Annual General Meeting will be required to be recorded by the company. Investors are therefore encouraged to treat each resolution on its merits.

The resolution requesting exposure reduction targets is an important opportunity for investors to publicly (through voting) and privately (through engagement) signal support for the proposed items.

Investor support is required for the resolution

Without significant and urgent action in both climate change mitigation and adaptation, QBE faces shrinking markets and growing and less predictable natural catastrophe claims. As part of this global effort, our company must get its house in order by having clear targets and plans for its own oil and gas phase out in line with keeping warming below 1.5°C. It has done this for thermal coal, and now must do the same for oil and gas. In addition, scenarios that assume a riskier and more damaging 1.7°C of warming (which allow for oil and gas expansion until 2030) need to be replaced with low-overshoot 1.5°C scenarios with oil and gas use decreasing immediately. The proposed resolution will provide the framework to ensure QBE doesn’t increase its climate risk exposure while continuing its work disclosing that risk.

We urge shareholders to vote **in favour of this resolution**.