The Treasury

Earthquake Commission (EQC) Act Review Submissions Information Release

Release Document

July 2017

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Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people;

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

The Treasury

on the

Discussion Document: New Zealand's Future Natural Disaster Insurance Scheme – Proposed changes to the Earthquake Commission Act 1993

15 October 2015

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Submission by the New Zealand Bankers' Association to The Treasury on the Discussion Document: New Zealand's Future Natural Disaster Insurance Scheme – Proposed changes to the Earthquake Commission Act 1993

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following fifteen registered banks in New Zealand are members of NZBA:
    - ANZ Bank New Zealand Limited
    - ASB Bank Limited
    - Bank of China (NZ) Limited
    - Bank of New Zealand
    - Bank of Tokyo-Mitsubishi, UFJ
    - Citibank, N.A.
    - The Co-operative Bank Limited
    - Heartland Bank Limited
    - The Hongkong and Shanghai Banking Corporation Limited
    - JPMorgan Chase Bank, N.A.
    - Kiwibank Limited
    - Rabobank New Zealand Limited
    - SBS Bank
    - TSB Bank Limited
    - Westpac New Zealand Limited.

Background

3. NZBA is grateful for the opportunity to make a late submission to The Treasury on the Discussion Document: *New Zealand's Future Natural Disaster Insurance Scheme – Proposed changes to the Earthquake Commission Act 1993* (**EQC Reforms**).

4. We appreciated meeting with you on 29 September 2015 to discuss the proposed reforms.

5. NZBA understands the rationale for proposing the EQC Reforms is to consider the parameters of risk that the Crown should bear in relation to EQC provisioning, particularly for natural disasters. The Christchurch and Wellington earthquake events of the previous five years have provided lessons that can be built into decisions about where allocation of risk should fall and who should bear the cost.

6. NZBA commends Treasury on the work undertaken to analyse the issues and propose the reforms in the Discussion Document. We are supportive of the majority of the EQC Reforms proposed.

7. However, further to our discussion on 29 September with officials from Treasury on the topic of underinsurance of New Zealand's housing stock in the past 18 months, NZBA wishes to raise the following concerns with two of the proposed EQC Reforms:

   a. **Extending EQC building cover to include more site-works and access-ways to the building; and**
   b. **Limiting land cover to situations where rebuilding is not practicable**

8. If you would like to discuss any aspect of the submission further, please contact:

Antony Buick-Constable
Policy Director & Legal Counsel
[1]

Risk of underinsurance to home owners and banks

9. In NZBA's view, the proposals noted above will significantly exacerbate the levels of underinsurance facing New Zealand home owners and banks as mortgagees.

10. The move to "sum insured" residential home insurance following the Christchurch earthquakes led to the transfer of underinsurance risk on homes from New Zealand insurance providers to New Zealand homeowners.

11. Banks require customers contractually to have home insurance for, among other things, credit risk reasons. However, industry practice has changed and homeowners have become responsible for determining the value of the home and the level of insurance cover needed.

12. Based on anecdotal evidence, NZBA understands that a significant percentage of home owners may be underinsured.

13. NZBA members believe this is caused by a lack of understanding around the actual cost to repair or rebuild, or a lack of understanding of how sum insured works.

14. NZBA members also consider that there is a financial disincentive on homeowners to properly insure themselves due to the cost of insurance cover or the cost of getting professional advice about how much they may need to insure for.

15. Banks bear this insurance risk when they lend against residential property as they take security for lending by registering a mortgage against the customer's home. So, any proposal to further increase the likelihood of customer unawareness and consequently, underinsurance, is concerning.

16. Under the terms of most banks' mortgages, home owners must hold sufficient home insurance to rebuild or replace their home in the event of a total loss. The insurance protects the asset the bank has taken as security, to make sure that if the home owner is unable to repay their loan, the bank can recover the money owing by selling that home. Importantly, the insurance also protects the home owner by ensuring they retain the wealth (i.e. the equity) they have in their home. If the home owner is underinsured and their home is destroyed or seriously damaged, the bank carries a credit risk as the value of the bank's security is impaired and the bank may not be able to recover the lending. Of greater concern, the home owner could face a situation of nil or negative equity resulting in serious adverse change to their financial circumstances.

Impact of the proposed EQC Reforms to underinsurance risk

17. The proposed EQC Reforms noted above will lead to the transfer of the risk of remediating the building platform (currently the eight metres of land surrounding the home) from EQC to the home owner.

18. The home owner must now additionally consider the cost of remediating the land and the sub structures of the home when calculating their sum insured.

19. NZBA believes:

    a. it is unrealistic to expect a home owner to know or understand the cost to reinstate their land and foundations in a wide range of possible natural disasters;

    b. homeowners will simply renew at current levels with a "it won't happen to me" approach – as it is too complex;

    c. homeowners are financially dis-incentivised to review their sum insured to cover the land and foundations as it may require costly reports from experts depending on the type of property or the location of their home;

    d. homeowners are also financially dis-incentivised to review and increase their sum insured to cover the land and foundations as it will increase their premiums; and

    e. it will be difficult for lenders to effectively manage this risk to ensure they hold adequate security for lending, putting the stability of financial markets at risk.

20. Ultimately, the risk of the home (from the move to sum insured) and now the transfer of risk of the land (proposed EQC reforms) to the home owner exacerbates the risk homeowners already face of a nil or negative equity situation and leads to a transfer of the risk to banks that have lent against affected properties. This leads to potential exposure for lenders to significant credit losses in the event of a major disaster or other risk event.

21. NZBA members believe this will have the most impact in areas like Wellington. The capital city is in a high earthquake risk zone and feedback from our members estimates the cost to remediate land on a steep site could be approximately $250,000. This, coupled with an already underinsured housing stock, could be devastating to customers and in turn lenders and the financial stability of New Zealand.

Potential solutions

22. In NZBA's view, if the government proceeds with the EQC Reforms as proposed, a potential solution to the risk of underinsurance borne by banks is the establishment by the government of an independent information bureau. The bureau should allow for the non-competitive sharing of information about residential property insurance cover. Banks can engage in meaningful conversations with customers who are significantly underinsured using information from the bureau.

23. The sharing of information would also lessen a potential legacy risk developing in Christchurch – the prevalence of 'As is, where is' properties, i.e. properties that have been damaged and left on the site unrepaired. Transparency from sharing insurance information would reduce the risk of losing track over time of damaged properties that have not been fully repaired. This would make it less likely that such properties are inadvertently insured, purchased or mortgaged in future without knowledge of their historic damage.

24. Companies such as CoreLogic and others would be in a position to offer this service as they already do this on a non-competitive basis for credit information in New Zealand.

25. Previous attempts to establish a New Zealand property register by NZBA have been hindered by a lack of consensus within the insurance industry. NZBA firmly believes that this should be revisited so that banks and insurers work together to help ensure that New Zealand homeowners have adequate insurance to reinstate their properties (both the house and the land) should New Zealand suffer another major natural disaster.