

# The Treasury

## Earthquake Commission (EQC) Act Review Submissions Information Release

### Release Document

January 2018

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# New Zealand's Future Natural Disaster Insurance Scheme

Proposed changes to the Earthquake  
Commission Act 1993

Submission Form

July 2015



THE TREASURY  
Kaitohutohu Kaupapa Rawa

New Zealand Government



## New Zealand's Future Natural Disaster Insurance Scheme Proposed changes to the Earthquake Commission Act 1993

### Your responses

Please write your response in the template below.

Please note:

- ▶ you **do not** need to answer all sections – just the ones where you have information you would like to contribute
- ▶ please expand or delete boxes as you need to but **do** keep the original question numbers.
- ▶ please **do not** send us reports or other documents but **do** include references or links to supporting evidence or information
- ▶ please submit your response to [Submissions.Eqcreview@treasury.govt.nz](mailto:Submissions.Eqcreview@treasury.govt.nz) by 5.00pm on Friday 11 September 2015.

Thank you for your time and effort in making your submission.

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Grounds for withholding information are outlined in the OIA. Reasons could include that the information is commercially sensitive or that you wish personal information, such as names or contact details, to be withheld. An automatic confidentiality disclaimer from your IT system will not be considered as grounds for withholding information.

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## Your contact details

### For individuals

Your name:	

Email address:	
Phone number:	

What city, town or province do you live in?	
Do you own your own home?	

### For organisations

Organisation name:	Tokio Marine Kiln
Nature of your business:	Reinsurer based at Lloyd's of London

Contact person name:	Jeremy Walker / Alex Dugand
Position:	Underwriter
Phone number:	[1]
Email address:	

In what city, town or province is your organisation's New Zealand headquarters?	Not applicable
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## What is the purpose of the EQC scheme?

### Proposal for discussion

1 That the purpose of the EQC Act be to establish a Crown-owned natural disaster insurance scheme for residential buildings in New Zealand that:

- ▶ supports, complements and is closely coordinated with the provision of effective private insurance services to the owners of residential buildings
- ▶ recognises the importance of housing in supporting the recovery of communities after a natural disaster
- ▶ supports improved resilience of New Zealand communities and an efficient approach to the overall management of natural hazard risk and recovery in New Zealand
- ▶ contributes to the effective management by the Crown of fiscal risks associated with natural disasters.

### What do you think?

1a Do you agree that these purposes are appropriate and complete?

*We broadly agree with this statement but would propose the following amendments, per below.*

1b If not, what changes would you suggest, and why?

1. *Reorder the list to reflect what the key priorities are.*
2. *Emphasise more strongly the provision of affordable insurance as a key purpose of the Act.*
3. *Clarify point 2 to confirm EQC's role in ensuring a swift and efficient rebuild and recovery process post a major event*
4. *We are not sure that the EQC Act necessarily supports the private insurance market to the extent implied in the statement. Indeed, to some extent the Act necessarily replaces the insurance market. We would therefore reword the statement slightly, per our suggestion below.*

1 That the purpose of the EQC Act be to establish a Crown-owned natural disaster insurance scheme for residential buildings in New Zealand that:

- ▶ ensures the availability of affordable Homeowner coverage to all New Zealand residents
- ▶ *contributes to the effective management by the Crown of fiscal risks associated with natural disasters.*
- ▶ assists in ensuring a swift and robust post-event rebuilding programme therefore supporting the recovery of communities after a natural disaster
- ▶ *supports improved resilience of New Zealand communities and an efficient approach to the overall management of natural hazard risk and recovery in New Zealand*
- ▶ *complements and is closely coordinated with the provision of effective private insurance services to the owners of residential buildings*

## What types of perils will EQC cover?

### Proposal for discussion

2 That EQC continue to insure against the following perils: earthquake, natural landslip, volcanic eruption, hydrothermal activity, tsunamis, and storm and flood (with, in the case of storm and flood, only residential land being covered).

### What do you think?

2a Do you agree that EQC should continue to provide cover against the same perils as it currently does?

No.

2b If not, what changes would you suggest, and why?

*We suggest that the EQC Act is amended to purely reference seismic risk. i.e. earthquake, volcanic eruption, hydrothermal activity, tsunami.*

*This is on the basis that it presents by the far the greatest challenge to the finances of the Crown and is also be the only real solvency threat to the New Zealand insurance industry. Risks having lower severity potential should be kept within the private insurance market.*

### What types of property will EQC insure?

#### Proposal for discussion

3 That EQC building cover continue to be available to residential buildings and dwellings in non-residential buildings.

#### What do you think?

3a Do you agree that EQC building cover should continue to only be available to residential buildings and dwellings in non-residential buildings?

*Generally Yes but see comments below regarding holiday homes.*

3b If not, what forms of accommodation or living arrangements do you think should be added or removed, and why?

*One area that seems out of line with the aims of the EQC Act is that holiday homes currently qualify for coverage. This should be reviewed given that holiday homes either operate as effectively commercial premises or they are not the primary residence of the insured. In either case, insurance coverage should be sought in the open market and not provided by the EQC Act, which should be restricted to residences only.*

#### Proposal for discussion

4 That EQC land cover only be available for land associated with residential buildings. Therefore, dwellings in non-residential buildings would not receive any EQC land cover.

#### What do you think?

4a Do you agree that EQC land cover should only be available for land associated with residential buildings?

No

4b If not, what coverage of land cover would you prefer, and why?

No. We think that the land coverage should be withdrawn completely on the basis that

1. Aspects of the coverage does not really help the EQC comply with its main objective of ensuring that homeowners are able to put a roof over their head after an earthquake.
2. The coverage remains poorly understood and adds a disproportionate amount of complexity and expense to the scheme.
3. By expanding the building coverage to include so called 'site works' the key parts of the land coverage can be retained.
4. Providing this coverage may actually encourage poor development and purchasing decisions on land that is highly vulnerable to seismic risk. This goes against another objective of the EQC Act, that of improving the resilience of New Zealand communities.

## Extending building cover to include more siteworks and main access way

### Proposal for discussion

5 That EQC building cover be extended to include siteworks and the main access to the building.

### What do you think?

5a Do you agree that EQC building cover be extended to include siteworks and the main access to the building?

*Yes. This would seem to be a sensible arrangement that removes the overlap with the land coverage but retains the key elements of this coverage.*

5b If not, what do you think should be done instead, and why?

## EQC to no longer provide contents insurance

### Proposal for discussion

6 That EQC no longer offer residential contents insurance.

### What do you think?

6a Do you agree that EQC should no longer offer residential contents insurance?

Yes

6b If not, what level of contents cover do you think EQC should offer, and why?

6c For insurers, what do you anticipate the impact would be on premiums your company charges for residential contents insurance, if EQC no longer offered residential contents insurance?

Please note the information in section 1.4 regarding the Official Information Act.

## How much insurance will EQC offer?

### Proposal for discussion

7 That the monetary cap on EQC building cover be increased to \$200,000 + GST.

### What do you think?

7a Do you agree with the proposed increase in the building cap to \$200,000 + GST?

Yes

7b If not, what cap would you prefer, and why?

7c Do you have strong views on the merits of a \$150,000 + GST cap versus a \$200,000 + GST cap?

Yes

7d If so, what are they?

*We think that \$150,000 is below the average dwelling unit rebuild cost and would be too low to provide a reasonable level of cover, especially if the scope of buildings coverage is expanded to include site works.*

7e For insurers, what do you anticipate the impact would be on premiums your company charges for residential property insurance, if the proposals in this document regarding changes to building cover were implemented? Please provide this information for a monetary cap for EQC building cover of both \$150,000 and \$200,000.

Please note the information in section 1.4 regarding the Official Information Act.

## Reinstatement of EQC cover after an event

### Proposal for discussion

8 That EQC building cover reinstate after each event.

### What do you think?

8a Do you agree that EQC cover should reinstate after each event? If not, what is your preferred alternative, and why?

*We think that the current reinstatement after an event provision should be maintained. There are however strong arguments in favour of limiting the coverage to an 'annual aggregate amount', on balance, it is probably best to maintain the status quo.*

8b Do you agree with retaining the current definition of an event?

No.

8c If not, what is your preferred definition, and why?

*We think that retaining a broad event definition subject to an hours clause is appropriate. However the hour clause could be broadened to allow earthquake aftershocks to be included in the same event as the original shock. 168 hours would probably therefore be a better event cap..*

## EQC land cover

### Proposal for discussion

9 That land cover be limited to situations where the insured land is a total loss meaning it is not practicable or cost-effective to rebuild on it.

### What do you think?

9a Do you agree that the proposed enhanced building cover, combined with restricting land cover to situations where the site of the insured building cannot be rebuilt on, would resolve, for future events, many of the recent difficulties with the interaction between land and building cover?

No

9b If not, what is your preferred alternative, and why?

*We agree with the enhanced proposed building cover but disagree with maintaining any separate land cover. (see 9d)*

9c Do you agree that restricting land cover to situations where the site of the insured building cannot be rebuilt on is appropriate, given the EQC scheme's focus on providing homeowners the resources to repair, rebuild or re-establish homes elsewhere?

9d If not, what is your preferred alternative, and why?

*On balance we think it would be appropriate to withdraw the land coverage in its entirety and not provide it even when the land is a total loss.*

- 1. The existing level of Land Coverage is, in view, overly complicated and adds a significant amount of complexity to the EQC scheme. This makes it difficult to accurately price and also makes loss settlement a problematic area.*
- 2. Retaining an element of coverage, will also retain this complexity within the programme. Indeed, it would potential add another area of uncertainty or policyholders as to whether the coverage would available or not.*
- 3. A more fundamental issue appear to us to be that this 'total loss only land coverage' will have some undesirable impacts in perpetuating or encouraging poor planning building decisions. The buildings that will benefit from this residual coverage are more likely to be located in dangerous and higher risk locations. Because of the nature of the EQC rating scheme, there is no disincentive within the rating or coverage provided to locate risks within lower risk building or areas. It is therefore impingement upon the planning and building control agencies to ensure good decisions are made regarding appropriate seismic risk levels within the housing market but retaining this coverage would appear to work against this process.*

9e Do you have any concerns regarding the proposed change to the configuration of building cover in light of the move by most insurers to provide sum insured home insurance policies?

*No. We believe that the EQC should configure the building coverage in the way it thinks is most appropriate. The move to sum insured policies is mainly relevant for buildings exceeding the EQC cap and the coverage*

*can anyway be configured by insurers to fit around the EQC policy.*

9f If so, what is your preferred alternative, and why?

## Better aligning EQC and private insurers' standard of repair

### Proposal for discussion

10 That EQC's current statutory repair obligation already appears broadly consistent with industry practice.

### What do you think?

10a Do you agree with the Government's assessment that EQC's legislated standard of repair is broadly consistent with current industry norms?

Yes

10b If so, do you have views on why EQC's standard of repair is seen as markedly different from current insurance industry norms?

*We are not convinced that it is out of line with industry norms.*

10c If not, do you have suggestions for reforms that you consider would move the EQC standard of repair closer to current insurance industry norms for residential property?

## Simplifying EQC's claims excess

### Proposal for discussion

11 That EQC has a standard claims excess of \$2,000 + GST per building claim.

### What do you think?

11a Do you agree that EQC's building claims excesses should be standardised and simplified to a flat dollar amount?

Yes

11b If yes, do you agree that \$2,000 + GST is the appropriate claims excess on building claims?

11c If not, what would you prefer, and why?

*We agree that the excess should change to be a monetary amount rather than as a percentage of loss. However we think that this amount should be indexed annually to preserve its value **and that this should be in line with an indexed increase in the Limit of coverage**. This will avoid the impact of inflation reducing the effective value of the excess and the coverage over time.*

*We believe an annual indexed increase is the best approach as this ensures that increases are regularly and gradually imposed. This removes or lowers the risk of shock increases and the risk of increases not being implemented on political grounds.*

*In our view an excess of \$4,000+ GST would be lower than international standards but it would also be consistent with ensuring that coverage is at a more financially sustainable level than currently.*

### Proposal for discussion

12 That EQC have no claims excess on land claims.

### What do you think?

12a Do you agree that EQC should have no claims excess on land claims?

*Our view is that Land Coverage as a separate cover should be removed. If an element is retained that responds only if the land cannot be rebuild on then a claims excess is not necessary.*

12b If not, what would you prefer, and why?

## Regularly reviewing main monetary settings of cover

### Proposal for discussion

13 That the EQC Act require monetary caps, premium rates and claims excesses on EQC cover to be reviewed at least once every five years.

## What do you think?

13a Do you agree that monetary caps, premium rates and claims excesses on EQC cover should be reviewed at least once every five years?

13b If not, what alternative would you prefer, and why?

*Our view is that caps, rates and excesses should be subject to an appropriate annual index. This will obviate the need for a 5 year review. This would have several advantages;*

- 1. An index will ensure that the coverage keeps up with inflation and will better track the underlying change in exposures.*
- 2. It will ensure that premiums grow each year in line with the growth in exposure. Any premium increases will only be marginal and therefore easier for policyholder to budget for.*
- 3. A 5 year review could result in significant jumps in premium that might be difficult to accept by policyholders.*
- 4. There may also be risks with a 5 year review that the Act becomes subject to (short term) political influence.*

## How will homeowners access EQC insurance cover?

### Proposal for discussion

14 That EQC cover continues to automatically attach to fire insurance policies on residential buildings, as defined in the EQC Act.

or

15 That EQC cover automatically attach to insurance policies on residential buildings, as defined in the EQC Act, on a peril by peril basis; so if a peril covered by EQC is excluded from the private policy, it is also excluded from the EQC cover.

### What do you think?

14a Do you agree that EQC cover should continue to automatically attach to fire insurance policies on residential buildings? Or

Yes

15a do you agree that EQC cover should automatically attach to insurance policies on residential buildings, and EQC cover should exclude any natural disaster peril that is excluded from the fire insurance policy it attaches to?

*We agree that the cover should automatically attach to the fire policy but not that the cover should exclude any natural disaster peril that is excluded from the fire insurance policy it attaches to? Our view is that the EQC cover should stand on its own and not be dependent on the coverage offered by the corresponding fire policy.*

15b If you do not agree with either of these options, what alternative arrangement do you prefer, and why?

### Proposal for discussion

16 That EQC continue to have the ability, but not the obligation, to directly provide EQC cover to homeowners who request it.

### What do you think?

16a Do you agree that EQC should continue to be able, but not be obliged, to directly provide EQC cover to homeowners who request it?

*No. We think that EQC policies should only be accessed by attachment to a Fire policy.*

16b If not, what alternative arrangement would you prefer, and why?

## Who will handle EQC claims in future?

### Proposal for discussion

17 That all EQC claims be lodged with claimants' private insurers.

### What do you think?

17a Do you agree that EQC claimants should be required to lodge all EQC claims with claimants' private insurers?

*Yes. It should then be the responsibility of the Insurer to notify the EQC of any claim and the EQC should retain the right to take over the adjustment of any claims at its discretion.*

17b If not, what alternative arrangement would you prefer, and why?

## Deadline for reporting claims

### Proposal for discussion

18 That the current three-month time limit for claims notification be retained, but EQC be able to accept claims up to two years after an event, unless doing so would prejudice EQC.

### What do you think?

18a Do you agree that the current three-month time limit for claims notification should be retained, but EQC should be able to accept claims up to two years after an event, unless doing so would prejudice EQC?

18b If not, what alternative arrangements would you prefer, and why?

*We think that any time limit should be strictly adhered to if it is to be meaningful. We would suggest that it should be 3 months but with EQC having the option to only accept claims outside this period in specified exceptional circumstances such the death of the policyholder..*

## Ensuring the scheme meets its expected costs

### Proposal for discussion

19 That the new EQC Act contain pricing and transparency principles requiring the scheme to adequately compensate the Crown for its expected costs and risks.

### What do you think?

19a Do you agree that the new EQC Act should contain pricing and transparency principles requiring the scheme to adequately compensate the Crown for its expected costs and risks?

*We strongly agree that that the new EQC Act should contain these pricing and transparency principles. It is our view that this is one of the critical fundamentals needed to ensure the long term viability and success of the scheme.*

*There are many additional benefits that follow from having the scheme placed on a sound and transparent basis. These include the following*

- 1. A clear assessment of the actuarial costs of the scheme is required in order to make informed decisions regarding the level and type of cover that can be realistically and affordably provided by the EQC. It will also enable the financial impact of any changes to the scheme details such as coverage extensions to be assessed.*
- 2. Secondly , the degree of cross subsidy of insurance premium can be assessed. Due to the uniform rating structure of the scheme, buildings with lower risk profiles effectively subsidise buildings with*

higher risk profiles. The extent of this subsidy is, in our view, significant but hidden by the nature of the EQC scheme. However it is important to calculate. In particular it will highlight the costs from seismic risks within the current make up the New Zealand building stock and highlight areas that this cost can be lowered. In addition the cost benefit of legislative changes in areas such as building code levels, retrofitting requirements and planning law can be accurately assessed and communicated.

3. Finally, it is only if there is a robust assessment of the scheme costs that it is possible to then make accurate decisions regarding the most efficient financial structure for the scheme to maintain. This would include issues such as assessing the true cost and benefits of purchasing reinsurance and what level of retention should be kept by the Fund.

4. It would also include the ability to assess what is the true, i.e. long term, cost to the state of providing the Crown Guarantee. This is in our view a significant cost which is possibly easily overlooked. Indeed it is the view of TMK that the scheme is currently underfunded based on the current premium levels with Crown guarantee effectively providing another insurance premiums subsidy.

19b If not, what alternative arrangements would you prefer, to ensure the scheme's future financial sustainability, and why?

## Allow but do not require differentiated EQC premiums

### Proposal for discussion

20 That the current legislative flexibility to charge flat-rate or differentiated EQC premiums be retained.

### What do you think?

20a Do you agree that the current flexibility to charge flat-rate or differentiated EQC premiums should be retained?

Yes.

20b If not, what alternative arrangement would you prefer, and why?

20c Do you agree with the Government's intention to continue charging EQC premiums at a universal flat rate?

Yes.,

## How will EQC finance its risk?

### Proposal for discussion

21 That the Natural Disaster Fund be retained in broadly its current legislative form.

### What do you think?

21a Do you agree that the Natural Disaster Fund should be retained in broadly its current legislative form?

Yes

21b If not, what changes would you like to see considered?

### Proposal for discussion

22 That the Act enable EQC to use other forms of risk transfer, in addition to traditional reinsurance.

### What do you think?

22a Do you agree that the Act should enable EQC to use other forms of risk transfer, in addition to traditional reinsurance?

*No. The performance of the reinsurance market after the Christchurch events has, in our view, been exemplary. The support and help that it has provided to aid the post disaster recovery has been notable. There is also no evidence that the reinsurance market will not in future be able to offer this again as well as providing all the required capacity for cost effective transfer of risk.*

*In comparison to the reinsurance industry however, the alternative risk transfer market is both relatively untested and unregulated.*

*We do not therefore see any compelling reason to amend the Act at this stage to allow alternative forms of risk transfer to be considered.*

## Do you have any other feedback?

### Other feedback

23a Are there any issues not discussed in this document that you would like to bring to the Government's attention at this stage?

23b What submissions would you like to make on those issues?

### **Risk based pricing capability**

*Whilst the EQC scheme operates on the principle of a flat rate or levy, we believe it important that in future the EQC is able to calculate the correct technical rate for each policy, even though it won't be using this to calculate the premiums charged. This should be done for the following reasons.*

1. *Information quality and data processing capability has developed so that it is now possible to derive very granular premium rates even for seismic risks.*
2. *The information gained from the Christchurch events would be invaluable and greatly assist this process.*
3. *The more accurate the rates that are generated, the more accurate the overall estimates for the costs of running the EQC scheme will be.*
4. *Risk pricing at a granular level will also enable the degree of cross-subsidy inherent in the scheme to be assessed.*
5. *The impact of the private insurance industry moving to more granular pricing can be assessed including the impact on coverage affordability and subsequent necessity for the EQC coverage.*
6. *The feasibility of creating different charging structures for the EQC can be reviewed using this data.*
7. *Areas of very high vulnerability and risk can be identified.*
8. *The long term seismic cost / benefit of specific building development or changes in building regulations proposals could also be calculated or validated using such a granular risk pricing framework.*

#### ***The Role of the EQC in Research and Education***

*The long term success of the EQC act should be linked to its role in promoting risk mitigation resilience. Indeed the EQC is ideally based to ensure that the lessons learnt from Christchurch are never forgotten and are embedded into the New Zealand society for the future. We would therefore suggest that in future the EQC could take the lead in the following areas*

1. *initiating and sponsoring further building code research and development,*
2. *monitoring and assessing local code enforcement and planning consents,*
3. *encouraging and mandating the retrofitting of older structures*
4. *overseeing disaster preparation activities.*
5. *Educating the public on seismic risk issues*