

The Treasury

Earthquake Commission (EQC) Act Review Submissions Information Release

Release Document

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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.

11 September 2015

VIA EMAIL submissions.eqcreview@treasury.govt.nz



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REVIEW OF EARTHQUAKE COMMISSION ACT

This letter forms part of FMG's submission on New Zealand's Future Natural Disaster Scheme and provides a summary of the main recommendations we have made in the submission template.

Our submission takes a principles-based approach. It seeks to ensure, as far as possible, that anyone who has insured a residential dwelling can be re-housed after a natural catastrophe. Consistent with that, we seek a scheme that keeps natural catastrophe cover affordable and available to all who choose to insure their residential dwelling.

Based on our experience with the Canterbury earthquakes, simplification and providing certainty about where responsibilities and obligations lie are absolutely essential to an effective recovery process. If adopted, this will eliminate factors that led to duplication of effort, inefficiencies, additional costs and delays with the residential recovery.

The following summarises our main recommendations:

- Legislating the requirement to lodge claims with insurers. This should, however, extend to assessment of building claims too. While EQC will have the option to engage insurers to manage the full claims process, the assessment and reinstatement of land should continue to sit with EQC.
- Due to the risk of underinsurance, we support separate EQC land and building covers.
- Land cover would include all land-enhanced foundation work required to create a building platform. Insurers would still be liable for foundation work up to what would be required if a house were rebuilt using pre-event building standards specific to that site, but EQC would pick up the additional foundations-landworks needed above this due to land damage from an earthquake or other natural peril it covers in order to provide a building platform to re-house people.
- We propose a combined excess of \$2000 for both land and building claims.
- Excess should be inclusive of GST so as not to confuse consumers.
- Retention of the status quo for the treatment of residential dwellings in non-residential buildings because apartment dwellings of all types will likely be more prevalent in future and those who live in them should not be disadvantaged.

- EQC building cover should follow the basis of settlement of the insurer's policy wording, so all assessments and repair standards are based on what homeowners took out their insurance cover for and so there is no bias in assessment whether the loss is under or over the EQC cap.
- We support the status quo in relation to the treatment of appurtenant structures.
- EQC cover only fully reinstates on the completion of repairs during the period of insurance. This significantly reduces EQC's exposure, preserves the principle of indemnity, encourages repairs to be undertaken in a timely fashion and removes incentives to under-insure for catastrophic events.

We thank you for the opportunity to provide a submission on this matter and would welcome an opportunity to discuss any aspects of our submission.

Yours sincerely,

FMG

A handwritten signature in black ink, appearing to read 'Chris Black', with a long horizontal flourish extending to the right.

Chris Black

Chief Executive

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?

FMG supports the need for the Act to contain a clear statement of the purpose for the legislation and agrees further consultation in this area would be worthwhile.

FMG notes that the objectives for the Act as enunciated in the Discussion Document would lead to a different focus than the objectives as stated above. In particular the objective in the Discussion Document *'to minimise the potential for property-owners to experience socially unacceptable distress and loss in the event of a natural disaster'* is not clearly captured within the objectives above. We believe this statement reflects the result of successful implementation of the legislation and therefore should be included within the purpose of the Act. This outcome is a measure of the success in implementing strategies that fit with the first three purposes stated above.

The first objective as stated is a desirable operational outcome from the legislation. Lessons learned from the Canterbury earthquake series illustrate the importance of removing or reducing as far as possible frictional costs and duplication that occurred between EQC and insurers. The EQC scheme needs to be simpler and clearer in order to enable a more efficient and effective post-disaster recovery for the benefit of homeowners, EQC and insurers. This outcome is desirable as it facilitates high levels of affordable protection for residential accommodation from damage from natural hazard risk supporting the objectives of an efficient approach to management and recovery from natural hazard risk.

The purpose is necessarily a high level declaration of intent however we wish to emphasise that we support EQC having a significant role in understanding the susceptibility of New Zealand communities to natural hazards and in providing a centralised framework for mitigating and responding to this risk consistently and effectively across communities.

We also support the fourth purpose as insurers themselves prudently seek to effectively manage their financial risks with respect to natural disasters. The Canterbury earthquake series occurred in the wake of the global financial crisis and incurred losses estimated by The Treasury to be about \$NZ40 billion; of which about \$20 billion will be covered by private insurers and \$13 billion by EQC. If New Zealand did not have high rates of insurance penetration, then the Crown would have incurred additional costs in a challenging economic environment. For these reasons, it is important that private insurance cover remains affordable and available to all.

The discussion document refers to a suggestion that EQC be permitted to play a role in natural hazard mitigation either by funding mitigation or carrying out mitigation works itself. It is said the proposed purpose statement is broad enough to permit, but not require this activity. FMG supports the notion of mitigation to reduce risk. However, FMG would have concerns if post a disaster that mitigation activity were funded using the under-cap EQC cover specific to individual properties. Area-wide mitigation should not absolve EQC from its site-by-site liability to homeowners.

1b If not, what changes would you suggest, and why? FMG notes that the objectives for the Act as enunciated in the Discussion Document would lead to a different focus than the objectives as stated above. In particular the objective in the Discussion Document to *‘to minimise the potential for property-owners to experience socially unacceptable distress and loss in the event of a natural disaster’* is not clearly captured within the objectives above. We believe this statement reflects the result of successful implementation of the legislation and therefore should be included within the purpose of the Act.

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, tsunami, and storm and flood (with, in the case of storm and flood, only residential land being covered).

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

FMG supports EQC continuing to cover those perils listed.

We note that the discussion document under the heading ‘technical issues’ refers to a proposal to change the definition of ‘volcanic activity’. FMG is not aware of the proposed extension of cover that is contemplated, but in principle would support a definition of this natural peril that is more comprehensive as this would minimise disputes around EQC cover. Further, and more importantly it would be

important for both EQC and insurers' cover to align. Currently, some insurers provide volcanic cover that mirrors the EQC Act. More information on the change of definition is needed in order to confirm our view.

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?

FMG believes that EQC should provide cover for residential dwellings regardless of whether this is a standalone residence, mixed use building or incorporated within a non-residential structure. While we recognise that the extension of cover to residences in mixed use and commercial premises has resulted in some practical difficulties with the settlement of claims post the Canterbury earthquake events it would be inconsistent with the objectives of the Act to exclude these dwellings. In particular, it would suggest that re-instating accommodation in these situations is not important to the recovery of a community post an event. As these situations are often associated with small business operators that service their local community this is clearly not the case.

The nature of residential accommodation in New Zealand is changing with a standalone dwelling on a quarter acre section no longer being the norm. With higher density housing there is a greater prevalence of multi-unit construction, mix-use buildings and apartments. The Act needs to recognise and accommodate these residential models in a way that will fulfil the intent of the legislation.

The rules with regards provision of cover, levy calculation and claims settlement are overly complex. FMG would support simplification of these rules to provide:

- levy based upon individual unit calculated replacement, nominated or present day value where available up to the cap;
- with a levy based on the size of the residence times a suitable square metre rate (as a proxy for the rebuild cost - e.g. \$2000 per square metre) where individual unit sum insured are not available;

With respect to settlement, the reinstatement standard should follow the sum insured basis and flexibility should be allowed to provide for cash settlement.

While settlement on a cash basis may not be completely aligned with the legislative objectives, it would avoid the complexities associated with settlement.

In this situation it would be very important that the insured is aware that the basis of settlement would be cash to reduce the post-event stress experienced.

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

FMG supports the industry view that EQC cover applying to retirement villages, but not to nursing homes reflecting that they are distinguishable on the basis that one is a dwelling of choice while the other is determined by patient care arrangements. However, the line between the two may not always be that clear as care arrangements can be provided in retirement villages, so greater definition in this area is desirable.

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?

FMG supports the proposal that land cover is only associated with residential buildings where residential building is defined as at least 50% of the building's floor area is used for residential purposes. While this may not a wholly principled approach, it is a pragmatic solution to land cover that has not caused undue difficulty in the Canterbury events

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

N/A

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?

FMG believes that the inclusion of siteworks in the building cover will leave the insured exposed to significant financial risk resulting in the EQC scheme not meeting its objectives with regards efficient natural disaster recovery and minimising socially unacceptable distress and loss in the event of a natural disaster.

The rebuilding cost in a Nominated Replacement policy is the cost to rebuild the dwelling (and other specified features) to a new condition allowing for changes required by current Government and Local Authority regulation (i.e. the cost assumes use of normal building solutions to reinstate the dwelling). It does not allow for additional costs that may be imposed due to changes in the land quality post-event and regulatory responses to this. Siteworks required as a result of changes of the land's ability to support the normal building solution are an example of such costs.

If such siteworks are included in the EQC building cover the total cover (EQC cover plus insurer top-up) will be insufficient to reinstate the building to the extent that the sitework costs cause the rebuild to exceed the Nominated Value. In an extreme situation the total \$200,000 of EQC building cover could be utilised for siteworks, leaving the insured party unable to reinstate a significant portion of the building.

For example take the situation of a building in Petone Wellington. To rebuild a property in this area with foundations similar to the original build may be \$240,000 + GST. However, recent land investigations suggest a higher building standard for foundations is now required in this area suggesting a \$290,000 +GST rebuild cost.

It is possible that post a major event damage to land means the building standards are strengthened again, resulting in reinstatement costs of \$350,000 + GST in total.

Under Nominated Value policy the sum insured would be set at \$290,000, the cost to rebuild using the "normal building solutions" for that site.

If the actual rebuild cost were \$350,000 + GST the cost would be shared:

EQC	\$198,000 +GST of siteworks & building repairs, less \$2k excess
Insurer	\$ 90,000 + GST top up to the Nominated Value
Insured	\$ 62,000 +GST additional cost above the Nominated Value plus \$2k excess

The transfer of risk to the insured is obvious in the above example. Where a Full Replacement policy is in place this transfer of risk would move to the insurer.

Combining the land and building cover means that the insurer could potentially have underestimated its exposure by up to \$200k +GST (assuming that is the

EQC contribution). The ultimate result is that all insurers will need to factor in this exposure into reinsurance purchases which will ultimately be reflected in premium levels.

Alternatively, in the face of this increased exposure, insurers may decrease their exposure by changing policy wordings to exclude post-event regulatory changes that increase the building cost. One insurer has already moved in this direction.

None of these outcomes are desirable as they ultimately result in a transfer of risk to the insured.

For these reasons FMG submits that siteworks need to be provided as a land cover separate to the building cover provided by EQC and be limited to the economic value of the land (i.e. remediation will only be undertaken up to the value of the land with a cash settlement where it exceeds the value).

Further, the standard for remediation needs to be well defined with the objective of providing a building platform suitable for reinstatement of the dwelling using normal building solutions for that site (specific to the Local Government requirements prior to the event occurring).

EQC should have the option, as part of the land cover, to contribute to the cost of a more extensive /expensive foundation solution (above the normal building requirement prior to the event) as an alternative to pure land remediation, where this is a more economic /pragmatic solution for the site.

The separation of land remediation from building cover also provides EQC with greater flexibility in situations where blanket remediation of a wider area is more economic /pragmatic than addressing individual building sites.

This solution will provide the greatest certainty to the insured minimising the level of distress and loss to individuals in the event of a natural disaster. This, in turn, will support the community resilience and recovery post an event.

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

FMG believes that siteworks need to be separate from the building cover. This means that land Cover would be required in situations other than total economic loss. FMG supports limiting this land cover to the building platform and structures required to stabilise this platform (and land /structures on the access way if required).

The land cover should cover siteworks sufficient to reinstate a building platform suitable to support reinstatement of the dwelling using normal building standards required by the Local Council for that site prior to the occurrence of the event. Cover should be limited to the economic value of the land.

EQC should have the flexibility with regards the solution used to provide the required building platform including:

- remediating individual building sites
- undertaking wider area land remediation

- contributing to the cost of a more expensive building solution in lieu of siteworks.

Using the example in 5a, where a building insured for \$290k + GST actually requires \$350k +GST to rebuild due to higher building standards for foundations, the outcome under this proposal would be:

EQC land cover	\$ 60,000 +GST of siteworks
EQC	\$148,000 +GST building repairs, assuming cap \$150k / \$2k excess
Insurer	\$ 140,000 + GST top up to the Nominated Value
Insured	\$ 2,000 +GST excess

Extension of the land cover for the access way and associated artificial surface and related structures (culverts, retaining walls or bridges) could be incorporated within this proposed model.

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?

FMG supports this change. The private insurance market will be able to absorb this additional risk and also removes another potential frictional cost and duplication of effort and resources between EQC and private insurers. .

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

N/A

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.

FMG does not anticipate any material change.

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?

FMG agrees that the building cap should be increased, however siteworks need to be excluded from the scope of the building cover. (See comments in 5a and 5b)

Assuming siteworks are excluded, a cap of \$150,000 +GST would be sufficient to meet the objectives of the Act. This level of cover would be sufficient to repair the damage for the majority of dwellings in all but the most extreme events. While higher cover levels could be considered this needs to be balanced against the affordability the EQC scheme and the cross-subsidisation between areas of low and high natural hazard risk across the country.

A cap above \$150,000 +GST will have little impact for the majority of claimants; of much more significance to them should be the increase in the excess to \$2,000 + GST. This change will result in a large number of small claims falling back onto the insured. To the extent that these repairs are emergency repairs (health and safety issues such as chimney removal or weather tightness issues) the higher excess may work against the objectives on the Act.

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

FMG supports a cap of \$150,000 +GST excluding the cost of siteworks (land cover), with the ability to review this along with the levy rate on a five yearly cycle.

This level would remediate dwelling damage for the majority of dwellings in all but the most severe events. This cover is in line with the original intentions of the Act in that it brings the old cap up to a current day value. Allowing for regular increases in the cap will future-proof the cap.

Further, we note that the consultation document indicates that \$50k would be sufficient to cover the average siteworks and thus it is a zero sum game if that \$50k was moved from building cover into land cover.

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

As indicated in 7b FMG supports a building cover cap of \$150k + GST excluding siteworks; this provides better certainty of the sharing of cost between the EQC,

the insurer and the insured.

See the comments above in 7a and 7b

7d If so, what are they?

The scope of the cover is more important than the level of the cap. Siteworks should be excluded from the EQC building cover in order that the reinstatement objectives of the building cover align with the industry dwelling insurance.

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.

We have not undertaken any investigation as to the likely impact on premiums as a result of an increase in the EQC cap. As indicated in 5a, the proposal to include siteworks in the EQC building cover increases the uncertainty insurers have as to the contribution EQC will make to the cost of reinstating the dwelling.

This additional risk will come at an indirect cost to the insured through premium increases which, in turn, erodes the benefits of the increased EQC building cap.

It is worth noting that any increase in EQC cap (or calculation of sum insured) will have a direct impact on Fire Service levies and this will need further consideration.

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?

FMG supports a third option (as proposed in the ICNZ submission). The proposed third option has some features of both options in the discussion document, but with fewer shortcomings than either of them. It is also more aligned with how current private insurance policies operate (compared to wordings historically in the market and during the Canterbury earthquake sequence).

Under the third option, EQC's maximum liability would not exceed an amount

equal to one maximum payment under that cover until the property is completely repaired. EQC would pay the full costs of accumulating damage in each event until it reached the cap, and pay nothing more until the repair was fully completed. The insurer would be liable for any further damage from earthquake (or other specified peril) above the cap, but only up to the sum insured until repairs were fully completed.

This approach is also consistent with the fundamental insurance principle of indemnity (i.e. for the insured to be put back to the same position after an event (or after several events) that they were in immediately prior to the loss. This means the insured should never obtain (or require) any more than what they were insured for regardless of whether loss was caused by fire or a series of earthquakes. The total that can be paid out should not exceed the sum insured and may involve a maximum to the EQC building cap with the balance paid by the private insurer.

This option proposes that the full sum insured should not be reinstated until after permanent repairs have been completed to a property. This does not mean that the dwelling would not have insurance cover, but that the cover would be limited by the amount of damage already sustained. Naturally each insurer will have its own specific policy wording but in general terms, policies would specify that the sum insured would be reduced by the amount of damage incurred prior to the completion of permanent repairs.

We recognise that this process envisages reinstatement of the property and both the EQC cover and industry cover may need to be amended to ensure that reinstatement is enacted appropriately where settlement is on a cash basis. Schedule 3 3(a) of the current Act envisages such a circumstance.

The responsibility for the repair work sits with EQC /insurer and consequently, they should bare the risk of any damage to that occurs to partially completed repairs. This risk can be addressed through a contract works policy or, alternatively the relevant party may choose to self-insure where the risk is low.

Contract works cover can be purchased for the project management programme and is more efficient and cost effective than covers for individual reinstatement work. The premium for contract works cover can be billed as a repair expense to the original claim as it is a natural and necessary incidence of the reinstatement work for the original loss.

For example if a property suffers damage of \$90k +GST (assuming the current cap of \$100k + GST) this would fall to EQC to repair. If half way through the repair (\$45k +GST of cost incurred), another loss occurs requiring the whole repair to be re-started, responsibility for this additional cost of \$45k + GST would sit with EQC.

EQC may have a contracts works policy, in which case, the relevant insurer would cover the additional \$45k +GST . If, however, EQC self-insured they bear the risk of the additional cost regardless of whether or not it goes over the (current) \$100k + GSTcap.

This approach means that there will be alignment between EQC cover and insurance policies indemnifying the insured for their economic loss. It will reduce the issues associated with the apportionment of damage between EQC and the insurers as the aggregate damage in the first or subsequent events falls solely on EQC until its cap is exhausted and then reverts wholly to the insurer after that point. Further, it will significantly lower EQC's risk of paying for multiple events damaging the same property which was not fully repaired in between events.

This change will not address all apportionment issues and the need to assess damage as quickly as possible post an event is still paramount. Both the EQC and insurers will continue to require a robust process to apportioning losses between multiple events for reinsurance recovery purposes. For example a total loss of \$350,000 + GST over two events may occur as

EQC loss event 1 \$100,000 + GST
EQC loss event 2 \$ 50,000 + GST
Insurer event 2 \$200,000 + GST

or it could be

EQC loss event 1 \$150,000 + GST
Insurer event 1 \$ 50,000 + GST
Insurer event 2 \$150,000 + GST

In the first scenario EQC has exposure to two events, and potentially two reinsurance recoveries while the insurer is only impacted in one event. In the second scenario the positions are reversed. If an assessment of the loss has not been completed between the two events the situation cannot be fully understood.

FMG believes that the most expedient way for all parties to get certainty around their exposure is for claims to be lodged and assessed with the insurer in the first instance, with systems in place to promptly notify EQC. This is discussed in further detail in section 17.

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

In principle, aligning the definition of an event across the industry and with the reinsurance agreements would reduce the likelihood of gaps in cover. However, this is impractical as there is range of definitions across the industry and in some cases, they differ for different perils. Further, legislating a common definition is likely to stifle product innovation.

The definition of an event within most commercial policies is 72 hours. Aligning the definition with this would mean better consistency in assessment for mixed use buildings where a commercial policy may be insuring a property with some residential dwellings.

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

Please see the answer to 8a and b.

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?

For the reasons outlined above in section 5 in relation to siteworks, FMG does not believe siteworks and building repairs can be included in one combined cap as it results in significant risk being transferred to the insured.

The proposal of a cap of \$200k + GST for EQC building cover including siteworks effectively limits the land cover to the \$200k + GST unless EQC decides the land is uneconomic to repair. This is because the insurer does not cover land.

For example a property on land worth \$300k + GST may require siteworks of \$250,000 + GST post an event. EQC would contribute \$200,000 + GST towards this cost; the remaining \$50,000 + GST would be uninsured. Unless the insured undertakes these repairs the dwelling could not be reinstated.

Instead, it is FMG's view that the solution to this siteworks and land cover issue can be resolved as outlined below:

- Legislative clarity is required around what constitutes siteworks and what structures EQC covers. FMG's view is that the definition of siteworks must include all work, including ground-testing, professional advice, design solutions, earthworks and actual on site work, that is required to enable the repair or rebuilds using normal building standards required by the Local Council for that site prior to the occurrence of the event. .
- The total amount of EQC's liability for siteworks will always be capped at the amount that EQC could be called upon to pay if the land itself cannot be built on (see below).
- The determination of whether a cost incurred on a site is dwelling or siteworks should be clarified by adopting the definition above. The legislation should be sufficiently flexible that EQC may elect to contribution to the cost of foundations in excess of the "normal building standard prior to the event" in lieu of siteworks where this is a more economic solution.
- Consideration should be given to whether the definition of cover for siteworks could be expanded to encompass either "true" siteworks such as

land remediation or a different and more economic approach such as more extensive foundations, depending on what is required at the site.

Appurtenant structures

FMG supports the status quo where there is still cover for appurtenant structures used for residential purposes (i.e. garages and sleep-outs). This would enable insurers to provide differentiated cover to the insured around other structures and the need for the changes to be focused on reinstatement of the dwelling.

The combination of excluded structures within the Act supplemented by the EQC /industry clarifications agreed (i.e. Protocol 5) has provided a workable framework that could be incorporated into an industry service agreement with EQC.

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

See above.

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?

As above, it is FMG's view that land cover should not be restricted to situations where the land cannot be rebuilt on. It is our view that siteworks should be a separate component of EQC money available to redress land issues up to the maximum that would be paid if the land was a total loss.

It is important to recognise that the decision not to remediate the land is separate from the assessment as to whether the property can be reinstated. It is possible (as was the experience in Christchurch Red Zone) that the land may be written off when the dwelling is repairable. In these circumstances the insurance payment is limited to the value of the damage and the insured is left with insufficient funds to compensate for the total constructive loss. Extending the land cover to compensate for this shortfall is a possibility; alternatively the Government may choose to retain the fiscal risk associated with providing compensation in these circumstances.

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

Please see answer to 9a.

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?

In 5a and 5b we have highlighted how the proposed changes would result in a significant transfer of risk to the insured.

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

See response in 5 7 and 8 with regards the need to separate siteworks into a separate EQC Land Cover.

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?

FMG disagrees with Government's assessment that EQC's legislated standard of repair is broadly consistent with industry practice. Under the current Act, EQC building cover is for replacement value, meaning "any costs which would be reasonably incurred in respect of ... replacing or reinstating the building to a condition substantially the same as but not better or more extensive than its condition when new, modified as necessary to comply with any applicable laws".

FMG agrees that this standard, on its own, broadly aligns with the standard usually applying under private insurer provisions, and includes a "reasonableness" qualification often (but not always) found in private policies.

However, other sections of the Act modify this standard in certain circumstances resulting in inconsistent outcomes depending method of claims settlement.

Condition 9(1)(a) of Schedule 3 deals with Replacement of Property states that where EQC reinstates, EQC's obligation is subject to the qualification that it "is not bound to replace or reinstate exactly or completely, but only as circumstances permit and in a reasonably sufficient manner". This type of qualification is not usually found in private policies, so the standard of reinstatement under the private policies does not differ depending on whether the insurer elects to reinstate.

Further:

- this limitation is open to interpretation and could be understood to permit use of different building material (i.e. chip board flooring as opposed to timber).
- different building style (i.e. 2.4m stud rather than replacing a higher stud).
- not reinstating a part of a building as it is not considered necessary for meeting the objectives of the Act (i.e. a conservator is not essential to the livability of a dwelling)

All of these interpretations would be considered inappropriate to the insurer as they do not fulfill the intention of the private insurance contract with the insured.

Condition 9(2) states that where the Commission elects to replace or reinstate any property....., the insured person shall furnish the Commission with such plans,

specifications, measurements, quantities and other particulars as the Commission may require.

The insurance industry generally only requires the insured to provide information that they could reasonably be expected to have additional expenses required to provide plans

Condition 10(2)(b) of Schedule 3 deals with Reinstatement if buildings are relocated, the stated standard is to “reinstatement the building to the same condition as the building was in immediately before the natural disaster damage”.

This suggests a “present day value” rather than a “when new” standard of remediation.

Condition 13(1) provides that “where...., because of the circumstances relating to the cause of the damage, the claim cannot be settled promptly, the Commission may in its discretion settle the claim on the basis of the value of the property at the time of settlement....”.

The full Condition suggests the intention was to allow the Commission discretion to include cost inflation after an event as part of cash settlement. However, the wording of the clause leaves the amount open to other interpretations.

These qualifications on the reinstatement standard are vague and at odds with the standard otherwise contained in the Act, which is, in any event, already subject to a reasonableness requirement (as replacement value only covers costs which would be “reasonably incurred” in reinstating). There does not appear to be any good reason for the standard applying to EQC cover to differ depending the settlement solution.

The experience in Canterbury has shown that EQC’s interpretation of its reinstatement standards has led to differences in repair assessments, scopes of work and estimates of costs and also contributed to apportionment differences between EQC and insurers. These issues have delayed recovery and contributed to disputes between residents and both EQC and insurers. Although some of the proposals in the discussion document may go some of the way toward addressing issues such as apportionment, the need to make the transition between an under-cap and over-cap reinstatement as seamless as possible is critical. This is further reinforced where insurers would be handling under-cap claims in future.

EQC’s discussion document refers to standards of repair, but does not address the associated difference in assessed repair costs that arose in Canterbury. While we accept that professional assessors will differ in their views on the cost of a repair, the greater the scope for interpreting a gap between EQC and insurer reinstatements the more likely there will be disputes. Most disputes in Canterbury arose because of differences around the value of the repair, whether repairs were under or over cap and the scope of works. If disputes can be minimised through greater alignment between the EQC Act’s wordings and that of insurers, then that will contribute to a more efficient and effective recovery.

FMG submits that most effective way to minimise these tensions between EQC cover and private insurance cover is for EQC to adopt a reinstatement standard which aligns to the private insurance policy on the particular site irrespective of whether claims were under or over cap. Most wordings are relatively standard in the market and economic and market tensions would suggest that broad alignment is likely to remain the status quo. This has the advantage of removing friction between EQC and private insurer cover and the various problems that this has created as outlined above. This would also fit squarely with insurers' management of claims and remove any bias for assessors as they would be applying the same standards across the site regardless of whether a claim is under or over cap.

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

The comments in 10a above highlight that the limitation contained in Schedule 3 of the current Act modify the reinstatement standard leading to an outcome different from the current industry norms.

It should be noted that the objectives of the Act may also have some influence on this in any new legislation. An objective that looks to 'support an efficient approach to the overall management of recovery' may require lesser standards of accommodation than an objective of 'minimising the potential for property owners to experience unacceptable loss in the event of a natural disaster'. The later objective is more aligned with the objectives of the insurance industries.

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?

EQC should consider adopting the standard of repair contained within the private insurance policy. This standard of repair would apply to the coverage within the EQC Act. Thus were an insurer has a "as new replacement" basis the repair would be conducted on this basis, but EQC would not be obliged to incorporate any additional coverages (i.e. sustainable building material if a policy included this as an option). An extended Protocol 5 listing could be used to clarify the extent of cover as required.

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?

FMG agrees that the current excess arrangements are unnecessarily complex. We note the importance of the insured being able to understand their own obligations as well as those of EQC; consequently a move to a simpler, standard excess is required. We also note that the minimum excess of \$200 has not been adjusted for 22 years which of itself would indicate that they are low for their intended purpose. The application of a flat dollar amount would provide greater certainty and be operationally more efficient.

We also submit that in the interests of simplicity a single excess should apply to an EQC claim, with no separate excess for Land and Building cover.

Furthermore, to align with the reinstatement proposal in question 8, a single excess should apply up until the time when the damage has been fully reinstated, with no additional excess being payable if another event causes further damage before the property is reinstated.

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

While an excess of \$2,000 + GST would significantly reduce the number of small claims being managed, FMG has concerns with regards the affordability of this excess for vulnerable individuals.

We would be particularly concerned if the level of excess meant that emergency repairs (particularly health and safety and weather tightness issues) were not completed promptly.

Making the excess too high will increase the collection costs as non-payment becomes a more significant issue; this would erode the savings from having a higher excess in the first place.

Insurers often offset the excess, in consultation with the insured, against the reinstatement work. For example, using a lower quality repair (i.e. lino rather than tiles) or not completing some part of a reinstatement (i.e. interior painting) to offset the cost of the excess. As the excess increases the ability to do this without significantly impact on the insured is reduced.

The consultation document indicates that the average excess from the Canterbury building claims was about \$500 (half of the maximum that could apply). In light of this and the concerns outlined above, FMG submits that an excess of \$1,000 inclusive of GST would be a fairer sharing of cost between EQC and the insured.

The customers are not generally registered for GST so excesses expressed exclusive of cause confusion.

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

We support an excess of \$1,000 including GST for the reasons outlined in 11b above, subject to our comments in 12.

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?

FMG's position is that only one excess should be applied by EQC. So we agree with the position in the discussion document, but for different reasons.

The consultation document envisages land cover would only be available in case of total economic loss of the land. In this scenario applying an excess will not reduce the number of claims incurred, so serves little purpose.

FMG proposes that a separate Land Cover should remain for siteworks required to remediate the building site. As the repairs are related to remediating the dwelling it seems inconsistent to apply an additional excess.

We agree that avoiding small land claims (e.g. cracked driveways) is desirable and would support a higher combined excess across land and building cover to accomplish this end, up to \$2,000 +GST

Furthermore, to align with the reinstatement proposal in question 8, a single excess should apply up until the time when the damage has be fully reinstated, with no additional excess being payable if another event causes further damage before the property is reinstated.

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

N/A

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?

FMG agrees with this recommendation.

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

N/A

How will homeowners access EQC insurance cover?

Proposal for discussion

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

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?

FMG proposes the EQ Cover should attach to any policy insuring a dwelling, as defined by the Act and the Act define the perils insured by EQC. The purpose of the Act is to broadly offer insurance cover for specified Natural Disaster perils and on a portfolio basis this should be acceptable.

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?

Please see answer to 14a.

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

N/A

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?

As a general principle, EQC cover should follow that of the insurer. There are though instances where insurers will not provide cover to individuals, for instance, the applicant for insurance may be a convicted arsonist or fraudster or the property may be in such a poor state of repair that the risk of total loss is too great for an insurer to accept the risk.

In such instances, FMG would have no objection to EQC having the discretion to provide its cover up to the cap. Insurers though would not be on risk for costs above the cap unless they had accepted that risk. We agree there should be no obligation on EQC to provide cover.

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

N/A

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?

FMG strongly supports this proposal. Our reasons for supporting this proposal are

1. **Simplification** - There is currently confusion about who to lodge a claim with; this often results in the clients ringing their insurer and then being referred to EQC. In addition, EQC looks to the private insurer to verify that a fire policy is in place before accepting a claim. This step can be avoided if lodgement is with the private insurer as only verified cases will be passed to EQC. It should be noted that a small number of claims could be lodged with EQC where EQC have used their discretion to provide cover to an individual who does not have private insurance.
2. **Speed of response** - Insurers already have claims lodgement staff and are used to scaling up quickly to deal with major events, and thus are better positioned to provide a quick response.
3. **Efficient Recovery** - If insurers have a clear picture of their total exposure early in the recovery process they are better able to support their clients through the process. It will also be possible for the insurer to identify potentially affected clients who have not lodged a claim allowing proactive contact with them.

While we understand the rationale for not legislating the claims process beyond initial lodgement we do not believe that shifting claims lodgement to the insurer alone will not significantly improve the settlement process.

At a minimum, FMG submits that the insurer should lead the claims management process until the extent of the damage of the building cover is fully understood (i.e. all parties are clear as to their financial obligation). Simply, this is the process of assessment. From there claims management models ranging from insurers handing all non-land claims on behalf of EQC, to managing claims above the EQC limit through to their conclusion could be effective.

There are two reasons why care needs to be taken before settling on a model where the insurer leads all building claims. EQC will therefore need a claims capacity at least in regards to land. EQC should have responsibility for assessing land damage and remediation for the following reasons:

- Consistency of approach across claims resulting from a single event
- Existing expertise in dealing with land claims, which would need to be duplicated by multiple insurers
- Flexibility to remediate land issues across wider areas, rather than dealing with each property separately
- Facilitate EQCs wider roles with regards understanding natural perils and building resilience within communities.

Secondly, prior to the Canterbury earthquakes EQC had largely settled natural disaster damage on a cash basis whereas insurers generally favour remediation in the first instance. A transfer of claims management responsibility to the private insurers may result in a change of customer expectations with regards settlement of EQC claims. While this may not be more expensive for EQC, it may result in EQC events remaining open for longer as the remediation is worked through.

Whatever model is adopted, it should be agreed at an industry level to ensure the process and financial compensation for claims handling are clear and consistent across the industry. At a minimum legislating that claims lodgement and assessment be handled by insurers would in our view minimise many of the frictional costs that have been evident (and still are evident with insurers receiving new over-cap claims five year post event); this was a significant problem in the recovery post the 2010 – 2011 Canterbury earthquake sequence.

It should be noted that different insurers will be impacted differently by a particular event depending on their exposure. They may, therefore, have varying capacity to manage claims on behalf of EQC. An option that may deal with this scenario is for the industry agreement to cover the insurers' minimum obligations (lodgement and initial assessment of building cover) and have an "opt in" section for insurers who have capacity to manage additional claims on EQCs behalf.

We agree that the Government would need to be confident with regards the accountability, quality of service, information sharing and scalability of the service provided by the industry. Insurers already address these issues with reinsurers and as part of their internal claims management process.

Regardless of the final outcome, there needs to be more efficient and transparent sharing of information between the EQC and the insurer. EQC is currently significantly constrained in its ability to share pertinent customer information with the insurer which only leads to delays in progressing to resolution and customer frustration. Further, there needs to be clear parameters around which body takes lead in customer communications. It is FMG's position that the private insurer should take lead on this as it has the on-going relationship with the customer.

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

FMG supports an arrangement where all claims are lodged and assessed with the insurer in the first instance. For the reasons outlined above we believe this will be more efficient than the current arrangement. We believe lodgement should be expanded to include

- Initial assessment of the claim (to determine over cap /under cap)
- Emergency repairs required during this initial period of assessment.

As outlined in 17a only after the initial assessment has been completed can it be determined where the financial liability for settling the claim will reside and where it is best managed.

EQC will continue to have responsibility for land claims so will need to have claim settlement capability in their own right, regardless of the model adopted

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?

FMG supports the current three-month time limit for the notification of claims. This supports an efficient and effective response to a disaster as an open-ended arrangement simply leaves claims in limbo which is in no one's best interests. We agree that EQC should be able to accept claims for a longer period in defined circumstances on a non-prejudice basis.

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

We agree that EQC should be able to accept claims for a longer period in defined circumstances on a non-prejudice basis.

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?

FMG agrees with this proposal. The Crown should receive compensation for the expected costs and risk associated with the covers provided under this scheme. However, the levy should be not used to compensate the Crown for other risk associated with Natural Disasters. Related to this, we believe the Natural Disaster Fund should be ring-fenced and only used to support the express purpose set out in the Act. In the situation where it is pre-funded to a greater level than required – as determined through actuarial assessment – then the EQC levy should be adjusted downwards to bring the level of the fund back into line. (please also see our response to Q21b)

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

N/A

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?

FMG supports continued flexibility to charge a flat or a differentiated rate recognising there are good arguments in favour of both approaches. The current flat-rate has a social policy benefit because the cross-subsidisation lowers the rate in high risk areas which enables those on low incomes in those areas to better afford cover. It therefore meets the objective of maintaining high levels of residential cover for catastrophe cover. Maintaining a flat rate also makes the administration around collection simpler and easier.

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

N/A

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

Please see answer to 20a.

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?

FMG supports retaining the Natural Disaster Fund in broadly its current form; however there needs to be some changes to the circumstances in which money can be withdrawn from the fund. These are detailed in 21b below.

The Natural Disaster Fund fulfil a number of important roles:

- Pay the first claims incurred prior to the reinsurance programme being called upon; this reduces the cost of the reinsurance programme.
- It meets the cost of the reinsurance programme. When this is insufficient, the fund can respond before calling on Crown resources.
- It funds research relating to the objectives and functions of the Commission.
- It funds natural disaster awareness and education programmes.
- Meets the expenses of running the Commission.

The existence of the fund gives the Commission autonomy outside of Crown funding to facilitate the objectives of the Act.

The fund provides a way of smoothing the funding cost of the scheme and provides some buffer against the pricing cycle of the reinsurance market. It also allows for funding of area wide (i.e. in respect of a group of properties covered under the Act) land remediation projects that are outside the traditional property insurance model.

The scheme has a role in understand natural hazards and working with local authorities and others to ensure efficient management of and recovery from natural disaster. We do not believe this responsibility should extend to funding pre-emptive mitigation work; this could see a significant change in the use of the NDF, with lower funds accumulated overall. It could be argued that risk mitigation work limits the EQCs exposure to future claims; however prioritising this work relative to other local risk mitigation is a decision for local authorities, so is more appropriately funded through local levies.

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

FMG submits that changes should be made to “Money Payable out of Fund”, (section 15 of the current Act) to ensure that the Crown is appropriately remunerated for the risk that they assume under the scheme, without an interest the scheme beyond this amount.

The current provisions (paraphrased below) allow the crown to receive payments from the fund in three ways:

1. Section 9 - the Minister may require the Commission to pay a dividend.
2. Section 10(2) - the Minister may require the Commission to pay an amount in lieu of income tax
3. Section 17 - the Minister will determine a fee payable by the Commission in respect of the Crown’s obligation to fund any deficit of assets over liabilities that arise by way of grant or advance upon such terms and conditions as the Minister determines.

Only Section 17 is linked in any way to the risk being undertaken by the Crown. Even then because the funding can be made as an advance on terms and conditions set by the Minister the role of the Crown may be more akin to a bank than an insurer making it extremely difficult to determine an appropriate fee for risk.

Allowing the Crown to access the NDF for purposes other than those aligned to the objectives of the Act undermine its purpose. As it stands the security of the NDF is not better than a model that sees EQC levies and having a reserve within the crown accounts for potential NDC liabilities. In the situation where it is pre-funded to a greater level than required – as determined through actuarial assessment – then the EQC levy should be adjusted downwards to bring the level of the fund back into line.

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?

FMG gives qualified support to EQC being able to use other forms of risk transfer. EQC has to purchase a large catastrophe reinsurance programme and in the absence of a fully rebuilt National Disaster Fund will be reliant upon this to meet claims without recourse to the Crown guarantee. Further, it is suggested that EQC also have a role as an agent for acquiring reinsurance cover for state sector organisations. To manage these obligations, EQC needs to have sufficient flexibility to purchase cover in a way that optimises its purchase opportunities in a competitive, global market.

FMG has reservations about some of the new forms of risk transfer being used to wholly displace traditional reinsurance cover. Providers of new forms of Insurance Linked Securities (ILS) have exit strategies. They may not show any “loyalty” when a major catastrophe strikes anywhere in the world. In general, large well-capitalised traditional reinsurers have no exit strategy and will stay on risk after an event. Global interest rate fluctuations can also influence the flow of capital to ILS (if interest rates increase capital may quickly leave the ILS market). If ILS is used on a temporary basis to fill a few gaps, it may provide EQC with flexibility, but it should not be used to do the heavy lifting or to support a sustainable risk based exposure.

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?

FMG supports those additional issues outlined in the ICNZ submission.

