

The Treasury

Earthquake Commission (EQC) Act Review Submissions Information Release

Release Document

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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 contact details

For organisations

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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?

They are okay as far as they go but need to be revamped to recognise the links with other policy settings that reduce risk exposure.

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

Local government in New Zealand has responsibilities that can reduce exposure to hazard risk. IT would be helpful if there was a legislative link that incentivised local government to reduce risk so that the EQC exposure could be managed better. Many hazard risks are covered by the EQC scheme but without local government at regional level having policies that enable existing uses to be changed over time to reduce risk territorial councils can only influence where new development takes place. Incentivising risk reduction by both local government levels would help make hazard risk management less fragmented and more coherent for the public and for the Crown managing financial exposure.

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).

What do you think?

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

Yes but add exacerbators and new hazard risks related to changing climate

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

Climate change will increase the frequency and magnitude of flooding, storms and coastal inundation on top of ongoing sea level rise. These changes will exacerbate existing hazards to the point where the risk exposure is likely to be exceeded and the capability of communities to cope will be challenged. (refer to more detail in the answer to the last question)

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 definitely since the ability to use a property depends on getting access to it.

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 but only if the new replacement valuation system recently introduced is operating to provide sufficient cover for people. This system relies upon people getting their own valuations which as an opt in system may leave some people exposed.

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.

The insurance premiums have already gone up as a result of the replacement valuation system having been introduced. This should be a once only rise excluding inflationary costs for building. This would need to be assessed before introducing.

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?

Keep it higher on the basis that not all damages claims will be that high but some will and they will be where there is significant personal hardship.

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?

The problems with Christchurch are particular to such earthquakes which while large in claims numbers the system works well in non-earthquake situations which are the 'normal' situation.

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

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

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?

The building site cannot be distinguished from the land because the ability to live on a site is affected by egress and the surrounding land. If a landslip occurs rendering access to a site impractical but the land under the building intact (several Wellington examples of this) the proposal would be silly and put people through hardship if they couldn't get to the house. This sort of situation should be accommodated within EQC policy. It happens particularly on steep land and where access is up a cliff or steep and it slips in an extreme weather event. The access in some circumstances like these can be more than 8 metres from the house unless it is measured on the distance horizontally from the house rather than vertically down a slope.

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

See 9 (a)

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?

Two questions here!! 1 No not in all cases and 2) Yes if EQC covers the move to another site.

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

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?

Yes.

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

This new policy by insurers needs to be reviewed after a while to make sure people are not under insured.

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?

Yes

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?

Yes and this could help address changing climate risk discussed in the last question.

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

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 because everyone should have fire cover and this is administratively simple to administer and avoids the chance people could opt to not insure.

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?

No we need all perils covered in an administratively simple system to make it affordable to manage.

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 this is a slippery slope potentially leading to those least able to opt in being disadvantaged.

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 this could simplify the process but they would need to have capacity to manage it.

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?

Yes

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

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?

YES

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 this is NZ inc at catastrophe level. For the normal risks these should be differentiated by risk as a deterrent to increasing risk by locating in risky areas.

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 and no

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

Exacerbated risk from climate change impacts should be considered (see suggestions in last question) as it affects exposure to risk for the Crown.

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?

Only if it is fair to all and under rights the risk to levels that also account for the unexpected and those risks that are known but aspects of which are uncertain. For example timing and magnitude of increased flood and storm inundation risk and the extreme ends of sea level rise.

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?

The impact of the catastrophic losses associated with the Canterbury earthquakes has triggered this review but it also provides an opportunity not to be missed to address changes in other hazard risk. For example, there is no discussion of the effect of climate change on New Zealand's risk exposure that already comes within the purview of the EQC. Nor is there any discussion of whether the current policy settings are adequate to manage the fiscal risk that this implies.

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

The review of the EQC Act does not occur very often in its lifetime. This review is a timely opportunity for consideration of how the EQC will address climate change related risk.

Currently the EQC Act covers a wide range of natural hazard risk. Some of these hazards will be exacerbated by changing climate such that they will occur more frequently and with greater magnitude. Examples are, heavy rainfall events resulting in floods and land instability that disrupt communities (Whanganui, Northland) and the free movement of goods and services along transport routes (Manawatu Gorge, Arthurs and Haast Pass and the Kaikoura and East coasts).

In addition, some climate change impacts like sea level rise will continue for centuries and will eventually render coastal areas at risk, unusable. Sea level rise will occur BOTH as incremental increases in sea level AND will exacerbate the increase in storm events on top of the sea level rise. The perception that sea level

rise effects will ONLY be incremental is misleading, since the effect of increased frequency and magnitude of storm events are certainly matters already within the scope of the EQC and sea level rise will exacerbate such risk to trigger points where large scale action to move settlements or change their land use will be required. While some of the response regarding land use planning is the responsibility of local government, event based damages to land are the responsibility of the EQC so those costs will increase EQC fund and Crown exposure. Such events will only become larger and likely be located in many areas of the coastal environment around New Zealand increasing and frequency, compounding existing exposures AND could occur contemporaneously, thus concentrating the EQC and the Crown fiscal exposure to risk. Clarity around this should be addressed in new policy settings in the EQC Act and the fund adjusted accordingly to manage the risk exposure that climate change impacts imply for homeowners and other landowners that the scheme may cover in the future.

A specific detail of the EQC scheme and policy settings is that after extreme climate events EQC has until the Canterbury quakes, only covered replacement in the same location. This has the effect of continuing risk exposure. It would be very prudent for the EQC to have the ability in law to enable a payout to replace buildings on sites elsewhere away from the peril. This could be complemented by local government planning responses that avoid and reduce risk exposure as a prerequisite for EQC and private insurance cover, thus providing an incentive for risk reduction.

The use of red zoning as a policy may have traction for areas of repeat flooding and at the coast where sea level rise will render continued habitation of dwellings perilous. It would reduce ongoing exposure to risk within the EQC system and provide a way of managing the changing nature of the risk over time. I am reminded of the New Zealand's SuperFund which has built into it ways of pre funding for future generations to provide sufficient funds for a changing demographic and periodic reviews to tune those policy settings. This adaptive approach reduces the risk overall while still being able to respond to uncertainty in the future and demographics change. Similar sorts of funding policy settings could be considered for EQC to manage its ongoing increasing exposure to climate related events.