

The Treasury

Earthquake Commission (EQC) Act Review Submissions Information Release

Release Document

July 2017

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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 by 5.00pm on Friday 11 September 2015.

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

Official Information Act 1982

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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.

We will take your objections into account when responding to requests under the OIA.

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Your contact details

For individuals

Your name:	Keith Westwater
	[1]

Email address:
Phone number:

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

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? **No**

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

1. **The purpose of the scheme needs to make reference to one of the major drivers for the creation of a government controlled natural disaster insurance scheme in 1944 and its continuance in a revised form in 1993, i.e., to assist in alleviation of distress to property owners caused by natural disasters (as referred to in discussion papers relevant to these Acts). Something like the following should be the primary sub-aim:..”contributes to the alleviation of distress to insured residential property owners caused by the effects of natural disasters”. (This would also more explicitly encourage insuring such property.)**
2. **The opening sentence should be changed as follows:**
 - a. **the word “establish” should be changed to “provide” (the scheme was *established* in 1944 and is now in the process of again being modified)**
 - b. **the scheme is being provided for *people or legal entities who have insured residential property*, so the purpose should be aimed at the insured person, not buildings.**
3. **The support, etc. to the provision of effective private insurance services should not be the *primary* sub-aim and should be moved down the list. If the “first-loss” insurance cap is increased to \$200,000 and cover for all contents moves to the private sector insurers, then the number of claims over which there are opportunities for and a need to co-ordinate will be greatly diminished. This review’s discussion document makes the observation that the number of over cap claims in Canterbury handled by private insurers would have reduced by two-thirds under the increased cap provisions in the review. The implication is that most building claim in most future disasters will be managed and settled by EQC and *all* contents claims will be managed and settled by the private sector insurers.**
4. **Effective provision of both EQC and private insurance services to residential property owners in natural disaster scenarios will continue to be confusing to claimants as long as the private insurers continue to carry out their own assessments of residential building damage at the same time or in advance of EQC. This has and will continue to lead to disputes concerning “whose**

damage assessment is right?”. (In and before Canterbury, anecdotal evidence suggests that in the case of disagreements EQC’s building damage assessments are nearly always more accurate than the private insurer’s, but that much unnecessary time and money is spent in establishing this fact.)

A way of reducing this confusion and cost is to include in the legislation *the right, as first-loss insurer, for EQC to carry out the first damage assessment* of residential buildings and that the private insurer only carry out their damage assessment when the claim as assessed by EQC is in an over-cap zone (say \$180,000 – \$200,000+) and is then passed to the insurer. (Private insurers could be contracted by EQC to carry out these first-loss assessments if the natural disaster event required a larger work-force than EQC could initially provide.) The private insurers will argue that “they need to be there for their customers in order to maintain existing relationships”. This argument is not a strong one:

- a. most persons who seek insurance do so through a broker and only “meet” their insurer when they make a claim
- b. insurance companies by and large contract out damage assessments to loss adjusting firms, so in fact the customer is dealing with a proxy for the insurer
- c. EQC also implicitly has policy-holding customers – the policy is the Act – who they need to establish a first-loss relationship with without the waters being muddied by private insurer assessments.

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 modified as per 2.b:**

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

The proposed perils to be covered preserves the status quo with respect to natural disasters insured against and the review doesn't take the opportunity to provide for a "cleaner" customer experience in respect of which insurer (EQC or private) deals with which type of exposure. Given that private insurers under the proposals in the review will now deal with all natural disaster contents claims, it would make a lot more sense if EQC was *first-loss residential building insurer for all perils, including flood and storm (provided that the recommendation in 1.b.5 was also implemented: that EQC had the right, as first-loss insurer, to carry out the first damage assessment for residential buildings)*.

EQC, until such time as its own assessment workforce developed expertise in flood and storm damage to residential buildings, should contractually engage private sector Loss Adjusters who had such experience to carry out this work in compliance with the Act.

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, with provisos as discussed in 5.b.**

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

Whether "Site works" cover, as outlined in the review, will be applied in the following situations needs to be clarified:

- a. **When there is no damage to the residential building but there is damage to the access way and land around the building (see also Section 9 response).**
- b. **When there is no damage to the residential building but there is damage to appurtenant structures and land around the building and/or appurtenant structures by themselves (see also Section 9 response).**
- c. **When there is no damage to the building's exterior but there is damage to land around the building and there is interior damage (see also Section 9 response).**

If "Site works" cover did not apply in any or all of these situations, there would be a diminution of cover provisions for claimants vis à vis the current Act.

There needs to be a clear definition of what building "siteworks" and "main access way" mean. At the least, the definition needs to ensure the current Act's provisions are maintained with respect to:

- a. **the 8 metre land damage envelope for residential buildings and associated appurtenant structures**
- b. **the 60 metre land damage coverage for main access ways.**

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?

Not entirely.

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

The proposed site works and access way solution does not go far enough and appears to have been formulated without due consideration to the inter-relationships between natural disaster perils (other than for earthquake), the residential building, and the land that pertains to it. Perils may cause land damage around and/or under a residential building without necessarily causing damage to the building.

Generally, natural disaster perils cause damage to land by *inundating* it with material (debris) that wasn't present before the disaster occurred and/or *evacuating* (removing) land which was present before the disaster. The following examples (which are common EQC claim occurrences) demonstrate how the enhanced building cover (site works) as currently proposed *would not* apply:

- a. A flood or tsunami inundates the land around and under a residential building with contaminated or toxic debris. The building itself is not damaged so there is no claim. The cost of commercially removing the debris is in the order \$5,000 - \$9,000 and would now be borne in total by the insured person, whereas cover would apply under the existing Act.
- b. A volcanic ash eruption inundates the land around a residential building with toxic material. Corrosive ash also settles on the building's roof but is quickly removed. The building itself is not damaged so there is no claim. The cost of commercially removing the debris is in the order \$5,000 - \$9,000 and would now be borne in total by the insured person, whereas cover would apply under the existing Act.
- c. A flood evacuates land within the legal boundary of a residential property and the evacuation encroaches within the 8 metre land-building envelope. It does not damage the building or the access way. There is no claim under the review provisions, *unless the imminent loss risk provisions of the current Act are retained in the new Act*. Imminent loss risk is not discussed in the review document.
- d. A landslide evacuates land from one hillside residential property and inundates residential land belonging to one or more insured persons without damaging any buildings or access ways. Again, there are remediation and repair options open to an insured person under the current Act, which would no longer be available. Imminent loss risk cover would also be applicable in this scenario under the current Act.
- e. A *slow-moving* landslide (of which there are several being monitored around the country) causes incremental damage over a period of years to several residential properties. Under the review proposals, the insured homeowners would have to wait a "creeping death" period of possibly years until their insured residence is so badly damaged that it is not practically or economically feasible to repair or rebuild the insured property on the current site.

Landslips occur relatively frequently around New Zealand and their occurrence can be expected over time to increase as a result of higher rainfall and more intense weather systems generated by global warming. Automatic cover for *landslip* damage has been included in the Act since 1970, well prior to the Abbotsford landslip. The new Regulations to the Act, which were introduced in 1984, included land cover for the first time, and were the direct result of recommendations of the Commission of Inquiry into the Abbotsford Landslip Disaster. Abbotsford was also a slow-moving landslip.

EQC Annual reports for the years 2003/04 – 2012/13 show that there were on average (excluding Canterbury earthquake claims) nearly as many landslip claims on EQC as earthquake claims and that payments on landslip claims exceeded payments on other peril claims, including earthquake. (EQC's Annual Report for 2013/14 did not include data on claim numbers or payments by type of peril and type of exposure. It is hoped that this will be rectified in future reports, as this information is vital to informed research and analysis on New Zealand's natural disaster insurance.)

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?

No, there needs to be a strengthening of the proposals in the review (see response to 9.d). Unless this strengthening happens, there will be a reduction in natural disaster cover which is provided under the existing Act.

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

The following suggestions are made with respect to strengthening the proposals in the review:

- 1. That the area liable for the proposed "site works" be defined as encompassing the current Act's 8 metre land envelope around the residential building and its associated appurtenant structures PLUS the land under the building or structure and that this definition, *for the purposes of the Act*, be included as part of the definition of a residential building in the Interpretation section of the Act.**
- 2. That cover for the access way continue to apply for a distance of 60 metres from the dwelling and that the access way similarly be included as part of the definition of a residential building.**
- 3. That site-works and access way cover applies *whether or not repairs to the residential building are required*.**
- 4. That reference in the definition of physical loss or damage in the current Act to including *imminent physical loss or damage* be retained.**

Implementation of these suggestions (or something like them) should remove the anomalies in cover created by the review's proposals and identified in 9.b

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?

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?

It is difficult to know what is meant by this observation. EQC is the first-loss insurer and determines in its interpretation and application of the Act that its standard of repair is in compliance with the Act. This interpretation has been tested many times through the courts. Current industry norms should be, in fact, those as determined by EQC - it has, by volume of natural disaster residential building claims that it settles, far more right, and natural disaster damage expertise, to be the standards-setter than any other insurer.

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?

It should be the other way round - the private sector should be required by the Act to comply with the residential building repair standards of the first-loss insurer, then this issue wouldn't arise.

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?

It is not clear how this figure was arrived at. Given that private sector insurance policies often provide for a range of excesses in return for a lower premium, which is not an option under the current natural disaster insurance compulsory set levy scheme, the excess figure has to be carefully arrived at. Doubling the cap to \$200,000 and at the same time increasing ten-fold the excess that would apply in most housing damage situations, will increase the liability for the claimant. If the effect of this has not already been estimated, it needs to be and the reasons why the insured is now required to carry more of the risk needs to be made known.

The excess also potentially has an effect on whether repairs will actually be carried out under a cash-settlement environment (where the excess is deducted from the pay-out prior to settlement). Cash-settlement was EQC's preferred method of settlement prior to Canterbury. If claimants can't afford to apply the excess to repairs from their own pocket, then "excess-unaffordable" unrepaired housing stock could be created following a natural disaster. Further and published modelling on the affordability and effects of the proposed \$2000 excess is needed.

11c 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**

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

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, this would have the effect of diminishing the overall cover now provided universally, regardless of peril. The frequency of natural disasters in New Zealand, particularly those that are weather related (landslip, flood, storm), are on the increase because of global warming. Now is not the time to change and weaken what is and has been a unique approach to natural disaster insurance in the world.

15b If you do not agree with either of these options, what alternative arrangement do 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? **No**

The statement in the discussion document that "private insurers have an existing capability to deal with a large number of claims that arise in a natural disaster" is not accurate. Of all the insurers, EQC has in place the organisational infrastructure, has done the planning, and has the experience at ramping up to handle a large number of claims following a natural disaster. It proved this in Canterbury, where it has handled over 460,000 exposures, while anecdotally, a number of insurers had trouble gaining traction in this department with far fewer claims per insurer.

Prior to Canterbury, EQC had contracted its post-disaster claims handling and management to an off-shore insurance services specialist firm (Gallagher Basset, based in Brisbane), partly because it had assessed that the New Zealand insurance industry had neither the capacity nor capability to do this for BOTH the commercial and residential sectors following a large natural disaster. This situation still exists. EQC, largely for reasons of cost, dispensed with Gallagher Basset's services in 2012, and has since established a claims management capability in-house, as well as having in place a business model that can continue to ramp up following a natural disaster. It would be interesting to know how many private insurers have such plans in place and have tested those plans.

The statement that EQC does not have the capability to deal with large numbers of claims because it deals with relatively few claims on a business-as-usual basis is not logical. EQC's business-as-usual *is* managing natural disaster claims - in the previous year it handled over 10, 000 non-Canterbury claims while continuing to manage claims from the Canterbury events. For this reason alone, it should

continue to manage its own core business.

The statement that assigning claims handling responsibilities to private insurers should simplify the claims handling process is also *not accurate* for the following reasons:

1. EQC is extremely reliant on claim lodgement information to plan and implement its event response. Private insurers have different claim management systems and claim business priorities, and won't necessarily gather information that EQC needs immediately or any more efficiently than they have in the past. EQC's claim management system is geared to natural disaster claim lodgement, private insurers' systems are not. If this proposed change is implemented, it has the potential to create confusion and inefficiencies, and detract from the quality of EQC's claim management process.
2. "Cooperation" in the private insurers' minds will be code for the opportunity to claw back some of the natural disaster levy that they are required by law to pay into the natural disaster fund and which they see as money which was legislated away from them. They will do this by "clipping the ticket" and charging for "services" that EQC used to perform more than adequately under the current legislation. Private insurers' intentions with respect to this probable outcome should be questioned.
3. Allowing private insurers to take over the very start of the natural disaster claims management process from the organisation that has been established by legislation to provide the cover just doesn't make sense. The global reinsurance world has continued to rate EQC's handling of Canterbury claims very highly, while private insurers have not necessarily fared as well in this department. Using a desired outcome of greater cooperation between the private insurers and EQC as the grounds for making this change will have unwarranted, unintended, and unfavourable consequences for the claimant and EQC.
4. Private insurers have difficulty reaching agreement amongst themselves (let alone with EQC) regarding how to best manage natural disaster claims and are extremely unlikely to do so in EQC's best interests unless they can recoup the costs of doing so. This cost will ultimately be borne by the claimant in increased premiums.
5. Private insurers will not necessarily verify insurance cover or validate claims any more quickly because claimants are required to lodge claims with them. They will continue to work at their own speed which, as we know from Canterbury, can be very tardy.
6. Claimants will continue to be confused about who to lodge their claim with because of the large amount of literature and general knowledge about lodging a natural disaster claim with EQC that will remain "out there".

This issue seems to have been manufactured by the private insurers in order to gain greater control of what will in effect be an area of decreased market share for them (residential building claims). It is also an area in which private insurers would now have no further contact with most claimants after initial lodgement. The Act reviewers seem to have accepted the private insurers' arguments in this area at face value. A better solution for claimants would be to:

1. Require EQC to handle all building and land claims on a first loss insurer basis for ALL perils and advise claimants to lodge their claim with EQC in the first instance. EQC, on assessing the claim would advise the claimant, as they currently do, to contact their insurer if they have claimed for any building elements not covered by EQ cover. Claims approaching an overcap threshold will be forwarded to the private insurer by EQC, as is the case now.
2. Require the private insurers to handle all contents claims and advise claimants to lodge these claims with their private insurer.
3. Include in the new legislation the requirement for private insurers to verify a claimant's insurance cover within a specified time frame in much the same that they are required under the current

legislation to pass the collected EQ levy to EQC within a certain period.

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, this will be particularly helpful in volcanic eruption events, when the "event" may last for longer than three months continuously.

18b If not, what alternative arrangements would you prefer, 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.

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

Yes