THE TREASURY
Kaitohutohu Kaupapa Rawa

Reference: 20170140

17 May 2017

[redacted]

Thank you for your Official Information Act request, received on 13 April 2017. You requested the following:

> *"On page 1 of its attached submission on Treasury's July 2015 Discussion Paper on changes to the EQC following the Christchurch Earthquakes ICNZ makes this statement:*
>
> *"ICNZ notes that four objectives for legislation in the Cabinet Committee paper on this aspect are more explicit in this regard than in the discussion document. For instance, an objective in the Cabinet Paper is 'to minimise the potential for property-owners to experience socially unacceptable distress and loss in the event of a natural disaster".*
>
> *I am writing to ask if Treasury could locate and email to me a copy of the Cabinet Committee paper or the Cabinet paper that ICNZ is quoting from."*

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	24 June 2015	Cabinet Economic Growth And Infrastructure Committee Paper: Release Of Discussion Document: Legislative Review Of The Earthquake Commission Act 1993	Release in full

I have decided to release the document listed above.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This fully covers the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

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IN-CONFIDENCE

Office of the Minister Responsible for the Earthquake Commission
Office of the Associate Minister of Finance

Chair
CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

RELEASE OF DISCUSSION DOCUMENT: LEGISLATIVE REVIEW OF THE EARTHQUAKE COMMISSION ACT 1993

Proposal

1. This paper seeks Cabinet agreement to (1) a set of proposed reforms of the Earthquake Commission Act 1993 (the EQC Act) and (2) release the attached public discussion document seeking feedback on those proposals.

Executive Summary

Introduction

2. The Government announced a legislative review of the EQC Act in September 2012. The Review is intended to capture the lessons learned from the Canterbury earthquakes, and other events since the current scheme was introduced in 1993, so that the insurance scheme provided under the EQC Act can better manage the risks and costs of future natural disasters.

3. This paper outlines the core features of a set of proposals for reform of the EQC Act. These proposals form the basis of a discussion document for public consultation.

4. Cabinet has agreed on the following objectives for legislation resulting from the Review (CBC Min (12) 6/2 refers):

   - Support the contribution of a well-functioning insurance industry to **economic growth** opportunities in New Zealand;
   - Minimise the **fiscal risk** to the Crown associated with *private property damage* in natural disasters;
   - Support an efficient approach to the **overall management of natural disaster risk and recovery**; and
   - Minimise the potential for property-owners to experience socially unacceptable **distress and loss** in the event of a natural disaster.

5. The EQC scheme has been successful in helping to create a domestic insurance market with, by international standards, very high rates of residential disaster

insurance coverage. That, in turn, has meant that homeowners in Canterbury have the resources they need to rebuild without pressing the Government to provide further assistance.

6. However, experience has revealed opportunities to improve the current configuration of EQC cover and its interaction with private insurance cover. Our proposals retain the broad structure of the current scheme, but introduce important changes to EQC's coverage, premiums and claims handling.

Proposed EQC Scheme Coverage

7. A key theme of the reforms is to more clearly focus the scheme on providing insurance cover to homes. Key features of the proposed EQC scheme coverage are the exit of EQC from contents insurance, increasing the monetary cap on building cover from \$100,000 to \$200,000[1], and reconfiguring EQC building cover so only building cover (i.e. no land cover) is available if an insured building can be repaired or reinstated on site.

8. This table summarises proposed major changes to EQC scheme coverage:

Scheme Coverage Item	Current Scheme	Proposed Scheme
Home contents	Up to \$20,000 of cover	No cover
Residential buildings		
Monetary cap	Up to \$100,000 plus GST of cover	Up to \$200,000 plus GST of cover
Siteworks (i.e. earthworks associated with repair or reinstatement of an insured building)	Covered, mix of building and land cover	Covered, building cover
Access to residential building Main access way (up to 60 metres) and any bridges and culverts on it.	Access covered as part of land cover. Artificial surfaces (e.g. concrete drives) not covered	Access covered as part of siteworks Artificial surfaces covered as part of building cover
Residential land		
What is residential land insured by EQC?	Land with an insured residential building on it	Land with an insured residential building on it
What land on the section is covered?	Land within 8 metres of an insured building	The entire section is covered to extent siteworks are necessary
Damage that is an increase in vulnerability to future damage (e.g. increased flood or liquefaction vulnerability)	Covered, diminution of value or cost of repair, up to value based land cap Future natural disaster damage covered at the time it occurs	Increase in vulnerability not covered Future natural disaster damage covered at the time it occurs

[1] All EQC monetary caps and insurance premiums in this paper are quoted excluding GST. These two caps, including GST, are \$115,000 and \$230,000 respectively.

Scheme Coverage Item	Current Scheme	Proposed Scheme
Damage to land that means it is not practically or economically feasible to rebuild on the site.	Covered, a site-specific value-based cap applies	Covered, a site-specific value-based cap applies
Retaining walls	Covered, as part of land cover	Covered, as part of building cover
Claims excesses		
Excess on building claims	The greater of $200 or 1% of the claim (with a $100,000 plus GST cap excesses range from $200-$1,150).	$2,000 excess on all building claims
Excess on land claims	The greater of $500 or 10% of the claim to a maximum of $5,000	No separate excess on land claims
Access to EQC Cover	EQC coverage automatically attaches to residential fire insurance policies	EQC coverage automatically attaches to residential fire insurance policies; or EQC coverage automatically attaches to residential insurance policies for those perils covered by EQC that the insurance policy also covers

While some elements of the proposed cover are more generous than the current scheme, e.g. the increase in the monetary cap on building cover, other elements are less generous, most notably the cessation of cover for land damage that has not damaged the insured building. We anticipate that change, the increase in the excess on building claims and the claims handling arrangements discussed below are the proposals most likely to draw negative public comment.

Further proposed changes are that:

- There be a legislative requirement that claimants lodge EQC claims with their private insurers rather than directly with EQC. Private insurers would then confirm the claimant has a valid insurance policy before claims were passed on to EQC. There would be no legislative impediment to insurers taking on further claim management responsibilities, if EQC and the insurers can agree appropriate arrangements.

- There be a legislative requirement that EQC premiums reflect the costs and risks to the Crown of running EQC and the scheme. Premium rates, monetary caps and excesses will be required to be reviewed at least every 5 years;

- EQC will continue to be a Crown Entity and the Natural Disaster Fund will be retained largely unchanged. The new EQC Act would likely include a raft of technical changes reflecting legislative developments since 1993 regarding Crown Entities and Crown Financial Institutions.

- EQC insurance cover and premiums will continue to be compulsorily attached to residential insurance policies.

Impact of Proposed Changes on Homeowners

The Claims Experience

9. The cumulative effect of the proposals should be to significantly improve the claims experience for EQC claimants:

   - Eliminating EQC contents claims will enable EQC to focus more on building claims and remove any frictions regarding the interaction between claims with EQC and private insurers.

   - The higher caps on EQC building cover will reduce EQC-insurer interaction on over-cap claims. Over-cap claims are a key point of friction and claimant uncertainty in Canterbury.

   - Including in the proposed EQC building cover land works necessary to repair or reinstate the building (siteworks) would remove the current interaction between land and building repair claims, which is a source of considerable uncertainty and friction. It would also better match the design of the scheme with the policy focus on housing rather than land.

   - With the proposed scheme, if a house can be repaired or rebuilt on site, then all claims will be under EQC building cover. This brings much more conceptual clarity to what land damage is covered and EQC's obligations regarding land damage being limited to damage that has damaged the building or access way. Both these questions have been subject to considerable legal action. Separate land cover would still be available in situations where land was so badly damaged that it is not practically or economically feasible to rebuild on the site.

   - Requiring claimants to lodge their EQC claim with their private insurer will reduce uncertainty and is expected to improve the claims experience. This is because insurers will need to validate the claimant's status before forwarding the claim to EQC, thus reducing the current information churn between the claimant, EQC and insurers. These benefits are expected to increase over time as this proposal creates stronger incentives for EQC and insurers to develop claims handling arrangements that appear more seamless from a claimant's perspective.

   - Technical improvements in the drafting of core elements of the legislation should improve the claims experience by increasing clarity about what EQC covers.

Impact on Insurance Premiums

10. Preliminary analysis by EQC's broker suggests that the increase in the EQC dollar building cap, combined with cost savings from higher excesses, will likely result in the current EQC building premium of $150 per annum increasing, to perhaps $180 or so. However EQC would no longer collect the $30 annual premium currently charged for contents cover, leading to little change in total EQC premium paid by home owners.

11. The proposed changes would also affect private insurance premiums. One insurer informed officials in 2013 that they estimated that the proposed changes would reduce private property insurance premiums by about $100 per annum, and increase private contents premiums by about the same amount. These estimates are subject to large uncertainties.

12. As the estimated premium changes are small relative to the total annual cost of home and contents insurance premiums, and subject to large uncertainties, the expected impact of the reform proposals on premiums appears broadly neutral.

Impact of Proposed Changes on the Crown Balance Sheet

13. The estimated long-run average annual claims costs of the current EQC scheme are about $118 million. With the proposed changes this reduces to about $111 million, as the savings from exiting contents cover and increasing the claims excess exceed the increased costs from increasing the building cap.

14. The proposed changes reduce by about $100 million EQC's current $5.6 billion modeled expected claims liability from a large Wellington earthquake.

15. Importantly, the proposed pricing framework will help ensure that the Crown is appropriately compensated for the costs and risks that the scheme imposes on it.

Background

The Review of the EQC Act

16. On 18 September 2012, the Government announced a review of the EQC Act. The Review's scope is to recommend changes to the Act. It is not a performance review or audit of EQC's actions in Canterbury.

17. The terms of reference included the following objectives for legislation resulting from the Review (CBC Min (12) 6/2 refers):

- Support the contribution of a well-functioning insurance industry to **economic growth** opportunities in New Zealand;

- Minimise the **fiscal risk** to the Crown associated with *private property damage* in natural disasters;

- Support an efficient approach to the **overall management of natural disaster risk and recovery**; and

- Minimise the potential for property-owners to experience socially unacceptable **distress and loss** in the event of a natural disaster.

18. The Review is jointly led by the Minister of Finance and the Minister Responsible for the Earthquake Commission. The Minister of Finance has delegated the Finance role to an Associate Minister of Finance (Hon Steven Joyce).

Where do we Stand Now?

19. The experience in Canterbury suggests the EQC scheme has been successful in two main respects. Firstly, EQC has supported high rates of disaster insurance coverage among homeowners. This has provided homeowners with the resources they need to rebuild. Secondly, EQC has helped the Government manage the fiscal impact of the Canterbury earthquakes by limiting homeowner demands for further Government support, and providing resources from the Natural Disaster Fund (NDF) and reinsurance to help fund claims.

20. However, EQC has not fully met community expectations for service delivery in Christchurch. Some issues in Canterbury relate to the challenges inherent in managing hundreds of thousands of claims. But there are areas where legislative change could help the EQC scheme deliver better outcomes in future significant events:

- **Out-dated monetary caps on building cover.** The $100,000 cap on building cover no longer provides sufficient resources to rebuild a basic, adequate house. Also, the insurance industry is now sensitised to the housing exposures they are carrying. This is putting upward pressure on property premiums, which may reduce New Zealand's high rates of disaster insurance coverage over time.

- **Land damage.** The EQC Act did not envisage land damage of the nature and complexity seen in Canterbury. There has been community uncertainty about the nature of EQC's obligations and the interaction of EQC land cover with private insurers' building cover.

- **Contents coverage.** EQC currently provides $20,000 (plus GST) of contents insurance per residence. Processing contents claims diverts significant EQC resources from dealing with building claims.

- **Claims handling.** There is a need to improve the claims interface between EQC, private insurers and homeowners.

- **Capturing other insights.** There is a need for greater clarity around key definitions and concepts such as 'dwelling' and 'residential building,' the standard of repair, and qualifying damage.

The Way Forward

21. The shape of the insurance scheme established by the EQC Act is broadly right, although there are many areas for improvement. Our proposed reforms would retain EQC's current focus as a government-owned and guaranteed insurer providing compulsory insurance cover for privately-insured residential properties. This paper proposes a package of reforms that we consider appropriately balance the four objectives set out for the review. Our proposals will:

- Maintain a large intervention in the market to help protect homeowners from unacceptable distress and loss and manage the fiscal risks that would otherwise arise from post-disaster homeowner pressure for assistance.

- Increase EQC cover where insurer pricing can undermine the Government's policy goals, and reduce EQC cover where there is policy scope to do so and insurer appetite to take on the extra business.

- Clarify the purpose of, and interaction between, land and building cover to better achieve recovery goals.

- Fairly compensate the Crown for the costs and risks of the scheme by introducing a new premium-setting framework.

Proposed Key Legislative Changes to EQC Scheme

EQC Scheme Coverage

22. We propose key changes to scheme coverage:

    - The introduction of an integrated building cover that includes both building and necessary siteworks to reinstate or repair the residential dwelling on the same landholding;
    - Higher dollar caps for the building cover;
    - A separate land cover for total loss of land where it is not possible or practicable to rebuild on the site;
    - The exit of EQC from personal property (residential contents) cover.

An Integrated EQC Building Cover Including Land Repair (Siteworks)

23. Unexpected and complex interactions between land and building cover, and uncertainties regarding the nature of EQC land cover, are an ongoing source of uncertainty, friction and legal action between EQC, insurers and homeowners. This has caused considerable dispute and delay.

24. The current boundary between EQC land and building cover does not match either insurance industry practice, or the Building Act and associated industry practice regarding what is considered part of a building.

25. Aligning EQC building cover with insurance and building industry practice has big advantages. It would remove the complex interactions between land and building cover and provide much more conceptual clarity regarding the differing purposes of EQC building and land cover. Therefore from a policy perspective this reform is very attractive.

26. However this proposal has two consequences that may attract community concern:

    - Firstly, EQC would no longer cover land damage that has not damaged the insured building or access to it. This would include forms of damage such as increased vulnerability to flooding and liquefaction, which have attracted a lot of attention in Canterbury. This is likely to be perceived as the loss of a current benefit, even though the EQC Act is unclear on this, and only proactive court action since the Canterbury earthquakes has determined that benefit currently exists.

- Secondly, the changes put more pressure on homeowners to get their "sum insured" values correct. Adding siteworks, access ways and retaining walls to EQC building cover will require homeowners to understand the costs of replacing these items for insurance purposes, as these items will count towards the maximum sum payable to home owners under the "sum insured" insurance policies that most insurers have moved to since Canterbury.

27. The discussion document invites submissions on the proposal that building cover be reconfigured to better match industry practice elsewhere as discussed above.

Land Cover Would Still be Available if a site Cannot be Rebuilt on

28. The proposed reform of building cover means that if an insured building is damaged or destroyed and the site can be rebuilt on, the only cover the claimant would be entitled to would be EQC building cover. This would be an important conceptual clarification of the purpose of the building cover. However land cover would still need to be retained for situations where it is not practical or cost-effective to rebuild on the original site of the insured building, so the home owner needs to re-establish a home elsewhere. Scenarios where this occurs include cliff collapse and landslip.

29. Therefore the discussion document proposes that land cover continue to be provided in situations where it is not practical or cost-effective to rebuild on the original site of the insured building.

Higher Dollar Caps for Building Cover

30. The EQC scheme should be large enough to keep insurance premiums affordable in higher-risk areas, so that high insurance coverage rates are maintained. EQC can make a powerful contribution to improving homeowner affordability because the scheme charges one price nationally. It faces no market pressures to price individualized or area-specific risks. This single national premium rate keeps cover affordable in higher-risk areas.

31. We propose to increase the dollar cap for building cover from $100,000 to $200,000 (plus GST). Maintaining ongoing affordability for homeowners is the main motivation for the increase.

32. Adjusting the existing building cap for inflation since the cap was set in 1993 results in an equivalent 2014 value of about $170,000.

33. The Insurance Council of New Zealand (ICNZ, an industry body for general insurers) recently wrote to Ministers responsible for the EQC Review outlining their preferred reforms. The ICNZ package included retaining the existing $100,000 monetary cap on building cover. This is in the context of maintaining the current split between building and land cover.

34. The shift to building cover of siteworks that were part of land cover also requires a compensating increase in the monetary cap. Officials have suggested that the monetary building cap be increased by a further $20,000-$50,000, compared to any building cap set reflecting the current separation of building and land cover. Historic EQC data suggests that 85% of land claims are for less than $20,000.

35. Therefore given the enhancements to building cover, there is a case for a broadly status quo cap, say increasing the cap to $150,000 (plus GST), or increasing the cap further, to $200,000 (plus GST). An increase to $150,000 would broadly match the insurers' proposal and, of the two options, would result in the smallest increase in explicit fiscal risks for the Government and the largest private insurer contribution to future claims.

36. However, as EQC charges the same premium nationwide and private insurer premiums are risk-rated, the $150,000 option would also result in the highest private premiums in higher risk areas. In consultations, insurers told us that private premiums in higher risk areas were likely to continue to increase over time, as insurer risk models become more sophisticated and competitive pressures led insurers to adopt increasingly individualised risk-based pricing.

37. On balance, responsible Ministers prefer the larger increase, to $200,000. That is because the EQC scheme's flat-rate pricing improves affordability for homeowners in higher risk areas, and is therefore likely to better maintain the high levels of homeowner take-up of natural disaster insurance, which is a central policy objective of the scheme.

38. In making this decision we noted that the risk of the scheme increases by much less than headline increases in the monetary cap imply. Increasing the monetary cap for building cover to $150,000 + GST increases the expected average annual EQC building claims liability, and the claims liability associated with a large Wellington event, by less than 10 percent. If the monetary cap is increased to $200,000 the further increase in building claims liabilities is less than another 5 percent.

39. However the higher cap also displaces more private cover from the market. At present private insurers take on about 20 percent of the entire residential building liability. With a $150,000 cap this drops to about 10 percent; at a $200,000 cap it drops further to about 6 percent.

40. Higher monetary caps reduce the claims interactions between EQC and insurers. An increase in the cap to $200,000 will reduce the percentage of over-cap building claims by about two-thirds. Over-cap claims have proved a significant point of settlement delay due to friction between EQC and private insurers.

41. The decision to propose a preferred building cap of $200,000 is taken in the context of other proposals in the reforms, including establishing legislative principles for pricing EQC premiums. Those principles should mean that any change in the risk of the scheme is accompanied by appropriate compensating changes in premium revenues.

42. Given the trade-offs and the insurance industry willingness to retain their current exposures, the discussion document includes a discussion of the above issues, puts forward the $200,000 cap as the Government's preferred proposal for consultation, and invites submissions on the merits of a $150,000 versus $200,000 cap.

Contents Insurance – EQC to Exit from Contents Insurance

43. EQC currently covers household contents up to a cap of $20,000. These claims generate a disproportionate amount of work for EQC. Private insurers have consistently indicated that they are willing to take on this cover. We therefore propose that EQC exit from contents insurance. This will simplify the settlement of contents claims and enable EQC to focus on its core housing obligations. The estimated expected cost to EQC of contents cover claims is an annual average cost of $8-9 million, and $660 million in a large Wellington earthquake.

Excesses – Increase and Simplify the Excesses Paid by Home Owners

44. The Act currently sets the excesses for residential buildings and land as follows:

    <u>Residential building</u>: $200 multiplied by the number of dwellings in the building, or 1% of the amount payable under the EQC Act.

    <u>Residential land</u>: $500 multiplied by the number of dwellings in the residential building on the land, or 10% of the amount payable under the EQC Act, whichever is the greater, to a maximum of $5,000.

45. In Canterbury the typical claims excess is about $500 per claim. These provisions are needlessly complex, especially when EQC is dealing with large numbers of claims in the context of a major disaster. In addition, the dollar value of the current excesses has not been updated for a long time. They predate the current 1993 EQC Act.

46. For land claims the discussion document proposes that the claims excess be zero. That is because it is proposed that land cover would only be available in situations where it is not practical or cost-effective to rebuild on the original site of the insured building. Therefore the primary purpose of a claims excess – to winnow out low value claims – is not applicable, as all land claims should be substantial. In addition anyone making a land claim would necessarily have a matching EQC claim for the loss of the related building, on which an excess would be paid.

47. For building claims we propose to introduce a flat $2,000 excess for each claim.

48. In determining the value of the excess, we have tried to strike a balance between administrative efficiency, social acceptability and disaster recovery concerns. A higher excess will reduce the number of low-value claims and allow EQC to focus on more serious damage. But if the excess is set too high, there is likely to be strong pressure to reduce the excess after a disaster.

49. EQC has modelled the impact of various changes to the excess on the number of expected building claims in a major Wellington earthquake.

Excess on building claims	Percentage reduction in number of EQC building claims from status quo
$1,000	5.0%
$2,000	8.9%
$5,000	17.2%

50. The Canterbury earthquakes have generated over 400,000 building claims for EQC, so these percentage reductions represent tens of thousands of low value claims that would no longer need to be processed by EQC.

Impact of Proposed Changes on the Crown's EQC Liability

51. The following changes will have the largest impact on the Crown's EQC liability:

- A higher building cap will **increase** the liability.
- The removal of contents cover will **reduce** the liability.
- The $2,000 building and land excesses will **reduce** the liability.
- The restriction of land cover to situations where the site cannot be rebuilt on will **reduce** the liability.

52. EQC modeling of the changes to the monetary caps on building and contents cover, and claims excesses indicates that the proposed changes will slightly reduce both the scheme's average annual claims liability, and the expected claims liability following a large Wellington earthquake. The impact of the proposed changes to the configuration of building and land cover cannot currently be modeled.

Fiscal impacts of potential reform options

	Expected annual claims liability $ million					**Expected liability, large Wellington event, $ million**				
	Building cap					**Building cap**				
	$100k	$150k	$200k	$250k	Uncapped	$100k	$150k	$200k	$250k	Uncapped
Expected claims, $m	$118	$128	$133	$136	$139	$5,585	$6,106	$6,380	$6,531	$6,725
Change from status quo (negative figures are liability *reductions*)										
Building cap changes, $m	$0	$10	$15	$18	$21	$0	$521	$795	$947	$1,141
Exit contents, $m	-13.74	-13.74	-13.74	-13.74	-13.74	-661	-661	-661	-661	-661
$2,000 excess, $m	-8.6	-8.6	-8.6	-8.6	-8.6	-239	-239	-239	-239	-239
Impact of combined changes	**-$22**	**-$12**	**-$7**	**-$5**	**-$1**	**-$899**	**-$378**	**-$104**	**$47**	**$241**

Collection and Pricing of EQC Premiums

53. We propose to retain the current arrangements in which the EQC premium is levied on insurance policies on qualifying buildings. The discussion document seeks feedback on two neutrally presented options – the status quo, where full EQC cover attaches to a fire insurance policy, or an alternative where EQC cover only applies to perils covered by EQC that are also covered by the attached private insurance policy.

54. We also propose to retain the current legislative flexibility to charge either a flat-rate or risk-rated premium. (However, we believe that the pricing approach that best matches the goals of the scheme is to retain the current flat-rate pricing structure in future.)

55. Regarding premium pricing, history suggests there is little incentive to adjust EQC pricing outside of a crisis: the increase in the EQC premium in 2012 was the first change in the premium rate (as a percentage of cover) since the scheme was established in 1945. We propose to require the premium rate to be set so that it fully compensates the Crown for EQC's costs and the scheme's costs and risks. This would work in a similar manner to ACC levy-setting: EQC would recommend a levy to Ministers based on technical analysis, and Ministers would decide the premium rates. Ministers could depart from pricing the scheme on a risk-adjusted basis subject to transparency disciplines akin to the fiscal responsibility provisions of the Public Finance Act.

56. Preliminary analysis by EQC's broker suggests that, with reasonable assumptions, the current EQC premium rate is fairly close to a rate that would fully compensate the Crown for the costs and risks imposed by running EQC and the current scheme. Therefore we do not expect this pricing approach would result in advice for large increases in EQC premiums.

57. Increasing the building cap to $200,000 (plus GST) will increase the EQC liability and hence increase EQC premium revenues. Preliminary analysis indicates that the maximum annual EQC premium payable would increase from $150 to around $200. Increasing the claims excess would reduce claims liabilities and hence reduce premiums, perhaps offsetting about half this increase. In addition EQC would no longer collect the $30 premium on contents cover. Therefore the proposed package appears broadly neutral from a customer and EQC revenue perspective.

Impact of Proposed Changes on Private Insurance Premiums

58. The proposed changes to the EQC scheme will reduce the residential building exposure carried by private insurers, while increasing their residential contents exposure. The proposed changes should result in lower future private insurance premiums on dwellings, and higher future premiums on contents, than would result if the current EQC scheme design was retained. Insurers have informally indicated that these premium changes are likely to be broadly offsetting.

Other Changes

Claims Handling

59. There has been significant stakeholder pressure for EQC to exit from claims handling. We propose that the legislation require EQC claims to be notified and lodged via private insurers. This will remove confusion for claimants, reduce costs for EQC and insurers, and require EQC and insurers to work closely together on business as usual claims, potentially leading to a positive dynamic where insurers take on more of the claims management processes over time.

60. But the EQC Act should not constrain choices about who handles claims beyond notification and lodgment. It would be risky to fix an outsourcing arrangement in legislation, particularly if EQC and the insurers are unable to arrive at an arrangement that works for all parties.

61. ICNZ has indicated that it would prefer the legislative reforms ensure that for building claims insurers carry out the entire claims settlement process on EQC's behalf. Engagement with insurers as part of the submissions process should provide an opportunity to determine the strength and nature of their concerns. The Cabinet paper seeking final policy decisions following the public consultation process will also report on intended next steps for improving claims handling interactions between EQC and insurers.

Review EQC Premiums, Monetary Caps and Excesses at least Every 5 Years

62. Experience since the scheme's inception is that updating the scheme parameters is a low priority for governments prior to a large disaster. The current $100,000 building cap has been unchanged since its introduction in 1993. The current excesses predate the current 1993 EQC Act.

63. We therefore propose that the EQC Act require that EQC premiums, monetary caps and excesses be reviewed at least every 5 years. We envisage this would usually be an EQC-led exercise, but the EQC Act would be permissive regarding the form of the review. This legislative requirement would not prevent more frequent, or broader, reviews if future Ministers so decided.

Institutional Design

64. EQC will continue to be a Crown Entity and the Natural Disaster Fund will be retained largely unchanged.

65. The new EQC Act will include technical changes to reflect legislation development since 1993 regarding Crown Entities and Crown Financial Institutions.

Technical Changes

66. The new legislation would require definitional and other changes to improve legislative clarity and reflect current drafting practice. This would include the addition of a purpose section and the revision of key definitions and concepts.

67. The EQC Act be redrafted in its entirety, rather than amended, given that it is generally outdated and is in places difficult to apply.

Fit with Crown's Broader Balance Sheet Management Strategy

68. The Government is still developing an integrated balance sheet management strategy, and such strategies need to be able to evolve over time. If the new legislation is to be durable, it must be robust to a broad range of approaches for managing the Crown's balance sheet. The review has thus focused on the appropriate allocation of accountability and decision rights for managing EQC's finances, rather than on deciding a particular balance sheet strategy.

69. The approach proposed in this paper has a range of features that would be robust to any likely Crown-wide balance sheet strategy. These features include sizing the scheme to both reflect and shape homeowner expectations, shedding EQC cover (and hence risk) where this is likely to be durable; identifying and pricing risks that would otherwise be implicit and unmanaged; and legislatively-established pricing principles for EQC premiums, while retaining existing Ministerial controls regarding the EQC's investment and reinsurance strategies.

70. In addition, we propose that the legislation enable EQC to place reinsurance or other risk transfer products on behalf of other Government agencies, if directed to do so by Ministers. This would be a permissive provision, so that if future Governments decided that other parts of the government should purchase reinsurance or other types of risk transfer, and that EQC was an efficient agent to facilitate or coordinate buying those products, there is the legislative ability for this to happen. However, the NDF would not be used to fund these activities or any resulting claims.

Future Processes

71. Expected future processes are outlined below, assuming a Bill introduction in 2016:

- Cabinet to consider paper (June);
- Discussion document to be released (June-July);
- Consultation period (July to mid-late 2015);
- Consider submissions (late 2015)
- Cabinet decisions on final design and direction to PCO to draft EQC Bill (late 2015)
- Parliamentary process (introduction, select committee and Bill passage) (2016)
- Entry into force (2017)

Consultation

72. Officials have consulted widely with the insurance industry, and have also consulted community groups in Christchurch, in the formation of these proposals.

73. The Earthquake Commission, Reserve Bank, Ministry of Business, Innovation and Employment, Department of Internal Affairs, and the Ministry of Civil Defence

and Emergency Management have been consulted on this paper. The Department of Prime Minister and Cabinet has been informed.

Financial Implications

74. None.

Human Rights

75. The proposals have been consulted with Ministry of Justice with regard to consistency with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Legislative Implications

76. Implementing these proposals will require legislative change. A bid has been made for the inclusion of an Earthquake Commission Amendment Bill (or a replacement Earthquake Commission Bill) on the 2015 legislation programme, with a priority of category 5 – a bill to be introduced in 2015.

Regulatory Impact Analysis

77. This will be provided when Cabinet makes final policy decisions following public consultation.

Publicity

78. No publicity is expected at this stage. Any media enquiries will be handled by the office of the Minister Responsible for the Earthquake Commission.

Recommendations

It is recommended that the Committee:

1. **note** that the Government announced a legislative review of the EQC in September 2012 in response to the lessons learned from the Canterbury earthquakes;

2. **agree** that the Government consult the public on a preferred legislative reform package that includes the following key elements:

   2.1. **retain** EQC as a Crown Entity;

   2.2. **retain** the Natural Disaster Fund, and EQC's management of it, and clarify that EQC manages that fund on behalf of the Crown;

   2.3. **increase** the dollar cap on building cover from $100,000 (plus GST) to $200,000 (plus GST);

   2.4. **remove** separate cover for land repair and **adopt** usual insurance industry practice to include in building cover any siteworks necessary to reinstate or replace the damaged building or access to it;

2.5. **retain** EQC land cover, but limit it to situations where it is not practical or cost-effective to rebuild on the original site of the insured building;

2.6. **introduce** a fixed excess on building claims of $2,000;

2.7. **introduce** a nil excess on land claims;

2.8. **exit** of EQC from the provision of contents insurance against natural disaster damage;

2.9. **introduce** legislative requirements that EQC's premium revenues must adequately compensate the Crown for the costs and risks of running EQC and the EQC scheme (with the responsible Minister able to transparently set premiums that depart from this principle);

2.10. **require** EQC policy holders to lodge claims via their private insurers. Insurers would confirm the details of the claimant and their entitlement to EQC cover before passing the claim onto EQC for EQC to process;

2.11. **introduce** a legislative requirement to review EQC cover premiums, monetary caps and excesses at least once every 5 years;

3. **note** the draft discussion document that is attached;

4. **agree** that the Minister Responsible for the Earthquake Commission and Associate Minister of Finance Steven Joyce may release this document for public consultation on the proposals it contains;

5. **agree** that the responsible Ministers may make minor and technical amendments to the final form of the discussion document without reference back to Cabinet, within the context of the decisions above;

6. **agree** that this paper be publicly released, subject to appropriate withholdings; and

7. **invite** the Minister Responsible for the Earthquake Commission and Associate Minister of Finance Steven Joyce to report back to the Committee in 2015 on the outcomes of the public consultation, and with proposals for legislative reforms to be referred to PCO for drafting a bill for introduction to the House and next steps for improving claims handling interactions between EQC and insurers.

Hon Gerry Brownlee
Minister Responsible for the Earthquake Commission

Date:

Hon Steven Joyce
Associate Minister of Finance

Date: