

# The Treasury

## Briefing to the Incoming Minister Responsible for the Earthquake Commission

**December 2020**

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# 1 Your responsibilities, and how the Treasury assists you

This briefing outlines your role as the Minister Responsible for the Earthquake Commission, and how the Treasury assists you in your role. It also highlights some considerations relating to the Earthquake Commission (EQC) that we wish to discuss with you.

As the Minister Responsible for EQC, you are also one of two shareholding Ministers of Southern Response Earthquake Services Limited (Southern Response). This briefing also provides an overview of Southern Response and some of the considerations relating to the company.

## 1.1 The Earthquake Commission

EQC is a statutory Crown entity and is subject to both the Crown Entities Act 2004 (Crown Entities Act) and the Earthquake Commission Act 1993 (EQC Act). EQC administers New Zealand's main source of residential natural disaster cover and is a key contributor to the management of natural disaster risk. EQC is a first-loss insurer, covering the cost of settling a claim up to a capped value (the cap). The cap is currently set at \$150,000 plus GST per dwelling. A private insurer typically covers any cost above the value of the cap (the over-cap portion).

### Your responsibilities and key opportunities to influence

You are required to oversee the Crown's interests in, and relationship with, EQC. You appoint the Board of Commissioners, which is responsible for exercising EQC's powers and performing its functions contained in the EQC Act.

You can also influence EQC through the business planning cycle. This includes communicating your expectations through an annual letter of expectations to the Board, and commenting on a Statement of Performance Expectations (that the Board produces each year) and a Statement of Intent that the Board produces at least once every three years.

Under the Crown Entities Act, you can issue a Ministerial direction that requires EQC to give effect to a Government policy that relates to its functions and objectives. Eight Ministerial directives, issued since 2001, are currently in effect.

### The Treasury is the lead advisor to you on EQC matters

The Treasury is the Government's principal advisor on economic and fiscal policy and is the lead advisor to you on EQC matters. We provide you with independent advice separate to EQC. This independent perspective is particularly critical with respect to anything that involves financial arrangements, and statutory powers or obligations.

We review and provide comment on EQC's quarterly reports and annual report. These reports are assessed against EQC's business planning documents. We also manage the appointment process of directors on your behalf and provide advice to you on the skills required for the EQC Board.

In addition to advice on performance and appointments, the Treasury has a dedicated EQC policy team. It focuses on two broad areas:

- Maintaining oversight and coordination of Canterbury insurance-related work programmes to support the timely, fair and enduring settlement of claims, including regular reporting to you on progress in resolving outstanding claims.
- Providing advice on the development of New Zealand's future natural disaster arrangements, including advice on further review of the EQC Act and policy issues arising from the Public Inquiry into the Earthquake Commission.

## 1.2 Southern Response

### Your responsibilities and key opportunities to influence

You are required to oversee the Crown's interests in, and relationship with, Southern Response. Similar to EQC, shareholding Ministers appoint the Board, and can influence Southern Response through the business planning cycle.

### Background to Southern Response, and the Treasury's role

Southern Response is listed under Schedule 4A of the Public Finance Act 1989. Previously called AMI Insurance Limited, it became a Crown-owned company in 2012, when the Crown took over the company to ensure that it could fulfil its obligations to policyholders. It has subsequently paid out over \$3 billion to settle claims.

Southern Response is working to wind down its operations in a manner that will allow it to fully discharge its obligations. It will not take on any new insurance underwriting, except to the extent that it is ancillary to its claims management business.

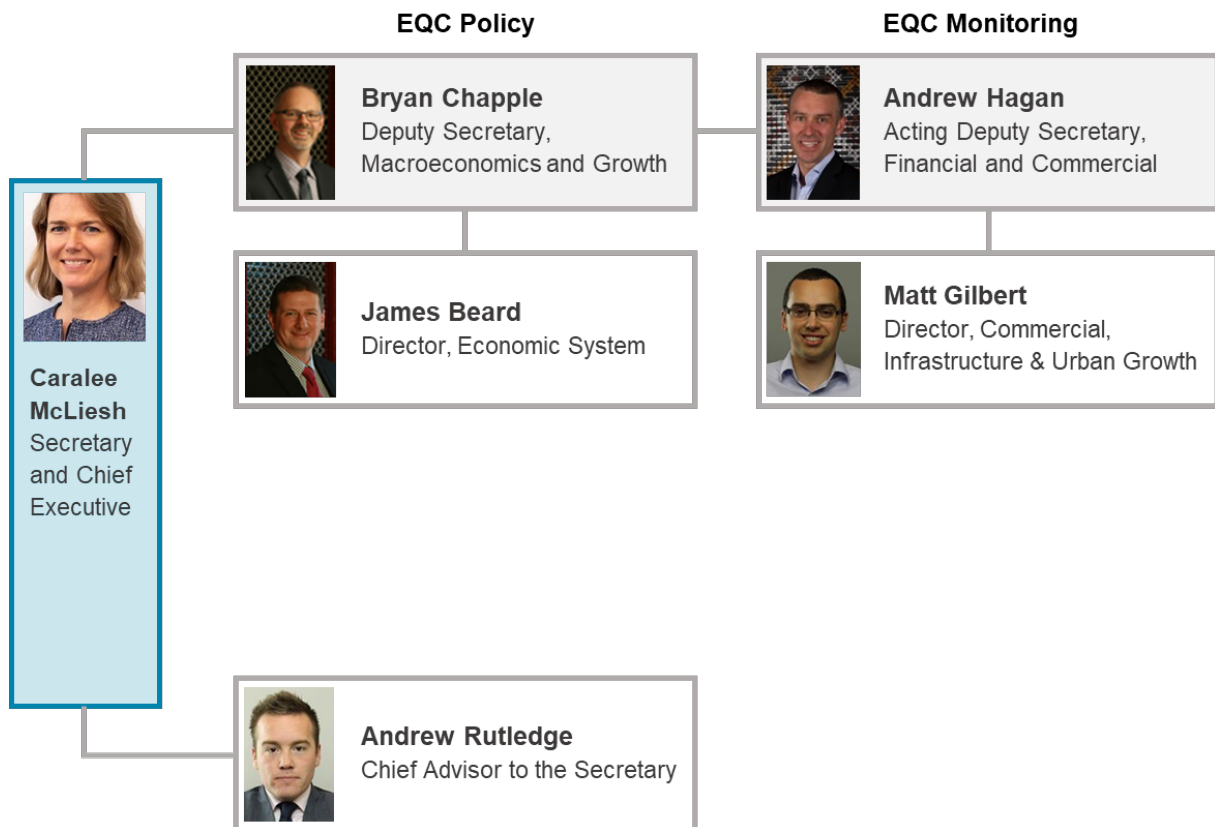
Southern Response has outsourced the management of its claims settlement activities to EQC. It now uses its residual resources to support EQC in delivering, on behalf of Southern Response, fair and enduring settlements for Cantabrians who are yet to resolve their earthquake claims. Acknowledging EQC's role under an Agency Agreement, key decision-making regarding claims settlements will still remain with Southern Response. Third parties, such as the Greater Christchurch Claims Resolution Service, are also used to assist customers in settling claims and identifying solutions.

The net outstanding claims liability is \$167.7 million as at 30 June 2020. There is considerable uncertainty around this liability estimate. As claims settlements have progressed, there are fewer claims; however, a greater proportion of the outstanding claims liability relates to more complex claims. The uncertainty around future settlement outcomes is therefore magnified.

The Crown has provided financial support to Southern Response through an uncalled capital facility. The balance remaining in this facility as at 30 June 2020 was \$179 million. This is sufficient to cover the net equity deficit of \$142 million on the balance sheet at 30 June 2020, leaving \$37 million in headroom. The Secretary to the Treasury has delegated authority to approve payments of up to \$50 million on the uncalled capital facility. This delegation remains in place until revoked by you.

The Treasury monitors claims settlement progress (in part through its monitoring of EQC), and engages with Southern Response on the company's funding requirements and the drawdown of its Uncalled Capital Facility. Funding arrangements may need to be extended in the current financial year. We will provide further advice to you as required.

## 1.3 Key Treasury contacts



## 2 Matters of current interest

### 2.1 The Earthquake Commission

#### Board appointments

You will need to make a decision very soon on the position of EQC Chair following the recent retirement of Sir Michael Cullen and the appointment of Mary-Jane Daly as interim Chair until 30 November 2020. The term of a long-serving Commissioner (Dr Alison O’Connell) is also due to expire on 30 November 2020. We will provide you with further advice very soon regarding the composition of the Board.

#### Public Inquiry into the Earthquake Commission

A Public Inquiry was established to examine the role and work of EQC in the aftermath of the 2010 and 2011 Canterbury earthquakes and subsequent events, and to ensure lessons can be applied to improve how EQC operates in future. The Inquiry reported back in March 2020, and its recommendations can be broadly grouped into three core themes:

- Modernising the EQC Act (see below).
- Making the claims system more people-centred.
- Clarifying roles and responsibilities.

In August 2020, the Government accepted in principle, or committed to further work on all 70 of the Inquiry’s recommendations. We propose to provide further advice on progress against these recommendations.

#### Review of the EQC Act

We have been considering how the EQC Act could be modernised to clarify the role of EQC, and to provide better insurance cover to New Zealand homeowners. A key issue for the review is advice on lifting the monetary cap on EQC cover, and the extent to which this supports affordability objectives for higher-risk properties.

Now that the Public Inquiry’s findings have been released, we have accelerated policy work on reviewing the EQC Act. As part of the Government’s response to the Public Inquiry, Cabinet directed officials to report back to Cabinet by 31 March 2021 with decisions for a bill modernising the EQC Act to ensure the bill can be introduced by July 2021. We intend to provide you with further advice on the policy issues and the timing of the review as soon as possible.



## Crown Guarantee and the Natural Disaster Fund

As a result of the Canterbury and Kaikōura earthquakes, it has been necessary since November 2018 for the Crown to fund cash shortfalls in the Natural Disaster Fund (NDF) in accordance with section 16 of the EQC Act.

Section 16 of the EQC Act provides that, if the assets of EQC are not sufficient to meet its liabilities, the Crown will provide EQC with a grant or advance to meet the shortfall. You can set terms and conditions for this guarantee. EQC currently pays the Crown an annual fee of \$10 million for this guarantee.

Under the terms of a deed put in place to operationalise section 16 of the EQC Act, EQC can request funds when it forecasts that the balance of the NDF will drop below an operational buffer of \$50 million. The Secretary to the Treasury has been delegated the authority to authorise individual payments of up to \$60 million. Any payment above this amount requires your approval. This delegation remains in place until revoked by you.

We will advise you as soon as it becomes apparent that further funding is required.

## Risk-financing framework

The Crown guarantee provided to EQC under section 16 of the EQC Act means that risk management decisions made by EQC have impacts on the Crown's fiscal position. The Treasury is preparing a Crown Risk Appetite Framework, focusing initially on EQC, to develop a repeatable risk appetite statement for contingent liabilities not included in the Crown's fiscal forecast. Through consultation between you and the Minister of Finance, this will allow the Government's fiscal risk tolerance to inform EQC's Board as it develops its risk finance strategy.

## On-sold over-cap policy

EQC is administering the on-sold over-cap policy on behalf of the Crown. This policy seeks to reduce litigation while addressing the social issues that arise from people living in unrepaired homes damaged by the Canterbury earthquake sequence. The policy provides an ex gratia home repair grant to cover the over-cap cost of missed earthquake damage and/or failed EQC-commissioned repairs of houses that have been sold and are not covered by private insurance policies.

EQC has indicated it could take up to eight months to assess applications and provide an offer to eligible applicants. The building and repair work could take a few years to complete. The Treasury and EQC propose to assess whether the current three-year \$300 million appropriation is adequate, and provide you with advice in late 2020.

## Residual Canterbury claims

The private insurance companies and Southern Response report that together they have around 740 residual over-cap Canterbury earthquake claims that are still outstanding as at 30 June 2020. In addition, some of the approximately 1,400 outstanding EQC under-cap insurance claims (as at 30 June 2020) may go over cap, which will require them to be handed on to the relevant insurance company.

All of these 1,400 outstanding under-cap claims had been settled, and later reopened. Reasons for claims reopening include failed repairs, missed scope, and underestimation of repair cost. Around 300 of the outstanding EQC claims have been open for more than 12 months.

The Canterbury Earthquake Insurance Tribunal (CEIT) and the Greater Christchurch Claims Resolution Service (GCCRS) were set up to assist with the resolution of the remaining outstanding Canterbury earthquake claims. The Ministry of Justice and the Ministry of Business, Innovation and Employment will provide advice on the future of the CEIT and the GCCRS respectively, as the number of residual insurance claims declines. You may be consulted on this advice, given the implications for EQC and Southern Response. We note that it may take several years to resolve all the remaining outstanding Canterbury earthquake claims.

## 2.2 Southern Response

### Litigation

Southern Response is currently subject to litigation. The eventual outcome of this litigation is unknown and may result in further liabilities that need to be recognised in the Crown's financial statements.

In response to the litigation risks, the Minister of Finance provided Southern Response with a Deed of Indemnity in September 2018. We are working with Southern Response and Crown Law to ensure Ministers are kept informed of legal developments and related matters. We propose to provide a briefing with further information on legal actions, and the implications of recent findings, as soon as practicable.

### Participation in the Greater Christchurch Claims Resolution Service

The Greater Christchurch Claims Resolution Service (GCCRS) continues to be the most popular avenue for Southern Response customers to seek support and representation. Southern Response continues to participate fully in the service and has regular claims discussions.

To 30 June 2020 GCCRS had closed a total of 179 Southern Response-related over-cap customer issues (noting that this does not necessarily always mean that a claim has settled) and had 252 open cases that involve an AML (Southern Response) policyholder. Of these cases:

- 155 are open under-cap claims for which Southern Response is not liable (unless they go over cap)
- 97 claims involve a Southern Response liability.

### 3 Upcoming key decisions and issues

We would like to engage with you on a range of key decisions and critical issues before the end of 2020. These relate to legislative requirements, your manifesto priorities, and other priority issues. We will provide you with a list of these issues and proposed timeframes for engaging with you ahead of our first meeting.