

# The Treasury

## Material Provided to the Public Inquiry into EQC Information Release

August 2021

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## Treasury Report: EQC - Insurance Excess

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<b>Date:</b>	18 November 2010	<b>Report No:</b>	T2010/2322
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### Action Sought

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	Action Sought	Deadline
Minister of Finance (Hon Bill English)	<b>Read</b> the report prior to attending the Adhoc Cabinet Committee for Canterbury Earthquake Recovery	Tuesday 30 November 2010
Associate Minister of Finance (Hon Simon Power)	<b>Note</b> contents of the report	None
Associate Minister of Finance (Hon Steven Joyce)	<b>Note</b> contents of the report	None

### Contact for Telephone Discussion (if required)

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Name	Position	Telephone	1st Contact
Diana Solomon	Analyst, Sector Monitoring	[39]	[23] ✓
Andrew Blazey	Manager, Sector Monitoring	[39]	[23]

### Minister of Finance's Office Actions (if required)

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None.
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**Enclosure: No**

## Treasury Report: EQC - Insurance Excess

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### Purpose of Report

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1. The purpose of the report is to brief you on the insurance excesses charged by the Earthquake Commission (EQC) under the Earthquake Commission Act 1993 (the EQC Act) and the EQC Regulations 1993.

### Background

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2. On 16 November 2010, Cabinet invited the Minister for Canterbury Earthquake Recovery and the Minister of Finance to report back to Cabinet as a matter of urgency with further information on insurance excesses for damaged residential land. Cabinet is seeking information on the legislative framework that applies to insurance excesses for damaged land and how the EQC will charge and collect the excesses from affected homeowners.
3. As a result, the Canterbury Earthquake Policy Response Team, Department of the Prime Minister and Cabinet are reporting back to the Adhoc Cabinet Committee for Canterbury Earthquake Recovery Cabinet within two weeks. The Treasury and the EQC are being consulted in the preparation of this paper. The Minister for Canterbury Earthquake will be provided information on this issue by the Canterbury Earthquake Policy Response Team, Department of the Prime Minister and Cabinet.
4. Given the level of urgency and sensitivities around insurance excesses, we thought it would be useful to brief you on various aspects of the issue prior to the Cabinet discussion, where the above paper will be considered.

### Legislative Framework

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5. The EQC Act and the Earthquake Commission Regulations 1993 require the EQC to impose an insurance excess on affected homeowners in relation to insurance claims for land, building and contents damage. These excess limits differ for each type of claim, and are as follows:
  - Land - \$500 or 10% of the amount payable, whichever is greater to a maximum of \$5,000.
  - Buildings - \$200 or 1% of the amount payable, whichever is greater to a maximum of \$1,000.
  - Contents – flat \$200 per claim.
6. For the above, it is assumed that excesses will only be collected on the land remediation work required under the EQC Act, i.e. excesses will not be charged on the land remediation work to a higher standard, which is being funded by the Crown. There would be a number of legal and practical difficulties in charging an excess on this extra land remediation work.
7. A summary of the above and the manner in which the EQC has or is planning to collect the insurance excesses from affected homeowners is outlined at Annex 1, which could be used as talking points.

## Insurance Excesses

8. Charging an insurance excess is an established insurance market practice, and it is designed to prevent a large volume of trivial claims being submitted by the insured, and to ensure that the insured have an incentive to avoid or mitigate damage to their property, where possible. The excesses notwithstanding, the EQC will typically meet 90% of the costs of remediating damaged land. Overall, affected homeowners are estimated to pay around 1% of the costs of the Canterbury earthquake in excesses, either to the EQC or private insurers
9. Usually, following damages from a natural disaster, the homeowner would privately contract for the repairs to their house or land, or replacement of any household contents, and the EQC would reimburse an insurance settlement amount to the homeowner less the required excess. This has been the case since at least 1993 with all the natural disasters covered under the EQC Act, including the more recent floods and land slip events. In some circumstances, the EQC has carried out the land repair itself, with the homeowners paying the excess to the EQC rather than having it deducted from a settlement payment made by EQC.
10. For the Canterbury earthquake, the EQC will be managing (via the Fletchers Project Management Office (PMO)) all house repairs between \$10,000 and \$100,000, rather than paying out an insurance settlement to homeowners.
11. Across the six categories of claims processed by the EQC, the manner in which the EQC has or is planning to collect excesses is outlined in Table 1. For the small and large building claims categories (i.e. less than \$10,000 and more than \$100,000 respectively), the EQC has already been paying out the settlement amounts less the required excess.

Table 1: EQC's excess collection mechanism across the main claim categories

<b>Claim Type</b>	<b>Status</b>	<b>Excess Collection Mechanism</b>
Urgent repairs (e.g. weathertightness)	Current	None at this stage. Repair costs are paid without deducting an excess, in the expectation that the excess will be deducted from the subsequent claim for the full amount of damage
Building damage less than \$10,000	Current	Settlement amount paid out less required excess (\$200 plus GST)
Building damage \$10,000 - \$100,000	<u>Potential</u> and not yet underway	<u>Proposed</u> : Excess collected from affected homeowner after remediation work has been completed. Excess is 1% of the cost of repairs, with a minimum of \$200 plus GST
Building damage more than \$100K	Current	Settlement amount paid out less required excess (\$1,000 plus GST)
Contents damage	Current	Settlement amount paid out less required excess of \$200 plus GST
Land damage	<u>Potential</u> and not yet underway	<u>Proposed</u> : Excess collected from affected landowner after remediation work has been completed. Excess is 10% of the cost of repairs, with a minimum of \$500 and a maximum of \$5,000 plus GST

12. The Fletcher PMO is managing the mid-range house repair claims, i.e. claims ranging from \$10,000 - \$100,000. The approach used by the EQC for collecting excess across the other house repair and contents claim categories (paying settlement amount less required excess) will not work for mid-range claims because the EQC is paying for the repairs itself, rather than making a settlement payment to claimants. The same is proposed to apply to land repairs.
13. Consequently, the EQC will need to ask the homeowner to make a contribution towards the house repairs and land remediation, equal to the excess, because the EQC will have incurred the full cost of the work itself.
14. For the house repairs handled by the PMO and for land repairs, the EQC are proposing to get an in-principle agreement from the landowner, before the work commences, to pay the insurance excesses. These excesses will be recovered from homeowners after the work is completed and final costs are known. This also means that the EQC has time to consider a process that will allow it to design appropriate solutions for collecting the excesses from affected homeowners.
15. This approach of handling the work for the customer and subsequently billing them for the amount of the excess is an established practice in the private insurance market.
16. EQC's solution to collect excesses from all claimants (including those in the mid - range of \$10,000 - \$100,000) is consistent with what has been done historically, and ensures fairness across all claim categories.

## Discussion

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17. The EQC will need to design and implement a process for collecting an excess for house repairs of between \$200 and \$1,000 (plus GST) from an estimated 60,000 homeowners. We estimate the total excess to be collected, across all house repair claims, to be around \$35 million. This is 1.1% of the total cost to the EQC of house repair claims (the figure is above 1% because claims for damage below \$20,000 pay the minimum excess of \$200). We estimate the average excess paid will be around \$340 per homeowner (although there is significant uncertainty around this figure).
18. For land claims, the EQC will need to design and implement a similar process for collecting an excess of between \$500 and \$5,000 from an estimated 12,000 landowners. We estimate the total excess to be paid for land repair claims to be somewhere between \$10 million and \$15 million, with the average excess paid around \$1,000 - \$1,500 (again, with significant uncertainty). Note, the Cabinet paper that was considered by ACE referred to a total land excess of up to \$10 million. The EQC's latest estimate is that it may be up to \$20 million.
19. In reality, the process for the two excesses (house repair and land remediation) is likely to be combined, with the homeowner being asked to pay a total excess of between \$700 and \$6,000 (plus GST), with our estimate of the average excess being \$1,340 - \$1,840 (plus GST).
20. It can be assumed that the affected homeowners could be facing additional excesses from their private insurers. The amount of the (private insurers) excess would be variable, depending on the provisions of the individual homeowners' private insurance contracts.

## Alternatives

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21. We understand that the Minister for Canterbury Earthquake Recovery may be concerned about the application of the EQC's excesses, particularly for land remediation. The Minister may wish to consider amending the EQC's excess provisions. We assume there is no issue with the EQC's excesses for contents, so we do not discuss this further.
22. As discussed above, the EQC is already deducting excesses for house repair claims below \$10,000 and above \$100,000 (the EQC cap). It would be highly inequitable to not charge excesses for repairs between \$10,000 and \$100,000, while charging homeowners for claims above and below these figures. There would also be numerous other policy, practical and fiscal issues. Therefore, we would recommend against making any changes to the EQC's house repair excesses.
23. Unfairness is not going to be an issue with respect to the excess for land repairs. However, charging an excess ensures consistency of treatment across all claim categories and that the insured have an incentive to avoid or mitigate damage to their property, where possible. Not charging excesses on land claims could result in a fiscal cost of at least \$20 million.
24. Possible alternatives whilst considering the EQC's insurance excess provisions could include a flat excess of \$500 across all claim categories; or a disappearing excess, where claims under \$500 face the full excess and so are not paid and claims over \$500 don't face an excess. With either of these alternatives, the Crown faces significant fiscal costs, and it also raises numerous practical and policy implications.
25. To give effect to any of the above alternative options, the EQC regulations that specify the excesses would need to be amended. We would recommend current insurance excess provisions be retained.

## Recommended Action

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We recommend that you:

- a **note** the Adhoc Cabinet Committee for Canterbury Earthquake Recovery will be considering how EQC will charge and collect the insurance excesses from affected homeowners;
- b **note** the EQC are required to impose an insurance excess on affected homeowners in relation to insurance claims for land, building and contents damage under the EQC Act and the Earthquake Commissions Regulations 1993;
- c **note** the EQC's solution to collect excesses from all claimants is consistent with what has been done historically, and ensures fairness across all claim categories; and
- d **note** the current EQC insurance excess provisions be retained.

Andrew Blazey  
**Manager, Sector Monitoring  
for Secretary to the Treasury**

Hon Bill English  
**Minister of Finance**

## Annex 1: Talking points - Summary of EQC's Insurance Excess Provisions

1. The EQC Act and the Earthquake Commission Regulations 1993 require EQC to impose an insurance excess on affected homeowners in relation to insurance claims for land, building and contents damage. These excess limits differ for each type of claim, and are as follows:
  - Land - \$500 or 10% of the amount payable, whichever is greater to a maximum of \$5,000.
  - Buildings - \$200 or 1% of the amount payable, whichever is greater to a maximum of \$1,000.
  - Contents – flat \$200 per claim.
  
2. For the above, it is assumed that excesses will only be collected on the land remediation work required under the EQC Act, i.e. excesses will not be charged on the land remediation work to a higher standard, which is being funded by the Crown. There would be a number of legal and practical difficulties in charging an excess on this extra land remediation work.
  
3. Across the six categories of claims processed by the EQC, the manner in which the EQC has or is planning to collect excesses is outlined below:

<b>Claim Type</b>	<b>Status</b>	<b>Excess Collection Mechanism</b>
Urgent repairs (e.g. weathertightness)	Current	None at this stage. Repair costs are paid without deducting an excess, in the expectation that the excess will be deducted from the subsequent claim for the full amount of damage
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