The Treasury

Material Provided to the Public Inquiry into EQC Information Release

August 2021

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[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

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[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: EQC Review: Feedback from Insurers on Willingness and Capacity to Insure Dwellings that are in non-Residential Buildings

Date:	4 December 2013	**Report No:**	T2013/2994
		File Number:	CM-1-3-15-1

Action Sought

	Action Sought	**Deadline**
Minister responsible for the Earthquake Commission (Hon Gerry Brownlee)	**Agree** to the recommendations in this report.	Joint Ministers are scheduled to discuss this report with officials at 3.30pm, Wednesday 11 December.
Associate Minister of Finance (Hon Dr Jonathan Coleman)	**Agree** to the recommendations in this report.	Joint Ministers are scheduled to discuss this report with officials at 3.30pm, Wednesday 11 December.

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
Steve Cantwell	Principal Advisor	[39]	[23]	✓
Fiona Ross	Manager, Financial Markets and International	[39]	[23]	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Enclosure: Yes

ICNZ Feedback
IAG Feedback
Vero Feedback
T2013/2594 EQC Act Review: Follow-up Reporting on Proposals for Public Consultation executive summary and recommendations.

Treasury Report: EQC Review: Feedback from Insurers on Willingness and Capacity to Insure Dwellings that are in non-Residential Buildings

Purpose of Report

1. When you met officials on 11 November to discuss the EQC review, you asked us to consult insurers on the implications of EQC no longer covering dwellings in buildings that are predominantly non-residential. This report briefs you on the outcomes of that consultation, and seeks policy decisions on the treatment of those dwellings for inclusion in the discussion document.

Key Messages from Insurers

2. Due to time constraints we consulted only the Insurance Council of New Zealand (ICNZ), IAG, and Vero. All three responded. Key common messages are:

   - The status quo causes a range of difficulties:

     - *"Difficulties can range from apportionment complexity, different bases of settlement, land complexity and the management of multiple insureds. Significant difficulty can arise when EQC does not accept liability or there is dispute as to the apportionment of liability over multiple events. This can delay commercial property reinstatement, adding to business interruption costs. EQC involvement at claim time has proven problematic in Christchurch, particularly given insurers are largely reliant/dependent upon them to assess and agree the 'first loss' response before insurers can begin the EQC loss settlement."* (ICNZ)

     - *"The current treatment of dwellings complicates underwriting and claims management. 'Mixed-use' as defined by the EQC includes a broad range of commercial properties such as apartment blocks, retirement villages and motels. These buildings can have both commercial and personal insurance policies applying to different areas of the same property. That makes claims management complex and difficult."* (Vero)

   - Insurers state that they currently have the capacity and willingness to insure residential units in non-residential buildings. Vero submits that the proposed 50% test is unnecessary and that EQC should only cover buildings that are entirely residential, with mixed-use buildings being covered entirely by private insurers.

     - *"Vero believes that applying a condition of '50% or more' for these buildings simply perpetuates existing complexity and associated operational difficulties. There is both industry and Vero willingness to insure these buildings and the more efficient option would be to have them 100% ground up commercial earthquake cover."* (Vero)

- *"A number of members have commented that there would likely be willingness and capacity to provide this cover. Capacity will largely be driven by reinsurance availability and affordability, so if capacity is currently available for EQC then it would similarly be available for private insurers. However, pricing would obviously be commensurate with the increased/decreased risk to the insurer."* (ICNZ)

- Any private insurance cover will be risk-rated, creating winners and losers.

  - *"the potential implications would come about from private commercial insurance risk-rating and deductibles being applied to the $100,000 EQC component, with no EQC cross-subsidisation. This may have some implication for buildings in some areas (i.e. potential price reductions in Auckland and increases in Wellington and Christchurch).*
    However it is important to note that soil type, location, age, earthquake proneness and construction type can already make it difficult and expensive to insure some mixed-use buildings. Accordingly, there may not be a significant transitional difference experienced for properties in these areas. Further, some members have highlighted that the implication will only be for the $100,000 component of the residential dwelling, which will likely make up a small proportion of the total insured value of the building if the residential area is less than 50%." (ICNZ)

  - All three responses note that although the market already risk-rates premiums, removing the EQC layer of community-rated risk and EQC land cover would exacerbate the impact of higher premiums on affected buildings.

3. The full responses from ICNZ, IAG and Vero are attached to this report.

Analysis

Insurers appear willing to provide cover

4. Strikingly, unlike the earlier consultation on EQC's $100,000 residential building cap, where a majority of insurers wanted the cap to increase, insurers expect industry to be willing and able to provide cover to household units in predominantly non-residential buildings. Vero goes so far as to recommend that EQC should only cover buildings that are entirely residential, while IAG's current underwriting practice is to insure all multi-story multi-unit buildings under a commercial "material loss" policy for the entire building, not individual units, and then determine if any EQC premium should be paid.

But in some cases premiums will be high

5. The responses also highlight the key trade-off recognised when we met – greater simplicity and clarity in coverage and claims management versus comprehensive community-rated coverage. Insurers are willing to insure these buildings without any EQC cover, at premium rates reflecting their assessment of the particular risks of the geographical area and building. Premiums vary widely, and may be very high for higher-risk buildings in areas of high seismicity. Insurers note that under the status quo EQC cover reduces but does not eliminate those impacts.

Do you wish to reconsider limiting EQC cover to predominantly residential buildings?

6. When we last met, you disagreed with our recommendations to limit EQC cover to predominantly residential buildings. You were concerned that private insurers may not be prepared to insure residential units within predominantly non-residential buildings (the executive summary and recommendations of that report *T2013/2594 EQC Act Review: Follow-up Reporting on Proposals for Public Consultation* are attached to this report for your reference).

7. If the responses from insurers have addressed your concerns, we recommend you now agree to our previous recommendation that EQC coverage be limited to predominantly residential buildings. If the responses have not adequately addressed your concerns, we have identified two options for providing EQC cover to residential units in non-residential buildings.

Options for providing EQC cover to dwellings in non-residential buildings

8. We have identified two options for providing building cover to predominantly non-residential buildings (you have agreed that these buildings will not get land cover):

   - **Option A:** Keep the current arrangements of compulsory attachment of EQC building cover to residences in predominantly non-residential buildings.

     or

   - **Option B:** EQC cover would be compulsorily attached to predominantly residential buildings only. But EQC would be able to provide voluntary cover to owners of household units in predominantly non-residential buildings if those owners can demonstrate that private disaster insurance cover is unavailable for their building at any price.

9. Our preferred option is Option B. The key advantages of Option B are that it will minimise EQC-insurer interactions on non-residential buildings and reduce Crown risk. Its closer alignment with the policy intent will also reduce the risks of future scheme expansion. The stringent requirements on access to EQC cover are necessary to secure these advantages.

10. A key judgement for Ministers is the sustainability of the Options. Both options may be vulnerable to scope creep. Under Option A, building owners may press the Government to extend land cover to these buildings, while under Option B, building owners may press the Government to relax the access requirements. Either change would increase claims settlement complexity, increase EQC administration and claims costs, increase adverse selection, and generate greater fiscal risks.

11. This table outlines the main advantages and disadvantages of each option in more detail:

Option A: Continued compulsory attachment of building cover	**Option B: EQC cover available only if private insurance unavailable**
Advantages • Comprehensive coverage – all owners of residences get the same community-rated EQC building cover (but not the same land cover). • Low EQC administration costs pre-event.	***Advantages*** • Keeps EQC role to the minimum necessary to fill market gaps. • Maintains a clearer policy separation between predominantly residential and other buildings. • Lower post-disaster workload for EQC.

• Compulsory attachment reduces scope for adverse selection.	• Minimises EQC involvement in predominantly non-residential claims. • Lower fiscal risks, if the stringent access conditions can be maintained. • No complex interaction with other insurers because EQC would only be providing cover on buildings that do not have private insurance.
Disadvantages • EQC involvement in predominantly non-residential claims may delay commercial insurance settlements and recovery. • EQCs post-event workload is significantly larger than under Option B. • Higher fiscal risks as the EQC scheme would be staying in a part of the market that insurers advise they are willing and able to take on. • As EQC cover is compulsory, the agreed-to exclusion of land cover may be hard to sustain. If land cover is added back in, this would add risk and considerable complexity to EQC settlements on these buildings.	***Disadvantages*** • Denies EQC cover to some owners of residences that may want it (owners of higher-risk buildings in high-risk areas). • Higher EQC administration costs pre-event as EQC would need to establish that a building was uninsurable. Owners of high-risk buildings would have strong incentives to represent their building as uninsurable, even if it could be insured. • EQC would be left with only high risk buildings that private insurers would not cover at any price. However, stringent access conditions would significantly reduce EQC's total risk exposure. • Stringent access requirements may be hard to sustain, as building owners paying high premiums may well press for easier access to the EQC scheme.

Fire Service Levy

12. IAG note that the *Fire Service Act* references the *Earthquake Commission Act* definitions of residential building and personal property to calculate the fire service levy on residential building and contents insurance. Therefore, depending on the outcome of the current review of fire service funding, any EQC amending legislation might require consequential changes to the *Fire Service Act*.

Consultation

13. The Insurance Council of New Zealand (ICNZ), IAG, and Vero were consulted on industry willingness and ability to respond to any reduction in EQC cover for predominantly non-residential buildings. The cross-agency EQC Review Governance Group (consisting of officials from Treasury, MBIE, EQC, Reserve Bank and independent insurance expert Bevan Killick) and the Department of Internal Affairs were consulted on this report.

Next Steps

14. We are scheduled to discuss this report with you at 3.30p.m. on Wednesday 11 December 2013. Following final decisions, we will provide you with a Cabinet paper outlining high-level scheme parameters and advising of your intention to consult other Parliamentary parties on those parameters.

Recommended Action

We recommend that you:

a **note** that ICNZ, IAG and Vero report that insurers have the capacity and willingness to insure dwellings in predominantly non-residential buildings;

b **note** that ICNZ, IAG and Vero report that the removal of the EQC community-rated first-loss layer would increase the spread in premiums charged to owners of affected buildings, with the largest premium increases being for higher-risk buildings in areas of high risk.

Either limit EQC cover to only predominantly residential buildings
(officials' first preference):

c **rescind** your previous disagreement to recommendations (b), (c) and (e) of *T2013/2594 EQC Act Review: Follow-up Reporting on Proposals for Public Consultation* (attached)

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

d **agree** to recommendations (b), (c) and (e) of *T2013/2594 EQC Act Review: Follow-up Reporting on Proposals for Public Consultation* (attached)

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

Or provide EQC cover for household units in predominantly non-residential buildings:

e **agree** that the EQC scheme cover household units in buildings that are used mainly for non-residential purposes;

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

f **agree** that the EQC scheme cover these household units only if private disaster insurance cover is unavailable for that building.
(officials' second preference); or

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

g **agree** that the EQC scheme cover these household units by retaining the current approach that EQC building cover apply to the residential part of any building. *(officials' least-preferred option)*

Agree/disagree. Minister Responsible for the Earthquake Commission	*Agree/disagree.* Associate Minister of Finance

h **note** you are scheduled to discuss this report with Treasury officials at 3.30p.m. on Wednesday 11 December 2013.

Fiona Ross
Manager, Financial Markets and International

Hon Gerry Brownlee
Minister Responsible for the Earthquake Commission

Hon Dr Jonathan Coleman
Associate Minister of Finance

ICNZ Insurance Council of New Zealand

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25 November 2013

Steve Cantwell
Project Leader - EQC Act Review Team
The Treasury
PO Box 3724
WELLINGTON 6140

By email: [35]

EQC LEGISLATIVE REVIEW – INDUSTRY FEEDBACK SOUGHT ON PROPOSAL TO CLARIFY EQC COVER FOR MIXED-USE BUILDINGS

The Insurance Council of New Zealand (Insurance Council) appreciates the opportunity to comment on The Treasury's consultation note regarding mixed-use buildings.

You have sought feedback on four specific queries. We provide industry feedback on those queries below. However, please note that given the short timeframe these comments are very high level. Officials should expect more comment during any public consultation period.

1. Difficulties with Predominantly Non-Residential Buildings

> *Q1 - Does the status quo treatment of dwellings in predominantly non-residential buildings cause difficulties for industry? How would you characterise those difficulties and their impacts?*

The status quo does cause problems for the industry, both when applying the current mixed-use definition and during claim settlement. Residential insurers often receive requests to provide cover on the dwelling part of a mixed-use building only, with the remainder being insured under a commercial policy. This can lead to potential confusion and complexity during claim time.

Difficulties can range from apportionment complexity, different bases of settlement, land complexity and the management of multiple insureds. Significant difficulty can arise when EQC does not accept liability or there is dispute as to the apportionment of liability over multiple events. This can delay commercial property reinstatement, adding to business interruption costs. EQC involvement at claim time has proven problematic in Christchurch, particularly given insurers are largely reliant/dependent upon them to assess and agree the 'first loss' response before insurers can begin the EQC loss settlement.

2. Capacity and Willingness to Insure

> *Q2 - If the EQC Act was changed to clarify that EQC cover is only for whole buildings where dwellings are 50% or more of the total floor area of the building, would industry*

have the capacity and willingness to insure dwellings that fall outside this definition (ie, to insure the disaster 'first loss' on dwellings no longer covered by EQC as they are in non-residential buildings)?

A number of members have commented that there would likely be willingness and capacity to provide this cover. Capacity will largely be driven by reinsurance availability and affordability, so if capacity is currently available for EQC then it would similarly be available for private insurers. However, pricing would obviously be commensurate with the increased/decreased risk to the insurer.

3. Potential Implications if Change Made

Q3 - Would industry see any particular building types, or geographical areas, being relatively difficult or expensive to insure if such a change was made? If it is a helpful way to capture your views, for each of the above stylised building types, please indicate for which categories you consider:

a) the whole building should be covered by EQC (ie, up to a cap) with private cover for any loss over the cap; or

b) the whole building should be covered by a private insurer only; or

c) part(s) of the building containing dwelling(s) should be covered by EQC up to a cap with private insurance over the cap; and private insurance only for the parts of the building that are not dwellings.?

As indicated above, the potential implications would come about from private commercial insurance risk-rating and deductibles being applied to the $100,000 EQC component, with no EQC cross-subsidisation. This may have some implication for buildings in some areas (i.e. potential price reductions in Auckland and increases in Wellington and Christchurch).

However it is important to note that soil type, location, age, earthquake proneness and construction type can already make it difficult and expensive to insure some mixed-use buildings. Accordingly, there may not be a significant transitional difference experienced for properties in these areas. Further, some members have highlighted that the implication will only be for the $100,000 component of the residential dwelling, which will likely make up a small proportion of the total insured value of the building if the residential area is less than 50%.

One further implication would be the removal of land cover/compensation for those dwellings that currently attract an EQC levy, as land cover is obviously not provided by private insurers.

As noted above, one of the potential advantages from the proposal would be from a claims settlement perspective, as this model would generally remove EQC involvement. A number of members have commented that they would be averse to having EQC further involved in the settlement of commercial claims (i.e. averse to option a) identified above). A number of members have commented that mixed-use buildings are more suited to being underwritten into a single Commercial Fire insurance contract.

4. Data on Number of Buildings Potentially Affected

Q4 - Does industry any have any data or other information on the numbers of buildings that would be helpful in considering whether or how to include such a change proposal in a public discussion document?

Insurers are unable to identify the number of mixed-use buildings potentially affected. Please note that without knowing the size and scope of the potential exposure, it is difficult to quantify the potential implications. Further, it would be interesting to understand what impact the increasing trend towards mixed residential/commercial property may have on any change in this space.

5. Timeframes

As noted above, given the short timeframe these comments can only be at a very high level. Officials should therefore expect more comment during the public consultation period.

6. Conclusion

Thank you again for the opportunity to provide input. This proposal is of significant interest to our members and we look forward to working with you on the EQC review going forward. Please contact Simon Wilson on [39] or at [35] if you have any queries.

Yours sincerely

Tim Grafton
Chief Executive

Simon Wilson
Regulation and Legal Manager

EQC Legislative Review – Proposal to clarify EQC cover for mixed-use buildings

Response from IAG

From: Bryce Davies [mailto: [35]]
Sent: Monday, 25 November 2013 8:59 a.m.
To: Steve Cantwell [TSY]
Subject: Cover for Mixed use Buildings

Steve,

Please find below IAG's response to the questions raised in the consultation on mixed-use buildings. As always, happy to discuss.

Does the *status quo* treatment of dwellings in predominantly non-residential buildings cause difficulties for industry? How would you characterise those difficulties and their impacts?

- The current definition does create problems that we seek to ameliorate through underwriting practice, e.g. depending on the layout (in particular multi-story buildings), we will only offer commercial insurance for the entire building, not the individual units.
- That said the current definition has the following difficulties:
  - Establishing the actual area that is residential in multiple tenancy buildings (particularly with apartments where there is a mixture of permanent residences and short stay rentals)
  - Establishing what is covered when EQC is involved in multiple tenancy buildings, e.g. site infrastructure, land, party walls, out buildings.
  - Uncertainty about the treatment and therefore level of cover for certain building types:
    - Boarding houses
    - Retirement villages
    - Holiday homes
    - Appurtenant structures in which commercial activity is undertaken, e.g. a dressmaking business being operated out of a standalone garage
  - Uncertainty about how cover attaches to residential buildings that include mix use; to the dwelling or the building, e.g. a building is 60% dwelling with 40% retail in front that suffers $50k damage, which is $20k to the dwelling and $30k damage to the shop – does EQC pay $50k or $20k?
- These uncertainties:
  - Lead to situation where a property is thought to be covered by EQC (and has paid the necessary levy) at the time of underwriting, but is reassessed at clam time and found not be entitled to EQC cover
  - Add to the complications associated with catastrophe reinsurance modelling

If the EQC Act was changed to clarify that EQC cover is only for whole buildings where dwellings are 50% or more of the total floor area of the building, would industry have the capacity and willingness to insure dwellings that fall outside this definition (i.e., to insure the disaster 'first loss' on dwellings no longer covered by EQC as they are in non-residential buildings)?

- Any buildings that would lose EQC cover as a result of the proposed definition would see that cover subject to the prevailing capacity, risk appetite, underwriting practices and pricing of individual insurers. So while it is possible / likely that capacity will be available in aggregate across the market, the insuring of an individual building will depend on the risks factors it presents. In that way the issue is one of risk and appetite, not capacity.

Would industry see any particular building types, or geographical areas, being relatively difficult or expensive to insure if such a change was made?

- The proposed definition change will have negative impacts on mixed use buildings in high natural catastrophe locations (e.g. Wellington and Christchurch), both in terms of the price and extent of cover as it moves from being community-rated to risk-based. We can't enumerate the scale of the problem, but we can expect it to grow with cities and their densification through greater use of larger mixed-use buildings. That said, low risk locations would benefit, e.g. Auckland.
- The loss of EQC cover on the building will also lead to the loss of land cover, adding to the disadvantage / detracting from the advantage some property owners will face.
- Buildings deemed earthquake prone will also be exposed as their community-rated, low excess EQC cover becomes risk rated and subject to prevailing market deductibles.
- We also see inequity in some property owners being eligible for 'government support' (in the form of reduced premiums and land cover) and others not, simply because of the structure they chose to own / can afford to own. This could be concentrated at the lower end of the income ladder, as more affordable housing will likely come in the form of multi-unit, mixed use buildings. It also sends an signal into the market that goes against the prevailing mixed-use densification planning approach / intent.

Does industry any have any data or other information on the numbers of buildings that would be helpful in considering whether or how to include such a change proposal in a public discussion document?

- Unfortunately no, or at least not in a readily accessible form.

BRYCE DAVIES
MANAGER EXTERNAL RELATIONS AND INSIGHTS

IAG

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T [39] **M** [35] **E** [35]

www.iag.co.nz

From: Bryce Davies [mailto: [35]]
Sent: Monday, 25 November 2013 10:10 a.m.
To: Steve Cantwell [TSY]
Subject: RE: Cover for Mixed use Buildings

Steve,

One additional late piece of feedback.

If EQC ceases offering cover for some residential buildings, then it will have a flow-on effect to the way in which the Fire Service Levy is charged. The Fire Service Act states that it follows the definitions of personal property and residential buildings in the EQC Act to determine the sum insured on which the Fire Service Levy is charged. Therefore changes to the definitions in the EQC Act will impact the properties on which and how the FSL is charged; potentially requiring changes to the Fire Service Act. This will also be the case with the removal of EQC contents cover.

Regards

BRYCE DAVIES
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EQC Legislative Review – Proposal to clarify EQC cover for mixed-use buildings

Vero Insurance New Zealand preliminary response

Summary

The Vero Insurance New Zealand (Vero) position on matters relating to the EQC Legislative Review has been influenced by the experience of managing over 19,000 Christchurch earthquake commercial and domestic claims with a potential cost of over $4.0 billion. It has also been influenced by the Vero view on what is required to ensure a sustainable general insurance sector that achieves a balance between effective risk assessment and pricing and affordable insurance products.

Both the earthquake claims management experience and our efforts to improve the resilience of our businesses have confirmed for Vero the fundamental need for a reduction in process and product complexity – not only for private insurers, but also for the EQC.

Duplicated and convoluted processes; widely divergent policy terms and conditions; and different insurers and policies applying to individual properties are some of the factors that have made the Christchurch recovery more complex and protracted than necessary.

There is no simple solution or model for the management of any natural disaster crisis such as Christchurch. There are, however, opportunities to reduce the complexity that current practices perpetuate. It is Vero's view that clarification of EQC cover for mixed-use buildings is one example of how current underwriting and claims management complexity can be reduced.

In general terms, Vero believes any apartment building or commercial building that includes dwellings should be ground up, commercial earthquake cover. Removing these properties from EQC cover would reduce process complexity and administrative cost without creating any insurance capacity concerns. The insurance industry and Government would need to be cognizant of the subsequent potential for different premiums across New Zealand and any associated affordability issues.

Responses to questions

Q 1: The current treatment of dwellings complicates underwriting and claims management. 'Mixed-use' as defined by the EQC includes a broad range of commercial properties such as apartment blocks, retirement villages and motels.

These buildings can have both commercial and personal insurance policies applying to different areas of the same property. That makes claims management complex and difficult.

Q 2: The EQC Legislative Review will be an opportunity to introduce reforms that create confidence in the future of New Zealand's general insurance sector – irrespective of the type of natural hazard disaster that may occur. Vero believes a combination of continuous improvement in major insurer operational efficiency and prudent EQC legislative change will ensure insurance capacity remains adequate to meet local demand.

For example, reform options such as an increase in the current EQC cap would partially balance any increased mixed-use exposure for private insurers.

Vero believes that applying a condition of '50% or more' for these buildings simply perpetuates existing complexity and associated operational difficulties. There is both industry and Vero willingness to insure these buildings and the more efficient option would be to have them 100% ground up commercial earthquake cover.

Q 3: The insurance industry continues to improve risk assessment and pricing capabilities. This continuous improvement has the advantage of ensuring premium price matches risk. It also inevitably leads to variation in price and associated affordability and customer-relations issues.

Geographic location, building type, construction and age all influence insurance premium cost. That, however, is not a reason for the continuation of a needlessly complex and higher cost approach to insuring mixed-use properties. Private insurers are introducing the corporate reforms needed to guarantee a sustainable industry. EQC changes need to keep pace with that.

Any introduction of this type of reform will require a concerted effort by both insurers and Government to manage any impacts associated with the removal of EQC cross-subsidies.

In regard to the various 'stylised building types', the Vero position is consistent. We do not believe the EQC needs to provide any cover. The whole building should be covered by private insurance.

Q 4: Vero does not have the data requested.

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: EQC Act Review: T2013/2594: Exec summ. and Recs of "Follow-up Reporting on Proposals for Public Consultation"

Date:	5 November 2013	**Report No:**	T2013/2594

Action Sought

	Action Sought	**Deadline**
Minister responsible for the Earthquake Commission (Hon Gerry Brownlee)	**Agree** to the recommendations in this report.	Joint Ministers are scheduled to discuss this report with officials at 3.00pm, Monday 11 November.
Associate Minister of Finance (Hon Dr Jonathan Coleman)	**Agree** to the recommendations in this report.	Joint Ministers are scheduled to discuss this report with officials at 3.00pm, Monday 11 November.

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
Steve Cantwell	Principal Advisor	[39]	[35]	✓
Fiona Ross	Manager, Financial Markets and International			

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Enclosure: No

Treasury Report: EQC Act Review: Follow-up Reporting on Proposals for Public Consultation

Executive Summary

You met officials on 16 September to discuss two Treasury Reports that recommended policy proposals for public consultation regarding reform of the EQC scheme. You agreed with most of the recommendations in those reports, and asked for more reporting on some others. The outstanding issues are:

- *EQC cover for non-residential (commercial) land:* You asked for more advice on the option of EQC cover being available for non-residential (commercial) land.

- *Definition of 'residential building':* You expressed concern that the proposed 50% rule (that a building is not a residential building unless more than 50% of the building floor area is comprised of household units) may cause difficulties for mixed-use developments. You also asked for more advice on how the boundary would be drawn between different building uses (e.g. motel units (not currently covered by EQC) versus units in retirement villages (which are covered).

- *Clarifying EQC's liability for damage caused by the exercise of powers during a state of emergency for indirect damage* (e.g. due to the exercise of emergency powers to maintain a safety/ security cordon)

- *EQC be able to decline claims that are declined by the policy owner's private insurer:* You expressed concern that this may result in EQC declining claims that had been inappropriately declined by a private insurer.

You also outlined your preferred process from here, namely that you make decisions on the above issues, and then take a noting paper to Cabinet advising of your intention to consult other parliamentary parties on the key elements of the proposed policy changes and, following that consultation, bring a draft Discussion Document back to Cabinet for approval to release.

This paper provides further advice on the above four outstanding policy issues and outlines a potential timeline to enact a new EQC Act that reflects that process.

EQC cover for non-residential (commercial) land- we strongly advise against extending land cover beyond the land cover associated with insured residential buildings. Reasons include the large fiscal and policy risks from diluting the EQC scheme's focus on insured residential property, the lack of business interest, and the potential to delay recovery.

Definition of residential building- we seek confirmation of previous decisions that EQC building cover only be available to 'household units' in buildings that are predominantly residential. This is a continuation of existing policy intent, although ambiguities in the existing legislation mean this has not always been achieved.

We seek your agreement to a 50% of floor area test to determine whether a building is predominantly residential. Under this approach, if a building is a 'residential building' and EQC levies have been paid in respect of the building, the building and associated 'residential land' will be covered by EQC. Household units in a non-residential building will not need to be covered by EQC as the entire building would be insured on a normal commercial basis.

Ministers also asked how the boundary would be drawn between different building uses – for instance, it was observed that "a retirement village looks a lot like a motel".

Individuals' living arrangements vary hugely and judgements will always need to be made on where to draw a line between residential (covered by EQC) and non-residential (not covered) accommodation.

Motel units operated in the normal manner (i.e. shorter-term accommodation for travellers) would not be 'household units' (to be defined in the EQC Act). In contrast, units in a retirement village used as the permanent home of village residents would be household units for the purpose of the EQC Act. The clearer definition of a residential building proposed in *EQC Act Review: Minor Policy Proposals for Public Consultation* along with associated definitions of 'household unit' and specified inclusions and exclusions aims to provide much greater clarity and guidance.

Clarifying EQC's liability for damage caused by the exercise of powers during a state of emergency- in response to Ministers' concerns that insured property owners should not face losses associated with the deterioration of property that cannot be accessed/protected due to security cordons, we recommend extending EQC cover to include damage by natural causes during the state of emergency. To protect the Crown's interest the EQC Act requirement that property owners take all reasonable steps to minimise consequential damage to their property is retained.

EQC be able to decline claims that are declined by the policy owner's private insurer- in response to Ministers' concerns we have narrowed this proposal and now recommend that EQC be able to consider declining its portion of a claim if that claim has been declined by a private insurer on grounds available to EQC to decline a claim.

Timeline and process- we outline for discussion a process that would see you taking a paper to Cabinet in February next year, followed by consultation with other Parliamentary parties, and release of a public discussion document in mid-2014.

Recommended Action

We recommend that you:

EQC Land Cover

a **confirm** that EQC land cover should continue to be limited to only residential land on which there is a residential building covered by EQC;

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

Definition of Residential Building

b **confirm** that EQC building cover should continue to be limited to buildings that are used only or mainly for residential purposes (or are intended for such use and occupation);

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

c **confirm** that the EQC scheme should not cover household units in buildings that are used, or intended to be used, only or mainly for non-residential purposes;

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

d **note** that insurance cover for household units in buildings that are used mainly for non-residential purposes is usually provided via the insurance cover on the entire non-residential building;

e **agree** that, for any building to qualify as a 'residential building' and to be eligible for EQC cover, household units must constitute 50% or more of the floor area of the building;

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

f **note** that agreeing to recommendation (e) would mean that EQC would not insure household units in a building that, according to the test set out in that recommendation, is not a 'residential building';

EQC Liability as a result of Actions Taken during State of Emergency

g **note** that in Treasury Report T2013/1556 you agreed that the natural disaster damage insured by EQC will include damage caused directly by measures taken under proper authority during a state of emergency declared under the Civil Defence Emergency Management Act 2002 for a period of up to 7 days;

h **agree** that natural disaster damage insured by EQC will include damage arising from natural causes (eg, rainfall) that is caused indirectly by measures taken under proper authority during the full extent of a state of emergency declared under the Civil Defence Emergency Management Act 2002 (ie, without the 7 day limitation);

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

Power to Decline Claims Declined by Private Insurers

i **agree** that EQC be able to consider declining its portion of a claim if that claim has been declined by a private insurer on grounds available to EQC to decline a claim, and

Agree/disagree.
Minister Responsible for the Earthquake Commission

Agree/disagree.
Associate Minister of Finance

Future Timelines and Process

j **discuss** the indicative timeline for completing the EQC Review in the *Next Steps* section of this report.

Fiona Ross
Manager, Financial Markets

Hon Gerry Brownlee
Minister of Transport

Hon Dr Jonathan Coleman
Associate Minister of Finance