The Treasury

Material Provided to the Public Inquiry into EQC Information Release

August 2021

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Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

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

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[26] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied

[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

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;

[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

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

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Reference: T2014/101 AL-2-4-5

THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 12 February 2014

To: Minister of Finance
(Hon Bill English)

Deadline: None
(if any)

Aide Memoire: Natural Disaster and the Crown's Contingent Liability

This aide memoire is to outline our work programme on the optimisation of the Crown's risk financing following on from our discussions late last year.

A framework for assessing the Crown's risk appetite

In December 2013 we presented our scenario analysis of direct fiscal costs to the Crown from a large (magnitude ~ 7.5) Wellington fault earthquake. Assuming no insurance/re-insurance the mid-point of our estimate was $23.5bn. The purpose of this scenario analysis was to begin a dialogue with you about the Crown's appetite for natural disaster risk.

In order to ensure the currently decentralised decisions for insurance and reinsurance purchases are appropriate, we need to determine what the Crown's overall appetite for this risk is. This will determine what proportion of this risk the Crown is willing to meet (either from reserves or from post-disaster government borrowing) and what should be transferred to third parties via the risk markets.

The Crown's appetite for natural disaster risk is unlikely to be static and will change over time as the fiscal and balance sheet positions become more or less resilient. As such, we recommend the development of a decision making framework, where the Crown's appetite for this risk is regularly assessed and communicated to the entities that manage it so they can implement their risk retention and transfer strategies accordingly.

Assessing the Crown's appetite for natural disaster risk over time is a complex task. The natural disaster risk that concerns us is the long-tail risk, namely those low probability catastrophe events that would have a significant impact on the Crown's fiscal and balance sheet positions should they occur. At the same time we need to balance the need to mitigate these impacts against the fact that they are no more likely to occur at times of relative fiscal and balance sheet vulnerability (e.g. now) than they are at times of relative strength. Additionally, quantifying natural disaster risk is a very difficult and relatively imprecise exercise.

Once a framework is developed, and the Crown's current appetite for natural disaster risk is assessed using it, we can decide whether the current amount of risk transfer purchased is optimal and represents good value for money.

We will test our assumption that post disaster government borrowing is the most cost effective option for financing long tail natural disaster risk by comparing it with the costs of transferring this risk. We will take into account the probability of these high impact events occurring and the likelihood of increased post disaster borrowing costs should such events occur.

A dual focus on EQC risk transfer and the local government cost sharing arrangement for essential infrastructure

Of the $23.5bn estimate of the direct fiscal cost to the Crown from a large (magnitude ~ 7.5) Wellington fault earthquake, an estimated $10.3bn (43%) arises from the Crown's Earthquake Commission (EQC) obligations and $3.3bn (14%) arises from the explicit support given to local government to assist in the restoration of essential infrastructure. Given the materiality of these two exposures, we propose to focus our assessment on the levers available for both enhanced, and more cost-effective, risk transfer in these two areas.

The EQC review proposes changes clarifying that the Crown owns the Natural Disaster Fund (NDF) and confirming Ministerial ability to make directions regarding EQC's investment and re-insurance strategies. These changes, if adopted, will make it easier for the Crown to influence the risk transfer decisions of the EQC and allow the integration of EQC's exposure into the Crown's approach to its natural disaster risk management as a whole.

We are of the view that the 60/40 cost sharing arrangements between the Crown and local government for the post disaster restoration of essential local government infrastructure has not incentivised effective risk management. Anecdotal evidence suggests local councils may have assumed an implicit Crown guarantee for a greater share of costs than specified in the relevant legislation, and have, as a result, under insured and/or failed to maintain sufficient borrowing capacity or financial reserves. As such, any investigation of alternative institutional arrangements for how local councils insure their assets may be of limited effectiveness unless the cost sharing arrangements are addressed in parallel.

The Christchurch earthquake sequence has also revealed that conflicting incentives on a local government owned mutual risk pool/insurance vehicle are likely to result in sub-optimal outcomes.

There is a trade-off between sufficiency of cover and affordability for all insured bodies. This is especially the case where an insurer writes policies for a limited pool of entities that face tight budget constraints, while being owned and governed by these same entities. This is the case for the current provider of local government insurer. Such an insurer is likely to find it comparatively more difficult to maintain premiums based on the underlying risks, with adverse affects on its financial viability.

We think there are valid reasons for the Crown to make material financial contributions to post disaster local government infrastructure restoration and will explore alternatives for the Crown to meet this commitment, taking into account the affordability concerns of local government.

Local Government New Zealand (LGNZ) has commissioned a report by Craig Stobo, current Chair of the Local Government Funding Authority (LGFA), on options to address the current issues with local government insurance of its infrastructure assets. We expect to receive a copy of this draft report next week, and our analysis of the options in this area will take note of its findings.

Next steps

EQC has long sought greater direction from the Crown in respect of its risk appetite so once our analysis is complete we report back to relevant Ministers and engage with EQC.

Better management of the Crown's exposure to local government is likely to require a mix of policy and institutional based change with varying levels of involvement for Treasury and other departments depending on the options developed. The first step for us is to commence some meaningful engagement with LGNZ.

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