The Treasury

Material Provided to the Public Inquiry into EQC Information Release

August 2021

This document has been proactively released by the Treasury on the Treasury website at

https://treasury.govt.nz/publications/information-release/public-inquiry-eqc

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

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).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are **© Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [https://creativecommons.org/licenses/by/4.0/].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

Reference: T2016/463 CM-1-3-15-2

THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 31 March 2016

To: Minister of Finance
(Hon Bill English)

cc: Minister Responsible for the Earthquake Commission
(Hon Gerry Brownlee)

Deadline: None

Aide Memoire: Update on the EQC Claims Liability

This Aide Memoire is in response to a request from the Minister of Finance for information regarding the change to the EQC claims liability over time and how this liability has been reduced.

The EQC claims liability has been revised up by $10m (0.08%) following an external actuarial valuation

EQC has its Canterbury claims liability valued by an external actuary every six months. The most recent actuarial valuation (the Insurance Liability Valuation Report (the ILVR)), completed by Melville Jessup Weaver (MJW), dated 10 February 2016 increased the total gross value of the claims liability by $10m to $11,259m, as at 31 December 2015. The previous six month period ending 30 June 2015 saw the claims liability amount decrease by $294m.

Canterbury event claims paid to date total $9,136m, leaving an estimated $2,123m of claims yet to be settled as at 31 December 2015.

The $11,259 million figure represents the central estimate of the total insurance liability (i.e. does not include any risk margin) for the 2010/11 Canterbury Earthquake series. The liability is to be met by EQC via the Natural Disaster Fund (NDF), reinsurers, and potentially the Crown guarantee of the scheme (under section 16 of the Earthquake Commission Act 1993). However, net of reinsurance recoveries the claims liability was $6,927m (as at 31 December 2015). This a $23m reduction from the previous period's net liability figure.

In February the EQC Board accepted the final valuation of the liability, which has now been incorporated into Treasury's forecasts.

Overall, the major movements in the gross liability were:

- a decrease in the Land Liability of $165m primarily due to the application of updated Diminution of Value (DoV) rates for some but not all Increased Liquefaction Vulnerability (ILV) damaged properties, and

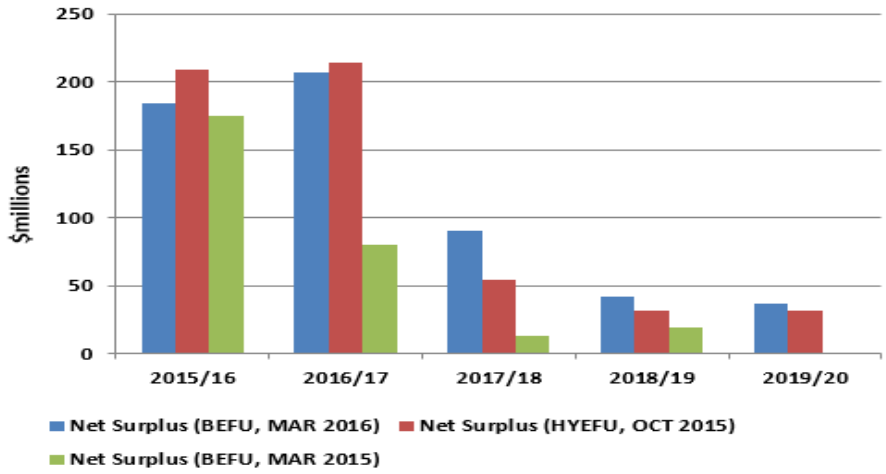
- an increase in the Building liability by $165m as a result of an increase in provisioning for settling reopened over cap claims with insurers (increased by $74m) and an observed increase in the average cost of repairs, recognising the remaining claims represent some of the most complex and costly claims in the home repair programme. Situations whereby claims may be reopened include building warranty remediation, the customer dispute process and finalisation of the different events with insurers.

EQC's BEFU 2016 operating balance forecasts have been revised downwards

To calculate EQC's forecasts a risk margin is included for the claims liability (being from the central estimate to the 75th percentile of the expected claims liability), reinsurance recoveries are netted off against the gross liability and the forecast profile of claims settlement is used to apportion the liability over the forecast period.

For EQC's forecasts (submitted for the budget forecast rounds i.e., HYEFU and BEFU), it is assumed that the risk margin is amortised (i.e., written off) from OBEGAL in future years. This represents an increase in OBEGAL for those forecasts years as an expense is being unwound. The assumption implies that the final cost of settlement will converge on the central estimate rather than the 75th percentile that the risk margin implies. The timing of the risk margin amortisation is matched to EQC's claims settlement profile.

The BEFU 2016 forecast for EQC's net surplus are shown in the table and figure below, compared to the HYEFU 2015, and BEFU 2015 forecast. The change to EQC's net surplus, in this case a $25m reduction, flows directly through to the Crown OBEGAL.



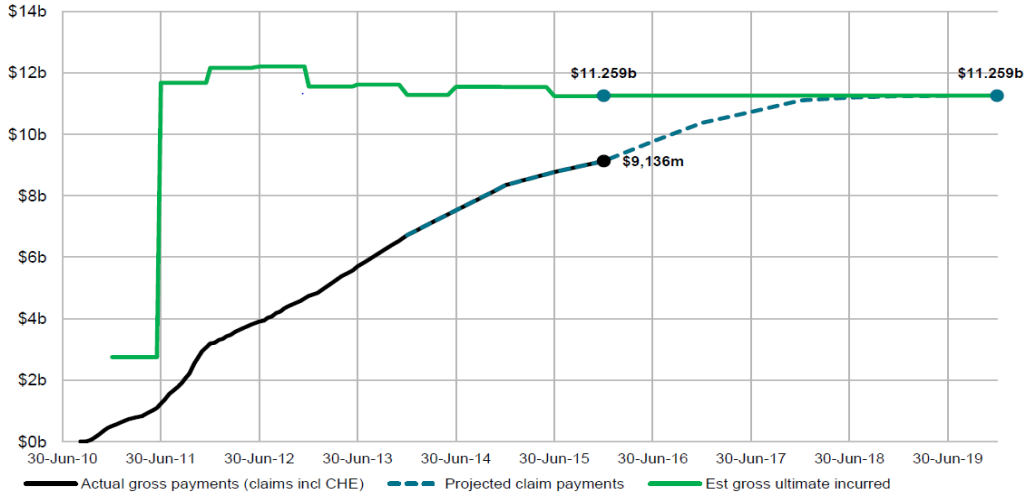
	Fiscal Year				
	2015/16	2016/17	2017/18	2018/19	2019/20
Increase (decrease) in Net Surplus from HYEFU (OCT 2015) to BEFU (MAR 2016) ($ millions)	(25.1)	(7.5)	36.0	10.3	4.4

The main reason for the negative change to OBEGAL in 2015/16 was due to EQC adding a provision of $30m for new claims in relation to the recent quake activity in Christchurch and Seddon.

Changes in the Insurance Liability Valuation

The following graph shows the movement in the central estimate of the Canterbury earthquake claim costs, including Claims Handling Expenses (CHE). Significantly the central estimate has declined by close to $1b from its peak of $12.2b, as at 30 June 2012. The graph also includes payments to date, part of which has been funded from reinsurance recoveries. Total reinsurance recoveries are forecast to be $4,223m, approximately 38% of the gross liability.

Canterbury earthquakes gross claims payments actual and future



Source: Melville Jessup Weaver, ILVR 31 December 2015

Major contributions to the reduced forecast total cost are the result of:

- Clarification of EQC's approach to settling complex land claims (i.e. increased flooding vulnerability (IFV) and increased liquefaction vulnerability (ILV)) which has reduce EQC's forecast exposure. Over time there has been greater certainty regarding which claims qualify for a settlement and with respect to the methodology to be used to settle the claims. The declaratory judgment process was used to provide this greater certainty and has resulted in a combination of Diminution of Value (DoV) and repair costs being used to calculate settlements.
- Greater recognition of actual settled costs for buildings as the percentage of building settlements increases, rather than cost forecasts. This data has also been used to refine future costs of settlements remaining.
- The structure of the Canterbury managed repair programme has been a significant contributor to both containing inflation related to the repair costs and minimising fraud across the entire programme of work.

Some of the above has been offset by claims handling costs increasing through this period as a result of need to bring in more external expertise to determine settlement methodology and approach (e.g. geotechnical and valuation expertise for land) and to recognise that the programme has needed to continue longer than originally forecast. Maintaining a flexible workforce through this period has allowed EQC to scale resources up and down as dictated by workflows.

The Natural Disaster Fund is no longer expected to be fully depleted

The Natural Disaster Fund (NDF) had previously been forecast to be fully depleted by the Canterbury earthquakes. Following this, EQC's liabilities would then be funded by the Crown as required under section 16 of the Earthquake Commission Act (until EQC levies started to build the NDF up again).

However, the two most recent cash forecasts, for HYEFU 15 and BEFU 2016, show EQC remaining cash positive. Consequently the Crown Guarantee is not expected to be called upon.

The lower forecast level of cash required by EQC reflects the gains from a slower than forecast pace of settlement resulting in additional investment income and levies, and a reduction in the forecast total claims liability (which has reduced by close to $1b since June 2012). Currently EQC is forecasting its low point year-end cash position to be $159m as at 30 June 2019.

	Fiscal year forecast (as at 30 June) $m				
	2016	**2017**	**2018**	**2019**	**2020**
HYEFU 2015					
Cash balance	245	173	111	141	204
Latest Update BEFU 2016					
Cash balance	316	307	169	159	197

Aaron Gill, Senior Analyst, Commercial Advice, [39]
Angela Graham, Manager, Commercial Advice, [39]