The Treasury

Proactive release of Treasury advice related to the increase to the EQC Residential Building Cap

October 2021

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

https://www.treasury.govt.nz/publications/information-release/proactive-release-treasury-advice-related-increase-eqc-residential-building-cap

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:

[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

[27] 9(2)(ba)(ii) - 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 otherwise to damage the public interest

[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;

[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 [25] appearing where information has been withheld in a release document refers to section 9(2)(b)(ii).

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Additional Information

To support our advice, IAG provided data to us on a commercial-in-confidence basis. We have witheld that material. We have recreated the relevant graphs without IAG's data.

Chart 1[1]

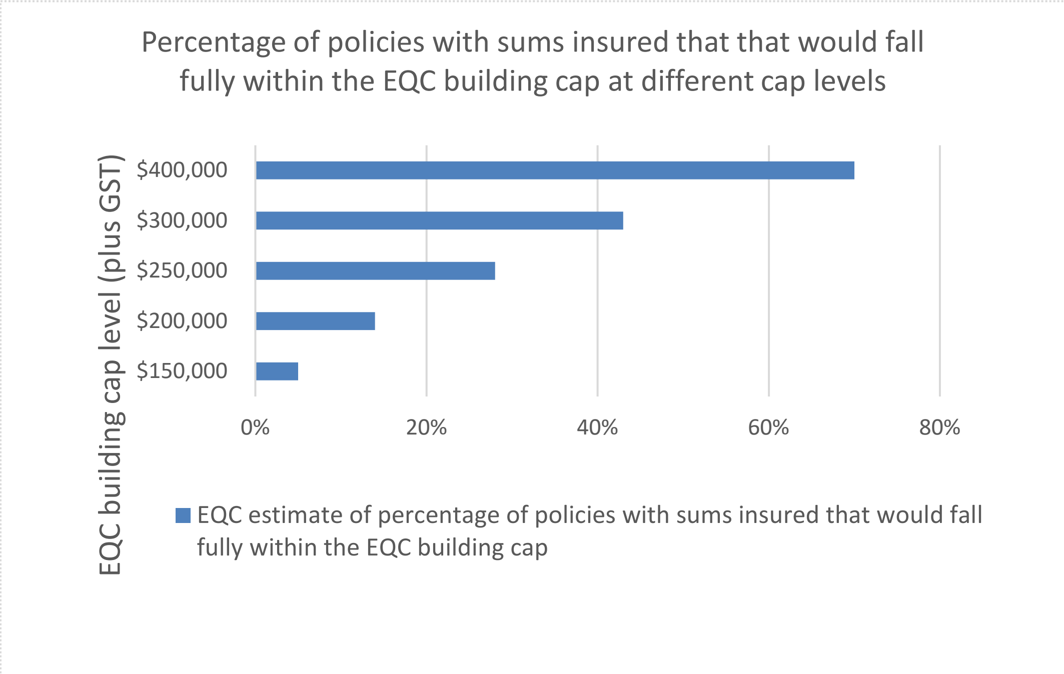
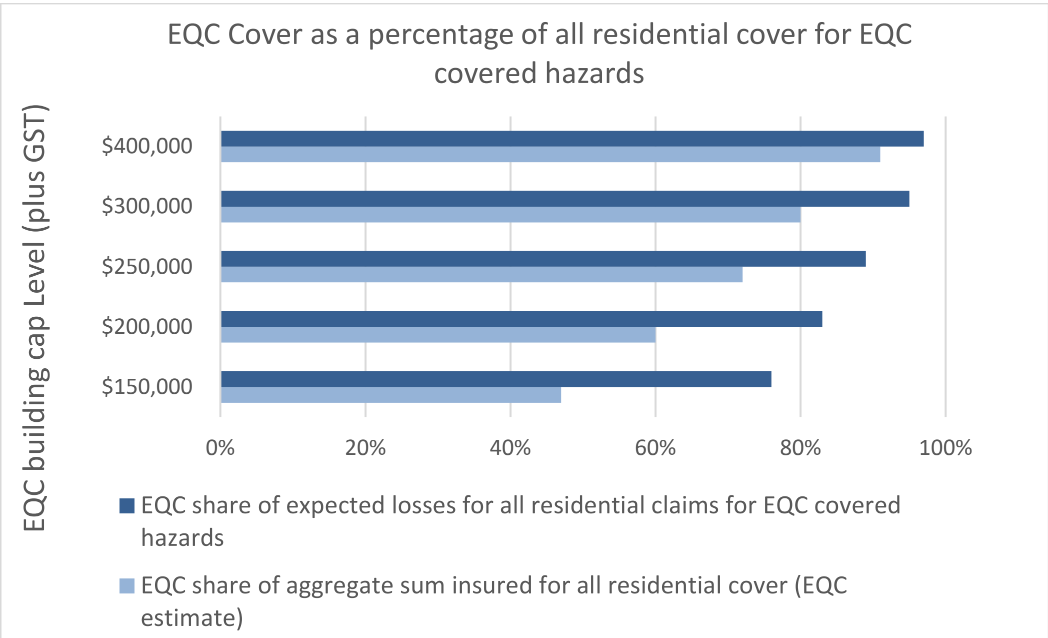


Chart 2



1 These charts show EQC modelled estimate subject to a range of assumptions and derived from publicly available rateable valuation data and estimate rebuild costs based on a sample of construction types)

TE TAI ŌHANGA
THE TREASURY

Reference: T2021/24 SH-11-4-3-4-7

Date: 20 January 2021

To: Minister Responsible for the Earthquake Commission (Hon Dr David Clark)

Deadline: 10 February 2021

Aide Memoire: Modernising the Earthquake Commission Act: Percentage of houses falling fully within different EQC caps

On 14 December 2020, you requested information about the proportion of residential properties that would have a sum insured fully within the Earthquake Commission (EQC) cap at different cap levels. This aide memoire provides estimates of this information (chart 1).

We have also included information about the allocation of expected losses and exposure between EQC and private insurers at different cap levels for all EQC covered hazards (chart 2).

We have included data from EQC and Insurance Group Australia (IAG) to show the range of estimates. IAG has provided the information on a commercial-in-confidence basis.

[27]

Analysis

The percentage of policies with sums insured falling fully within the EQC cap is a proxy for the share of sum-insured policies that would not face insurers' granular pricing for EQC-related risks.

We consider that this framing is unlikely to feature significantly in insurers' decisions on participating in this market and on whether to process claims on EQC's behalf. For example, consider a $400,000 plus GST cap (ie. $460,000), and two houses – House A with a sum insured of $440,000, and House B with a sum insured of $480,000. In chart 1, these two houses are depicted as binary (ie. House A falls fully within the cap, but House B does not). However, from an insurer's perspective, there is very little difference between the two risks – the insurer has no exposure for natural disaster risk on House A, and also has virtually no exposure for natural disaster risk on House B.

The level of insurer exposure and expected loss (chart 2) are more illustrative of how much risk insurers are taking in the system, which is more likely to determine insurers' involvement in the market. At higher levels of cap, the EQC is taking on a greater expected loss for covered natural disasters as a percentage of all residential claims. For example, at a cap of $300,000 plus GST, EQC is taking on 95% (compared to the current 76%) of the expected losses for all residential claims for EQC covered hazards. At this level, there is a more limited role for insurers in the market. The above cap insurance can be more volatile as it relates to high impact, low probability events which are difficult to price, making it difficult to predict how insurers are likely to respond.

Other factors that we suggest should be considered as a part of the decision on cap level are set out in detail in T2020/2182 and include:

- effectiveness in achieving insurance affordability and availability objectives
- distributional impacts
- precedent risks
- implementation complexity, and
- unintended consequences.

The differences between IAG data and EQC estimates

The differences between the IAG data and the EQC estimates show the uncertainty around how much additional residential property risk is taken on via a cap increase.

The differences may indicate that EQC considers that there is lower loss exposure in the system as a whole than what IAG's sums insured indicate. This could be explained in part by the following:

- IAG has the specific sum insured data for every property it insures, whereas EQC's estimate is based on estimates for sums insured derived using QV data.

- EQC's loss exposure estimates do not take into account the cost of demolition and removal of debris – losses which insurers (and EQC at high levels of cap) are exposed to).
- IAG's sum insured figures do not distinguish between what is covered and not covered by the EQC cap. They include non-Act components such as swimming pools, driveways and fences whereas the EQC's figures do not.

IAG's data will not necessarily be representative of other insurers, but it has merit as a proxy, [27]

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