

The Treasury

Treasury Advice Related to Modernising the EQC Act Information Release

December 2021

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Treasury Report: A Future EQC Act: High-Level Policy and Design Issues

Date:	14 February 2019	Report No:	T2019/77
		File Number:	TY-2-1-17-2

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note	None
Minister Responsible for the Earthquake Commission (Hon Dr Megan Woods)	Discuss with officials policy and process for future EQC bill.	Meeting with officials scheduled for 4.45 p.m. 18 February 2019.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Steve Cantwell	Principal Advisor – Earthquake Commission Policy [39]	[35]	✓
Helen McDonald	Manager – Earthquake Commission Policy		

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

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: A Future EQC Act: High-Level Policy and Design Issues

Executive Summary

The purpose of this report is to start engaging with you on policy and process to review and amend the EQC Act. This is expected to result in a future substantial EQC amendment bill. This process can usefully start before the Public Inquiry into EQC claims reports.

This paper considers the policy rationale for EQC, proposes objectives for the review of the EQC Act, and proposes future steps and timelines. We would like to discuss this paper with you. A suggested agenda is attached at Annex 1. Outcomes from that discussion will shape future work regarding the review of the EQC Act.

We seek your feedback on our view that the primary policy rationale for EQC is to support high levels of disaster insurance coverage rates on residential property. This ensures disaster-affected communities have the financial resources to rebuild, without relying on ad-hoc government assistance.

We also seek your feedback on our proposal that the focus of the review of the EQC Act be to achieve a future Act that supports the following objectives:

1. minimise the potential for property owners to experience socially unacceptable distress and loss in the event of a natural disaster;
2. support an efficient approach to the overall management of natural disaster risk and recovery, both nationally and across regions;
3. contributes to the effective management by the Crown of fiscal risks associated with natural disasters; and
4. that, in achieving the above three objectives, the future Act both reflect lessons from previous events, and positions EQC to support government and national preparedness, mitigation and response to future natural disasters, including those exacerbated by climate change.

The indicative project timeline proposes initial policy decisions in 2019, a public consultation process including a discussion document, and legislation drafted, in 2020, and legislation introduced and passed in 2021. Identified risks to this timeline include delays in the final report of the Public Inquiry into EQC, more complex than expected reforms, and any dependencies on wider Government processes (such as climate change policy).

The Earthquake Commission and Parliamentary Counsel Office were consulted on this report.

Recommended Action

We recommend that you:

a **agree** to discuss this report with officials.

Agree/disagree.

b **note** a suggested meeting agenda is attached at Annex 1.

Refer/not referred.

Helen McDonald

Manager - Earthquake Commission Policy

Hon Dr Megan Woods

Minister Responsible for the Earthquake Commission

Treasury Report: A Future EQC Act: High-Level Policy and Design Issues

Purpose of Report

1. The purpose of this report is to start engaging with you on policy and process to review and amend the EQC Act. This is expected to result in a future substantial EQC amendment bill. This paper considers the policy rationale for EQC, proposes objectives for the review of the EQC Act, and proposes future steps and timelines. We would like to discuss this paper with you. Outcomes from that discussion will shape future work regarding the review of the EQC Act.

Background

2. In April 2018 Cabinet agreed to introduce an EQC Bill, ahead of the then-intended (and since established) Public Inquiry, that makes four focussed changes to the EQC Act (i.e. that EQC exit contents cover, increase the monetary cap on EQC building cover to \$150,000, plus GST, extend filing deadlines for EQC claims, and facilitate easier information sharing).
3. That Cabinet paper noted your intention to introduce a more comprehensive EQC amendment Bill following the Inquiry (CAB-18-MIN-0081 refers). The first EQC Bill was introduced on 22 March 2018 and completed its third reading on in February 2019.
4. We understand that bill is intended to reflect a more thorough review of the policy objectives and legislation of the EQC. We recommend making a start on that work now. A thorough process will take time. Starting now will enable faster future progress, as policy development can be progressed in parallel with the Inquiry, rather than paused until after the Inquiry reports.
5. The Inquiry focuses on EQC's operational practices and claims outcomes. While final policy decisions on the content of a 2020 EQC Bill should wait until after the Inquiry reports, useful policy work can continue in parallel with the Inquiry where the conclusions of that work are unlikely to be significantly altered by the Inquiry's recommendations.
6. To ensure that work is well-grounded, we first want to confirm the policy rationale for EQC – why does the Government provide natural disaster insurance to homeowners – and the objectives to guide the review. We outline these below.

Why have an EQC Scheme?

7. The conventional policy rationale for EQC is to keep take-up rates of residential insurance very high. Doing so greatly improves the resilience of New Zealand communities against the financial and housing losses that natural disasters can inflict. The presence of pervasive disaster insurance also protects the Government from the fiscal and policy risks created by ad-hoc assistance and gives homeowners greater certainty of their entitlements. The collective impact of this is to protect homeowners, insurers and the government against a range of large financial, housing and policy risks associated with natural disasters.

8. The EQC Act does this directly by providing affordable, capped natural disaster insurance cover for residential buildings, associated residential land and, currently, personal property (contents) against earthquake, volcanic eruption, tsunami, landslip, and hydrothermal activity. Residential land is also insured against storm and flood damage. By taking on the great bulk of the disaster risk, the scheme also indirectly supports the provision of top-up disaster insurance (i.e. insurance beyond the EQC monetary cap) by private insurers.
9. EQC cover is mandatory for residential buildings and contents privately insured against fire. Private insurers issuing such fire policies must collect and pass on the EQC premiums.
10. Without EQC cover, international evidence suggests that many New Zealand homeowners would be under-insured or uninsured against natural hazard risks. In such situations, the evidence is also clear that governments face significant pressure to provide ad hoc assistance to those homeowners after large natural disasters. This creates risks and uncertainty for homeowners, insurers and governments.
11. Responding to events in an ad hoc fashion reduces the incentives for property owners to make suitable personal provisions against future events, such as taking out insurance. This has the potential to generate substantially larger future risks for homeowners and governments. A scheme like EQC can eliminate that dynamic.
12. EQC's flat-rate pricing of the great bulk of natural hazard risk helps keep private insurance premiums affordable nationwide. That in turn helps keep national homeowner take-up rates of insurance against natural hazards very high.¹
13. Viewed through Treasury's living standards framework these outcomes support the housing and safety domains of current wellbeing, and the financial and physical capitals, and the resilience of those capitals for future wellbeing.
14. If this policy rationale for EQC is accepted, the key goal of any future EQC scheme is that it retains and sustains the high rates of insurance coverage of residential buildings necessary to achieve the policy goals.
15. Confirming that goal has implications for the design of the scheme, in particular helping inform analysis and decisions about which assets are covered, against which hazards, to what extent, and through what scheme design. It also helps inform analysing implications for the scheme design of changes in the external environment, such as changing private insurer risk appetite and pricing, or the treatment of new or emerging risks, such as those exacerbated by climate change.

Question for discussion: do you agree with this view regarding the policy basis for the EQC scheme?

Potential Objectives in Reviewing the EQC Act

16. We suggest that, broadly, the aim of the second bill be to ensure that the future EQC Act reflects both the lessons from EQC operations to date, and positions EQC well for future challenges. This would include, but not be limited to, consideration of issues such as the treatment of risks exacerbated by climate change, other hazards covered

¹ The Lloyd's of London October 2018 study, 'A World at Risk', rated New Zealand the second most exposed country in the world to the costs arising from natural disasters as a percentage of GDP. Notwithstanding this, the same report also commented that New Zealand has the fourth highest insurance penetration rates in the world. As a result, losses that were covered by insurance from the Canterbury earthquake sequence were substantially higher than recent natural hazard events in Japan, Chile, and the USA.

by EQC but not tested to any substantial degree to date, such as tsunamis and volcanoes, and the evolving insurer appetite and pricing for New Zealand disaster cover.

17. The previous Government's review of the EQC Act sought to achieve these objectives:
 1. support the contribution of a well-functioning insurance industry to economic growth opportunities in New Zealand;
 2. minimise the fiscal risk to the Crown associated with private property damage in natural disasters;
 3. support an efficient approach to the overall management of natural disaster risk and recovery; and
 4. minimise the potential for property owners to experience socially unacceptable distress and loss in the event of a natural disaster.
18. We suggest that all these objectives continue to be relevant and remain broadly appropriate for this review. We suggest two changes. Firstly, dropping objective (1). Although it is important, it is also contained in objective (3), as an efficient approach to the overall management of natural disaster risk and recovery requires, amongst other things, a well-functioning insurance industry, which in turn requires EQC legislation that facilitates EQC cover and operations working effectively with other insurers. Secondly, we suggest amending objective (2) to better align with the fiscal element of the purpose statement proposed in the 2015 discussion document.
19. In addition the context of the current review is different. Other initiatives such as the Public Inquiry, and Government's work on climate change mitigation and adaptation, will also need to be considered.
20. Therefore we suggest that the review seek to achieve an EQC Act that supports the following policy objectives:
 1. minimise the potential for property owners to experience socially unacceptable distress and loss in the event of a natural disaster;
 2. support an efficient approach to the overall management of natural disaster risk and recovery, both nationally and across regions;
 3. contributes to the effective management by the Crown of fiscal risks associated with natural disasters; and
 4. that, in achieving the above three objectives, the future Act both reflect lessons from previous events, and positions EQC to support government and national preparedness, mitigation and response to future natural disasters, including those exacerbated by climate change.
21. Climate change issues are potentially challenging for the review. On one hand, any review aiming to credibly consider future challenges for the scheme will need to consider climate change issues. On the other hand, considering the implications of climate change for the scheme's coverage creates major policy sequencing risks. EQC-specific policy questions may prove difficult to answer until strategic whole-of-government questions regarding the role of government and other economic actors in managing the costs and risks of climate change are answered.
22. If this risk eventuates, it may be able to be addressed by taking a relatively conservative approach on any climate-change related reforms in this bill, and signalling that those issues will be reconsidered once the broader policy framework clarifies.

Question for discussion: do you agree with the proposed objectives?

Indicative Project Outline

23. Enacting an EQC Bill that is well-informed by policy analysis and stakeholder engagement requires a number of phases that in total are likely to spread over several years. An indicative structure and timeline is:

Indicative Timing	Phase
To Dec 2019 ²	Policy development (i.e. reports and meetings with you) and informal stakeholder engagement prior to Inquiry reports to progress issues that can be progressed prior to Inquiry report, possibly culminating in an interim Cabinet policy paper.
To June 2020	Policy development and stakeholder engagement following Inquiry report to progress remaining issues, culminating in Cabinet paper(s) seeking policy approval to proposals, and approving release of discussion document.
August 2020	Discussion document released (seeking public feedback on intended reforms, typically 6-12 weeks for submissions).
Nov 2020	Next general election required on or before 21 November 2020.
Late 2020	Consider feedback and finalise policy, Cabinet commission drafting of bill.
Jan-May 2021	PCO draft bill (we anticipate PCO requiring at least 16 weeks).
June 2021	Cabinet approve exposure draft of bill for release, exposure draft released for public comment (typically 3-6 weeks for comment).
Late 2021	Cabinet approves bill as amended for introduction; bill introduced.
Late 2021 to mid-2022	Parliamentary process and passage (assuming usual 6 months consideration by select committee).
2022-2024	Phased implementation of new legislation (insurers have previously indicated that for major changes insurers need at least 18 months between enactment and implementation).

Next Steps

24. We would like to discuss this report and the questions posed in it with you. We will then develop, in consultation with EQC, a policy work programme that reflects that discussion. We suggest providing a series of papers to you over the next few months that consider various elements of EQC policy and design. These could then be discussed as part of our fortnightly meetings. Topics to cover could include:
- Objectives and purpose of EQC, and the review of the Act – any follow-up on this paper, if required.
 - An overview of intervention options and designs for government-mandated disaster insurers and reinsurers.
 - Types of property covered by EQC; should the current focus on residential buildings and land be retained?

² December 2019 is an assumption. Although the Inquiry's mandated date for reporting is 30 June 2019, we understand that this is currently being reviewed with a view to deferring it.

- Types of hazards covered by EQC now, and potential changes in hazards covered.
 - EQC funding and risk financing policy issues and options.
25. There is also a wide range of issues that can be most usefully be progressed after the inquiry reports. These include:
- Consideration of changes to residential land cover and its interaction with building cover.
 - Reviewing the monetary cap on building cover.
 - Reviewing EQC claims excesses.
 - Adding a purpose statement to the EQC Act.
 - Updating the Act's offences and penalties.
 - Reviewing or defining key terms used in the Act.
 - Clarifying what is included in EQC cover, including what costs are included or excluded from the monetary cap.
 - Settlement of EQC claims: clarifying who EQC can pay claims to, and assign and settle claims with; consider if and when EQC settlements should be "full and final".
 - Review EQC's powers to cancel cover, or recover payments made.
 - Reviewing obligations and sanctions on insurers to share information with EQC.
 - A range of other currently-identified technical amendments, advice on which may be informed by the Inquiry's findings.

Question for discussion: Do you agree with this approach? Do you want more background or advice on any of these issues prior to the Inquiry reporting?

Risks

26. Key risks that could delay completion of this project include:
- the Public Inquiry taking longer to report than currently envisaged;
 - complex policy questions and decisions taking some time to resolve (e.g. if there is major changes to the EQC scheme design or coverage); and
 - dependencies on other government policy work, most notably, dependencies on broader climate change policy noted earlier in this report.

A Future EQC Act: High-Level Policy and Design Issues: Suggested Agenda

Issue

1. **Why have an EQC Scheme** – Confirm policy rationale for Government role in residential disaster insurance.

2. **Potential Objectives in Reviewing the EQC Act** – We suggest that the review of the EQC Act seek to achieve the following objectives:
 5. minimise the potential for property owners to experience socially unacceptable distress and loss in the event of a natural disaster;
 6. support an efficient approach to the overall management of natural disaster risk and recovery, both nationally and across regions;
 7. contributes to the effective management by the Crown of fiscal risks associated with natural disasters; and
 8. that, in achieving the above three objectives, the future Act both reflect lessons from previous events, and positions EQC to support government and national preparedness, mitigation and response to future natural disasters, including those exacerbated by climate change.

Question for discussion: Do you agree with the proposed objectives?

9. **Indicative project timeline** – Do you have any feedback on the proposed structure and indicative timings?

10. **Next Steps** – We suggest providing a series of papers to you over the next few months on various elements of EQC policy and design.

Are you comfortable with his approach? Do you wanted any issues added? This report also lists issues that we consider best left until after the Inquiry reports. Do you want more background or advice on any of these issues prior to the Inquiry reporting?

11. **Risks** – Do you have any feedback on the identified risks?