

The Treasury

Treasury Advice Related to Modernising the EQC Act Information Release

December 2021

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Treasury Report: Modernising the Earthquake Commission Act: Building Cover Issues

Date:	1 December 2020	Report No:	T2020/2874
		File Number:	TY-2-1-17-2-2

Action sought

	Action sought	Deadline
Hon Dr David Clark Minister Responsible for the Earthquake Commission	Agree or provide feedback on the recommendations in this report regarding the scope of building cover under the EQC Act 1993.	18 December 2020
Hon Grant Robertson Minister of Finance	None.	N/A

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Danijela Tavich	Analyst, Earthquake Commission Policy Team ^[39]	N/A (mob) ^[35]	✓
Helen McDonald	Manager, Earthquake Commission Policy Team		

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Modernising the Earthquake Commission Act: Building Cover Issues

Executive Summary

This report seeks decisions from you on the scope of building cover under the Earthquake Commission (EQC) Act 1993. The EQC scheme provides a capped level of insurance to help insured homeowners recover in the event of a qualifying natural disaster.

The Public Inquiry into EQC recommended that Government: *review the legislative framework so that there is a greater clarity of key provisions and definitions, in particular concepts related to EQC's repair standard like "when new" and "reinstatement"* (recommendation 1.3.1). We have reviewed the key concepts in the EQC Act 1993 which underpin the scope of building cover.

While there will always be judgements on where to draw the line for what EQC should or should not cover, for the most part, existing concepts in the Act do appear to be largely fit-for-purpose. The existing concepts have also been well-tested by the courts and in responding to the Canterbury earthquake sequence.

Our review determined the main problem with the status quo is a general lack of clarity in what EQC covers. The definitions provided in the Act itself are high-level and incomplete, with key building cover concepts sitting across legislation, case law and EQC operational policy. The scope of building cover is not always clear for the public, which leads to confusion about entitlements. EQC operational staff have also informed us that it is not always clear to them what the intent of the legislation is across some of these concepts, which can also make the Act difficult to implement in a consistent way.

As a result, our recommendations for change are primarily for the purposes of clarifying, rather than amending, EQC building cover. The proposals set out in this paper have been largely uncontroversial in our discussions with stakeholders to date.

We have developed several design principles as a guide to navigating the relevant policy choices in this space. In our view, EQC building cover should be:

- efficient and effective
- clear, certain, and transparent
- resilient and durable
- aligned with insurance frameworks
- fair and equitable.

In line with these principles, we propose the following clarifications:

- **The treatment of appurtenant structures:** The Act should be clear that an appurtenant structure is a structure separate to the residential building that is used for the purposes of the household, and that services related to appurtenant structures are also covered by EQC. The Act should also clarify that appurtenant structures need to be covered by a current fire insurance policy to be covered by EQC.
- **The definition of temporary and transient accommodation:** We propose to define a temporary and transient period as less than 28 days, in line with the definition used by the Residential Tenancies Act 1986.

- **The treatment of mixed-use buildings:** We propose the changes to the treatment of mixed-use buildings under the EQC Act approved by Cabinet on 23 March 2020 should be implemented through the Bill to modernise the EQC Act [CAB-20-MIN-0120 refers].
- **The definitions of the specific hazards covered by the EQC Act:** We propose adding definitions for the currently undefined hazards in the EQC Act to clarify the extent of coverage intended for each scenario. We propose definitions be added for erosion, flooding, earthquake, tsunami, storm, and volcanic eruption. We also propose the period of time for a single volcanic event should be extended from 48 hours to 7 days, in line with the Act's treatment of natural disaster fire.
- **EQC's repair standard:** We propose a clear and consolidated statement of EQC's repair standard is added to the Act.
- **Associated costs:** We propose the Act clarify that costs associated with claims handling are covered by EQC, and temporary accommodation costs are not.

By way of modernising the Act, we recommend the Act should no longer require dwellings to have laundry facilities to meet the requirement to be self-contained (and consequently be eligible for EQC cover). This will ensure the EQC Act reflects changes in the way people live. This proposed change would mean an increase in EQC cover for some living situations.

Recommended Action

We recommend that you:

Spaces in a home covered by EQC

- note** the current EQC Act requires that a dwelling must include spaces to sleep, live, cook, wash and carry out ablutions in order to be eligible for EQC cover.
- agree** that whether these facilities are located within one or more buildings should continue to be irrelevant for EQC purposes.

Agree/disagree.

- agree** the requirement for a dwelling to contain laundering facilities should be removed so that the Act better reflects modern living (**recommended policy change**).

Agree/disagree.

Appurtenant structures

- note** current EQC guidance defines appurtenant structures as structures that belong to the dwelling in a way that is ancillary, that is, where there is an ownership interest and the structure is used for household purposes.
- agree** the term 'appurtenant structures' should be defined in the Act for clarity in line with the status quo operational interpretation as outlined in **recommendation d**.

Agree/disagree.

- agree** the Act should clarify that coverage for services extends to appurtenant structures.

Agree/disagree.

- g **agree** the Act should clarify appurtenant structures need to be covered by a current fire insurance policy to be covered by EQC.

Agree/disagree.

Identifying residential buildings

- h **agree** the Act should retain the 50% threshold to determine if a mixed-use building is a residential building.

Agree/disagree.

- i **agree** the Act should define a temporary and transient living arrangement not eligible for EQC cover as one that is normally for a period of less than 28 days.

Agree/disagree.

- j **agree** EQC should continue to insure holiday homes used for short-term letting, provided they are not solely for commercial use.

Agree/disagree.

Clarifying the treatment of mixed-use buildings

- k **agree** the changes to the treatment of mixed-use buildings under the EQC Act approved by Cabinet on 23 March 2020 should be introduced through the Bill to modernise the EQC Act [CAB-20-MIN-0120 refers].

Agree/disagree.

- l **agree** that, in line with Cabinet's decisions on 23 March 2020, the Act should state that the residential building test will be calculated based on:

- i. the floor area of the self-contained dwelling (behind the door)
- ii. appurtenant structures
- iii. in effect, the homeowners' proportionate interest in common areas.

Agree/disagree.

- m **agree** that, in line with Cabinet's decisions on 23 March 2020, the Act should clarify that where a building is less than 50% residential, EQC cover will extend to common areas on a proportionate basis, determined using residential floor area in the building.

Agree/disagree.

- n **note** we will work through any further technical details of implementing this policy as part of preparing drafting instructions for the Parliamentary Counsel Office.

Hazards insured by EQC

- o **agree** that the scope of hazards insured by EQC should not be extended beyond those currently listed: earthquake, volcanic eruption, tsunami, landslip, hydrothermal activity, fire caused by these named perils, and, in the case of land cover, storm and flood damage.

Agree/disagree.

p **agree** the term 'volcanic eruption' should be changed to 'volcanic activity' to align more with the intended scope of EQC cover.

Agree/disagree.

q **note** the EQC Act currently excludes erosion from cover.

r **agree** the Act should continue to define erosion for the purposes of exclusion in line with the following proposed scope:

- i. Erosion: means by the normal action of the wind or water (including coastal erosion, bank erosion, and sheet erosion).

Agree/disagree.

s **either: agree** the current approach to covering flood and landslip should be retained, including cover for non-natural damage (**Treasury recommended option**).

Agree/disagree.

t **or: agree** the scope of flood and landslip cover should be more targeted to natural hazards, in line with the intended scope of the Act (**EQC recommended option**).

Agree/disagree.

u **if you agree to recommendation s, agree** to remove the term 'natural' from the definition 'natural landslip' given that the scope of **recommendation s** can include hazards triggered or exacerbated by human activity in some cases.

Agree/disagree.

v **if you agree to recommendation t, note** Treasury will provide further advice on options to implement this.

w **note** Treasury will work with the Parliamentary Counsel Office to develop an appropriate definition for flood, and on any necessary amendments to the wording of the natural landslip definition, in line with your decisions on **recommendations s and t**.

x **agree** the term 'landslip' used in the Act should be changed to 'landslide' to align with more commonplace language.

Agree/disagree.

y **agree** definitions for the remaining insured hazards should be added to the EQC Act in line with the following proposed scope:

- i. Earthquake: a sudden, rapid shaking of the earth caused by the breaking and shifting of rock beneath the earth's surface.
- ii. Tsunami: a natural phenomenon consisting of a series of waves generated when a large volume of water in the sea, or in a lake, is rapidly displaced by an earthquake, landslide, a meteorite, or volcanic unrest.
- iii. Storm: violent disturbances of the earth's atmosphere including high winds and/or heavy falls of precipitation, or thunder and lightning. Includes tornadoes.

- iv. Volcanic and hydrothermal activity: a sudden or continuing release of energy, gas, or other matter due to near-surface or surface magmatic processes. Includes lahar.

Agree/disagree

- z **agree** the period of time for a single volcanic event should be extended from 48 hours to 7 days, in line with the EQC Act's current treatment of natural disaster fire (**recommended policy change**).

Agree/disagree.

EQC repair standard

- aa **agree** the Act should include a clear statement of EQC's repair standard upfront and in one place.

Agree/disagree.

- bb **note** the proposal at **recommendation aa** is for the purposes of clarifying EQC's current repair standard and is not a proposed policy change.

- cc **note** we will work with the Parliamentary Counsel Office to capture appropriate and clear language for the legislation.

Reinstatement of cover

- dd **note** EQC has requested more time to consider options for different approaches to reinstatement of EQC cover, due to the complexities that arose from the Canterbury earthquake sequence.

- ee **note** we will provide advice on this issue by early February 2021.

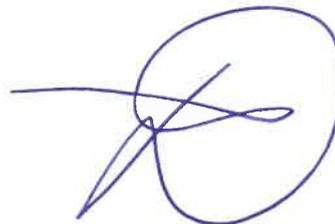
Costs included in EQC building cover

- ff **agree** the Act should clarify the status quo policy position that EQC does not provide temporary accommodation costs.

Agree/disagree.

- gg **agree** the Act should clarify the status quo policy position that claims handling expenses are paid for by EQC, and are not part of the EQC cap.

Agree/disagree.



Helen McDonald
**Manager, Earthquake Commission
Policy Team**

Hon Dr David Clark
**Minister Responsible for the Earthquake
Commission**

3/12/20

Purpose of Report

1. This report seeks decisions from you on the scope of building cover under the Earthquake Commission (EQC) Act 1993.
2. The proposals in this paper have been informed by targeted consultation with stakeholders including the Insurance Council of New Zealand (ICNZ), IAG, Inner City Wellington, the Body Corporate Chairs Group, the EQC Claimant Reference Group, and the New Zealand Bankers Association.

The EQC Act targets residential buildings

The EQC Act in a nutshell

3. The EQC Act provides for capped natural disaster insurance cover for residential buildings and associated residential land against earthquake, volcanic eruption, tsunami, landslip, and hydrothermal activity. Residential land is also insured against storm and flood damage.
4. EQC cover is mandatory for residential buildings insured against fire. Private insurers issuing such fire policies must collect and pass on the EQC premiums. EQC cover helps to ensure affordable, defined insurance cover for residential building owners against the specified hazards.
5. Without EQC cover, international evidence suggests that many New Zealand homeowners would be under-insured or uninsured against catastrophe 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.
6. The scope of EQC cover for each natural disaster event is currently:
 - *Building cover*: up to \$150,000 (plus GST), less claims excess, for each dwelling in the insured residential building.
 - *Land cover*: the value of the damaged insured land (up to the minimum lot size under the applicable district plan), or the cost of reinstating the land to its pre-event condition, whichever is lower, less claims excess. Covered land is land under the insured residential building and appurtenant structures, land within 8 metres of the building/structures, land supporting up to 60 metres of the main access way to the building, and associated retaining walls, bridges and culverts.
7. The claims excess for building and contents claims is \$200, or 1 percent of the value of the claim, per dwelling, whichever is the larger. The excess on a building claim for a single dwelling can range from \$200 to \$1,150 (including GST), depending on claim value. For land claims the excess is 10 percent of the value of the claim, but cannot be less than \$500 per dwelling or more than \$5,000 in total.

Several key concepts shape the scope of current EQC building cover

8. The EQC scheme targets people's homes, so needs to define them. Several key concepts relating to both the use and physical characteristics of residential buildings and parts of buildings are embedded in the EQC Act, and these collectively shape the overall scope of building cover provided by EQC. These key concepts are:

- **The 'dwelling'**. This concept encompasses both how a space is used and its physical characteristics. A dwelling can be an entire residential building (like a house), or part of a building (like an apartment):
 - i **in terms of how the premises is used:** A dwelling must be used as or be capable of being used as the home or holiday home of 1 or more persons. The Act does not define what constitutes a 'home', but EQC operational practice takes this to be a premises 1 or more persons reside in on more than a temporary or transient basis.
 - ii **in terms of the physical requirements of a dwelling:** The scheme targets 'self-contained' premises, meaning to constitute a dwelling and attract EQC cover, the home must have somewhere to cook, sleep, live, wash and carry out ablutions.¹ While the facilities needed to live in a self-contained manner do not have to be in one building (i.e. there can be a collection of buildings and/or outbuildings containing the necessary facilities), they must be for the exclusive (non-communal) use of the residents.²
- **The 'residential building':** A residential building can be made up of one or more dwellings and other non-residential parts. A residential building also includes the practical facilities needed to support day-to-day living in the dwelling. That includes services like sewerage, and appurtenant structures like garages.

The Act provides a test for scenarios where a multi-unit building has some units that are dwellings and some units that are used for non-residential purposes, such as a store or office (i.e. a 'mixed-use building'). The Act considers that a mixed-use building is a 'residential building' when at least half of the floor area of the building, or part of the building, are dwellings. This is called the 'residential building test'. The test is currently calculated by taking the floor space of the dwelling as a proportion of the total floor space of the building. We note Cabinet has approved changes to the way this test is calculated, which are discussed later in this paper (see paragraph 36) [CAB-20-MIN-0120 refers]. Dwellings within non-residential buildings will still receive EQC cover, for the footprint of that dwelling and its associated services and appurtenant structures.

- **Repair standard:** The Act sets out the standard to which EQC should repair buildings. The EQC repair standard is to replace or reinstate homes to a standard "substantially the same as but not better or more extensive than the building's condition when new", modified to comply with any applicable laws, and subject to caveats around circumstances permitting this standard.³
- **Reinstatement:** In 2011 the High Court determined how regularly the EQC cap should be reinstated following a disaster event. It has been found that the cap resets after each disaster event, rather than being limited to an aggregate claim of \$150,000 over the term of the underlying insurance contract. The exception to

¹ Set out in the EQC Claims manual
https://www.eqc.govt.nz/sites/public_files/documents/corporate/EQC_Building_Manual_FINAL_2020.pdf

² Buildings under construction are typically not insured by EQC because, at the point the policy is taken out, it is not a home and is not "capable" of being a home, and so does not meet the definition of a dwelling in section 2 of the EQC Act 1993.

³ See Schedule 3 clause 9(1)(a), 10(2)(b), and the definition of 'replacement value' in section 2 (interpretation) of the EQC Act 1993.

this is that multiple events occurring within 48 hours (or seven days for fire) are treated as one claim and therefore one cap and one excess.⁴

The scope of EQC building cover is largely fit-for-purpose, but could be clearer

9. While there will always be judgements on where to draw the line for what EQC should or should not cover, for the most part, existing concepts in the Act do appear to be largely fit-for-purpose. The existing concepts have also been well-tested by the courts and in responding to the Canterbury earthquake sequence. During our stakeholder engagement, the EQC Claimant Reference Group highlighted this as a positive argument for retaining the status quo as much as possible, so the public, the courts, the insurers, and EQC would not need to relearn a new regulatory framework.
10. Our review determined the main problem with the status quo is a general lack of clarity in what EQC covers and the extent of that cover. The definitions provided in the Act itself are high-level and incomplete, with key building cover concepts sitting across legislation, case law and EQC operational policy. While there will always be a need for EQC operational guidance to interpret legislation in 'real world' situations, the relatively high-level guidance provided by the EQC Act means the scope of building cover is not always clear to the public, leading to confusion about entitlements. EQC operational staff have also informed us that it is not always clear to them what the intent of the legislation is across some of these concepts, which can also make the Act difficult to implement in a consistent way.
11. As a result, our recommendations for changes to the Act are primarily for the purposes of clarifying, rather than amending, EQC building cover. The proposals set out in this paper have been largely uncontroversial in our discussions with stakeholders to date.

We have developed design principles which underpin our analysis

12. The previous Minister Responsible for the EQC agreed [T2020/2370 refers] that the below list accurately captured the policy objectives for the future scheme and the Act:
 - to help create the right conditions for high levels of homeowner disaster insurance, including through supporting availability and affordability of insurance, and facilitating better public understanding of property risks and insurance
 - to minimise the potential for property owners to experience socially unacceptable distress and loss in the event of a natural disaster
 - to support an efficient approach to the overall management of natural disaster risk and recovery, that contributes to New Zealand's long-term preparedness and resilience, both nationally and across regions
 - to contribute to the effective management by the Crown of fiscal risks associated with natural disasters, and
 - to respond to the recommendations of the Public Inquiry into the EQC that have been identified as being addressed through the review of the Act.

⁴ Schedule 3, clause 1 of the EQC Act 1993.
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13. Based on this and on our assessment of the problem definition, we have developed several design principles as a guide to navigating the relevant policy choices in this space. In our view, EQC building cover should be:
- efficient and effective
 - clear, certain, and transparent
 - resilient and durable
 - aligned with insurance frameworks
 - fair and equitable.

The Act needs to be able to target the right kinds of homes

EQC cover should capture the spaces in a home required for day-to-day wellbeing

14. A key policy goal for the EQC scheme is to minimise the potential for homeowners to experience socially unacceptable distress and loss in the event of a natural disaster [T2020/2370 refers]. To ensure the scheme achieves this, it needs to cover the aspects of a home that are most important for people's wellbeing. We consider the EQC Act should continue to capture the spaces of a home where one or more persons sleep and live. It should also continue to capture the areas where people cook, wash and carry out ablutions.
15. In our view, whether these facilities are located within one or more buildings should not be relevant for EQC purposes. This view is consistent with the status quo. For example, where ablutions are located in an outbuilding separate from the main building, EQC should continue to see the collection of buildings as the 'dwelling'.
16. We recommend it is useful to retain the requirement that homes covered by EQC provide the abovementioned facilities. The fact that these facilities are necessary is consistent with the requirements set out in the Building Act 2004.⁵
17. This is to ensure that EQC cover is targeted toward dwellings that meet minimum housing standards and not substandard living situations. A more permissive approach would introduce a risk of EQC cover becoming available to unlawful living situations, or inappropriate claims that non-residential buildings are a dwelling simply because they contain a bed, sink, some form of cooking appliance and a shower for instance.

The Act's 'self-contained test' should be more permissive

18. The Act currently requires that facilities such as those to cook, wash and carry out ablutions should be for non-communal use (i.e. must be self-contained). This means that if there are two apartments that share a kitchen, the entirety of the space would be counted as one self-contained dwelling by EQC and attract one \$150,000 cap in total. These kinds of communal living situations have been relatively uncommon to date, but anecdotal evidence and EQC experience suggest homeowners are increasingly looking to innovative solutions to housing affordability, such as co-housing developments where separate units may share some facilities.⁶
19. The purpose of having a requirement for dwellings to be self-contained in the EQC Act is to enable EQC to draw a clear line around what a dwelling would need to be to

⁵ The building code requires that buildings should be provided with appropriate spaces and facilities for personal hygiene, adequate space and facilities for laundering, and space and facilities for the hygienic storage, preparation, and cooking of food.

⁶ See Hayden (2019). *A life together: The rise of cohousing, papakāinga and the 'social mortgage'*. Retrieved from the Spinoff: <https://thespinoff.co.nz/atea/atea-otago/03-12-2019/a-life-together-the-rise-of-cohousing-papakāinga-and-the-social-mortgage/>

receive its own EQC cap. For example, if the self-contained requirement did not exist, flatting situations, where rooms in a house are let to individuals on individual leases, could claim that each room is its own unit and thus entitled to its own EQC cap.

20. We have considered whether any changes are required to the self-contained requirement for dwellings, given the apparent increase in communal living arrangements. We see three possible options:
- **Option A: The Act makes clear that EQC cover will not extend to (still relatively rare) communal housing situations and cover for such situations should be left to private insurers.** We consider this option not to meet the design principle of *fairness* that we see as central to our policy framework. It also does not meet the design principle of *durability* of the scheme, which requires some flexibility to respond to changes in how New Zealanders live, particularly if communal housing situations continue to increase in popularity. Note this option would be a reduction in cover compared with the status quo – currently these situations (provided they meet other required criteria for EQC cover eligibility) will count as one dwelling and attract one EQC cap.
 - **Option B: A dwelling needs to have facilities to cook, wash and carry out ablutions for exclusive use of the household. The Act makes clear this does not include a requirement to have laundering facilities.** Under relevant building regulations, laundering facilities are only required for properties if more than two people live there.⁷ This makes the requirement for laundering facilities comparatively more permissive than legal requirements for cooking or bathroom facilities, which are required regardless of how many people live in a home. A range of other factors also lead us to believe that overall, laundering facilities are less of a fundamental necessity for housing:
 - i We reviewed a sample of private insurer new customer proposals to ascertain what questions insurers ask new customers regarding the degree to which their dwelling is self-contained. The sample indicated that insurers may sometimes ask customers if they had a kitchen and bathroom, but do not appear to ask if the dwelling has a laundry.
 - ii Anecdotal evidence suggests more innovative medium and high-density buildings in New Zealand may increasingly provide shared laundry facilities. Examples include the Urban Habitat collective which is aiming to build a development of 24 units in central Wellington, with shared laundering facilities on each floor.⁸ Another example is 26 Aroha in Auckland, which is a development of 14 rental apartments due to be completed in 2020, and provides a shared laundry on the rooftop with no laundry facilities in the individual apartments.⁹
 - iii Dwellings with shared or no laundry facilities have long been common overseas, for example in the United States, though evidence suggests this may be declining.¹⁰

⁷ See page 14 of *Acceptable solutions and verification methods for New Zealand Building Code clause G2 Laundering* published by MBIE: <https://www.building.govt.nz/assets/Uploads/building-code-compliance/g-services-and-facilities/g2-laundering/asvm/g2-laundering-1st-edition-amendment3.pdf>

⁸ See Urban Habitat Collective's website <https://www.urbanhabitatcollective.nz/available-homes/> the collective has purchased land in Wellington and is seeking resource consent for the construction.

⁹ See the 26 Aroha website: <https://26aroha.nz/money-matters/#rents-leases-costs>

¹⁰ According to data from the U.S Census Bureau, the number of laundry facilities in the U.S. has declined by almost 20 percent since 2005, with especially precipitous drops in metropolitan areas such as Los Angeles (17 percent) and Chicago (23 percent): <https://www.theatlantic.com/business/archive/2017/07/decline-american-laundromat-gentrification/535257/>

- **Option C: A dwelling needs to have facilities to cook, wash and carry out ablutions (including laundering facilities), but they can be shared communally.** The owner would need to have a legal interest in the facilities (i.e. there needs to be some lease or ownership arrangement to the facilities). Option C would make it difficult to draw the line around what a dwelling would need to be to receive its own EQC cap. What constitutes a ‘legal interest’ in the facilities could vary significantly. For example, a lease to use the facilities could be considered a legal interest, despite the user not necessarily having any financial responsibility for the facilities.

Additionally, living situations with shared cooking and bathroom facilities appear to be less prevalent than those with shared laundry facilities. These appear to be primarily boarding house/hostel facilities with one owner for the building rather than self-contained and individually owned dwellings.¹¹ Our research did not turn up any examples of medium or high-density housing that only had shared cooking or bathing facilities, where the separate units were intended to be owned (as opposed to rented) by independent households.¹²

21. **We propose the new Act should implement Option B** – so that laundering facilities are no longer required for a dwelling to be eligible for EQC cover, provided it meets the other requirements of the self-contained test (i.e. includes other key self-contained cooking, washing and ablution facilities).
22. We expect that co-housing situations will continue to evolve and become more prevalent in New Zealand. In future, it may be appropriate to review this position and reconsider the feasibility of providing more flexibility for communal living arrangements like shared cooking facilities through the Act, particularly if this would be in line with potential evolution of related legislation like the Building Act 2004. Consideration will also need to be given to alignment with how private insurers treat these living situations at that time.

The new Act should clarify which appurtenances associated with a residential building are eligible for EQC cover

23. Appurtenant structures are any building or structure other than the main residential building. The current EQC interpretation is that a structure is ‘appurtenant’ if it belongs to the dwelling, in a way that is ancillary, i.e., there is an ownership interest and the structure is used for household purposes.
24. Appurtenant structures are included in the current definition of ‘residential building’ in the EQC Act, so are covered by EQC unless specifically excluded (such as wharves). Structures currently covered by EQC range from substantial items such as garages and sleepouts through to clothes lines, chicken coops, dog runs, playhouses (where these are permanently fixed), and fixed outdoor entertainment areas such as barbeque pits.
25. You signalled in a meeting with officials on 24 November 2020 that the status quo approach of restoring housing and appurtenances with few limits or exclusions best captures the Government’s objectives for the scheme (in response to briefing T2020/3164). This entails full reinstatement or replacement of all residential buildings, appurtenant structures and some associated land, with exclusions to specified ‘lifestyle’ amenities like swimming pools¹³ and non-essential ‘finishes’ such as paving on accessways, which are currently excluded in Schedule 2 of the EQC Act.

¹¹ We note boarding houses are entitled to one EQC cap per the *Morley v EQC* [2013] NZHC 230 judgment.

¹² We are aware of some examples of co-housing developments that include a shared kitchen for optional use by residents, in addition to including private kitchens in the individual units.

¹³ We note swimming pools would be covered by EQC if they are inside the dwelling.

26. We recommend that the term ‘appurtenant structures’ should be defined in the Act for clarity. We propose the definition should be consistent with current EQC practice and will work with the Parliamentary Counsel Office (PCO) on the exact wording.
27. We also propose that the Act should:
 - Correct what appears to be a drafting error in the current definition of residential building, to clarify that coverage for services extends to appurtenant structures.
 - Clarify that appurtenant structures need to be covered by a current fire insurance policy to be covered by EQC.

The Act needs to distinguish between residential and non-residential buildings

28. As the scope of the scheme is to provide cover for residential buildings, there will always be a need to distinguish between which buildings are and are not “residential” for the purposes of the scheme. A 50% threshold is, in our view, a relatively simple and fair way to ensure a building is primarily, more than half, residential.
29. Forthcoming amendments to the treatment of mixed-use buildings under the EQC Act are also likely to mitigate any perceptions of unfairness around how the test is calculated by weighting it more generously toward counting the residential spaces in a building [CAB-20-MIN-0120 refers]. We discuss these amendments further as part of analysis on clarifying the treatment of mixed-use buildings under the Act below.

There is also a need to distinguish between residential and non-residential use

30. EQC operational staff have identified that it is not clear what the intent of the Act is in terms of when a premises can be considered as someone’s ‘home’, rather than somewhere they are staying on a temporary or transient basis (such as hotels and motels).
31. We recommend the new Act should define temporary and transient accommodation as accommodation that is ordinarily provided for a period of less than 28 days. This is consistent with the Residential Tenancies Act 1986 and is a clarification of EQC’s current operational policy. This will help the public better understand what EQC will consider to be a ‘home’. It will also help to exclude premises that provide temporary or transient accommodation, such as commercial accommodation, from the scope of the scheme. We will work through the specific wording of the definition with PCO.
32. We note holiday homes would specifically be excluded from this requirement as the EQC Act explicitly classifies them as residential buildings, as discussed further below.

We consider holiday homes should continue to be ‘residential’ under the Act

33. The current Act covers holiday homes used for personal use as residential buildings. The rise of short-term letting platforms like Airbnb and Bookabach have led to an increase in people earning revenue from letting out holiday homes. Clearly any such regular use of a holiday home for commercial gain is a business use. We have considered whether EQC should discontinue cover for holiday homes that are also used for short-term letting, as outlined below. The analysis has been structured around relevant design principles in our policy framework for building cover.

Building cover design principle	Implications of removing cover for holiday homes for specific principle
Clear, certain and transparent	<p>A key issue that would arise if EQC ceases to provide cover for holiday homes used for short-term letting is a reduction in the certainty and clarity of the scheme. As use of holiday homes change over time and from year to year, it is likely that these buildings would move in and out of eligibility for EQC cover. This will affect the certainty of EQC cover for homeowners.</p> <p>Multi-unit building representative groups Inner City Wellington and the Body Corporate Chairs Group were also concerned about how this might affect other owners in a mixed-use building. It is often difficult for body corporates to keep track of how apartments are being used, and they were concerned that one or two owners' use of their apartment as an Airbnb could disadvantage others by an overall reduction in EQC cover available to the building as a whole, by dropping them below the 50% threshold required to be classified as a 'residential building'.</p>
Fair and equitable	<p>EQC providing cover for holiday homes that are used for commercial letting most of the time might be considered a loophole for properties listed on short-term letting platforms when compared to similar arrangements like motels and hotels which are not eligible for EQC cover.</p> <p>We tested this issue with private insurers, who suggested that there is a distinction to be made between a motel, and a homeowner who is not strictly in the business of providing short-term letting. We agree with this assessment and consider on this basis it may be unfair for these homeowners to be treated as commercial entities by EQC. The lack of certainty as abovementioned may also cause perceptions of unfairness as homeowners may find it difficult to comply with the rules and difficult to determine if they are covered by EQC.</p>
Aligned with current insurance framework	<p>EQC discontinuing cover for holiday homes would result in increased administrative costs for private insurers in monitoring intended and actual use of holiday homes and collecting the EQC levy. In part this is because the approach would not align with private insurer practice. Insurers have advised us that they would insure a holiday home under a domestic policy unless it was used for short-term letting 100% of the time.</p>

34. In addition to the above considerations, there is merit in EQC continuing to cover holiday homes, even if they are regularly used for short-term letting, as holiday homes can be converted to actual homes or emergency accommodation if required. In this sense, continuing to insure holiday homes helps to support the quality of the housing stock following a natural disaster.
35. For these reasons, we consider EQC should continue to insure holiday homes used for short-term letting, provided they are not solely for commercial use.

The application of the EQC Act to mixed-use buildings should be clarified

36. The Public Inquiry into EQC recommended that Government should consider the need for legislative change to provide greater clarity on EQC's responsibilities to property owners in multi-unit and mixed-use buildings (recommendation 1.7.1).

37. We agree there is scope to clarify how EQC classifies mixed-use buildings and the entitlements of residents in buildings which are less than 50% residential under the Act. This was also emphasised to us by stakeholders Inner City Wellington and the Body Corporate Chairs Group
38. On 23 March 2020, Cabinet considered the paper *Mixed-use buildings under the Earthquake Commission Act 1993*. Cabinet agreed [CAB-20-MIN-0120 refers]:
- to amend the residential building test to account for the floor area of the dwellings, appurtenant structures, and, in effect, the homeowners' proportionate interest in common areas,¹⁴ and
 - where a building is less than 50% residential, EQC cover will extend to common areas on a proportionate basis, determined using the residential floor area in the building (which is measured from behind the door of a dwelling).
39. Because of the other changes being proposed to clarify the definition of residential buildings under the EQC Act, we recommend that these changes should be implemented as part of the Bill to modernise the Act, rather than as a standalone bill.
40. Additionally, we consider further clarifications could be made to the Act regarding what areas are included in the residential building test. It is currently unclear in the legislation how the residential building test is calculated. This was emphasised by Inner City Wellington, who suggested the areas included for measuring the 50% test should be included in the Act.
41. We agree with this proposal and consider the Act should clarify that, as decided by Cabinet on 23 March 2020,¹⁵ the residential building test will be calculated based on:
- the floor area of the self-contained dwelling (behind the door)
 - appurtenant structures
 - in effect, the homeowners' proportionate interest in common areas.
42. Note we will work through any further technical details of implementing this policy as part of preparing drafting instructions for PCO.

The EQC Act should define the natural hazards it covers

43. We have considered how the hazards in the Act are characterised currently and whether any changes are required for clarity or modernisation.

We do not consider the scope of the hazards covered by EQC needs to be expanded

44. The previous Act review undertaken by the Treasury over 2012-2015 identified no need for changes to which hazards are insured by EQC. This remains our view. In determining whether additional hazards should be including in the Act, we considered:
- whether the nature of the hazard was appropriate for insurance, that is, whether it is a sudden and unforeseen event. This would determine whether private insurers would provide top-up cover for the hazard if it were covered by the EQC scheme and would also have implications for EQC securing reinsurance, and
 - whether there are insurance supply or pricing pressures in the market that may warrant government intervention.

¹⁴ Meaning that if a mixed-use building is 40% residential, EQC will consider that the residents own 40% of the common areas in the building, such as a lobby.

¹⁵ CAB-20-MIN-0120 refers.

45. We also consulted with insurers and EQC on whether a range of additional hazards might be included in the Act. The hazards we considered, and our analysis on whether they should be covered by EQC, are as follows:
- **Drought.** You received advice on drought in a recent paper on the scheme's treatment of hazards exacerbated by climate change [T2020/3782 refers]. We recommended that the scheme should not be extended to drought as it is an example of gradual damage that is commonly excluded from insurance cover.
 - **Erosion.** The EQC Act currently excludes erosion from cover. You received advice on erosion in a recent paper on the scheme's treatment of hazards exacerbated by climate change [T2020/3782 refers]. Similar to drought, erosion is an example of gradual damage that is commonly excluded from insurance.
 - **Storm and flood (in the case of residential buildings).** We are not aware of any market supply or pricing pressures on storm and flood insurance for residential buildings at this time. Our recent report on the scheme's treatment of hazards exacerbated by climate change noted that this may change as New Zealand insurers develop more granular pricing based on better information and flood mapping [T2020/3782 refers].
 - **Bush fires.** We are not aware of any insurance problems arising from the two significant fire events New Zealand experienced in the past – the Tasman District fire in February 2019, which had an estimated cost to the insurance industry of \$3.98 million, and the Port Hills fire in February 2017, which cost \$18.3 million. The Insurance Council of New Zealand agreed they were not aware of any supply or market pressures in New Zealand for bush fires at this time.
 - **Meteor strikes.** Private insurers suggested EQC might consider providing coverage for meteor strikes, because the sudden and unforeseen nature of a meteor strike makes it an insurable event. They noted a meteor strike would be considered a natural hazard, which is consistent with the scope of the EQC Act. We are not aware of any market supply or pricing pressures regarding insurance for meteor strikes at this time, and insurers conceded in our discussions that they were also unaware of any specific supply issues.

We recommend that the existing hazards covered by EQC should be clearly defined

46. EQC have raised that providing specific definitions in the Act for each hazard type under the current definition of 'natural disaster' in the Act would help to provide greater clarity of the scope and intent of EQC cover regarding the different hazards insured.
47. The Act currently provides definitions for erosion (which is excluded from cover), natural disaster fire, and natural landslip. It does not provide definitions for any of the other listed hazards it covers, which are: earthquake, volcanic eruption, hydrothermal activity, and tsunami. Nor does it define the terms 'storm' or 'flood'.
48. Definitions would also help provide greater clarity for the public in understanding their entitlements under the Act. For example, the EQCover inbox has received some queries about whether EQC would cover tornadoes – this would technically be part of a 'storm' but that is not clear in the EQC Act currently.

EQC currently provides cover for natural and non-natural damage for flood and landslips

49. EQC is intended to be a natural disaster scheme. However, due to both features of the scheme's design, and to the evolution of EQC operational practice, the boundary of what EQC covers in terms of purely natural hazards versus damage due to non-natural causes is not entirely clear. This has been exacerbated by the lack of definitions for the natural hazards in the EQC Act.

50. The causes of damage exist on a spectrum from entirely natural to entirely manmade with many combinations in between. They could be broadly grouped in three categories:
- Damage entirely from natural causes.
 - Damage ultimately attributable to natural causes but where a manmade structure has been overwhelmed or has failed, e.g. a flood bank has burst (such as happened in Edgumbe in 2017), a retaining wall has failed, etc. Many EQC claims relate to this category given the vast amount of manmade structures attempting to mitigate damage from natural hazards.
 - Damage that occurs when manmade structures fail without a natural disaster trigger.
51. In practice, the lines between the groups can be unclear. For example, a manmade structure can be overwhelmed by a 1-in-500-year event if it is designed to withstand a 1-in-100-year event. There is no negligence in this scenario – the structure was built to a reasonable standard and overwhelmed by an extreme event – a natural disaster.
52. In other circumstances, manmade structures fail due to negligence or poor maintenance. It can be very difficult to tell which factors have contributed to damage for a particular event without significant assessment. Almost every claim made to EQC involves a natural and a manmade element. As it is not always clear to what extent natural and manmade factors have contributed to an event, EQC can create a better customer experience by accepting a claim and using its subrogation powers to recover costs from liable parties. EQC currently considers subrogation with events that are directly attributable to third party actions.
53. This issue is relevant to flooding and landslip claims. Given this, from EQC’s perspective, it makes sense to align the treatment of floods and landslips in the EQC Act with each other.
54. In practice, EQC takes a broad approach to coverage from these events and may cover claims related to both natural disasters and, in some circumstances, non-natural causes. An example of a previous claim of this nature was where a toby¹⁶ (owned and maintained by the local council and Watercare Services) failed, causing extreme damage to insured land (flooding inundation and landslip) and building.¹⁷ EQC covered this claim, even though it was not the direct result of a natural disaster.
55. EQC also covers claims arising from both landslips that occur naturally, and those that are triggered by non-natural causes. The current Act does include a definition of “natural landslip”¹⁸ but this is provided at a high level and is silent on human involvement in the cause of the landslip.¹⁹

There is a policy judgement to be made regarding whether EQC should continue to cover floods and landslips that result from entirely non-natural causes. We see two options for a way forward, each with pros and cons: either clarifying the status quo scope of cover in the Act, or targeting EQC cover to focus on natural hazards only.

¹⁶ A toby is the water shut-off valve, generally located at the boundary of a property, that sits between the council water main and a private water pipe.

¹⁷ Note EQC does not cover buildings for storm and flood damage, only land.

¹⁸ We propose to amend the Act to refer to “landslides” for consistency with common parlance in the hazard sector.

¹⁹ Although there is the word “natural” in “natural landslip” (and also in “natural disaster” more broadly), there is nothing in the current text of the definition that confines landslips to only those that are natural.

Option	Pros	Cons
<p>Clarify the status quo (recommended option): Retain the status quo scope of cover for flood and landslip and articulate this position clearly in the Act through introducing a flood definition and amending the landslip definition to clarify its scope.</p>	<p>EQC scope and entitlements are clear and transparent. This will assist the public understanding and also the ability of EQC and the Courts to implement and decide on the Act.</p> <p>Avoids homeowners having to prove public liability for non-natural disaster damage in order to receive compensation. This process can be costly and time-consuming.</p> <p>Avoids complexity of establishing whether damage is caused by natural or non-natural causes as in many cases this will be a combination of both (e.g. poorly maintained stormwater drains overflowing, as well as river flooding).</p>	<p>Will enable EQC to provide cover beyond the intent of the Act, which is focused on natural hazards.</p> <p>Risks creating liability for EQC in instances where the responsible party should have public liability insurance, although EQC's subrogation powers limit this to an extent.</p> <p>Potentially reduces incentives on infrastructure providers such as local government to undertake maintenance. Note that EQC subrogation powers mitigate this to an extent.</p>
<p>Target the Act to natural hazards only.</p> <p>EQC excludes damage arising from non-natural causes and damage that occurs in the absence of a natural hazard trigger event (e.g., purely due to lack of maintenance).</p> <p>There are options available for the scope of this exclusion.</p>	<p>Consistent with the purpose of the EQC Act and intent of the scheme. Focuses resources on the policy goal regarding natural hazards.</p> <p>Removes risk of Crown liability for damage that should be covered by public liability insurance.</p>	<p>EQC withdrawing from flood and landslip cover for damage resulting entirely from non-natural causes would amount to an overall reduction in cover for the public compared to status quo.</p> <p>It can be costly and time-consuming to prove public liability. Shifting this risk to the public may have equity issues. We expect these scenarios would lead to ad hoc calls for financial assistance from Government.</p> <p>Disasters often have a combination of natural and non-natural causes, for example where damage caused by a heavy rainfall event is exacerbated by poorly maintained stormwater systems. Creating an administrative situation where EQC must attribute the damage to particular causes would lead to slower claims</p>

Option	Pros	Cons
		settlement. However, there are ways we could manage this risk and still have a more targeted scheme, for example by enabling EQC to cover any event that has a natural disaster trigger regardless of exacerbating non-natural factors (the most likely being lack of maintenance of pipes, stormwater etc).

56. On balance, we recommend **Option 1 – clarifying the status quo**, primarily because Option 2 means an overall reduction of insurance cover for the public as private insurers do not provide land cover. Additionally, Option 2 would force homeowners to prove liability of a third party where there is a need to claim for damage from non-natural causes, which can be a complex, costly and time-consuming process. However, if you do want to proceed with **Option 2 – a more targeted scheme**, we will provide further advice on how to operationalise this in a way that minimises administrative inefficiency and boundary issues in determining if damage has natural or non-natural causes. We note the EQC’s preference is for the scheme to focus on natural hazards, and therefore EQC prefers Option 2.
57. If you agree to proceed with Option 1, we will work with PCO to develop an appropriate definition for flood. Under Option 1, we would envision wording for a flooding definition may be similar to the following scope:
- **Flooding:** includes inundation or evacuation of normally dry land by water due to storm, storm surge, meteotsunami, or water that has escaped or been released from its normal confines.
58. As mentioned, the current Act already defines ‘natural landslip’. Regardless of the option chosen, we propose the Act refer to ‘landslide’ to align with more commonplace language.
59. If you select Option 1, we propose removing the word ‘natural’ from the landslip definition. As the status quo coverage of landslips can include those that are in some cases triggered or exacerbated by human activity, the word ‘natural’ appears out of place. This would be a drafting change for clarity and has no policy implications in and of itself for operationalising the Act.
60. Alternatively, if you choose to proceed with Option 2, we will provide further advice on the appropriate definition of ‘landslip’/‘landslide’.
61. In addition, we recommend definitions be added to the EQC Act for the remaining hazards in line with the following scope:
- **Erosion (note erosion is already defined in the Act in order to be excluded from EQC cover):** means by the normal action of the wind or water (including coastal erosion, bank erosion, and sheet erosion).
 - **Earthquake:** a sudden, rapid shaking of the earth caused by the breaking and shifting of rock beneath the earth’s surface.
 - **Tsunami:** a natural phenomenon consisting of a series of waves generated when a large volume of water in the sea, or in a lake, is rapidly displaced by an earthquake, landslide, a meteorite, or volcanic unrest.

- **Storm:** violent disturbances of the Earth’s atmosphere including high winds and/or heavy falls of precipitation, or thunder and lightning. Includes tornadoes.

Volcanic eruption is a complex hazard to define

62. The Act currently provides cover for volcanic eruptions. However, volcanic activity includes a wide range of potentially damage-causing events that may not be an “eruption”, such as a lahar (volcanic mudflow) and ash fall. It is unclear what the intent of the Act is when it comes to covering non-eruption volcanic events.
63. A further complicating factor is that, similar to the Canterbury earthquake sequence, volcanic activity is likely to be sustained over time (significant volcanic activity may continue for decades). The EQC Act provides a 48-hour period for a singular event, which is eligible for an EQC claim.²⁰ Where volcanic activity lasts longer than 48 hours, the Act becomes relatively unworkable in this respect.
64. Previous work on the EQC Act review over 2012-2015 proposed that the Act define volcanic activity in line with the following scope, which was reached in consultation with natural hazards experts:

Volcanic and hydrothermal activity: a sudden or continuing release of energy, gas, or other matter due to near-surface or surface magmatic processes. Includes lahar.

65. We agree the current term volcanic ‘eruption’ is too narrow and that the term ‘volcanic activity’ is preferred. This may appear to be an extension of EQC cover but is a clarification of the intent of the Act in covering a range of volcanic-related events. We recommend a definition of volcanic activity be added to the Act, in line with the scope in the above previously proposed definition of volcanic and hydrothermal activity.
66. As New Zealand has not had recent experience of significant volcanic activity causing damage to residential properties, current EQC coverage of volcanic events is relatively untested. It is possible that shifting the definition from ‘volcanic eruption’ to ‘volcanic activity’ may be an expansion of cover from entitlements under the current Act.
67. We note the following apportionment process would currently be followed by EQC to define a singular volcanic event:
 - The start of the 48 consecutive hour period applicable to a single claim for damage caused by volcanic activity should be the time when the first volcanic damage occurred at the residential property.²¹
 - Claims can be lodged with EQC in relation to damage caused by each 48-hour ‘event’. In a multiple event situation, a new cap and excess will attach to each valid claim.
 - If more than one eruption causes damage to a dwelling within a single 48 consecutive hour period, all the damage will be settled under a single claim, single cap and single excess.
68. The Insurance Council of New Zealand (ICNZ) noted that having to apportion damage across multiple 48-hour window ‘events’ would likely cause complexities for EQC and insurers in dealing with over-cap claims for volcanic activity. This is the same complexity that arose in the multi-event scenario of the Canterbury earthquake sequence. This may be particularly complex where insurers and EQC are unable to

²⁰ Schedule 3, clause 1(a).

²¹ This is comparable to EQC’s response to natural landslip damage where the damage is only caused at some time after the landslip started.

access a property to assess damage within the 48-hour period, to be able to accurately apportion which damage links to which event.

69. We propose that the period of a single volcanic event should be extended from 48 hours to 7 consecutive days. This is in line with the treatment of natural disaster fire under the Act, which also has a 7-day period for a single event.²² Extending the time period to 7 days is likely to help ease the administrative complexity of apportioning event damage between EQC and private insurers.
70. Additionally, EQC and insurers are developing improved collaborative processes, including for apportionment, as part of implementing the Natural Disaster Response Agreements (NDRA) which will see insurers managing claims on behalf of EQC.
71. We note that while the development of the proposal for a 7-day period for volcanic activity was informed by ICNZ feedback on the inadequacy of the current 48-hour event period for volcanic activity, we have not tested the 7-day proposal itself with insurers. If you agree to proceed with a 7-day event period, we will inform ICNZ of this.

EQC's standard of repair is fit-for-purpose

72. The issue of standard of repair frequently arises in relation to the repair or replacement of residential buildings under the EQC Act. Section 18 of the Act provides that any residential building is deemed to be insured against natural disaster damage for its replacement value. The Act defines "replacement value" as "replacing or reinstating a residential building to a condition substantially the same as, but not better or more extensive than, its condition when new."²³ It also requires the standard to be modified as necessary to comply with any applicable laws, including the Building Act 2004 and the Building Code.
73. The standard of repair under the EQC Act is subject to Schedule 3 of the Act. Condition 9 of Schedule 3 provides that EQC may at its option replace or reinstate any residential building that suffers natural disaster damage, but:
 - EQC shall not be bound to replace or reinstate exactly or completely, and
 - it only needs to undertake reinstatement of earthquake damage as circumstances permit and in a reasonably sufficient manner.
74. Following the Canterbury earthquake sequence, there were some inconsistencies in the way individual personnel and contractors applied EQC's interpretation of the Act. The Public Inquiry into EQC report stated that to some extent the uncertainty reflected a lack of clarity within the Act itself – in particular around the interaction between EQC's obligation to replace or reinstate to a "when new" standard, and the caveats in Condition 9 of Schedule 3 that this should be only as circumstances permit and in a reasonably sufficient manner.²⁴
75. Many submissions to the Public Inquiry into EQC commented on the standard of repair under the EQC Act. A number of submissions described the difference between the repair standard of their private insurance policies and what they believed to be the EQC standard of "like-for-like" or repairing to pre-earthquake condition. Many submitters felt EQC should have been required to repair to an "as new" standard and

²² See Schedule 3 clause 1(b) of the EQC Act 1993.

²³ The term 'reinstatement' is often used in reference to standard of repair under the EQC Act. This report uses the term 'repair standard' to refer to matters pertaining to EQC's obligations for repair under the Act, and uses the term 'reinstatement' to refer to matters relating to reinstatement of EQC cover following an event (as described in paragraphs 18-21).

²⁴ See page 128 of the report of the Public Inquiry into EQC: <https://eqcinquiry.govt.nz/assets/Inquiry-Reports/Report-of-the-Public-Inquiry-into-EQC.pdf>

described their fight to have this recognised in their claims. Several people told the Inquiry that EQC staff appeared to be unaware or were untrained in their obligations under the EQC Act to repair to a “when new” standard.²⁵

76. The Public Inquiry into EQC recommended that Government should “*review the legislative framework so that there is greater clarity of key provisions and definitions, including definitions of the phrases in the legislation such as “when new” and “reinstatement”*”.²⁶

EQC’s repair standard is already broadly consistent with private insurers’ standards

77. There are policy choices about what standard homeowners should be restored to following a disaster. The questions are identical to those previously raised in our advice on refining the objectives for the review [T2020/3164 refers]:

- Do the Government’s interests extend beyond repairing homes to a safe and sanitary standard?
- Do the Government’s interests extend beyond reinstating the damaged residential buildings? If so, how much further?

78. The two strategic options are:

- **Restore housing:** The current EQC repair standard, which is in line with the common standard among insurers, is to restore housing to a state that is at least the same as prior to the disaster, with opportunities for improvements in line with the Building Code to be made where appropriate (**recommended option**).
- **Improve housing:** An alternative option, which would go beyond the traditional role of an insurer, would be to improve the quality of a house beyond what was legally required by relevant building regulations. An example would be raising the floor level of a house in a flood-prone area to improve the overall resilience of the home.

79. We recommend that the status quo standard of restoring housing should be retained. If the EQC scheme is to help minimise the experience of socially unacceptable distress and loss following a natural disaster, homeowners need to be restored to at least the standard they were in prior to the event, which is achieved by this proposal. Taking a housing improvement approach would be akin to a first principles change to EQC as it moves EQC beyond the obligations of an insurer and may jeopardise EQC’s reinsurance contracts.

80. Additionally, homeowners can undertake other repairs at the same time as EQC repairs if appropriate, for example, installing insulation which was common following the Canterbury earthquakes. Further advice on enabling non-EQC repairs is provided in a companion report on claims handling and settlement [T2020/2491 refers].

81. We consider that EQC cover should closely align with insurance industry practice. From a legislative perspective this appears to already be the case, although there may be differences within the industry as to how that standard is applied in practice. As abovementioned, EQC building cover is for replacement value, with the standard being “substantially the same as but not better or more extensive than the building’s condition when new”, though subject to caveats around circumstances permitting this standard.

82. Private insurer provisions regarding this standard of repair often incorporate similar concepts, namely replacement as new, subject to a reasonableness test.

²⁵ See page 128 of the report of the Public Inquiry into EQC: <https://eqcinquiry.govt.nz/assets/Inquiry-Reports/Report-of-the-Public-Inquiry-into-EQC.pdf>

²⁶ Recommendation 1.3.1 of the Public Inquiry into EQC.

83. Additionally, the thorough testing of EQC's repair standard following the Canterbury earthquake sequence has led to the development of valuable jurisprudence. This was emphasised by the EQC Claimant Reference Group who posited that the fact the repair standard was now well-tested and better understood within EQC means there are significant benefits in retaining the status quo.
84. Based on this, we consider the current EQC repair standard to be fit-for-purpose and recommend the current standard should be retained.

EQC can deem private insurer repair standards to be equivalent to that of EQC

85. Insurers have proposed aligning EQC's standard of repair with the policy the EQC cover attaches to. This is unattractive on government policy and EQC operational grounds as it would mean the standard of repair offered to EQC claimants would be determined by their insurance policy, not legislation. Also, if in future EQC is handling the claim rather than the insurer, EQC would need to be familiar with, and apply, repair standards that might vary between different insurance policies, adding to claims processing complexity.
86. In response to these concerns, insurers have suggested the EQC Act include 'deemed equivalence' provisions for 'standard of repair' entitlements where private insurers are acting as EQC's agents. This would enable EQC, at its discretion, to allow private insurers acting as agents to apply the standard of repair in the relevant private insurance contract. There is nothing in the current EQC Act that prevents this currently, so we consider it is possible under the current legislation despite not being explicitly provided for in the Act.
87. Consequently, we propose no change is needed to enable a future EQC Board to confirm equivalence between the Act and an insurer's policy, where that was the case.

The Act should include a clear statement of EQC's repair standard

88. While we consider EQC's repair standard to be fit for purpose, the way it is currently drafted in the legislation causes confusion for the public.
89. In particular, the fact that the repair standard is effectively drafted in two places in the Act is unnecessarily confusing. That is, the repair standard outlined in Section 18 of the Act is subject to the caveats at Schedule 3 of the Act regarding EQC not replacing exactly or completely, and only in a reasonably sufficient manner.
90. We propose the new Act should include a clear statement of EQC's repair standard upfront and in one place. The relevant section should combine all relevant language in the EQC Act currently so it is clear what EQC will and will not cover as part of settlement.²⁷ We note our intention is that the wording will not cause any policy change to the EQC repair standard but will consolidate the language in the EQC Act that describes the standard currently.
91. We will work with PCO to capture the appropriate and clear language for the legislation.

We are undertaking further work on reinstatement of EQC cover

92. In late 2011, the High Court ruled that EQC cover reinstates to the cap (then \$100,000 plus GST) after each natural disaster event, rather than being limited to an aggregate claim of \$100,000 over the term of the underlying insurance contract. Damage resulting from each earthquake could give rise to a claim. Therefore, it became necessary to

²⁷ Specifically, the Section 2 definition of replacement value and Schedule 3 clause 9.
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determine new or aggravated damage to properties following each event. This became known as “apportionment” and increased complexity and contributed to delays in the processes for assessment and for managing claims, in part because the Court’s decision was applied retrospectively.

93. Apportionment between different earthquakes led to many disputes. The financial consequences of apportionment were also significant. For example, a home with \$300,000 of damage led to a \$200,000 liability for a private insurer if all the damage came from one earthquake, but potentially no liability for the private insurer if the damage was spread evenly among four earthquakes.
94. The Canterbury experience of multiple events is rare, even by international standards. It is unusual for a series of aftershocks to cause greater levels of damage than the original shock. Nevertheless, the complexity, uncertainty, and delays of the apportionment process mean it is worth considering other models that might better manage multiple events if a similar situation arose in the future.
95. The Public Inquiry into EQC paid some attention to this issue, and recommended that Government “*review the EQC Act in light of the High Court ruling on reinstatement of cover following each natural disaster event and other judicial determinations that have had a significant impact on EQC’s work.*”²⁸
96. We have been working through advice on reinstatement in consultation with EQC. EQC has requested further time to consider the issues and available options in more detail, due to the complexities that arose from the Canterbury earthquake sequence. We will report back to you on this issue by early February 2021, to inform your Cabinet paper on modernising the EQC Act.

The EQC Act should make clear what costs are covered by EQC

97. We consider the new Act should clarify EQC’s obligations regarding costs associated with building cover. These include:
 - clarifying that EQC does not provide temporary accommodation costs
 - clarifying that claims handling expenses are paid for by EQC, but not part of the EQC cap.

EQC should continue not to provide temporary accommodation costs

98. Temporary accommodation is generally provided for in terms of a customer’s private insurance policy and is often utilised when residents are asked to leave a property so that repairs can be undertaken. Making use of that provision in the private insurance policy makes it possible for EQC to focus its resources on building repairs.
99. In the Canterbury scenario, EQC paid for temporary accommodation as an ex gratia payment because customers’ private insurance allowances for temporary accommodation had been exhausted as a result of failed EQC managed repairs.
100. Insurers appear to broadly favour the idea of EQC providing for temporary accommodation costs, with ICNZ suggesting this would incentivise EQC to arrange repairs promptly and work with others effectively, with private insurers topping up this cover once any EQC limit is reached. However, insurers such as IAG have noted that this may also cause complexities around how EQC temporary accommodation cover might interact with that provided by insurers that would need to be worked through.

²⁸ Recommendation 1.3.2 of the Public Inquiry into EQC.
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101. As EQC is clear its preference is to cash settle claims rather than manage repairs, we do not expect temporary accommodation costs to be an issue in future. If the EQC Act provided temporary accommodation cover this may divert monies from the EQC building cap and cause private insurers to exit from providing cover for temporary accommodation.
102. We consider it is more appropriate for EQC to continue to have the ability to make ex gratia payments if necessary due to failed repairs caused by EQC, rather than provide for temporary accommodation costs as a requirement. We note no legislative changes are required to introduce any specific ex gratia power to enable this.
103. Consequently, we recommend the EQC Act should make it clear that EQC does not provide cover for temporary accommodation costs.

The Act should clarify that claims handling expenses are not part of the cap

104. The current Act makes clear the claims handling expenses (CHE) are not part of the EQC cap. Section 18 confirms that a residential building is covered for its replacement value up to cap, and accordingly the only amounts that are included in the cap are those that meet the replacement value definition. CHE is a part of the costs of claims settlement and therefore can be funded from EQC's Natural Disaster Fund.
105. However, there are individual items where it can be unclear which side of the line they fall on in terms of being CHE or replacement value, for instance an engineering assessment that is required to establish the repair methodology for the building.
106. We consider the 'bright line' between CHE costs and costs that must be included in the cap would best be drawn between the activities undertaken to determine the most cost-effective reinstatement method (i.e., CHE) and the activities required to complete, support or enable the actual reinstatement works.
107. We propose that the Act be clear that the line between CHE costs and costs that must be included in the cap is to be drawn between the fees/costs incurred in establishing the loss (not part of the settlement) in comparison to the fees/costs of reinstating the loss (part of the settlement).
108. Note that this proposal aligns with feedback from ICNZ in response to the 2015 discussion document on the previous review of the Act, and insurers have also supported this proposal in our recent consultation.

Next Steps on building cover

109. If you agree to the recommendations in this paper, we will include the relevant proposals in a draft Regulatory Impact Statement and Cabinet paper on modernising the EQC Act for you to consider in early 2021.

Consultation

110. In preparing this advice, we undertook targeted stakeholder consultation to gather information and test draft proposals. Stakeholders included the Insurance Council New Zealand, IAG, Inner City Wellington, the Body Corporate Chairs Group, the EQC Claimant Reference Group, and the New Zealand Bankers Association.
111. We also consulted other agencies including EQC, the Ministry for the Environment, the Department of Internal Affairs, the Inland Revenue Department, Land Information New Zealand, the National Emergency Management Agency, the Ministry of Housing and

Urban Development, and the Department of Prime Minister and Cabinet. Relevant feedback from agencies and stakeholders has been reflected in the final content of this paper.