The Treasury

Residential Flood Insurance Issues Information Release

December 2022

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https://www.treasury.govt.nz/news-and-events/reviews-consultation/residential-flood-insurance-issues

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

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

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Flood insurance: Insurer feedback and next steps

Date:	2 December 2021	**Report No:**	T2021/2921
		File Number:	SH-11-4-3-14-3

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson) **Minister Responsible for the Earthquake Commission** (Hon Dr David Clark)	**agree** to Treasury continuing to work at pace to progress the Government's response to flood insurance issues through either (i) a 12-month work programme linked with development of National Adaptation Plan (Option 1, Treasury recommended); or (ii) on a faster timeframe that bypasses that process (including public consultation therein) (Option 2). *If you agree to Option 2,* **indicate** your preference for further advice on short-listed interim potential solutions. **agree** to refer this report to the Climate Response Ministers Group for discussion at their meeting in December.	9 December 2021

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Sam Thornton	Senior Analyst, Financial Markets	s9(2)(k)	N/A (mob)	✓
Daniel Jury	Senior Analyst, Financial Markets		N/A (mob)	
Dasha Leonova	Manager, Financial Markets		s 9(2)(g)(ii) (mob)	

Minister's Office actions (if required)

Return the signed report to the Treasury.

Refer this report to the Climate Response Ministers Group.

Note any feedback on the quality of the report	

Enclosure: No

Treasury Report: Flood insurance: Insurer feedback and next steps

Executive Summary

We previously provided you with advice on issues related to access and affordability of flood insurance for residential homes (T2021/1900 and T2021/2377 refer). This report: (i) provides feedback from consultation with insurers on how flood risk currently affects residential home insurance access and pricing, and how this could change in the future, and (ii) outlines options for how to proceed with the Government's response to flood insurability issues due to increased risk-pricing in the near-term.

What we learned from insurers

When asked about how flood risk currently affects residential home insurance, insurers told us that flood risk is currently largely community-rated for home insurance (with some house specific adjustments where flood risk is known to be particularly high), and there are a small number of residential homes each insurer is unwilling to insure due to high flood risk (but we have not yet been able to quantify the number of homes or identify any specific examples of particular homes being unable to obtain insurance from any insurer due to high flood risk).

s9(2)(f)(iv)

[redacted]

Options for next steps

We **recommend** that we continue to work at pace on the Government's response to flood insurance issues.

We have considered two options.

- Option 1 – Progress work through public consultation and coordination with wider government adaptation policy aligned with development of the National Adaptation Plan, with a view to providing you with a series of advice over that period culminating in decisions in the third quarter of 2022 an option.

- Option 2 – Develop a flood insurance intervention as quickly as practicable, without being subject to, or informed by, the wider National Adaptation Plan process or public consultation, and provide you with further advice *in early 2022* on options (including more detail on the design of potential solutions) for starting to *implement* a flood insurance support scheme within the next 12 months.

The key difference between them is Option 1 is integrated and coordinated with the wider National Adaptation Process. This brings policy, process, coordination and risk management benefits. However, it results in a project that is currently envisaged to take about 12 months longer to implement than Option 2, with implementation in early 2024 rather than 2022 (exact timing significantly depends on the option).

Option 2 trades earlier implementation for significantly higher risks of some incoherence between the initial insurance and subsequent National Adaptation Plan policy decisions and settings. Moreover, under Option 2 the initial decisions on flood insurance interventions may cause a deterioration in the policy context in which future decisions on the National Adaptation Plan are made. Therefore, we recommend option 1.

Resourcing this work

s9(2)(f)(iv)

Recommended Action

We recommend that you:

Background

a **note** Tower recently announced it intends to implement greater and more granular risk-based pricing for pluvial and fluvial (river and surface) flooding from late 2021, withdrawing cover from s9(2)(b)(ii) and s9(2)(ba)(i) and significantly increasing premiums for around s9(2)(b)(ii) and s9(2)(ba)(i) as policies are renewed over the course of the next 12 months;

b **note** the impact of Tower's new approach on the wider residential home insurance market (and timing thereof) largely depends on:

- how other insurers respond to Tower's change in approach; and
- whether those customers impacted by Tower's change in approach find alternative cover from other insurers (which could mean that those customers may not ultimately face significant premium increases or loss of cover);

c **note** any widespread and significant shift in the insurance market to greater and more granular risk-pricing for flood risk could:

- increase the implicit fiscal risk from uninsured homes (if some homeowners cannot obtain insurance or choose not to insure due to the cost), and
- have significant wellbeing impacts for affected homeowners, both before and after a flooding event (from increased premiums or loss of access to insurance);

d **note** we previously provided you with advice on issues related to access and affordability of flood insurance for residential homes (T2021/1900 and T2021/2377 refer);

e **note** you asked us to: (i) consult with insurers on how flood risk currently affects residential home insurance access and pricing, and how this could change in the future, and (ii) provide you with options for how to proceed with the Government's response to flood insurability issues due to increased risk-pricing in the near-term;

Feedback from consultation with insurers on the current situation, and the potential scale / significance / distributional impacts of a shift to greater and more granular risk-based pricing

f **note** we recently consulted eight general insurers about how flood risk currently affects residential home insurance access and pricing and how this could change in the future;

g **note** insurers told us:

- flood risk is currently largely community-rated for home insurance (with some house specific adjustments where flood risk is known to be particularly high), and
- there are a small number of residential homes each insurer is unwilling to insure due to high flood risk (but we have not yet been able to quantify the number of homes or identify any specific examples of particular homes being unable to obtain insurance from any insurer due to high flood risk);

h **note** to help quantify the significance of a shift to greater risk-based pricing for flood risk, s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]

i s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]

j s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]

k **note** EQC, in consultation with the Treasury, has commissioned Aon to assess the potential **distributional** impacts of flood hazards across different communities, such as income distribution and ethnicity, which will help with judgements about the potential increased implicit fiscal risk from uninsured homes and wellbeing impacts on affected homeowners, which we expect to receive in January 2021;

Timing of any widespread and significant shift to greater and more granular risk-based pricing

l s9(2)(f)(iv) [redacted]

m [redacted]

s9(2)(f)(iv)

Wider considerations for any government response

n **note** any decision for the Government to intervene to improve access and affordability of insurance involves a key trade-off between:

- the potential increased implicit fiscal risk from uninsured homes and wellbeing impacts on homeowners, and
- the unquantified impact of a softening of insurance price signals on long-term resilience and wellbeing from delayed or deferred risk reduction measures;

o **note** while there would be benefits in considering the full range of options available across the risk management spectrum to manage flood risk (including measures to <u>reduce flood risk</u> such as strengthening community flood protection through information, funding, and regulation) when considering options to support flood insurance affordability and availability, **this wider app**roach could take several years to deliver benefits and therefore we have considered two main options for progressing this work now on a faster timeframe ahead of any such wider work being completed;

Options for progressing the flood insurance work

p **agree** to Treasury continuing to work at pace to progress the Government's response to flood insurance issues;

Agree/disagree

q **direct** the Treasury to progress the Government's response to flood insurance issues through:

EITHER:

- **Option 1 (recommended):** progress work now to form a view on how best to respond to flood insurance issues through public consultation and coordination with wider government adaptation policy in parallel with the development of the National Adaptation Plan, with a view to providing you with a series of advice over that period culminating in decisions in the third quarter of 2022 an option;

  Agree / disagree

OR

- **Option 2 (<u>not</u> recommended):** if you wanted to move faster, we could develop a flood insurance intervention as quickly as practicable, without being subject to, or informed by, the wider National Adaptation Plan process or public consultation, and provide you with further advice *in early 2022* (including more detail on the design of potential solutions) for starting to *implement* a flood insurance support scheme within the next 12 months;

  Agree / disagree

r **note** Option 1 will allow us to:

- consult the wider public and industry (including affected communities) alongside or as part of consultation on the National Adaptation Plan to expose and prompt wider public discussion about the different trade-offs and issues; and

- be better able to coordinate with wider government adaptation policy, including designing any insurance intervention consistent with the Government's longer-term policy approach to climate change adaptation (including any formal managed retreat policy and position on risk-and cost-sharing of adaptation) and s9(2)(f)(iv) [redacted]

s **note** Option 2 will have significant downsides, including: (i) limiting our ability to engage with the insurance industry on options; (ii) limiting our ability to consult with the wider public; and (iii) increasing the likelihood of any intervention being inconsistent with, and setting unhelpful precedents for, the Government's to-be-determined climate adaptation policies.

t *if you agree to Option 2,* **indicate** your preference for that further advice to cover (or not) the following currently identified short-listed interim potential solutions:

- s9(2)(f)(iv) [redacted]
-
-

NA / Yes / No

u **note** a key advantage of Option 1 is that it aims to minimise the risk a flood insurance intervention pre-emptively determines or restricts the Government's future options for climate adaptation policy, including how the costs of climate change fall, and who decides and who pays for adaptation measures, by giving time for the National Adaptation Plan to be further developed and have better engagement / understanding of different approaches;

v **note** the benefits of aligning the flood insurance work with climate adaptation policy work rely on the National Adaptation Plan consultation publicly exploring issues relating to the risk and cost-sharing of climate adaptation;

w **note** the choice between Option 1 (aligning the flood insurance work with climate adaptation policy work) and Option 2 (a quicker solution) will in large part be driven by balancing the following competing risks:

s9(2)(f)(iv)

- [redacted]
- [redacted]

x **agree** to meet with the Treasury to discuss this report;

Agree/disagree

y **agree** to refer this report to the Climate Response Ministers Group for discussion at their **meeting** in December with a covering note, which the Treasury will prepare for you, outlining your position on these matters.

Agree/disagree

Dasha Leonova
Manager, Financial Markets

Hon Grant Robertson
Minister of Finance

Hon Dr David Clark
Minister Responsible for the Earthquake Commission

Treasury Report: Flood insurance: Insurer feedback and next steps

Purpose of Report

1. This report:

- provides feedback from consultation with insurers on how flood risk currently affects residential home insurance access and pricing, and how this could change in the future, and

- outlines options for how to proceed with the Government's response to flood insurability issues due to increased risk-pricing in the near-term.

Context

2. The Treasury previously provided you with advice on issues related to access and affordability of flood insurance for residential homes (T2021/1900 and T2021/2377 refer). In particular, the advice in T2021/2377:

   a. advised on high-level options for supporting flood insurance access and affordability,

   b. noted the Government has a broad range of options for supporting flood insurance, depending on the relative priority for affordability or availability, the allocation of costs, and how quickly you wish to implement an intervention; and

   c. s9(2)(f)(iv) [redacted]

3. On 27 August 2021, you commissioned the Treasury, working with EQC, to explore options to support access and affordability of flood insurance for residential homes in response to indications insurers are moving toward greater and more granular risk-pricing of flood insurance.

4. You asked the Treasury to seek further information from insurers on the scale and timing of any flood insurance access and affordability problem before making decisions on next steps.

5. The Climate Response Ministers Group (CRMG) discussed flood insurance matters in October and invited you to report back to the group in December on the findings from consultation with insurers and reinsurers. The next CRMG meeting is tentatively scheduled for the week of 6 December 2021.

Feedback from insurers on flood insurance pricing and availability

6. In October and November, officials met with IAG, Suncorp, Tower, AA, QBE, Ando, MAS, Chubb and the Insurance Council of New Zealand (ICNZ) to obtain information about how flood risk currently affects residential home insurance access and pricing, and how this could change in the future. The Treasury also joined your meetings with Flood Re, Swiss Re, and Munich Re.

7. The key themes from the meetings are outlined below.

The current approach by insurers to flood insurance pricing and availability

8. Overall, insurers said insurance for homes with flood risk is currently widely available and well-priced (relative to homes with no flood risk), except for a small number of homes subject to significant flood risk where insurance may not be available. In particular:

    - **Flood risk is currently largely community-rated for home insurance** (that is, the cost of flooding losses is widely spread across many homes), but the degree of risk-pricing vs community-rating varies by insurer. Some insurers told us flood risk is largely community-rated because flood risk information has been patchy and unreliable, often based on local government hazard information of varying quality and coverage. The insurance industry's focus has been on earthquake risk. Accordingly, pricing for flood risk tends to be relatively blunt (generally 'postcode- level' pricing), although most insurers make some adjustments for a subset of homes that they see as particularly risky.

    - **Flood insurance is currently unavailable for only a small number of homes with high flood risk**, which are spread across New Zealand, generally in areas with well-known flood hazard. Some insurers said they embargo specific areas where flood risk is known to be high, while some take a more case-by-case approach to offering cover (e.g. online quotes may be unavailable and prospective customers would be referred to a call centre to provide more information about the property). s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]. We are awaiting further information from ICNZ on the number of homes that insurers are currently unwilling to insure due to flood risk.

    - s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] Insurers said single peril exclusions can create reputational and moral hazard risks and any exclusion would need a clear definition of 'flood' and would require clear messaging to customers. For example, whether pluvial flood damage caused by a cyclone would be counted as a flood loss or severe-weather loss. However, we have heard flood exclusions are common in other countries.

    - **Reinsurance is not a major factor in flood insurance pricing or availability currently**. s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] Unlike earthquakes which tend to be rare and cause catastrophic losses that trigger reinsurance, flood losses tend to be driven by higher frequency events with smaller losses per event. Reinsurers s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] also confirmed that flood risk was not a major concern for their pricing and willingness to provide reinsurance for New Zealand risks. However, significant recent flooding events in Europe have caused large reinsurance losses, heightening reinsurer awareness of flood risk globally with potential for future impacts on reinsurance prices for New Zealand.

How flood insurance pricing and availability is expected to change <u>within the next year or two</u>

9. There remains uncertainty about the timing of other insurers' (other than Tower) moves towards greater and more granular flood risk pricing. s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] However, almost all insurers said they are planning to investigate new models for fluvial and pluvial flood risk (river and surface flooding) and consider pricing changes in the next year or two. As the new models do not cover coastal flood risk, this may be considered later and, we are told by insurers, could present much more significant insurability challenges.

10. Insurers did not commit to any pricing approach or timing as they had not yet closely investigated the new flood models. One insurer indicated they are likely to consider the new flood risk models as they move to more granular risk-pricing, and that the timing for this may align with the implementation of the EQC cap changes from October 2022 so their system changes can be done at the same time. Most insurers also indicated they were cautious about the value of national flood models, which could be less accurate than local government flood information (as flooding is highly localised). [redacted] s9(2)(b)(ii) and s9(2)(ba)(i)

11. Counterintuitively, Tower suggested the improved modelling and greater risk-based pricing could in fact lead to *improved / better* access to insurance for some currently uninsurable homes in high risk areas. Some properties that are currently not offered insurance due to being in high flood risk areas may now be offered insurance if they are found to be (because of the improved more granular information) lower risk than previously thought. Tower did not provide us with the net expected change.

How flood insurance pricing and availability is expected to change <u>in the longer-term</u>

12. All insurers indicated a clear direction of travel towards greater risk-pricing for climate change-exacerbated perils, including flooding, as information about risk improves and risks increase. Future engagement with insurers could explore how risk pricing may possibly apply, over time, to other climate related hazards in New Zealand including wildfire, coastal flooding or inundation, or wind damage.

13. Insurers said risk needs to be sufficiently rare to be insurable, meaning that, as the frequency of damaging natural hazard events becomes more certain, insurance will become unavailable for at-risk homes.

14. Insurers indicated they do *not* price future risk (e.g. risk exacerbated by future climate change) into current premiums. Insurance contracts are typically for one year and are priced to reflect the risk taken on by the insurer for that period.

15. A common view expressed by insurers was that flood risk reduction can have major beneficial impacts on insurability, and, compared to earthquakes, flood risk is more amenable to mitigation. Insurers were open to helping the Government to understand flood risk and the benefits of mitigation (and are already doing so to some extent) but did not see a role for insurers to share in the costs of climate change.

16. Insurers also raised concerns that existing adaptation policies/incentives are not enough to prevent new developments in high risk areas, and greater central and local Government efforts to manage risk was needed.

What this means for the timing of insurance issues due to flood risk

17. In the near term, while there remains uncertainty about the timing of other insurers' moves towards greater flood risk pricing and the impact on insurance access and prices, based on what insurers told us, s9(2)(f)(iv) [redacted]

s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]

s9(2)(f)(iv) [redacted]

18. s9(2)(f)(iv) [redacted] However, those changes played out over a couple of years and, to our knowledge, no stand-alone residential homes have been unable to obtain insurance as a result of greater risk-pricing for seismic risk. s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]

19. s9(2)(f)(iv) [redacted]

The public policy problem if insurers moved to fully risk-price flood risk for individual residential homes' insurance policies

20. If there were to be a widespread and significant shift in the insurance market to greater and more granular risk-pricing for flood risk, this could both materially increase premiums for some homes and / or materially increase the number of homes that do not have home insurance (either because they no longer have access to cover or choose not to buy given higher costs). These could result in the following key public policy problems:

- An increase in the implicit fiscal risk given the possible increased likelihood that the Government may be called on to step in and protect uninsured homes following a major flooding event; and

- Negative impacts on the wellbeing of, and / or increased hardship for, some affected homeowners arising from both increased premiums and loss of access to insurance prior to an event. Some groups may also be impacted more than others in ways the Government deems unacceptably inequitable. s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] The wellbeing and hardship impacts may also differ depending on whether the homes are primary residences, investment properties, holiday homes, etc.

s9(2)(b)(ii) and s9(2)(ba)(i)

[redacted]

21. Assessing the potential impacts on homeowners is uncertain and indefinite. It is therefore a difficult judgement for the Government about whether the impacts above warrant a significant government response.

22. In the Treasury's judgement, Tower's proposed changes at this stage are not significant enough in and of themselves to create the public policy problems above because:

- a small number of homes s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] will not have their cover renewed by Tower, but other insurers may pick them up (as occurred following Tower's initial moves to increasingly risk-price for earthquake risk). Some other homes potentially will gain insurance that they are currently not getting.

- the loss of insurance for those s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] homes will occur over the next year as the one-year insurance contracts are renewed,

- the homes are spread across New Zealand (i.e. not concentrated in few areas), lowering the implicit fiscal risk, and there are already flood and other peril insurability issues which homeowners / communities appear to live with), and
- s9(2)(b)(ii) and s9(2)(ba)(i) for the [redacted] homes facing significant premium increases, s9(2)(b)(ii) and s9(2)(ba)(i) [redacted] and it is possible that those customers may be able to find alternative cover from other insurers (which could mean that they may not ultimately face significant premium increases).

23. s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]

24. s9(2)(b)(ii) and s9(2)(ba)(i) [redacted]

25. The Treasury has not formed a view about the impact of such changes on implicit fiscal risk and wellbeing impacts on affected homeowners. EQC, with Treasury support, have commissioned Aon to assess the potential distributional impacts of flood hazards across different groups, such as by income distribution and ethnicity, which will help with judgements about the potential increased implicit fiscal risk and wellbeing impacts on affected homeowners. We expect to receive this analysis before Christmas 2021.

26. s9(2)(f)(iv) [redacted] We recommend the development of the Government response to flood insurance issues as part of a 12-month work programme (further discussed below). However, if you wish to proceed with an interim support for flood insurance on a faster timeline, we have outlined some initial parameters below.

Options for next steps to progress the Government's response

27. In light of insurer feedback on the timing and scale of a shift to greater and more granular risk-based pricing for flood risk, you have choices about the pace of further work on an insurance intervention to support access and affordability for residential flood insurance.

28. There would be benefits in considering the full range of options available across the risk management spectrum to manage flood risk when considering options to support flood insurance affordability and availability (including measures to reduce flood risk such as strengthening community flood protection through information, funding, and regulation). However, this wider approach could take several years to deliver benefits, meaning the Government will not be well-positioned to respond to changes in insurance markets arising from greater flood insurance risk pricing. Therefore, we have considered two main options for progressing this work now on a faster timeframe ahead of any such wider work being completed.

29. We recommend that we continue to work at pace on the Government's response to flood insurance issues. We have considered two options.

- Option 1 (**recommended**) – Progress work through public consultation and coordination with wider government adaptation policy aligned with development of the National Adaptation Plan, with a view to providing you with a series of advice over that period culminating in decisions in the third quarter of 2022 an option.

- Option 2 – Develop a flood insurance intervention as quickly as practicable, without being subject to, or informed by, the wider National Adaptation Plan process or public consultation, and provide you with further advice *in early 2022* on options (including more detail on the design of potential solutions) for starting to *implement* a flood insurance support scheme within the next 12 months.

30. The key difference between them is Option 1 is integrated and coordinated with the wider National Adaptation Process. This brings policy, process, coordination and risk management benefits. However, it results in a project that is currently envisaged to take about 12 months longer to implement than Option 2, with implementation in early 2024 rather than early 2022 (exact timing significantly depends on the option).

31. Option 2 trades earlier implementation for significantly higher risks of some incoherence between the initial insurance and subsequent National Adaptation Plan policy decisions and settings. Moreover, under Option 2 the initial decisions on flood insurance interventions may cause a deterioration in the policy context in which future decisions on the National Adaptation Plan are made. Therefore, we recommend Option 1.

Option 1 – Progress work through public consultation and coordination with wider government adaptation policy aligned with development of the NAP

32. The Government's response to greater and more granular risk-based pricing could be aligned with the climate adaptation policy work, and seek to address outstanding questions, as outlined below.

33. This approach has key benefits by allowing us to:

- consult the wider public and industry (including affected communities) alongside or as part of consultation on the National Adaptation Plan to expose and prompt wider public discussion about the different trade-offs and issues; and

- be better able to coordinate with wider government adaptation policy. Coordination would help to design any insurance intervention consistent with the Government's longer-term policy approach to climate change adaptation (including any formal managed retreat policy and position on risk-and cost-sharing of adaptation). It could also mitigate some of the adverse adaptation incentives an insurance intervention could create (e.g. local government deferring or delaying necessary flood protection measures, or developers not having due regard to flood risk).

Question	*Issue*	*Next step*
How risk reduction can support insurance availability and affordability?	Risk reduction to support insurability may be more cost-effective and provide other longer-term benefits (including to the wellbeing of homeowners) that cannot insurance support.	The Government's response to recent flooding in Westport provides a possible case study for risk reduction supporting insurability.

What are the implications of the Government's climate adaptation policy for any insurance intervention?	There are risks from any flood insurance intervention pre-emptively determining or restricting the Government's future options for policy on climate adaptation, including how the costs of climate change fall, and who decides and who pays for adaptation measures.	Sequencing any flood insurance intervention decisions after the Government makes initial decisions on these matters, perhaps around mid-2022, would help manage the risk of inconsistency.
What are the community, local government and Māori views about the choices and trade-offs between supporting insurance and other risk management interventions, and the design of an insurance intervention?	Public consultation on these matters could help inform the Government's response.	The Government could consult publicly on these matters alongside consultation on the National Adaptation Plan in April 2022.

34. Further information on these questions and how they relate to any flood insurance intervention is set out in Annex 1.

35. The key next steps would be reporting to you in early 2022 on a draft consultation, document and process, consultation in April 2022, followed by further advice (and decisions) in the third quarter of 2022 on an option. A high-level indicative timeline is set out below:

Date	***Action***
Dec-Feb	Preparing consultation document.
Feb	Advice to Ministers seeking feedback and agreement to consultation document.
Mar	Cabinet paper seeking agreement to release consultation document.
Apr	Public consultation begins alongside or as part of National Adaptation Plan consultation.
May	Public consultation closes.
Jun-Aug	Reviewing submissions and policy development.
Sep	Advice to Ministers on response to flood insurance issues.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

[redacted]

Option 2 – Move faster and instead bypass the public consultation and coordination with wider government adaptation policy

36. If you wanted to move faster, we can instead bypass the public consultation and coordination with wider government adaptation policy and provide further advice in early 2022 on options (including more detail on the design of potential solutions) for starting to *implement* a flood insurance support scheme within the next 12 months (option 2).

37. Moving this quickly will have significant downsides, including:

- limiting our ability to consult with the wider public; and
- increasing the likelihood of any intervention being inconsistent with, and setting unhelpful precedents for, the Government's yet-to-be-determined climate adaptation policies.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv) [redacted]

40. [redacted]

41. [redacted]

Treasury recommends Option 1

42. The choice between the options is a balance between competing risks that:

- the insurance market moves faster and more significantly than expected, and the Government is not well-positioned to respond, and

- there are adverse impacts from a quick interim insurance solution that conflicts with an optimal flood risk management approach and climate adaptation policy.

43. On the balance of risks, the Treasury recommends Option 1 based on our judgement about:

- s9(2)(f)(iv) [redacted]

- the benefits of being able to undertake [better] public consultation with affected communities;

- being better able to design any insurance intervention consistent with the Government's longer-term policy approach to climate change adaptation (including any formal managed retreat policy and position on risk-and cost-sharing of adaptation)

- the potentially significant long-term implications from a quick interim insurance solution that conflicts with the Government's longer-term policy approach to climate change adaptation (including any formal managed retreat policy and position on risk-and cost-sharing of adaptation), which may be difficult to change or unwind later.

44. However, we envisage Option 1 taking about 12 months longer than Option 2 to implement. If a key concern for you is the insurance market moving faster than expected and the individual wellbeing issues that would create, you may prefer Option 2).

Resourcing

45. s9(2)(f)(iv)

Next Steps

46. The Treasury would like to meet with you to discuss how you would like to take this work forward.

47. The Climate Response Ministers Group (CRMG) are expected to meet in December 2021 to discuss the next steps for the Government's response to flood insurability issues and the sequencing with the wider climate adaption policy work. Once you make decisions on the proposed next steps for this work, we will prepare a cover note for you to circulate to the CMRG with this briefing.

Annex 1: Key outstanding policy issues for the Government's response to flood insurability issues due to increased risk-pricing

How can risk reduction support insurance availability and affordability?

48. If the Government wants to support access and affordability of flood insurance, it has a range of options across the risk management spectrum (including supporting measures to reduce flood risk such as strengthening community flood protection through information, funding, and regulation, which indirectly supports insurance access and affordability).

49. Natural hazard insurance spreads the financial cost of uncertain natural hazards over time. Insurance is one risk management approach alongside:

    - avoiding risk through land use planning
    - controlling risk through structural design and mitigation, and
    - accepting risk through emergency management and community education/engagement tools.

50. A key question is where central government invests across the risk management spectrum to optimally reduce the social and economic impact of natural hazards, including the loss of insurance or increasing the cost of insurance. Most countries spend far more on response and recovery from natural disasters than they do on mitigation of natural hazard risk. NZIER research commissioned by the Department of Internal Affairs (DIA) suggested shifting investment towards mitigating known hazards (particularly flood risk) for which measures can materially reduce expected future costs. The report found a return on investment of around $5 for every $1 spent on flood mitigation measures. The report also found that hazards with the most scope for cost-beneficial mitigation to 2050 are flooding, storm surge and monitored landslips.

51. The different characteristics of flood risk compared to most EQC-covered perils (e.g. earthquakes, volcanic eruptions) mean a different treatment by the Government may be justified. Compared to earthquakes, there is arguably a stronger role for avoiding and controlling flood risk, and greater costs from relying on insurance, because:

    - flood risk may be more amendable to targeted preventative adaptations with broader community benefits (earthquake adaption is less easily targeted because almost all properties in New Zealand face some risk); and
    - flood risk affects a more distinct set of properties compared to earthquake risk, creating clearer winners and losers from government support (almost all properties in New Zealand face some seismic risk, but only around ten percent face some flood risk).

52. Optimising the Government's approach to these different risk management options is challenging and are currently being considered through the DIA-led Community Resilience Programme. The Community Resilience Programme is undertaking adaptation work to support Buller District Council in relation to Westport flooding and will pilot-test a Crown / local government co-investment model for flood risk management. At a meeting on 27 October 2021 Community Resilience Ministers instructed DIA to undertake further work to scope/cost the optimum mix of measures to reduce flood risk at Westport, including co-investment in flood protection.

What are the implications of the Government's climate adaptation policy for any insurance intervention?

53. The Government's approach to supporting flood insurance for homes in the short term has links with, and implications for, the Government's longer-term approach to adapting to increased risks from climate change (which will cover other risks and asset types).

54. In particular, there are common key policy questions where there are clear benefits in alignment / risks of non-alignment. For example (non exhaustive):

Who should be responsible for making decisions (what, when, how, etc) on community adaptation measures, such as stop-banks and managed retreat?

55. Some potential options to support flood insurance affordability / availability for homes could involve the Crown taking on the underlying risk (e.g. if EQC were to provide flood cover). If this were the case, the Crown would need the ability to appropriately manage that risk, which could potentially involve a more active role in reducing the underlying risk of flooding via flood defences or a stronger managed retreat framework.

56. It is possible that the outcome of the wider work on climate change adaption could find a compelling case (e.g. for subsidiarity type reasons) for the Crown to have a more limited role vis a vis local councils for deciding on community defences and / or have a smaller role for the Crown in managed retreat.

How should losses / costs faced by asset owners arising from flood risks (including flood risks exacerbated by climate change) be shared across society?

57. Any option to support flood insurance *affordability* for homes will involve some element of subsidisation of, and reallocation of, costs away from some homeowners that have homes subject to high flood risk, to reduce the premiums that would otherwise be payable. There will be choices for where this subsidy is funded from, including other homeowners (e.g. community rated premiums), the Crown, or some combination thereof. There will also be choices about the extent of any subsidy.

58. It is possible that the outcome of the wider work on climate change adaption could result in losses / costs of increased risks being shared in a different way than as outlined above – e.g. in some cases there might be a compelling case for the losses / costs to remain with some asset owners themselves, or be shared differently across society.

59. s9(2)(f)(iv)

What is the appropriate balance between relying on market mechanisms vs government direction to respond to flood risks?

60. Any option to support flood insurance affordability for homes will involve some element of subsidisation, which will blunt the market price signal and associated incentives on homeowners (and local councils via the political process) to respond to this signal.

61. s9(2)(f)(iv)

To what extent are any key policy decisions transitional / temporary?

62. s9(2)(f)(iv) [redacted]

63. [redacted]

64. The forthcoming National Adaptation Plan (NAP) and Climate Response Act will provide further clarity about the Government's position on these matters (as will the wider resource management reforms).

65. There are benefits in developing the Government's response to this flood insurance issue in parallel with the development of the Government's longer-term policy approach to climate change adaptation, as it will:

   - lower the risk of any flood insurance support pre-emptively determining or restricting the Government's future options for policy on climate adaptation,

   - lower the risk of needing to subsequently unwind elements of any flood insurance support to align with the longer-term approach to climate change adaptation (which may be challenging / not practicable, particularly given political economy considerations),

   - lower the risk of any flood insurance support undermining the longer-term approach to climate change adaptation,

   - allow any flood insurance support to be designed to actively support the longer-term approach to climate change adaptation.

What are the community, local government and Māori views about the choice and trade-offs between supporting insurance and other risk management interventions?

66. Public consultation could help inform the Government's response regarding the trade-offs between insurance and different flood risk management approaches. Public consultation would also provide an opportunity for Māori consultation on flood insurance issues as initial information from MfE suggests Māori are likely to be disproportionately affected by flood risk.

67. Consultation could be at a high-level on some key questions for the design of an insurance support, including:

   - whether a flood insurance scheme would support insurance access only or affordability and access,

   - how any insurance scheme may be targeted, including in terms of characteristics of homes / ownership of the homes (e.g. owner occupied, rental/investment properties, holiday homes, primary home vs secondary home, etc.),

   - the degree of any affordability support (e.g. insurance price caps or partial subsidy),

   - how any flood insurance scheme should be funded (Crown or all homeowners),

- what incentives for adaptation should be included in a flood insurance scheme (build back better, limitations on multiple claims), and
- whether a flood insurance scheme should be transitional or permanent (for the life of the occupant, fixed timeframe).

Annex 2: Flood Re in the New Zealand context

68. A scheme like Flood Re is a potential option for supporting access and affordability of flood insurance in New Zealand.

69. Flood Re is a private UK company owned and operated by its member insurers. It is not-for-profit but is commercially run. The scheme is funded by:

- fixed-price reinsurance premiums on flood-prone homes that an insurer chooses to reinsure with Flood Re
- a compulsory levy (Industry Levy 1 below) on all homeowner insurance premiums (approximately £10 per insured home)
- a potential further levy on the insurance industry if flood claims are in excess of available reserves (Industry Levy 2 below).

70. Flood Re's fixed-price reinsurance premium is set below the technical risk-price. It effectively sets a maximum price on home flood insurance (with adjustments based on the property's local council tax code). The capped reinsurance costs provided by Flood Re allows the insurer to charge lower insurance premiums for flood prone homes.

71. s9(2)(f)(iv) [redacted]

s9(2)(f)(iv)