Earthquake Commission Amendment Bill

Advising agencies	*The Treasury*
Decision sought	*Agreement to:* • *EQC exiting personal property (contents)* • *cover, increasing EQC monetary cap on building cover* • *lengthening EQC claim filing deadlines, and* • *reducing barriers to EQC sharing claim-related information.*
Proposing Ministers	*Hon Grant Robertson, Minister of Finance* *Hon Dr Megan Woods, Minister Responsible for the Earthquake Commission*

Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

A review of the EQC Act has been ongoing since 2012. More recently, preparations for a statutory inquiry into EQC and its claims management processes are progressing. Although a full-scale reform of the EQC Act would not be appropriate until the inquiry is complete, a few key, self-contained amendments could usefully proceed before the inquiry findings are reported.

The four pre-inquiry amendment proposals are:

- to remove EQC cover for personal property (contents),
- increase the EQC building cover cap from $100,000 (plus GST) to $150,000 (plus GST),
- lengthen EQC claim notification time limits, and
- clarify EQC's authority to share and publish claim-related information.

Proposed Approach

How will Government intervention work to bring about the desired change? How is this the best option?

The proposed amendments retain the overall legislative scheme while substantially improving the operation of the EQC Act by simplifying and speeding up claims handling, and resolving issues with the EQC Act that have previously been identified by the Ombudsman and the Canterbury Earthquakes Royal Commission.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?
Monetised and non-monetised benefits
The higher EQC monetary cap on building claims should improve residential building insurance affordability in higher-risk areas. Insured homeowners are expected to have a better claims-handling experience from the scheme once the reforms come into force. EQC exiting contents cover will enable EQC to better focus on building claims, and longer claims filing times and improved claims information sharing arrangements will help improve information flows between EQC and insurers, and enable information to be shared to support natural disaster preparedness, response and recovery.

Where do the costs fall?
Monetised and non-monetised costs; for example, to local government, to regulated parties
The higher monetary cap means that EQC will take on more risk through potentially higher claims costs, although the increase in risk is not proportional to the increase in the cap. The Natural Disaster Fund (NDF), from which claims are paid, is close to being exhausted. This raises the risk that the government will be required to use general revenue to pay to rebuild housing in the next natural disaster. There are no significant costs associated with the other amendment proposals. As at June 2017, EQC's current best estimate of the long-run average annual cost of the current scheme, including its claims, administration and EQC's research and reinsurance programmes, was $447 million per annum. This figure includes the cost of low-frequency, high-cost major natural disasters, so EQC's annual costs seldom reach this average level. The estimated aggregate impact of the two most significant proposals (changes to contents and building cover) is to increase EQC's expected average annual costs by around $38 million (8-9 percent). The financial impact of extending the claims notification period has not been costed but is expected to be minor. Counter-intuitively, expected earthquake-related costs, such as from a large Wellington event, decline slightly, by about 2 percent. This is because, for earthquakes, the increase in liabilities associated with the increase in the building cap is more than offset by liability reductions associated with EQC exiting household contents cover. In contrast, total expected average annual costs increase as the reduction in earthquake costs is more than offset by increases in the expected costs of tsunami and volcanic events (which, compared to earthquakes, are expected to destroy rather than damage a larger fraction of affected homes, resulting in more payments at the maximum monetary cap). A November 2017 increase in the EQC premium rate means that implementing the proposed changes would have no immediate implications for the EQC premium rate. Maintaining the current premium rate would be consistent with an established EQC scheme pricing principle – that the premiums collected should, on average, be sufficient to meet the long-run cost of the scheme.

However, the aggregate effect of the changes are that:

- EQC will insure up to $30,000 more per household. The $30,000 extra cover is due to building cover increasing by $50,000 and contents cover reducing by $20,000. The current 20-cent rate will be applicable to the $30,000 of extra assets covered by EQC.

- On this basis if the EQC exit from contents cover and the increase in the monetary cap on building cover both proceed, the $276 maximum annual EQC premiums paid per dwelling from 1 November 2017 would increase by $69 (including GST), to $345 per annum, on implementation.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?

Risks and unintended impacts appear low. Risks are mitigated by limiting the reforms to four self-contained, high-priority amendments ahead of the statutory inquiry into EQC and its claims management processes. The government intends that another, more comprehensive EQC Bill will follow the findings of the inquiry. This will provide an opportunity to review and alter these changes if necessary.

Changes similar to, or the same as, the key proposals (removing contents and increasing the cap) were included in a government discussion document in 2015. The other two changes are straightforward technical refinements. All the proposals have been subject to extensive consultations with insurers.

The transfer of risk from private insurers to EQC for building insurance and from EQC to private insurers for contents insurance will create pressures for lower private residential building premiums and higher private contents premiums. The EQC contents premium is currently $46 (incl. GST). The aggregate impact of the changes is to increase EQC's expected annual average claims costs.

As this is a swapping of risk between EQC and private insurers, private insurers' average annual expected claims costs should reduce by the same amount, and residential building premiums should decline by more than contents premiums increase, all else being equal. However, the ultimate timing and magnitude of any response in private premium levels will also be influenced by any other unrelated factors beyond the EQC change that apply at the time, so is difficult to foresee accurately.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.

With clear drafting, broad public awareness of the policy purpose of the scheme, and the flexibility that the Crown Entities Act gives to EQC and its board, we cannot see any significant incompatibility between these reforms and the list of expectations for the design of regulatory systems.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?
As discussed in sections 2.1 and 2.2, we consider there is strong evidence that EQC supports high levels of insurance cover of residential property in New Zealand. Despite some data and modelling limitations, we have a relatively high level of confidence in the assumptions and modelling used to inform recommendations and Ministerial preferences.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
The Treasury
Quality Assurance Assessment:
The Regulatory Quality Team at The Treasury considers that this Regulatory Impact Statement meets the quality assurance requirements.
Reviewer Comments and Recommendations:
The proposals and their relationship with the wider ongoing review of the EQC Act are clearly explained and the analysis of their likely consequences is well evidenced, including with reference to extensive stakeholder engagement.

Impact Statement: Changes to EQC Scheme Coverage, Claims Filing, and Claims information Sharing

Section 1: General information

Purpose
Treasury is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.

Key Limitations or Constraints on Analysis
Because of the narrow scope of the change proposals, there are few significant limitations or constraints on the analysis provided in this RIS. The narrow set of problems being addressed by the amendment proposals are widely acknowledged and have been well scoped. Key proposals were covered in the 2015 discussion document about the EQC scheme. The 62 submissions that came from this consultation are a rich source of ideas about solutions and subsequently helped to change or support possible policy solutions. Following completion of the public consultation process, the Treasury, with EQC and Insurance Council of New Zealand assistance, has undertaken impact analysis and tested a wide range of options. There are some limits on available data and the ability for modelling to cover all areas of interest is also limited. However, we are confident the cost estimates prepared around the proposed cap and contents cover changes provide a reasonably accurate picture of how those costs will fall after the amendments are made.

Responsible Manager (signature and date):
Steve Cantwell Principal Advisor, Financial Markets New Zealand Treasury   *Steve Cantwell* 28 February 2018

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

Internationally, private markets for catastrophe insurance tend to be marked by low rates of insurance uptake and fluctuations in supply of this type of cover. This results in significant levels of under-insurance or non-insurance among homeowners.

Without something like the EQC scheme, many homeowners would not be insured against catastrophe risks. The experience elsewhere in the world is that, in that situation, governments provide ad hoc assistance to those homeowners after large natural disasters. This creates risks and uncertainty for homeowners, insurers and governments.

Through its “first loss” insurance scheme (public-private partnership), EQC gives New Zealanders access to affordable natural hazard insurance. The current scheme design has EQC taking on a lot of the risk (covering something like 85 per cent of the damage to housing from natural disasters). This contributes to high rates of insurance among New Zealand homeowners compared with other countries that face similar high risks from natural disasters. The scheme plays an important role in re-establishing local communities hit by natural disasters.

Through its research function, EQC improves knowledge and professional practices in order to reduce the Government’s liabilities from natural disasters and make communities more resilient to such events

Through its education function EQC helps raise awareness of the ways individuals and communities can better protect their property. Stakeholders have expressed strong support for these educational activities.

Through its reinsurance/risk transfer function, EQC contributes to a better understanding of New Zealand and our risks by international reinsurers/international risk capital markets – EQC's support of high quality science and engineering research and practice underpin ability to assess risk and price it.

2.2 What regulatory system, or systems, are already in place?

As first insurer, EQC pays for the damage costs (less the excess) up to a $100,000 cap (excluding GST) for residential building damage and $20,000 (excluding GST) for residential contents. All of these caps are on a per event basis. The land cover is also capped, depending on locality.

The homeowner's private dwelling insurer (second insurer) covers the value of the claim above the cap, up to the sum-insured or replacement cost of the building, and less any private insurer excess if applicable, depending on the particular policy terms.

The EQC regulatory system, described above, has succeeded in achieving very high coverage for residential properties, and the land they are built on. It managed to do this by having the same low premiums nation-wide, no matter how risky the area was to natural disasters. There has been broad acceptance over time of this cross-subsidy from low-risk areas to high-risk ones. As a result of the Canterbury earthquakes, we have seen what seemed to be a low-risk area become a high-risk one.

Most importantly, EQC cover has succeeded in reducing political pressure for unplanned government interventions to repair or replace housing after a disaster with costs borne not by the government, but by a mix of public and private insurers and homeowners.

The EQC administers the Natural Disaster Fund (NDF) with income to the fund from premiums, returns on investment and reinsurance funds. Outlays from the NDF include reinsurance premiums and insurance claims, a guarantee fee paid to the Crown and EQC operating expenses. The government has statutory obligation to cover any deficiency in the fund, but that hasn't been required yet. This provides an efficient way of back-stopping the scheme without tying up cash in a fund that may hardly ever be drawn down.

The Earthquake Commission (EQC) was set up in 1994, to provide affordable natural disaster insurance for residential properties, closely associated land, and contents. This disaster insurance is automatically attached to private fire insurance, under a dual-insurance model ("co-insurance" by public and private insurers). It was created from an earlier and broader scheme established in 1945.

EQC Act review process

In 2012, the Government announced a review of the EQC Act 1993 (EQC Act) and the regulations governing the EQC scheme. It would draw on past experience on how to improve the way the dual-insurance scheme works, the claims experience of homeowners, and communications between insurers.

In July 2015, after a period of internal consultation and analysis of potential policy changes, the Government published a discussion document, *New Zealand's Future Natural Disaster Insurance Scheme*, seeking submissions on proposed changes to the EQC Act.

Subsequently, the Treasury continued policy development of possible reforms to the EQC scheme, taking information from the submissions into account. Further consultation among the Treasury, EQC and insurers has led in some cases to changes from early positions.

The EQC scheme and its predecessor scheme (under the Earthquake and War Damage Commission) has had several reviews, particularly after major disasters. The current review, however, has been the most extensive since the policy work that culminated in the 1993 EQC Act.

2.3 What is the policy problem or opportunity?

The EQC scheme's effectiveness was severely tested by the earthquake sequence in Canterbury, starting with a magnitude 7.1 earthquake on 4 September 2010, the destructive 6.3 aftershock of 22 February 2011, and the long series of smaller aftershocks.

Both public and private insurers faced institutional challenges in gearing up to meet vastly higher claimant demand arising from this major series of earthquakes. Multiple waves of damaging seismic activity sometimes made it unclear which insurance assessment applied to which event.

As evidenced by the Canterbury experiences, the dual-insurance model can create costs, confusion and complexity.

2.4 Are there any constraints on the scope for decision making?

Preparations are currently being made for a statutory inquiry into the EQC, under the Inquiries Act 2013, with the intention of:

- inquiring into EQC's approach to the land and residential building claims management process and the related outcomes for the Canterbury earthquake events; and

- achieving an outcome that ensures that lessons are learned from past Canterbury earthquake experiences, and that EQC has the appropriate policies and operating structures in place to ensure improved claims management experiences in the future.

Ministers have determined that, a full-scale reform of the EQC Act would not be appropriate until the inquiry is complete.

2.5 What do stakeholders think?

Stakeholders of the EQC scheme are homeowners, EQC, the Crown, private insurers, reinsurers, the Insurance Council of New Zealand (representing private insurers), banks, residential construction businesses, engineers, actuaries, lawyers, central and local governments, and other agencies, businesses and institutions. Most of these groups contributed their commentary and suggestions in response to the discussion document, and in some cases subsequently, which helped shape the policy options contained in this RIS.

The Treasury administers the EQC Act and its regulations. The Reserve Bank regulates the supply side of the private insurance industry (financial sustainability) and the Ministry of Business, Employment and Innovation (MBIE) regulates demand side of the private insurance industry.

The following lists the major stakeholders affected by the operation of the EQC scheme and their roles:

- ***Homeowners*** Would benefit from improvements in the way disaster insurance claims are handled, from shorter response times for claims settlement, to more efficient repairs and timely rehousing.

- ***Local councils*** Want to see their communities back functioning well as quickly as possible after a disaster and this requires people being rehoused efficiently. Councils also benefit from the research and education functions of EQC

- ***EQC*** Has an interest in running an efficient scheme that has a high coverage rate among homeowners, can manage claims arising in both average years and also large-scale events, and works well with its private insurance partners. It also has a research and educational role in assisting homeowners mitigate the effects of natural disasters.

- ***The Crown*** Needs to have the EQC scheme working well and lowering the risk of requests for ad hoc financial support for non-insured and under-insured homeowners. The Crown is the financial guarantor for the EQC (under Section 16 of the EQC Act).

- ***Private insurance companies*** *(including reinsurers)* Need to have clear roles vis-à-vis the EQC scheme. EQC also takes on most of the disaster risk, helping to keep private premiums affordable.

- ***Lending institutions*** Want to see houses and associated land insured against natural disasters as they have an interest in having their mortgaged assets protected against loss.

- ***Research community*** EQC funds the Geonet sensor array, contributes funding to teaching and research positions in four New Zealand universities and funds a range of short-term and longer-term research projects.

Stakeholders were invited to contribute their reactions to the discussion document proposals. By the close-off of submissions in mid-September 2015, 62 stakeholders, roughly an even split between individuals and organisations, had responded. These submissions (with redactions) have since been published on the Treasury website.

http://www.treasury.govt.nz/publications/reviews-consultation/eqc/submissions

After the discussion document process, Treasury continued policy development of possible reforms to the EQC scheme, taking the information from the submissions into account. Subsequent consultation among the Treasury, EQC and insurers has led in some cases to changes from early positions.

Stakeholders and other members of the public will also be able to make submissions on the Bill to Select Committee after it is introduced to the House.

Section 3: Options identification

3.1 What options are available to address the problem?
The four proposed amendments will update the monetary cap, which has not changed since the 1993 Act came into force, EQC exit contents insurance, and make other changes that will help to ensure EQC's primary focus is on housing recovery, and the claims process is both fair and expedient and information held by EQC is available for public good purposes. These are interim high-priority measures, in anticipation of a more comprehensive review of the EQC Act, so do not represent the full scope of potential beneficial reforms of the EQC Act. Other significant, and usually more complex, reforms that are addressed in the 2015 discussion document and we anticipate being considered in future include: • EQC land cover and how it interacts with EQC and insurer building cover • Claims handling, and the role of insurers in handling EQC claims • EQC's standard of repair • EQC claims excesses • Reinstatement of EQC cover following an event • Pricing, financing and periodic review of EQC cover • A range of other technical issues were also identified for future consideration.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?
The EQC Review established in 2012 sought to achieve the following objectives: 1. minimise the potential for property owners to experience socially unacceptable distress and loss in the event of a natural disaster. 2. minimise the fiscal risk to the Crown associated with private property damage in natural disasters 3. support the contribution of a well-functioning insurance industry to economic growth opportunities in New Zealand 4. support an efficient approach to the overall management of natural disaster risk and recovery ***Minimising owner distress and loss*** The coverage of EQC plus private insurance needs to meet post-disaster community expectations of support. If not, there will likely be public pressure on the government to expand coverage or provide other assistance after a catastrophe. It is a difficult judgment as to what level and type of losses are likely to prove socially unacceptable. Options that do not result in high levels of insurance for residential buildings,

both nationally and in higher-risk areas, should be rejected as inadequately managing the political-economy risks the scheme is intended to address.

The current $100,000 (excluding GST) per dwelling monetary cap achieved this goal in Canterbury by supporting high levels of homeowner catastrophe insurance. However, we do not know if the current cap will continue to achieve this goal in light of insurer supply responses to the Canterbury earthquakes, including a shift from full-replacement to sum-insured cover, the approximate doubling of premiums since early 2011, and the increasingly granular pricing of cover (higher in riskier areas). Therefore, a key decision is how to best balance future policy risks from a cap that is too low against the fiscal risks of the scheme.

Community pricing (applying the same premium rate nation-wide) is a key feature of the EQC scheme that helps minimise socially unacceptable loss and cannot be matched by private markets. This keeps cover affordable to homeowners in higher-risk areas, avoiding the pressure on fiscal accounts that would flow from lower rates of insurance in those areas.

Minimising Crown fiscal risk

We consider that fiscal risk is minimised when the EQC scheme provides and charges appropriately for sufficient EQC cover to support sustainably high take-up rates of private catastrophe insurance by homeowners both nationally, and in higher-risk areas such as Wellington.

As the EQC cap increases, it converts implicit Crown liabilities and privately insured risk into explicit Crown liabilities that can be charged for and actively managed.

Reforms of the EQC scheme have the potential to shed fiscal risks where the resulting risk transfer does not create socially unacceptable distress and loss. The 1993 reforms, which removed EQC from all non-residential disaster insurance, proved a success in that regard. Risk was transferred to owners and private insurers and has not returned to the Crown.

Supporting insurance's contribution to growth

In this context, insurance supports long-run growth performance by providing homeowners and communities the resources to recover following major natural disasters. This in turn is shaped by the supply and demand characteristics of residential property insurance.

Supply characteristics of private catastrophe insurance

For a given EQC scheme, the sharing of risk between insurers and homeowners depends on homeowners' risk appetite and insurance market conditions. Prior to the Canterbury earthquake sequence, the EQC cap of $100,000 (excluding GST) was enough to preserve the industry practice of all-perils (no exclusions) top-up cover. A central, but currently unanswerable, question is what level of cap will be required to keep disaster top-up cover ubiquitous in private insurance contracts in the face of changing market conditions, particularly more granular pricing[1]. This is likely to increase markedly the price of top-up cover in higher-risk areas.

Demand characteristics of residential catastrophe insurance

A recent estimate of the impact of changes in the EQC residential premium rate on demand for residential insurance suggests that a 5 cent increase in the rate would over a period of years lead to an additional 5,400 of dwellings (out of a total of 1.8 million, or 0.3 per cent) not

1 Granular pricing means differentially pricing the risk by area or other criteria (for example, by specific type or age of housing).

being covered by building insurance, adding to the estimated 200,000 existing uninsured dwellings.

While the effect of a higher premium rate on demand for EQC disaster insurance is relatively small, the expected shift of private insurers to more granular pricing, suggests that EQC cover should continue to be community-rated and that, given other changes in the insurance market, an increase in the EQC monetary cap may be necessary to keep private top-up cover affordable and attractive to the great majority of homeowners in high-risk areas.

For these reasons, we think that the EQC scheme contributes significantly to New Zealand's high rates of residential catastrophe insurance.

Support disaster recovery

Scaling and shaping the EQC scheme to focus on the government's core objectives, so the government takes on risk only to the extent needed to support those objectives, help ensure that risks are appropriately distributed among the Crown, householders and insurers.

Additional considerations in selecting options inclusion in an early EQC Bill

These objectives provide useful strategic guidance in assessing reform options. In addition, the primary considerations that determined whether amendments should proceed ahead of the findings of the anticipated inquiry into EQC and its claims management processes were that the amendments:

- would substantially improve the operation of the EQC Act by simplifying and speeding up claims handling – particularly when dealing with a large-scale natural disaster.
- are self-contained and would not unduly change the overall legislative scheme, or its relationship with private cover, while the inquiry is underway.
- are likely, based on Review feedback and other feedback, to be well-supported by private insurers and other stakeholders.
- would resolve issues with the EQC Act that have previously been identified by the Ombudsman and the Canterbury Earthquakes Royal Commission.

These criteria are complementary and mutually supportive. They did not require trade-offs.

3.3 What other options have been ruled out of scope, or not considered, and why?

The experiences of implementing the EQC Act for almost 25 years and during the recent series of large-scale events have highlighted a need to update and improve some of the EQC scheme design and operational requirements. The EQC Legislative Review process, including public consultation in 2015, identified several substantive issues with current EQC Act provisions and a larger number of minor, but desirable technical refinement opportunities.

Ministers considered the full range of amendment options arising from the Review and determined, based on the criteria outlined above, that only the four proposed changes should proceed ahead of the findings of an inquiry into EQC and its claims management processes. All other amendment options have been deferred for further consideration once the findings from that inquiry are known.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

	No action	Increase monetary cap	Exit contents cover	Extend claim time	Clarify information sharing
Improve operation	**0**	**+** reduces somewhat the number of overcap claims and scope for EQC/insurer 'friction'	**++** enables EQC to focus on its core housing role	**++** much fairer on claimants who do not identify damage within 3 months	**+** increases info availability and removes room for debate on privacy grounds
Self contained	**0**	**++** a simple increase in value	**++** simple removal of all provisions related to contents	**++** simple change to the conditions of EQC cover	**++** simple clarification of the status of claim-related information
Well-supported	**0**	**+** largely supported, but a few individual submitters prefer the status quo	**++** almost universal support	**++** almost universal support	**+** largely supported, but some concern from EQC about 'sensitive' owner objections
Resolve issues	**0**	**+** substantial improvement, but a higher increase is possible	**++** completely resolves issues	**++** completely resolves issues	**+** almost completely resolves issues
Overall assessment	**0**	**+** better than doing nothing/the status quo	**++** much better than doing nothing/the status quo	**++** much better than doing nothing/the status quo	**+** better than doing nothing/the status quo

Key:

++	much better than doing nothing/the status quo
+	better than doing nothing/the status quo
0	about the same as doing nothing/the status quo
-	worse than doing nothing/the status quo
- -	much worse than doing nothing/the status quo

Increasing the monetary cap on EQC building cover

The policy aim of having a monetary cap on EQC cover is to provide just enough EQC cover to result in high take-up rates, on a sustainable basis, of private catastrophe insurance by homeowners in high-risk areas.

A cap that is too low is more damaging than a cap that is too high. A cap that is too high simply misallocates some risk away from insurers to EQC/the Crown, but continues to price the risk. On the other hand, a cap that is too low has real-world effects on community resilience and recovery after a disaster; and exposes the Crown to political-economy pressures to provide further unplanned and unpriced support to homeowners.

EQC exiting contents cover

The Crown does not have a clear public policy interest in the provision of contents insurance. Contents losses are distressing to individuals, but do not create the type of widespread dislocation that motivates the Crown's concern in mitigating the impact of housing losses. Assessing the damage to contents is labour-intensive and best handled by private insurers, who have indicated they are happy to do so and are expected to provide the additional contents cover at a reasonable price.

Contents claims can be numerous and require disproportionate resources during the recovery phase. For example, about a quarter of EQC's Canterbury earthquake claims were contents claims.

Therefore the 2015 discussion document suggested that EQC should exit contents cover. Submissions on that document, including from home owners and private insurers, strongly supported that proposal.

Extending the time limit for EQC claims

The Ombudsman has observed, more than once, that the current three-month time limit for claims notification is not always reasonable. This is especially so in the aftermath of a major disaster. Absentee or displaced owners and owners with disabilities (e.g. poor eyesight) may genuinely not become aware of damage for many months, or longer, after the disaster. It may also take much longer than three months for the natural disaster damage to become apparent (e.g. earthquake damage to the building 'envelope' that may not immediately be visible, but water ingress over time reveals the existence of the damage).

There is significant value to EQC and insurers for operational planning and loss modelling in encouraging claimants to notify their claims for natural hazard loss within a reasonable timeframe. For that reason, we propose to retain the current provision for notification of loss of within three months of an event. In addition, we propose an amendment to the EQC Act to give EQC discretion to accept claims notified more than three months and less than two years after the natural disaster event.

There may be some difficulty for claimants and EQC to establish that a loss was related to a specific natural hazard, particularly if there is a significant passage of time between the loss occurring and the damage being notified. The Insurance Law Reform Act 1977 provides that a private insurer may decline to accept a claim where the insurer is prejudiced by the failure of the insured to make a timely claim. EQC would require similar discretion to decline claims where the delayed claim lodgement prejudices EQC's ability to properly assess the claim.

The 2015 discussion document proposed an absolute two-year time limit for EQC claim notifications. This is supported by private insurers, who consider that it is helpful to have this absolute limit to enable insurers and reinsurers to eventually ‘close the book’ on each disaster event.

Clarifying EQC’s authority to share and publish information

Amendments are proposed to clarify that EQC may share claim-related information to support effective implementation of the EQC Act, facilitate settlement of natural disaster claims by EQC and private insurers, and publish information about natural disaster damage to property covered by EQC where this is in the public interest, including to support natural disaster preparedness, response and recovery, prevent or lessen a threat to public health, public safety, or to the life or health of any person.

This clarification would address insurer and EQC concerns regarding potential privacy constraints on EQC’s ability to share claim-related information (including, where relevant, information about the claimant). It would also facilitate EQC sharing claims data with other agencies, or local government.

It is appropriate to align EQC’s information sharing ‘rights’ as an insurer under the EQC Act with relevant standard terms and conditions in private insurance contracts. This will remove any doubts about EQC’s, private insurers’ and their respective specialist advisors ability to share information about insurance contracts, claims and claimants – to help ensure timely and accurate claim settlements.

Also the wider public interest would be met by EQC publishing, or providing to local authorities, some claim-related information (e.g. EQC’s property damage assessments). This would, for example, enable real estate agents, prospective purchasers and insurers to formulate, or obtain answers to, questions about the damage and future insurability of damaged property.

EQC advise that in the past some owners of damaged buildings have strongly objected to damage data on their buildings being released. A clear legislative statement regarding the status of this information will confirm EQC’s ability to share it.

This proposal also addresses recommendation 94 of the Royal Commission of Inquiry into Building Failure caused by Canterbury Earthquakes that “…the Earthquake Commission Act 1993 should be amended to allow for disclosure of information that may affect personal safety…”. Addressing this recommendation is not urgent from a safety perspective as, following the 22 February 2011 earthquake, EQC implemented protocols and procedures to notify local authorities if EQC staff or contractors become aware of a serious safety hazard during their EQC work. However, given the status of Royal Commission recommendations, and the long-standing commitment to address this recommendation as part of the Review, we consider that the recommendation should be addressed at the first available legislative opportunity.

The Office of the Privacy Commissioner (OPC) has indicated that it has no concerns about an amendment to the EQC Act to enable disclosures by EQC to protect public safety. However, OPC also notes that such circumstances may now be covered by the “serious threat” exception under information privacy principle 11(f) of the Privacy Act. Parliament widened this exception in 2013 to ensure agencies could share information when it is necessary to prevent serious harm (i.e. after the Royal Commission’s recommendation).

Also, OPC share officials’ view is that there are likely to be purposes wider than public safety, where the privacy value in property damage information is low and sharing it is likely to be justified in the public interest. OPC encourage being as clear as possible on the scope of the intended purposes and the benefits expected from information sharing.

The amendments will clarify that EQC may share claim-related information (including, where relevant, information about the claimant) to support effective implementation of the EQC Act, facilitate settlement of natural disaster claims by EQC and private insurers, and publish or share information about natural disaster damage to property covered by EQC where this is in the public interest, including to:

- support natural disaster preparedness, response and recovery
- prevent or lessen a threat to public health, public safety, or to the life or health of any person
- make information about natural disaster damage to residential property publicly available (e.g. to enable real estate agents, prospective purchasers and insurers to readily access the information as part of their normal due diligence checks).

While this measure would improve the transparency of property damage that results in an EQC claim, there is no equivalent requirement for private insurer information. Accordingly, care will need to be taken to ensure that users know that information disclosed by EQC is not a complete or authoritative set of documentation regarding damage to a property. For example, EQC does not hold information about natural disaster damage to property that does not attract EQC cover, or property that is damaged by a cause that is not insured by EQC.

Consequences of not proceeding with these options

Not proceeding with the four proposed amendments would mean a delay in delivering the associated benefits. Those include:

- substantially improving the operation of the EQC Act by simplifying and speeding up claims handling – particularly when dealing with a large-scale natural disaster; and
- resolving issues with the EQC Act (time limits for claim notifications and information sharing) that have previously been identified by the Ombudsman and the Canterbury Earthquakes Royal Commission.

Financial implications

The table below provides a detailed assessment of the expected long-run costs of the proposed changes, including the potential impact of the changes on the costs arising from a Wellington earthquake. This information was initially included in the 2015 discussion document on the EQC Legislative Review and has been periodically updated by EQC and Treasury.

Over the short to medium term removing household contents from EQC cover and increasing the monetary cap on EQC building cover is forecast to increase EQC's premium cash receipt is expected to increase by between $70-80 million per annum from 2019/20 onwards. Increased premiums will be offset, in part, by an expected increase in the costs EQC incurs for its reinsurance as a result of the greater risk assumed in building cover.

EQC's expected average annual costs, and costs of a large Wellington event under the status quo, the proposed changes, and, for reference, a $200,000 cap on EQC building cover

	Expected Annual Loss			Expected Liability, Wellington Reference Event		
Option	**Status Quo**	**Proposed**	**$200k**	**Status Quo**	**Proposed**	**$200k**
Building Cap	**$100k**	**$150k**	**$200k**	**$100k**	**$150k**	**$200k**
EQC building claims	$279m	$329m	$367m	$4,870m	$5,401m	$5,679m
EQC contents claims	$26m	$0m	$0m	$659m	$0m	$0m
Total Claims	$305m	$329m	$367m	$5,529m	$5,401m	$5,679m
Change in claims costs compared to current scheme						
Change in expected claims costs	$0m	$24m	$62m	$0m	-$128m	$150m
Non-claims costs						
EQC annual operating costs	$58m	$58m	$58m	Non-claims costs of large events not modelled		
Net reinsurance costs	$84m	$98m	$106m			
Total EQC claims and non-claims costs	$447m	$485m	$531m			
Total change in EQC claims and non-claims costs						
Positive numbers are increases in modelled costs	**$0m**	**$38m**	**$84m**	**$0m**	**-$128m**	**$150m**

Source: EQC Minerva model and *Earthquake Commission: A Risk-based Premium Framework for EQCover*, Aon Benfield and Taylor Fry, November 2016

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?
The preferred option is to implement all four amendments as proposed. The analysis and assessment against criteria show that all the amendments will deliver an improvement over the status quo – in some cases a very significant improvement. The risks of proceeding with the amendments ahead of the inquiry findings are small and benefits to key stakeholders (in particular insurers and homeowners) substantially outweigh the risks. As a key criterion was a high level of stakeholder support, proceeding with the amendments is likely to be very well received. We anticipate that EQC's residual concerns about the detail of information sharing proposals will be addressed in the course of drafting the Bill and any remaining issues can be considered in the course of the Select Committee process.

5.2 Summary table of costs and benefits of the preferred approach

Costs, compared with status quo			
Affected parties	**Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks**	**Impact**	**Evidence certainty**
Regulated parties			
EQC	Potentially higher costs for dwelling damage (higher cap, steady state, annual average claims costs) more than offsets the savings from exiting contents insurance Potentially higher reinsurance premiums from higher total average costs to run scheme Potentially higher claims costs as claims between 3 months and 2 years after an event are no longer automatically declined. Potentially higher administration costs if EQC claims information is more readily accessible to parties other than insurers	+$38m (annual average) Medium Low Low	High High Medium Medium
Private insurance companies	Higher claims costs for contents damage	Low	High
Homeowners with fire insurance	Possibly higher premiums for private contents insurance (ongoing) Less land covered around the house	Medium Medium	High High
Regulators			
New Zealand Treasury	On-going monitoring of EQC	Low	High
Ministry of Business, Employment and Innovation	Monitoring private insurers (consumer protection) via the Insurance Act	Low	High
Reserve Bank of New Zealand	Monitoring the prudential side of private insurers, who should face less risk from building claims under these changes	Low	High
Wider government			
Parliamentary Counsel Office	Costs of drafting EQC Bill	Low	High

Other parties			
Total monetised cost		+$38m (p.a.)	Medium
Non-monetised costs		Low - Medium	Medium – High
Benefits, compared with status quo			
Affected parties	**Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks**	**Impact**	**Evidence certainty**
Regulated parties			
EQC	Improved information sharing with insurers potentially reduces claims handling costs and improves claim processing times	Medium	Medium
Private insurance companies	Potentially lower costs for dwelling damage (higher EQC dwelling cap) More premium income for contents cover Improved information sharing with EQC potentially reduces claims handling costs and improves claim processing times	Low Medium Medium	High High Medium
Homeowners with fire insurance	Smoother claims experience in dealing with EQC and private insurer	Medium	Medium
Regulators			
New Zealand Treasury			
Ministry of Business, Employment and Innovation	Changes should mean a better functioning private insurance sector	Low	Medium
Reserve Bank of New Zealand			
Wider government			
Local government	Potentially better access to EQC claims information of interest to local government	Medium	Medium
Total monetised cost		---	---
Non-monetised costs		Low to Medium	Medium to High

5.3 What other impacts is this approach likely to have?

There are no other significant impacts or risks associated with the proposals.

As the terms of reference for the inquiry are yet to be finalised, it is possible that one or more of the recommended amendments in this report could ultimately be inconsistent with a recommendation from the inquiry. However, we consider that risk to be very low as the proposals have been heavily consulted on, have broad support, and are consistent with a very broad range of future final design choices for EQC. If an inconsistency did arise, the anticipated post-inquiry EQC Amendment Bill would provide an opportunity to resolve the issue.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

As outlined below, the preferred option of proceeding with the amendments is compatible with 'Expectations for the design of regulatory systems', because:

- The objectives of the proposals are clear (as expressed in assessment criteria).
- The proposals seek to achieve those objectives in a least cost way, and with the least adverse impact on market competition, property rights, and individual autonomy and responsibility.
- The Crown Entities Act provides EQC with the flexibility and governance arrangements it needs to meet the new requirements, while producing predictable and consistent outcomes for regulated parties across time and place
- The proposals are proportionate, fair and equitable in the way they treat regulated parties and align with existing requirements (they do not significantly affect the current overall scheme design or purpose).
- The proposals remain consistent with relevant international standards and practices (noting that the scheme is restricted to residential and does not cover commercial property)
- Conforms to established legal and constitutional principles and supports compliance with New Zealand's international and Treaty of Waitangi obligations.
- Drafting will ensure that the EQC Act sets out legal obligations and regulator expectations and practices in ways that are easy to find, easy to navigate, and clear and easy to understand
- Has some scope to evolve if there are changes in the construction and insurance markets.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?
Removing EQC contents cover and increasing the amount of the cap for EQC building cover will require EQC and private insurers to make necessary system, process and marketing (customer information) adjustments. The assumption of additional risk by EQC arising from the increase in the building cap will also have potential implications on the renewal of EQC's reinsurance contracts, which currently renew on a 1 June basis. The proposed amendments will therefore need to provide for a transition period. Following Treasury consultation with EQC and private insurers, an effective date of 1 July 2019 was chosen for EQC exiting contents cover and introducing the $150,000 monetary cap on building cover. This date is chosen to align with the expected implementation date for changes to Fire and Emergency New Zealand (FENZ) levies collected and paid by insurers. Insurers advise that implementation on this relatively short timeframe can only happen if the date of the EQC and FENZ changes is the same. This would enable insurers' contracts with customers and reinsurers, system changes, customer communications and education to address both changes at once. Therefore insurers consider that if the FENZ 1 July 2019 date shifts, the EQC date should also shift to match any new FENZ date. The new arrangements would apply to any new insurance contract and all renewals from 1 July 2019. This means that insurance contracts established before that date would move to the new EQC premium and cover arrangements upon renewal of the policies (i.e. over the following 12 months). The extension of EQC claim notification limits and information sharing/publication amendments take effect immediately upon enactment. These changes can be implemented more quickly as they do not share the contractual, systems and communication complexities of the changes to EQC building and contents cover. The changes will be given effect through an EQC Amendment Bill. Once implemented, EQC's Board will be responsible for the ongoing operation and enforcement of the new provisions. The private insurance sector is monitored on the supply side by the Reserve Bank and on the demand side by the Ministry of Business, Innovation and Employment. The Treasury administers the EQC Act.

6.2 What are the implementation risks?
No significant implementation risks have been identified beyond achieving the relatively challenging timeframe.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
We have not identified a requirement for monitoring or new data collection beyond that already collected. Substantial data collections and effective monitoring and reporting arrangements already apply to the EQC scheme. In addition to the usual Crown monitoring requirements, EQC is subject to close scrutiny by international reinsurers as well as claimants and their advisors.

7.2 When and how will the new arrangements be reviewed?
The arrangements will be reviewed along with the findings and recommendations from the inquiry into EQC and its claims handling. If there are any issues or concerns, there will be an opportunity to address them in the further, more substantive Amendment Bill we anticipate will follow the inquiry.