November 2020

Policies for a Responsive and Sustainable Insurance Sector to Safeguard New Zealand

Insurance Council of New Zealand

This document outlines ICNZ's policy positions on key issues across five themes. It supports the infographic titled 'Policies to help Safeguard NZ'.

ICNZ first released this document one year ago. Since then COVID-19 has reshaped the world. We have updated and revised our recommendations in light of these changes and new challenges, while recognising many pre-existing issues remain relevant.

CONTENTS

INTRODUCTION

General insurance plays a key role in protecting individuals, families, businesses and in turn communities and New Zealand as a whole from a range of risks.[1] The peace of mind this ability to transfer risks provides, gives people and businesses confidence to invest, and to undertake activities.

New Zealand is highly vulnerable to natural disasters. It was ranked as the second riskiest country in the world in a major international study released by Lloyd's of London in 2018, primarily due to seismic risks.[2] Climate change will raise the overall risk profile by increasing the intensity and/or the frequency of weather-related natural disaster events. The effect of these will be more acute given the extent and growing proportion of people living and working in large urban areas, most of which are coastal or next to rivers. These risks are increasingly being reflected in insurance premiums.

New Zealand's people and organisations also remain vulnerable to longstanding risks such as fire and theft, and to emerging risks such as cyber-threats. COVID-19 has also demonstrated the potential for pandemics to have massive and rapid global impacts on societies and economies.

As a risky country, it is critically important our assets are well-insured. That means not only insuring our assets, but making sure coverage levels are sufficient to replace them if necessary. Fortunately, New Zealanders understand the value of insurance and demonstrate this in consistently high levels of insurance uptake.[3] It is must be remembered though that insurance is not a substitute for risk management, nor does it reduce risk, it simply transfers the risk for a price. The transfer of risk

---

[1] General insurance includes various types of personal and commercial insurance such as property (e.g. car, home and contents, marine), business interruption, liability insurances etc. It does not include life insurance or health insurance.

[2] A world at risk, Closing the insurance gap, Lloyds, October 2018, https://www.lloyds.com/~/media/files/news-and-insight/risk-insight/2018/underinsurance/lloyds_underinsurance-report_final.pdf. It was the second report of its kind, the first of which was published in 2012, and looks at non-life underinsurance and insurance penetration data for 43 countries.

[3] New Zealand has the fourth highest rate of insurance penetration globally based on the Lloyds study cited above.

becomes more expensive as the risk gets higher. Accordingly, it can become unaffordable or unavailable if the risk gets too high, which is why it is critical we better manage our risks and improve our resilience.

ICNZ's members underwrite about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, business interruption and directors and officers liability insurance). Our members pay out around $2.5 billion to their customers annually in response to approximately 1.1 million claims.

The regulatory environment applying to general insurance in New Zealand is currently undergoing significant change. The policy and regulatory changes being pursued are being driven by responses to the Canterbury and Kaikōura earthquakes, due to concerns with consumer outcomes emanating largely from the 2018 Australian Royal Commission into Financial Services and to address legal frameworks due for review or in need of updating.

In our view, it is critical that changes to legislation and regulation are carefully considered. Any additional requirements should be proportionate to the matters they seek to address, evidence based and justified based upon a thorough cost-benefit analysis. Changes should avoid unintended consequences, moral hazards and unnecessary duplication and inefficiency. Effort should also be taken to ensure they are well co-ordinated, consistent and support the need for predictability, certainty and regulator transparency within the general insurance market. This will be achieved if there is a genuine commitment to open-minded dialogue with stakeholders from the early stages of the policy development process.

These policy and regulatory processes were all started before COVID-19 emerged and the effects of it on these need to be carefully considered, and appropriate changes made. Notwithstanding the disruption caused by COVID-19, it also remains critically important to take steps to improve New Zealand's resilience and to put in place a regulatory framework that encourages a competitive and dynamic insurance industry into the future.

In this paper ICNZ sets out policies for a responsive and sustainable general insurance industry to safeguard New Zealand, across five key themes:

- efficiently managing New Zealand's risks
- improving resilience in New Zealand
- meeting customer needs
- maintaining the affordability of insurance, and
- financial stability.

Efficiently managing New Zealand's risks

Insurance transfers risks for people and businesses - providing protection when they suffer loss, encouraging innovation and enabling risk taking. The price for taking on that risk reflects the risk, so policyholders pay a fair premium according to the risk of loss they bring to the pool of premiums. Accurate pricing of risk is fundamental to the sustainable provision of insurance. It reflects steps taken to reduce risk by insureds and incentivises further risk reduction.

The regulatory environment needs to incentivise appropriate risk management and support the provision of insurance.

Ensure level of EQC cover supports the provision of private insurance and appropriate risk signals

New Zealand remains the envy of the world with a very low protection gap[4] for residential property. The existence and design of the EQC scheme, and access to global reinsurers, both underpin the provision of private insurance cover in New Zealand for natural disaster related losses for residential buildings.

EQC taking the first $150,000 of residential property damage in relevant natural disasters[5] reduces private insurers' exposure to such events and consequentially enable them to offer 'all perils' insurance cover to homeowners.[6] This level of EQC cover provides a degree of risk sharing across New Zealand but also means that the prices for customers meaningfully reflect varying natural disaster risks applying in different areas, which incentivises risk management and limits cross-subsidisation. It also helps to keep the Government's direct exposure to large natural disasters manageable.

In making any changes to increase the EQC cover it is important to remember that this would not change the underlying risk, so it is not a sustainable solution. The Government also needs to ensure that any increase is not set so high that:

- the level of cross subsidisation means that the risk signal to customers living in higher risk areas is overly muted, discouraging prudent risk management and investment in resiliency improvements and/or incentivising conduct which constitutes a moral hazard (e.g. the conversion of poor-quality buildings to residential)
- affordability issues arise for those outside high risk areas (who due to EQC's community rating approach across the country, will effectively be subsidising those within them)
- the taxpayer takes on exposures that are increasingly difficult to manage and fund
- avoids raising expectations that similar approaches would be taken to address climate risks, which would encourage living in high risk areas
- distortions are created between commercial and residential property, and

[4] The 'insurance protection gap', otherwise referred to as 'underinsurance', is the difference between the amount of insurance coverage that is economically beneficial and what is purchased. It can also be thought of as the difference between what is paid out by insurance and the total cost of an incident or disaster.
[5] Earthquake, natural landslip, volcanic eruption, hydrothermal activity and tsunami.
[6] All perils insurance policy is an insurance policy that covers all risks unless explicitly excluded in the policy (e.g. acts of war). The opposite to an all perils insurance policy is a define events insurance policy that covers only those perils that are explicitly mentioned. Such policies are often cheaper than all perils policies as they do not cover everything and require the customer to understand what perils they are exposed to and what is covered by the policy.

- it discourages the provision by private insurers of residential property insurance in New Zealand and/or private insurers from having a role in claims management on EQC's behalf.

All of these risks have the potential to adversely impact customers, reduce insurance penetration and thereby increase the exposure of people, and ultimately Government, to adverse events. A significantly increased cap would also be a totally disproportionate response to an unquantified issue and again would not reduce the underlying risk.

In this context it is also important to note that shifting the natural disaster exposure for residential properties from private insurers to EQC will not lead to more insurance capacity becoming available because private insurers and EQC are ultimately reinsured by the same reinsurance market (who ultimately hold the vast majority of the underlying risk). Additionally, such a shift may ultimately be more expensive because as reinsurers are likely to apply higher loading (compared to private insurers' existing reinsurance programmes) to reflect the homogenous and community rated nature of EQC's portfolio. Private insurers will also need to take account of their remaining long tail natural disaster risk. It is likely that these added costs will need to be passed through to customers raising further affordability concerns.

An evidenced based and proportionate approach is required in respect of this matter, based on a clearly identified and quantified problem, and an established connection between that problem and the outcome sought to be achieved, avoiding unintended consequences and unfair outcomes.[7] A thorough analysis and understanding of the underlying insurance market and the impact of any changes to EQC cover is also required in this regard.

Central and local government responses to natural disaster and climate change risks must support the provision of insurance and risk reduction

Good development choices are fundamental to ensuring resilience and future insurability. The *Resource Management Act 1991* (RMA) and the *Building Act 2004* are critical laws underpinning property development choices in New Zealand.

While these legal frameworks take some account of the potential impacts of natural disasters, careful reform and implementation of both is required to take full account of natural disaster and climate change related risks. There is also a need for stronger alignment between the RMA regime (including the New Zealand Coastal Policy Statement) and the Building Act and any future National Policy Statement for Natural Hazards, in particularly a need for consistency between timeframes and the assessment of extreme events and climate change effects.

The Building Act states a building consent (50-year default timeframe) must be granted for building work on land subject to a natural hazard if the work will not worsen the situation and the land and building will be protected. However, once a housing or other building development has been permitted, that land use will generally extend for a period well beyond 50 years, over which the risks facing the building may change, potentially significantly, due to climate change for example. An outlook over a longer period (such as 100 years) is required to ensure that long term risks are properly considered. Another shortcoming is that the Building Act definition of 'natural hazard' is limited and

[7] For example, if it turns out that the Wellington market is the focus area, what about other high seismic risks areas in New Zealand or properties in flood plains, at risk due to coastal erosion or other climate change related risks?

excludes fault lines, tsunami and geothermal activity. It is necessary to revise this to include the full suite of natural hazards to ensure that all natural hazard risks associated with new building work are properly considered.

With any reform of the RMA, it is important that the mechanisms introduced in 2017 for managing natural hazard risks are not eroded. Steps should also be put in place to ensure the regime is applied rigorously and consistently, and that in making planning and consenting decisions councils take a prudent approach. This has proved challenging in some cases and councils will need to be sufficiently resourced and supported by wider policy settings to make sure this happens in practice. As discussed further below it is particularly important to stop new developments in areas vulnerable to flooding or sea level rise.

Continue research enabling people to better understand their natural hazard risks and respond to them

It is critical that decision making by people, businesses and local and central government is underpinned by good quality information on natural hazard risks at both a community and individual property level. Significant natural hazard risks already exist, and climate change will affect various locations and properties in different ways. Some will face changes over time in the frequency of certain weather-related events (e.g. storms, droughts). Others will face changes in the nature or extent of such events, and for properties exposed to sea level rise the increased risks and inexorable impacts of this will be driven by the speed and extent of sea level rise. The need for such risk information is not limited to climate change, but it is a crucial dimension of it.

It should be a goal to ensure that all property owners understand the specific natural disaster risks facing their properties (e.g. from flooding, earthquake, landslip etc), both now and in the future. ICNZ supports publicly funded research being undertaken by GNS, NIWA and LINZ in this regard. This research needs to continue, and steps need to be taken, to make the information is publicly available at an individual property and at more aggregated level. This will help to inform sensible decision making and investment and motivate action on resilience by people, businesses and communities.

Promote sharing of aggregated data on cyber incidents and encourage uptake of cyber insurance to help

Technology is at the heart of almost every business today and so network security and data protection are key risk issues for all businesses. CERT NZ received a total of 3,102 incident reports in Q1 and Q2 2020 equating to $7.8 million in financial losses (including increases in phishing and credential harvesting, scams and fraud and online trading scams over these periods).[8] Notwithstanding this, it would appear that breaches are still being under-reported and some businesses don't even know they have been breached. Recent major incidents here and overseas have highlighted how the growing reliance on digital technologies comes with major digital security and privacy protection risks for businesses and other entities. Large numbers of people working from home, as a consequence of COVID-19, have demonstrated the opportunities of remote working and drawn attention to the additional risks associated with it. To that end, CERT NZ reported a 73% increase in incidents reported from Q1 and Q2 2020, with 820 incidents reported in April alone, which is the greatest number of reports received in any month since they launched in April 2017.

[8] https://www.cert.govt.nz/assets/Uploads/Quarterly-report/2020-1st-half/cert-nz-q1-and-q2-2020-quarterly-report.pdf.

Cyber Liability insurance policies assist businesses by responding to both their own losses and their liability to others in connection with a cyber security breach or attack. Policies can provide services to help businesses proactively manage cyber risks as well as promptly responding to, and recovering from, a cyber event, responding to third party claims and regulators, and protecting it from financial loss and loss of reputation. When businesses apply for cover they are asked about what steps they are taking to mitigate their cyber risk, prompting them to think about their resilience and what would happen should something seriously go wrong (e.g. their entire computer and/or telecommunication systems are out of operation for a week or more).

Currently, the availability and the pricing of Cyber Liability insurance is hamstrung by New Zealanders apathy and a lack of data about the true costs of cyber breaches and attacks in New Zealand (including their severity and frequency). Effective and efficient sharing of data on cyber incidents is critical to support better underwriting of cyber risk by private insurers. A New Zealand register of data breaches, using aggregated, anonymised data, would help businesses and insurers get a better grasp on the scale and issues being experienced.

Progress a comprehensive review of the Unit Title Act and address issues with fee simple multi-unit buildings

Prior to 2017 the Government started work to reform the Unit Titles Act 2010 (**UTA**). ICNZ submitted on this in early 2017, with a focus on improving body corporate governance and issues encountered with multi-unit buildings (**MUBs**) during the Canterbury recovery. Responsibility for the UTA was passed to the newly created Ministry of Housing and Urban Development (**HUD**) in 2018. There are a number of tensions in the current UTA that also need addressing - these issues should be addressed comprehensively rather than in a piecemeal fashion.

One issue we have raised for almost a decade is the requirement under the UTA for there to be consensus among co-owners as to the remediation approach following a loss. This proved a significant stumbling block to recovery in Christchurch for MUBs and cross-lease situations, some of which were cash-settled and not rebuilt.

Another issue with the UTA is the blunt requirement for body corporates to fully insure. This limits the ability of commercial building owners to flexibly manage some of their risk through retention. Relaxing this requirement where resilience work has been undertaken would incentivise construction of highly resilient, base-isolated buildings. We also understand that some body corporates are non-compliant with this requirement and that the lack of earthquake insurance has prevented some from being able to sell, leaving them “trapped”. By way of contrast, in California lenders loan on commercial property if it meets a certain level of structural resilience. If this level is not met, insurance must be obtained. Lenders on property developments also wish to have their loans secured against insured properties, so accounting for resiliency work would have an added benefit in that respect too.

A related issue is the recent trend for new MUBs to be structured as separate fee simple titles rather than as unit titles under a body corporate structure under the UTA. Such developments are sold on the basis that this will reduce costs and complications for the owner. However, the opposite can be true. Without body corporate/unit title arrangements in place, serious issues can arise with property maintenance and responsibility for shared spaces (stair well, roof, access points etc) and common property (driveways, fences/walls, BBQ area, utility building etc), or where a loss affecting multiple units, shared spaces and/or common property occurs. These also present barriers for insurers and this approach can affect affordability for customers and result in a poor claims experience, especially where uninsured owners are involved. Buyers are often not aware of these issues.

Improving resilience in New Zealand

New Zealand is one of the most vulnerable countries in the world to the impact of natural disasters. When they strike they can take a heavy social and economic toll. We cannot control the forces of nature, but we can reduce their impact significantly by building our capacity to withstand and recover from natural disasters.

Improving resilience is critical to the future of the economy and society and helps to keep risk transfer to insurers affordable. Government funding and supporting risk reduction through policy, research funding, collaboration with local government and other entities, and public communications is fundamental to putting in place a resilient society. Every dollar spent on reducing risk saves many more after a disaster - without even including the social cost and dislocation.

Incorporate building resilience into the Building Code

The major earthquakes in the last decade in Canterbury and Kaikōura have demonstrated that New Zealand's buildings are not as resilient as was thought. Building codes and practices have ensured that lives are generally saved but buildings, even modern buildings, have essentially been lost and written off. This is very inefficient and damaging to the functioning of a city after an event and the likelihood of this scale of losses is also being reflected in the availability and pricing of insurance. A step-change in building resilience is required that goes well beyond the current focus on strengthening what are considered 'earthquake prone-buildings'[9], to constructing and maintaining highly resilient buildings that can remain useable after even a major event.

One notable effect of the 2016 Kaikōura earthquake was the total loss and demolition of a number of modern multi-storey buildings in Wellington, some of which exceeded the seismic resilience requirements in the NBS. New Zealand has always prided itself on the seismic resilience of its buildings, so to have lost so many new buildings shows that something is fundamentally wrong with our current building standards. While they appropriately address the importance of preserving the lives of those within them during an earthquake, they clearly do not adequately address building resilience – the ability to withstand a big quake with limited damage and ability to be used again.

It has become apparent that we need to use low-damage designs that are much more resilient to larger earthquakes, for example buildings utilising base isolation. Such designs are commonly utilised in some other earthquake prone parts of the world, and to some extent here already. While highly resilient buildings can be more costly, however, the increase is often modest when the advantages are factored into the lifecycle cost of the building (including insurance costs), business interruption and cost of rebuilding in the event the building has to be written off.

Currently, a % of NBS rating doesn't say anything about the damage that a building could be expected to sustain in an earthquake, whether it will be able to be used again or the potential impacts to/from adjacent buildings. The current focus of the Building Code on life-safety needs to be complemented by requirements that provide for buildings that are less prone to serious earthquake damage and more repairable when they do. Including in the Building Code an objective measurement of, and rigorous requirements for, resilience of buildings would enable owners, occupants and insurers to understand

[9] Those with a New Building Standard (NBS) of less than 34 percent.

and price the exposure of buildings to major earthquakes. This will ensure that in future New Zealand's buildings are both more resilient and more insurable.

Improve regulation of building sector and products

There is also a wider need to improve the regulation and oversight of the building sector beyond the specific issue of structural earthquake resistance. Fundamentally this is about ensuring that a range of risks to people and property are minimised, and facilitating affordable insurance into the future. Beyond improving the overarching regulation of the building sector generally to improve quality, insurers see there is a need for action in three specific areas:

- non-compliance with passive fire requirements
- high rise buildings with attached aluminium composite panelling (ACP), and
- non-compliance with non-structural seismic restraints.

New Zealand has a systemic problem with non-compliance of passive fire systems.[10] There have been problems with achieving compliant passive fire protection in many new building projects and also in the maintenance of that compliance over time during the work and refurbishments that occur over the lifecycle of a building. Correctly designed, coordinated, installed and signed-off passive fire systems are critical to protecting life and reducing economic loss, as well as providing trust and confidence in the construction industry. Currently, however, there is no requirement for installers to have any qualifications which is a critical gap given the importance of getting passive fire installations right. Installers of passive fire related systems need to be licensed, with the licence requiring them to have had the appropriate training.

Another fire risk issue is flammable cladding, particularly cladding made of aluminium composite panels (ACPs). Some ACPs pose a high fire risk. If one panel of ACP cladding catches fire, it can drive the fire up the building, quickly setting alight the floors above where the fire started. In one case overseas, an entire high-rise apartment building caught fire because a smouldering cigarette on a balcony had set alight a single ACP.

Installation of new flammable ACP cladding or other flammable claddings should be banned. Steps should also be taken to actively manage and reduce the risk posed by the existing use of such claddings on buildings. Not all ACPs are flammable and they can be tested to establish their flammability. If they turn out to be highly flammable, they should be replaced as soon as possible. Taking these steps is much more cost effective than repairing a building after a major fire and it is safer for its occupants.

Beyond structural seismic issues, it is also important that internal fittings and fixtures are safe and secure. Following the Canterbury earthquakes, it was discovered that a significant proportion of the damage costs for commercial buildings in Christchurch was attributed to the failure of non-structural elements of buildings such as ceilings and services housed above ceilings. In the Cook Strait earthquakes of 2013 and the 2016 Kaikōura earthquake some buildings in Wellington also suffered significant non–structural damage. With a significant proportion of a building's value comprising architectural and building service components, significant financial losses can occur if they fail and the buildings is rendered unusable for long periods.

[10] Passive fire protection refers to the use of construction elements within a building that are designed to prevent or delay the spread of fire and/or smoke to different parts of the building. Passive fire protection is one of the methods used to protect buildings and people from fire. Other methods that may also be used include active fire protection such as fire sprinklers and alarms.

While New Zealand Standards[11] exist for the design of seismic retention systems, and bracing for non-structural mechanical systems in buildings, compliance with these is lacking. Together with many engineers, building owners and tenants, insurers have learnt from recent earthquake damage that there appears to have been very little in the way of compliance with these standards in buildings that have needed to be repaired. Steps need to be taken by the construction and building maintenance industry and regulators to make sure standards are being adhered to. Building owners are sometimes unaware of these requirements or they simply choose to ignore them because of the perceived cost. Some education is required in this regard

Stop developments in areas vulnerable to flooding or sea level rise

Developers should take a long view about where to locate developments. However, with the demand for housing high, a shorter-term view may prevail if land is relatively cheap. It is often cheap for a good reason – it is of poor quality or prone to natural hazards like flooding.

It is critical to avoid investing in new property and supporting infrastructure on land that is vulnerable to flooding, or that will be in future due to climatic changes and/or sea level rise. Where the risks become too high, insurance will signal this through higher prices, reduced cover or unavailability. If the property value or the property itself is at risk, pressure then falls on government to invest in protection and/or to compensate owners for retreat. Whether investing in protection will be practical or affordable will depend on the circumstances, but in some cases it will not be.

To avoid these adverse outcomes local authorities need to preclude or deny consent applications for new developments where taking the long view (50 to 100 years) shows risks from hazards will increase too much. Some local authorities should already be applauded for tackling the issue by reviewing their district plans and signalling the need to avoid or retreat from vulnerable areas.

Central government needs to amend legal frameworks (RMA and the *Local Government Act 2002*) to give councils support to do the right things in land-use planning and infrastructure investment.

ICNZ will continue its long-standing engagement with local and central government to encourage adaptation measures to reduce risks particularly with respect to flood, sea-level rise and seismic events. We also support recommendations from the Randerson-led Report[12] to introduce a Managed Retreat and Climate Change Adaptation Act addressing current complexities faced by local and national government regarding climate change risks and managed retreat. We are also supportive of the establishment of the proposed adaptation fund and the introduction of powers to modify existing land uses, acquire land and impose targeted rates, in connection with climate change impacts.

Prioritise climate change adaptation policy and investment

Climate change is one of the most significant challenges for the world and to New Zealand's future economic, social and environmental wellbeing. The Paris Agreement of 2015 requires action on both mitigation (greenhouse gas emission reduction) and climate change adaptation (risk reduction). ICNZ considers there should be an equal focus on both issues.

---

[11] NZS 4219:2009 Seismic performance of engineering systems in buildings, and AS/NZS 2785:2000 Suspended ceilings - Design and installation.
[12] New Directions for Resource Management in New Zealand, 29 July 2020, https://www.mfe.govt.nz/publications/rma/new-directions-resource-management-new-zealand.

Failure to give due weight to adaptation could potentially lead to significant economic loss or disruption, which in turn could thwart efforts to achieve emissions targets. By the same token, a failure to achieve emissions reductions targets may necessitate more urgent and drastic measures that could potentially adversely impact the ability to invest in required adaptation. It is important to remember that mitigation is being addressed because of the profoundly negative impacts of further climate change.

Regardless of New Zealand's and the World's success in achieving greenhouse gas emissions reductions, which it must do, we face significant adaptation challenges. As greenhouse gas emissions are cumulative, some adverse consequences from climate change are already set, such as an amount of sea-level rise or more frequent or extreme weather events. The ultimate severity of the economic, social and environmental impact will depend on how much the climate changes, but also on society's adaptive capacity and willingness to adapt to that change. The inevitable adverse impacts of climate change demand a long-term systematic, stable pathway to reduce them via adaptation.

It is critical to reduce the risks from climate change because if the risks become too great, insurance will become unaffordable or unavailable. The consequences of this can be severe so taking steps earlier, when they are often less costly, is vital to enable risks to continue to be transferred through insurance. As well as taking proactive steps, the simplest action is to stop investing in new assets and infrastructure that are inherently vulnerable to climate change risks, particularly given the value of vulnerable assets/infrastructure is already high. Unless risks are reduced, insurance may not be affordable or available and banks may shorten the terms of loans for at risk property, with a consequential fall in asset prices.

Off the back of the recently released national climate change risk assessment,[13] the Zero Carbon legislation provides for a national adaptation plan to be developed by the Government and reviewed by the Climate Change Commission. This is an appropriate approach. The development of a national plan for climate change risk reduction is critical to ensuring resilience is maintained, communities can continue to prosper, and the long-term costs of climate change are minimised. It will be important for a range of central and local government agencies and stakeholders, including the general insurance industry, to be involved in the development and review of the plan. Executing the plan will require dedicated policy work and the allocation of appropriate resources.

Being a resilient country is not just about the economic costs and protecting physical assets. Resilience is the result of cumulative action to strengthen our human, social and natural capital too. All are inter-linked and must respond to the pervasive impacts of climate change.

[13] https://www.mfe.govt.nz/climate-change/assessing-climate-change-risk (August 2020).

Meeting customer needs

Regulation needs to maintain a high level of consumer protection while allowing insurers to react, adapt and innovate to meet evolving consumer expectations.

There will always need to be a layer of formal regulation established by government in the public interest, but it can be made more effective when it is supported by robust self-regulation at the industry level.

ICNZ knows trust is at the heart of the relationship between insurers and their customers. That is why we take the view that the Fair Insurance Code, which sets the standards for ICNZ members' dealings with their customers, must set the bar high. The Code specifies the responsibilities of insurers and customers and details disclosure requirements, communication timelines, and complaint processes.

Enable insurers to support their customers and the economic recovery in the aftermath of COVID-19

New Zealand insurers are committed to supporting their customers. In response to COVID-19, ICNZ's members activated their business contingency plans in late March to protect their business and staff – while ensuring they could maintain their level of service to their customers during the Level 4 lockdown. Insurers agreed 10 Core insurance Principles for COVID-19 and each developed and deployed dedicated teams and processes to ensure they continued to assist with claims, sales and support and payment queries during the lockdown phases. Insurers also put in place arrangements to assist customers facing vulnerability including financial hardship.

While the initial lockdown phase has passed, difficult economic times will continue to put pressure on families and businesses finances. Nonetheless it remains critical that customers maintain insurance to keep their assets covered, protecting them against financial shocks and meet the obligations of mortgages and loans etc.

Insurers' are supporting their customers with a range of measures to maintain protection while cushioning those facing financial hardship by adjusting terms to reduce costs and providing flexibility regarding payment arrangements. ICNZ has also established relationships with those who work with the most vulnerable in the community to ensure a dedicated person with each insurer is there to appropriately respond to any issues.

The Fair Insurance Code sets out obligations for ICNZ members to prioritise vulnerable customers in a natural disaster using the Human Rights Commission best practice guidelines for the prioritisation of vulnerable customers. ICNZ also facilitates an insurer bi-monthly vulnerability discussion group with the purpose of sharing vulnerability best practice and to learn from each other. Through this work we support our members to continually review and develop their approaches to identifying and managing customers experiencing vulnerabilities.

Government policy and regulation also has a part to play in helping insurers support their customers. Regulators such as the RBNZ and FMA have been proactively adjusting the application of existing regulation to reduce the regulatory burden where possible. Such measures need to continue, with the impacts and costs of new policy/regulation being carefully evaluated. Direct costs on insurance, such as the FENZ levy, should also be removed.

These steps will ensure that insurance remains affordable, and insurers can focus on meeting their customers' needs through the difficult economic times ahead.

Review EQC Act and provide homeowners one point of responsibility to settle natural disaster claims - their insurer

The scale and complexity of the Canterbury earthquakes and its effects created a range of challenges, including for EQC and private insurers. It also illuminated the inherent problems with a model that provides for multiple agencies (private insurers and EQC) to manage the claim of a single customer for a single property. The duplication and uncertainty associated with this dual process complicated and delayed the settlement of some claims beyond acceptable timeframes, resulting in adverse outcomes for individual customers, delaying recovery and likely increasing the overall costs for EQC, the taxpayer and insurers.

Following the success of the a new model for settling claims in the response to the 2016 Kaikōura earthquake (with insurers acting as agents of EQC to settle claims), ICNZ and eight private insurers[14] recently worked with EQC to put in place an improved and more comprehensive version of this model for future events, with a singular focus on delivering improved customer outcomes. Under the new model, anyone with home insurance whose home and/or land is damaged in a natural disaster can lodge one claim through their private insurer, who will assess, manage and then settle the claim,[15] providing one point of accountability and responsibility and avoiding inefficiencies, hand-over issues and duplication of resources. Under the new model, insurers will also provide data to EQC about where insured homes are located, so EQC can better model its exposure to natural hazards. EQC and private insurers are in the process of establishing the necessary systems and processes to support these arrangements, with the new model formally going live in the second quarter of 2021.[16] It is essential that these arrangements are not jeopardised by, for instance, a significant increase to EQC cover (discussed further below) which would force private insurers to reconsider whether it is appropriate for them to manage and settle claims on EQC's behalf.

The issues identified above and other matters were also considered in the Public Inquiry into the Earthquake Commission that reported in April this year.[17] A thorough review of the *Earthquake Commission Act 1993* is required, working closely with private insurers to ensure that clear and effective provisions are put in place for land and building covers and for claims settlement, with a view to avoiding inefficient inconsistencies and customer expectation issues. Following future disasters, it is vital that there is immediate post-event certainty for customers, private insurers and EQC on how claims settlement will work occur. To that end, we support adjusting EQC's treatment of covered houses and standard of repair, to align with that of private insurers. We also support an adjustment providing for compensation for land damage to be clear and primarily directed towards ensuring a viable building platform for a house after an event, while taking into account Government's long-term preparedness and resilience objectives. In our view, attributing compensation for land damage to building remediation costs is appropriate where this is the most cost-effective solution.

---

[14] AA Insurance, Chubb, FMG, Ando (Hollard), IAG, MAS, Vero and Tower.
[15] This includes the EQC claim for land damage, the EQC portion of building cover up to the statutory cap ($150,000), and then any claim under their private insurance up to the relevant sum insured (if applicable).
[16] Until then the status quo will prevail.
[17] https://eqcinquiry.govt.nz/. Other matters being considered as part of the EQC Act review include potentially increasing the current $150,000 EQC cap on residential building cover, providing greater clarity regarding reinstatement, EQC land and building covers and clarifying EQC's future role and mandate in the emergency management system.

Finish review of insurance contract law and close loopholes that allow unregulated insurance services and deferred payments by intermediaries

ICNZ has welcomed the progression of the review of insurance contract law that commenced in 2018. We support changes to the law for insurance contracts in response to issues that have been identified, where they support the sustainable and efficient provision of insurance in New Zealand and facilitate innovation. This includes rationalising and modernising the insurance law regime (which is currently fragmented across six pieces of separate legislation) and rules regarding the disclosure obligation, noting that under the Fair Insurance Code our members are already required to explain what disclosure means and act proportionally in the event this obligation is breached, as proposed.[18]

We recognise the importance of having well informed customers and also support changes designed to make insurance policies easier to understand, noting again that this is something covered off already under the Fair Insurance Code.[19] However, further regulatory intervention in this regard is not considered necessary. There is no evidence of a public policy problem warranting intervention with information on policies and pricing being easily accessible. There is also a risk that such changes will result in customers being bombarded and overwhelmed with additional written materials, oversimplify matters and/or increase the risk that consumers are only making decisions on price, noting that insurance is not a commodity like electricity, and a number of matters need to be considered in decision-making to determine what best meets customers' needs.

Our overarching view is that the legal regime should aim to create the right environment for good customer outcomes, while supporting fair competition, continuous innovation and certainty, which is also to customers benefit. This requires a legislative regime for insurance contracts that gives insurers, and the reinsurers that support them, confidence and certainty to commit their risk capital to the New Zealand insurance market. With that in mind, disclosure obligations for consumers and businesses need to be consistent. Alternatively, no change should be made to the current disclosure duty for businesses because no problem has been identified that warrants this.

In addition to the issues highlighted in the review so far, the review should also take into account outstanding matters that are foundational to the provision of insurance in New Zealand, including unlicensed insurance activity and aspects of the relationship between insurers and intermediaries that need to be modernised. Failing to address these issues would be major missed opportunity.

Most insurance activity in New Zealand is undertaken by insurers that are licensed by the Reserve Bank under the *Insurance (Prudential Supervision) Act 2010* (**IPSA**). Nonetheless, there is a material amount of insurance business carried out in New Zealand by entities that are not licensed insurers. This includes both types of contract currently deemed not to be insurance contracts under IPSA (e.g. warranties, guarantees and waivers) and unlicensed (by the Reserve Bank) foreign insurance firms that insure New Zealand policyholders. Unlicensed insurance activity in New Zealand is a problem because it means consumers are not appropriately protected and competition is not fair. Consumers may also be under the impression they are dealing with a licensed insurer when that is not the case, which can lead to problems should there be an issue with the provider and discover they are not protected by the framing regulating licensed insurers.

Monitoring and compliance of current laws also needs to be stepped up. Mismatches of definitions under New Zealand law that allow entities to undertake unregulated insurance services by calling them something else also need to be removed. It is important for customers to be fully aware of

[18] See pages 3 – 6 of the Fair Insurance Code.
[19] See page 3 of the Fair Insurance Code.

whether they are engaging with an insurer or non-insurer (regardless of name and licensing). To achieve this there is also a need for a more general prohibition on activity and conduct by non-insurers representing themselves to customers as insurers.

The deferral of payments from intermediaries to insurers under section 8 of the *Insurance Intermediaries Act 1994* causes a range of problems and creates risks.[20] These ultimately add to the complexity and costs of providing insurance to customers in New Zealand. In principle it would be most efficient for all parties if the legislation provided for the payment of premium to be transferred from intermediaries to insurers as swiftly as practical following receipt from the customer in line with normal commercial arrangements. This issue needs to be thoroughly considered in the current review of insurance contract law and before new legislation is introduced to Parliament.

To ensure the new consolidated legislation for insurance contracts is workable, and unintended consequences are identified, worked through and resolved, there must be consultation on an exposure draft of the Bill before it is introduced. This will also enable a proper consideration of unfair contract terms, ensuring these reflect the unique nature of insurance contracts (as further discussion below).

Ensure unfair contract terms requirements reflect the unique nature of insurance contracts

Insurance contracts can be distinguished from many other types of consumer contracts in that the contract for the product and the product are, in effect, one and the same thing. There are some areas of regulation, such as the 'unfair contract terms' (**UCT**) provisions introduced a few years ago into the *Fair Trading Act 1986*, where it is necessary for the regulations to reflect the unique nature of insurance contacts.

The transfer of risk from insured to insurer underlining insurance contracts warrants a different relationship than that of a standard seller to consumer. Accordingly, it is appropriate these should have different requirements. If an insurer cannot define a risk, or a risk related contract term can be challenged, this increases the risk for the insurer and uncertainty, which in turn would be reflected in the ultimate price the consumer pays. It is important to make clear that the specific treatment for insurance contracts under the UTC provisions of the Fair Trading Act do not preclude consumer insurance contracts from having to satisfy unfair contract term requirements. The relevant provisions instead reflect the unique nature of insurance contracts and the necessity of the relevant terms to protect the legitimate interests of insurers, ensuring insurers can appropriately manage the risk transferred to them.[21]

---

[20] Under the *Insurance Intermediaries Act 1994* insurance intermediaries are: (a) entitled to defer the payment of premiums to insurers (the default period for this is 50 days but it is capable of being varied by arrangement between the insurer and the intermediaries); (b) required to establish insurance broking client accounts for the purposes of, among other things, holding premiums paid by purchaser of insurance; (c) allowed to invest money held in their insurance broking client accounts and keep any profit they make on that investment (but must personally repay any loss).

[21] See s 46L(4) of the *Fair Trading Act 1986*. The relevant terms include terms that: (1) identify the uncertain event or that otherwise specifies the subject matter insured or the risk insured against; (2) specify the sum or sums insured or assured; (3) exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances; (4) describe the basis on which claims may be settled or that specifies any contributory sum due from, or amount to be borne by, an insured in the event of a claim under the contract of insurance; (5) provide for the payment of the premium; and (6) related to the duty of utmost good faith or disclosure obligations. This provision provides that the relevant

Making changes to address issues that have yet to be clearly identified risks adversely impacting the provision of insurance and its affordability. This is because insurers will need to re-price risks being underwritten to reflect the element of uncertainty about whether a particular term can be relied upon. This may also impact reinsurance arrangements, the capital insurers are required to hold and affect the scope of cover of available.

The revision of UCT provisions applying to consumer insurance contracts need to be carefully considered in the review of insurance contract legislation (discussed above) and consulted on. If changes are to be made, these should be confined to revising/removing requirements related to disclosure obligations and the duty of good faith[22] or tailored generic UCT provisions for consumer insurance contracts, with a view to continuing to protect the legitimate and reasonable interests of insurers.

Any extension of UCT provisions to business-to-business insurance contracts also needs to be considered in the review of insurance contract law rather than being extended through the *Fair Trading Amendment Bill* currently before Parliament. Including standard form business-to-business insurance contracts under the UCT regime as proposed under this Bill is plainly inappropriate and goes well beyond the intention of the Bill. The $250,000 annual value (insurance premium) threshold proposed for 'small trade contracts' would capture the vast majority of all commercial insurance contracts (including complex insurance contracts for extremely large and sophisticated corporates covering tens of millions of dollars in potential losses). Additionally, if this change was made before the insurance contract law review was completed, this would be inefficient and create unnecessary duplication and regulatory burden, as insurers would need to review their commercial insurance contracts twice (once to reflect the changes made under the Fair Trading Amendment Bill and then again once the insurance contract law review is completed).

Sufficient time also needs to be allowed for insurers to implement these sizeable pieces of reform, noting that such a wide-ranging review of insurance contracts would be a significant undertaking involving multiple business units. Time also needs to be allowed to implement any changes, which may require adjustments to be made to systems and processes, training and communications to customers. These complexities would be compounded for insurers operating in the intermediated market or other non-direct distribution model, with changes needing to be communicated through these channels and adjustments made by partners in these respects.

We are conscious that Consumer NZ has identified a very small number of practices which they say are unfair. These require further discussion and review and are not grounds for a wholesale change to the treatment of key insurance terms. We also recommend consultation with our prudential regulator if such changes are contemplated, noting they have previously not supported doing so for sound reasons.

Ensure intermediaries have the appropriate treatment under the new conduct legislation

ICNZ supports efforts to ensure good conduct in financial services. This is why we introduced the Fair Insurance Code in 2011, which covers all our members' dealing with their customers and sets high

terms are reasonably necessary to protect the legitimate interests of the insurer. This is a defence to an allegation that a term is unfair.

[22] See sections 46L(4(f) and (g) of the *Fair Trading Act*.

standards in excess of statutory minima. We recently reviewed the Code and a revised version came into effect from 1 April 2020.

We support in concept the introduction of conduct legislation for financial services to ensure good conduct and fair treatment of customers is more widely achieved. However to ensure that such provisions are to the benefit of consumers (regardless of who they deal with for their insurance), it is critical that the *Financial Markets (Conduct of Institutions) Amendment Bill* and the regulations and other instruments developed under them, are comprehensive, proportionate, and carefully integrated with related regulatory frameworks, with clear accountability and consistent fair conduct obligations specifically sitting with all parties directly involved in developing/selling/distributing insurance across the value chain to the end consumers (including intermediaries). If not, there is a risk of inconsistency, poor consumer outcomes and the potential for regulatory arbitrage.[23]

A major concern in this respect is that the latest version of the Bill (as amended by the Select Committee) leaves financial institutions (including insurers) responsible for having fair conduct programmes and supervising and training intermediaries in this respect, while removing the obligation for intermediaries (e.g. insurance brokers) to do so themselves. The result is that insurers are accountable for intermediaries conduct but they may have no means of ensuring this ultimately occurs.[24] This results in an uneven playing-field and there is a risk that intermediaries arrange their affairs so as minimise or bypass these fair conduct requirements entirely.

One solution to this issue is to amend the Bill to require intermediaries to develop their own fair conduct programmes and comply with them. Another option would be to amend the Bill to require intermediaries to reasonably co-operate and constructively engage with the relevant financial institution, to assist that financial institution in complying with its fair conduct programme. Another concern is that the definition of 'intermediaries' under the current Bill continues to extends to all manner of parties unrelated to the actual sale and distribution of insurance to consumers (including those completing claims work, e.g. builders, panel beaters and cleaners). This should be narrowed to just those directly involved in the sale and distribution of the relevant products and services to consumers. This broad framing extends well beyond the problem that this Bill is purportedly trying to solve (ensuring financial institutions act fairly in their dealings with consumers regarding the relevant services and associated products the offer, avoiding poor consumer outcomes in this regard).

In general terms, extra complexities and unnecessary costs introduced by the Bill will ultimately act against consumers interests rather than in favour of them. For instance, there is a risk that the added compliance burden deters financial institutions from entering the market or broadening their range of products into consumer products, or will result in costs being passed onto consumers in the form of increased prices.

The current Bill also includes some novel concepts, particularly the nature and role of the fair conduct programme (**FCP**). These concepts have not been the subject of specific consultation as they were rapidly developed after a mid-2019 consultation. Also, while the minimum requirements of these FCPs have been expanded upon in the current version of the Bill, these remain extremely broad. Consequently, it is not possible to fully understand how this would work in practice nor what the full implications will be until further regulatory detail is put in place and they have become implemented.

---

[23] Because, without if intermediaries are not to be directly responsible, they may look to minimise or bypass fair conduct requirements entirely to reduce costs and inefficiency.

[24] This is a particular issue when a smaller insurer and large national brokerage is involved.

It is likely this will reveal issues with the provisions in the Bill that are not evident at this stage and which may later require amendment.

Taking a more careful and considered approach to developing a conduct regime through this Bill and subsequent regulation would have advantages in terms of regulatory coherence and integration. Specifically it would enable the impacts and practical operation of the new financial advice regime and areas of potential duplication to be better understood and the detail of changes for insurance in the review of insurance contract law to be worked through, which also importantly include matters related to intermediaries and their interactions with insurers and consumers.

We are also mindful that further developing and then implementing the proposals in the Bill would put significant additional pressure on an industry already stretched by years of ongoing regulatory reform and now wider global events. Combined with FMA levy increases over coming years, and expected further increases to fund FMA's increased jurisdiction under the proposed conduct Bill, affected businesses will be concerned about their ability to resource these new regulatory obligations and costs.

Also, since the Bill was developed the global context has radically changed due to the spread of COVID-19. The significant impacts on global economic conditions, and all the consequences that flow from this will mean these reforms land in a very different environment to the one they were designed in.

Ensure any consumer data right model is thoroughly analysed and improves consumer outcomes once implemented

While insurers are supportive of giving customers more choice and control over their data (and specifically allowing them to transfer this more easily between providers) in principle, there are significant issues with a Consumer Data Right (**CDR**) as proposed by the Government that need to be addressed. These include:

- The need for adequate safeguards to protect against the heightened risk of privacy and data security breaches associated with greater data portability. This includes
- Appropriate protections and consideration of informed consent and transparency for those who lack access to technology, financial or digital literacy, or who have accessibility or disability issues or are underage.
- Ensuring that any CDR implemented has regard to the fact that good consumer outcomes extend beyond the stated aims of making it easier to compare prices and switch. Other important considerations in this context include ensuring consumers have a good understanding about product/service they are purchasing and are making a fully informed decision in this regard. There is a risk that focussing overly on price will result in a 'race to the bottom'; with lower specification products being developed so providers can appear cheapest in a category to 'win' business.

We consider that a staged approach to implementing any CDR is appropriate, focussing on those sectors where there is clear benefit to introducing a CDR (i.e. high volume simple transactional products/services such as, where provider decisions are based upon a small number of data points, such as banking, electricity or broadband internet providers). This approach ensures that the right sectors can be prioritised and enables regulators and industry participants to efficiently test, learn, and refine the regime before rolling it out more broadly to more complex sectors such as insurance, noting that insurance is not a commodity and involves:

- a range of data and information sources (much broader than just information previously provided by a consumer),
- product variability, and
- complex decision-making (both insurer and consumer).

Particular attentions is required to ensure the consumer has a good understanding of what they are covered (and not covered) for, different offerings available (including different structures and cover/benefit options, excesses and sums insured) and that the product selected is fit for purpose.

We are concerned that a specific model for implementing a CDR has been identified as being preferrable (a sectorial-designation approach) without a cost benefit analysis of all options being completed. We also note the challenges faced in Australia where such a model has been introduced.[25] Consideration should also be given to providing for a data portability right on a more principled basis under the Privacy Act and extending a CDR to public agencies.

To the extent that insurers are to be included in a CDR sufficient checks need to be put in place to protect their valuable commercially sensitive underwriting data (including pricing and historic claims data, models and mapping) as this is essential to the proper functioning of the insurance sector. This data, which will have been acquired or developed at significant cost, is key intellectual property and an essential commercial asset for insurers which underlies their core underwriting function; assessing and pricing risk.

Support innovation and fair competition through technology neutral regulation

Like other sectors, digitalisation is transforming the insurance business. This is being driven by the application of a range of technologies including mobile and wearable devices, the internet of things (IoT), Big Data, artificial intelligence (AI), robo-advice and distributed ledger technology, across the insurance value chain: from the design, underwriting and pricing of products and product customisation, to marketing and distribution and claims processing.

New technologies can be applied both to the distribution of existing products and to enable new products to be offered (e.g. on-demand insurance, usage-based insurance or insurance in conjunction with the shared economy). Technologies are being utilised by existing insurance sector players (i.e. insurers, reinsurers and brokers) as well as fintech start-ups, and potentially by established technology firms.

The various regulatory regimes applying to insurance (e.g. insurance contract law, prudential requirements, financial services conduct requirements, financial advice requirements etc.) will need to evolve so that they impose equivalent requirements on different technologies and distribution platforms. Achieving this will be critical to protecting customers and ensuring fair competition.

Make financial capability mandatory in the New Zealand curriculum

Financial capability is all about enabling people to make informed decisions about their money. This requires them to have good financial knowledge, confidence and be motivated to make sound financial decisions.

---

[25] While the framework for the sectorial-designation based The Australian Consumer Data Right (**ACDR**) has been in place for some years and rules have been developed for one sector (banking), this is taking much longer to roll out than expected and is proving to be very expensive.

Managing risks and insurance education sets people up for financial wellbeing and resilience. We believe financial education should start early in life and its best taught from a strengths base and through simulating real-life situations.

ICNZ data shows low levels of knowledge of insurance and government consultation papers have highlighted a gap in consumer understanding of insurance policies.[26] While New Zealand compares well internationally in financial literacy (based upon knowledge test results), this does not translate well to financial capability, nor does it reflect that New Zealand is overrepresented in terms of both women, and racial minorities such as Māori and Pasifika, being financially illiterate.[27]

ICNZ members fund a sector-wide financial capability programme as one of its strategic priorities, with a focus on vulnerable customers and youth. FinCap is our partner for a risk management and insurance education programme for financial mentors who have vulnerable clients. Our youth focus includes partnering with Banqer for delivery of 'Banqer High', an online financial education tool for secondary students. Through simulated scenarios on this platform, students learn about the importance of insurance and how to recognise risks and manage them.

Financial capability has been introduced into the curriculum via the Ministry of Education's 'financial capability progressions' and is reasonably well integrated into core subjects. However, our youth education partners report that the majority of teachers are either not familiar with these and need to be made aware of them, or lack the confidence to teach financial capability.

Insurance and risk management is included in the national financial capability strategy that the Commission for Financial Capability leads, but the focus of their efforts is on retirement and savings. The Commission's Sorted in Schools initiative has insurance as one of the six modules, however, these are only optional resources for schools to use.

The education system framework currently means nothing is mandatory from a subject perspective and the Government/Ministry of Education has not prioritised financial capability. The insurance industry advocates for the Government to prioritise financial capability in the curriculum by making it mandatory.

Work with insurers to develop products for managing new risks

As we prepare for the future, insurers will have the opportunity to deploy their risk expertise and learnings from COVID-19's impacts and work with governments to reduce the impact of the next global pandemic. There may be a role for government to work with insurers on innovative products to meet demands during the ongoing COVID-19 crisis and beyond.

One option is to provide a flat rate cover, with businesses paying a levy to create a pool that pays out a flat rate when a pandemic event occurs. Another option is a risk-based cover, under which the business chooses the amount of pay-out they want and contribute reflecting what they have opted for. These covers may be structured to relate to specific types of expenditures (e.g. employee wages/salaries, rental payments) or financial loss in broad terms (e.g. loss of income).

[26] https://www.mbie.govt.nz/dmsdocument/5157-insurance-contract-law-review-options-paper

[27] https://gflec.org/initiatives/sp-global-finlit-survey/ and https://www.oecd.org/skills/piaac/ and https://cffc-assets-prod.s3.ap-southeast-2.amazonaws.com/public/Uploads/Research-2020%2B/CFFC-Barometer-Financial-Literacy-2020.pdf.

These options can be entirely state administered or involve a public private partnership with the insurance sector, leveraging their insurance distribution and customer networks. In the case of the latter, the state would remain the overwhelming funder because the substantial potential losses cannot be met by the insurance and reinsurance sector. Other countries are looking to the global reinsurance sector and wider capital markets to support sovereign risks.

A central tenet underlying all these options is planning and investment to meet the future costs associated with an outbreak so that governments do not have borrow to fund this expenditure on an ad hoc basis as they are doing currently.

Maintaining the affordability of insurance

Maintaining New Zealand's high uptake of insurance relies on it being affordable. This requires competitive markets, the removal of inappropriate levies, and balanced regulation.

Resolve issues with the new Fire and Emergency New Zealand (FENZ) levy regime

The Fire and Emergency New Zealand Act 2017 (**FENZ Act**) created a single, unified fire services organisation for New Zealand, repealed the Fire Service Act 1975 and the Forest and Rural Fires Act 1977, and provided a new way for FENZ levies to be calculated, noting that the FENZ is funded almost entirely by a levy applied to people who take out insurance for motor vehicles and property. Initially the intention was for these new levy rules to go live from 1 July 2019.

Notwithstanding a considerable amount of work by ICNZ, its members and government agencies (including FENZ and the Department of Internal Affairs (**DIA**)), throughout 2017 and 2018, this deadline was not achieved. This was due to:

- problems with the specific provisions under the FENZ Act and proposed levy regulations, with considerable complexity and many of the relevant definitions and mechanisms being deeply flawed (resulting in inconsistent or unfair treatment, or issues with their practical application),[28] and
- considerable costs involved with implementation and insufficient time being available to build and test new systems before the new regime was to commence.

Commencement of the new levy rules was subsequently extended until no later than 1 July 2024.[29] Until the new regime is introduced, levies continue to be charged under the old regime (albeit at increased rates). We understand that DIA 's work on this matter has slowed while it focussed on COVID-19 response and recovery work and all other work on the previously expected second amendment Bill, Levy Regulations and potential future Levy rates is currently suspended.

As outlined above, there are significant issues with the new levy rules and a lot more work would be required to progress these to a stage they will be in a workable state. In these circumstances, ICNZ and members' strong view is that the current regime ought to be retained and an amendment made to the FENZ Act to reflect this. This will also avoid the 1 July 2024 deadline not being met, noting that once insurers have certainty about the legal compliance obligations it would take around 15 months to implement the required changes. This will also avoid the estimated $30 to $40m cost of system and process changes to move to a new funding system, which will ultimately have to be passed onto and borne by customers.

---

[28] These issues include: (1) the definition of amount insured ('expressed maximum loss'), which is open to interpretation, lacks flexibility to reflect changes in insured values and may lead to unintended consequences; (2) inconsistencies with the treatment of motor vehicles; (3) the definition of residential building, which does not refer to structures unattached to buildings as provided for in home insurance policies. Changes are also required to avoid double or even triple application of the levy and regarding the treatment of sundry farm assets and in respect of travel insurance. Issue also arise regarding the disproportionate application of the regime on commercial insurance and in terms of the treatment of apartments, where uncapped levies would apply as insurers treat them as commercial properties. Consequential issues may arise regarding the treatment of apartments due to changes to the EQC Act (e.g. changes to the treatment of mixed-used units).
[29] Via the Fire And Emergency New Zealand (Levy) Amendment Act 2019.

Please note that the position in this section reflects the practical challenges with the looming 2024 deadline and challenges with the new levy regime in the short term. In the next section we set out the case for changes in the way FENZ is funding overall in the medium to long term.

Stop funding FENZ through a tax on insurance

Unlike other emergency services that are predominantly funded by government, FENZ is almost entirely funded through a levy on property and vehicle insurance. Insurers collect this from their customers on behalf of FENZ. Community expectations of FENZ have changed over the years and its role now extends beyond fighting property fires to include many non-fire activities such as responding to storm damage, medical emergencies, hazardous spills and motor vehicle accidents, noting that dealing with motor vehicle accidents and hazardous spills accounts for 40% of FENZ's current activities.

Funding FENZ through what is effectively a tax on insurance is flawed for a number of reasons and needs to change:

- First, it is inequitable way of funding a public service - FENZ responds to various events unrelated to the asset the levy is collected (with fire-fighting making up only a small part of FENZ's work) and regardless of whether parties have insurance.
- Secondly, it directly reduces the affordability of insurance due to the added levy cost, which can be significant.
- Thirdly, this is an inefficient and complex way to collect funding that imposes significant compliance costs on insurers. The extra costs associated with all this puts pressure on lower income householders and some businesses (noting that the levy for commercial property is uncapped) from an affordability perspective and potentially reducing insurance penetration, which is undesirable from a wider public policy perspective.
- Finally, relying on a levy on insurance will not necessarily provide FENZ with a stable or sustainable source of funding into the future.

Additionally, the current approach to funding FENZ is out of step with international best practice. ICNZ has long argued that FENZ should be funded through mechanisms that are efficient to collect and non-distortionary (e.g. through central government funding, or alternatively by a combination of that and a direct property-based levy and incorporated in the motor vehicle licensing fee, like the ACC levy is). We supported the Government launching a review of FENZ funding in early 2019. It is important this review is progressed and an alternative effective, efficient and sustainable source of funding for FENZ established for the future. Over half of those that submitted on consultation regarding ways to fund FENZ in February 2020 noted that general taxation had been ruled out of scope for the review and suggested, like ICNZ, that this should be in-scope.[30]

Support efforts to reduce the costs of insurance fraud

Insurance fraud is an illegal act where the consumer lies to an insurer to gain a benefit. Most insurance fraud occurs at claim time, with claims being padded to include items that were not subject to loss,

[30] https://www.dia.govt.nz/diawebsite.nsf/Files/FENZ/$file/FENZ-funding-review-subs-summary-and-analysis.pdf.

claims made for events/losses that didn't happen or that were staged– for example claims for assets that were deliberately damaged by the insured.

Insurers bear the cost of these fraudulent claims. This increases their overall costs and results in higher premiums for all customers. It is difficult to accurately quantify how much fraud the insurance industry suffers but based on local and international surveys, ICNZ estimates fraudulent insurance claims cost over half a billion dollars every year and so Insurers want to help their customers understand that insurance fraud is illegal and the impacts it can have on them.

An initiative ICNZ is progressing to reduce the cost of fraud is the establishment of a New Zealand Insurance Fraud Bureau (IFB).[31] The IFB was launched in September last year and will take the lead role in:

- educating New Zealanders about insurance fraud
- providing a central point of contact for general insurance fraud issues and allegations of insurance fraud
- developing a centre of excellence for anti-fraud initiatives
- researching national and international trends
- developing strong multi-agency relationships, and
- analysing and working with insurance fraud data to help detect and reduce instance of insurance fraud.

Balance benefits of new regulation/regulatory change with costs

ICNZ supports efforts to ensure good conduct in financial services. This is why we put in place the Fair Insurance Code in 2011. ICNZ ensures the Code evolves by reviewing and updating it every 3 years. Building consumer trust relies on being truly customer focused, communicating clearly and transparently with customers, and addressing poor customer outcomes in a timely and effective manner when issues arise. An efficient functioning insurance system also relies on insureds engaging honestly with their insurer and making reasonable efforts to understand the insurance policies they choose to purchase.

A number of reforms of financial services laws that will affect the provision of insurance are being progressed or considered.[32] ICNZ supports the drive to improve regulation. However, in undertaking and implementing these reforms, it is important to balance the benefits of new consumer protections with the costs and complexities involved which may in turn be passed onto customers. It is also critical to make sure the various regimes are comprehensive and appropriately integrated with each other so as to avoid unnecessary duplication and regulatory burden.

The outcomes of these reviews will also need to reflect new distribution channels and technological change and carefully balance customer needs with the costs of regulation and reflect the unique aspects of insurance, which distinguish it from other financial products and services.

---

[31] See www.ifb.org.nz for more detail.

[32] These include reviews of insurance contract law and IPSA, the *Financial Markets (Conduct of Institutions) Amendment Bill*, amendments to the Credit Contracts and Consumer Finance Act 2003, and the implementation of the financial advice reforms.

Financial stability

Insurance plays a key role in supporting New Zealand's financial stability. New Zealand's long-term financial stability relies on taking account of and managing various risks including those posed by climate change.

Ensure the regulatory environment remains attractive for global insurers and reinsurance

Given New Zealand's small size and high exposure to natural hazards, global reinsurers play a critical role in supporting our insurance market. For example, over $22 billion[33] so far provided to insurers' customers in relation to the Canterbury earthquakes, around $19 billion of this came from reinsurers. It is noteworthy that EQC is also heavily dependent on reinsurance to meet its liabilities in a major event because its own reserves (the Natural Disaster Fund) were fully depleted by the Canterbury and Kaikōura earthquakes.

The costs of the Canterbury and Kaikōura earthquakes to reinsurers were very significant relative to the premiums paid domestically for reinsurance. For example, the amount paid by reinsurers in relation to the Canterbury earthquakes was the equivalent of around 100 years of annual premiums paid to reinsurers at 2010 rates. Reinsurers have nonetheless continued to provide cover for private insurers and EQC, but the costs of this cover have increased in recent years, in recognition of the losses incurred and perceptions of risk going forward.

In addition to the costs themselves, delays with settling claims and other post event changes created uncertainty for reinsurers when operating in New Zealand. While the payment of claims for disasters is inherent to the business of reinsurance, uncertainties related to delays and post event changes are not. A regulatory regime that encourages reinsurance by providing contractual certainty, and for the swift settlement of claims following a disaster, is fundamental to maintaining reinsurance support for New Zealand.

Review and update the prudential framework in IPSA

The framework for prudential regulation[34] is a critical part of the overall regulatory regime for insurance in New Zealand. Current reviews of the *Reserve Bank Act 1989* and the *Insurance (Prudential Supervision) Act 2010* (**IPSA**) need to be progressed to conclusion in order to ensure the regulatory framework for prudential supervision promotes a robust and resilient insurance sector that facilitates competition, innovation, contestability and efficiency in the sector.

Important reforms to the legislative framework for, governance, approach and resourcing of the Reserve Bank are being considered in the current Reserve Bank Act Review.[35] It is essential this review is concluded, and these reforms implemented.

It is positive that the review of IPSA, which commenced in 2017 and was then put on hold in 2018 and then sensibly deferred to later in 2020 due to COVID-19, has now recommenced and is progressing. There is a need for greater transparency and accountability for regulatory decisions under the IPSA,

[33] Approximately half of this relates to domestic customers claims with the other half relating to commercial customers claims.
[34] Prudential regulation is a type of financial regulation that requires financial firms such as insurers to control risks and hold adequate capital as defined by capital/solvency requirements.
[35] Reserve Bank of New Zealand Bill.

with a stronger focus on competitive neutrality and minimising compliance costs and merit reviews of key decision. The use of the term insurer by unlicensed insurers must also be prohibited.

Ensure solvency requirements balance customer protection with costs

New Zealand insurers are currently subject to the most stringent prudential/capital requirements in the world for natural catastrophes. The prudential requirements set by the Reserve Bank mean insurers already have to carry sufficient capital or reinsurance to meet the claims from a 1 in 1000 year earthquake event (i.e. the largest expected loss causing event over a 1000 year period). In most other countries it is the maximum losses expected on a 1 in 200 year or 1 in 250 year basis. This means less capital is required to be held in those jurisdictions.

The higher prudential requirements applying in New Zealand mean that insurers are highly capitalised and recognise the significant natural disaster risks that New Zealand faces. Reserve Bank statistics show that general insurers maintain capital buffers well above the regulated levels, with buffers noted as having increased in the year to May 2020.[36] Increased capital requirements nonetheless increase the costs of providing insurance in New Zealand and these are ultimately reflected in prices charged to customers.

In reviewing existing prudential requirements and considering changes to them, it is necessary to balance customer protection with costs and do not discourage insurers from participating in the New Zealand market.

Support green finance and investment in climate change adaptation

Alongside a range of policy measures, reducing emissions from the economy (risk mitigation) requires investment and innovation on a massive scale. While there is a clear role for government, it will also be important that green projects are able to develop sustainable commercial revenue streams as a large proportion of the funds will need to come from private capital markets.

Assessment and disclosure of climate change risks is critical to help guide investment decisions and encourage property and infrastructure owners to improve their management of physical risks. Enhanced disclosure requirements will facilitate this, but further support will also be required to generate the level of investment and change required to meet climate change mitigation objectives.

Building resilience to the physical risks from climate change, and adapting to it, will also be essential. Given the massive costs of reducing risks from climate change to vulnerable infrastructure and communities, as well as putting in place appropriate policies, innovative financing options are going to be required to support investments in resilience and risk reduction.

There is a need to identify the long-term risk for relevant communities and infrastructure based on credible scenarios of climate change impacts. This will involve a cost-benefit analysis of investment over suitably long timeframes and, where necessary, developing financial products that monetise the value and provide funds for up-front investment. Innovative approaches that seek to incentivise resilience, make funds available, and also provide an insurance element to manage risk include[37]:

- Insurance-Linked loan packages – which include concessional loans from public bodies with integrated resilience conditions.

---

[36] Reserve Bank, Financial Stability Report, May 2020, page 35.

[37] Refer to the following document for more information on these concepts - Innovative finance for resilient infrastructure, Preliminary findings, Centre for Global Disaster Protection & Lloyd's of London, 2018, available

- Resilience Impact Bonds – which involves a bond with outcome-based repayments focussing on resilience and social goals.
- Resilience Bonds – which are catastrophe bonds where bond coupon payments are reduced when resilience measures are implemented.
- Resilience Service Companies – which involves an entity that invests in upfront resilience measures in exchange for a share of future insurance premium savings.

In this context it will also be important for decision-makers to reflect on the appropriateness of adopting an adaptive pathways approach.[38] This involves testing a range of responses to climate change against possible future scenarios and then mapping pathways that will best manage, reduce or avoid risk. Under this approach a plan is subsequently developed with short-term actions and long-term options with pre-defined trigger points when decisions can be revisited. Ways forward can then be identified despite uncertainty, with flexibility provided should the agreed course of action need to change (e.g. because more scientific information or new technology becomes available). By foreshadowing future change at the outset without committing to a particular course of action long term, this approach helps avoid locking in investments early that may be later rendered obsolete or which make future adjustments difficult and/or costly.

from https://www.lloyds.com/~/media/files/news-and-insight/risk-insight/2018/innovative-finance-forresilient-infrastructure.pdf

[38] Preparing for coastal change: A summary of coastal hazards and climate change guidance for local government (December 2017), https://www.mfe.govt.nz/sites/default/files/media/Climate%20Change/coastal-hazards-summary.pdf. See also Supporting decision making through adaptive tools in a changing climate: Practice guidance on signals and triggers (2020), https://www.deepsouthchallenge.co.nz/sites/default/files/2020-03/Supporting%20decision%20making%20through%20adaptive%20tools%20in%20a%20changing%20climate%20Practice%20guidance%20on%20signals%20and%20triggers.pdf