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Committee Secretariat  
Finance and Expenditure Committee  
Parliament Buildings  
Wellington

Emailed to: [fe@parliament.govt.nz](mailto:fe@parliament.govt.nz)

Dear Committee Members,

## **ICNZ submission on Earthquake Commission Amendment Bill**

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Thank you for the opportunity to submit on the *Earthquake Commission Amendment Bill* ("the Bill"), which was introduced to Parliament on 22 March 2018.

ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including over half a trillion dollars' worth of New Zealand property and liabilities. Individual members may take differing views to ICNZ on some issues and those members will submit to you separately.

We wish to appear before the Committee to speak to our submission.

Please contact Andrew Saunders ([andrew@icnz.org.nz](mailto:andrew@icnz.org.nz) or 04 914 2224) if you have any questions on our submission or require further information.

### **Submission**

Overall ICNZ supports the legislative changes provided in the Bill. ICNZ participated in the Review of the *Earthquake Commission Act 1993* ("EQC Act") conducted by The Treasury over the 2012-2017 period and welcomes these changes emanating from it being progressed now. Notwithstanding our support for making these changes at this time we continue to strongly support wider changes to the EQC Act, most notably insurers being mandated to manage and settle claims on behalf of the Earthquake Commission ("EQC").

### **Changes to the building insurance cap and contents cover**

#### *Building insurance cap (clause 8)*

ICNZ supports the proposed increase in the building insurance cap to \$150,000 + GST. This change was thoroughly consulted on in 2015 during the Review of the EQC Act and we supported it then.

### *Personal property (contents) cover (clause 9)*

ICNZ supports the removal of contents cover (i.e. the repeal of section 20 of the EQC Act). The private insurance market will be able to cover this additional risk and removing EQC from dealing with any contents claims removes potential frictional cost and duplication of effort and resources between EQC and private insurers.

Due to the absence of relevant historical loss data (because contents up to \$20,000 has been covered by EQC for natural disasters), we recommend that EQC is required to release to insurers the last 15 years loss history for contents on a region or by event basis to enable insurers to model likely losses so they can price on a sufficiently robust basis.

### *Commencement and transitional arrangements in relation to increase in building insurance cap and removal of content cover*

ICNZ is supportive of the changes in Part 2 of the Bill (increasing the building insurance cap and removal of contents cover) and so welcomes these coming into effect at the earliest practical opportunity. Nonetheless there is a need for a period between when the Bill is enacted and when the changes in Part 2 come into legal effect, so as to allow for the policy wording, system and contractual changes and the related communications required as a consequence of these changes. We note these changes are to the cover itself and so unlike previous changes to levy rates have a compliance impact that is different in nature.

Clause 2(2) of the Bill proposes that the amendments relating to residential property and personal property come into force on one of two possible dates:

- If sections 80 to 140 of the *Fire and Emergency New Zealand Act 2017* (“FENZ Act”) have come into force, then 12 months after this Bill receives Royal assent. This is intended to ensure that there is sufficient time for private insurers to implement the necessary changes.
- If the sections 80 to 140 of the FENZ Act have not come into force, then the same date they come into force. This is intended to create the opportunity for private insurers to realise considerable efficiencies by implementing the FENZ and EQC changes at the same time.

We recognise the link to the implementation of changes to the FENZ Act was included with the constructive intent of reducing compliance costs and with expectations at the time of drafting the Bill that the FENZ changes would come into effect by mid-2019. There has been support from insurers to align the date of implementation of the EQC and FENZ changes if practical as making both sets of required system changes at the same time will have efficiencies.

However, due to increasing uncertainty with the timing for the commencement of FENZ changes, uncertainty as to when the Bill will be passed, and the inherent differences in implementation timeframes (e.g. the FENZ levy has greater impacts in terms of IT systems, EQC Act changes have less impact on IT systems but effect cover) we consider timelines for commencement of the changes in the Bill should be legislatively decoupled from the commencement of the FENZ changes to ensure each can be appropriately timed.

ICNZ therefore considers clause 2 of the Bill should be amended to provide that the changes in Part 2 of the Bill come into force on a date appointed by the Governor-General by Order in Council. This will give the relevant minister and Cabinet the flexibility to determine and confirm the appropriate date for these changes to come into effect, having regard to the specific transitional issues, the wider context and in consultation with affected parties.

ICNZ has previously advocated during the Review of the EQC Act for the need for an 18-month transition period for the implementation of changes. Matters we have identified that need to be worked through in advance of commencement include:

- Modelling changes in Probable Maximum Loss (PML) and addressing the resulting changes to reinsurance limits. Reinsurance contracts renew for a year in advance and work needs to begin at least 6 months prior to this – this as much as anything drives an 18-month transition period.
- Updating all relevant collateral (policy wordings, renewal notices, marketing material) - removing references to the EQC Act for contents policies and adjusting deductible amount (if defined within wording) for house cover.
- Pricing - calculation of revised price to reflect the alteration of the EQC Act deductible for both home and contents products.
- Defining, commissioning, undertaking and testing any required IT system changes.
- Communication to ensure staff, banking partners, brokers, underwriting agencies, other distribution channels and customers have been communicated with and understand the changes.

Government should consult closely with the insurance industry and other relevant stakeholders and then confirm later this year an appropriate date for commencement of the changes in Part 2 of the Bill.

#### *Application of transition arrangements to insurance contracts established across the commencement date*

We note that in the context of insurance contracts established across the commencement date the use of “entered into” in the wording “continues to apply in relation to a contract of fire insurance entered into before” in clause 11 creates potential uncertainty. The process of entering into a new insurance contract can have multiple steps (potentially over a period of time) but the time at which the insurance coverage is provided from (i.e. when the insurer is “on risk”) is always clearly defined. In some cases this all occurs on the same date but often for home/contents policies they won’t.

This will not be an issue for existing policies that are simply renewed around the commencement date, as they will renew on a specific date before or after it, but it could be an issue for new policies established in the following circumstances. Where a consumer contacts an insurer to provide home insurance, and the insurer agrees to provide it, before the commencement date of the changes in Part 2 of the Bill, but the coverage does not begin until after the commencement date, whether the insurance contract was “entered into” before or after the commencement date could be ambiguous. Amending clause 11 to provide instead that the relevant existing sections continue “to apply in relation to a contract of fire insurance where the period of insurance commences before that date” would resolve any ambiguity.

#### *Application of transition arrangements to “periodic” insurance contracts*

We note the clause by clause analysis of the Bill states in relation to transitional arrangements for Part 2 of the Bill that:

“The current insurance levels will continue to apply to contracts entered into before that date.....so the new insurance levels will take effect gradually over the following 12 months as those policies are renewed”.

We support such a gradual transition taking place over the course of 12 months. Clause 11 of the Bill inserts a new clause 3 into a new Schedule 1AA of the EQC Act that states the current sections (e.g.

the cap of \$100,000 on residential property) will remain in force for contracts of fire insurance entered into before the commencement date. This assumes the key terms of all insurance policies (e.g. levels of cover and price) are updated on their renewal and that this occurs annually. Whilst this is the usual approach it is not always the case (e.g. in regard to “periodic policies”). There are two key dates to consider in relation to a policy, the policy anniversary date (being the date that policy terms are set) and the renewal date (being the date that the insurance contract commences). For “periodic policies” these two dates do not generally coincide as the anniversary occurs once a year, whereas the renewal occurs periodically, either fortnightly, monthly or quarterly.

This means that for such policies, under the current drafting of the Bill, the new residential property cap would generally apply within the first month/quarter of the commencement date of these provisions in the Bill as these policies renew on a monthly/quarterly basis etc. This will have the following operational impacts and make the overall transition less gradual than envisaged:

- Updating system functionality to force systems to complete anniversary date processes for periodic policies on the first renewal date, and only that one renewal date, after the commencement date.
- Recalculating premiums as an additional one-off pricing exercise outside of the annual pricing review.
- Altering affected customers’ direct debits as an additional one-off exercise outside of the anniversary renewal.
- Communication to customers explaining the changes to cover, premium and direct debits as an additional one-off exercise outside of the anniversary correspondence.

Combined these factors increase the complexity and costs of implementing the changes for private insurers offering these types of policies to consumers. In addition, we note it would cause a spike in the EQC’s residential property exposure. Addressing this could be achieved by amending clause 11 of the Bill to provide that for periodic policies the existing sections continue to apply until the anniversary date of a contract of fire insurance. The inclusion of a definition of “anniversary date” may also be required.

**Recommendations:**

- **Clause 2 of the Bill is amended to provide that Part 2 of the Bill will come into force on a date appointed by the Governor-General by Order in Council.**
- **Amend clause 11 of the Bill to:**
  - **replace “entered into before” with “where the period of insurance commences before” or similar; and**
  - **provide that in relation to “periodic policies”, the existing sections of the Act continue to apply until the “anniversary date” of such policies.**

**Release of information (clauses 5 and 6)**

ICNZ supports the changes provided in the Bill to enable EQC to release information in situations where it would be in the public interest to do so. Clear legislative reinforcement for the sharing of claims and policy information is essential. This is especially so following a major disaster where it is important to identify and prioritise the vulnerable and to readily share information about matters affecting public safety.

Fraudulent activity is an ongoing issue for the insurance industry and also occurs in relation to natural disaster claims. The costs of fraud are ultimately passed on via premiums to those consumers who do not commit fraud or in the case of EQC are borne by levy payers (i.e. homeowners). Sharing information about people committing, or attempting to commit, fraud amongst insurers can reveal fraud and minimise the risk of further fraud.

The ability to further tackle this problem through acceptable information sharing practices between EQC and private insurers would therefore be strongly welcomed by ICNZ members. We accordingly recommend the Bill be amended to also provide for sharing of information in circumstances relating to fraud, including where fraud has occurred or is suspected on reasonable grounds, and where there would be a public interest in allowing this.

We support the changes in clauses 5 and 6 taking effect from enactment of the Bill, as is provided for in clause 2 of the Bill.

**Recommendation:**

- **Clause 5 of the Bill is amended to also provide for sharing of information in circumstances relating to fraud, including where fraud has occurred or is suspected on reasonable grounds.**

## **Deadlines for notifying claims (clause 7)**

### *Notification periods*

EQC currently requires insured persons (homeowners) to lodge claims within 3-months of natural disaster damage occurring.<sup>1</sup> The Regulatory Impact Assessment for the Bill states:

“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).”

Whilst in most cases the current 3-month notification timeframe in the EQC Act provides a sufficient period for homeowners to notify damage to EQC, ICNZ recognises this period may be not adequate in the sort of situations identified above. It nonetheless remains important to encourage the notification of claims to EQC at the earliest practical opportunity because swift claims handling and the efficient operation of the insurance sector rely on claims being promptly notified following a natural disaster event. We note the following:

- The potential for later notification delays certainty in the valuation/cost of an event and makes it more challenging for insurers to adequately resource to respond to an event.

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<sup>1</sup> The EQC Act provides for insured persons (homeowners) to lodge claims within 30-days of natural disaster damage occurring, however, this was extended to 3-months in October 2010 by regulation and has remained so since. The Act also provides for a second deadline of 3-months if the EQC is satisfied that the damage was not apparent to the homeowner within 30-days or due to the homeowner’s absence, incapacity or disability they were unable to lodge the claim within 30-days and in either case the EQC is not prejudiced by the lapse of time. This extended period was however effectively made redundant by the extension of the standard notification period from 30-days to the same 3-months.

- The longer it takes for claims to be notified the more difficult some damage will be to determine as arising from an earthquake (e.g. cracks in walls), which increases risks of dispute and delay.
- A longer timeframe complicates apportionment of damage between events. This is pertinent as the issue of delayed notification is most likely to be an issue in a major earthquake event sequence due to the types of damage that can occur and the wider context. These earthquake sequences generally involve a series of events but it is important for EQC/insurers/re-insurers to determine which event caused the damage, which can be made much more difficult if notification is delayed.
- Some notified claims to EQC are not covered under the EQC Act but are picked up under the insurer's policy. Delays in notifying insurers will affect insurers' ability to address claims in a timely manner.
- Later notification can add costs to private insurers as they need to provision for yet to be reported claims (in terms of both reserving and resourcing) for longer.

Encouraging prompt notification of claims whilst also potentially allowing more time for notification in some situations are to an extent competing objectives and it is therefore necessary to find an approach that appropriately addresses and balances them.

The Bill proposes replacing the current 3-month deadline for notification with a 2-year deadline and also uses different criteria from what is currently provided in clause 7(2) of Schedule 3 of the EQC Act. We understand the criteria for the discretion provided in the Bill is intended to align with elements of insurance law but we consider given the framework of the EQC Act the current discretion is clearer in its purpose and provides a greater emphasis on swift notification. We are concerned the unspecific and open nature of the discretion in the Bill (i.e. material prejudice to EQC's ability to assess the claim) will in practical terms create uncertainty as to whether customers need to submit a claim within 3 months or 2 years and make providing clear communication to homeowners on this more challenging.

During the Review of the EQC Act ICNZ emphasised the importance of prompt claims notification under the EQC Act. In the context of the wider proposed reforms made then we indicated a level of comfort with the proposal of allowing EQC a discretion to accept notification up to 2-years after an event. In our view, however, the extent of change proposed in the Bill is greater than required to address the issues identified and we are concerned the proposed approach risks increasing uncertainty and costs in the case of a major natural disaster event. Given further consideration of the above factors and in light of the specific proposals in the Bill (the timeframe and the proposed criteria), ICNZ is of the view that a 1-year deadline for claims notification using the current criteria<sup>2</sup> in the EQC Act would provide a better balance than 2-years using the criteria proposed in the Bill.

Enabling claims notification up to 1-year after an event would provide a substantial opportunity (four times that of the current 3-months) for any damage to become apparent, to undertake inspection of residential buildings to identify potential damage that may not be obvious, and then to notify EQC of any damage suffered. A 1-year deadline also provides a reasonable level of certainty to insurers and reinsurers. Retaining the current criteria in clause 7(2) of Schedule 3 of the EQC Act would provide a clear scope and rationale for the extended timeframe and help keep the focus on early notification wherever possible.

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<sup>2</sup> Refer clause 7(2) of Schedule 3 of the EQC Act.

ICNZ accordingly recommends the following:

- Generally require homeowners to lodge claims within **3-months** of damage occurring.
- Allow homeowners to lodge claims up to **1-year** after damage occurs where:
  - the homeowner was unable to give notice because the natural disaster damage was not immediately apparent **or** the homeowner was unable to provide notice due to absence, displacement, incapacity or disability; **and**
  - the EQC is not prejudiced by the lapse of time.

ICNZ's proposal in relation to claims notification periods is outlined in the following table in comparison to the status-quo under the EQC Act and what is proposed in the Bill:

	<b>Status-Quo (EQC Act)</b>	<b>ICNZ proposal</b>	<b>Bill</b>
<b>Standard notification</b>	30-days (extended to <b>3-months</b> by regulations in Oct 2010)	<b>3-months</b>	<b>3-months</b>
<b>Extended notification (subject to specified criteria)</b>	<b>3-months</b>	<b>1-year</b>	<b>2-years</b>

#### *Simplifying notification for homeowners*

To make it easier for homeowners when lodging earthquake claims there is a further amendment to the EQC Act that could be made. This would be providing that a claim relating to earthquake damage to a house that is lodged with a private insurer is deemed to be a residential building claim lodged with the EQC.

This would reflect the current arrangement between EQC and insurers operating in regard to the 2016 Kaikōura earthquake, which has delivered faster and more certain claims resolution for homeowners. This change would have the following benefits:

- Easier for homeowners as only one notification required.
- Removes the need for the EQC to check with private insurers that the homeowner has private insurance cover and eligibility for EQC cover, thereby speeding up the claims process
- Increases the likelihood of private insurers uncovering residential building claims where the damage is not immediately apparent. We envisage that customers' lodging contents claims with their insurer can be queried about the nature of the event and a house claimed lodged if damage to the home is suspected. This allows the home to be assessed by an expert. This would also reduce the incidence of late notice claims (further responding to the issues being addressed through extended notification timelines).
- Enables a quicker and single assessment of claims due to private insurers existing arrangements with internal and third-party loss adjustors.
- Will improve the accuracy with which claims costs can be apportioned to insurers, the EQC and reinsurers.

This change could be implemented through the addition of a new sub-clause into clause 7 of Schedule 3 of the EQC Act providing that a claim relating to earthquake damage that is lodged with a private insurer is deemed to be a residential building claim lodged with the EQC. We recognise this change by itself has some limitations (e.g. dual notification of insurers and EQC may still occur) but these exist already.

As noted above we remain of the view that wider changes to the EQC Act are required to achieve efficient claims handling, in particular for insurers to be mandated to manage and settle claims on behalf of EQC. Whilst we would welcome these changes being implemented sooner rather than later, introducing a deeming provision through the Bill related to notification would nonetheless support more efficient processes being implemented for natural disasters in the interim.

We would welcome the opportunity to engage with the Committee and government officials on how a deeming provision could be appropriately included in the EQC Act.

*Implementation of changes to clause 7 of Schedule 3 of the EQC Act*

We support, as is provided in the Bill, that changes to claims notification deadlines would apply from enactment of the Bill and in relation to natural disasters occurring after that date.

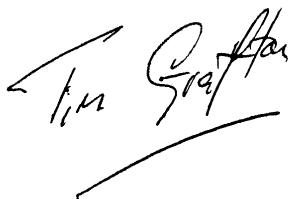
**Recommendations:**

- **Amend the notification provisions in clause 7 of the Bill to:**
  - **generally require homeowners to lodge claims within 3-months of damage occurring; and**
  - **allow homeowners to lodge claims up to 1-year after damage occurs where:**
    - **the homeowner was unable to give notice because the natural disaster damage is not immediately apparent or the homeowner was unable to provide notice due to absence, displacement, incapacity or disability; and**
    - **the EQC is not prejudiced by the lapse of time.**
- **Consider adding a new sub-clause into clause 7 of Schedule 3 of the EQC Act providing that a claim relating to earthquake damage to a residential building that is lodged with a private insurer is deemed to be a residential building claim lodged with the EQC.**
- **Change clause 7 of Schedule 3 of the EQC Act to apply from enactment of the Bill and in relation to natural disasters occurring after that date.**

**Conclusion**

Thank you again for the opportunity to submit on the Bill. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing [andrew@icnz.org.nz](mailto:andrew@icnz.org.nz).

Yours sincerely,



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