ICNZ Insurance Council of New Zealand

# Wellington Insurance Mayoral Forum

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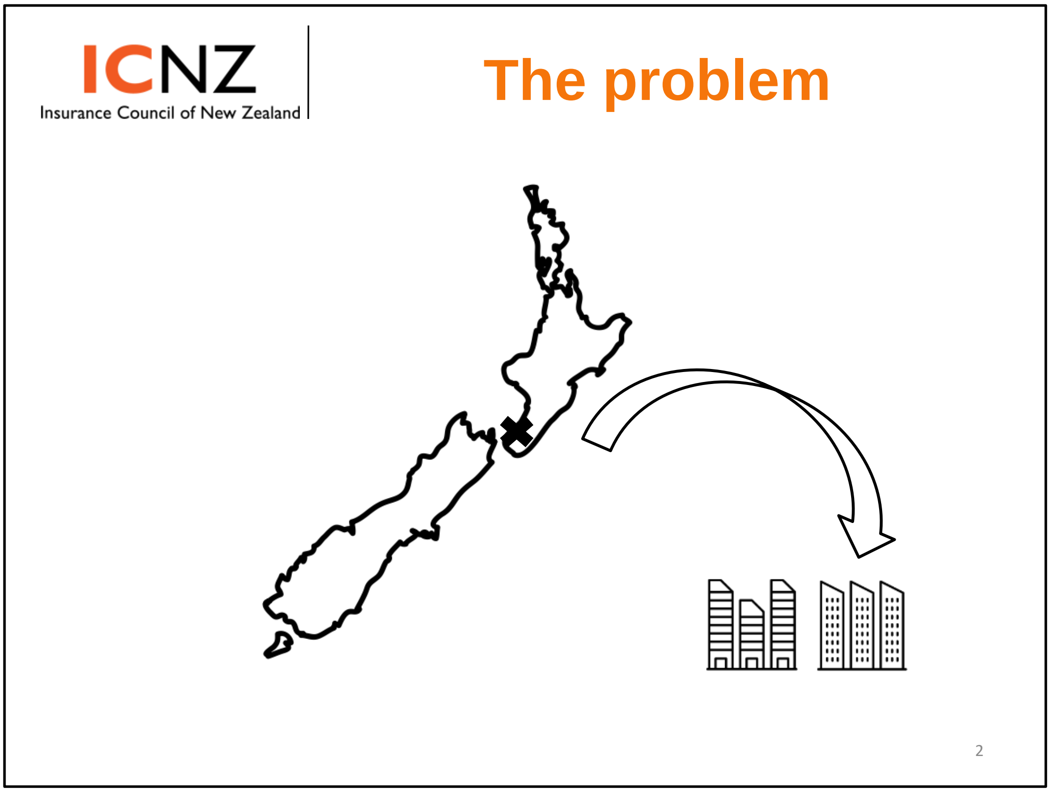
Morena

Tena kotou katoa

Tena kotou nga rangatira

Tena kotou nga manuhiri

Talofa lava Minister Faafoi

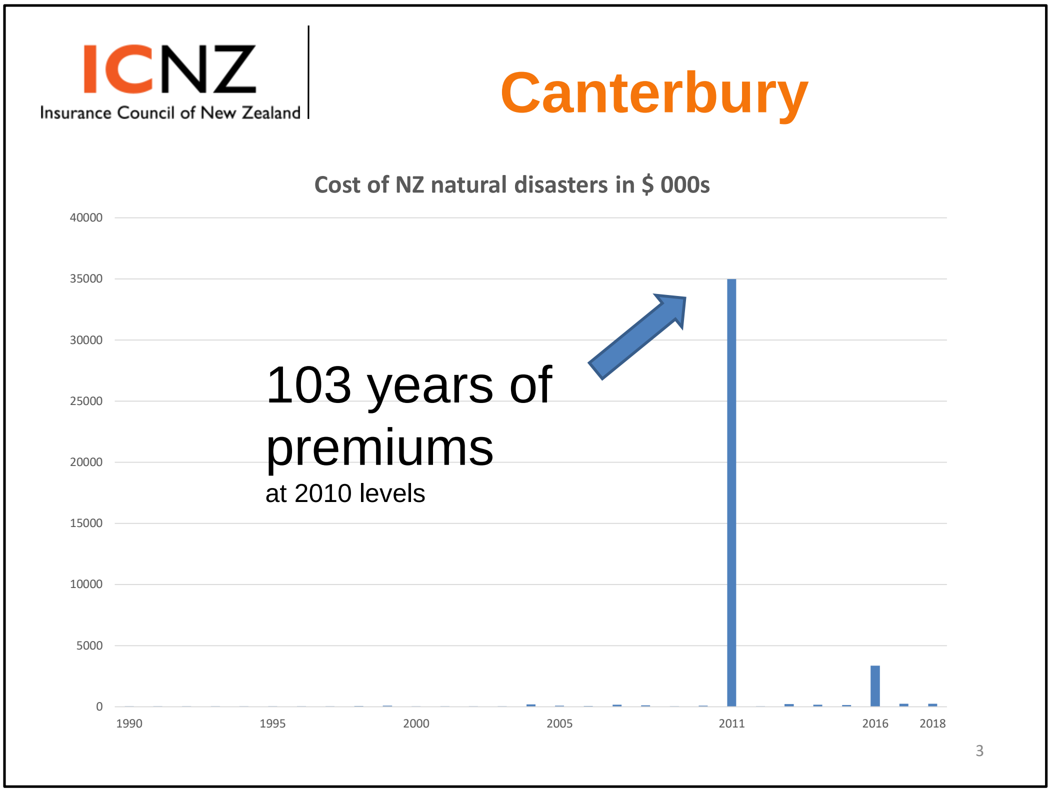



Insurance premium increases in Wellington is said to be why we're here today. Really though it's about how we manage our seismic risks.

That is a collective responsibility for all – government, council, regulators, banks, developers, building owners, their advisers, the insurance brokers, and insurers.

There are 3 Ps to managing risk. **Preparedness** so the risk is understood, **Prevention** so the risk is reduced and **Protection** so it can be transferred to insurers.

I want to share with you how we understand the risk, how we compare with similar countries and offer potential solutions mindful that they should be proportionate to the scale of the problem.




The Canterbury earthquake series caused insured losses of about NZ$35 billion. Over 70% of those losses were met by those who insure the insurers, offshore reinsurers. Those losses were equivalent to over 100 years of earthquake premiums in place at that time, not profit, but premiums.

Those reinsurers still support New Zealand even though we are one of the riskiest places for insurance loss for our size. Luckily, we have the highest insurance penetration for residential property in the world and the most generous polices in terms of the extent of the cover provided. In other countries, earthquakes and floods are additional covers you pay for and pay a lot more for.

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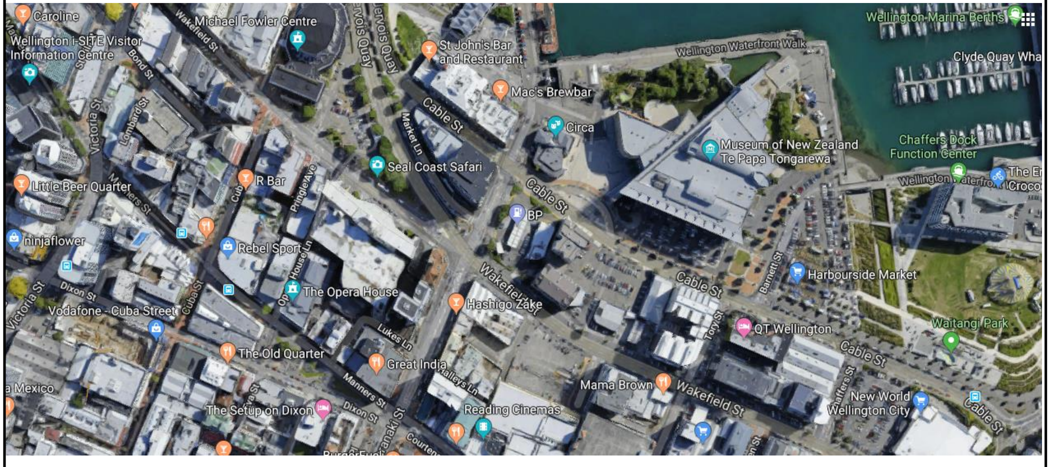
# Risk rating individual buildings

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Models are the main tool used to assess risk. In 2017, a company called RMS, revised its earthquake model for New Zealand based on global research and Canterbury. It concluded that New Zealand's losses from a major event was 30% higher than its pre-Canterbury model.

Risk for insurers is probability of loss multiplied by the severity of loss and informs pricing. The same RMS model concludes that the annual average loss for greater Wellington, was 15% higher than previously.

The loss from a massive 1:1000-year quake has gone down a bit, but losses from large, more frequent quakes has gone up between 40-70%.

Insurers use this data to get a granular measure of risk by property reflecting things like soil type, height, construction type etc.

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# Failure of new buildings

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In November 2016, the Kaikoura earthquake, epicentre 200 kms from here, caused over $1 billion of damage in Wellington. Well over 90% of that cost was commercial property.

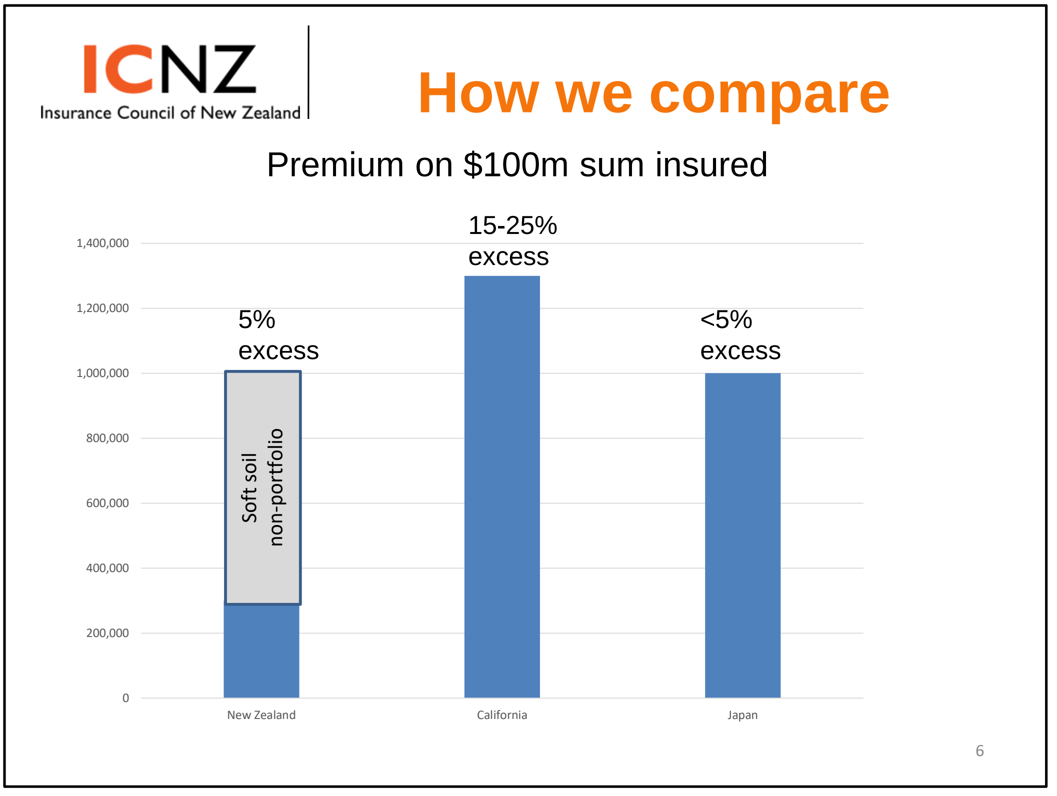
Recently constructed buildings became total losses even though they were more than 100% of the New Building Standard, a life risk measure, and built to the higher structural code required for Wellington. Some commercial property insurers sustained very large losses relative to the total business they do in New Zealand.

So, insurers' understanding of Wellington risk is better than it was. The NBS is no real guide to resilience and not an input to the models. Building age, materials, height and location on soft soil or reclaimed land tell us more about the risk.

Some insurers have reduced their exposure to commercial property and/or limited the amount of cover they will extend to a property.

Offshore reinsurance costs have also increased. There is still plenty of capital available, but at a price. Premiums increased here after Canterbury, the Tohuku tsunami and after Hurricane Sandy hit New York. Premiums came down three years later and are rising again.

Rates are generally lower than in 2012-13 when reinsurance costs increased by 300%.




Let's compare New Zealand with California and Japan with similarly high seismic risks. About 80% of all property, commercial and residential, is insured here compared to about 10% in both those locations.

Our residential cover is for all perils and 98% of all residential dwellers in New Zealand are covered. We can buy up to the full sum insured to rebuild. In Japan the insured earthquake limit is 50% for residential. In California and Japan, earthquake is an optional add-on.

Business interruption cover is widely available here. In Japan it is virtually zero and in California it is very expensive to buy.

In New Zealand commercial property insurance, which includes apartment buildings because of the complexity of the risk relative to stand-alone house insurance, has a 5% excess, the amount that must be paid before the insurance cover applies. Japanese excesses are similar, but in California they are 15-25% of the Sum Insured.

Premium rates in New Zealand for earthquake have recently increased to between 0.3% and 0.4% of the Sum Insured. It's more for high risk Wellington commercial buildings in soft soil, reclaimed land, and stand-alone risks as the grey bar shows. Some of these are much the same as in Japan and California at about 1%.

Of course, total premium costs also reflect revaluation of buildings.

So, generally we have enjoyed more, better and cheaper cover than places just as risky as we are. Now as insurers and reinsurers have a better understanding of Wellington risk premiums have gone up, more so for those that were significantly under-priced for the risk.

A tiny number of Wellington apartment dwellers relative to all New Zealand homeowners claim premiums are unaffordable. It is troubling a few have decided not to take out earthquake cover.

Some real estate agents say they can't sell apartments because the insurance is not in place and people can't get mortgages.

How do people buy and sell property in Japan and California or get access to bank loans to develop and build with only 10% insurance penetration?

They have better and more appropriate building codes. Banks in California loan on a comprehensive risk assessment of probable loss and if the loss is to high require insurance above that.

So, developers are incentivised to build extremely resilient structures driven by banks who face the risks.

It’s been claimed the insurance market is broken.  Well, our cover is generally the best and most affordable in the world. There at least 6 providers even for commercial property in Wellington Central.  There is plenty of offshore capacity, but at a price not dissimilar to other countries with the same risks.

That is not a broken market.

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## Solutions
### should reflect scale of problem

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|---|---|---|
| Reduce risk | • New buildings more resilient e.g. Base isolators<br>• Change building code to increase resilience, not just life risk<br>• Invest in low cost retrofits to make current stock more resilient<br>• Look at where we build<br>• Invest in infrastructure | |
| Ride the cycle | • Global market is cyclical<br>• NZ rates become attractive to new entrants and bring downward pressure on price | |
| Retain more risk with owner | • Increase deductible from 5-10% sum insured<br>• Amend Unit Titles Act to allow owners to retain more risk | |
| Remove Fire Service Levy | • Government already looking at that | |
| Change EQC Act | • Enable residential owners in >50% commercial property same rights as residential | |
| Other interventions | • Increase EQC cap<br>• Pooling<br>• Local Govt purchases cover | removes the incentive to be resilient, creates a moral hazard, and unfair cross-subsidisation to others outside Wellington which still needs offshore capital. |

Any solutions to this very real, but localised problem should be proportionate and sustainable.

Insurance is simply a way to transfer risk whether it is provided privately or by the State. Transferring risk does not reduce risk. The only way to ensure long-term, affordability in a sustainable way is to reduce risk.

That requires changing building standards to increase resilience and reduce risk of total insured loss.

We need to invest in retrofitting properties for resilience, not just life risk. We need low-cost remediation techniques. We need low cost seismic devices installed that tell us what happened to the building, what needs fixing and how soon it can be re-occupied.

We need to think where to consent and if proposals don't meet high performance standard don't consent them.

These aren't overnight solutions but are needed to keep Wellington thriving and surviving for years to come.

We could look to ride out the global market cycle as some of the premiums increases reflect this. Possibly, higher rates will attract others into the market.

A short-term solution is to share more of the risk. The Unit Titles Act requires body corporates to fully insure themselves. Give them the flexibility to increase their excess. Retaining more risk happens the world over.

Get rid of the Fire Service Levy on insurance premiums which is uncapped for commercial property. Some commercial property owners pay more in that levy than they do in insurance premiums. Kudos to the Government for looking at that.

All commercial property is brokered. Some brokers charge a flat-fee others a 25-30% commission on the premium. If premiums have shot up 30% this year, is it necessary to add another 10% on top?

Government is reviewing the EQC Act. It could make it fairer for apartment dwellers. Currently, the 5% excess they face under commercial property insurance means they have less cover than stand-alone houses.

Those living in buildings that have less than 50% residential use can only apply their EQC cover to their unit, not to damage elsewhere in their building. Give them more flexibility.

Some options avoid reducing risk. Having another State insurer or raising the EQC cap still means having to buy reinsurance support like we do.

Governments should not replace private capital unless there is market failure. There is choice and offshore capital, but it comes at a price and for Government too.

Government capital is far better invested in low cost repair methods and resilient retrofits than being an alternative source for risk transfer.

Increasing the EQC cap has been proposed. That shifts the costs to every New Zealand homeowner. Instead of getting a relative reduction in earthquake premium from their private insurer, everyone else would pay more to support Wellington.

Is it really the policy objective that every New Zealander is fully insured no matter how high the risk at an affordable premium? That happens nowhere else in the world, and it only ever happened because we never really understood the risk.

Insurance is the canary in the mine.  Genuine hardship is traditionally addressed through our social support system. It should not be addressed by pretending the risk isn't there.  For our part, we will work with our members to communicate more openly and transparently about the risks that people face.