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Financial Markets Team
The Treasury

Emailed to: consultation@treasury.govt.nz

ICNZ'S SUBMISSION ON THE CONSULTATION DOCUMENT 'REVIEWING THE FINANCIAL SETTINGS AND LEVY SETTINGS IN THE NATURAL HAZARDS INSURANCE ACT 2023'

1. Thank you for the opportunity to provide a submission on the Treasury's consultation document 'Reviewing the financial settings and levy settings in the Natural Hazards Insurance Act 2023'.

2. Te Kāhui Inihua o Aotearoa | The Insurance Council of New Zealand (**ICNZ**) represents general insurers. ICNZ's members provide insurance products ranging from those usually purchased by individuals (including home insurance) to those purchased by small businesses and larger organisations. Our members accept the risks of over NZ$2 trillion of New Zealand's assets and liabilities.

General comments

3. The Natural Hazard Commission's (**NHC**) updated risk modelling indicates that the current levy rate is not sufficient to meet the expected costs of the NHC scheme.

4. New Zealanders see the value in having insurance and this is reflected in the relatively high levels of home insurance coverage compared with other countries.

5. This will mean increasing the levy rate will have an impact on the affordability of insurance for a significant number of consumers. This needs to be considered in the context of the current 'cost of living' pressures and may diminish the current level of insurance coverage in New Zealand. Taxes and levies already make up a significant portion of the total amount policyholders ultimately pay for their insurance, accounting for approximately 43% of an average home insurance premium. The impact of the proposals on levels of home insurance coverage will need careful consideration.

6. However, assuming that any levy increase is based on robust modelling, it will contribute to the long-term viability of the scheme. It will help ensure that there are funds available to pay for the expected costs and continue to build the fund for future generations of homeowners.

7. Insurance pricing can provide some signal of risk to current or prospective property owners, which can help to raise awareness of natural hazards risks and incentivise appropriate decision-making. The value of insurance pricing to provide this signal is likely to be increasingly important as New Zealand adapts to climate change. Increasing the NHC cap, together with NHC's community-based pricing, weakens the incentives to respond to natural hazards risks.

Responses to consultation questions

Reviewing the Levy Settings

8. ICNZ's responses to the questions set out in Chapter 3 'Reviewing the Levy Settings' of the consultation document are set out below.

Q1. Do you think the levy rate should be set to achieve the technical levy rate?

9. It is appropriate that the Natural Hazards Commission (NHC) undertakes and makes public its financial modelling and assumptions as is now occurring through the Funding and Risk Management Statement and this review process.

10. It is important that the Natural Hazard Fund is managed appropriately to maintain the ongoing sustainability of the NHC scheme. This requires a fund of sufficient size to enable ongoing claims to be met and reinsurance retentions to be paid for following large events. Meeting the costs of providing cover for natural hazards while balancing the impacts of technical pricing on affordability is an ongoing challenge. The levy should be based on robust modelling and set at a level that balances the affordability of insurance for customers and the viability of the scheme without the need for frequent changes to the levy rate.

11. If the government wishes to mitigate the impact of the proposed levy increase on the affordability of insurance for customers, then of the options proposed Option 3 (technical rate less two cents) would represent a slightly lower increase to the overall levy (from current $552 ($480 + GST) to $759 ($660+GST), rather than $828 ($720+GST)). This may mitigate affordability issues to a degree but is ultimately a trade-off between affordability for consumers and the long-term viability of the scheme.

Q2. If not, what is your preferred option, and why?

12. See our comments above.

Q3. What impacts would increasing the levy rate have on you, or any other persons, that you think should be considered?

13. Increasing the levy rate will impact the affordability of home insurance for consumers, which could lead to some consumers choosing not to insure or to underinsure their properties. It may also mean consumers choose not to insure other property (for example, home contents) to offset the increase.

14. The increase in the levy rate to 24 cents will mean the total price for home insurance or per apartment (for multi-unit residential) will increase from $552 ($480+GST) to $828 ($720+GST) for most customers, (and proportionally higher or lower increases at the 22 or 25 cent options).

15. Premiums for property insurance has increased over recent years for a number of reasons related primarily to increased peril costs and modelled risks and significant building construction/repair inflation. Along with other inflationary changes, this has put pressure on household budgets, although the pace of insurance premium increases has slowed materially over the last year or so. However, an increase in the NHC levy of $276 ($240 + GST) will have major impacts on home insurance premiums, particularly for more modest homes where the NHC scheme provides a significant portion of the total cover and represents a significant proportion of the price.

16. The total NHC levy of $828 ($720 + GST) would be a particularly substantial cost for a homeowner in a low seismic risk area who could potentially face materially lower costs for this cover on a risk-based pricing basis.

17. If premiums become unaffordable for some customers, there is a risk that underinsurance could increase. This could have an adverse impact on our customers if an event were to occur and their cover is not sufficient to help them recover from any losses.

18. Increasing the levy rate would also mean significant costs for insurers to make system and operational changes to implement the levy change. Significant resource will be required for communicating changes with customers and brokers, and training staff.

19. Assuming that any levy increase is based on robust modelling, it will contribute to the long-term viability of the scheme. It will help ensure that there are funds available to pay for the expected costs and continue to build the fund for future generations of homeowners.

Q4. What do you consider an increase from the current levy rate to the technical levy (an increase of up to $240 (plus GST) per dwelling per annum) would have on the availability, affordability, and uptake of NHI and private catastrophe insurance for residential buildings?

20. We expect there would be a negative impact on insurance affordability, which could lead to lower uptake and leave people uninsured.

21. Levies and tax (NHC levy, FENZ levy and GST) make up a significant proportion of the premium a customer pays for insurance and any increase creates affordability issues and financial pressures for customers. Customers may be particularly sensitive to premium increases, especially in the context of current "cost of living" pressures. We would expect to see an increase in customers cancelling their insurance. Those customers that have a mortgage, who can afford the increase, or those that value insurance cover will maintain cover. We would expect this to be the majority of customers. These customers may seek to reduce the cost of their home cover by selecting voluntary excesses, reducing the cover from replacement to indemnity cover or choosing to deliberately underinsure. There may be further impacts on other types of insurance cover as customers seek to reduce their overall insurance costs to offset a rise in house insurance costs, for example, they cancel cover on contents and motor vehicles or reduce vehicle cover from comprehensive to third party fire and theft or third party only.

22. Underinsurance leads to poor customer outcomes in the event of a claim as the customer needs to contribute financially themselves to fully repair or rebuild their homes. This can put the customer into financial hardship. For major claims events, the impacts of this could be widespread and lead to slower recovery in the economy.

23. We do not expect the proposed increase in levy will affect the availability of insurance.

Q5. How do you think this impact would change for a smaller or larger increase in the levy rate (plus GST) per annum per dwelling?

24. The impacts described in Q4 should be proportional to the magnitude of the levy increase.

Q6. Do you consider the proposed approach to levy setting (e.g. temporarily increasing levy rates after a major event) appropriately balances certainty and flexibility in future levy rates? If not, why not?

25. While we do not have full details and we do not know what is intended by 'temporary', in principle, we do not support temporary increases to levy rates after major events as a mechanism for sustaining the scheme and consider this should not be factored in as an option to rebuild reserves.

26. For the purposes of planning and certainty in the market, changes to the levy rate should not be made on a temporary basis. We would prefer that the levy is reviewed on a regular, predictable cycle so that insurers understand when regular changes are likely to occur, and they can then allocate resource to make system changes and communicate the changes to customers.

27. The consultation paper states that a post-event levy increase would need to be implemented either by an Act of Parliament, or by implementing a levy increase through the processes specified in the Natural Hazards Insurance Act (NHI Act). We

question whether a temporary levy would be straight-forward or quick to implement in practice in the aftermath of a major event.

28. There is no difference to the insurer resource required to implement a temporary or a permanent levy change. As with an ordinary levy, imposing a temporary increased levy rate would require insurers to make system and operational changes to implement the levy change. Significant resource would also be required for communicating changes with customers and brokers, and training staff. This could potentially pull resources away from the insurers' response to the event itself.

29. As with any levy rate change, insurers would need at least 12 months to implement the change. Because the change takes effect at policy renewal, it would take two years for the scheme to benefit fully from the temporary increase.

30. Any reversal of a temporary increase would take the same amount of time to implement. This means that the time taken to temporarily increase and then reduce the levy rate will likely see the five-year period for the review of the financial settings and levy settings (as part of the Funding and Risk Management Statement required by section 136 of the NHI Act) pass or be imminent. As such, this negates the concept of a 'temporary' increase.

31. We also see a risk that 'temporary' increases would not in fact be removed in time but rather made permanent the next time the levy rate was reviewed as part of the usual process.

32. A temporary increase in the levy will generate uncertainty, require significant resource, has the potential to cause consumer confusion and will not give consumers confidence in the scheme. A temporary increase in the levy would also impact the affordability of insurance as identified for ordinary levy increases.

Q7. How much time would be needed to implement a levy rate change?

33. Insurers would need a period of at least 12 months from when the levy rate change is confirmed and announced. This assumes it is only the levy rate changing and not the building cover cap.

Q8. Is there a particular good or bad time of year to introduce a levy rate change?

34. Different dates have been used for previous changes (July in 2019 and October in 2022) and have proved workable. The key is the amount of time provided to implement and how the change relates to other regulatory changes, particularly those with overlapping system impacts or resource requirements. From a resource perspective, the summer holiday period (December to March) should be avoided.

Reviewing the Financial Settings

35. ICNZ's responses to the questions set out in Chapter 4 'Reviewing the Financial Settings' are set out below.

Q1. What impacts would increasing the building cover cap have on you, or any other persons, that you think should be considered?

36. We recommend that the building cover cap should remain at $300,000. While, as the consultation document states, the cap is no longer aligned with the original metric (the average rebuild cost of a home), this has been the case for a significant period of time. The average rebuild exceeded the cap from soon after it was set under the 1993 Earthquake Commission Act, noting that the cap was not changed until 2019. There are other considerations that should be balanced while setting a cap. These included natural hazards risk signalling via insurance pricing, the overall programme cost, and the impact of the cap on the private market. A cap of $300,000 appropriately balances these factors.

37. Increasing the cap would increase the total exposure for the natural hazard fund (and the Crown) following a large seismic event.

38. It would also require NHC to increase the size of its reinsurance programme. Insurers would also likely need to resize and renegotiate their reinsurance programmes.

39. A higher cap would increase the percentage of costs related to levies for the customer and will increase the cost of insurance for those customers in lower risk areas. A higher cap would reduce risk signalling to an extent for residential buildings in higher seismic risk areas and subject to seismic risk-based pricing.

40. Increasing the cap would also reduce the amount of residential property underwritten and premiums received by private insurers and increase volatility for insurers – and thereby reducing the attractiveness of participating in the market.

41. There would also be broad impacts across insurers' businesses, including claims, pricing, finance, reinsurance sales and distribution, and marketing and communications, to implement the cap change. Insurers would be required to update their IT systems, customer documentation and customer communications. Significant resource would be required for communicating changes with customers and brokers and responding to their queries. Insurers would need to review their natural hazards pricing models which would require a significant allocation of resources. Any change may also potentially impact NHC claims reporting, financial reporting and payment processes.

42. Customers have a limited understanding of the cap and how their cover works. Communications and education would be required to support any change. The situation can be particularly confusing for customers if an event occurs within a year of an increase to the cap, when some customer's policies will be subject to the new

cap (because the policy has recently been entered into or renewed) but others are still subject to the lower cap.

Q2. What do you consider would be the impact of increasing the building cover cap to $400,000 (plus GST) per dwelling on the availability, affordability, and uptake of NHI and private catastrophe insurance for residential buildings?

43. More community pricing encapsulated in the cap de-emphasises and reduces insurer risk-based signalling. It will reduce the impact of insurance cost as a means to discourage building new homes in high-risk areas.

44. Increasing the cap potentially increases the cost to customers, particularly those in low-risk areas who pay a disproportionate amount for NHC cover. This encourages underinsurance as customers seek to reduce the overall cost of insurance and decrease their cover to nearer the cap, seeing the cap as a means of replacement of natural hazard peril without understanding the implications of this decision. This can lead to a difficult claims experience, and financial and emotional stress for customers as well as bad publicity for the insurance market and NHC.

45. Those in low-risk areas would pay a disproportionate amount of NHC cover that is not comparable to the natural hazard risk in those areas. As such, this change will increase the subsidisation of high-risk customers by low-risk customers which may result in affordability challenges for low-risk customers.

46. However, the precise impact of the cap increase is uncertain as changes to insurers' reinsurance programmes and external model changes will also influence this.

47. We do not expect the proposed cap increase to meaningfully affect the availability of insurance.

Q3. Would increasing the building cover cap to $400,000 per dwelling have any other impacts that you think could be considered? If so, what are they?

48. The Natural Disaster Response Agreement (NDRA) was recently re-negotiated and fees agreed on the basis of the current cap of $300,000. If there is a change to the cap, then consideration would need to be given as to whether the current arrangements and insurers' participation in the NDRA is still appropriate.

Q4. Do you consider that the floor on NHI building cover of $2,500 per square metre should increase? If so, why, and what do you consider the basis for setting the new rate should be?

49. It may be appropriate to increase the floor on cover given the level of building inflation in the last five years. However, it is worth noting that the impact on the funding model will not be significant due to the low number of policies affected (such a change would apply to indemnity contracts which only a very small proportion of customers have). Despite this, insurers should still need to allocate significant resource to implement the change. If this change occurs at the same

time as a levy rate change, and/or a building cover cap change, this will extend the time insurers would need to make the changes.

Q5. Do you think any of the excesses and caps on retaining walls, bridges and culverts should be changed? If so, which ones, by how much, and why?

50. We do not consider any changes are required.

Q6. How much time do insurers and brokers need between when a building cover cap change is announced or gazetted, and its commencement? Please explain the key drivers of your estimate.

51. A cap change has a wide set of impacts for general insurers on claims, pricing, underwriting, perils budgets/reinsurance, and marketing and communications that means more time is required than for a simple NHC rate change.

52. Insurers would also require external vendors to provide updated models and reinsurance programmes would need to be renegotiated. Insurers would need time to potentially resize their reinsurance programme so that they are appropriately calibrated to what will be a reducing level of exposure as a cap increase flows through over one year of renewals. Insurers' programmes also renew at different times of year and so significant notice is required to allow this to occur efficiently.

53. The time needed to implement a cap increase would depend on whether a levy rate increase is being introduced at the same time. If both are to change at the same time, then we consider the changes should not take effect until 1 July 2027 as a significant lead time is needed to make the changes concurrently (noting that FENZ levy changes come into effect on 1 July 2026 so insurers will be putting significant resources into that).

54. If the change to the NHC levy rate and an increase to the cap were to happen separately then we consider there should be at least 12 months in between the changes.

Q7. Is there a particular good or bad time of year to introduce a cap change?

55. From a resource perspective, the summer holiday period (December to March) should be avoided. What is most important is to allow an adequate time period overall and to consider whether the change needs to align with, or significantly avoid, other relevant regulatory changes.

Phasing in levy rate changes over time

56. ICNZ's responses to the questions set out in Chapter 5 'Phasing in the levy rate changes over time' are set out below.

Q1. Would phasing the proposed levy rate increase over time meaningfully mitigate the cost implications for household budgets?

57. We do not support phasing the proposed levy increase over time.

58. There is potential to mitigate the immediate cost impacts for homeowners but the difference in the levy is not substantial enough to warrant phasing in the levy rate increase over time given the downsides of this approach. We support having the levy increase once rather than in two or three steps. This would mean communicating with customers only once about the change in levy rate which will be clearer and less confusing for customers. Phasing creates a prolonged period of continual change, creating possible confusion and additional communications and change requirements. There is significant resource and system costs for insurers in any levy rate change and to do this a number of times detracts resource from other initiatives that would benefit our customers.

59. Phasing also requires higher levy rates in later years and leaves the Natural Hazard Fund more depleted in earlier years.

Q2. The Government is also currently reviewing FENZ levies. Do you prefer the timing of any NHI levy settings changes to align with changes in the FENZ levy, or that the changes occur at different times?

60. If there is only to be a NHC levy change (and no change to the building cover cap), then we would support alignment with FENZ levy changes at 1 July 2026. Aligned effective dates of FENZ and NHC changes does provide synergies and opportunities to deliver these changes more efficiently.

61. Where possible, we consider aligning NHC and FENZ levy changes is preferrable so that the timing for the changes is predictable which allows insurers to plan and allocate resources to implement the changes and customers can budget for increases well in advance.

62. If there is a NHC Levy and a residential building cap change at the same time, then as we would recommend a 1 July 2027 effective date.

Q3. If you prefer different times, how much of a time gap do you prefer between a change in the FENZ levies and the NHI levy settings?

63. If the changes are made at different times, there should be a 12-month gap between the two changes. A large gap would reduce overlap of specialist resources and provide space for dedicated change work. Separating them by a small amount of time (e.g. July and October) would remove the potential synergies and create more complexity with few, if any, benefits.

Q4. Would phasing in any changes over time cause any implementation issues?

64. Our strong preference is to increase the NHC levy in a single increase. This would help reduce the NHC related workload on the business over the next five years.

65. Phasing in changes would require insurers to allocate resources repeatedly to the changes and this would increase the overall cost. Multiple changes need to be planned, executed and tested and have consequential impacts on customer

documentation and communications. It would create a multi-year period of effectively continuous change for insurers, brokers and customers.

Q5. Do you have any other comments on implementation?

66. We reiterate the need to provide as much lead time as possible and the earlier we have certainty on any new changes the better.

67. Insurers have a significant amount of change to implement over the next few years, including the FENZ levy regime changes taking effect on 1 July 2026 and the Contracts of Insurance Act 2024 coming into effect by November 2027 (date yet to be confirmed). In setting the timing for any changes to the NHC levy for the financial settings, it is important that this is taken into consideration in respect of the impact for both customers and insurers. There will need to be extensive changes communicated to customers across the various regimes with potential impacts on the cost of insurance. We need to mitigate the risks of confusing customers and increasing underinsurance. Insurers will need to use significant resources to implement regulatory changes detracting resources from other initiatives that could be undertaken for the benefit of our customers.

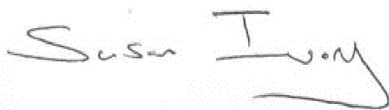
68. If there is an increase to the cap, insurers and NHC should consider consumer education as NHC cover is not well understood.

<u>What happens next?</u>

69. Chapter 6 'What happens next?' asks stakeholders for any other comments on the discussion document. We do not have any further comments.

70. Please feel free to contact me if you need any further information about this submission.

Yours sincerely



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