Insurance and reinsurance issues after the Canterbury earthquakes

There have been more claims and affected policyholders as a result of the Canterbury earthquakes than from any other insurance event in New Zealand, and the insurance cost of the earthquakes far exceeds the cost of all previous disasters in New Zealand. The complexity of the Canterbury earthquake claims settlement process, due to many aftershock events, means that there is considerable uncertainty about the timing of insurance claim settlements.

Insurance cover is provided by several insurers including the Earthquake Commission, private insurers and reinsurers.

Earthquake Commission

The Earthquake Commission (EQC) is a government owned Crown entity that provides primary natural disaster insurance to the owners of residential properties in New Zealand. A levy is collected from all private insurance premiums and contributes to the EQC’s Natural Disaster Fund. Prior to the Canterbury earthquakes there was $5.6 billion in the Fund. However, in August 2011, the EQC announced that its Natural Disaster Fund is likely to be exhausted by earthquake claims. The Commission pays up to $100,000 + GST for house repairs and $20,000 + GST for contents.

Earthquake Commission claims overview

<table>
<thead>
<tr>
<th>Event</th>
<th>Number of claims</th>
<th>Open</th>
<th>Resolved</th>
<th>Claims with a payment made</th>
<th>Total paid to date (m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>4-Sep-10</td>
<td>156,745</td>
<td>107,880</td>
<td>48,865</td>
<td>77,985</td>
<td>$1,212</td>
</tr>
<tr>
<td>22-Feb-11</td>
<td>156,463</td>
<td>136,720</td>
<td>19,743</td>
<td>67,366</td>
<td>$1,344</td>
</tr>
<tr>
<td>All events (including aftershocks)</td>
<td>407,549</td>
<td>330,306</td>
<td>77,243</td>
<td>166,132</td>
<td>$2,554</td>
</tr>
</tbody>
</table>

Source: New Zealand Earthquake Commission

Private insurers

The private insurance sector is characterised by a small number of large insurers with large market share and several smaller providers. One of the larger insurers, AMI Insurance Limited, was particularly affected by a high number of building and household claims after the earthquakes. Concerns surrounding the ability of AMI to meet these claims led to government intervention. In April 2011, the government announced a backup financial support package to give AMI policyholders certainty and to ensure an orderly rebuild of Christchurch in the aftermath of the Canterbury earthquakes. The support package will be called on only as a last resort if AMI’s own reserves are completely depleted.

If required, the package will involve the government investing up to $500 million of equity in AMI, with the right to take ownership and assume control of the company if needed. The ultimate cost to the government will depend on the final cost of AMI’s claims, which remain uncertain, and the outcome of AMI’s recapitalisation process which is currently underway. However, Treasury estimates that the likely cost of the support package will be $337 million.
Reinsurance

Reinsurance is insurance that is purchased by an insurance company from another insurance company (referred to as the reinsurer) as a means of risk management. Without the support from reinsurance there would have been either more insurers in financial difficulty as a result of the earthquakes, or reduced levels of insurance coverage. Reinsurance cover will contribute the majority of total funding for property-related insured losses from the Canterbury earthquakes. The remainder will be met by a combination of funding from the EQC and the original private insurers. The EQC also relies heavily on reinsurance to cover a significant proportion of its residential insurance claims.

Distribution of Canterbury earthquake insurance claims

The reinsurers funding the majority of earthquake claims are large global reinsurers. They generally have strong financial ratings and the ability to absorb the elevated level of global reinsurance claims from a series of recent natural disasters around the world (including the Japanese tsunami, Australian floods and a large earthquake in Chile).

Insurance costs and availability

An important short-term impact of the Canterbury earthquakes has been the reduction in the availability of new insurance in the region. Most businesses and households are unable to change insurers at present. For those currently without insurance cover, the impact is more significant. For example, owners of some earthquake-prone buildings and infrastructure can no longer get insurance cover in Canterbury or elsewhere in New Zealand. Other changes to date include higher premiums to fund increased reinsurance costs and larger excesses. On 11 October 2011, the Government announced that EQC levies would triple from February 2012 to meet EQC’s higher reinsurance costs and begin replenishing the Natural Disaster Fund.

In the long term, insurers and reinsurers will reassess their risks and opportunities in New Zealand. It is expected that this will include the eventual return of an active market for new customers in Canterbury. There will also be a review of EQC within the next few years which could affect the interaction between the public and private provision of insurance for earthquake related risk in New Zealand.

Charles Feltham, Research Services Analyst

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