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The Insurance Council is an industry association representing New Zealand's property and casualty insurers.

John has 28 years of experience in the insurance industry and has had varying roles in New Zealand, the UK, and Australia.

John is a Senior Associate of the Australian & New Zealand Institute of Insurance & Finance (ANZIIF), and he is pleased to address this forum on the lessons learned from the Gisborne Earthquake.

Good afternoon everyone.

I'm going to speak briefly about residential issues, and then concentrate on commercial property and probably add to and answer some of the questions that previous speakers have outlined.

My role, or one of my many roles within the Insurance Council, is the Insurance Council Emergency Plan Co-ordinator. This means that when there is a major event that our members feel may overwhelm their day to day resources, I get involved and go to the event area to find out what the key issues are. My main point of call is with the local authority.

I am a member of the National Welfare Co-ordination Group that operates in Wellington. The purpose of this group is basically to pull together information and knowledge from outlying areas of the country on any events that occur. I was contacted on the night of the Gisborne earthquake event, so we do get very good information from the National Welfare Co-ordination Group here in Wellington.

Some days later I travelled to Gisborne and met with Ian Petty at the Gisborne District Council (GDC) and we started to get a handle on what had happened. In particular, we discussed the extent of the damage, the situation in the commercial area, and the assistance that was needed. The main insurance issue facing the GDC was that some properties had been issued earthquake prone building notices some years before. There were also general issues with façades, and a number of limitations associated with the building work that were in place at the time.

1 Residential Property

I'm going to speak briefly on behalf of EQC regarding residential property. The total claims paid by the EQC were \$26.3 million for Gisborne. There were actually 6,220 claims to the EQC for residential housing and contents in Gisborne. Sixteen of those claims exceeded the \$100,000 cap and that's where our members, the insurance companies, started to pay the difference between the cost of the damage and what EQC pay up to their \$100,000 cap.

The Insurance Council members paid out \$1.7 million for residential damage on roughly 310 claims. These payments may not just be for damage to buildings. Other things that are covered may be differences in conditions between the policies, such as swimming pools, temporary accommodation – things that are not covered by the EQC.

The only real longer-term issue that became a concern for insurers and GDC was damage to chimneys that was not picked up during the inspections immediately following the earthquake, or if damage was identified and the repairs had not been undertaken. Even so many home owners were unaware of any chimney damage. As the winter of 2008 approached and people used fireplaces with damaged chimneys the risk of house fires became the insurers' and GDC's primary concern. At least one fairly significant house fire in Gisborne occurred due to a chimney that had more than likely been damaged in the December earthquake. The Insurance Council got together with the EQC and the GDC and we agreed on some media messages that were dispatched fairly quickly to the Gisborne Herald and a number of other papers throughout the country. We also, along with help from our members, sent a notice out to home owners that had claims paid in the Gisborne area. The message directed home owners to check their chimneys because what invariably happens is that the EQC settles losses with the insured directly in the form of cash and repairs are not necessarily made. We were afraid that some people may not have actually spent that money wisely and had failed to check or repair their chimneys. Insurers have had no problems since sending out these media releases and message and we are pretty sure most of the chimneys have been repaired now.

2 Commercial Property

2.1 Under-Insurance

As Abigail outlined earlier, under-insurance was a problem in Gisborne. Some of the areas of under-insurance involved buildings which were insured just for present day value, not replacement. This may have been a choice made by the owner being faced with potentially higher insurance premiums, or maybe insurers were unable to offer replacement cover because the building did not meet certain risk acceptance criteria for example the building may have been of unreinforced masonry construction.

In Gisborne, there were very few buildings that had significant damage which rendered them a total loss. Most were repairable, however there were a number of cases where you had buildings with significant structural damage and the building was insured for present day value only and that will not cover the repair costs. If the building was unsafe to occupy, the tenants moved out. An untenanted building is not generating income, so the building sits damaged and vacant. The owner's insurance claim is settled in cash because it will not be enough to start the repairs. After a number of years the GDC may be forced to look at demolition options because the building is in dangerous condition. Unfortunately, in Gisborne that could mean the loss of a heritage building.

2.2 Building Upgrades

When building owners are presented with earthquake prone building notices and upgrade requirements, they are normally given a period of between 5-15 years (depending on which part of the country you're in) to upgrade the building. This simply means that the owner of the building is required, within a certain period of time, to bring that building up to current earthquake strength code.

In the case of Gisborne, the GDC required strengthening to two-thirds of the current code; most parts of the country go for at least one-third. There's nothing wrong with that, but it may have been a barrier for many owners to actually upgrade because they were potentially looking at greater costs to upgrade the full two-thirds than they would do for the one-third. Maybe that's why a lot of people in Gisborne did not upgrade as soon as they were given notice. The problem that causes with insurance is that once you've received a notice, most insurance policies will state the insurance company won't be responsible for the cost of the upgrade that's already been notified. There can be some exceptions due to contractual differences but that is the norm. In the case of Gisborne it is possible a lot of people may have failed to understand this, and that it probably wasn't explained very well by insurers or insurance advisors. So if you have a building notice requiring an upgrade, especially a seismic upgrade, and the building has a loss within the period of the notice, you are going to be on your own for those upgrade costs – the insurers will meet the rest of the claim.

2.3 The Availability of Engineers

The other issue, from our members' point of view, was the low availability of engineering resources. There was, as both Felicity and Abigail mentioned earlier, a huge shortage of engineers in Gisborne for the longer term. The initial earthquake assessments were fine; they were done very quickly under the control of the Gisborne District Council. However after the immediate response, engineers may have been facing time constraints if they were coming from the Hawkes Bay, Auckland, or the Bay of Plenty. The event happened pretty much during the height of New Zealand's building boom and there was plenty of work for engineers in their own patches. If the event happened today, it might be a very different story - there may be a lot of engineers with the capacity to work in a remote area like Gisborne. Certainly in Gisborne there weren't enough engineers available to get the work done for the insurers.

We rely on the engineer to assist with the building consents because they are quite complex. It helps when engineers understand the difference between what is and what is not insured under the policy. In other words, earthquake strengthening issues weren't covered in a lot of cases, and information about what the insurer will pay under the policy is important. This information needs to be clearly communicated to the building owner, the engineer and the local authority. It would be great if the Insurance Council along with say IPENZ could facilitate some sort of understanding or even training in this area.

Right now, the Insurance Council has a joint working group in Auckland that includes the seven Auckland building consent authorities developing an understanding what is required with the Building Act for insurance repairs and reinstatements.

We have an idea now of how quickly insurers can apply for a building consent, get it approved, and then get the building repairs underway. There are no short cuts because building consent authorities are governed by the Building Act 2004 and insurers do not want to be liable for any form of noncompliance. There are provisions for emergency repairs but at the end of it the building owner needs to get a code of compliance certificate. We have witnessed a lot of misunderstanding around how the building code works and – I will be honest – even our members struggle with this at times. If you have one bit of application information missing, you could delay your claimant getting back into their home or business. The Insurance Council will be developing a guideline for all its members in 2010 on building act compliance.

2.4 Business Interruption Insurance

The uptake of business interruption cover is low. Business interruption insurance is not well understood by many landlord property owners; it's really a loss of rental income insurance cover. You've got a building, you rent it out, you have a loss, and your tenants can't pay rent anymore because they can't occupy the building. The insurance pays out the loss of profit or loss of rents until such a time as your turnover or your profit is back to where it was prior to the event. That might mean that you start trading again or you get a few tenants back into your building, but if you're not back to where you were prior to the event, the insurance company is still paying you money. This, of course, assumes that the actual sum insured for your business interruption or your loss of rents is adequate and you have an adequate indemnity period. The indemnity period is the period of time of which the interruption cover runs. Most insurers will provide up to 36 months business interruption following earthquake. If you've got a building with unreinforced masonry and is quite marginal insurance risk you may see that limited. In Gisborne the maximum cover that we saw was too short – 12 months certainly wasn't enough. Some people had six months cover, most building owners had 12 months, and the odd one had 24 months. It took 12 months to start repair work on some buildings, so for some owners, the business interruption insurance or loss of rents cover had actually run out before anyone started to pick up a hammer.

3 Total Claims

All up the Insurance Council members paid \$26 million for the 425 commercial property claims. For the residential payout, which I mentioned earlier, the EQC paid out \$26.3 million, and the insurance companies paid \$1.7 million. The total payout for the whole event was around about \$55 million. Insurers have not paid all that money yet because not all those buildings have been repaired, but the insurers have reserved that money against their accounts and that money will be paid once those buildings are repaired.

4 Poor Conduct

In response to comments from Abigail's and Felicity's, earlier presentation, the Insurance Council is striving to develop standards and systems that will allow us all to work efficiently and to improve our business.

We have learnt lessons from this event and will continue to learn lessons from future events. With regard to the comment about poor conduct either from loss adjusters, insurers, or engineers – I have to be honest – there is no room for poor conduct in our industry. Poor conduct will mean those people are not going to be used in the future and that's a given.

5 Demand Surge

The people who have insured their home and contents over the last couple of years have seen, throughout the country, a general increase in insurance premiums. It wasn't because of the Gisborne earthquake. A lot of those residential claims were actually paid by EQC anyway however over the last 2 years insurers have had to put up their insurance rates to cover the major storm and flood losses of recent years not to mention the large increase in one off structure fires around the country. So, premium increases are something that's just been ongoing.

Certainly there would have been a problem if this had been a bigger event in say Auckland or Wellington because we were at the height of the building boom. Valuations on buildings need to factor in possible

demand surge if you have a catastrophe event like a widespread weather event or a major earthquake. A lot of people who insure buildings don't understand what is really required to insure a building for "full replacement". Owners need to get a valuation from a registered valuer who understands all the insurance provisions that need to be included. These include the indemnity value required for the charging of fire service levies, the inflation on top of your replacement value, and demand surge increases. It's quite complex and a valuer really needs to know what insures require.

Many building owners from my experience are simply just a bit shy about paying for the work of those valuers to ensure that insurance values are correct. People are going to be caught short time and time again if they don't have those values correct.

Thank you.

6 Questions

David Thompson:

Thanks John, David Thompson from Continuity Forum just following your last remark, do I take it that you're saying that building owners should have regular assessments of their valuation for insurance purposes?

John:

The initial valuation of your building for insurance purposes is quite costly but we recommend having it done every two years. From about 2002 onwards we started to witness massive increases in building costs and a lot of our members were telling us that even though they weren't getting total loss claims, they were dealing with a lot of partial loss claims. With minor fire damage to a building the cost of the damage was getting up to 75% of the actual total value of the building – you straight away knew that there was under insurance in a lot of cases. Housing is not a problem generally as we have total replacement policies based on the size of the house recorded in square metres. It's inflation proof. Certainly for commercial buildings and plant, under insurance is a big problem – not just in Gisborne.

Anon:

You said a quite a few things about not allowing for poor performance. It's all quite clear what people need to do and I think that's all very positive and it's good to hear that the Insurance Council is conveying those messages. I just want to ask you, do you think that those messages are actually quite clear to the general public? Or do you see maybe a more prominent role for insurance in conveying the message to the general public?

John:

No I think those messages are unclear. Gisborne people may be a bit more alerted to those issues because they have been through a big event, but I think the rest of New Zealand are pretty passive about it. We need to do more to make people aware of business continuity issues so they can survive a moderate event and get back in business. I think we do very well with EQC and earthquake education – being safe in an earthquake, surviving events, finding your family, all that sort of Civil Defence stuff. I think we need to do more for the business community. Most businesses in New Zealand are small to medium enterprises and that's what we need to target. In comparison, the big corporate enterprises that are responsible to shareholders normally have in-depth continuity plans. We need to facilitate the uptake of continuity planning with the smaller

businesses.

Michelle Rafferty:

Michelle Rafferty from Mayston Consulting. In our area, and in a lot of other regions, we are doing a lot of the earthquake assessments on commercial buildings. I was just wondering about the effect on insurance premiums if the building is actually declared an earthquake prone building or an earthquake risk building in the NZSE guidelines – is there a lot of awareness amongst insurers? Are they asking people about the outcomes of these assessments? And is it having a direct effect on the premiums?

John:

Yes, they are – I can't really talk about pricing. I just don't know what the pricing is and I wouldn't be allowed to know given my position. First of all, under your insurance policy it's a disclosure requirement to notify your company if you are issued an upgrade notice. If you fail to disclose this it could void your policy, it's something very important to know. If you've employed a risk engineer to assess your building once the Territorial Authority have done their initial earthquake risk assessment and they're satisfied about the earthquake risk of your building you really must disclose that to your insurer. If you need to earthquake strengthen then talk to your insurer or through your insurer's advisor about what sort of timeline you're thinking that you may be able to do the upgrade work. You should also get an indication from your insurer about their views towards continued cover after the upgrade. In many cases the insurance risk will have improved somewhat. Remember a lot of this is life safety.

If you get a decent earthquake, insurers could still be faced with what we call a constructive total loss on some strengthened buildings. That it doesn't mean to say that the building will collapse and you will have a loss of life – you probably would not see parapets coming off like we did in Gisborne, which is potentially quite costly and very dangerous.

Out of interest I attended a public meeting at Wellington City Council recently on plans for earthquake strengthening on many buildings. There were a lot of concerned property owners including apartment owners and their upgrade scheme was actually discussed openly. They were saying "if we upgrade to one-third now and in ten years time you move the goal post forward again to keep up with future Building Act advances, we are going to have to go through this whole process again and perhaps upgrading to two-thirds now might be more sensible and it may not cost much more". So I feel that's what building owners should think about when they're faced with these notices.