

Commercial in confidence

Report for CERA

Overview Analysis of

Residential Insurance Claims Process

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Executive summary

1. This report relates to the period mid-October 2012 to mid-December 2012. Some information was obtained or updated in mid March 2013 and early August 2013. The key findings and recommendations set out in this report were conveyed to CERA in April 2013.
2. As at September 2012, there were widespread perceptions that EQC and insurance companies were not making sufficient progress in processing and settling claims. There were conflicting impressions and anecdotes of problems and rates of progress.
3. CERA engaged me to provide an independent view on:
 - The nature and extent of any significant problems in the residential insurance claims process of EQC and insurance companies (together referred to in this report as 'the RICP'); and
 - What, if anything, should be done from a Government perspective to address those problems.
4. Key steps in the RICP are summarised in Figure 1 on page 6 below.
5. The proposed quantitative pilot survey of a representative sample of claims turned out not to be possible. My information collection and analysis has therefore relied on a mix of qualitative and quantitative data. Southern Response and Vero provided aggregated numbers of claims at different stages in the RICP. A range of parties in the RICP provided qualitative descriptions of perceived problems.
6. I carefully weighed both sets of information. Self-interested or apparently biased information has been discounted. The absence of alternative views on some perceived problems has been taken into account. Weight has been given to information that has been corroborated by independent sources. To this distillation, I have applied my independent professional judgement.
7. In summary, my findings are as follows:
 - a. The Canterbury earthquakes of 2010 and 2011 put the RICP under enormous pressure. The challenges have been substantial – for EQC, insurers, claimants, and other stakeholders.
 - b. For EQC and insurers, the efficiency¹ of their normal claims processes was challenged by a combination of several significant external factors, including an extended period of material seismic activity; a very high volume of claims; incomplete information for a large proportion of claims; uncertainties in the law relating to EQC's liability, and how it applies across a range of claims; and a 'charged' political environment with disconnects between public expectations of fairness, claimants' perceptions of entitlement, and that which the law allows under EQC's statutory liability or relevant insurance policies.

1. _____

¹Efficiency' in this context means settling with the claimant in a timely and cost-effective manner that which he or she is entitled to under the relevant insurance policy or EQC legislation.

- c. To maintain an efficient RICP in the face of these drivers, EQC and insurers needed to radically strengthen their respective capacities quickly across all key fields, including human resources, organisational systems, data collection and management, claims processing systems, customer service, corporate services, and stakeholder communications.
- d. It was to be expected in a natural disaster of this scale and complexity that all sorts of significant problems and uncertainties would arise in the claims processes of EQC and insurers.
- e. During the period under review, the main problems were in the 'Assessment' stage of the process outlined in Figure 1. However, as more claims move to repair or rebuild, problems in the 'Action' stage are becoming more prominent. Some of the issues distilled in the course of this review are set out in Appendices 1 and 2.
- f. The parties' approach to resolving issues seems to have been reactive and piece-meal. It is fair to say that the environment has been characterised by constant 'fire fighting'. Apparently new issues in the RICP have continued to surface, for both EQC and insurance companies.
- g. Some short term or issue-specific 'fire fighting' is unavoidable. However, failure to fix systemic weaknesses with systemic solutions is likely to have sustained the flow of apparently new problems, or impaired the resolution of known problems.
- h. Greater gains could be achieved by identifying the underlying issues that cause clusters of problems, and systemic improvements that could be made, by EQC and insurers, to reduce the frequency, scope and scale of those problems.
- i. Based on preliminary analysis, it would appear at a systemic level that (among other things):
- o Core systems and processes put in place following the earthquakes have not been capable of efficiently handling the 450,000+ claims relating to approximately 170,000 residential properties. Further, the systems and processes of EQC (on the one hand) and insurers (on the other) do not seem to have been well integrated, making data management and claims processing in a 'two tier' insurance structure relatively inefficient;
 - o The key parties (EQC, insurers, Government, or local authorities) have not recruited the number and quality of people required to manage the volume and complexity of claims generated by the earthquakes;
 - o EQC's claims settlement process is unnecessarily convoluted and inefficient, even taking into account the complexities caused by apportionment and volume. I understand that it is not uncommon for a claim to go through 30 sets of hands before settlement. Further, as noted in Appendix 1, claims commonly 'churn' through EQC's process (and between EQC and insurers) many times; and

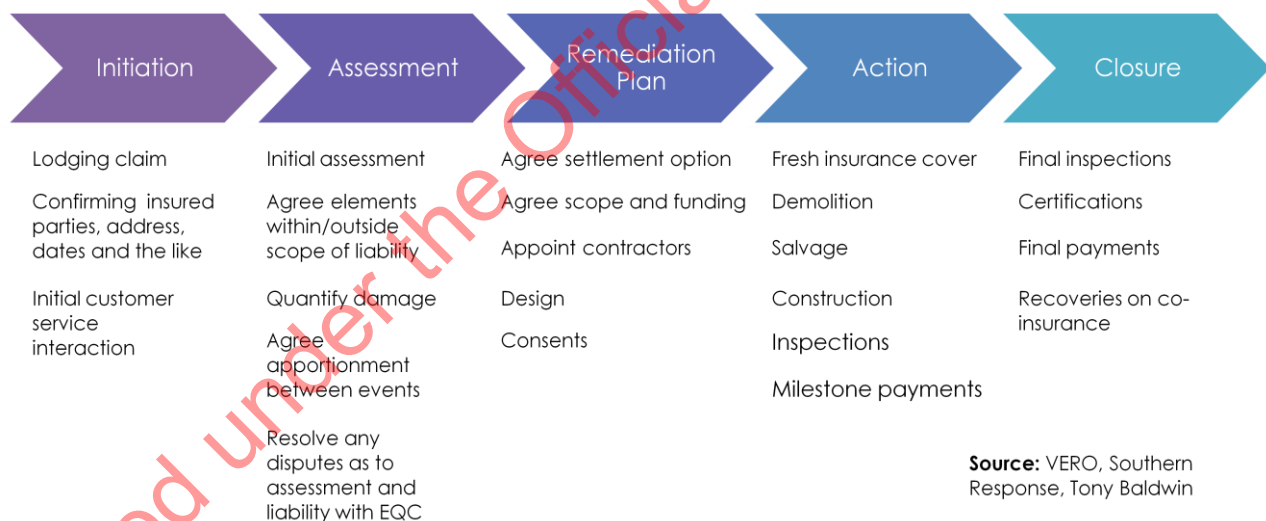
- o EQC's claims process seems to have evolved in an ad hoc manner. As noted in Appendix 1, I am advised that it fails to anticipate and provide guidance to claims officers on how to handle predictable issues, so whole categories of claims frequently stall in the settlement process waiting for EQC managers to make a policy decision. I also understand that EQC's claims process is subject to constant piece-meal variations by EQC management – typically eight to 10 per week.
- j. Further analysis of systemic issues and solutions should be undertaken as soon as possible. Based on my preliminary analysis, it is recommended that EQC and insurance companies:
 - o **Upgrade skills:** Systematically and urgently upgrade the quality of key people through-out their organisation – by better training and/or replacing staff with more capable people, and 'right-sizing' to ensure sufficient quality resource is where it is needed;
 - o **Upgrade data and other key systems:** Systematically upgrade the quality of data and other key operating systems through-out the relevant organisations, including customer service delivery. (EQC processing than 400,000 claims makes it comparable with large scale data processing by banks, electricity and telecom service providers. EQC should have comparably robust and efficient systems);
 - o **Invest in process design:** EQC is constantly changing its claim process on a short term and ad hoc basis. Improving the design of the claims process on a more structured basis (using external expertise if required) should significantly improve the quality and quantity of claim settlements over the medium term;
 - o **Reduce 'churn' in current process:** Claims staff need to correct clear defects or inefficiencies in individual claims within the current RICP when they are first observed, rather than allowing a claim to be continually re-cycled through the claims process due to low level errors or verification issues. Reducing 'churn' would increase both the quality of outcomes for customers and the volume of correct claims settled over time;
 - o **Align KPIs and provide strategic guidance:** Ensure that key managers' incentives are properly aligned with desired outcomes. The boards of EQC and insurers should ensure that they have in place efficiency focused policies and guidelines: for example, there should be an operating policy that the assessment process should not impose more costs than it saves (in seeking to reduce the cost of settling a claim); and
 - o **Change of culture:** Move from an adversarial or (in EQC's case) 'siege' mentality (particularly in dealings between insurers and EQC) to a more neutral approach. The focus should be to deliver an efficient claims process, consistent with relevant law, and to work constructively with insurers to minimise inefficiencies in 'boundary' issues between the EQC layer and the insurer layer.
- k. As the claims settlement process moves more into the repair and rebuild stage, greater focus needs to be given to improving organisational efficiency and performance by PMOs at a systemic level.
- l. The board and CEO of EQC and the insurance companies respectively are responsible for making the type of systemic improvements recommended above. Some of these changes may already be in progress.

- m. Arising from the Crown's ownership of EQC and Southern Response, the Government is responsible for ensuring that each board has the necessary mix of skills and experience to guide (at a governance level) the delivery of an efficient RICP.
- n. For completeness, I outline in paragraph 56 below the menu of capacities that each board (EQC and Southern Response) should have in order to provide effective governance guidance to senior management in relation to the RICP.
- o. Without measures of the type referred in paragraph 7(j) above, new problems, and variants of old problems, are likely to keep arising in the RICP over the medium term as clusters of claims progress through various stages of the process. Fixing systemic issues at a systemic level is more likely to deliver better results in a more timely manner than continuing with a short-term 'fire fighting' approach.

Residential insurance claims process

8. The key steps in the residential insurance claims process of EQC and insurers ('the RICP') are outlined in Figure 1 below. Each organisation has its own diagrammatic representation of the RICP; however, the diagram below, which integrates and distils different insurers' flow charts, is a reasonable simplification of the key steps for the purposes of this report.

Figure 1: Residential insurance claims process for EQC and insurers



Note the process will vary for different types of settlement.

Overview of claims

9. As at mid-November 2012:
- Claims had been made on approximately 170,000 dwellings. Of these, up to 30,000 were expected to be managed by an insurer, and up to 140,000 by EQC.
 - Of the EQC-managed claims under \$10,000 in value, a relatively high proportion had been settled (usually with minor property repairs). A significant number of insurer-managed lower value claims had

been progressed. For example, about half s9(2)(ba)(i) were 'under cap' and excluded from EQC coverage (for example, claims involving drives, fences and the like).

- Of the claims between \$10,000 and \$83,000 (which are EQC-managed), a relatively low proportion had been completed. Delivery by the EQC-EQR process appeared to be slow.
- Of the claims agreed by EQC and insurers to be above \$100,000 in value, few had been fully settled. A very high proportion s9(2)(ba)(i) were still in the assessment phase. In short, EQC and insurers could not readily agree on whether claims estimated to be more than \$83,000 in value were 'over cap' or not. Each claim was grinding through a process of 'joint review' (which is discussed in Appendix 1).
- Across all claims, I was advised that the minimum time to process a claim (since the February 2011 event) was about [90] days, with an average of about [500] days.

Problem

10. Settling residential insurance claims in Christchurch in a timely and robust manner is critical to the overall recovery programme. As at September 2012, I was advised that less than 15% of insurance claims relating to residential dwellings had been settled. A relatively limited proportion of residential damage had been repaired, rebuilt or replaced. By comparison, CERA advised that insurers had resolved over 50% of claims relating to commercial buildings.
11. There was a widespread perception that EQC and insurance companies were not making sufficient progress. Public confidence in the residential insurance claims process was reported to be low.
12. Neither CERA nor any other agency had a clear and rigorous overview of the nature and extent of any underlying problems in the claims process. Each key party – EQC and the various insurance companies – proffered different explanations.
13. As CERA advised in September 2012, efforts by CERA and Treasury to obtain comparable performance measures from EQC and insurers was impaired by differing data collection, classification and disclosure standards across insurers and EQC, which made the data dubious and comparisons between insurers unreliable.

Objective

14. CERA's objective was to get a better factual understanding of:
 - Whether there were any serious problems in the process for settling residential insurance claims;
 - If so, what they are;
 - What (if anything) the insurance companies and EQC could do to address those problems; and
 - Whether there was (is) anything the Government should do to assist.
15. To this end, it was proposed to carry out a basic survey of a small (but statistically indicative) sample of insurance claims through the claims process, with a view to identifying any common blockages or other issues, and any potential solutions for which benefits would exceed costs.

16. Another objective was to provide an overall framework within which to view the issues relating to the RICP.

Proposed methodology

17. The preferred methodology was set out in a proposal dated 15 September 2012, which was developed in close consultation with Roger Sutton and James Hay of CERA. It was to have involved methodically going through a sample of (say) 35 to 50 claims across EQC, Vero and Southern Response. The aim was to generate a detailed summary of each claim, tracking it through the five key steps in the claims settlement process outlined in Figure 1 above:
- Initiation, including lodging the claim and confirming key details;
 - Assessment, including scope of damage and determination of liability;
 - Remediation Plan, including settlement options, scope of work, contractors, design and consents;
 - Action, including execution of repair (or cash payout), management of contractors' performance, how any variations are to be handled, system of payment, sign offs; and
 - Closure, including final inspections, certifications, final payments and 'wash up'.
18. From this analysis, a spreadsheet summary was to have been developed identifying any common or recurring points of blockage across these five key steps.
19. It was to be a pilot survey, the viability of which would depend on the cooperation of EQC, Vero, and Southern Response.

Proposed parameters

20. Other key parameters included the following:
- The survey would look at an indicative sample of insurance claims, and the steps followed by EQC and the insurer (and broker) in processing each claim;
 - It would be made very clear that the purpose of the survey is not to find fault with any party, or to become involved in any way with how any individual claim had been handled or resolved;
 - The survey would be both quantitative and qualitative – it would be based on a sample of actual claims data, combined with 'off the record' discussions to get a 'behind the scenes' sense of what was happening inside the claims process;
 - Any information obtained, including conversations with any party, would be non-attributable;
 - The survey would not involve any discussions with individual claimants;

- Before providing any information for the survey, EQC and the relevant insurance companies would first exclude any personal or other information that may be private under the privacy legislation. Data relating to any claim would be presented for the survey without names or any other means of personal identification;
- The survey would be carried out in a unobtrusive, low key manner by an independent person, contracted by CERA, who would work in cooperation with EQC and the insurance companies; and
- The survey would run in parallel with the then current Treasury/PWC claims process mapping work, but would aim to support that work by going into greater depth on the sample set of claims with respect to the processes of EQC and insurers.

Engagement and steps taken

21. CERA engaged me in mid-September 2012 to undertake the work outlined above.
22. My review work for this report was undertaken between mid-October 2012 and mid-December 2012. Some information was obtained or updated in mid March 2013 and early August 2013.
23. My first step was to seek the cooperation of EQC, Vero and Southern Response to take part in the pilot survey. To this end, I met with:
 - EQC: Ian Simpson (CEO), Bryan Dunn (GM Strategy) and Bruce Emson (GM Customer Service);
 - Southern Response: Peter Rose (CEO); and
 - Vero: Gary Dransfield (CEO).
24. Southern Response indicated at an early stage that they would be willing to participate in the pilot survey. Vero provided some assistance, but only at a relatively general level.
25. EQC was reluctant to participate in the pilot survey, but indicated a willingness to provide a sample of files relating to 'red zone' properties. Given that the insurance claims for those properties had, in effect, been put on hold pending completion of the Government's 'buy out' offer, and that subsequent claims against EQC and the insurance companies would be made by the Crown (through CERA), reviewing 'red zone' claims would not have been of much assistance in analysing problems in the RICP relating to claims by private property owners.
26. Without EQC's participation, the proposed pilot survey was not viable.
27. Following consultations with Roger Sutton and James Hay, it was decided to continue the project but relying more extensively on a qualitative evaluation of the RCIP.
28. To this end, I engaged closely with the following contributors to obtain relevant information:
 - s9(2)(ba)(i) [REDACTED]
 - s9(2)(ba)(i) [REDACTED]

- s9(2)(ba)(i) [redacted]

29. I also had discussions with the following:

- s9(2)(ba)(i) [redacted]
- s9(2)(ba)(i) [redacted]
- s9(2)(ba)(i) [redacted]
- s9(2)(ba)(i) [redacted]

30. In addition, to focus more particularly on the PMO and building activities undertaken as part of a residential property settlement, I had discussions with the following parties:

- s9(2)(ba)(i) [redacted]
- s9(2)(ba)(i) [redacted]
- s9(2)(ba)(i) [redacted]
- Other individuals referred to me by the above people.

31. My collection and analysis of information relied on a mix qualitative and quantitative data. Southern Response and Vero provided aggregated numbers of claims at different stages in the RICP. A range of parties in the RICP, s9(2)(ba)(i) [redacted], provided qualitative descriptions of perceived problems.

Approach to qualitative information

32. I have exercised careful professional judgement and discounted views that appeared to be self-interest or biased, and given weight only to those views that appeared to me to be logical and relatively objective. I have particularly taken into account descriptions of perceived problems that were independently corroborated by a range of unconnected people who, in my professional view, appeared to be fair and balanced in their approach.

33. Appendices 1 and 2 outline a range of examples and views of perceived problems in relation to the RICP during the period under review. Appendices 1 and 2 do not purport to be comprehensive or complete. A wide range of other issues and concerns were in play during the relevant period.

34. The views of EQC's senior management on the examples set out in Appendices 1 and 2 have not been obtained. Nor have they been commented on by any insurer. I have factored this asymmetry of inputs by only taking into account those views that, in my professional opinion, appear to be balanced and reliable.
35. While the issues and concerns described to me in the course of my qualitative review were of interest (and it may be useful to explore some in more detail), the details and relative merits of each example were not my prime focus. Rather than evaluating each individual issue or assertion, my approach was to look for underlying causes and patterns that might point to more systemic solutions.

Key findings

36. The Canterbury earthquakes of 2010 and 2011 put the residential insurance claims process ('RCIP') under enormous pressure. The challenges have been substantial – for EQC, insurers, claimants, and other stakeholders.
37. For EQC and insurers, the efficiency of their normal claims processes was challenged by a combination of several significant external factors, including:
- An extended period of significant seismic activity;
 - A very high volume of claims;
 - Incomplete information for a large proportion of claims;
 - Uncertainties in the law relating to EQC's liability, and how it applies across a range of claims; and
 - A 'charged' political environment with disconnects between public expectations of fairness, claimants' perceptions of entitlement, and that which the law allows under EQC's statutory liability or relevant insurance policies.
38. To maintain an efficient RCIP in the face of these drivers, EQC and insurers needed to radically strengthen their respective capacities quickly across all key fields, including human resources, organisational systems, data collection and management, claims processing systems, customer service, corporate services, and stakeholder communications.
39. It was to be expected in a natural disaster of this scale and complexity that all sorts of significant problems and uncertainties would arise in the claims processes of EQC and insurers.
40. During the period under review, the main problems were in the 'Assessment' stage of the process outlined in Figure 1. However, as more claims move to repair or rebuild, problems in the 'Action' stage are becoming more prominent. Some of the issues current during the period of this review are set out in Appendices 1 and 2.
41. The parties' approach to resolving many of these problems seems to have been reactive and piece-meal. It is fair to say that the environment has been characterised by constant 'fire fighting'. Apparently new issues in the RCIP have continued to surface, for both EQC and insurance companies.

42. Some short term or issue-specific 'fire fighting' is unavoidable. However, failure to fix systemic weaknesses in a more timely and effective manner with systemic solutions has (continuing the 'fire fighting' metaphor) allowed "fuel to keep flowing on to the ashes of fires that have not been properly extinguished" (my quote).
43. Greater gains could be achieved by identifying the underlying issues that cause clusters of problems, and systemic improvements that could be made, by EQC and insurers, to reduce the frequency, scope and scale of those problems.
44. Based on preliminary analysis, it would appear at a systemic level that (among other things):
- Core systems and processes put in place following the earthquakes have not been capable of efficiently handling the 450,000+ claims relating to approximately 170,000 residential properties. Further, the systems and processes of EQC (on the one hand) and insurers (on the other) do not seem to have been well integrated, making data management and claims processing in a 'two tier' insurance structure relatively inefficient;
 - The key parties (EQC, insurers, Government, or local authorities) have not recruited the number and quality of people required to manage the volume and complexity of claims generated by the earthquakes;
 - EQC's claims settlement process is unnecessarily convoluted and inefficient, even taking into account the complexities caused by apportionment and volume. I understand that it is not uncommon for a claim to go through 30 sets of hands before settlement. Further, as noted in Appendix 1, claims commonly 'churn' through EQC's process (and between EQC and insurers) many times;
 - EQC's claims process seems to have evolved in an ad hoc manner. As noted in Appendix 1, I have been advised that it fails to anticipate and provide guidance to claims officers on how to handle predictable issues, so whole categories of claims frequently stall in the settlement process waiting for EQC managers to make a policy decision (for example, how to handle total loss houses that EQC repaired after the first or second earthquakes). I also understand that EQC's claims process is subject to constant piece-meal variations by EQC management – typically eight to 10 per week.
45. Further work on systemic issues and solutions should be undertaken as soon as possible.
46. Until underlying causes are identified and systemic solutions put in place, new problems, and variants of old problems, are likely to continue to surface over the medium term as clusters of claims progress through various stages of the process. Patching previous patches is only likely to cause more cost and delay.

Recommended improvements

47. Based on my preliminary analysis, several strategic levers have the potential to deliver significant improvements in the RICP over the medium term. In particular, it is recommended that EQC and insurers (as appropriate):
- **Upgrade skills:** Systematically and urgently upgrade the quality of key people throughout their organisation – by better training and/or replacing staff with more capable people, and 'right-sizing' to ensure sufficient quality resource is where it is needed;

- **Upgrade data and other key systems:** Systematically upgrade the quality of data and other key operating systems through-out the relevant organisations, including customer service delivery. (EQC processing more than 400,000 claims makes it comparable with large scale data processing by banks, electricity and telecom service providers. EQC should have comparably robust and efficient systems);
 - **Invest in process design:** Good process design is fundamental to efficient claims processing, particularly in the Canterbury context. As noted above, EQC has been constantly changing its claim process on a short term and ad hoc basis. Improving the design of its claims process at a core and overall level (using external expertise as required) could significantly improve the quality and quantity of claim settlements over the medium term. It would seem that EQC's PMO processes and procedures also need to be significantly improved. As noted below problems in PMO processes are likely to become more prominent as claims settlement moves more into the repair and rebuild stage;
 - **Improve customer service:** Claims staff need to correct clear defects or inefficiencies in proposed claims settlements (at an individual claims level) when they are first observed, rather than allowing a claim to be continually re-cycled through the claims process. Reducing 'churn' should increase both quality of outcomes for customers and the volume of correct claims settled over time;
 - **Align KPIs and provide strategic guidance:** Ensure that key managers' incentives are properly aligned with desired outcomes. Boards should ensure that they have in place efficiency focused policies and guidelines; for example, there should be an operating policy that the assessment process should not impose more costs than it saves (in reducing the cost of claims settlements). Qualitative information provided in the course of preparing this report would suggest that this is not necessarily the case in the assessment processes followed by EQC or the joint review process; and
 - **Change of culture:** Move from an adversarial or (in EQC's case) 'siege' mentality (particularly in dealings between insurers and EQC) to a more neutral approach. The focus should be settle with the claimant in a timely and cost-effective manner that which he or she is entitled to under the relevant insurance policy or EQC legislation, and to work constructively with insurers to minimise inefficiencies in 'boundary' issues between the EQC layer and the insurer layer;
48. Each organisation should have a range of other systemic changes they could be making to deliver improvements in the RICP. As the claims settlement process moves more into the rebuild stage, greater focus needs to be given to improving organisational efficiency and performance by PMOs at a systemic level.
49. It is possible that EQC and insurance companies have taken steps over recent months to address some of the underlying issues. As noted earlier, this review concentrated on the period between October and December 2012, with updates in mid March and early August 2013.

50. Some insurers expressed a strong view that EQC should have followed the approach that insurers are reported to adopt in other countries in a disaster situation – namely, insurers pool resources (including contracted professional loss adjustors) to build economies of scale and quality in claims processing. However, EQC appears to have followed the standard model, even though there was (and, at the time of this review, still was) a serious shortage of qualified people to operate in standard model mode. The 'pooling' approach could be scoped as part of a more general review in considering how to improve processes for the next major disaster.
51. Some of the conflicts and inefficiencies that have arisen between EQC (on the one hand) and insurers (on the other) in relation to assessing damage and the cost of remediation could significantly be reduced under different policy approaches. No doubt, these will be considered in the Government's review of the EQC regime in general.

Implementation

52. The board and CEO of EQC and the insurance companies respectively are responsible for making systemic changes to address systemic problems in the RICP.
53. The Government's role and influence in relation to the insurance companies is relatively limited. However, the Government could (for example) invite each insurance company to advise on the nature and scope of systemic improvements it could make to systems and resources used in the RICP. Government could then follow up with each company over time to gauge whether those changes have been put in place.
54. The Government could do the same in relation to EQC. However, the Government's potential influence in relation to EQC and Southern Response is stronger. Arising from the Crown's ownership role, the Government is responsible for ensuring that each board has the mix of skills and experience required to provide effective governance oversight in relation to the RICP.
55. I have not assessed (and it was not within my brief to do so) whether there are any gaps in the skill mix on the EQC and Southern Response boards, and therefore I make no comment on this matter.

Governance capacities

56. For completeness, however, I outline below the menu of capacities that each board (EQC and Southern Response) should have to provide effective governance guidance to senior management in relation to the RICP (in no particular order):
- **Human resources** – As noted above, lack of quality people in key positions is a key cause of problems in the RICP. The board's membership needs to have a strong ability to understand, at a strategic level, whether EQC's human resource capacity is up to the required standard (from CEO level to key manager positions); and, if it is not, to put in place, in a manner consistent with good governance, measures to bring about the required improvements;
 - **Data collection and processing** – Upgrading data collection and processing systems (while continuing to progress claims) would seem to be a key strategic challenge for EQC. The board should have a strong understanding of best practice standards and delivery in businesses with analogous scale (for example, banking, telecommunications and electricity);

- **Customer service** – This is clearly fundamental for EQC and Southern Response. Here again, the boards need to understand best practice standards and delivery in businesses with analogous scale;
- **Legal** – Some legal issues have the potential to have significant value and customer impacts for EQC and insurance companies. Boards need to have the capacity to provide guidance on how to approach and manage these legal issues from a strategic perspective;
- **Project management** – With about 80,000+ properties to be repaired by EQC, understanding the building industry, and project management, is vital to EQC's business. It needs a board member with the capacity to provide strategic guidance in this area;
- **Performance measures** – Like any board, the boards of EQC and Southern Response need the skills and experience to ensure that key managers' incentives are effectively aligned with the organisations goals, and that those goals are clearly expressed with meaningful measures;
- **Understanding the business of insurance** – This is obviously central to both EQC and Southern Response. In the period of this review, considered questions were raised by some key stakeholders as to whether there was sufficient depth in this field within EQC as a whole;
- **Stakeholder relationships and communications** – EQC and Southern Response each have a complex set of stakeholder relationships to manage. The stakeholders include the Government (as owner, regulator, and 'leader' of the overall recovery), insurers, reinsurers, claimants, the general public, local government, NGOs, and other political parties. Providing guidance and leadership for EQC and Southern Response in this area is a key governance role;
- **Culture** – Governance experience at guiding organisational culture change is essential, particularly to deliver the culture change referred to in paragraph 47 above;
- **Future of EQC** – As a background role, the EQC and Southern Response boards should have the capacity to contribute at a strategic level to Government policy-making in relation to the future of EQC and any related changes to the regime within which it operates; and
- **Quality of board** – Overall, the boards of EQC and Southern Response need to be of a calibre that will attract the required talent to senior management positions.

CERA's role

57. Settlement of residential insurance claims is expected to account for a very significant proportion of the total cost of the Canterbury earthquake recovery. Timely resolution of residential claims is also fundamental to achieving CERA's overarching, long-term strategy for the reconstruction, rebuilding, and recovery of greater Christchurch, which is central to CERA's statutory mandate.

58. During the period of this review, CERA seemed to have concerns that EQC and the insurers were not, of their own initiative, identifying and implementing efficient solutions in a timely manner to problems in the RICP where joint action and coordination among EQC and insurers may have been required.

59. However, CERA's approach in relation to EQC and the insurers seemed to be confused:

- On the one hand, CERA was properly concerned to ensure that the incentives and accountability for performance of EQC and the insurance companies in relation to the RICP were not diminished by any actions or interventions by CERA or the Government.
- On the other hand, CERA would act as an intermediary, facilitator or apparent problem-solver in relation to a range of RICP-related issues that would arise from time to time, apparently accepting the risk of creating perceptions (and behaviour changes among some parties) that CERA would become responsible for procuring solutions to RICP problems.

60. In my view, CERA's role in relation to the RICP is as follows:

- CERA should ensure that incentives and accountability for performance in relation to the RICP remain clearly with EQC and the insurance companies.
- Within this parameter, CERA should ensure that it is well informed on an on-going basis and in a timely manner as to how efficiently claims are being processed by EQC and insurance companies. To this end,
 - Good quantitative information is clearly useful. However, difficulties of correlating and reconciling different aggregated numbers from different sources has to be properly weighed against the value and relevance of the information derived.
 - Good qualitative information can be as (or more) useful than aggregated numbers if it is obtained from reliable sources who are insightful and well-balanced in their appraisals.
- CERA should monitor progress in the RICP by obtaining information from both sources.
- If a material problem emerges that appears to be having a significant adverse impact on progress in the RICP, CERA should:
 - Ensure that it has properly defined the problem and objectives, and evaluated the relevant options; and
 - Where possible, act in a surgical manner to enable EQC and the insurance companies to resolve the problem in a manner consistent with their normal incentives and accountabilities. (This was the approach followed in relation to the land liability dispute on which I have reported separately).
- CERA has a range of tools it can deploy to achieve this purpose. Most are relatively subtle and need to be exercised with a 'deft touch'.

Conclusion

61. As noted above, this report relates to the period mid-October 2012 to mid-December 2012. Some information was obtained or updated in mid-March and early August 2013. Some elements may well have evolved since then. The key findings and recommendations set out in this report were conveyed to CERA in April 2013.
62. The key conclusion set out in this report is that EQC and insurers should focus on fixing systemic issues in the RICP at a systemic level. This approach is more likely to deliver better results in a more timely manner than continuing with a short-term 'fire fighting' approach.
63. Based on preliminary analysis, measures of the type referred to in paragraph 47 above have the potential to deliver significant improvements in the RICP over the medium term.
64. Without a systemic approach, new problems, and variants of old problems, are likely to keep surfacing in the RICP as clusters of claims progress through various stages of the process, and the settlement process is likely to take longer.
65. I would be pleased to discuss this report and provide any further advice or information that CERA may require.



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Appendix 1: Examples of specific problems in claims assessment

Sources and purpose:

This appendix lists some examples (during the period of this review) of perceived problems in relation to the 'assessment' stage of the RICP. The views of EQC's senior management on these specific issues have not been obtained. Nor have they been commented on by any insurer. I have factored this asymmetry of inputs by only taking into account those views that, in my professional opinion, appear to be balanced and reliable.

Further, the examples and views set out below do not purport to be comprehensive or complete. A wide range of other issues and concerns were in play during the relevant period.

While the issues and concerns described in the course of my qualitative review were of interest (and it may be useful to explore some in more detail), their specifics and relative merits were not my prime focus. Rather than evaluating each individual issue or assertion, my approach was to look for underlying causes and patterns that might point to more systemic solutions.

The examples below are not set out in any particular order or priority.

The purpose of this appendix is simply to record for completeness some of the specific matters raised with me in the course of my review.

This report relates to the period mid-October 2012 to mid-December 2012. Some information was obtained or updated in March 2013 and early August 2013.

Apportionment

1. The High Court's decision relating to "apportionment" has clearly created significant incremental costs and complexities in the residential insurance claims process. However, the process followed by EQC and insurers to determine "apportionment" is unnecessarily cumbersome and complex. In particular:
 - The process causes many claims to keep "churning" through multiple rounds of pre-repair estimates of damage and remediation costs, which in many cases will turn out to be incorrect when the actual nature and scope of damage is established in the actual repair process.
 - Apportionment for a single claim can be re-calculated multiple times even before repair or rebuild work has been started. Then, if a variation comes in from the PMO's "hub", the assessment and settlement may be re-apportioned, even before the actual apportionment is made in the "wash up" based on actual costs (rather than endless pre-work estimates).
 - If the repair work finds that the actual damage is greater than estimated, EQC's PMO is strongly incentivised to keep the repair cost "under cap" so they keep the work (rather than it going to the insurer's PMO). This can result in "short cut" repairs, or not doing repairs to avoid pushing the claim "over cap".

- With such a high level of “churn” and handling by different people in the claims process, the risk of human error is high (wrong address, arithmetical mistakes and the like); and small errors result in a claim being further “churned” and delayed.
 - The costs (direct and indirect) imposed by the assessment process are likely to be greater than the amount saved by EQC and insurers.
2. In summary, apportionment for a single claim can occur multiple times –
- Pre-apportionment – as noted above, the proposed decision on apportionment can be ‘churned’ (revisited) due to multiple pre-work (theoretical) assessments
 - Post-apportionment (still pre-repair or rebuild work) – the claim is reviewed for insurance issues, and apportionment can be ‘churned’ (revisited) again if there are any (even small) verification issues;
 - In-work (during repair or rebuild) – if a variation comes in (which may be due to finding that the repair cost is more or less than expected), the claim can be sent back to EQC’s pre-apportionment stage to be re-apportioned, and then have to once again wind its way back through EQC’s claim settlement process with all of its risks of further ‘churn’ as the claims passes through 30 or more pairs of hands.

Joint Review Process

3. The joint review process has the following key steps:
- Desk top assessment
 - Site visit by representatives from EQC and insurer. Often agreement reached on site
 - Back at its office, EQC then recalculates its previous assessment (damage, liability and value)
 - Insurers then analyse EQC’s revised assessment
 - Outcome is then agreed or (if not) repeated
4. The joint review process started in January 2012 with about 12 teams. The flow rate was about 50 desk tops assessments per week, of which 70% would go to a site visit.
5. Insurers advised that over 90% of claims that go to joint review come out as over-cap. Insurers proposed that EQC should take a ‘batch’ approach, grouping like claims together, and reduce significantly the number of claims that needed to go to joint review. EQC is reported to have declined this approach.
6. As at early March 2013, the joint review process was making better progress than was the case as at November 2012, and it was expected that EQC would settle most over-cap claims by the end of May 2013.

Design of EQC’s claims settlement process

7. EQC’s claims settlement process is unnecessarily convoluted. It is not uncommon for a claim to go through 30 sets of hands before settlement.

8. Claims staff work in narrow 'silos', and EQC focuses on settling an arbitrary number of claims of a certain type. However, settling a claim does not equate to settling a property. For example:

EQC has treated internal walls repairs in isolation from the roof, even though the roof is damaged (leaking) and subject to a claim.

People at various stages of EQC's internal claims process see that the roof needs to be fixed before the internal walls are repaired, but no action is taken to integrate the repairs. As a result, the internal wall repairs are subsequently damaged by water from the leaking roof and the wall repairs have to be re-done.

9. Errors in PMO "hub" processes (including minor file note errors or simple arithmetic errors) cause claims that were cleared for settlement to be returned to EQC for re-processing. Similar errors within the EQC process get picked up by EQC's Settlement Support team and the claim "churns" yet again.
10. EQC's claims process is ad hoc and poorly designed. It fails to anticipate and provide guidance for claims officers on how to handle predictable issues, so whole categories of claims frequently stall in the settlement process waiting for EQC managers to make a policy decision (for example, how to handle total loss houses that EQC repaired after the first or second earthquakes).
11. EQC's internal claims process is subject to constant ad hoc variations from EQC management – typically eight to 10 per week. This causes considerable inefficiencies.
12. EQC's PMO "hubs" also frequently changes their processes and procedures in an apparently ad hoc manner, which also causes real inefficiencies.
13. The design of the overall settlement process within EQC and its PMO needs to be significantly improved.
14. Case management to selected customers is now offered by EQC. This is a new innovation.

Settlement targets

15. EQC settles claims by category, not property. So a property with several claims in different categories can have some parts of the property repaired but not other parts. This can result in some highly inefficient outcomes (for example, repairing walls in a house before the leaky or defective roof is repaired, with the result that the repaired walls are damaged and need to be re-repaired).
16. EQC also sets arbitrary volume targets for settling claims, which do not reflect the relative priority of claims. In addition, settlement of a certain number of claims does not correspond to settling the same number of properties as a property often has multiple claims of which only certain categories may have been settled.
17. In short, EQC does not seem to take a "whole of property" approach.

Specific issues

18. From certain insurers' perspective, EQC's approach to claims assessment had a range of problems during the period of my review (mid-October to early December 2012):
- Selective presumption against total loss: EQC seemed to start from a general presumption everything is repairable, rather than assessing each claim with an open mind on its merits. EQC's approach would result in all sorts of absurdities; for example, the impracticality of lifting a house and slab together; not properly taking into account access to a steep hill site or through narrow access way; and not first determining whether the proposed solution is consentable; and so on.
 - Selective presumption of total loss: However, EQC would also apply a total loss view (to the first earthquake event) to decline damage claims from later events, even if there is clear evidence showing the damage from the first event was not total loss. This approach meant that EQC's payouts assumed total loss for contents, but for other purposes EQC assessment held the dwelling was repairable.
 - Foundation damage: EQC was poor at identifying foundation damage and consequential damage (eg cost of lifting house – remove cladding and services excluded completely)
 - Repair methodology on concrete slabs: Some PMOs would re-level a slab by injection, when EQC would say it was not repairable. Also considerable disagreement between EQC and insurers on whether EQC was required to contribute to slab repairs (lifting) relating to September and/or February events.
 - Cost estimates: EQC would consistently underestimate costs. Costing differences between EQC and insurers typically ranged from \$200k – \$800k. Some examples:
 - Lifting: EQC's estimate to lift a house (\$12,000), compared to s9(2)(ba)(i) estimate of \$45,000. EQC would not agree to actual costs based on heavy lifting guidelines.
 - Consents: not allow for cost of obtaining consent (EQC would assume it is not required).
 - Re-painting: costed only one wall when several walls to be repainted
 - Re-using bricks: excluded cost of re-testing
 - Insulation: excluded insulation costs required under fresh consents
 - Wiring: included repair socket but not repair old wiring (to meet new standards for fuse box if make change to any socket)
 - Health and safety standards were not factored into EQC's estimates
 - 'Preliminary and General' allowances appeared to be too low (maybe by 35%). (This is supported by parties in the building industry).
 - Prioritisation: If there was a large difference of assessed loss between EQC and insurers, EQC would simply put the claim on-hold or re-prioritise it down the queue.
 - EQC's Comet I-Pad system:

- It was widely accepted that EQC's Comet I-Pad system is seriously defective. It is reported that a review indicated that 78.2% of its assessments were inaccurate, and 29.2% of those were (in effect) entirely incorrect.
 - It is also widely perceived that EQC was aware of Comet's fundamental defects, but continued to use it, causing considerable unnecessary delay and friction. The waste of resources caused by this approach has been very significant.
 - PMOs are now correcting for the Comet defects, however EQC's assessors are still (as at early March 2013) sending out Comet assessments, and waiting for on-site joint reviews to fix them.
 - For under-cap claims, the errors in Comet assessments by EQC assessors continue to go uncorrected, leaving claimants short of the amount required to repair their house (by on average between 7.5-15%).
 - As at early March 2013, s9(2)(ba)(i) in particular was still using Comet.
- Estimate of costs where damage from first event not assessed: EQC would apply an 'area formula'. It would be applied to repair costs, not rebuild costs even if EQC and the insurer accept it is a rebuild.
 - Re-assessment of EQC settlements before February 2011: EQC's settlement payments before 5 December 2011 of over \$30,000 are likely to have been incorrect (in many cases, too large). During part of this period, settlements were paid by the EQC claims team without guidelines from EQC management. From 5 December 2011, EQC is reported to have (finally) put in place guidelines for its claims team.
 - Building standards: EQC's assessments were often not to building standards
 - Culture of over-claiming: A culture of over-claiming has developed among claimants, assessors and contractors. It is reported that quite a lot of regular or routine maintenance has been included in earthquake claims.
 - Apportionment: A professional loss adjustor commented that it was not aware of any insurers seeking through joint review process to change allocation to get losses under cap across all events; however, perversely EQC, seemed to be doing it. (Some insurers expressed the same view).
19. As at late July 2013, claims under \$50,000 have been "on hold" within EQC since March 2013 (excluding partial cash settlements (for example, where a claimant has done he or her own repairs).
20. Insurers do not seem to have increased their human resource capacity adequately to handle the Canterbury claims. Delays by some insurers are arising for relatively routine verification that could and should have been completed much earlier (such as checking that levies have been paid or verifying the foot print of a house).
21. The underlying (fundamental) problem has been a lack of experienced loss assessors. The EQC team now has better people fronting the joint review process, but it has taken an unnecessarily long time reach this point. Many assessors s9(2)(ba)(i) are viewed as "simply unqualified".

22. On the insurers' side, many builders acting for insurers as loss assessors have also been (and still are) inadequately qualified and experienced. They are reluctant to say no to over-reaching customers, and often do not have sufficient building experience to understand properly the nature and extent of repairs required to return a dwelling to its pre-earthquake condition (as many are relatively young and have only built new houses).
23. Insurers do not seem to have adequately increased their HR capacity. Since March 2013, additional layers of verification seem to have been imposed by insurers on claims that have already been verified. Delays of three to six months to process basic information are not reasonable.
24. EQC's approach is to assess each individual claim that may be over-cap in considerable detail. In September 2011, some insurers proposed taking a 'global' approach by agreeing among EQC and insurers on a repair methodology to apply across groups of like claims. This was never achieved. However, it clearly points to a fundamental policy parameter to which EQC would appear to be indifferent: namely, it makes no sense to incur more costs than you save in assessing claims.
25. As at early March 2013, it was reported that, at its operational level, EQC claims teams were refusing to respond to any queries from some insurers on individual assessments.
26. To overcome these perceived blockages in EQC's claim process, Southern Response is offering its customers an assignment option, under which Southern Response will take the risk of EQC paying out an amount that reflects Southern Response's assumptions in relation to EQC's liability.
27. For under-cap claims, it is reported that EQC will pay out many claimants at an amount that is less than the likely actual costs of their repairs. (This is due, among other things, to defects in the Comet I-pad system, which are discussed further above). Many insurers are aware of this risk but not actively engaging on behalf of their customers with EQC. (This was mentioned by several parties).
28. Some insurers expressed a strong view that EQC should have followed the approach that insurers usually adopted in other countries in a disaster situation – namely, insurers pool resources to build economies of scale and quality in claims processing, which would include professional loss adjustors. EQC has, in effect, insisted on a business as usual approach, with a serious shortage of qualified people to operate in this mode.
29. Various professional loss adjustors have described dealing with EQC as like "nailing jelly to a plate" and "squeezing smoke"

s9(2)(ba)(i) **views**

30. s9(2)(ba)(i) commented that:

- s9(2)(ba)(i)
- An insurer should be a project manager for their claimant – be proactive, not leave all burden on the claimant.

- On the question of why commercial claims have been processed faster than residential claims, this is because “commercial people look at things in a commercial manner – that’s why they are settled faster. Nothing to do with insurers giving priority to commercial claims”.
- In relation to the time taken to settle claims, the claims process in Christchurch has a “surprisingly very gentlemanly tempo. The only strictures are to get reserves more accurate”.
- Overseas, even in a disaster situation, insurers would inspect, assess, set out an action plan, provide updates, and so on, with a clear expectation that the claim will be settled within a specified period. Insurers would set these standards for contracted loss adjusters. In the UK, if a loss adjuster doesn’t perform, his fee is reduced and he may not be used next time.
- Insurers’ KPIs in NZ should measure life-cycle outcomes – faster settlement, lower overall cost. s9(2)(ba)(i) It can then allocate and manage resources accordingly.
- EQC’s culture should focus on efficient claims settlement, not reducing the cost of payouts and following mechanistic processes. EQC does not understand the fundamentals of insurance. This view was shared by other s9(2)(ba)(i)

Other views

- I note a letter dated 4 October 2012 from s9(2)(ba)(i) which comments extensively on EQC’s approach and performance, particularly in relation to customer service.

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Appendix 2: Examples of specific problems in residential building process

Sources and purpose:

This appendix lists some examples (during the period of this review) of perceived problems in relation to the 'building' stage of the RICP. The views of EQC's senior management on those specific issues have not been obtained. Nor have they been commented on by any insurer. I have factored this asymmetry of inputs by only taking into account those views that, in my professional opinion, appear to be balanced and reliable.

Further, the examples and views set out below do not purport to be comprehensive or complete. A wide range of other issues and concerns were in play during the relevant period.

While the issues and concerns described in the course of my qualitative review were of interest (and it may be useful to explore some in more detail), their specifics and relative merits were not my prime focus. Rather than evaluating each individual issue or assertion, my approach was to look for underlying causes and patterns that might point to more systemic solutions.

The examples below are not set out in any particular order or priority.

The purpose of this appendix is simply to record for completeness some of the specific matters raised with me in the course of my review.

This report relates to the period mid-October 2012 to mid-December 2012. Some information was obtained or updated in March 2013 and early August 2013.

1. Progress on rebuilds and repairs has been slow. For example, s9(2)(ba)(i) advised in early March 2013 that their work had virtually ground to a halt. s9(2)(ba)(i)
2. Key problems from the perspective of people in the building industry include the following:
 - Each EQR hub seems to have different systems and process (particularly weak accounting processes), and lack of transparency on rules and criteria
 - Performance of PMO hubs varies considerably across hubs.
 - A lot of repair work done under the PMO regime is not compliant with relevant building codes
 - Fletchers do not pay on-time. Some contractors have a considerable value of unpaid invoices (the value of which is not disputed by EQC or Fletchers).
 - The Fletchers/EQR process is unnecessarily bureaucratic and over-staffed
 - Fletchers/EQR are making the 'opt out' route for customers unnecessarily difficult (among other things, by excluding costs relating to 'preliminary and general' and health and safety)

- Christchurch City Council is creating nonsensical and trivial requirements in the consenting process (for example, rejecting an application due to a drawing missing a smoke detector), then adding a further 20 working days to their timetable for considering the application, when it could have been approved and the missing smoke detector added at the site inspection level
- Perception of 'mates' approach to consenting: some contractors get their consent applications processed more quickly than others, leading to a strong perception of insider favours or preferences
- Staff on some PMOs are seen as poorly qualified, lacking appropriate experience in the contracting and building industries
- EQC is seen as inept, treating its clients and contractors poorly and lacking in staff with good project management skills
- There is (or will be) a shortage of properly skilled subcontractors – in concrete, roofing, plastering, plumbing.
- There is a lack of common sense – simple issues are blown out of proportion by EQC and Fletchers/EQR
- Small scale corruption is rife: Contractors and PMO staff are too often adding in additional work to a repair or rebuild. Petty kick-backs by a contractor to PMO staff are reported to be not uncommon (in the form of tickets to events, overseas holidays and the like)
- To succeed as a builder or contractor with EQC or Fletchers/EQR, there is a strong perception that it is a case of "who you know" not "what you know".
- The quality of fraud oversight within EQC is perceived to be very poor
- Health and safety requirements are perceived to be excessive by small scale builders. However, there is a contrary view that the industry has been lax and needs to improve its standards
- The Fletcher EQR regime imposes significant administrative costs on small firm builders, which are not covered by EQR's pricing policy. Certified Builders Association of New Zealand has calculated that this could amount to up to [25%] of a builder's total costs. Smaller firm builders are therefore considerably less interested in taking on EQR work.
- The quality of training within EQC and insurers in the claims assessment, processing and contracting fields is perceived to be very poor
- The limited supply of good people within EQC are massively over-worked and exhausted
- In terms of specific managers within EQC, it is reported to be a widely held view within the building industry that certain key managers are not up to their respective jobs and their approach adds net-costs to the process.
- Houses have been repaired in a piece-meal fashion resulting in some repairs having to be re-done because a more fundamental issue has not been fixed first (for example, walls are repaired without fixing a defective roof even though the builder could see that the repair to the walls would be compromised in the short term by the defective roof)

3. Other specific recurring problems in the residential building process include retaining walls, contaminants, and heritage status dwellings.

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