

LIABILITY MARKET AND CLAIMS OVERVIEW

VICTORIA POWER NETWORKS AND UNITED ENERGY

29 OCTOBER 2019

CONTENTS

| | |
|--|---|
| 1. Scope of Report | 1 |
| 2. Market Drivers..... | 2 |
| • Insurance Market Overview | 2 |
| • Significant Capacity Withdrawal..... | 4 |
| • Impacts to Policy Coverage | 4 |
| 3. Bushfire Claims Examples..... | 5 |
| 4. Credentials..... | 7 |

1

Scope of Report

This paper is provided to Victoria Power Networks (VPN) and United Energy to provide a detailed rationale for increases in Liability premiums, this includes:

- A summary of the local and global market drivers
- Examples of claims activity globally for bushfire/wildfire

This liability market and claims update report is provided in the context of the focus on bushfire liability exposures.

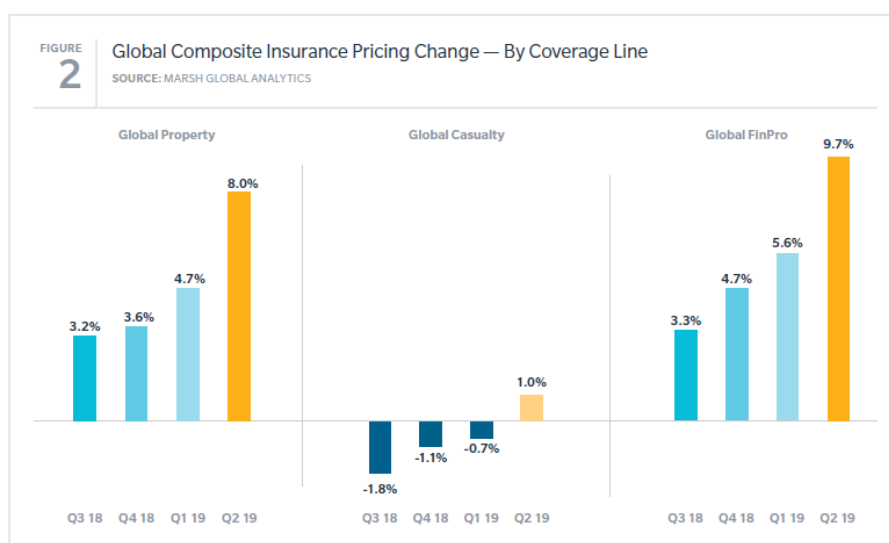
2

Market Drivers

Insurance Market Overview

The Marsh Global Insurance Market Pricing Index is a proprietary measure of global commercial insurance premium pricing changes over the past four quarters. This is a historical view of actual average percentage pricing movement by region, globally and by product line. This historical view evidences trends and helps us to more clearly predict future insurance market trends.

At the end of Quarter 2, 2019 there was an increase in the average pricing across all lines, with casualty showing an increase for the first time in the last 12 months. Following on from the trend we have seen in other classes of insurance over the last 12 months, we anticipate this is the beginning for casualty and that we will see a continuing trend over the next four quarters.



The above is based on the entirety of the general liability market, however, and is not a true representation of what we are seeing for energy utility risks, particularly those with large bushfire exposures such as Victoria Power Networks and United Energy. Due to significant capacity withdrawal from the sector, as highlighted in further detail below, pricing increases are rising rapidly and capacity is coming at a high cost.

This capacity withdrawal is due to a number of factors including the increased wildfire/bushfire activity globally, other local and global casualty non-fire related losses, continued consolidation of insurers through merger and acquisition activity, increased focus by insurers on capital deployment, closure of Syndicates and changes in insurer appetite.

To provide the capacity required for a program such as VPN and United Energy, capacity is required globally, so it is important to assess the regional landscape, which is summarised as follows:

Australian Markets

- Allianz Global Corporate and Specialty have pulled out of long tail business entirely in Australia. They were a large capacity provider (up to \$100m) on utility risks
- Zurich and Vero have been assessing their portfolios and are pulling out of bushfire and in some cases broader energy risks
- Other markets are seeking pricing increases from 10% to 180% reflecting the volatility in this market segment

London Markets

- Greater scrutiny from Lloyds has seen closure of a number of syndicates and more tactical deployment of capital from the remaining syndicates
- Many syndicates have already written their quota for new business in 2019 and obtaining new capacity is very challenging
- Where new capacity is offered, the pricing is punitive

Bermudan Markets

- Capacity remains in Bermuda, however, is coming at a significant cost. Premium indications for the 2019/2020 renewal for VPN and United Energy were at \$250k per million
- Bermuda insurers also utilise their own policy form, which is generally more restrictive than existing covers

Chinese Markets

- While Chinese markets are continuing to engage on expanding their geographic footprint, particularly for Chinese connected business, capacity is still not being deployed for casualty risks

Insurers are also looking closely at their pricing models with a focus on 'payback' period and assessing rate increases accordingly

Significant Capacity Withdrawal

In 2019, we have seen significant capacity withdrawal globally for bushfire liability risks either due to a combination of insurer consolidation, appetite changes and (re)insurers being more selective in how they deploy their capacity.

| Insurer | Rationale |
|--|---|
| CNA Hardy | Withdrawal of capacity |
| Apollo | Withdrawing from the sector |
| Brit | Reduced capacity deployment |
| Allianz Global Corporate and Specialty | Withdrawal from Long Tail business in Australia |
| Vero | No longer providing bushfire liability capacity |
| Ironshore | Syndicate has closed |
| Zurich | Withdrawal from Energy business |
| Navigators | Reduced capacity deployment |

Impacts to Policy Coverage

The hardening market conditions, also leads to restrictions in coverage. For the 2019/20 renewal, insurers are increasing pressure to raise bushfire liability deductibles from \$5m to \$10m. While we have been able to avoid such increases this year, we anticipate greater pressure in future years and recommend VPN and United Energy begin budgeting for a higher retained amount.

In addition, the insurance program has historically included one automatic reinstatement of limits within a single policy year. In effect, this ensured that coverage would be in place should the Insured sustain two catastrophic fire losses in a single year. We anticipate similar restrictions to reinstatement if the market conditions continue to deteriorate.

Looking the future we expect capacity to continue to reduce, particularly as Wildfire/Bushfire events continue to occur. The effect of PG&E and the class action environment is threatening a risk of market failure for Bushfire risk. If there is another large fire it is likely that capacity will not be available for risks going forward.

3

Bushfire Claims Examples

Bushfire is not a hazard or phenomena unique to Australia. In recent times, major bushfires/wildfires have occurred throughout the world in North America (with frequency in California), France, Germany, Greece, Indonesia, Italy, Poland, and Russia. The consequences are typically measured in terms of hundreds or thousands of buildings destroyed, number of lives lost, and millions of dollars in property damage and resources spent fighting the fire.

Specifically in Australia, while there has been a large number of bushfire losses and increased activity recently, the largest events from an insurance perspective include:

- The Black Saturday Fire (VIC) in 2009, which burnt 4,500 km² of land, killed 173 people and destroyed some 2,000 homes. Overall losses A\$1.7bn, insured losses A\$1.07bn (in original values)
- The Ash Wednesday Fire (VIC/SA) in 1983, which burnt 5,200 km², destroyed some 2,400 homes and killed 75 people. Overall losses A\$335m, insured losses A\$176m (in original values)
- The Tasmanian Black Tuesday Fires (TAS) in 1967, which burnt more than 2,600 km², destroyed some 1,400 homes and killed 62 people. Overall losses were A\$35m, insured A\$14m (in original values)
- The Black Friday Fire (VIC) in 1939, which burnt almost 20,000 km², destroyed more than 700 homes and resulted in 71 fatalities

Other Australian bushfire events, while not as significant from an insurance perspective, are becoming more of a frequency issue which is also contributing to a more selective approach from insurers on where they will provide capacity, how much capacity they will provide and the cost of that capacity.

Notable other global bushfire incidents include:

- March 2010: Western Russia — Several hundred individual wildfires caused an estimated US\$15 billion in damage.
- May 2016: Alberta, Canada — The Fort McMurray Wildfire destroyed at least 2,400 homes and buildings. With estimated losses of around CDN\$4 billion, it is the costliest disaster in Canadian history.
- November 2018: Butte County, California, US - The Camp Fire was the deadliest and most destructive in California history. It caused at least 86 fatalities and destroyed 18,804 structures. It was also the world's costliest natural disaster in 2018 and is the most destructive wildfire in history with total damage of US\$16.5 billion.

Whilst the above catastrophic events gain attention globally, like Australia, there continues to be frequent 'smaller' bushfires that still generate substantial losses to the insurance market.

For insurers, who are looking at the pay-back for their capacity, a loss such as this eliminates all profitability for insurers on Primary layers. The insurance market is at a level that should we have another severe bushfire event, capacity will withdraw significantly and insurance capacity will reduce considerably to the point where market failure could occur.

APPENDIX A

Credentials

This report has been prepared by the following individuals:

| Name | Experience | Qualifications |
|--|---|--|
| Joanne Silberberg National Manager, Strategy and Growth | <p>Joanne has significant experience in client relationship management and designing risk financing programs across a diverse range of clients in the Energy & Power, Construction and Infrastructure sectors.</p> <p>She has deep Industry experience across a variety of clients in the Energy & Power sector and in addition to her role as Client Executive for some of Australia's largest clients she has held various strategy and growth roles for Energy & Power, Construction, FINPRO, Credit Specialties, Marine, Aviation and PEMA specialties.</p> <p>Joanne also has specific expertise with electricity and gas transmission and distribution exposures having worked with Endeavour Energy, TransGrid, Powerlink, ElectraNet, APA Group</p> | <ul style="list-style-type: none"> • Bachelor of Law • Bachelor of Business (International Business) • Australian and New Zealand Institute of Insurance and Finance (Fellow) • Graduate Diploma of Financial Services (Insurance) |
| Jeremy Rowsell National Casualty Leader | <p>Over the past 28 years, Jeremy has placed complex casualty programs across a number of key international markets including the UK, Africa and Asia-Pacific.</p> <p>Having worked in both Australian and broader Lloyd's and London markets, Jeremy can leverage significant expertise in the negotiation and successful placement of clients' programs.</p> <p>Jeremy is extremely adept at being innovative and creating beneficial solutions for his clients. Having working across all casualty lines, General Liability, Professional Indemnity and MPT / ACI, Jeremy has strong experience with</p> | <ul style="list-style-type: none"> • Master of Business Administration (Executive) • Australian and New Zealand Institute of Insurance and Finance (Fellow) • Certified Insurance Professional (CIP) • Diploma of Financial Services (Insurance Broking) • Fellow, Australian Insurance Institute |

| | | |
|--|--|--|
| | <p>coordinating, designing and implementing major programs, and has been instrumental in adding value to clients across all market conditions.</p> <p>Jeremy also has specific expertise with electricity and gas transmission and distribution exposures as the casualty placement broker for Victoria Power Networks, United Energy, South Australian Power Networks, Western Power, Horizon Power, APA Group and historically other Victorian based distributors.</p> | |
|--|--|--|



Marsh Pty Ltd
ABN 86 004 651 512
One International Towers Sydney
100 Barangaroo Avenue
Sydney, NSW Australia 2000
PO Box H176
AUSTRALIA SQUARE NSW 1215
+61 2 8864 8888