

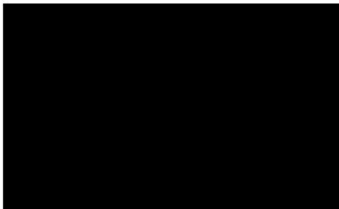



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Dear 

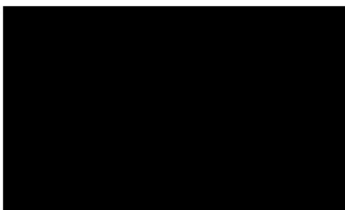
AusNet bushfire liability insurance review on behalf of the Australian Energy Regulator

Public Summary

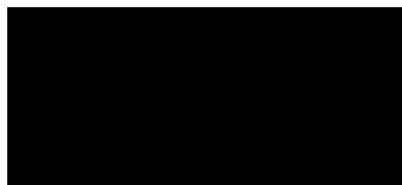
Please find enclosed the public summary of our report reviewing AusNet's bushfire liability insurance and the forecasts put forward by their broker.

Please do not hesitate to call should any aspect require clarification.

Yours sincerely,



Daniel Smith
Fellow of the Institute of Actuaries of Australia
Taylor Fry



Adam Baker
Executive Director – Broking
Willis Re

Introduction

The Australian Energy Regulator (AER) regulates electricity networks and natural gas pipelines by setting the maximum amount of revenue they can earn. Decisions generally apply for five years, and network businesses adjust their prices annually during the five-year period.

The AER is currently in the process of reviewing AusNet's proposal for 2021-2026 revenues in Victoria. As part of this review, the AER has engaged Taylor Fry and Willis Re to provide expert advice on the increase in insurance premium costs expected to be incurred by AusNet to manage its bushfire liability risks.

The scope of the review into the AusNet bushfire insurance step change and pass through event proposals is split into three core components:

- Review AusNet's proposed insurance premium forecasts and provide our own estimates
- Assess the certainty of the insurance premium forecasts
- Assess the current and expected insurance market characteristics.

Our report is intended to be used by the AER in its assessment of the reasonableness of the bushfire liability insurance cost projections put forward by AusNet. This document provides a public summary of the scope and conclusions of our review. We have also provided the AER with a confidential document containing our full analysis which draws upon, the confidential information provided by AusNet. We note that the conclusions presented may be inappropriate for other purposes.

Information that has been relied upon

In preparing this report, we have considered a variety of information, the majority of which was provided by AusNet, much of which is confidential in nature. This information has broadly included:

- AusNet's historical premium costs and recent history of their insurance structure
- A presentation prepared by AusNet's insurance broker which included:
 - Observations about the current market and future of the market and the impact of changes to various factors on the capacity of the market.
 - The possible impact of changes to the market to the premiums paid by AusNet
 - AusNet's expected future insurance cost
- Discussions between AusNet and their stakeholders regarding insurance costs
- Responses from AusNet and their broker to questions regarding the certainty of their forecasts and their future capacity

We have also considered current factors within the industry, external information and our industry knowledge, such as:

- The nature of AusNet's risk and how this relates to the impacts caused by changes to the market
- Our own observations about the current market and future of the market and the impact of changes to various factors on the capacity of the market

The results and subsequent conclusions we have made have been based on the information provided and our industry knowledge.

Conclusions

Based on the information provided to us, we have made a number of observations and conclusions, as required by the scope.

Our conclusions with regards to the current and expected market characteristics are:

- A significant amount of global capacity for bushfire liability risks has left the marketplace because of the perception of inadequate pricing, increasing volatility and insufficient returns.
- Insurers globally are increasingly updating their technical rating models to include the impact of the increase in natural catastrophe claims arising from climate change.
- The changes in the market have greatly reduced the negotiating power of AusNet. In essence AusNet and other electricity distributors have become price takers in the market, as insurers dictate a minimum rate.
- There are limited alternatives to obtaining bushfire liability insurance in the manner currently utilised.

Our conclusions with regards to the insurance premium forecasts over the regulatory period are:

- Both forecasts proposed by Aon are directionally consistent with our expectations of future premiums, given our understanding of the prevailing market conditions, and can be considered reasonable. Without a change in the market cycle, AusNet will continue to have its premiums dictated by the market, and efforts to improve its risk management will have a limited impact on reducing premiums.
- By using historical year on year increases to project forward, both forecasts are assuming that the historical impact of market hardening on the insurance costs will remain consistent into the future.
- Forecast 1 has implicitly allowed for future reductions in cover while forecast 2 has explicitly removed reductions in the level of cover for historical insurance costs and assumed no further reductions.
- Given the prevailing market conditions, a further withdrawal of capacity from the market which reduces the supply of insurance to the point where AusNet are compelled to purchase lower levels of cover is a reasonable scenario.
- In the event of a further deteriorating market, any reduction in the premium cost due to a modest reduction in the upper layer of cover purchased would be expected to be outweighed by the increases in premiums for the remaining lower layers of cover, resulting in an increase of the total premiums incurred.
- Our forecast has used Aon's forecast 1 as a starting point and suggests a range around this forecast. The percentages are applied to Aon's forecast increases and not the premiums.
- While we believe forecast 1 is the more likely scenario with regards to the total premium costs over the regulatory period, the corresponding decreases in coverage that result in these total premium costs may not be as large as those forecast by Aon.

Our conclusions with regards to the certainty of the insurance premium forecasts are:

- We consider the projected insurance costs in Aon's forecast 1 to be the more likely scenario. This is due to a number of factors influencing their expected future level of cover.
- When forecasting future premiums, certainty is difficult to establish, especially in an increasingly hardening market where there is a perception of increased underlying exposure. It is equally difficult to show that the methodology used in Aon's forecasts are flawed or incorrect.
- It is extremely difficult to maintain a high level of certainty over forecasts for availability of capacity for bushfire liability insurance over the next five years.
- It is quite possible that the segment sees more capacity exit as insurers and reinsurers look towards allocating their capital to more sustainably profitable areas of the insurance market.