

Marsh: Estimation of insurance premiums over the regulatory control period - Public

Appendix 16



Tasmanian Networks Pty Ltd



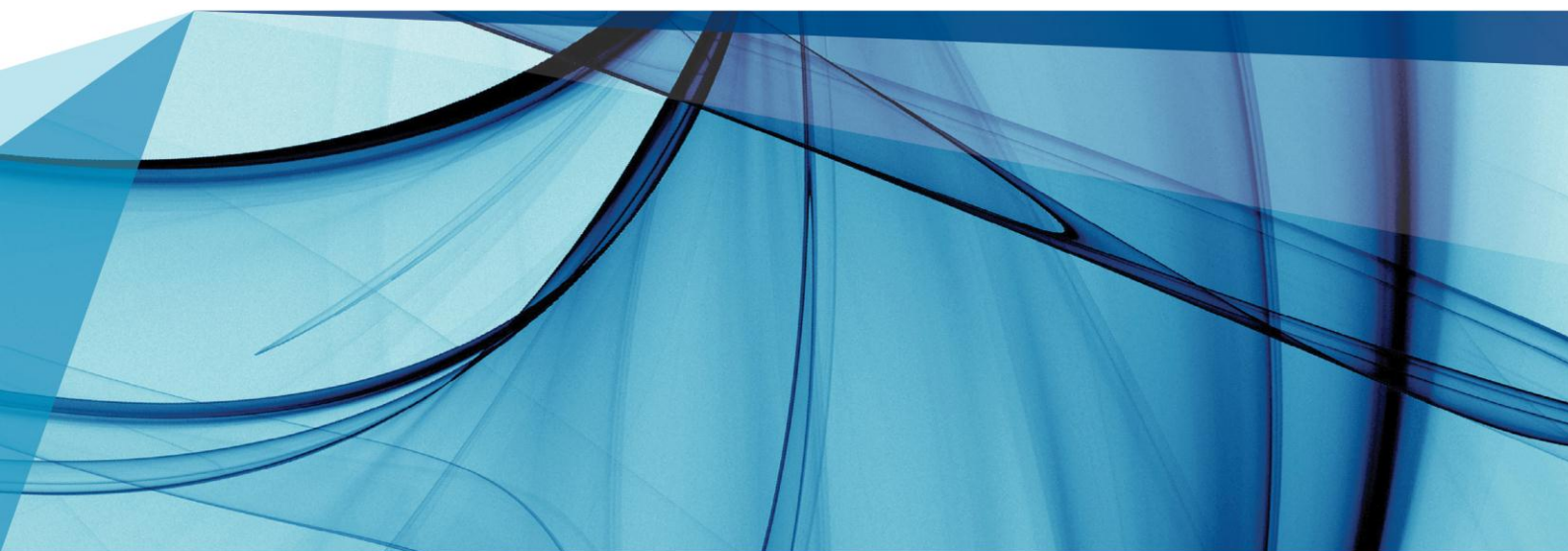
Transend Networks Pty Ltd

1 May 2014

TRANSEND NETWORKS PTY LTD

ESTIMATION OF INSURANCE PREMIUMS (2014/15 TO 2018/19)

FINAL





LARGE BROKER OF THE YEAR FOUR YEARS RUNNING

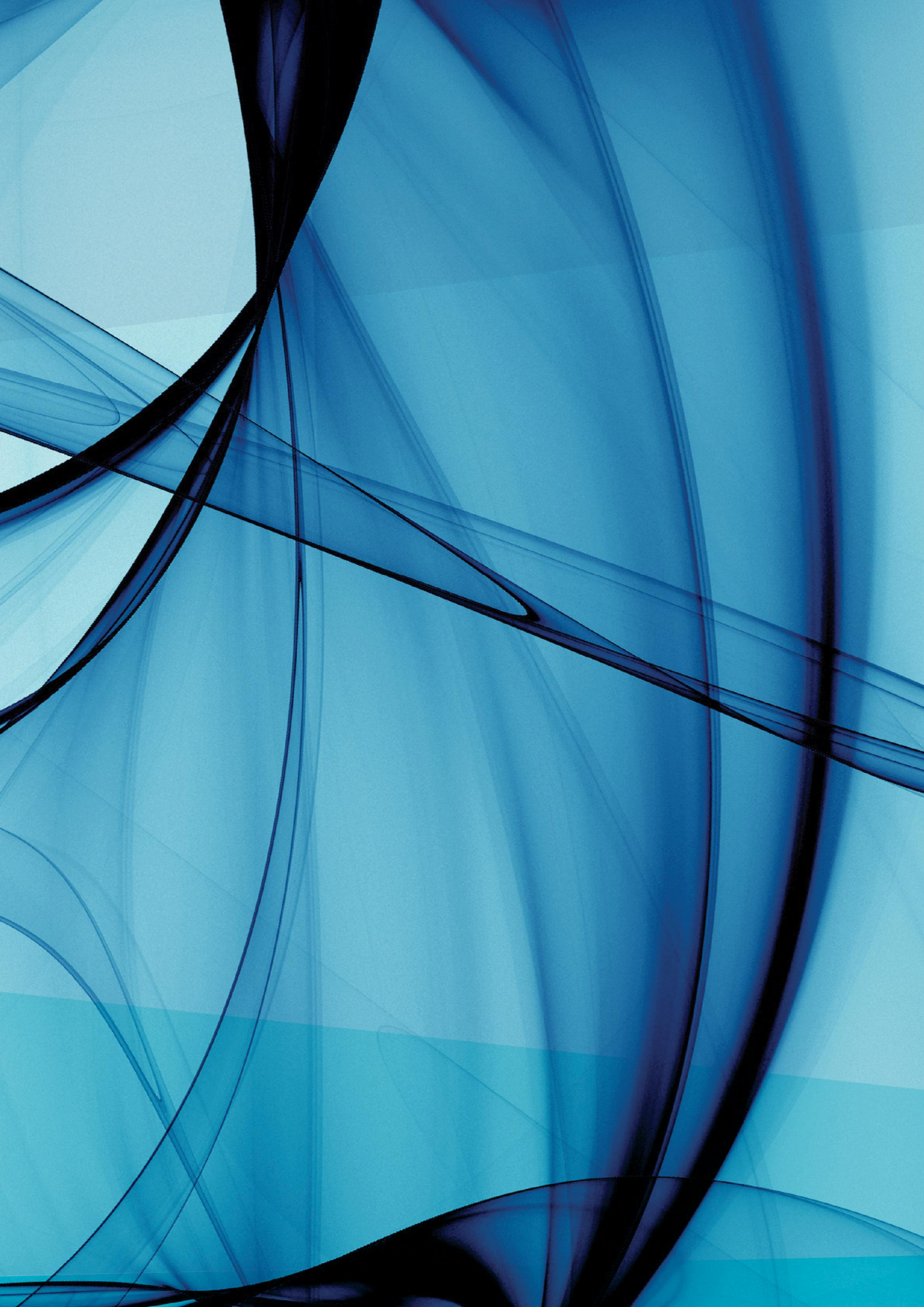
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AUSTRALIA AND NEW ZEALAND INSTITUTE OF INSURANCE AND FINANCE

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SECTION ONE

EXECUTIVE SUMMARY

Marsh Australia (**Marsh**) has been engaged by Transend Networks Pty Ltd (**Transend**) to estimate the insurance premiums payable for the five year period spanning 2014/15 to 2018/19. These estimates are to support Transend's revenue regulatory submission to the Australian Energy Regulator (**AER**).

We have provided estimates of premiums relating to Transend's prescribed or regulated activities only (**Regulated Premiums**). These total up to \$5.2m, with an average annual spend of \$1.0m. These are shown in the table below.

TABLE 1: REGULATED PREMIUM FORECASTS (\$ June 2014)

Policy year	Projection Year	ISR	Liability	Motor	Others	Total
2014/15	1					1,005,026
2015/16	2					1,028,744
2016/17	3					1,046,893
2017/18	4					1,064,087
2018/19	5					1,078,322
Total Forecast						5,223,071

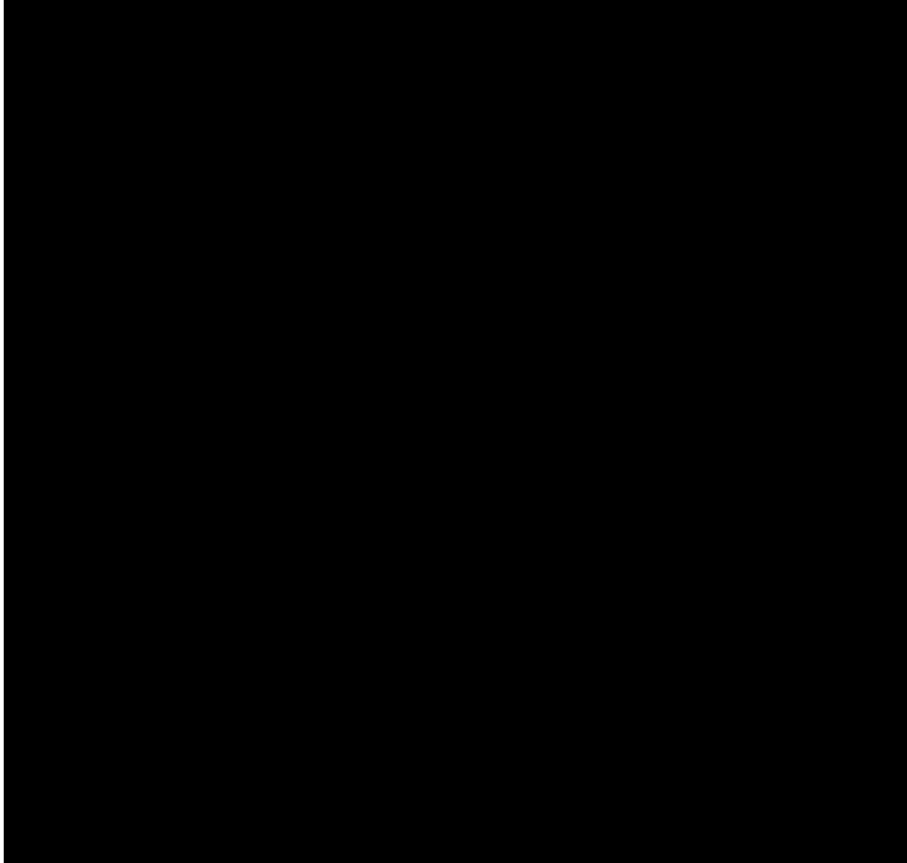
In arriving at the premium forecasts above, we have firstly derived **Base Premiums** relating to both Transend's regulated and non-regulated activities, and then added stamp duties, FSL, brokerage and other related costs to arrive at **Total Premiums**. A fixed proportion allocation by insurance class has been applied to arrive at the final **Regulated Premium** forecasts.

A breakdown of the Base Premium and Regulated Premium forecasts for each insurance class is provided in Sections Six to Ten. Section Eleven provides a summary of Base Premiums, Total Premiums and Regulated Premiums, whilst Appendix Two provides a detailed further breakdown by each insurance class.

Our premium forecasts have been indexed to 30 June 2014 values.

Our premium estimates consider inflationary pressures as well as changes in Transend's risk profile and the broader insurance market. The following chart shows the average contribution that each of these factors, excluding inflation, has on the annual change in real terms in the total base premiums over the forecast period.

CHART 1: DRIVERS OF FUTURE MOVEMENTS IN BASE PREMIUMS (EXCLUDING INFLATION)



We have also applied an economic inflation rate of 2.5% p.a. to inflate 2013/14 premiums (effective as at 30 September 2013) to 30 June 2014 values.

Transend / Aurora Energy merger

Given the upcoming merger between Transend and Aurora Energy's distribution business effective 1 July 2014, the two entities will be combining their insurance policies. We understand that the existing property and combined liability insurance policy premiums already incorporate the diversification effect of the combined entity; hence we have not allowed any further reductions due to impact of the merger. These two policies currently make up the majority, approximately 90% of the total premiums for Transend. For this reason, we have not incorporated any potential premium reductions due to the merger for the other (smaller) insurance classes as these are unlikely to be material.

The following sections of this report highlight details on approach, reliances and limitations, premium projections by each insurance class.

SECTION TWO

PURPOSE AND SCOPE

Marsh was engaged on 25 June 2013 to undertake a review of Transend's insurance-related costs in preparation for the upcoming five-year regulatory control period commencing 1 July 2014. The outcomes are intended to form the basis of Transend's revenue regulatory submission to the AER.

As described in the Marsh submission to Transend's request for services titled "Consultancy Proposal: Review of Insurance-Related Costs" dated 12 June 2013, one of the proposed services was to estimate the cost of the insurance premiums payable during this regulatory period (the relevant excerpt of the submission has been replicated in Appendix B for reference). This report "Estimation of Insurance Premiums (2014/15 to 2018/19)" (the **Report**) constitutes the deliverable of these services.

The Report provides estimates of the total premium payable by Transend across the five-year period commencing 1 July 2014, with separate estimates for each year.

The premium estimates are intended to reflect Transend's expected insurance programme during the regulatory period. As a result, our estimates incorporate allowances for the following insurance classes:

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

SECTION THREE

DISTRIBUTION AND USE

No other use of, or reference to, our report should be made without prior written consent from Marsh, nor should the whole or part of this report be disclosed to any other person, other than persons for whom it is or has been intended.

Except insofar as liability under statute cannot be excluded, Marsh, its directors, employees and agents will not be held liable for any loss or damage of any kind arising as a consequence of any use of the Report or purported reliance on the Report including any errors in, or omissions from, the utilised models.

The Report must be read in its entirety. Individual sections of the Report, including the Executive Summary, could be misleading if considered in isolation from each other. In particular, the opinions expressed in the Report are based on a number of assumptions and qualifications which are set out in full in the Report. port.

SECTION FOUR

RELIANCES AND LIMITATIONS

We have assumed that the information provided to us is accurate and complete in all material aspects. We have considered the reasonableness of the data but have not undertaken a complete review to verify the accuracy. In particular, we have relied on the forecasts provided by Transend as indicators of future exposure. To the extent that exposure deviates from forecasts provided, our estimates will also differ.

We have projected premiums for the insurance classes as outlined in Section Two – Purpose and Scope. We are not aware of any other insurance that Transend will be, or is considering, purchasing throughout the reset period. However, we note that it is possible that Transend will obtain other insurances that may become necessary throughout the regulatory period. To the extent that additional insurance is required, our total forecast will be underestimated.

We note that our estimates assume coverage for each line of business is unchanged from the expiring 2013/14 structure – e.g. deductibles, limits of liability, extent of coverage, lead insurer.

To the extent that these aspects change, our forecasts may deviate from quoted premiums.

The opinions and estimates contained in the Report constitute our best judgement as of the date of the Report and are subject to change without notice. In our judgement, we have employed techniques and assumptions that are appropriate, and the conclusions presented herein are reasonable, given the information currently available.

We have estimated additional costs within future premiums, relating to stamp duties, FSL, brokerage and other related costs based on the reliance that these are still applicable in the forecast period and do not materially change from the 2013/14 year.

We have also relied on fixed allocations provided by Transend to estimate the proportion of premiums relating to Transend's prescribed activities only. Our estimates will be largely dependent to the extent whether Transend's operations significantly deviate from the allocated basis between its prescribed and non-prescribed activities during the forecast period.

SECTION FIVE

APPROACH

We have considered each insurance class separately to derive standalone premium forecasts based on the individual circumstances of that insurance class.

Our estimated premium forecasts have been inflated to 30 June 2014 values.

In deriving our estimates for each insurance class, we have considered the following factors influencing premium levels:

- Historical changes in insurance cover
- Historical variation in exposure
- Historical claims experience
- Forecasts of exposure
- Inflationary impacts
- Expected market outlook
- Other historical market factors (e.g. changes in insurers, changes in insurer profit margins, industry claims experience, etc.) to the extent that historical premium trends are observed which cannot be directly attributable to other factors.

A high-level framework of the approach undertaken for each insurance class is summarised as follows:

1. Collate information on the historical insurance programme structure, exposure and premium.
2. Investigate the relationship between historical premium movements and changes in various drivers such as changes in exposure growth, deductibles and limits.
3. Normalise the historical premiums to reflect the 2014/15 insurance programme structure.
4. Where a clear relationship is identified, forecast premiums incorporating expected changes in exposure growth.
5. Where a clear relationship cannot be identified, forecast premiums by making explicit assumptions which factor in expected inflationary impacts and market rate movements.
6. Adjust estimated base premiums to determine:
 - Total Premium, which includes stamp duties, FSL, brokerage and other related costs; and
 - Regulated Premium, to allow for share of premiums relating to Transend's prescribed activities only.



[REDACTED]

SECTION SIX

RESULTS - ISR

Loss Experience

There have been no claims in the past five years. The current premium level is likely to reflect the low claims experience of Transend and so any deterioration in claims would be expected to increase premium costs.

Projection Approach

Our ISR premium projections are largely based on an exposure method. We have selected this method given the sparsity of claims experience and the expectation that changes in ISR premiums are related to movements in Insured Value. We note that ISR risks are often priced as a rate per Insured Value. By comparing normalised historical premiums to historical Insured Values, we can see that the two items move generally together which supports our expectation of the relationship.

Prior to determining a premium rate per unit of exposure, we have adjusted historical premiums to current 2013/14 year deductibles and limits by using a statistical regression model.

We have been provided by Transend the estimated values of the Regulated Asset Base (**RAB**), separated by net capex, inflation and depreciation at the end of each future regulatory year. We have incorporated only the future real growth in the RAB and applied these to the Insured Value. These will form the exposure unit for our premium projection. In addition, we have applied a future economic inflation rate of 2.5% p.a. (being the midpoint of the Reserve Bank Australia's long term target of 2-3%) to inflate values to 30 June 2014.

In terms of future market movements for the following years, the most recent Marsh global insurance market briefing indicates property rates may increase up to 10% in the markets that Transend participate in. ■

Base Premium projections

Based on our approach, the estimated annual increase in ISR premium

We have applied an economic inflation rate of 2.5% p.a. to expiring 2013/14 premiums (effective as at 30 September 2013) to present all premium forecasts at 30 June 2014 values

Table below shows our premium projections for ISR.

TABLE 2: ISR BASE PREMIUM FORECASTS

Policy Year	Projection Year	Base Premium	% Change in real value of asset	% Change due to inflation	% Change due to market movement

Regulated Premium projections

In addition to the **Base Premium** forecasts above, we have allowed for an to reflect the stamp duties, FSL, brokerage and other related costs to arrive at **Total Premium**. This is based on the 2013/14 premiums and the additional costs.

We have shown these in the table below:

TABLE 3: ISR PREMIUM FORECASTS

Policy Year	Projection Year	Base Premium	Total Premium	Regulated Premium

SECTION SEVEN

RESULTS – COMBINED LIABILITY

Loss Experience

There have been no claims in the past five years. The current premium level is likely to reflect the low claims experience of Transend and so any deterioration in claims would be expected to increase premium costs.

Projection Approach

Given the nature of Transend's operations within a regulatory environment, its revenue, which is often used as measure of exposure for other types of businesses for liability insurance classes, does not appear to be a good measure in this case. Hence we have relied solely an interpolation of past rate movements, incorporating any future economic inflation and market movements.

We have applied a future economic inflation rate of 2.5%, being the midpoint of Reserve Bank Australia's long term target of 2-3% to inflate values to June 2014.

In terms of future market movements for the projection years, we have relied on market commentary from the underwriters in London Markets where Transend's current insurance programme is currently placed with. Indications of liability premium increases have been flagged, particularly given the insurers' 'blanket' view on bushfire liability risk for the Australian transmission and distribution operators, despite Transend seen as having managed this risk very well historically compared to its peers.

Base Premium projections

Based on our approach,

We have applied an economic inflation rate of 2.5% p.a. to expiring 2013/14 premiums (effective as at 30 September 2013) to present all premium forecasts at 30 June 2014 values. This results in a

Table below shows our premium projections for liability. [REDACTED]

TABLE 4: LIABILITY BASE PREMIUM FORECASTS

Policy Year	Projection Year	Base Premium	% Change in historical rate	% Change due to inflation	% Change due to market
[REDACTED]					

Regulated Premium projections

In addition to the **Base Premium** forecasts above, we have allowed for an [REDACTED] to reflect the stamp duties, FSL, brokerage and other related costs to arrive at **Total Premiums**. This is based on the 2013/14 premiums and the additional costs. [REDACTED]

[REDACTED] We have shown these in the table below:

TABLE 5: LIABILITY PREMIUM FORECASTS

Policy Year	Projection Year	Base Premium	Total Premium	Regulated Premium
[REDACTED]				

SECTION EIGHT

RESULTS – MOTOR VEHICLE

Loss Experience

[REDACTED]

Projection Approach

Our motor premium projections are largely based an analysis of the historical rate per vehicle, and adjusting the historical premiums to incorporate the most recent fleet profile. [REDACTED]

We have applied a future economic inflation rate of 2.5%, being the midpoint of Reserve Bank Australia’s long term target of 2-3%. In terms of future market movements, we have kept it flat at 0%.

Base Premium projections

[REDACTED]

We have applied an economic inflation rate of 2.5% p.a. to expiring 2013/14 premiums (effective as at 30 September 2013) to present all premium forecasts at 30 June 2014 values. [REDACTED]

[REDACTED]

Table below shows our premium projections for motor. [REDACTED]

TABLE 6: MOTOR BASE PREMIUM FORECASTS

Policy Year	Projection Year	Base Premium	% Change in historical rate	% Change due to inflation	% Change due to market
[REDACTED]					

Regulated Premium projections

In addition to the **Base Premium** forecasts above, we have allowed for an additional [REDACTED] to reflect the stamp duties, FSL, brokerage and other related costs to arrive at **Total Premiums**. This is based on the 2013/14 premiums and the additional costs. [REDACTED]
[REDACTED] We have shown these in the table below:

TABLE 7: MOTOR PREMIUM FORECASTS

Policy Year	Projection Year	Base Premium	Total Premium	Regulated Premium
[REDACTED]				

SECTION NINE

RESULTS – WC

[REDACTED]

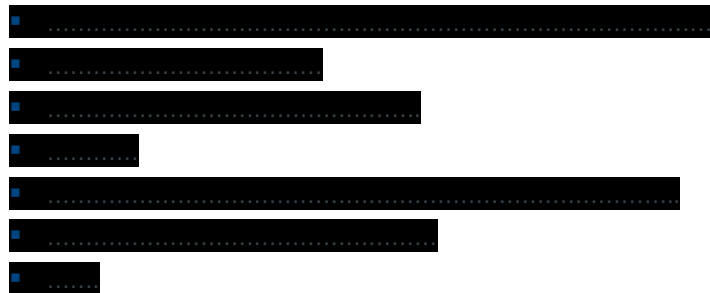
[REDACTED]

[REDACTED]

SECTION TEN

RESULTS – OTHERS COMBINED

We have chosen to combine this section of the report for the remaining [REDACTED] insurance classes. These make up [REDACTED] of the total premium for Transend. The insurance classes include:



Projection Approach



Base Premium projections

Based on our approach, [REDACTED]

We have applied an economic inflation rate of 2.5% p.a. to expiring 2013/14 premiums (effective as at 30 September 2013) to present all premium forecasts at 30 June 2014 values. [REDACTED]

The table below shows our premium projections for all other classes. [REDACTED]

TABLE 8: OTHER COMBINED BASE PREMIUM FORECASTS

Policy Year	Projection Year	% Change in Base Premium	% Change due to inflation	% Change due to market movement
[REDACTED]				

Regulated Premium projections

In addition to the **Base Premium** forecasts above, we have allowed for an [REDACTED] to reflect the stamp duties, FSL, brokerage and other related costs to arrive at **Total Premiums**. This is based on the 2013/14 premiums and the additional costs. [REDACTED]
[REDACTED] We have shown these in the table below:

TABLE 9: OTHER COMBINED PREMIUM FORECASTS

Projection		Others Combined Base Premium	Others Combined Total Premium	Others Combined Regulated Premium
Policy Year	Year			
[REDACTED]				

SECTION ELEVEN

RESULTS – OVERALL

Base Premium only

These are representative of the base premiums only, as disclosed in sections six to ten of this report.

Total Premium

From the estimated Base Premiums for each insurance class, we have estimated the Total Premiums, payable for each regulatory period which is inclusive of stamp duties, FSL, brokerage and other related costs. These are derived by applying the same proportional increase from the base premium to the total premium payable in 2013/14 for each insurance class.

Regulated Premium

These proportional allocations have been provided by Transend as part of the internal allocations based on the 2012/13 year. We have assumed these will remain unchanged for the forecast years.

The following table highlights the overall results for all insurance classes.

TABLE 10: TOTAL PREMIUM FORECASTS

Policy year	Projection Year	Base Premium only	% Change in Base Premium	Total Premium	Regulated Premium

APPENDIX ONE

DATA

Historical Premiums

Transend has provided historical premiums for all insurance classes for policy years 2008/09 to 2013/14.

Historical Claims

We have been provided with claims histories for each insurance class for policy years 2008/09 to 2013/14.

Historical Insurance Cover

We received detail around the deductibles and limits for the majority of insurance classes for the active policies from 2008/09 to 2013/14. This includes the relevant deductible and limit for sections within policies.

[REDACTED]

[REDACTED]

[REDACTED]

While coverage has for the most part remained stable across the last five years, material changes to the programme include:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Historical Exposure Indicators

For years 2008/09 to 2013/14 we have obtained:

- Total declared asset values for ISR
- Number of declared motor vehicles

Forecast Economic Indicators

To adjust for inflationary impacts, Transend has assumed expected increases of 2.5% in the Consumer Price Index (CPI) for all years from 2014/15 to 2018/19. We assume this figure is also applicable for 2013/14.

APPENDIX TWO

INSURANCE CLASS BREAKDOWN

Historical Base Premiums (excl stamp duties, FSL, brokerage and other related costs)													
Policy year	Projection Year	ISR	Liability	Motor	BPL	D&O	EPL	Travel	IT Liability	Group PA	Crime	Total	% Change

Forecast Base Premiums (excl stamp duties, FSL, brokerage and other related costs)													
Policy year	Projection Year	ISR	Liability	Motor	BPL	D&O	EPL	Travel	IT Liability	Group PA	Crime	Total	% Change

Total premiums (incl stamp duties, FSL, brokerage and other related costs)												
Policy year	Projection Year	ISR	Liability	Motor	BPL	D&O	EPL	Travel	IT Liability	Group PA	Crime	% Change

Premiums for regulated activities												
Policy year	Projection Year	ISR	Liability	Motor	BPL	D&O	EPL	Travel	IT Liability	Group PA	Crime	% Change

