Horizons Regional Council

Insurance Market Summary and Strategy

November 2020

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National Complaints Manager
Aon New Zealand
PO Box 1184
Shortland Street
Auckland 1140

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Introduction

This paper is designed to give an overview of the of the insurance renewal for 2020-2021 period for the Horizons Regional Council, and future considerations that will further refine the Horizons Regional Council Insurance Programme.

We will discuss the following topics:

- Current Market
- Insurance Strategy
- Valuations
- Insurance Levers
- Renewal Outcomes

The development of an Insurance Programme is an iterative process that needs to be integrated into an organisation's risk management framework.

Overview of Insurance Market and Trends

International insurers and reinsurers continue to be impacted by major catastrophe events. Over the last few years, we have seen a significant hardening of the local New Zealand and the global markets.

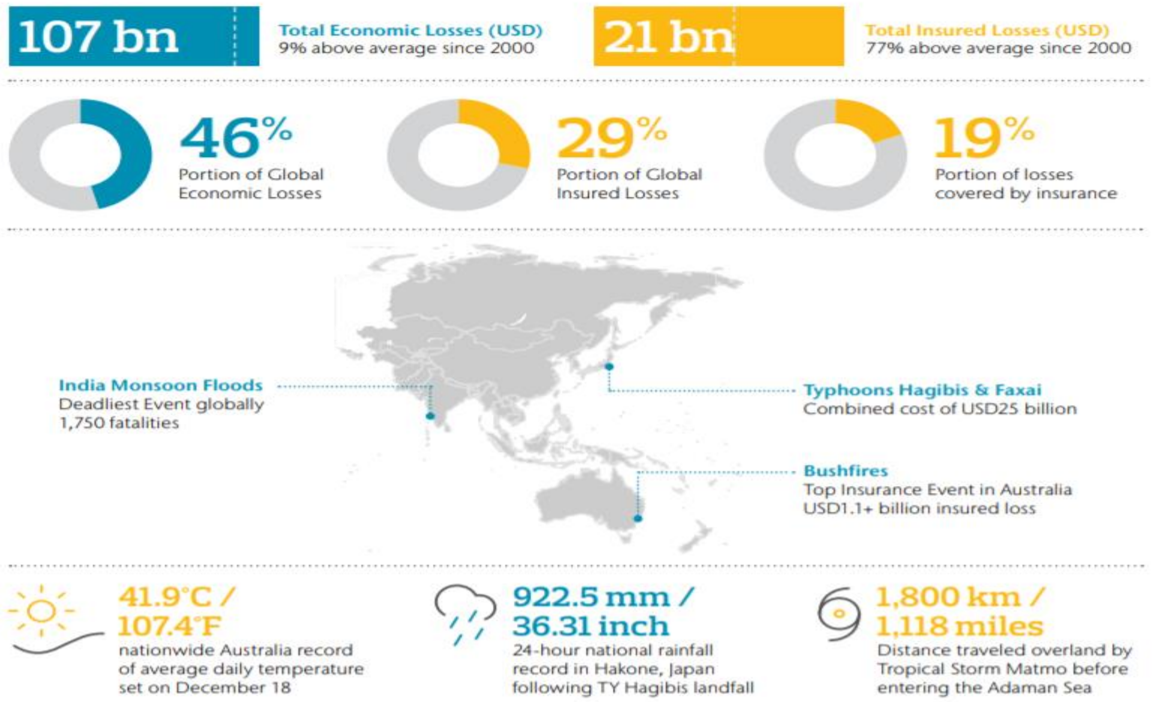
Increases were accompanied by restrictions in capacity for locations in higher risk earthquake zones.

The COVID-19 pandemic has presented significant challenges for the economy, and while insurance policies generally contain infectious diseases or pandemic exclusions, there are some types of policies that provide coverage. Global indications of losses related to COVID-19 are in excess of GBP150billion.

Insurers are focusing on climate change and its impact on risk profiles. We are seeing insurers looking very closely at regions and areas susceptible to flood or sea inundation and imposing underwriting discipline when considering risks in these categories.

The global property insurance market continues to be strongly influenced by losses arising from natural disaster events. Significant losses over the past decade have eroded underwriting profits and when coupled with low investment returns, there is now a strong focus on disciplined underwriting. High quality risk data is required in order to obtain terms. Presentations to international markets, such as London, Singapore and Bermuda, have been significantly impacted by the effects of COVID-19, and as such, were conducted remotely via web conferencing, rather than in person. We continue to monitor this position and will keep affected clients updated as the situation evolves.

The last decade has featured record-breaking instances of each individual peril including earthquakes, tsunamis, tropical cyclones, severe convective storms, inland flooding, wildfires, drought and extreme heat and cold.



Many countries globally, including New Zealand, registered an event that resulted in their costliest economic natural disasters on record. The economic costs were almost certainly enhanced by a combination of more intense weather events, increased vulnerable exposure and population in the path of the event, and elevated direct business interruption impacts due to a greater supply chain dependency within the globalised economy.

The table below shows recent NZ Weather related events.

2020	Southland Flooding	03 - 08	February	Flood	29.64
2019	Nationwide Storm & Southern Lakes Floods	03 - 12	December		15.29
2019	Timaru Hail Storm	20	November		130.7
2019	Christchurch Tornado	18	November		4.04
2019	Taranaki and Auckland Storms	10 - 13	August		7.9
2019	West Coast Wind and Flooding	26 - 27	March		4.09
2019	Tasman District fires	05 - 23	February		3.98
2018	New Plymouth-Whakatāne tornadoes	20	August		2.9
2018	Northland-Bay of Plenty flooding	14 - 15	July		3.7
2018	Gisborne-Hawke's Bay flooding	11 - 12	June		4
2018	Upper North Island-Hawke's Bay flooding	03 - 04	June		4.3
2018	Nationwide severe weather including flooding in Rotorua	27 - 29	April		21.3
2018	Severe weather including tornadoes	10 - 11	April		74.4
2018	Ex-Tropical Cyclone Gita	20	February		35.6
2018	Cyclone Fehi	01	February		45.9
2018	Nationwide severe weather	04 - 07	January		34.2

Insurance Strategy

As we are in a hard market, with expectations that this will not change in the foreseeable future there needs to be a focus on Insurance Strategy. As is shown below this is an integrated approach with the last part of the process being the purchase of an insurance programme.

By using this model as a template, it allows for a structured approach to be taken.

The objective of this process is to reduce the level of uncertainty over outcomes that can affect Horizons, which therefore allows for a tailored insurance programme to be designed.

Over the last 18-24 months Horizons Regional Council and Aon have been working through this process with work being done or to be done in:

- Determining risk – valuations data
- Risk positioning – risk profiling workshop
- Loss volatility & estimation – high level loss modelling completed.

Determining Risk -Valuations Data

At a presentation given by London Underwriters to South Island Councils and representatives of Waikato LASS, BOP LASS and MWLASS at the start of 2020, the underlying message from the underwriters was clear; a continued need to improve the accuracy of data and accuracy of valuations. This is of importance to the Infrastructure insurance programme, but with the current market conditions, it is also relevant for "above ground" assets under your Material Damage programme.

We are working in a competitive market and as a LASS, we needed to differentiate you as a purchaser from others. This comes down to the quality and accuracy of information and being able to demonstrate to underwriters' good asset management practices.

Underwriters by their nature are conservative, and if through poor data, there is uncertainty in their minds, they will apply premium to this uncertainty.

Horizons have undertaken significant work in assessing values and accurate asset data. The better the quality of data that can be provided to underwriters, the better the premium outcomes.

In a hard market this does not necessarily mean and reduction in premiums but does allow for the market impacts to be mitigated.

Having complete and accurate data allows for accurate Loss Modelling to be completed, as the overall values are fed into the loss Modelling process. Poor data in equals poor data out.

However, increasing values does have an impact on premium pricing, as there are greater values exposed. But this does provide greater certainty in the event of a claim as accurate values are declared.

The more accurate data does allow for better 'asset selection' to take place. What this means is Horizons can review its' asset schedules to decide whether all assets should be insured, or if some can be removed from the schedule This then reduces the total declared values, which in turn will reduce the premium spend. However there needs to be a full understanding of the vulnerability or criticality of assets being considered.

Whilst Horizons valuations data is improving, a concentrated look at how such things as demolition costs etc, are applied to each asset, as they aren't always needed. This is a conversation we are currently having.

Risk Profiling

As part of the Risk Positioning process in the Insurance Strategy model, Aon have recently undertaken a Risk Profiling Workshop with Horizons.

The objectives of the workshop are to:

- Evaluate Council's approach to risk governance, management and financing
- Identify worst-case scenarios to help inform insurance coverage and limits
- Recommend actions to improve Council's risk profile and optimise insurance outcomes.

The overall risk profiling process is shown below:

This is currently being analysed by our Risk Specialists and a separate report will be provided.

The results will then be reported to Horizons, to allow further conversations to take place about risk positions and risk appetite.

The conversations could further refine the current insurance programme.

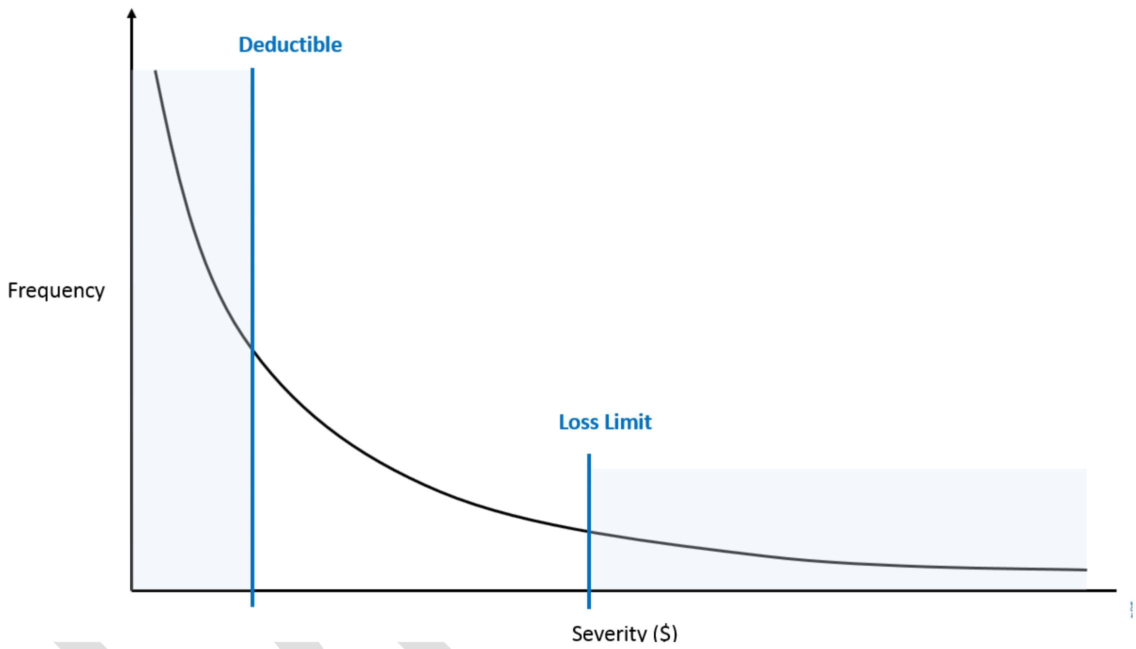
Insurance Levers

Premiums – a Balancing Act

Insurers calculate premiums for Material Damage and Infrastructure programmes by applying a rate percent to the total declared values.

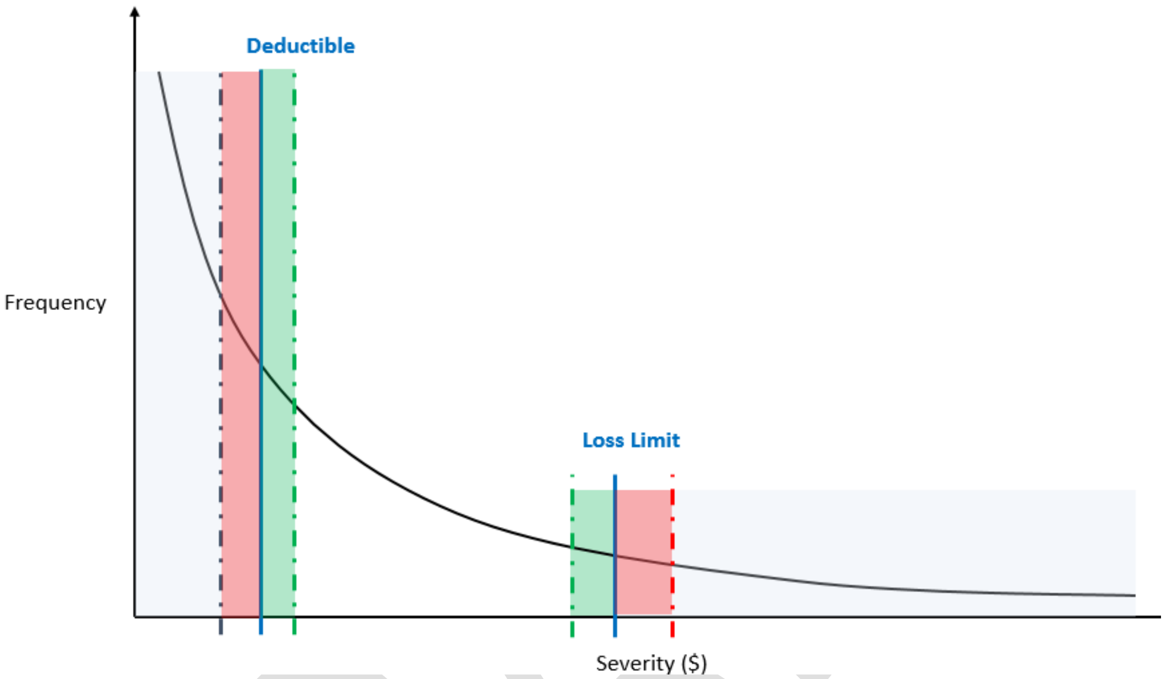
The rate percent that insurers calculate is based on the following diagram. Through understanding Horizons' risk appetite, the point at which the insurance attaches on this curve affects the pricing.

As shown an attachment point further to the left, which provides cover for more frequency type losses will increase pricing. Conversely further to the right, moving away from frequency losses will decrease pricing.



Deductibles – Finding the Sweet Spot

Risk retention is the financial risk that remains on your balance sheet. The deductible removes the most expensive part of risk transfer (or what the market deems to be too volatile to insure). The loss limit if the limit up to which a claim will be paid, normally an overarching policy loss limit.



Effects on Premiums

Deductibles

Increasing deductibles can have a positive impact on pricing i.e. a reduction in pricing. However, there is a downside to this as it increases Horizons exposure to the "frequency" losses. Before any decision is made to increase deductibles a full understanding of what these below deductible exposures are, is required.

Additionally, there also needs to be a cost benefit analysis done to assess whether any reduction in premiums is worth the additional exposure.

For example:

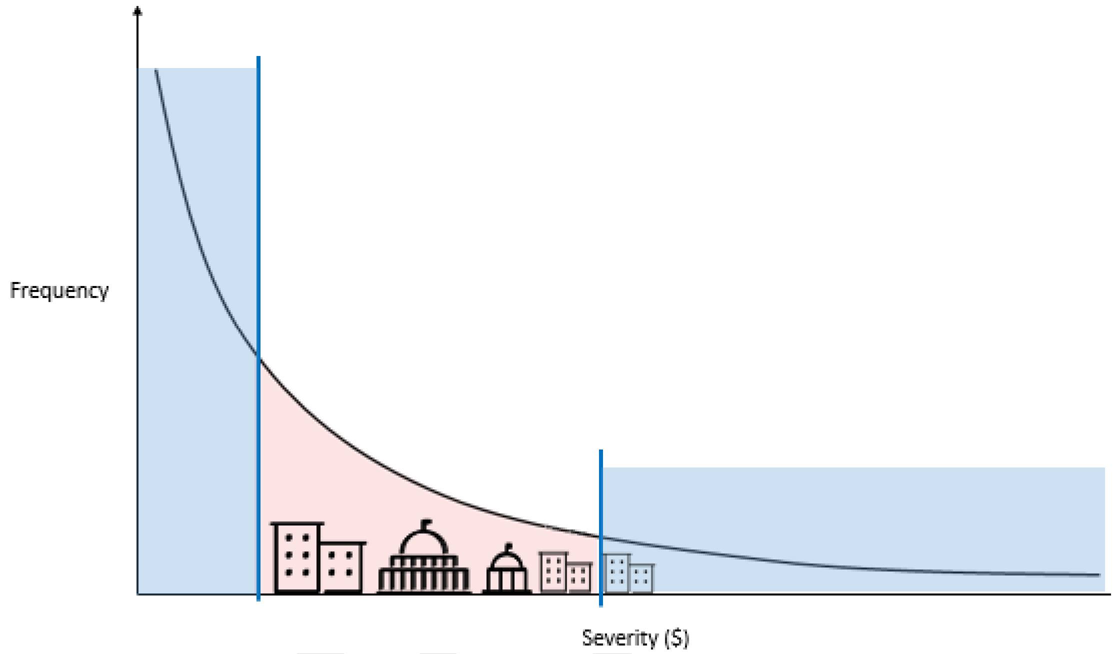
If increasing the deductible under the Material Damage and Business Interruption policy from $10,000 to say $100,000 provides a premium reduction of $20,000. Is this worth the potential increased exposure of $90,000 in the event of a loss.

For the current infrastructure insurance programme which has a Natural Disaster deductible of $3,000,000 in 100% terms, the market has indicated that there would be no significant premium savings unless the deductible were increased to a figure nearer $10,000,000 in 100% terms, an increase in potential exposure of $7,000,000 in 100% terms.

It should also be noted that in the current market once the deductible is increased until the market changes to a "soft" market the underwriters are unlikely to allow the deductible to be reduced in the future. So, any change made to the deductible needs to be considered as a long-term change.

Valuations vs Premiums

Premium is calculated by multiplying the rate by the total declared values. Increasing or decreasing the total declared values directly impacts cost. Changing values may require change to deductibles and loss limit levels. The following graphics show how valuations impact premiums pricing and when accurate values are important.



What can Horizons control?

Understanding that Horizons can not control the Insurance Market, there are some areas that can be controlled, and these are detailed below as a summary.

Rate

What is controllable?

- Risk understanding
- Risk management (asset management)
- Active engagement with markets
- Coverage

Retention

Can you retain more risk?

Declared values

Are the values sufficient for you to rebuild what you need?

Does everything need insuring?

Risk understanding

Are you able to quantify your risks? Both severity and frequency?

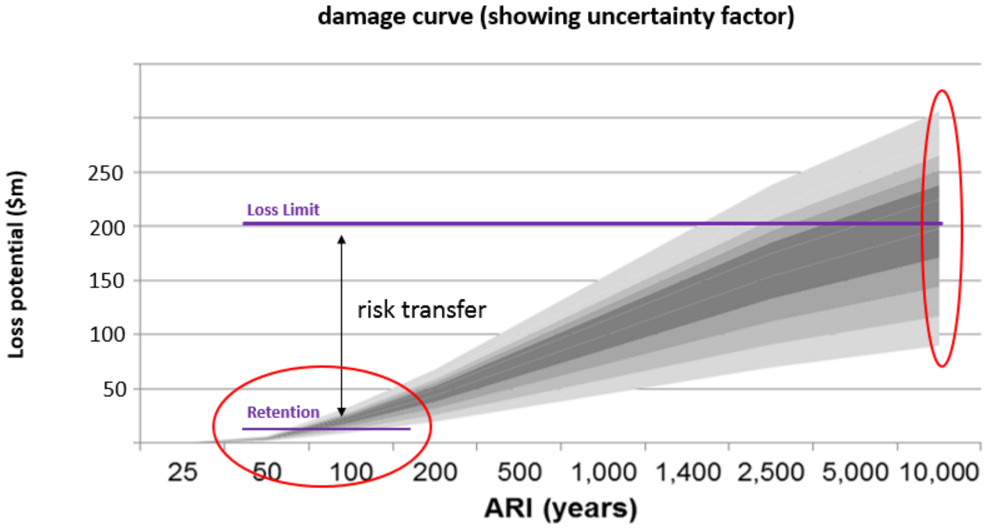
Is your cashflow/ balance sheet able to withstand these losses?

Do you have the information to make informed decisions?

Loss Modelling

Horizons and the MW LASS councils have recently engaged Aon to undertake a high-level portfolio loss modelling review, and this report is still being finalised.

Loss modelling provides a damage curve, which is created by combining probabilistic and deterministic loss models in order to provide a more holistic view of damage(loss) for a range of return intervals. This could be either for a single or a multi hazard scenario, depending on the analysis. Once this report has been provided, advice on suitable limits or assistance is given to analyse appetite/tolerance within the organisation for risk retention. Depending on the organisations risk tolerance, cost benefit analysis and an understanding of the current cycle of insurance, the risk transfer programme is tweaked accordingly. Probabilistic loss modelling is ideal for determining suitable risk retention levels. However, loss limits need to be assessed, usually through a deterministic approach and deep dive into specific data, either around hazard, hazard /mitigation etc.



The completed loss modelling will provide Horizons with suggested damage values following defined events. This will allow a review of the current Infrastructure asset policy limit to be done. Once completed the decision can be made (following a cost benefit analysis), as to whether the existing limit needs to be amended.

Renewal Outcomes

Below is a summary table showing the current premium outcomes for renewal. This table compares premiums to declared values where appropriate, to show the impact that the increase in declared values has on the premium pricing.

The major impact this year has been the significant increase in values for the Infrastructure Assets increasing from approx. $380M to approx. $835m. These figures are currently being reviewed to ensure this is not an over declaration of values.

MW LASS Summary of Premium 2020

Horizons Regional Council 2019 v 2020 Renewal Premium Comparison

Policy	Premium 2019	Sum Insured 2019	Premium 2020	Sum Insured 2020	% Change Premium	% Change Sum Insured
Material Damage (excl Fire)	$ 130,059.73	$ 91,460,019.00	$ 144,896.00	$ 94,482,160.00	11.41%	3%
Material Damage (Fire)	$ 55,004.42	$ 91,460,019.00	$ 62,098.00	$ 94,482,160.00	12.90%	3%
Business Interruption	$ 6,601.57	$ 2,732,617.00	$ 13,178.00	$ 6,015,234.00	99.62%	120%
Excess Layer MDBI	$ 44,013.54	$ 91,460,019.00	$ 54,903.00	$ 94,482,160.00	24.74%	3%
Infrastructure Cover	$ 343,574.30	$ 379,583,902.00	$ 812,002.00	$ 835,020,551.00	136.34%	120%
Infrastructure Cover - Excess Layer	$ 154,727.02	$ 379,583,902.00	$ 154,727.00	$ 835,020,551.00	0.00%	120%
Commercial Motor	$ 96,913.48	$ 5,267,189.00	$ 91,825.35	$ 5,874,942.00	-5.25%	12%
Employers Liability	$ 2,366.93	$ -	$ 2,684.00	$ -	13.40%	
Statutory Liability	$ 6,212.49	$ -	$ 7,044.00	$ -	13.38%	
Fidelity/Crime	$ 8,133.97	$ -	$ 8,637.18	$ -	6.19%	
General Liability	$ 23,150.68	$ -	$ 26,250.00	$ -	13.39%	
Professional Indemnity	$ 65,828.24	$ -	$ 85,304.00	$ -	29.59%	
Excess Layer Liability	$ 14,045.31	$ -	$ 15,940.11	$ -	13.49%	
Cyber Liability	$ 8,660.00	$ -	$ 8,660.00	$ -	0.00%	
Personal Accident	$ 1,949.30	$ -	$ 1,949.30	$ -	0.00%	
Business Travel	$ 187.34	38 days	$ 80.00	min deposit	-57.30%	
Standing Timber	$ 9,188.96	$ 5,867,288.17	$ 33,239.46	$ 6,076,202.34	261.73%	4%
Aviation Hull	$ 754.22	$ 3,320.00	$ 1,366.40	$ 11,349.00	81.17%	242%
Aerial Applicators Liability	$ 9,000.00	$ -	$ 9,900.00	$ -	10.00%	
Aviation Non Owners	$ 1,350.00	$ -	$ 1,550.00	$ -	14.81%	
Marine Hull	$ 4,600.00	$ 555,400.00	$ 6,182.50	$ 660,900.00	34.40%	19%
Harbour Masters / Wreck Removal (Port Operators)	$ 10,455.00	$ -	$ 14,250.00		36.30%	
Fee Invoice	$ 15,909.65	$ -	$ 14,117.65	$ -	-11.26%	
Total Premium (excl GST, FSL & EQC levies)	**$ 1,012,686.15**	**$ 1,047,973,675.17**	**$ 1,570,783.95**	**$ 1,972,126,209.34**	55.11%	88%

If the significant increase in premium associated with the Infrastructure programme is removed from the above table, then the overall premium increase for 2020 over 2019 is only ~13%, which is an excellent result as this is ahead of current market conditions.