



Draft Guidance Note

Guidance note on insurance coverage pass through events

February 2021

© Commonwealth of Australia 2021

This work is copyright. In addition to any use permitted under the Copyright Act 1968, all material contained within this work is provided under a Creative Commons Attributions 3.0 Australia licence, with the exception of:

- the Commonwealth Coat of Arms
- the ACCC and AER logos
- any illustration, diagram, photograph or graphic over which the Australian Competition and Consumer Commission does not hold copyright, but which may be part of or contained within this publication. The details of the relevant licence conditions are available on the Creative Commons website, as is the full legal code for the CC BY 3.0 AU licence.

Requests and inquiries concerning reproduction and rights should be addressed to the Director, Corporate Communications, Australian Competition and Consumer Commission, GPO Box 3131, Canberra ACT 2601 or publishing.unit@acc.gov.au.

Inquiries about this publication should be addressed to:

Australian Energy Regulator
GPO Box 520
Melbourne Vic 3001

Tel: 1300 585165

Email: AERInquiry@aer.gov.au

Overview

This draft Guidance Note sets out the Australian Energy Regulator's (AER) expectations with respect to the types of information that should be kept by a Network Service Provider (NSP), and the related processes that should be adopted by the NSP, to facilitate our assessment of a pass through application for an insurance coverage event. The insurance coverage pass through event covers general insurance risks that an NSP faces, including bushfire risks.

The information proposed in this draft Guidance Note is informed by feedback from stakeholders in response to the Consultation Paper.

This guidance applies to both electricity and gas, distribution and transmission NSPs.¹ It is intended to help guide electricity and gas NSPs on where our attention would likely be directed to when asked to assess whether an NSP is prudent and efficient in obtaining a given level of insurance cover with respect to an insurance coverage pass through event application. It may be revised over time in light of subsequent experience assessing any pass through applications of this kind.

This draft guidance is intended to assist NSPs by providing information about the guiding principles that will influence our assessment of insurance coverage pass through event applications. In particular, about how we will assess NSPs ongoing management of insured risks, including bushfires, and in identifying what levels of insurance cover (including associated trade-offs) are consistent with what a prudent and efficient NSP would do. This draft guidance takes into account that in recent times there have been unusual conditions in the international and domestic insurance liability markets.

The guidance recognises the starting premise that an NSP is responsible for managing its network's business risk, including any potential risks associated with catastrophic bushfires. This draft guidance is expected to provide greater clarity to both the NSPs and energy customers about the pass through process, prior to an actual insurance coverage event occurring, in light of the material consequential impacts of such events.

The principles underlying this guidance rely on established energy regulatory frameworks and good corporate governance and practices. It is not expected to impose additional burden on a NSP above what a prudent and efficient NSP would normally have done to manage its risks associated with infrequent but high impact events.

Table 1 sets out the proposed timelines in developing the final Guidance Note. In developing this draft Guidance Note we have taken into account the submissions received in response to the Consultation Paper and as set out below are seeking further submissions prior to finalising the Guidance Note. Depending on feedback, we are open to having further one on one meetings with the industry.

¹ NER, cl. 6.5.10(a); 6A.6.9(a); similar arrangements exist for gas network service providers as detailed in the AER's Access Arrangement Guideline March 2009 under the National Gas Law and National Gas Rules framework.

Table 1: Process for developing a Guidance Note and indicative timeline

Key steps	Purpose	Indicative dates
Release consultation paper	Publish the consultation paper seeking submissions	28 August 2020
Submissions on consultation paper	The purpose of this period is to allow adequate consultation to receive views across the industry on matters that should be covered in a final guidance note	30 October 2020
Draft guidance	Publish draft guidance and seek submissions	26 February 2021
Submissions on draft guidance	Opportunity for Stakeholders to provide feedback on the proposed draft guidance	30 April 2021
Final guidance	Publish final guidance	July 2021

How to make a submission

Interested parties are invited to make submissions on this draft Guidance Note by 30 April 2021. In providing responses, please explain your reasons for proposed positions and provide supporting evidence and data where possible.

You do not need to comment on all issues in your feedback and we invite you to respond to the questions that are relevant to you and your circumstances.

We prefer that all submissions are in Microsoft Word or another text readable document format. Any submissions that include data should be provided in Microsoft Excel format. Submissions should be emailed to: AERInquiry@aer.gov.au with the subject heading "Attention: General Manager – Transmission and Gas – Submission on assessing an insurance coverage pass through event"

Alternatively, submissions can be send to:

Sebastian Roberts
General Manager
Transmission and Gas
Australian Energy Regulatory
GPO Box 520
Melbourne VIC 3001

We prefer that all submissions be publicly available to facilitate an informed and transparent consultative process. Submissions will be treated as public documents unless otherwise requested. Parties wishing to submit confidential information should:

- Clearly identify the information or data that is subject to the confidentiality claim and provide reasons why it is considered to be confidential.
- Provide a non-confidential version of the submission in a form suitable for publication if applicable.

All non-confidential submissions will be placed on our website. For further information regarding our use and disclosure of information provided to us, see the ACCC/AER Information Policy (October 2008), which is available on our website.

Background

Under the National Electricity Rules (NER), a NSP may propose a nominated pass through event in its revenue proposal.² The AER must then assess any such proposals and determine whether to accept them. In doing so, under the NER it must take into account:

- Whether the event is covered by another category of pass through events
- Whether the nature or type of event can be clearly identified at the time the AER makes its determination
- Whether a prudent NSP could prevent or substantially mitigate the cost impact of the event
- Whether the service provider could insure against the event.³

Similar arrangements exist for gas network service providers as detailed in the AER's Access Arrangement Guideline March 2009 under the National Gas Law and National Gas Rules framework.⁴

In the past, we accepted insurance cap pass through events as a nominated pass through event. An insurance cap pass through event allows a NSP to recover material costs that are incurred above its insurance policy limit. In recent decisions,⁵ we renamed the insurance cap event to an insurance coverage event for reasons outlined below. This draft guidance note applies to both.

Our acceptance of these events as pass through events is consistent with the Australian Energy Market Commission's (AEMC) final decision on pass through arrangements for NSPs where it stated that the purpose of nominated pass through events is to provide NSPs the opportunity to recover their efficient costs in those limited circumstances where insurance is limited or not available on commercial terms and self-insurance is not appropriate. The AEMC stated that this should be limited to instances where efficient costs are incurred because unforeseen costs arise as a result of events outside a NSP's control.⁶

² NER, cl. 6.5.10(a); 6A.6.9(a).

³ NER, cl 6.5.10; 6A.6.9 and chapter 10.

⁴ AER, *Access Arrangement Guidelines – section 6.1.3*, March 2009, p. 77; NGR, r. 97.

⁵ AER, *Final Decision – SA Power Networks distribution determination 2020–25 – Attachment 14 – pass through events*, June 2020; AER, *Final Decision – Energex distribution determination 2020–25 – Attachment 14 – pass through events*, June 2020; AER, *Final Decision – Energy Queensland distribution determination 2020–25 – Attachment 14 – pass through events*, June 2020; AER, *Draft Decision – CitiPower 2021–26 – Attachment 15 – pass through events*, September 2020; AER, *Draft Decision – Powercor 2021–26 – Attachment 15 – pass through events*, September 2020; AER, *Draft Decision – United Energy 2021–26 – Attachment 15 – pass through events*, September 2020; AER, *Draft Decision – Jemena 2021–26 – Attachment 15 – pass through events*, September 2020; AER, *Draft Decision – AusNet Services 2021–26 – Attachment 15 – pass through events*, September 2020.

⁶ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012.

If an insurance cap pass through event occurs, and a NSP makes a pass through application, the AER commences its assessment process. We must determine the amount the NSP can recover from consumers via the NSP's charges for regulated services. In undertaking this assessment, we must take into account a variety of matters under the NER, including the following:

- Any matters or proposals set out by the NSP
- The change in costs that has occurred, or is likely to occur, as a result of the event
- The efficiency of the NSP's actions in relation to the risk of the event occurring, including the actions taken, or not taken, by the NSP to reduce the magnitude of the costs
- The need to ensure the NSP only recovers any actual or likely incremental costs as a result of the event
- Whether the costs have been, or will be, factored into the NSP's annual revenue requirement
- Any other factors that the AER considers relevant.⁷ In most (if not all) cases, the AER is likely to consider that the prudence and efficiency (or otherwise) of the NSP's actions in response to the event is a relevant factor.

The insurance cap pass through event definitions that are currently in many NSPs' determinations also note that we will have regard to, amongst other things:

- The relevant insurance policy for the event
- The level of insurance that an efficient and prudent NSP would obtain in respect of the event.

In the recent SA Power Networks, Ergon Energy and Energex 2020–25 Final Determinations and the 2021–26 Draft Determinations for the Victorian DNPSs, we took changing insurance market conditions into account. In particular, we took into account the changing conditions following bushfire events in Australia, and overseas, that resulted in bushfire insurance coverage becoming more expensive and difficult to procure. We refined the pass through definition to allow for potential gaps in a NSP's insurance coverage that may occur if it is unable to find suitable insurance providers to fill withdrawn capacity, or if it cannot economically justify higher premiums. At the same time, we sought to preserve appropriate pass through event incentives under a normal operating environment. As a result, the broader coverage of the amended definition applies only under what we defined as 'changed circumstances' where movements in the relevant insurance liability market that are beyond the control of a NSP, and those movements mean that it is no longer possible for a NSP to take out an insurance policy or set of insurance policies at all, or on reasonable commercial terms.

These determinations also updated the name of the pass through event. The change from 'insurance cap event' to 'insurance coverage event' recognises that in the future, pass through event applications may relate to costs incurred as a result of potential insurance gaps where a NSP has not been able to efficiently purchase insurance.

In this draft Guidance Note, we have used the term insurance coverage pass through event to include both insurance cap events and insurance coverage events.

⁷ NER cl 6.6.1(j); 6A.7.3(j).

AER guidance

The decision to develop this guidance stemmed from initial representations from a number of NSPs that considered it would be beneficial to provide the broader industry with greater clarity and guidance around the matters we are likely to have regard to in assessing an insurance coverage pass through event. This is particularly the case given we have not had to assess such a pass through event in the past). We agree that there is a need for the regulatory process surrounding an insurance coverage application, including the matters we will have regard to and our assessment approach, to be clear and predictable given the potential material impacts that affect NSPs and energy customers. This is the purpose of this draft Guidance Note which follows on from our Consultation Paper.

1. Stakeholder views from Consultation Paper

Our Consultation Paper in relation to this guidance explored three key topics:

- The key matters we will likely have regard to when assessing an insurance coverage pass through application
- Whether there would be value in developing an annual information provision process in relation to insurance
- The feasibility of benchmarking annual insurance information across the industry.

We received 11 submissions in response to our Consultation Paper, eight from NSPs, one from a retailer, one from an industry body and one from insurance provider. These are summarised in Appendix A. The key themes from these submissions were as follows:

- All submissions supported us providing further guidance in the event of an insurance coverage pass through event application occurs and setting out our proposed approach to consider the emerging issues within the insurance liability market. Submissions were in broad agreement with the key matters outlined in our Consultation Paper and one submission provided additional suggestions for the types of technical analysis that may be useful in our assessment.⁸
- There were conflicting views on the practical aspect of using independent expert reports to verify prudency levels of insurance.
- Two submissions considered that the least cost option (premiums) would not always be the best option as it involved a trade-off in restrictions to apply for a claim.⁹
- Most submissions were of the view that consumer engagement would be important but difficult to pursue due to complex nature and confidentiality of the material.
- One submission noted that the impact on gas businesses is similar in the prevailing insurance liability market¹⁰ and another stated that it purchased liability insurance collectively across both gas and electricity networks, although the premium increases are considered to be driven largely by the risks associated with electricity distribution networks.¹¹

⁸ AON, *Submission on assessing an insurance coverage pass through event*, November 2020.

⁹ Evoenergy, *Submission to the AER on Insurance Guidance Note*, October 2020, p. 8; SA Power Networks, *Submission on Insurance Coverage Pass Through Event*, October 2020, p. 8.

¹⁰ Evoenergy, *Submission to the AER on Insurance Guidance Note*, October 2020, p. 11.

¹¹ AusNet Services, *Response on Insurance Guideline*, October 2020, p. 6.

- Submissions were divided on the need for an NSP to provide annual information and insurance renewal updates to us (four in favour of some form of annual process¹² (with SA Power Networks advocating a two-way consultation and engagement),¹³ three not in favour¹⁴ and two silent on this issue¹⁵). Some viewed the annual information process would be useful to streamline the process should a possible application eventuate, whereas others considered it unnecessary if the AER cannot form a position in an annual process.
- All submissions did not see benchmarking as a reasonable approach due to individual operating and structural differences as well as the bespoke nature of the liability cover.

We have taken these submissions and the information received into account in refining the key matters that we are likely to have regard to when assessing an insurance coverage pass through event. In particular, in expanding the proposed guiding principles and information to be provided as set out in the following sections.

2. Proposed guiding principles

The proposed guiding principles set out below facilitate greater clarity in our assessment of whether an NSP has acted prudently and efficiently in its actions leading to an insurance coverage pass through event. These are drawn from:

- The policy issues identified by the AEMC at the time it amended the NER to allow for the inclusion of nominated pass through events in revenue determinations;¹⁶ and
- Best practice corporate governance processes that should already be operating within an NSP. These corporate governance processes are expected to be robust and well documented, to support the claim that an NSP has carefully followed its processes (e.g. complying with its risk management policies and strategies) and has a clear rationale in circumstances where it has to depart from them (e.g. explanations on why changes have been made to the allocation of risk between itself and customers and evidence of this being considered by decision makers).

At a high level, the policy issues identified by the AEMC in relation to a cost pass through event include:

1. Efficient allocation of risks between NSPs and end consumers: We agree with the AEMC that NSPs are best placed to manage these risks, having to constantly address them through commercial and self-insurance decisions, mitigation efforts and in extreme circumstances, the need to share some of these risks with customers. Consistent with this view, we would expect our assessment to consider to what degree the NSP has considered and achieved this and arrived at an efficient trade-off between the NSP mitigating its risk through commercial (level of coverage) and/or self-insurance, and end consumers bearing the risk over and above the insurance premiums paid by, or offered to, NSPs.

¹² SA Power Networks, *Submission on Insurance Coverage Pass Through Event*, October 2020; AusNet Services, *AST Response on Insurance Guideline*, October 2020; Essential Energy, *Submission Insurance Pass Through Events*, October 2020; ENA, *AER insurance coverage pass through event guidance note*, October 2020.

¹³ We understand this two way process to mean the AER may comment on SA Power Networks' yearly renewals noting we cannot make any pre-emptive decisions.

¹⁴ Ausgrid, *AER insurance coverage consultation*, October 2020; Endeavour Energy, *Submission to AER on insurance guidance note*, October 2020; Evoenergy, *Submission to the AER on Insurance Guidance Note*, October 2020.

¹⁵ CitiPower Powercor United Energy, *submission to AER consultation on insurance coverage pass-through event*, October 2020; Electranet, *Insurance cost pass through event*, October 2020.

¹⁶ AEMC 2012, *Cost pass through arrangements for Network Service Providers, Rule Determination*, 2 August 2012.

2. Recovery of efficient costs: Our view is that NSPs should seek, in the first instance, to determine the optimal, most efficient and least cost, way to manage their risks through commercial, and/or self, insurance in combination with other mitigation activities. We would expect our assessment to consider the analysis that the NSPs have undertaken to evaluate the various options available in order to determine the particular insurance structure that provides the least cost option relative to the chosen level of insurance cover and the reasons for the departure.
3. The extent to which the events are unexpected and outside of the NSPs control: Our view is that NSPs should seek to manage those risks which are within their control and use commercial or self-insurance (e.g. deductible level) for low probability, high severity events beyond their control. We would expect our assessment to consider details of the NSP's ongoing risk management framework, how it is capturing, assessing and responding to changing low probability high consequence risks and how this has been used to inform a NSPs commercial and self-insurance coverage choices. This may include supporting evidence that the NSP has been taking actions to avoid or mitigate the impact of the event, to the extent possible, such as relevant operating and capital expenditure initiatives. Furthermore, we would consider whether the NSP meets mandatory bushfire-risk standards and requirements (such as those set up jurisdictional regulators).

Having regard to these matters, our views on the types of information and documentation that NSPs should keep, and about the processes that NSPs should adopt, are set out below.

Taking into account the discussion in our consultation paper, and our guiding principle as set out above, we have refined our guidance on the key matters and information that we are likely to have regard to when assessing an insurance coverage pass through event, as discussed below.

3. Proposed information that should be provided by the NSP

While we anticipate that insurance coverage cost pass through applications will need to be considered on a case by case basis, our draft view is that the information set out below should be a part of NSPs ongoing business considerations and be included in any insurance coverage pass through event applications to assist the AER in making its decision.

It is important to note that no single factor will determine the outcome of our assessment, particularly as noted by CitiPower, Powercor and United Energy's there is little uniformity between NSPs.¹⁷ We view the information set out below as that we consider to be relevant to ensure that a NSP can adequately demonstrate that it has exhausted all reasonable commercial avenues, chosen the most efficient option based on its individual operating environment, and strived to achieve the best allocation of risk with its end users.

Question 1: *For each of the following categories of information, do stakeholders agree they are relevant? Please provide details about why or why not.*

Question 2: *Is there any other related information or processes in each category that stakeholders consider relevant for the outlined purpose? Please detail any additional information that you consider should be taken into account.*

¹⁷ CitiPower Powercor United Energy, *submission to AER consultation on insurance coverage pass-through event*, October 2020, p. 1.

3.1. Historical information and market conditions prior to the event

The purpose of this category of information is for us to understand whether there have been significant changes to an NSP's insurance policy and the rationale for these movements. Further, understanding the prevailing insurance market conditions prior to the occurrence of the cost pass through event will assist in explaining the level and structure of insurance that the NSP had in place at the time the cost pass through event occurred.

Under the current definition of the insurance coverage pass through event, there may also be instances in which we need to be satisfied that there has been 'changed circumstances'.

Information evidencing 'changed circumstances' would include the following:

- If there have been material shifts in a NSP's historical insurance structure such as premiums costs or coverage levels – details of these movements and the key drivers.
- If the NSP has incurred historical high severity, low probability losses and claims, supporting evidence to show that identification of the root causes and contributing factors for the occurrence have been identified, how they have been addressed and the impact on insurance premiums.
- A report from the NSP's insurance broker that accurately details the market conditions (such as the level capacity and premium trends) prevailing at the time of the NSP's insurance renewal that is relevant to the year the cost pass through event occurred.

In the event that NSPs make material changes to their insurance policy or level of coverage that may not be related to market conditions, such information should also be provided. We would also see value in businesses providing information on key parameters (such as total premiums, deductible levels and coverage limits) at the start of the regulatory period to serve as a comparison point on how the insurance market may have changed from the NSP's expectations.

3.2. Modelling analysis of possible losses from insured events

The purpose of this category of information is to demonstrate that the NSP has undertaken the relevant options and quantitative analysis that we would expect a prudent NSP to undertake as part of understanding its risk exposure and choice of insurance policy, including the level of coverage. This represents the analyses and information that would support a NSP's application that it has acted prudently and efficiently in respect of the event.

The information that we expect NSPs to provide includes:

- Supporting documentation demonstrating that appropriate risk exposure calculations, such as maximum foreseeable or probable loss assessment, have been carried out. This should include methodology, assumptions and data sets applied in the analysis. Within the context of a hardening insurance liability market, NSPs are encouraged to overlay additional quantitative analysis (for example, weather patterns, location of assets and impacts of bushfire events in other jurisdictions or countries and liabilities of businesses following these events) to ascertain trade-offs and risk return periods¹⁸.
- Supporting documentation demonstrating that appropriate financial stress testing, to loss scenarios that establishes a NSP's risk tolerance level, has been carried out. A NSP should outline the methodology used to test the loss scenarios (e.g. Monte Carlo simulations) and explain how risk tolerance levels are linked to its business characteristics (e.g. its financial position).

¹⁸ Risk return period is an average time or an estimated average time between events.

- Supporting evidence demonstrating that the NSP has calculated and considered the relevant return periods and probability of exceedance¹⁹ for potential limits in its selected insurance structure.

3.3. Risk mitigation considerations and actions

The purpose of this section is to demonstrate that the NSP has undertaken adequate levels of risk mitigation actions and measures to manage its overall risks with bushfires.

- Assessment of risk mitigation planning and risk controls to ensure that, where reasonably possible, mitigations and controls are in place and effective as well as evidence that additional improvements have been considered and / or implemented. For example, as proposed by Ausgrid,²⁰ this could include information related to a bushfire preparedness program, relevant vegetation management actions and other any technical solutions that have been implemented prior to or during the event to reduce impacts.

3.4. Customer engagement

Some submissions supported consumer engagement²¹ but raised concerns around the difficulty in having meaningful discussions with consumers on a topic that is highly technical and confidential in nature. While this may be the case, we consider that it is possible to have broader level engagement with consumers so they can provide input on the high level risk and benefit trade-offs that a NSP is considering as part of its insurance policy and coverage. This could be undertaken during the reset process or when there are material changes in the insurance market.

The purpose of this category of information is to demonstrate that the NSP has undertaken sufficient targeted effort to familiarise and educate its consumers as far as reasonably possible, and to understand its consumer's preferences (at least at a high level). This is consistent with the need for an NSP to show that its choice for a certain insurance coverage represents an efficient allocation of risks between itself and its customers. One example of this type of customer engagement was AusNet Services' decision to increase its deductible from \$10 million to \$25 million based on customer preferences in order to keep ongoing costs low, with the trade-off being that costs would be higher if an event occurred.²²

The information that we expect NSPs to provide includes:

- Supporting documentation that demonstrates that the potential customer impacts from cost pass throughs have been considered. This may include the questions put to customers, including stress testing loss scenarios and measuring the bill impact on end consumers and customer preferences in response to these questions

¹⁹ Probability of exceedance refers to the probability that a certain limit will be exceeded.

²⁰ Ausgrid, *AER insurance coverage consultation*, October 2020, p.7.

²¹ AusNet Services, *AST Response on Insurance Guideline*, October 2020; ENA, *AER insurance coverage pass through event guidance note*, October 2020; Endeavour Energy, *Submission to AER on insurance guidance note*, October 2020; CitiPower Powercor United Energy, *submission to AER consultation on insurance coverage pass-through event*, October 2020.

²² AusNet Services, *2021–26 Revised Regulatory Proposal*, December 2020, pp. 88-89.

3.5. Appropriateness of cover, structure and premiums

The purpose of this category of information is, firstly, to understand both the information and the decision making process that the NSP has undertaken in arriving at its insurance coverage. Secondly, to provide confidence and evidence that the chosen cover is reflective of the decisions a prudent and efficient NSP would make given its operating environment. This conforms to the obligation under the current definition of the insurance coverage pass through event that a NSP has to demonstrate that the level of insurance that it obtained, or would have sought to obtain, in respect of the event is efficient and prudent. In essence, we expect the NSP to provide documentation which sets out the rationale and decision of the NSP to purchase, or not, a particular insurance cover. It should also demonstrate how all of the above information has been taken into account to reach a decision about the appropriate insurance coverage, structure and premiums.

In our consultation paper we raised the concept of the least cost option and that NSPs are expected to determine the optimal and least cost approach to manage their risks through commercial and/or self-insurance.²³ At this stage, our view is that NSPs should not be forced to choose the least cost option in order to satisfy the cost pass through assessment, rather it should be clear that an NSP has considered this option and if it has chosen to depart from it, then appropriate justification is provided. Evoenergy gave the example in its submission that the least cost option may not be appropriate as low cost insurers are more likely to refuse payout or have unreasonable restriction terms, and therefore the least cost option may not reflect prudent insurance coverage decisions.

The information that we expect NSPs to provide includes:

- Ideally, an independent report or certification from an insurance expert that the NSP's insurance cover is appropriate based on its operating environment and risk tolerance levels. We note that some submissions raised concerns that a mandatory review from an insurance expert is not practical due to the confidential nature of the process,²⁴ and may compromise the competitive market process.²⁵ While we acknowledge that the level of cover, structure and premium is essentially a Board decision, we consider that, at a minimum, the NSP's insurance broker should provide information about the reasonableness of the NSP's insurance policy based on the market conditions at the time (such as a reasonable range that would allow the board to exercise its discretion). The NSP's insurance brokers report should be at a level of detail that is capable of being reviewed by an independent expert²⁶ should we decide to do so at the time of the pass through event application.
- Evidence demonstrating that viable alternative insurance coverage options have been considered or implemented by the NSP. For example some of the types of information could be provided include, using a captive or protected cell company as proposed in one of the submissions,²⁷ seeking coverage through an aggregated structure, and exploring access to capacity in other insurance markets.

²³ AER, *Insurance coverage pass through event consultation paper*, August 2020, p.9.

²⁴ SA Power Networks, *Submission on Insurance Coverage Pass Through Event*, October 2020, p. 7–8.

²⁵ CitiPower Powercor and United Energy, *Submission to the AER consultation on insurance coverage pass-through event*, October 2020, p.1.

²⁶ The independent expert report would be confidential.

²⁷ Ausgrid, *AER insurance coverage consultation*, October 2020, p.6,

3.6. Corporate and risk governance

The purpose of this category of information is to understand the NSP's overarching corporate governance and risk management framework. Further, to enable us to be satisfied that the NSP has appropriate processes in place that are utilised to review and manage insurance liability exposure. This will assist an NSP in demonstrating that, consistent with the AEMC's policy approach to nominated pass through events, that it has an ongoing and robust risk management framework that captures, assesses and responds to changing low probability high consequence risks and how this has been used to inform its choice for insurance cover.

The information that we expect NSPs to provide includes:

- Supporting documentation outlining the rationale of the NSP's risk tolerance levels based on empirical evidence and consideration for end customers.
- Supporting documentation that demonstrates regular identification and monitoring of risks and what controls have been implemented – for example, a NSP's risk register that shows evidence of the NSP's risk mitigation planning and decisions.
- Supporting documentation that demonstrates that the relevant risk Committee and or Board within a NSP, have considered the material issues relating to the matters identified under each of the categories of information in the Guidance Note (as part of the risk Committee's or Board's role in managing risk, including bushfire risk).

4. Annual process for information provision

We have considered the merits of establishing an annual information provision process. As noted in the Consultation Paper this could provide NSPs the opportunity to inform and update us if there are any material changes relating to its insurance position or to enable benchmarking across Network Service Providers.

On balance, we consider that this is not necessary and it would provide only limited value as we are unable to form any ex-ante views (that is, prior to a pass through event actually occurring) based on such information.

Some submissions highlighted that insurance information is already collected through the Regulatory Information Notice (RIN) process and that further resources dedicated to an annual process may not be necessary. This view was shared by Endeavour Energy and Evoenergy.²⁸ Our view is that while some NSPs do report on insurance costs in the Annual RIN 8.4 opex and Economic Benchmarking RIN 3.2 opex, this is unlikely to satisfy the level of detail we would require to complete our assessment of a cost pass through.

We are open to hearing from stakeholders about changing market conditions, and we do see value in becoming aware of, and understanding material changes within the insurance market, as this may help facilitate our assessment of an insurance coverage cost pass through event if one actually occur. However, we do not believe it is necessary to formalise a particular process for such information to be provided to us. An NSP can submit any relevant information to us on a "for information" basis" at any time.

²⁸ Endeavour Energy, *AER re consultation paper – insurance coverage PTE submission*, October 2020, p.3; Evoenergy, *Submission to the AER on Insurance Guidance Note*, October 2020, p.9.

5. Benchmarking

At this stage we do not intend to benchmark of insurance policies across NSPs. Various submissions²⁹ made it clear that, due to the fact that each NSP's coverage is bespoke and dependent on their individual operating environments, risk appetite, and network, comparisons, benchmarking across the industry would not provide any meaningful conclusions. We agree with that view.

6. Miscellaneous Issues

There were a number of matters raised in the submissions which are not directly related to this guidance note – they are discussed below together with our preliminary views.

a. Period for cost recovery

Lumo Energy queried when NSPs should be allowed to recover the positive pass through amounts.³⁰ Our preliminary view is that this issue should be decided on a case by case basis at the time of our decision. This is because the impacts on prices could vary depending on the amounts to be recovered. In this regard, NSPs should include as part of their applications for such pass throughs, options on how they would manage potential price shocks for their customers.

b. Maximum Probable Loss information

ElectraNet queried whether the AER could assist NSPs to access any information used by underwriters to inform their assessment of NSPs' maximum loss exposures (to the extent that the information is not confidential and/or proprietary).³¹ Our preliminary view is that the use and dissemination of such technical and business-specific information is best retained by the businesses and the AER has no role in this.

c. Setting the baseline in each reset

AusNet Services queried whether it is appropriate to establish for each reset the five year premium allowance, deductible limit and coverage level as an agreed baseline from which annual movements could be assessed for reasonableness.³² Our understanding is that the NSPs set their commercial levels of premium, coverage and deductibles annually through the renewal process. Whilst we understand that forecasting insurance premium costs and coverage levels over a five year period can be difficult, particularly when the market is volatile, we would see value in understanding what assumptions a business has built into its regulatory proposal to serve as a reference point if an event was to occur during the regulatory period. As described in Section 4 – Annual process for information provision, we are unable to form pre-emptive positions on cost pass throughs but believe the transparency of sharing such information would be beneficial.

²⁹ Evoenergy, *Submission to the AER on Insurance Guidance Note*, October 2020; SA Power Networks, *Submission on Insurance Coverage Pass Through Event*, October 2020; AusNet Services, *Response on Insurance Guideline*, October 2020; Ausgrid, *AER insurance coverage consultation*, October 2020; CitiPower Powercor and United Energy, *Submission to the AER consultation on insurance coverage pass-through event*, October 2020; Endeavour Energy, *AER re consultation paper – insurance coverage PTE submission*, October 2020; ENA, *AER insurance coverage pass through event guidance note*, October 2020.

³⁰ Lumo Energy, *AER Guidance note cost pass throughs*, October 2020.

³¹ ElectraNet, *Insurance cost pass through event*, October 2020.

³² AusNet Services, *AST Response on Insurance Guidance*, October 2020, p. 5.

Appendix A – summary of submissions

<p>Question 1: Are there any other key elements that stakeholders believe should be included as part of our assessment process? Please detail what these are and why should they be taken into account. This could include any aspects which Network Service Providers consider are specific to their business circumstances and operating environment.</p>	
Essential Energy	Considered that the assessment elements outlined in the consultation paper were sufficiently broad.
AusNet Services	<p>AusNet Services was of the view that the type of information listed in the consultation paper would likely be available with two exceptions:</p> <ul style="list-style-type: none"> • Certification from an independent expert that the level of cover is appropriate have to be realistic. The level of cover is fundamentally a Board decision and while an independent review will provide appropriate analysis and advice it will not warrant the level of cover is appropriate. • Expectations on customer engagement need to be realistic due to confidential nature and lack of technical expertise.
Ausgrid	Ausgrid agreed with the AER's view that the assessment should consider an NSP's decision relating to the risks and costs associated with low probability, high severity set of circumstances. It also highlighted that it was considering self-insurance on some layers of its insurance cover depending on the premiums.
SA Power Networks	SA Power Networks stated that the AER should be engaging with NSPs each year about material changes within the insurance market and that information provided by NSP should form one of the key considerations that is taken into account as part of the AER's assessment.
CitiPower, Powercor and United Energy (CPU)	CPU cautioned against expectations of uniformity in insurance policies, documentation and risk appetites, given the vast differences in risk profiles of each distributor from its asset profile, environment, weather exposure and policy sharing.
Endeavour Energy	<p>Endeavour Energy was of the view that assessing a network's coverage would include two key elements; the quantification of risk and the allocation of risk between a network provider and its customers. It also considered independent advice from an insurance expert would be a key component of assessing the first element.</p> <p>It also stated that customer engagement can help inform the second element of the AER's assessment of the efficient allocation of risk. It was of the view that whilst this engagement will be limited by the commercial sensitivity and complexity of insurance markets, it could help inform the extent to which customers were willing to be exposed to the financial impacts of insurance coverage gaps.</p>
Evoenergy	Evoenergy was of the view that the AER proposed criteria of 'least cost option' may not be as appropriate as the other criteria. This was because low cost insurers are more likely to refuse payout of insurance claims or have unrealistically restrictive terms and conditions. The least cost option did not always reflect prudent insurance coverage decisions of NSPs. Instead it proposed 'reasonable cost' may be a more appropriate criterion.
Lumo Energy	Lumo Energy was of the view that NSPs should only be permitted to recover the costs of an insurance coverage event as part of the annual pricing proposal and they should not be permitted to recover these costs immediately.

Question 2: Within each of the relevant key elements, what specific issues, considerations, analysis and information should be included as a part of our assessment process? Please set these out in detail and explain why they should be taken into account.

Essential Energy	Essential Energy was of the view that the AER should obtain independent and up-to-date assessments of insurance risks and coverage for the NSP that has submitted a cost pass through application.
AusNet Services	AusNet Services was of the view that the reset process provides an allowance for premiums at a set level of coverage. If these remain stable over the regulatory period, then questions relating to the level of coverage procured in the interim period would not be relevant. However, if there are significant changes in the insurance market that result in changes to coverage levels, then the information requested by the AER needs to ensure that the changes are efficient. Otherwise information presented in the consultation paper is reasonable.
Ausgrid	Ausgrid was of the view that there may be time constraints between the renewal process and customer engagement as insurance is secured around one week after getting feedback from insurers. It also stated that the AER should consider other insurance products such as using a captive or protected cell company
SA Power Networks	SA Power Networks was of the view that a mandatory independent insurance expert report should not be required. It also considered that consumer engagement is difficult due to the complexity and confidential nature of the subject matter.
CitiPower, Powercor and United Energy (CPU)	CPU did not believe independent reports are practical or in the long term interest of consumers. 'Allowing a competitor insurance expert or broker to review policies and processes available to and considered by other insurance brokers would compromise competitive market processes, including any distributors' competitive position in the future and is likely to result in convergence of prices that is not in the long-term interest of consumers.'
Evoenergy	Evoenergy considered the issues, analysis and information would vary with each cost pass through event application, nature of the applicants and over time as new information becomes available.
AON	AON provided a detailed list of assessment analysis and supporting information related to the key elements raised in the consultation paper. Some of these included: review of risk exposure calculations, risk tolerance levels (for both business and consumers), structure of insurance program, assess significant deviations in coverage through benchmarking and risk mitigation practices.

<p>Question 3: Is there any other specific information or processes that stakeholders see as crucial, and consistent with the National Electricity Rules, that we should take into account in assessing how low probability, high severity risks and costs should be managed between an Network Service Provider's insurance program and its customers (to inform whether an Network Service Provider has established a prudent and efficient level of insurance)?</p>	
AusNet Services	AusNet Services considered the relevant price review decisions should establish clearly the five year premium allowance, deductible limit and coverage level assumed. This would establish the agreed baseline from which annual movements could be assessed for reasonableness.
Ausgrid	Ausgrid considered specific information to be requested by the AER should include the NSP's bushfire preparedness program, vegetation maintenance program and any technical solutions that have been implemented to mitigate any bushfire risk. Further information by Ausgrid included the use of drones, light detection and range scanning, additional inspections and electrical asset maintenance regimes.
SA Power Networks	SA Power Networks was of the view that consultation with the AER during each insurance year, and the extent and quality of the information provided by the NSP during that consultation, is the most critical.
CitiPower, Powercor and United Energy (CPU)	CPU supported consumers' input into the insurance discussion but noted engagement would be challenging.
Energy Networks Australia	Energy Networks Australia supported consumer engagement but noted that the insurance market for NSPs is highly complex, and also subject to highly confidential information which limits meaningful consumer engagement.
Evoenergy	Evoenergy supported the AER's consideration of the availability and cost of insurance coverage and explained that the AER's guidance note may be used by insurers for information required to support a DNSP claim or insurance application.
Electranet	Electranet considered it would be helpful if the AER could assist NSPs to access any information used by underwriters to inform their assessment of NSP maximum loss exposures (to the extent that the information is not confidential and/or proprietary).
AON	<p>AON provided further examples of information that should be considered such as:</p> <ul style="list-style-type: none"> • Historical high severity, low probability losses and claims • Root causes and contributing factors for the occurrence and severity of past losses; • NSP risk management actions, planning and execution relating to past losses; • Financially viable alternative insurance coverage options available to NSPs (which may be limited); and • Past insurance renewal submissions and programme changes.

Question 4: Do stakeholders see benefits in us having an annual information provision process for Network Service Providers to inform us of material changes relating to its insurance position? Please detail what value / advantages and costs / disadvantages you consider such an information process would provide for the AER, Network Service Providers and other stakeholders. Please also detail what information you consider could be provided and outline your views about the form and timing of any process. We would also be interested to understand whether Network Service Providers are likely to use an annual opt in process?

Essential Energy	Essential Energy was supportive of an annual process but noted confidentiality concerns and explained that the information needs to be summarised and anonymous.
AusNet Services	AusNet Services considered some annual information on premiums and insurance market conditions would be useful for the assessment process and ensure a no surprises process in the event of a cost pass-through application.
Ausgrid	Ausgrid was of the view that sufficient disclosures are already made for the annual insurance operating expenditure as part of the annual Regulatory Information Notices, specifically Annual RIN 8.4 opex and Economic Benchmarking RIN 3.2 opex.
SA Power Networks	SA Power Networks stated that it is not merely information provision that is needed, but rather the two-way consultation and engagement between the AER and the NSP that is most critical. Such provision of information should be undertaken as a standalone exercise and not as part of the AER's existing annual RIN processes.
Energy Networks Australia	Energy Networks Australia welcomed an annual consultation with the AER, rather than RIN data collection, as a means to ensure a shared understanding of the ongoing insurance challenges NSPs are facing. It expected that this would help streamline the application process.
Endeavour Energy	Endeavour Energy explained that Schedule 1 of the Annual RIN could provide a mechanism by which DNSPs provide any updates. Given an insurance cost pass-through event is currently a rare occurrence, some networks may consider it more time and cost effective to have their insurance practices assessed as part of a cost pass-through application rather than reporting on it annually (although Endeavour Energy considered proactive disclosure to be a more optimal approach).
Evoenergy	Evoenergy considered an annual process for DNSP provision of insurance information to the AER is unnecessary. It was of the view that the usefulness of annual provision of information to the AER is questionable when the AER has indicated that it would be inappropriate to form any ex-ante or pre-emptive views

Question 5: Do stakeholders see benefits in us collecting insurance information for benchmarking purposes in the annual information provision process? Please detail what value / advantages and costs / disadvantages you consider this would provide for the AER, Network Service Providers and other stakeholders. This information could be captured as part of the annual Regulatory Information Notice or a separate annual opt in process.

Essential Energy	Essential Energy agreed that information can be collected as part of the Annual RIN but raised concerns about benchmarking due to differences in assets, risk, insurance history, timing and operating conditions.
AusNet Services	AusNet Services did not support insurance benchmarking as the results will be largely meaningless due to bespoke nature of insurance policies for each business.
Ausgrid	Ausgrid did not see any benefits in the AER collecting additional annual insurance costs for each NSP through the annual RIN process or a separate annual opt in process. Ausgrid was of the view that each NSP's network and risk profile are different and therefore the premium cost for transferring this risk to an insurance provider would vary.
SA Power Networks	SA Power Networks saw limited value in the AER conducting benchmarking, at least in relation to bushfire liability insurance.
CitiPower, Powercor and United Energy (CPU)	CPU believed there are merits in having an on-going conversation about the global insurance market between the industry and the AER. However, CPU did not support benchmarking of insurance policies between the networks and comparisons of policies are unlikely to result in reliable outcomes
Energy Networks Australia	Energy Networks Australia did not support the use of benchmarking when assessing insurance cover due to the bespoke nature of insurance arrangements. Decisions around how to manage the risks and level of cover would vary materially between NSPs due to operating environment factors
Endeavour Energy	Endeavour Energy considered each network's insurance coverage is a bespoke, negotiated package that is reflective of its network characteristics, risk appetite and operating environment and may not be appropriate to benchmark insurance coverage and costs
Evoenergy	Evoenergy was of the view that benchmarking of insurance coverage information is problematic as premiums and coverage details are specific to the DNSP risk profile and reflects circumstances such as the DNSPs location for bushfire insurance. Confidentiality of insurance premiums and insurance coverage details would limit the publication of the information

Question 6: What processes are in place (or planned) by Network Service Providers to manage circumstances where costs are incurred beyond policy limits or there are gap(s) in their insurance cover, and they face potential third party claims arising from bushfires? How do Network Service Providers manage or plan to manage their exposures in cost effective ways under these circumstances? Given that an insurance coverage pass through event is in place, how do stakeholders think that the incentives of Network Service Providers to be efficient and cost effective are affected in their efforts to minimise their exposure above the insurance cover limit or gaps in their insurance policies? How can we incentivise a Network Service Provider to be prudent and efficient under these circumstances?

Essential Energy	Essential Energy acknowledged that its insurance limit and policy deductible are relatively high and viewed a cost pass through event is used only in exceptional circumstances due to problematic timing in settling large liability claims.
AusNet Services	<p>AusNet Services considered insurance cover requires businesses to undertake all reasonable measures to mitigate the risk of the cover being voided (which would also void the pass through protection).</p> <p>It also stated that networks are subject to strict legislative and regulatory requirements by government such as Energy Safe Victoria and Department of Environment, Land, Water and Planning.</p>
Ausgrid	Ausgrid provided details of the continual improvements it has been implementing relating to its asset management strategies and maintenance programs. Such example included revised vegetation standards, new pre-bushfire ignition impact modelling and independent external audits.
SA Power Networks	<p>SA Power Networks considered NSPs are already strongly incentivised to be efficient and cost effective in their efforts to minimise their exposure. The NSP's insurer would drive the NSP to minimise the costs associated with an insurance coverage pass through event, as it would otherwise bear all of the costs up to the insurance limit. These insurers also typically engage external lawyers in relation to any claim by a NSP, which provides an additional level of oversight and incentive to mitigate costs.</p> <p>It also considered that the multi-million dollar deductible would incentivise NSPs to reduce events or costs associated with events.</p>
CitiPower, Powercor and United Energy (CPU)	CPU did not consider that the pass-through event would diminish the effectiveness of the existing incentives schemes under which CPU operate and that it has continuous incentives to ensure it employs cost effective risk mitigation measures irrespective of the pass-through provisions.
Evoenergy	Evoenergy considered existing operational incentive mechanisms in the rules apply to electricity and gas operations and that no additional incentives are required to be established by the AER.
Electranet	ElectraNet noted that it was actively exploring the merits of the alternative risk transfer mechanism options available to it – specifically, the feasibility of a captive insurance vehicle. One of the key considerations in determining the potential value of a captive instrument is assessing how any instrument of this kind would be funded. Electranet would welcome the opportunity to engage with the AER to explore potential funding options for such a mechanism (in addition to the self-insurance allowance).
Lumo Energy	Lumo Energy considered the cost pass through has the potential to create the conditions for NSPs to underspend on insurance exposing them to uninsured risk. If this occurs, NSPs should not be permitted to recover losses through an insurance coverage application where they have failed to obtain a level of insurance that an efficient and prudent NSP would obtain.

Question 7: We understand that the recent volatility in the liability insurance market have been having a major impact on electricity distribution and transmission businesses; do gas businesses face similar impacts?

AusNet
Services

AusNet Services stated that in its experience, insurance has been purchased for the entire business, not individual networks and the risk is considered largely on electricity distribution networks.

Evoenergy

Evoenergy considered that declining coverage and increased premiums in the insurance market are impacting Evoenergy's gas network as well as the electricity network. It stated that all the same principles apply to gas insurance, as Evoenergy could only obtain lower coverage with more exclusions for higher cost premiums this year
