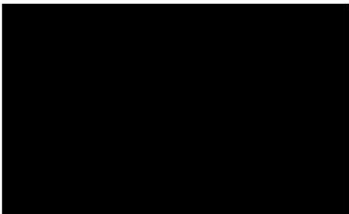




19 March 2021



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Dear 

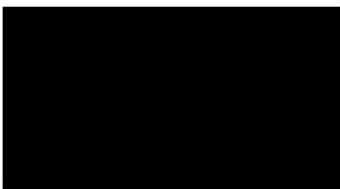
## United Energy bushfire liability insurance review on behalf of the Australian Energy Regulator

### Public Summary

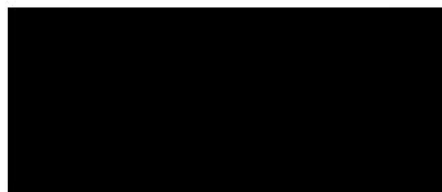
Please find enclosed the public summary of our report reviewing United Energy's bushfire liability insurance and the forecasts put forward by their broker.

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

Yours sincerely,



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



**Adam Baker**  
Executive Director – Broking  
Willis Re

## Introduction

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

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

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

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

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

## Information that has been relied upon

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

- United Energy's historical premium costs and recent history of their insurance structure
- A report prepared by United Energy's insurance broker which included:
  - Observations about the current market and future of the market and the impact of changes to various factors on the capacity of the market.
  - The possible impact of changes to the market to the premiums paid by United Energy
  - United Energy's expected future insurance cost
- United Energy's justifications for their proposal to the AER
- Responses from United Energy and their broker to questions regarding the certainty of their forecasts and their future capacity

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

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

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

## Conclusions

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

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

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

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

- Given the current trend in market deterioration, it is unlikely that premiums would fall below current levels while keeping coverage levels constant.
- The forecasts proposed by Marsh are directionally consistent with our expectations of future premiums, given our understanding of the prevailing market conditions, and can be considered reasonable. Without a change in the market cycle, United Energy will continue to have its premiums dictated by the market, and efforts to improve its risk management will have a limited impact on reducing premiums.
- Given the prevailing market conditions, a further withdrawal of capacity from the market which reduces the supply of insurance to the point where United Energy are compelled to purchase lower levels of cover is a reasonable scenario.
- In the event of a further deteriorating market, any reduction in the premium cost due to a modest reduction in the upper layer of cover purchased would be expected to be outweighed by the increases in premiums for the remaining lower layers of cover, resulting in an increase of the total premiums incurred.
- We have reviewed the premium forecast methodology presented by Marsh and find their approach to be both reasonable and consistent with the approach we would adopt.
- The increases proposed are broadly consistent with those we used in other submissions and we have no reason to believe these forecasts are either overly conservative or too aggressive. The similarity between our own view of forecasts and the Marsh view would make a formal comparison redundant.

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

- There is significant uncertainty when forecasting into the future, and we cannot warrant that the magnitude of the premium increases are certain across the full regulatory period.
- It is extremely difficult to maintain a high level of certainty over forecasts for availability of capacity for bushfire liability insurance over the next five years.
- We expect that further reductions to the level of cover will be less significant than the reductions seen during 2020/21. In this scenario, price increases could be expected to fall within the range forecast by Marsh. Further hardening of the market resulting in another substantial reduction in cover could be considered a reasonable, although less likely, scenario.
- It is quite possible that the segment sees more capacity exit as insurers and reinsurers look towards allocating their capital to more sustainably profitable areas of the insurance market.