Actuarial and Insurance Consultants

19 January 2018

Mr Anthony Honeybone
Chief Executive Officer
Southern Response Earthquake Services Ltd
10 Show Place
Christchurch 8149
NEW ZEALAND

Dear Anthony

Earthquake Claim Liabilities as at 31 December 2017

We have been asked by Southern Response Earthquake Services Limited ("SRES") to make an assessment of its insurance liabilities as at 31 December 2017. SRES is the Crown-owned entity which emerged from a transaction whereby, with effect from 5 April 2012, the ongoing business of AMI Insurance Limited ("AMI") was separated from the existing AMI entity and sold to Insurance Australia Group.

The purpose of this letter is to provide an estimate of the earthquake claim liabilities for Southern Response Earthquake Services Limited ("SRES") as at 31 December 2017. This valuation follows on from the update we provided at 30 September 2017 and is based on a roll forward of our detailed valuation as at 30 June 2017, with changes to valuation assumptions where emerging experience suggests changes are appropriate. We include commentary on the key changes to the assumptions later in the letter.

This letter does not deal with the other non-earthquake retained events that were retained by SRES following the transaction on 5 April 2012.

Summary of Results

Table 1 summarises our estimates of SRES' earthquake liabilities at 31 December 2017. The line below the table indicates our estimate of the total amount which will ultimately be paid once all claims are settled (including payments already made but excluding SRES CHE expenses). This represents our central estimate of the ultimate liability. Our recommended provisions incorporate a risk margin which we believe to be consistent with the requirements to establish provisions which incorporate at least a 75% probability of sufficiency.

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Table 1 – Recommended EQ Provisions at 31 December 2017

Provisions for Outstanding Claims as at 31 Dec 2017	Cat 93 4-Sep-10 $m	Cat 106 22-Feb-11 $m	Cat 112 13-Jun-11 $m	Total Major $m	Total Minor $m	Total Overall $m
Gross Outstanding Claims						
Inflated Values	74.8	333.3	15.1	423.2	3.7	426.9
Discount to Present Value	-1.0	-4.5	-0.2	-5.6	-0.1	-5.7
OSC Discounted to 31 Dec 2017	**73.8**	**328.8**	**14.9**	417.6	3.6	421.2
Claims Handling	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Gross Central Estimate	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Catastrophe R/I Recoveries	0.0	0.0	-14.9	-14.9	-1.0	-15.9
Aggregate R/I Recoveries	0.0	0.0	0.0	0.0	0.0	0.0
Net Central Estimate	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Risk Margin	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Recommended provision	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Inflated Gross Central Estimate (Incl paid to date, excl CHE)	**750**	**2,367**	**99**	**3,216**	**43**	**3,259.1**
Change on 30 Sep 2017 Valuation	**-6**	**8**	**1**	**4**	**-3**	**0**
Change on 30 Jun 2017 Valuation	**-6**	**-2**	**1**	**-7**	**2**	**-5**

9(2)(i)

9(2)(i)

Our central estimate of the gross inflated ultimate cost excluding CHE at 31 December 2017 is unchanged from the 30 September 2017 estimate. [redacted]

9(2)(i)

[redacted]

9(2)(i)

Table 2 shows the main components of cost underpinning our overall estimate of SRES' ultimate earthquake liabilities, while Table 3 shows the breakdown of the outstanding claims liabilities.

Table 2 – Estimated Ultimate EQ Liabilities at 31 December 2017

	30 Sep 17 $m	31 Dec 17 $m	Mov't Sep17 to Dec17 $m	
Ultimate Outflows				
Over Cap	3,594	3,596	2	
Out of Scope	336	336	0	
Other	153	154	1	
Claims Cost (Excl PM Cost)	4,083	4,086	2	
Project Management Costs	[redacted]	[redacted]	[redacted]	9(2)(b)(ii)
SRES Claims Handling	[redacted]	[redacted]	[redacted]	9(2)(i)
	[redacted]	[redacted]	[redacted]	9(2)(b)(ii) and 9(2)(i)
Ultimate Inflows				
EQC Contributions	1,030	1,032	2	
Reinsurance Recoveries	1,291	1,291	0	
	2,321	2,323	2	
Gross Outflow (net EQC, ex CHE)	3,259	3,259	0	
Ultimate Net Outflow (net of RI)	[redacted]	[redacted]	[redacted]	9(2)(i)
Gross Cum. Paid	3,844	3,930	86	
Paid to Claimants	3,507	3,585	77	
Arrow	[redacted]	[redacted]	[redacted]	9(2)(b)(ii)
SR Claims handling	[redacted]	[redacted]	[redacted]	9(2)(i)
EQC Recoveries Received	-930	-944	-14	
Cum. Paid Net of EQC	2,914	2,986	72	
Discounted Net Liability				
Central Estimate	495	429	-66	
Risk Margin	[redacted]	[redacted]	[redacted]	9(2)(i)
Recommended Provision	[redacted]	[redacted]	[redacted]	

Table 3 – Estimated Outstanding Liabilities at 31 December 2017

	Outstanding 30 Sep 17 $m	Outstanding 31 Dec 17 $m	Mov't Dec17 to Sep17 $m	
Outflows				
Claims Cost (Excl PM Cost)	576	501	-75	
Project Management Costs	[redacted]	[redacted]	[redacted]	9(2)(b)(ii)
SRES Claims Handling	[redacted]	[redacted]	[redacted]	9(2)(i)
Inflows				
EQC Contributions	100	89	-12	
Reinsurance Recoveries	17	16	-1	
	118	105	-13	
Net Central Estimate (undisc)	503	435	-68	
Discounting	-7	-6	2	
Net Central Estimate (disc)	495	429	-66	
Risk Margin	[redacted]	[redacted]	[redacted]	9(2)(i)
Recommended Provision	[redacted]	[redacted]	[redacted]	

Summary of Key Movements

While the inflated ultimate costs remains unchanged relative to September 2017, this is a result of some offsetting movements within the various valuation categories. The key underlying movements in the central estimate are set out in the table below.

Table 4 – Summary of Key Movements in Liability Estimate (net of EQC, excluding CHE)

	Traffic Light	Notes	$ Mov't from Sep-17
Post 1 Oct16 Over Caps	Yellow	Leaving the ultimate number unchanged allows for another 168 more Over Caps to emerge. We will need to monitor new Over Cap emergence closely over 2018 to ensure the adequacy of this number. A small release arises from a slight reduction in size in line with emerging experience on new assessments and settlements on JART properties over the quarter being lower than our assumed size. At this stage, we have not lowered the assumed size for unassessed properties, but this may be warranted if better than expected experience continues.	-$2M
BAU Properties	Yellow	Experience emerging in line with expectations. A greater incidence of partial cash settlements on repair constructions is pushing more costs into the "post completion" payments category, but this is offset by settled values for this group being slightly better than expected. Rate of settlements is slowing, which could have cost implications in the longer term.	$0M
TRR Properties	Yellow	[redacted]	
Other PMO Managed Properties	Red	Average sizes of properties managed by other insurers completed over the quarter were materially higher than historical experience. We have increased our assumed ultimate size for these properties. There are 48 outstanding properties in this group.	$4M
Closed Properties	Yellow	Around $1 million of payments were made on Closed* claims, as a result of focused effort on clearing outstanding post construction disputes. We have allowed for a further $2.5 million of payments on closed claims.	$3M
Other Movements	Yellow	A small increase in the projected ultimate cost for Other (non-House) Classes, predominantly for Temporary Accommodation costs, where we have allowed for higher claim sizes to emerge for the tail claims.	$1M
Total Inflated Ultimate Excl. CHE			**$2M**

9(2)(i) and 9(2)(j)

Closed as per our definition of anything that reached either constuction completion or where the cash settlement was made over 18 months ago

Red	Higher than previous valuation
Yellow	In line with previous valuation
Green	Better than previous valuation

9(2)(i)

[redacted]

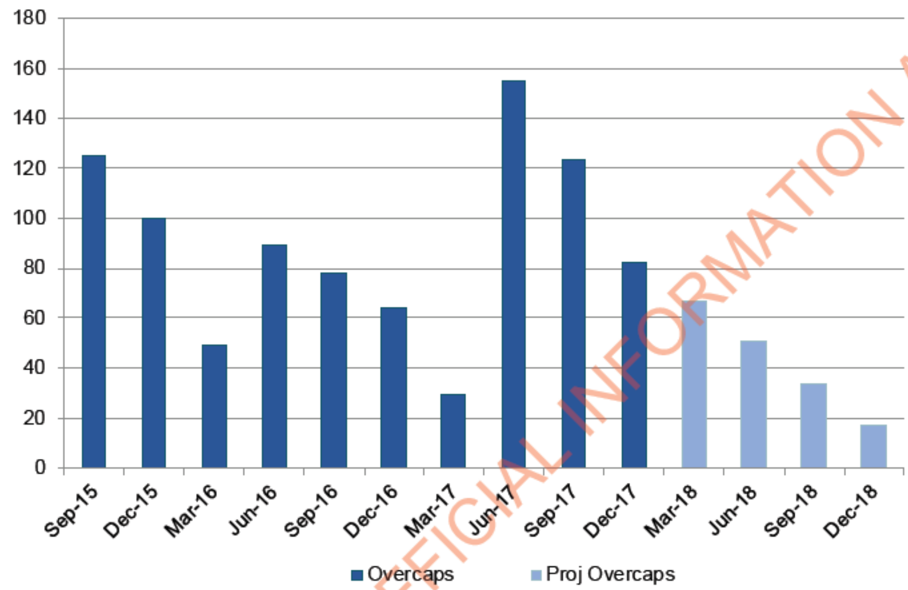
We comment on each of the key aspects of experience below.

New Over Caps

Numbers

The projected ultimate number of Over Cap claims (8,562) remains unchanged relative to the September valuation. This allows for another 168 new Over Caps to emerge in future. The figure below shows historic reporting patterns of new Over Cap claims, and our projected emergence pattern.

Figure 1 – New Over Cap Reporting



There has been a high level of new Over Cap reporting over the last three quarters, which has been a result of the detailed reviews that SRES conducted of EQC only properties with known remedial issues. We understand that SRES staff have been able to review most of the outstanding EQC remedial properties, and identified those that are expected be Over Cap. This detailed review has brought forward the identification of new Over Caps that may otherwise have taken a lot longer to emerge.

Future new Over Caps will predominantly emerge from the continuing flow of new remedial issues reported to the EQC for currently Under Cap claims. Information supplied by the EQC suggests that the flow of new remedial issues has reduced over 2017.

Taking these factors into account, it is reasonable to expect a slowdown in new Over Cap reporting activity in future. However, the ultimate number of Over Caps remains highly uncertain at this stage, and ongoing new Over Cap reporting will need to be monitored closely. If recent levels of new Over Cap reports continue into 2018, then the ultimate number of Over Caps is likely to be higher.

Average Size

There are now over 100 New Over Cap properties that have either had an assessment or cash settlement completed. The average size of assessments and settlements to date has been lower than our projected sizes for these properties. We had already assumed that the New Over Caps would, on average, have incurred less damage than the older Over Caps. The experience to date suggests that the extent of damage may be even less than we had assumed. At this stage we have not adjusted our assumed sizes for unassessed properties but, together with the new Over Cap reporting volumes, we will continue to monitor sizes closely.

Furthermore, the assessed values do not make any allowance for EQC spend that may ultimately be disregarded (due to faulty or incorrect work that is deemed to be of no value, or to lead to consequential damage) and would therefore be recoverable from the EQC in addition to the normal EQC contributions. At this stage there is no reliable dataset available to us that can be used to estimate the potential recoveries relating to disregarded costs, and it remains uncertain as to how much of this liability the EQC will ultimately accept. As such, we have made no allowances for disregarded cost related recoveries for New Over Caps at this stage.

Valuation of existing properties

BAU properties

The table below shows the settlement experience for BAU properties settled during the quarter.

Table 5 – Actual vs Expected Settlement Experience

Completed/Settled properties (BAU)	No.	Projected Completed ($m)	Actual Completed ($m)	Diff ($m)	Average Projected Completed	Average Actual Completed	Diff
Repair		[redacted]					
Cash Settled without BP	23						
Cash Settled with BP	14						
Construction Completion	17						
Other PMO	3						
Total	**57**						
Rebuild							
Cash Settled without BP	6						
Cash Settled with BP	2						
Construction Completion	47						
Other PMO	7						
Total	**62**						

9(2)(i) and
9(2)(j)

Excluding the Other PMO managed constructions, settlement experience during the quarter was better than expected. Some of this is tempered by the greater incidence of partial cash settlements being made for Repair constructions, where that cost is only recognised in the "post completion payments" allowance. We have increased this allowance for Repair constructions accordingly, which results in the overall projected size for Repair constructions being largely unchanged.

Whilst we have flowed the better than expected settlement experience through to the valuation projections, this good experience has been offset by additional cost development allowances made for the outstanding properties. Settlement activity and progression of Builder's Price quotes has been slower than expected. All else being equal, the longer it takes to progress properties to settlement, the greater the cost development expected. As such, we have increased the future cost development allowances for outstanding properties, the effect of which has been to offset the better than expected settlement experience to date.

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TRR properties

Around 50 TRR properties have settled over the last two quarters. [redacted] 9(2)(i) and 9(2)(j)

[redacted]

Other PMO Managed multi-units

Over the last twelve months we've seen a steady upward drift in settlement values for this group. The figure below shows settlement experience for Other PMO managed properties, compared to Arrow managed and cash settled multi-unit properties.

Figure 2 – Settlement Experience for Other PMO Managed Properties

Multi Rebuild Settlement Experience

[redacted]

9(2)(i) and 9(2)(j)

Multi Repair Settlement Experience

[redacted]

9(2)(i) and 9(2)(j)

Whilst the experience is volatile, and volumes are relatively low, there has been an upward trend in settled values for both Repairs and Rebuilds. Management are investigating recent settlements for underlying trends. We have adjusted our assumed sizes for outstanding properties upwards accordingly. This has resulted in a $4 million increase to the projected ultimate cost of these properties.

Risk Margin

[redacted] 9(2)(i)

[redacted]

[redacted]

[redacted]

Uncertainty of our Estimates

It should be noted that considerable uncertainty still surrounds the projection and valuation of SRES' EQ liabilities. As the claim settlement process has progressed, an increasing proportion of SRES' outstanding claims relates to more complex claims, meaning the uncertainty around future settlement outcomes for outstanding claims is magnified (as compared to 'normal' residential property claims).

In our view, there remain two key areas of uncertainty which could result in material adjustments to the ultimate outcome for SRES' remaining claims:

- the volume of future new Over Cap claims which might emerge, and the proportion of these which will ultimately be the subject of dispute and/or litigation
- higher than allowed escalation in settling the remaining body of outstanding claims, including the additional costs involved in settling disputed and litigated claims.

Reliances and Limitations

This letter has been prepared for the use of SRES for the stated purpose. We understand that a copy of the letter may be provided to the Board of SRES. No other use of, nor reference to, our letter other than as required by the Crown, should be made without prior written consent from Finity, nor should the whole or part of our letter be disclosed to any unauthorised person.

Third parties, whether authorised or not to receive this letter, should recognise that Finity will not be liable for any losses or damages howsoever incurred by the third party as a result of them receiving, acting upon or relying upon any information or advice contained in the report.

Our letter should be considered as a whole. Members of Finity staff are available to answer any queries, and the reader should seek that advice before drawing conclusions on any issue in doubt.

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9(2)(a)

Yours sincerely

[redacted]

Fellow of the New Zealand Society of Actuaries
Fellow of the Institute of Actuaries of Australia

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