

26 October 2017

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 30 September 2017

We have been asked by Southern Response Earthquake Services Limited (“SRES”) to make an assessment of its insurance liabilities as at 30 September 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 30 September 2017. This valuation is predominantly 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 30 September 2017. The line below the table indicates our estimate of the total amount which will be ultimately 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 30 September 2017**

Provisions for Outstanding Claims as at 30 Sep 2017	Cat 93	Cat 106	Cat 112	Total		
	4-Sep-10	22-Feb-11	13-Jun-11	Major	Minor	Overall
	\$m	\$m	\$m	\$m	\$m	\$m
<b>Gross Incurred Cost in 30 Sep \$ before EQC</b>	1,062.6	3,031.1	139.5	4,233.2	56.2	4,289.4
Expected EQC Share	-307.1	-673.0	-41.4	-1,021.4	-9.5	-1,030.9
<b>Gross Incurred Cost in 30 Sep \$ after EQC</b>	755.5	2,358.2	98.1	3,211.8	46.7	3,258.5
less paid to 30 Sep 2017	-665.6	-1,973.9	-82.2	-2,721.7	-42.4	-2,764.1
<b>Gross Outstanding Claims</b>						
Inflated Values	90.0	384.4	15.9	490.3	4.3	494.6
Discount to Present Value	-1.3	-5.7	-0.2	-7.2	-0.1	-7.3
<b>OSC Discounted to 30 Sep 2017</b>	<b>88.7</b>	<b>378.7</b>	<b>15.6</b>	<b>483.1</b>	<b>4.2</b>	<b>487.3</b>
Claims Handling	█	█	█	█	█	█
<b>Gross Central Estimate</b>	█	█	█	█	█	█
Catastrophe R/I Recoveries	0.0	0.0	-15.6	-15.6	-1.5	-17.2
Aggregate R/I Recoveries	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Central Estimate</b>	█	█	█	█	█	█
Risk Margin	█	█	█	█	█	█
<b>Recommended provision</b>	█	█	█	█	█	█
<b>Inflated Gross Central Estimate (Incl paid to date, excl CHE)</b>	<b>756</b>	<b>2,358</b>	<b>98</b>	<b>3,212</b>	<b>47</b>	<b>3,258.7</b>
<b>Change on 30 Jun 2017 Valuation</b>	<b>0</b>	<b>-10</b>	<b>0</b>	<b>-10</b>	<b>5</b>	<b>-5</b>
<b>Change on 30 Sep 2016 Valuation</b>	<b>-76</b>	<b>319</b>	<b>25</b>	<b>268</b>	<b>7</b>	<b>275</b>

9(2)(i)

9(2)(i)

Our central estimate of the gross inflated ultimate cost excluding CHE at 30 September 2017 is \$5m lower than our 30 June 2017 estimate. █

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 30 September 2017**

	30 Jun 17	30 Sep 17	Mov't Jun17 to Sep17
	\$m	\$m	\$m
<b>Ultimate Outflows</b>			
Over Cap	3,603	3,594	-9
Out of Scope	334	336	2
Other	153	153	0
Claims Cost (Excl PM Cost)	4,090	4,083	-7
Project Management Costs	█	█	█
SRES Claims Handling	█	█	█
	█	█	█
<b>Ultimate Inflows</b>			
EQC Contributions	1,032	1,030	-2
Reinsurance Recoveries	1,291	1,291	0
	2,323	2,321	-2
<b>Ultimate Net Outflow (net of RI)</b>	█	█	█
<b>Gross Cum. Paid</b>	<b>3,727</b>	<b>3,844</b>	<b>116</b>
<b>EQC Recoveries Received</b>	<b>-892</b>	<b>-930</b>	<b>-38</b>
<b>Cum. Paid Net of EQC</b>	<b>2,836</b>	<b>2,914</b>	<b>78</b>
<b>Discounted Net Liability</b>			
Central Estimate	563	495	-68
Risk Margin	█	█	█
Recommended Provision	█	█	█

9(2)(b)(ii)

9(2)(i)

9(2)(b)(ii) and 9(2)(i)

9(2)(i)

9(2)(i)

**Table 3 – Estimated Outstanding Liabilities at 30 September 2017**

	Outstanding 30 Jun 17 \$m	Outstanding 30 Sep 17 \$m	Mov't Sep17 to Jun17 \$m	
<b>Outflows</b>				
Over Cap	677	562	-115	
Out of Scope	3	5	2	
Other	10	9	-1	
Claims Cost (Excl PM Cost)	690	576	-114	
Project Management Costs	■	■	■	9(2)(b)(ii)
SRES Claims Handling	■	■	■	9(2)(i)
	■	■	■	9(2)(b)(ii) and 9(2)(i)
<b>Inflows</b>				
EQC Contributions	141	100	-40	
Reinsurance Recoveries	27	17	-9	
	168	118	-50	
<b>Net Central Estimate (undisc)</b>	573	503	-71	
Discounting	-10	-7	3	
<b>Net Central Estimate (disc)</b>	563	495	-68	
Risk Margin	■	■	■	9(2)(i)
<b>Recommended Provision</b>	■	■	■	

## Summary of Key Movements

The major drivers of the movements in the central estimate are described in the table on the following page.

**Table 4 – Summary of Key Movements in Liability Estimate (net of EQC)**

		Traffic Light	Notes	\$ Mov't from Jun-17	
Post 1 Oct16 Over Caps	Numbers	●	Numbers of new overcaps resulting from the JART process have been in line with our expectations from the June valuation. Our projected ultimate number of Over Cap claims is unchanged.	\$0M	
	Sizes	●	We have increased the assumed size on unassessed JART overcaps by [REDACTED] to align with assessments emerging during the quarter.	\$7M	9(2)(i) and 9(2)(j)
BAU Settlements	Rebuilds	●	Rebuilds and Repairs settlements over the quarter settled for less than assumed at the June valuation. This includes both construction completions and non-TRR cash settlements.	-\$4M	
	Repairs	●		-\$3M	
BAU Open Properties		●	Ultimate costs on open properties are unchanged from the last valuation. Movements over the quarter have been within our previous allowances. At this stage the good settlement experience has not been reflected in our projection of costs for the open properties.	\$0M	
TRR Properties		●	TRR properties settled in the quarter, as well as estimate movements on open TRR properties, are within our allowances. We have left the ultimate cost on these properties unchanged.	\$0M	
Closed Properties		●	[REDACTED]	-\$2M	9(2)(i)
Other Movements		●	Non-JART properties newly assessed during the quarter had a higher proportion of Repairs than expected. We have recognised the new ultimates on these properties, and changed our mix for the remaining unassessed non-JART properties. We also had fewer Repairs switching to Rebuilds over the quarter and have released some of our Repair to Rebuild allowance.	-\$4M	
Other Classes		●	There continue to be new Out of Scope claim report. We have added an allowance for more Out of Scope claims to be reported in future. Minor (\$0.4 million) increase for all other classes.	\$2M	
<b>Total Inflated Ultimate Excl. CHE</b>				<b>-\$5M</b>	

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

## New Over Caps

SRES staff has now reviewed 3,600 properties through the JART process, including 1,200 more having been reviewed since the June valuation. Since our last review, around 100 of these were confirmed as owned by SRES and were not previously known Over Caps. Also, there are currently 44 properties which are subject to joint legal proceedings against EQC and SRES` and which have the potential to move Over Cap in the future.. Assuming that some of these properties will eventually turn Over Cap, the rate of Over Caps emerging from the JART review process is in line with what we allowed at the June valuation. Therefore, the projected ultimate number of Over Cap claims remains unchanged at 8,562.

The average size of new assessments on all previously unassessed properties (both JART and non-JART) during the quarter were marginally larger than we had allowed for at June. Accordingly, we have increased the assumed average size on unassessed properties [REDACTED]

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

## Valuation of existing properties

### *BAU properties*

Settlement experience over the quarter has been slightly better than expected across both Rebuilds and Repairs. We have recognised this good experience for the properties that have been settled in the quarter, but at this stage we are not assuming that this favourable experience will extend to properties that remain open.

Cost movements over the quarter on open properties that had a Builders Price DRA (or RFP in some cases) completed have also been favourable relative to our allowances. In particular, new Builder's Price assessments on Repairs have had slightly lower development than projected. We have not reflected this positive experience for the open properties at this valuation. Hence, the ultimate values adopted on open properties remain unchanged from the June valuation.

[REDACTED]

9(2)(i)

### *TRR properties*

There were 35 TRR properties settled during the quarter. The overall settled value for these properties was broadly in line with our projected settled values. Cost development to date for open TRR properties has also been within our allowances, but we note that the emergence of added costs for TRR properties can be quite sporadic. To date the open TRR property costs appear to be developing in line with expectations, and the existing loadings allow for further development. As such, we have not changed the ultimate adopted cost for TRR properties.

Some properties have had their TRR issue resolved, and moved back into BAU but have not yet been settled. We have held the additional loadings on these properties in order to ensure that any lag in updating the expected costs recorded in the systems will not cause these properties to be under-reserved.

The flow of properties into the TRR stream has been lower than projected, but again we note that the TRR flows can be quite volatile. At this stage we are assuming that the low volume of new TRR properties this quarter does not indicate a reduction in the level of disputed and litigated claims that we can expect in aggregate. As such, we have left the projected ultimate numbers of TRR claims unchanged. We will continue to monitor this and if new TRR flows continue to be lower than projected we will consider reducing the adopted ultimate TRR number.

## Out of Scope claims

Previously, we assumed that there were no new Out of Scope (OOS) claims to come. However, we have observed that there continue to be new claims still being reported. These appear to be coming from customers who were previously unaware that the EQC is not liable for this portion of cost, and as such had not lodged an OOS claim previously. For this valuation we have added an allowance for IBNR OOS claims. We have assumed new OOS claim reporting will continue at a rate in line with recent months until June 2018, and will have a similar size to our currently open OOS claims.

## 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).

Unchanged from our previous valuations, we have set our risk margin at 14% of the estimated liability (net of EQC contributions but gross of reinsurance recoveries) which maintains SRES' approach of its provisions containing a margin sufficient to produce at least a 75% probability of sufficiency.

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

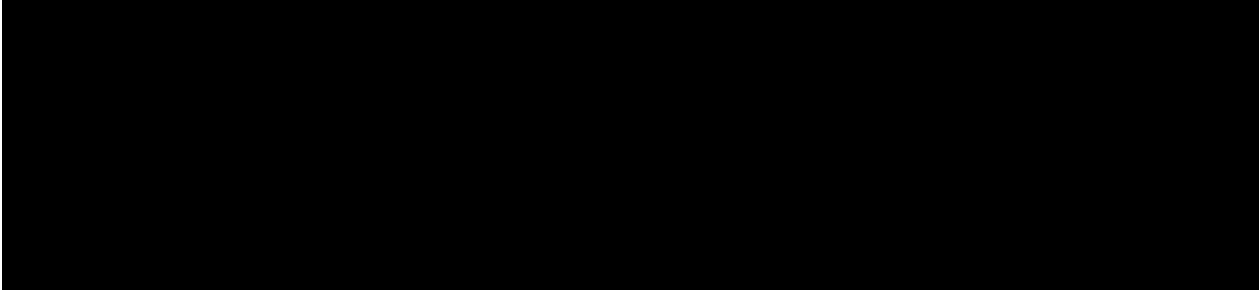
This letter has been prepared for the use of SRES for the stated purpose. We understand that a copy of the letter may be provided to the Board of SRES. No other use of, nor reference to, our letter other than as required by the Crown, should be made without prior written consent from Finity, nor should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

Yours sincerely

9(2)(a)



**Fellows of the New Zealand Society of Actuaries  
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