

29 October 2018

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

Dear Anthony

Earthquake Claim Liabilities as at 30 September 2018

We have been asked by Southern Response Earthquake Services Limited ("SRES") to make an assessment of its insurance liabilities as at 30 September 2018. 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 2018. This valuation is based on a roll forward of our detailed valuation as at 30 June 2018, with changes to valuation assumptions where emerging experience suggests this is 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 and recommended provision at 30 September 2018. The provision includes an estimate of SRES future claims handling expenses (CHE) and a risk margin which we believe to be consistent with the requirements to establish provisions which incorporate at least a 75% probability of sufficiency. 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). This represents our central estimate of the ultimate liability.

Note that our recommended provision does not include the potential costs arising from the GCA class action. Based on discussion with its auditors, and the information known as at 30 September 2018, SRES considers this to be a contingent liability. We understand that if any liability were to emerge from this class action, SRES would be indemnified for the outcome by the Crown. We understand further that legal costs relating to SRES' defence are not covered by the Crown indemnity and SRES is provisioning separately for the expected legal costs.

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Table 1 – Recommended EQ Provisions at 30 September 2018

Provisions for Outstanding Claims as at 30 Sep 2018	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
Gross Outstanding Claims						
Inflated Values	29.9	241.3	8.1	279.3	2.4	281.7
Discount to Present Value	-0.4	-3.4	-0.1	-3.9	0.0	-3.9
OSC Discounted to 30 Sep 2018	29.5	237.9	8.0	275.4	2.3	277.8
Claims Handling	█	█	█	█	█	█
Gross Central Estimate						
Catastrophe R/I Recoveries	0.0	0.0	-8.0	-8.0	-1.3	-9.3
Aggregate R/I Recoveries	0.0	0.0	0.0	0.0	0.0	0.0
Net Central Estimate						
Risk Margin	█	█	█	█	█	█
Recommended provision						
Inflated Gross Central Estimate (Incl paid to date, excl CHE)	693	2,441	88	3,223	42	3,264.5
Change on 30 Jun 2018 Valuation	-3	19	-2	14	-2	12

Our central estimate of the total amount that will ultimately be paid (before reinsurance) at 30 September 2018 is \$12 million higher than the 30 June 2018 estimate.

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9(2)(i)
 9(2)(i)

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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 2018

	30 Jun 18	30 Sep 18	Mov't Jun18 to Sep18
	\$m	\$m	\$m
Ultimate Outflows (Net of EQC)			
Over Cap	2,548	2,557	10
Out of Scope	333	332	-1
Other	155	158	3
Claims Cost (Excl PM Cost)	3,037	3,048	11
Project Management Costs	█	█	█ 9(2)(b)(ii)
SRES Claims Handling	█	█	█ 9(2)(ii)
Reinsurance Recoveries	1,283	1,281	-2
Ultimate Net Outflow (net of RI)	█	█	█ 9(2)(ii)
Cum. Paid Net of EQC	3,095	3,151	56
Discounted Net Liability			
Central Estimate	325	284	-41
Risk Margin	█	█	█ 9(2)(b)(ii)
Recommended Provision	█	█	█

In addition to the higher ultimate Over Cap claim numbers, there has again been a small reallocation of costs away from the June event which has also contributed to an increase in the net of reinsurance projected ultimate cost. The increase in the "Other" claim costs relates to Temporary Accommodation claims. We are seeing a higher rate of Temporary Accommodation claims associated with more recent Over Cap claim settlements, and have increased our reserves for these claims accordingly.

Table 3 – Estimated Outstanding Liabilities at 30 September 2018

	Outstanding 30 Jun 18	Outstanding 30 Sep 18	Mov't Sep18 to Jun18
	\$m	\$m	\$m
Net Outflows			
Claims Cost (Excl PM Cost)	304	269	-35
Project Management Costs	█	█	█ 9(2)(b)(ii)
SRES Claims Handling	█	█	█ 9(2)(i)
	330	288	-42
Net Central Estimate (undisc)	330	288	-42
Discounting	-5	-4	1
Net Central Estimate (disc)	325	284	-41
Risk Margin	█	█	█ 9(2)(i)
Recommended Provision	█	█	█

Summary of Key Movements

The gross inflated ultimate cost has increased by \$12 million relative to 30 June 2018. The key underlying movements in the estimate of the ultimate cost are set out in the table below, including commentary on each of the movements.

Table 4 – Summary of Key Movements in Ultimate Cost Estimate (net of EQC)

		Notes	\$ Mov't from Jun-18	
Post 1Oct16 Over Caps	Numbers	An increase in the projected ultimate Over Cap numbers by 176 properties. [REDACTED]	[REDACTED]	9(2)(i)
	Sizes	Settlement experience in the quarter was better than expected. Average sizes for properties that had their first assessment completed during the quarter were lower than expected, and we have reduced our assumed size for unassessed properties accordingly. [REDACTED]	[REDACTED]	9(2)(i)
Pre 1Oct16 Over Caps		[REDACTED]	[REDACTED]	9(2)(i)
Other Areas		[REDACTED]	[REDACTED]	9(2)(i)
Total Inflated Ultimate			\$12M	

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

Ultimate Over Cap Numbers

At our June 2018 valuation, the projected ultimate number of Over Cap claims was 8,598 (with 181 still to be reported). As at the end of August 2018 there were 8,434 Over Caps reported to date (leaving an IBNR allowance of 164). At our previous valuation we had noted that there had been limited information forthcoming from the EQC with regard to unresolved properties sitting with the EQC that were at risk of turning Over Cap, and that the IBNR allowance for Over Cap claim numbers was subject to significant uncertainty.

During early September, EQC provided SRES with a list of unresolved SRES properties for SRES to review. After excluding properties that SRES already had as Over Cap on its systems, there were:

- 475 currently Under Cap properties where SRES had previously reviewed available EQC information and deemed there was insufficient evidence to treat as Over Cap, but where EQC is now able to provide more complete information. This group is categorised as “EQC Flow” in the table below.

- 373 currently Under Cap properties where SRES was reviewing EQC’s information for the first time. This group is categorised as “EQC Flow 2” in the table below.

The table below summarises the results for the properties where SRES staff were able to review and make a decision regarding the Cap status, along with our projected emergence rate of Over Caps from the properties that SRES staff have not yet reviewed.

Table 5 – Results from review of unresolved EQC property list

	EQC Flow	EQC Flow 2
Properties on review list not already Over Cap	475	373
Reviewed	86	58
Assessed as Over Cap	31	9
<i>Over Cap as % of Reviewed</i>	36%	16%
Awaiting Review		
Properties	389	315
Assumed Over Cap %	30%	15%
Over Caps expected from unreview ed	117	47
Total Over Caps Expected	148	56

From our discussions with SRES staff that have been leading the review, we understand there has been no specific prioritisation of properties. As such we have assumed the proportion of properties that will be Over Cap from the unreviewed group will be broadly consistent with those reviewed so far. A higher rate was observed for the previously reviewed “EQC Flow” group, which is not surprising as these claims were initially reviewed by SRES more than a year ago. It is expected that those that EQC has not been able to resolve in that time will be inherently more complex and therefore more likely to be Over Cap.

Our assumed Over Cap rate for the unreviewed properties in this group is a little bit lower than the experience to date. We understand that in a small number of cases EQC has identified certain claims for SRES to review, and as such the Over Cap rate to date for this group will be higher than it would be if the review had been done in purely random order.

Therefore, in addition to the 8,434 Over Caps known as at the end of August, another 40 have been identified from the list reviewed to date, and further 164 are expected to be Over Cap from those awaiting review. Another seven Over Caps emerged over September that were not on the review lists at all, possibly due to new EQC reopening inflow during September. Relative to the remaining IBNR allowance for Over Caps of 164 at the end of August, we are already seeing potentially 211 Over Caps based on the information provided by EQC in September.

Furthermore, it is expected that EQC will continue to reopen claims, of which some will emerge to be Over Cap. Based on information shared by EQC with SRES and published on the EQC website, we estimate that EQC has been reopening between 600 and 750 claims (at an Industry level) each month between May and August.

Information EQC shared with SRES earlier in the year suggested the monthly volume of reopenings between November 2017 and February 2018 was in the 200-300 range. However, we

are aware that EQC has since identified missing properties so it is quite possible that the reported volumes for earlier periods were understated. The EQC itself forecasts an average of 500 reopenings a month, across all insurers, but does not provide any indication of how long it expects this to continue.

With the available information, it is difficult to judge what the volume of future reopenings may be, or how long we can expect EQC reopenings to continue. At this stage, we have allowed for approximately another 4,300 EQC reopenings, of which around 30% will be SRES insured. We have assumed 10% of these will ultimately be Over Cap (an additional 129 Over Caps). This is a little lower than the 15% observed in the most recent list, to allow for a higher proportion of future reopenings not being accepted by the EQC, or being resolved prior to escalation to SRES.

Therefore, the projected ultimate number of Over Cap claims has increased relative to the June valuation from 8,598 to 8,774, with an IBNR allowance as at 31 August 2018 of 340. We note that there remains considerable uncertainty, around the Over Cap IBNR projection. The greatest uncertainty relates to the total volume of future EQC reopenings, but there is also uncertainty in respect of EQC's data about unresolved properties, which has historically been understated.

As the outstanding claim liability continues to run down as older claims are settled, the IBNR uncertainty gains greater significance in the context of the liability valuation. The lack of good quality information on which to base the IBNR projection has been a limitation for some time. In order to resolve this uncertainty, it would be worthwhile exploring how SRES can access better quality information about EQC claims so that a more detailed assessment of future Over Cap exposure can be made.

Settlement Experience

The table below summarises settlement experience over the quarter.

Table 6 – Summary of Settlement Experience (net of EQC)

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

Assessment Sizes for Post Oct16 Over Caps

At 30 June 2018 there remained a large number of Post Oct16 Over Caps that had not yet had a detailed damage assessment completed. As such we made assumptions about the sizes that would emerge for these properties once an assessment was completed. The figure below shows the average assessment size by assessment quarter, for both Builders Price DRAs as well initial DRAs where one was completed.

Table 7 – Average Assessed Size for Post Oct16 Over Caps



9(2)(i)

As the emerging experience is lower than we had assumed we have reduced the assumed sizes for unassessed properties slightly.

EQC Contributions for Post Oct16 Over Caps

At the previous valuation we had adopted an expected EQC contribution (██████████ per property) that was lower than the amounts SRES was invoicing the EQC (██████████ per property), as a substantial part of the invoiced costs represented disregarded work and consequent damage. As SRES had not yet made any recoveries from the EQC in respect of these items, we had not given full credit to these elements of the expected EQC contributions. 9(2)(i)

Since June, SRES has received payments from the EQC for a number of the invoiced claims. Where SRES has received payment from the EQC, recoveries received have been close to 100% of the invoiced amount. We note that there remain unpaid invoices, but understand SRES expects full recoveries on the outstanding invoices. Given we now have some evidence of SRES being able to recover disregarded work and consequential damage costs, we have increased our assumed EQC contributed to ██████████ per property. This is still a little lower than the amount SRES has invoiced, recognising that there is still some risk while there remain outstanding invoices. If the recovery rate continues to remain close to 100% as more payments come in from the EQC, we would consider increasing the assumed EQC contribution further. 9(2)(i)

The higher assumed EQC contribution for the properties acts to reduce the projected net of EQC sizes, and therefore contributes to a reduction in the projected ultimate cost.

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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.

In light of this uncertainty and the increase in the proportion of the central estimate relating to the IBNR liability for Over Cap claims, we have left the risk margin unchanged in dollar terms for this update.

GCA Class Action

On May 29 2018, GCA Lawyers initiated a new class action proceeding against SRES, proposing to represent all policyholders that entered into a settlement agreement with Southern Response prior to 1 October 2014 (which is when the Court of Appeal issued its decision in *Avonside Holdings*). The class action seeks to re-open full and final settlements, seeking the difference between what was recorded in the 'Office Use' version of a DRA and the 'Customer DRA' that was issued to policyholders.

As at 30 September 2018, SRES continues to defend against the action within the courts. SRES has also received an indemnity from the Crown in respect of the class action. Based on discussion with its auditors, and the information known as at 30 September 2018, SRES considers this to be a contingent liability. If any liability were to emerge from this class action, SRES would be indemnified for the outcome by the Crown. Therefore, our recommended outstanding claims provision as at 30 September 2018 makes no allowance for any liability arising from the GCA Class Action. Legal costs relating to SRES' defence are not covered by the Crown indemnity and SRES is provisioning for the expected legal costs separately. The expected legal costs are not included in our claims liability estimate.

EQC MOUs

SRES is currently in discussions with the Crown and the EQC regarding MOUs under which SRES may take over the management of certain Under Cap claims. We understand that as at 30 September 2018 no agreements had been reached. Our liability valuation does not allow for any liability that may arise for SRES as a result of these MOUs.

Reliances and Limitations

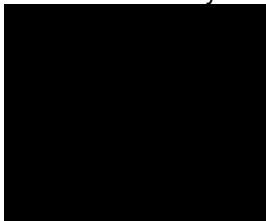
This letter has been prepared for the use of SRES' management and Board for the stated purpose. No other use of, nor reference to, our letter other than as required by the Crown, should be made without prior written consent from Finity, nor should the whole or part of our letter be disclosed to any unauthorised 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.

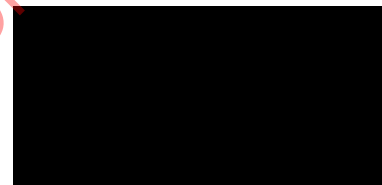
Our letter should be considered as a whole. Members of Finity staff are available to answer any queries, and the reader should seek that advice before drawing conclusions on any issue in doubt.

Yours sincerely

9(2)(a)



9(2)(a)



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