

Southern Response Earthquake Services Limited

(Formerly AMI Insurance Limited)

Statement of Performance Expectations

Financial year 2018 - 2019

Introduction

This Statement of Performance Expectations (SPE) is submitted by the Board of Directors of Southern Response Earthquake Services Limited (Southern Response), pursuant to the Crown Entities Act 2004. It sets out the performance expected of Southern Response for the period 1 July 2018 to 30 June 2019.

Statement of Responsibility

Southern Response is responsible for the statements contained in this document including the appropriateness of the assumptions underlying them. Southern Response is responsible for internal control systems that provide reasonable assurance as to the integrity of its financial reporting.



Alister G James
Chairman



Anne J Urlwin
Deputy Chairman

15 February 2019

Objectives, Scope and Output for Financial Year 2019

Strategic Objectives

Southern Response's core purpose is to settle insurance claims made by AMI policyholders arising from the Canterbury earthquakes up until 5 April 2012, in a timely and fair manner, within the terms of the insurance policy and existing funding arrangements.

On 23 October 2018, as an initiative to promote a more integrated cross-agency claims management model, the Shareholding Ministers extended Southern Response's purpose¹, to provide assistance to EQC in processing unresolved Canterbury claims. In practical terms this means that Southern Response is to assist EQC to process unresolved 'undercap' Southern Response customers' claims (and potentially other insurer customers').

In undertaking its role and fulfilling its core purpose of settling its customers' claims in a timely and fair manner, within the terms of the insurance policy and existing funding arrangements, Southern Response will meet the following strategic objectives:

- To be customer centric
- To ensure people are safe
- To have processes that are prudent, robust and responsible
- To plan for the end of the Company's operational life

Scope and Life of Southern Response

Business as Usual

Southern Response's Constitution defines its purpose as:

"To manage Covered Claims², to manage the Company's recoveries from reinsurers, to manage its investment portfolio and to conduct any activities that are associated with those purposes."

The company's original purpose will have been achieved once the insurance claims associated with the Canterbury earthquake events up until 5 April 2012 have been settled and the Company has performed all of its obligations, including re-builds of properties, in respect of those settled claims. It is expected that this will take until the end of financial year 2019, with a minor proportion of very complex claims and litigated claims outstanding.

The Company does not take on any new insurance business except to the extent that it is ancillary to its claims management business.

Extended Mandate

As advised by the Shareholding Ministers in their Letter of Expectations dated 23 October 2018, the Shareholding Ministers agreed that Southern Response's mandate be extended to include contribution to the Greater Christchurch Claims Resolution Service (GCCRS), and to support the management of designated claims currently sitting with the Earthquake Commission, by:

¹ Letter of expectations, 23 October 2018

² Covered Claims are as defined in the Crown Support Deed

- assisting EQC in the processing of certain claims EQC receives from customers prior to any determination as to whether they are overcap claims and potentially including claims by customers of insurers other than Southern Response,
- assisting the unit of MBIE which will provide claims management services to Southern Response customers participating in the GCCRS to the fullest extent it can and in a manner which contributes to the more timely, fair and enduring resolution of the claims of those customers; and reimbursing the costs of that unit to the extent agreed by way of a Memorandum of Understanding between the company, EQC and MBIE.

Functions and Operations

The Southern Response Board of Directors has appointed a Chief Executive of the Company, who is responsible for the company's day-to-day operations supported by a senior management team responsible for the operations of the three key business areas of Claims Settlement and Shared Services, Legal and Strategy, and Finance.

Southern Response's capability to achieve its core purpose of settling its customers' claims is a resource base that is a mix of in-house and outsourced:

- Southern Response employees – approximately 60, down from a peak of 160 in 2015.
- Outsourced specialist support – technical and legal.

What Southern Response intends to achieve in 2018/2019

In conjunction with the Statement of Intent, this Statement of Performance Expectations describes key 2018/2019 activities to achieve the key strategic objectives supporting the Company's core purpose.

Southern Response produces outputs, impacts and outcomes from its activities. However, these are not defined as reportable outputs under the Crown Entities Act.

Southern Response will report on its performance in implementing these activities in its 2018/2019 Annual Report.

| Strategic Objective | Outcome | 2018-19 proposed targets |
|---|---|--|
| 1. To settle remaining Southern Response Claims | The remaining Southern Response claims are settled in a timely and fair manner, within the terms of the insurance policy and funding support provided by the Crown. | <ul style="list-style-type: none"> ▪ 8,132 (97%) of the 8,383 claims notified by 30 June 2018 are settled by 30 June 2019. |
| 2. To be customer centric | Our organisational culture ensures the customer is at the centre of everything we do. | <ul style="list-style-type: none"> ▪ Business will engage in customer focus groups and implement appropriate recommendations. |
| 3. To ensure people are safe | Everyone involved in a Southern Response claim is safe and their wellbeing is supported by our processes and practices. | <ul style="list-style-type: none"> ▪ A minimum score of 90% for critical H&S risks assessed as being adequately managed by contractors. ▪ Staff Wellbeing Score (currently in development) |

| Strategic Objective | Outcome | 2018-19 proposed targets |
|---|---|---|
| 4. To have processes that are prudent, robust and responsible | We achieve fiscal efficiency and comply with legislative requirements. | <ul style="list-style-type: none"> ▪ External audit ESCO³ ratings of at least “good”. |
| 5. To plan for the end of the Company’s operational life | The Company is ready to transition to a receiving agency as and when appropriate. | <ul style="list-style-type: none"> ▪ Transition Plan is complete and ready to be operationalised (when required) by 31 March 2019. |

³ Environment, systems and controls for measuring financial and service performance

Forecast Financial Statements

The forecast financial statements below include a Statement of Forecast Comprehensive Income, Statement of Forecast Financial Position, Statement of Forecast Changes in Equity and Statement of Forecast Cash Flows for the 2019 financial year.

Southern Response is funded to deliver its objectives. Under the terms set out in the Crown Support Deed and its subsequent amendments, funding is recognised as share capital. Other funding received by Southern Response is by way of interest on surplus cash balances, which will be recorded as revenue in the Income Statement.

Southern Response incurs expenditure as part of its activities. Operating expenditure (i.e. the day to day running of Southern Response) is recorded in the Statement of Forecast Comprehensive Income. This expenditure is funded by the Shareholders through drawdowns on the uncalled capital facility.

Statement of forecast comprehensive income

For the year ending 30 June 2019

| | 2019 Forecast \$000 |
|---|---------------------------|
| Net claims incurred | (26,053) |
| Depreciation and amortisation | (79) |
| Net underwriting loss | (26,132) |
| Investment income and expenses | 1,073 |
| Profit/(Loss) for the year before tax | (25,059) |
| Tax expense | - |
| Profit/(Loss) for the year after tax | (25,059) |
| Other comprehensive income: | |
| Other comprehensive income for the year after tax | - |
| Total comprehensive Profit/(Loss) for the year | (25,059) |

Statement of forecast financial position

As at 30 June 2019

| | 2019 Forecast \$000 |
|------------------------------------|---------------------------|
| Shareholders' equity | |
| Total shareholders' deficit | <u>(153,790)</u> |
| Represented by: | |
| Assets | |
| Financial assets | |
| Cash and cash equivalents | 26,122 |
| Receivables | 3,495 |
| Reinsurance receivables | 6,827 |
| Plant and equipment | 225 |
| Intangible assets | - |
| Total assets | <u>36,669</u> |
| Less: | |
| Liabilities | |
| Trade and other payables | 4,076 |
| Employee entitlements | 1,300 |
| Outstanding claims | 185,083 |
| Total liabilities | <u>190,459</u> |
| Net liabilities | <u>(153,790)</u> |

Statement of forecast changes in equity

For the year ending 30 June 2019

| 2019 | Forecast Ordinary Shares \$000 | Accumulated Losses \$000 | Total Equity/(Deficit) \$000 |
|---|---|--------------------------------|------------------------------------|
| Opening balance 1 July 2018 | 1,040,939 | (1,397,670) | (356,731) |
| Profit/(Loss) for the year | - | (25,059) | (25,059) |
| Other comprehensive income for the year | - | - | - |
| Total comprehensive income for the year | | (25,059) | (25,059) |
| Call on uncalled ordinary shares | 228,000 | - | 228,000 |
| Closing balance 30 June 2019 | 1,268,939 | (1,422,729) | (153,790) |

Statement of forecast cash flows

For the year ending 30 June 2019

| | 2019 Forecast \$000 |
|---|---------------------------|
| Cash flows from operating activities | |
| Interest received | 1,073 |
| Claim costs - earthquake | (226,101) |
| Claim costs - reinsurance recoveries | 4,220 |
| Payments to suppliers and employees | (13,423) |
| Income tax paid | - |
| Net cash outflow from operating activities | (234,231) |
| Cash flows from investing activities | |
| Payments for plant and equipment | (300) |
| Net cash outflow from investing activities | (300) |
| Cash flows from financing activities | |
| Proceeds from the uncalled capital facility | 228,000 |
| Net cash inflow from financing activities | 228,000 |
| Net (decrease)/increase in cash and cash equivalents | (6,531) |
| Add opening cash and cash equivalents | 32,653 |
| Ending cash and cash equivalents | 26,122 |

Notes to the Forecast Financial Statements For the year ending 30 June 2019

Reporting entity

Southern Response Earthquake Services Limited (the Company) is a limited liability company incorporated and domiciled in New Zealand and registered under the Companies Act 1993.

The Company is a Crown-owned company listed in schedule 4A of the Public Finance Act 1989.

The Company's principal business is to manage the settlement of claims from AMI Insurance customers arising from the Canterbury earthquakes occurring between 4 September 2010 and 5 April 2012.

Basis of preparation

These prospective financial statements have been prepared for the purpose of providing information on Southern Response's future operating intentions and financial position against which it must report and be formally audited at the end of the financial year.

These prospective financial statements have been prepared:

- in accordance with the relevant requirements of the Public Finance Act 1989 and the Crown Entities Act 2004, which include the requirement to comply with New Zealand generally accepted accounting practice (NZ GAAP)
- in accordance with FRS42 and NZ GAAP as it relates to prospective financial statements
- in accordance with NZ GAAP as appropriate for profit oriented companies
- on a GST-exclusive basis, except for receivables and payables which are presented on a GST-inclusive basis
- on a historical cost basis, except for certain assets which have been measured at fair value and all outstanding claims liabilities and reinsurance receivables have been measured in accordance with NZ IFRS 4 Insurance Contracts
- in New Zealand dollars rounded to the nearest thousand, unless separately identified.

The forecast financial statements have been presented on a going concern basis, deemed appropriate given the funding arrangement provided under the Crown support deed.

Statement of Significant Underlying Assumptions

Timelines and Scope of Activities

The forecast is based on

- the Company meeting its targets for settling covered claims under its original mandate, with 97% of claims that are notified at 30 June 2018 settled by 30 June 2019
- assistance to the Greater Christchurch Claims Resolution Service and EQC for designated claims to the extent provided under the extended mandate.

Income Statement

- Investment income is based on 2.0% yield on all funds
- Staff numbers reflect the claims management workload to achieve the settlement claims objectives

- Under its extended mandate, the Company is acting in an agency capacity for EQC on the management of designated claims and accordingly any recoveries from EQC on those claims are not recorded as revenue but are offset against the relevant costs incurred.

Statement of Financial Position

- The Crown has provided Southern Response with Crown funding under the Crown Support Deed and its subsequent amendments, with the undrawn balance classified as uncalled capital and available for drawdown as required.

Claims Liability

- The Actuarial valuation at 30 September 2018 assessed the risk margin, with a 75% probability of sufficiency, at \$65 million, which at that point represents 23% of the outstanding Central Estimate. The forecast financial statements assumes the risk margin will be required to settle customer claims and accordingly the provision is not amortised (credited) to the profit and loss account as claims are paid.
- The Claims Liability includes a provision for Claims Handling Expenses. As Southern Response is solely a claims settlement organisation the Actuarial valuation includes a provision for both claims handling costs and corporate costs for the projected settlement period.
- On 25 September 2018, the Crown, through the Minister of Finance, agreed to indemnify the Company in relation to certain litigation. The indemnity enables Southern Response to continue to focus on settling the remaining outstanding claims of its customers.

Cash Flow

- The uncalled capital is drawn quarterly as required to meet claims payments and operating expenses.
- The Uncalled Capital facility forecasts drawdowns totalling \$228 million in the year ending 30 June 2019.

Taxation

- Southern Response is a tax paying entity.
- The company has incurred tax losses totalling \$1,144 million to 30 June 2018. The tax losses are available to offset assessable income arising in future years, however the tax benefit of the losses has not been recognised.
- No allowance is recognised for the tax benefits from forecast tax losses.

Going Concern

- The financial forecasts have been prepared using the going concern assumption.
- At 30 June 2018 Southern Response had a net asset deficit of \$357 million. At that date the Company had issued \$417 million of uncalled capital to the Crown. As the Company requires additional capital to meet its claims payment obligations it can access this capital from the Crown.
- On the basis of the above the Directors concluded that it is appropriate to prepare the forecasts on a going concern basis.

Key Risks to the Financial Forecasts

- The Actuarial valuation of the claims liability may increase in subsequent valuations. Key components of this are:
 - ultimate claim numbers impacted by claims transferring from EQC
 - building cost escalation
 - repair scope creep due to engineering and compliance requirements and customer expectations
 - enhanced foundation costs and the impact on build costs
 - EQC contributions to the repair of land damage and impact on foundation costs
- The risk margin of \$65 million, to provide a probability of sufficiency of 75% for the provision, is subject to ongoing review by the Actuaries and may be amended in response to changes in the risk profile of outstanding claims.

Significant accounting policies

The following accounting policies significantly affect the measurement of financial performance and position.

Accounting policies related to insurance contracts

All of the general insurance products utilised, meet the definition of an insurance contract (a contract under which one party, the insurer, accepts significant insurance risk from another party, the policyholder, by agreeing to compensate the policyholder if a specified uncertain future event, the insured event, adversely affects the policyholder).

Outwards Reinsurance

Premiums paid to reinsurers for contract works reinsurance policies held by the Company are allocated to claims and recognised as a claim cost, reducing the outstanding claims liability.

Outstanding Claims Liability

The outstanding claims liability is measured as the central estimate of the present value of expected future claims payments plus a risk margin.

The expected future payments include those in relation to claims reported but not yet paid; claims incurred but not reported (IBNR); claims incurred but not enough reported (IBNER); and estimated claims handling costs.

To allow for the inherent uncertainty of the central estimate, a risk margin is applied to the outstanding claims liability net of reinsurance and other recoveries. The risk margin increases the probability that the net liability is adequately provided for.

The estimation of the outstanding claims liability involves a number of key assumptions and is the most critical accounting estimate. All reasonable steps are taken to ensure that the information used regarding claims exposures is appropriate. However, given the inherent uncertainty involved in determining the liability, it is likely that the final outcome will prove to be different from the liability established.

Reinsurance and Other Recoveries

Reinsurance and other recoveries received or receivable on paid claims and on outstanding claims (notified and not yet notified) are recognised as income in net claims incurred. Reinsurance

recoveries on paid claims are presented as a component of reinsurance recoveries net of any provision for impairment based on objective evidence for individual receivables. All recoveries receivable on outstanding claims are measured as the present value of the expected future receipts calculated on the same basis as the outstanding claims liability. Reinsurance does not relieve the originating insurer of its liabilities to policyholders and is presented separately on the statement of financial position.

Accounting policies applicable to other activities

Investment Income - Interest

Interest is recognised using the effective interest method

Critical accounting estimates and assumptions

In preparing these prospective financial statements, Southern Response has made estimates and assumptions concerning the future. These estimates and assumptions may differ from the subsequent actual results and the variations may be material.

Estimates and assumptions are continually evaluated and are based on expectations of future events that are believed to be reasonable under the circumstances. The estimates and assumptions that have significant risk of causing material adjustment to the carrying amount of the assets and liabilities within the forecast financial statements are as follows:

The ultimate liability arising from claims made under insurance contracts

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the reporting date, including the cost of claims incurred but not yet reported to the Company.

The estimated ultimate cost of claims includes direct expenses to be incurred in settling claims, gross of the expected value of salvage and other recoveries. The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the liability established.

The estimation of claims incurred but not reported (IBNR) is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim event is generally available.

In calculating the estimated ultimate cost of unpaid claims the Company uses an actuarial valuation carried out by an independent actuary.

Assets arising from reinsurance contracts

Assets arising from reinsurance contracts are computed using actuarial valuations. In addition, the recoverability of these assets is assessed on a periodic basis to ensure that the balance is reflective of the amounts that will ultimately be received, taking into consideration factors such as counterparty and credit risk.

Impairment is recognised where there is objective evidence that the Company may not receive amounts due to it and these amounts can be reliably measured.