
Southern Response Earthquake Services Limited Statement of Performance Expectations

For Financial Year 2020

INTRODUCTION

This Statement of Performance Expectations (SPE) is submitted by the Board of Directors of Southern Response Earthquake Services Limited ('Southern Response' or the 'Company'), pursuant to the Crown Entities Act 2004. It sets out the performance expected of Southern Response for the period 1 July 2019 to 30 June 2020, taking into account the updated operational model for the Company which was approved by the Shareholding Ministers in November 2019. This SPE supersedes the SPE dated 21 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 JAMES

Chair

05-03-2020



ANNE URLWIN

Director

Strategic Objectives

Southern Response's purpose from 5 April 2012 has been to operate as a run-off insurer in relation to Covered Claims, with the intention to operate its business consistent with normal commercial and financially prudent principles. It has not and will not take on any new insurance underwriting business, except to the extent that it has been ancillary to its claims management business.

With the outsourcing of the management of its claims settlement activities to the Earthquake Commission (the EQC) at the end of December 2019, Southern Response will utilise its residual resources to support EQC to succeed in delivering, on behalf of Southern Response, fair and enduring settlements for Cantabrians that are yet to resolve their earthquake claims.

As a Crown-owned company, Southern Response will continue to ensure its ongoing governance, financial and legal obligations are met. Acknowledging EQC's role under the Agency Agreement, key decision-making regarding claims settlements will still remain with Southern Response

The Company will maintain a focus on delivering a customer centric approach for the settlement of outstanding claims. This includes the utilisation of third parties, such as the Greater Christchurch Claims Resolution Service (GCCRS), to assist customers through to the settlement of their claims.

Business Scope

Southern Response (formerly AMI Insurance Limited) became a Crown-owned company on 5 April 2012. It was named in Schedule 4A of the Public Finance Act, following the sale of its non-earthquake related business to IAG (NZ) Holdings Limited.

Southern Response is responsible for Covered Claims, which are defined as:

- a) Any Retained Claim – any claim made by or on behalf of a policyholder under any customer insurance contract relating to any Retained Claim Event, irrespective of whether the claim is made prior to, on or after 5 April 2012.

Retained Claim Event means the Canterbury earthquake events recognised by EQC as occurring from 4 September 2010 through 9 October 2011; and any other event that occurred prior to, or was continuing in progress, as at 5 April 2012 which entitles Southern Response to make a reinsurance claim

- b) Any other claim for which Southern Response is or may be liable pursuant to Clause 13 of the IAG Sale Agreement (relating to customer insurance contract indemnities and retained claims not clear at 5 April 2012 – essentially claims for which AMI was entitled to make a reinsurance claim and which are being managed on its behalf by IAG).
- c) Any claim arising in respect of any Covered Insurance Contract.

Covered Insurance Contract means any contract works or similar insurance policy under which Southern Response is or may be

**OBJECTIVES, SCOPE
& OUTPUT FOR
FINANCIAL YEAR
2020 (continued)**

liable from time to time; and any other insurance policy under which Southern Response may be liable from time to time and which has been approved by the Crown (either individually or as a class of insurance business).

**REPORTABLE
OUTPUTS &
PERFORMANCE
TARGETS**

Reportable Outputs

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

Performance Targets

Performance targets for the Company's activities are measured as milestones and KPIs which have been set as follows:

2020 Financial Year

Outcome: Outsourcing of Covered Claims to EQC is embedded and effective

Utilising the Company's retained capability to support EQC to deliver fair and enduring settlements for customers with unresolved claims with both Southern Response and EQC.

What will achievement of this outcome look like?

- Organisational run down is in accordance with forecasts.
- The outcome of audits of EQC acting as the Company's agent at the end of the financial year record only minor or moderate findings.

Outcome: Settling notified Covered Claims

Although EQC will be acting as Southern Response's agent, the Company will still retain the decision-making obligations and ultimate responsibility for covered claims.

What will achievement of this outcome look like?

- 99.73% of Covered Claims notified to the Company by 30 November 2019 will be settled by 30 June 2020.

Outcome: Completing finalisation work with EQC

Southern Response and EQC will continue to engage with one another to agree any outstanding amounts that may be owed due to allocation of costs to earthquake events from the Canterbury Earthquake Sequence.

What will achievement of this outcome look like?

- By 30 June 2021, Southern Response will have completed all technical and operational work necessary for finalisation.

Outcome: Southern Response has outsourced arrangements in place to ensure that the Company meets its ongoing obligations

As a Crown-owned company, Southern Response will have ongoing financial, governance, legal and reporting obligations that will continue for a number of years.

What will achievement of this outcome look like?

- Compliance with obligations arising from the Public Finance Act 1989 and the Crown Entities Act 2004.
- Manage liquidity in accordance with the investment management policy directed by the Crown, including reporting of actual and projected shortfalls in a timely manner.
- Continue to regularly review the adequacy of capital facilities at an appropriate confidence level, in recognition of the possible claims liability valuation volatility, due to ongoing uncertainty around claim numbers, ongoing litigation and final cost.
- Review the Company's operating structure and associated budget annually.

Outcome: Litigated claims and legal risks generally are appropriately managed

Southern Response is involved in ongoing litigation that is of significance to the Company and the Crown more generally. It is important that litigation and legal issues faced by the Company are appropriately managed and the implications of any judicial decisions are understood.

What will achievement of this outcome look like?

- The number of litigated claims as at 30 November 2019 is reduced in accordance with the Company's actuarial forecasts.

**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 2020 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 Statement of Comprehensive Income.

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.

**FORECAST STATEMENT
OF COMPREHENSIVE
INCOME**

	Year Ended 30 June 19	Year Ending 30 June 20
	ACTUAL	FORECAST
	\$000	\$000
Income		
Investment Income	1,257	916
	1,257	916
Expenses		
Net Claims Handling Expense	(5,358)	(1,439)
Additional Claims Provision	14,920	(1,065)
Reduction in (Additional) Claims Handling Expense Provision	(10,448)	3,550
Revaluation of Risk Margin	21,709	10
Amortisation of Discount on Outstanding Claims	(2,827)	(646)
Amortisation of Discount on Reinsurance	179	-
Total Cost of Claims	18,175	410
Corporate Expenses		
Depreciation ¹	-	(90)
Company administration	-	(2,084)
Total Corporate Expenses	-	(2,174)
Gain on Disposal of Fixed Assets	9	13
Total Expenses	18,184	(1,752)
Surplus/(Deficit) Before Tax	19,441	(836)
Taxation	-	-
Surplus/(Deficit) After Tax	19,441	(836)

¹ Depreciation has been treated as a claims handling expense in periods up to and including December 2019, and as a corporate expense in periods from January 2020 onwards.

**FORECAST STATEMENT
OF CHANGES IN EQUITY**

	Year Ended 30 June 19	Year Ending 30 June 20
	ACTUAL	FORECAST
	\$000	\$000
Opening Equity	(356,731)	(154,290)
Surplus / (Deficit) After Tax	19,441	(836)
Call on Uncalled Share Capital	183,000	65,000
Closing Equity	(154,290)	(90,126)

**FORECAST STATEMENT
OF FINANCIAL POSITION**

	As at 30 June 19	As at 30 June 20
	ACTUAL	FORECAST
	\$000	\$000
EQUITY		
Share Capital	1,223,939	1,288,939
Retained Earnings / (Losses)	(1,378,229)	(1,379,065)
TOTAL EQUITY	(154,290)	(90,126)
Represented By:		
ASSETS		
Cash & Cash Equivalents	51,097	27,277
EQC Debtor	2,623	-
Sundry Debtors	4,064	-
Fixed Assets	317	137
TOTAL ASSETS	58,101	27,414
LIABILITIES		
Sundry Creditors	3,662	2,936
Total Outstanding Claims	216,248	114,603
Less Reinsurance Recoveries	(7,519)	-
TOTAL LIABILITIES	212,391	117,539
NET ASSETS/(LIABILITIES)	(154,290)	(90,126)

**FORECAST STATEMENT
OF CASH FLOWS**

	Year Ended 30 June 19	Year Ending 30 June 20
	ACTUAL	FORECAST
	\$000	\$000
Cash Flows From Operations		
Investment Income Received	1,257	916
Operating Expenses Paid	(165,456)	(89,749)
Net Cash Flow From Operations	(164,330)	(88,833)
Cash Flows From Investing		
Sale of fixed assets	4	13
Purchase of fixed assets	(361)	-
Net Cash Flow From Investing	(357)	13
Cash Flows From Financing		
Proceeds from Uncalled Capital Facility	183,000	65,000
Net Cash Flow From Financing	183,000	65,000
NET CASH MOVEMENT	18,444	(23,820)
Opening Cash Balance	32,653	51,097
CLOSING CASH BALANCE	51,097	27,277

Reporting Entity

Southern Response 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 settle claims under AMI policies 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:

- An ultimate number of 8,721 properties with overcap claims will be managed by the Company. As at 31 October 2019, 8,550 have been reported to the Company.
- The Company outsourcing its claims handling processing to EQC as agent, effective from 31 December 2019. A small number of staff and contractors will continue to be engaged directly by the Company to provide administrative and support services, initially on fixed term contracts through to 31 August 2020, at which point demand for services will be re-assessed based on the remaining level of outstanding claims.

**NOTES TO THE
FORECAST FINANCIAL
STATEMENTS (continued)**

The forecast includes actual, unaudited results to 31 October 2019.

Income Statement

- Investment income is based on 2.0% yield on all funds.
- Claims handling expense reflects the cost of claim management services outsourced to EQC, along with any directly relevant costs of claims-related staff and contractors engaged directly by the Company.
- Other staff costs (e.g. management, reporting, and administration) along with legal & professional fees that are not directly claims related, are shown as Corporate administration costs.

Statement of Financial Position

- The Crown has provided Southern Response with 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 2019 assessed the risk margin, with at least 75% probability of sufficiency, at \$43 million, which at that point represents 24% 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, but not for corporate administration expenses.
- The Claims Liability does not include any provision arising from the finalisation exercise with EQC. It has been assumed that the finalisation exercise will not be complete by 30 June 2021.
- On 26 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. On 28 June 2019, the scope of the indemnity was amended to include any present or future legal proceeding or claim relating to a housing claim against the Company that is agreed as covered by both the Company and the Crown.
- No financial impact has been allowed for in the event of material precedent setting litigation outcomes from current or future legal actions.
- It is assumed that the Company will continue to receive new claims (albeit at a reduced rate) until July 2022.
- The total number of outstanding overcap claims as at 30 June 2020 is forecast to be 212.

**NOTES TO THE
FORECAST FINANCIAL
STATEMENTS (continued)**

Outsourced Claims Management

- At 31 December 2019, approximately 250 open claims are forecast to be in the business. The Company has outsourced its claims handling to EQC who will act as the Company's agent.
- EQC will invoice the Company on a monthly basis for staff costs relating to management of claims, and once a claim is settled for direct claim costs.
- Funding for payment of expenses will be met by drawing uncalled capital.

Cash Flow

- The uncalled capital is drawn quarterly as required to meet claims payments and operating expenses.
- The Uncalled Capital facility forecasts drawdowns totalling \$55 million in the year ending 30 June 2020.

Taxation

- Southern Response is a tax paying entity.
- The Company has incurred tax losses totalling \$1,125 million to 30 June 2019. The tax losses are available to offset assessable income arising in future years, however the tax benefit of the losses has not been recognised.

Going Concern

- The financial forecasts have been prepared using the going concern assumption.
- At 30 June 2019 Southern Response had a net asset deficit of \$154 million. 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:
 - The ultimate number of claims
 - Escalation in settling the remaining body of outstanding claims, including additional costs for settling disputed and litigated claims.
- The risk margin is subject to ongoing review by the Company's appointed Actuary 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).

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.

**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 have significant risk of causing material adjustment to the carrying amount of the assets and liabilities within the forecast financial statements.

**CRITICAL ACCOUNTING
ESTIMATES AND
ASSUMPTIONS
(continued)**

**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 IBNR.

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 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.