

30 October 2020

Mr Sebastian Roberts
General Manager | Transmission and Gas
Australian Energy Regulator

Sent via email

Dear Mr Roberts,

Insurance coverage pass through event – guidance note

Energy Networks Australia welcomes the opportunity to provide feedback on the Australian Energy Regulator's (AER) insurance coverage pass through event consultation paper.¹

Energy Networks Australia (ENA) is the national industry body representing Australia's electricity transmission and distribution and gas distribution networks. Our members provide more than 16 million electricity and gas connections to almost every home and business across Australia.

Key messages

- The insurance market has been tightening in recent years. It is expected with extreme climate conditions and more insurance losses, premiums may increase into the future and the access to some types of insurance could substantially reduce as some insurers exit the market.
- ENA welcomes the recent refinement of the AER's insurance pass through definition to allow for potential gaps in a network's insurance coverage that may occur if it is unable to find suitable providers to fill withdrawn capacity, or cannot commercially justify higher premiums.
- ENA welcomes the proposed development of a guidance note to provide stakeholders with upfront clarity on the key matters that the AER is likely to have regards to when assessing an insurance coverage event application.
- NSPs would welcome annual consultation with the AER, rather than RIN data collection, as a means to ensure a shared understanding of the ongoing insurance challenges NSPs are facing.

In addition, ENA welcomes continued engagement on the longer term cost effective availability of insurance and options for NSPs under the current

¹ Australian Energy Regulator, Consultation Paper: Guidance note on key matters the AER is likely to have regard to when assessing an insurance coverage event application, August 2020.

regulatory framework to ensure that it continues to be fit-for-purpose in changing insurance market conditions.

- **ENA does not support the use of benchmarking when assessing insurance cover due to the bespoke nature of insurance arrangements.** As highlighted in the AER's consultation paper, the decisions around how to manage the risks and costs of possibly catastrophic circumstances, and the prudent and efficient level of insurance cover, will vary materially between NSPs and will involve consideration of the context in which each individual NSP operates. **ENA therefore does not consider that insurance benchmarking will provide meaningful results.**

1 Network insurance market developments

In recent years, both the local and global insurance markets have experienced significant loss claims activity, driven by increasing natural catastrophe events. As a result, networks are reporting that as the access to some lines of insurance reduces and existing insurers charge material premium increases, access to insurance coverage is becoming increasingly difficult to obtain.

It is expected with extreme climate conditions and more insurance losses, premiums may further increase into the future and the access to some types of insurance could substantially reduce further as some insurers exit the market.

For networks, the risks and potential volatility of claims are more complex and usually of a larger scope than general insurance risks. For these reasons they are often underwritten by specialist insurers. A significant number of these insurers operate outside of Australia, with the majority in London, as there is not enough capacity to write the whole of their risks locally. Network service providers (NSPs) typically source insurance from a combination of London and Australian insurers, with some NSPs able to achieve some insurance sourced out of other markets due to their ownership structures.

1.1 Catastrophic events

The global insurance industry is seeing an increased number and value of catastrophe events, resulting in significant insurance claims and pay-outs. Consequently, many insurance providers are facing larger than expected financial losses. As an example, three of the top four largest insurance loss years have occurred within the past eight years, with 2017 recorded as the largest insurance loss year ever experienced, and 2018 the fourth largest loss year. This is driving substantial insurance market changes.

Specific to insurance for bushfire risk, recent major bushfires have occurred throughout the world in North America (with increased frequency in California), France, Germany, Australia, Greece, Indonesia, Italy, Poland and Russia. The consequences of these events include numbers of lives lost, thousands of buildings

destroyed, and billions of dollars in property damage and resources spent fighting the bushfires.

Renewed focus on liability risks has also occurred following multiple rounds of scheduled forced outages to reduce potential further fire risks to the community, affecting up to 2.7 million Californian customers of Pacific Gas and Electric.

With the current history of fires in multiple states every bushfire season and record high numbers of extreme heat days being experienced, there is an increasing focus on the risks presented by bushfires in Australia.

1.2 Market turmoil - pricing impacts and capacity changes

In general insurance markets, insurers typically measure various risk factors and potential claims against a premium payback period to derive pricing and decide whether to offer insurance.

Increased claims activity is pushing insurers to focus on more measurable and known risks. This is contributing to a more selective approach from insurers covering energy infrastructure assets on where they will provide capacity, how much capacity they will provide, and the cost of that capacity.

With at least eight specialist insurers either pulling out or drastically reducing capacity on bushfire risks within the last 12 months, and any new capacity offered being at much higher prices, it has become more difficult and costly to obtain the same level of insurance cover held by NSPs today. NSPs have been notified of the likely complete withdrawal of insurance lines in future years.

Beyond financial loss history, capacity withdrawal is also being influenced by insurer merger and acquisition activity, closures of previously operating insurance syndicates, changes in insurer appetite, and an increased focus by insurers on their capital deployment.

2 Regulatory framework

The regulatory framework offers a number of potentially complementary options to addressing network insurance, including step changes, and pass through arrangements.

Under the National Electricity Rules, a NSP may propose a nominated pass through event in its building block proposal for a forthcoming five-year regulatory control period. ENA broadly welcomes the recent refinement of the AER's insurance pass through definition to allow for potential gaps in a NSP's insurance coverage that may occur if it is unable to find suitable insurance providers to fill withdrawn capacity, or it cannot commercially justify higher premiums.

We note that this update, most recently in the AER's 2020-25 final decisions for SA Power Networks, Ergon Energy and Energex, will take time to be incorporated into the rounds of reset determinations for each NSP. We consider continued engagement with the AER on the longer term cost effective availability of insurance and options for NSPs, is appropriate to ensure that the regulatory framework continues to be fit-for-purpose in changing insurance market conditions.

ENA welcomes the proposed development of an AER guidance note to provide stakeholders with upfront clarity on the key matters that the AER is likely to have regard to when assessing an insurance coverage event cost pass through application.

Putting in place a comprehensive framework during the aftermath of any single low probability high impact event is likely to be more challenging, time constrained and costly to all parties than it being resolved upfront.

3 Assessment of an insurance CPT application

It is reasonable for customers to expect that NSPs will act in the customer's and communities' best interests by taking an efficient and prudent approach to risk allocation and costs. To do this, NSPs must be:

- » enabled to meet existing and any new jurisdictional obligations in a financially sustainable way,
- » supported to efficiently manage risk in their operational and investments decisions, based on their individual network characteristics,
- » able to provide an efficient risk allocation balance between current customers, future customers, and networks – which minimises expected costs to customers over the long-term, and
- » able to promote and encourage high levels of community confidence in the continuity of safe and reliable service provision in the event of catastrophic (low probability/high consequence) network events which result in financial and legal exposures.

As previously mentioned, ENA welcomes the development of a guidance note that clarifies aspects of the cost pass through arrangements. The AER has outlined the proposed list of material that it would expect to receive in order to assess whether the NSP has achieved an efficient allocation of risks.

3.1 Engagement

ENA is strongly supportive of the role of consumer engagement in network regulation, and NSPs recognise the need to engage with customers about how risks are appropriately managed, which can take place in the lead up to a network submitting its regulatory proposal.

ENA, however, does not consider that whether an NSP has undertaken meaningful insurance-specific engagement should be a determinative factor to consider in the

AER's assessment of a pass through application. As noted in Section 1, the insurance market for NSPs is highly complex, and is also subject to highly confidential and commercially sensitive information, which limits the ability of NSPs to undertake meaningful consumer engagement about appropriate levels of insurance, and the terms of such cover.

NSPs, however, do welcome annual insurance consultation with the AER, particularly during these current unusual market circumstances. It is recognised that the purpose is not for the AER to form an ex-ante assessment on the appropriateness of insurance coverage but rather ongoing meaningful and confidential engagement between individual NSPs and the regulator ensures a shared understanding of the ongoing insurance challenges NSPs are facing, and the internal processes that have been put in place by the NSP.

We expect that this will streamline a cost pass through application should an insurance event occur, and assist with continued engagement on the appropriateness of the regulatory framework in changing insurance market conditions. This collaborative engagement approach is considered strongly preferable to data collection via the AER's annual Regulatory Information Notice (RIN) processes. There are material differences between NSPs, outlined in Section 3.2 below, that will considerably reduce the usefulness of standardised data templates that do not allow for operating context.

3.2 Benchmarking

While ENA recognises that benchmarking is one of a number of tools used by an economic regulator, ENA does not consider that insurance can be effectively benchmarked.

As highlighted in the AER's consultation paper, both the insured and the insurers have to make complex decisions around how to calculate and manage the risks and costs of possibly catastrophic circumstances, and the prudent and efficient level of insurance cover to seek or offer. This will vary materially between NSPs and the insurers, and will involve consideration of the context in which each individual NSP operates, previous claims histories and the insurers' strategies, exposures and risk appetite. Material differences between NSPs include:

- » NSPs' operating environment, in particular the level of bushfire risks that each NSP faces,
- » Jurisdictional and regulatory requirements that each NSP is subject to,
- » The design, construction and operation of each network, and
- » NSPs' risk management approaches and ownership structure taking the above considerations into account.

As a result, each NSPs' insurance lines and coverage are bespoke individually negotiated packages that are obtained in different market circumstances, at different

times and subject to highly confidential and commercially sensitive information. These factors render attempts at benchmarking largely futile.

While information shared widely with stakeholders and other businesses is problematic, individual networks should be able to provide transparency on these risk trade-offs for the regulator on a one-on-one basis. Furthermore, information provision is a conversation that should include insurers and insurance brokers.

ENA reiterates our support for the development of the proposed guidance note. It is important the regulatory framework continues to be fit-for-purpose in changing insurance market conditions and we welcome ongoing engagement with the AER on addressing this challenge. If you would like to discuss this submission in further detail, please contact Lucy Moon, Head of Regulation, at lmooon@energynetworks.com.au.

Yours sincerely,



Andrew Dillon
Chief Executive Officer