Appendix 2.3: Insurance premium step change

Regulatory proposal for the ACT electricity distribution network 2024–29

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Glossary

AER	Australia Energy Regulator
CAM	Cost Allocation Methodology
ESA	ACT Emergency Services Agency
ISR	Industrial Special Risks
Marsh	Marsh Pty Ltd
Opex	Operating expenditure
RBA	Reserve Bank of Australia

1 Executive summary

1.1 The need for increased insurance expenditure

Since 2019, the global insurance market has experienced significant volatility, driven by the increased frequency and severity of natural disasters, pandemics, cyber threats, litigation losses and general macroeconomic conditions. Consequently, insurers have reviewed their risk appetite, withdrawn available market capacity and reduced coverage while seeking to recover current and anticipated losses. These structural changes to insurance markets have resulted in material upward pressure on premiums.

Over the same timeframe, Evoenergy has deployed several insurance strategies that have resulted in capacity reductions, retention increases, condition reviews, and introduced alternative products into the general insurance portfolio. These measures are prudent and efficient ways to partially offset the full extent of premium cost increases while balancing the risks associated with reduced insurance and increased self-insurance within the context of Evoenergy's risk management framework.

Based on current market factors and advice from Marsh Pty Ltd (Marsh), Evoenergy's insurance broker, premiums are forecast to continue increasing over the next regulatory period, which is expected to be above the calculated base opex amount and rate of change. The insurance premium market has also shifted considerably between our base year and the adjusted base used to forecast opex.

This business case evaluates three options for insurance coverage for the 2024–29 regulatory period. To ensure Evoenergy continues to procure insurance in a prudent and efficient manner, a financial assessment of the premium costs versus policy terms has been performed across the following investment options:

- **Option 1 – Maintain the current level of coverage** – Maintain existing insurance coverage levels subject to the coverage available from the market. This option results in an increase in self-insurance as the market no longer offers the coverage levels it had provided previously. [redacted]
- **Option 2 – Procure prudent and efficient insurance coverage** – Seek efficient insurance products that balance the cost of insurance premiums with market conditions and the level of self-insurance exposure in alignment with Evoenergy's risk management framework.
- **Option 3 – Maintain insurance levels at current cost** – Maintain the current insurance cost through further reduction in capacity, retention levels, ventilation, increased self-insurance, and other premium-reducing levers. This option would increase Evoenergy's self-insurance exposure and, therefore, the level of financial risk adopted by Evoenergy.

Details of insurance market conditions and forecasts are included in a specialised report provided from Evoenergy's insurance broker, Marsh, in Appendix 2.4.

1.2 Recommended option

Option 2 is the recommended option based on a financial assessment of the costs and risks associated with all three options. Option 2 received the greatest support through Evoenergy's community consultation (84 per cent support from our community panel) and represents the advice of our insurance broker as a balance between absorbing a prudent amount of risk while protecting our consumers through appropriate levels of financial risk transference provided by insurance policies.

[redacted]

[redacted]

Table 1 Cost summary for all options, adjusted for network scale ($ million, 2023/24)

[redacted]

1.3 Proposed opex step change

Table 2 outlines the forecast insurance premium opex for the 2024–2029 regulatory period.

Table 2 Insurance premium opex step change ($ million, 2023/24)

	2024/25	2025/26	2026/27	2027/28	2028/29	EN24 Total
Insurance premium step change	0.65	0.86	1.03	1.17	1.28	**4.99**

The additional opex costs for insurance reflect global conditions in the insurance market. These include the impact of climate change, resulting in increases in severity and frequency of bushfires, weather, and natural disaster events; pandemics and the ongoing implications from COVID-19, the increasing frequency of cyber threats and malicious events; and record litigation losses, particularly class actions.

The Global Risks Report, produced by the World Economic Forum in January 2023, documents the top 10 Global Risks ranked by severity across two-time scales, a short-term (two-year) outlook, and a long-term (ten-year) outlook. Across the short-term and long-term scales, natural disasters and extreme weather events are ranked number two and three, respectively. Failure to mitigate climate is ranked number four and one, respectively, and widespread cybercrime insecurity is ranked number eight across both scales.[1] This outlook and the severity of the rankings demonstrate that the current structural changes experienced by global insurance markets are likely to continue to negatively impact insurance market conditions over the next ten-year period. Sustained losses and increased

[1] World Economic Forum (WEF), *The Global Risks Report 2023 18th Edition*, accessed from https://www.weforum.org/reports/global-risks-report-2023

exposures to these risk events will further tighten global insurance markets, and increased insurance costs are likely to be unavoidable in the future.

Marsh, our current insurance broker, understands Evoenergy's current risks and has been engaged to best predict how those market factors will impact insurance premiums for the forthcoming regulatory period. We have based our opex step change upon Marsh's advice.

2 Insurance overview

2.1 Procuring prudent and efficient insurance coverage

In 2022, the ActewAGL Joint Venture[2] engaged Marsh to provide a forecast of insurance premiums for the 2024–2029 regulatory period across the ActewAGL Joint Venture. Evoenergy procures insurance at prudent and efficient levels to manage the financial consequences of business risk events such as bushfires, liabilities, professional indemnity, asset losses, and other exposure to meet our obligations and community expectations.

Evoenergy procures a range of insurance policies, including:

- Property insurance, including Industrial Special Risks (ISR) to cover major insurable assets
- Combined General liability insurance, including General and Products Liability, Bushfire Liability, Failure to Supply Liability, Public Liability and Professional Indemnity
- Directors and Officers liability insurance
- Cyber insurance
- Ancillary insurance products, including Motor Vehicle, Corporate Travel, Voluntary Workers, Employment Practices Liability, Statutory Liability and Crime.

All insurance policies are procured to cover all members of the ActewAGL Joint Venture, as this scale allows us to pool the risks and costs associated with insurance, thus obtaining significant value for Evoenergy customers. Insurance premium costs are allocated to Evoenergy based on the 2018 Cost Allocation Methodology (CAM), approved by the Australian Energy Regulator (AER). All Evoenergy values shown in this business case reflect the application of the CAM.

Evoenergy's insurance premium step change excludes costs associated with the growth in the scale of the network. For example, many variables, including global climate events and the size of our insurable asset base influence the cost of the ISR policy. To ensure that we do not double-count costs in the step change with the opex trend, ISR costs associated with our asset base were frozen. This means that factors outside of our control, such as climate disasters are captured in the step change, but increased costs associated with output growth reflected in the rate of change are not double counted.

[2] ActewAGL provides corporate services to Evoenergy, explained in *Evoenergy's Expenditure Forecasting methodology 2024–2029* and the *ActweAGL Distribution (Evoenergy) Cost Allocation Method*.

2.2 The current insurance market is tightening with premiums increasing

As outlined in the attached Marsh report (Appendix 2.4), the insurance market is currently in the 'Hard Market' section of the insurance market cycle, characterised by increasing premiums, selective underwriting, and shrinking capacity.[3]

The market cycle and cost of insurance is influenced by several key factors, including:

- The size of premium pool
- Claims paid and/or provisioned
- Major loss events
- The cost of reinsurance
- Investment returns and flow of additional funds into the sector from the Insurance-Linked-Securities

Insurance premiums are also impacted by global events and economic conditions. In early 2020, major weather and natural disasters, including bushfires, floods, and hailstorms, caused widespread property damage and business interruption losses which negatively affected insurers' profitability. In summarising the current insurance market conditions, Marsh estimates that over $500 million in capacity has exited the bushfire liability sector since the beginning of 2019.[4]

Economic conditions impact the cost of insurance premiums passed through to the energy sector, as the Reserve Bank of Australia (RBA) noted that:[5]

> *"General insurers have experienced an increase in both the cost and frequency of claims. Higher inflation and labour shortages have increased the cost of claims that are paid, particularly for building repairs. At the same time, the number of insurance claims have increased following several natural disasters along the east coast of Australia. Insurers use reinsurance to mitigate the impact of rising claims on profits, along with increasing premiums."*

Another key driver influencing insurance premiums is the recent COVID-19 Australian business interruption insurance test case. The NSW Court of Appeal rejected insurers' argument that policies do not cover COVID-19 losses, which has further added to the stress of the market.[6]

The frequency of cyber threats and malicious events has also increased globally and specifically accelerated in the Asia Pacific region over the last two years, including the recent incidents in Australia which have impacted the telecommunications, health, and other critical service industries.[7] As a result of higher malicious cyber-attacks, there is extremely limited availability for cyber insurance in the current market and, therefore, significantly higher premium costs.

[3] Marsh Premium Projections and Insurance Market Update Evoenergy Distribution Network, Australian Energy Regulator Report 2024-2029, page 20.
[4] Marsh, *Appendix 2.4 Premium Projections and Insurance Market Update Evoenergy Distribution Network, Australian Energy Regulator Report 2024-2029*, page 32
[5] RBA, Financial Stability Review, October 2022, p. 53
[6] HDI Global Specialty SE v Wonkana No. 3 Pty Ltd [2020] NSWCA 296
[7] Australian Cyber Security Centre Alerts and advisories (https://www.cyber.gov.au/acsc/view-all-content/alerts&advisories)

2.3 Driving improved value in insurance

Evoenergy seeks to drive increased value for customers through the procurement of insurance. Evoenergy market tests our insurance brokerage regularly. In 2019, Evoenergy undertook a Request for Quotation for market brokerage, which resulted in Marsh being selected as the successful tenderer. We now have an agreement with Marsh with key performance measures assessed at regular intervals.

Evoenergy, supported by Marsh, regularly reviews its insurance requirements against the organisational and external environment. Policy limits, sub-limits, deductibles, and uninsured risks are reviewed annually and may change based on risk profile, market capacity, and pricing. Products are procured using a risk-based approach to ensure products are in line with the risk profile of Evoenergy. The ActewAGL Joint Venture Board Safety & Risk Committee is consulted on all insurance products prior to procuring new policies. All insurance claims are managed in accordance with the delegation of authority.

To control rising insurance costs, Evoenergy procured less bushfire liability capacity in 2022/23.

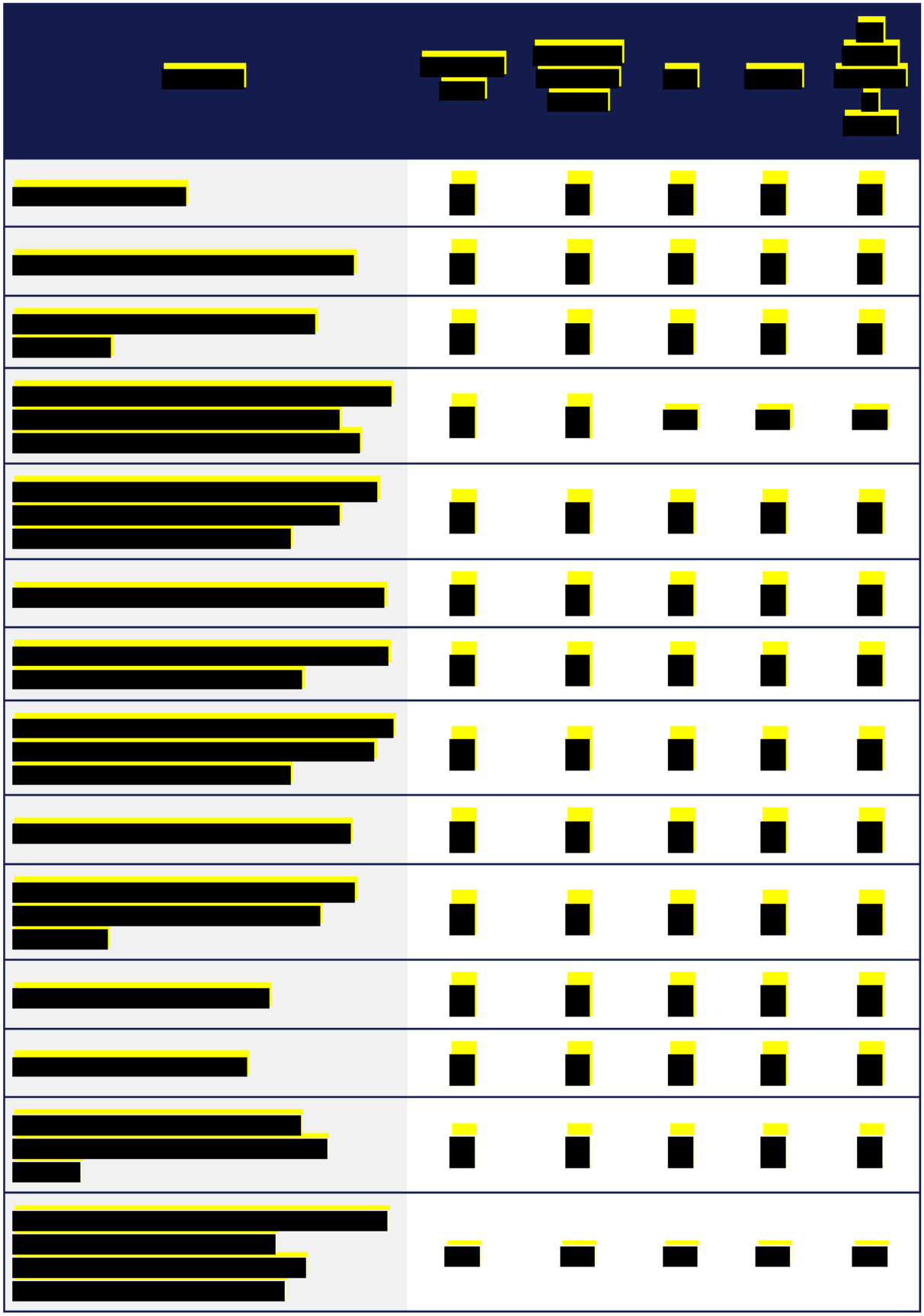
Evoenergy also uses various measures to mitigate the impact of extreme events or natural disasters. The Evoenergy Bushfire Management Strategy was developed to minimise the risk of a bushfire starting from Evoenergy's network infrastructure or activities to prevent impacts to life, property, and the environment.

Vegetation management is an integral part of Evoenergy operations, promoting the safety and reliability of network assets. Vegetation management plans are used to manage bushfire risk and comply with legislative requirements, detailed in Appendix 2.3.B.

In addition to these plans, procedures and maintenance schedules are used to manage and lower the impact of any bushfire event, including Asset Maintenance and inspection plans, the Risk Management Framework, Cyber Strategy and Business Continuity Plans.

After the 2003 bushfires, the ACT Government created bushfire abatement zones to provide added protection between rural and urban zones. The ACT Government is ultimately responsible for maintaining the abatement zones.

Table 3 Evoenergy strategies to manage insurance premium increases



3 Step change forecast

3.1 Reviewing options for insurance

Evoenergy engaged Marsh to consider three different options for its insurance coverage:

- **Option 1 – Maintain current coverage level** – Maintain existing insurance coverage levels subject to the coverage available from the market. This option results in an increase in self-insurance as the market no longer offers the coverage levels it had provided previously. [redacted]
- **Option 2 – Procure prudent and efficient insurance coverage** – Seek efficient insurance products from the global insurance market through our insurance broker. This option was based on a high level financial and risk assessment between the costs of increased insurance coverage and the risks associated with increasing deductibles.
- **Option 3 – Maintain insurance at current cost** – Maintain current insurance costs through reduction in capacity, retention levels, ventilation, self-insurance, and other levers.

Option 2 is the recommended balanced option based on a financial assessment of the costs and risks of all three options. Option 2 received the greatest support through Evoenergy's community consultation (84 per cent support) and represented the advice of our insurance broker as the balance between absorbing a prudent amount of risk through deductibles while protecting our customers through appropriate levels of coverage. Detailed analysis is outlined in Appendix 2.3.A.

3.2 Proposed 2024–29 insurance premiums for Option 2

In 2022, Marsh provided a forecast of insurance premiums for the 2024–29 regulatory period, outlined in Figure 1 below, with a 2021/22 base year. This forecast reflects Option 2.

Figure 1 Evoenergy's insurance premium between 2021/22 and 2028/29 ($ million, 2023/24)

[redacted]

In developing the 2024–2029 forecasts, Marsh also identified key factors influencing the premiums for the various insurance classes. These are outlined in Table 4. Further information about these factors can be found in Appendix 2.4.

Table 4 Factors influencing premiums during the 2024–2029 regulatory period

Insurance policy	Key factors that impact insurance costs
Property/Industrial Special Risks	• Global climate/natural catastrophe events • Inflation and interest rates • Type, condition, and maintenance of assets
General liability and professional indemnity	• Bushfires • Reduced market capacity due to consolidation of insurers • COVID-19 • Non fire related casualty losses
Directors and Officers liability	• Legal fees, which may differ between jurisdictions • Class actions • COVID-19
Employment practices / Statutory liability	• Defence costs • Frequency of claims • Available market capacity
Motor vehicle	• Natural catastrophe events such as hailstorms • Market risk appetite • Reinstatement/repair costs
Corporate travel and voluntary workers	• COVID-19 • Global claims frequency
Crime	• Market capacity limited due to large insurer retraction
Cyber	• Global increase in malicious cyber-attacks • International events and conflict, such as between Russia and Ukraine

3.3 Base year

[redacted] An uplift in insurance cost is expected for each year of the 2024–2029 regulatory period and, as such, requires an opex step change in costs.

3.4 Calculation of step change

The insurance premiums included in our step change reflect our business' prudent and efficient opex. The step change is derived on a basis consistent with the AER's preferred base-step-trend approach, Expenditure Forecast Assessment Guideline, Better Reset Handbook, and in accordance with the AER approved CAM.

Costs are not double counted in the opex forecast as aspects of insurance premiums associated with network scale have been held constant, and factors outside of our control only influence costs. Table 5 shows that many drivers of each insurance policy are not within our control. To avoid misrepresenting how premiums are derived in markets while ensuring that scale factors are not double counted, Evoenergy has isolated network growth factors in our step change forecast, holding constant growth in motor vehicle fleet, the insured asset base, and revenue projections. This approach ensures that there is no overlap or double counting of costs between the trend component of the opex forecast and the insurance premium step change. Specifically, we have isolated scale factors for each relevant insurance policy in deriving the step change to ensure costs are not double counted. The step change also captures incremental costs not included in the opex base year and which only relate to factors outside of Evoenergy's control.

The insurance premium step change is calculated as the difference in costs between the base year and the relevant year in the 2024–2029 regulatory period to ensure that changes in market conditions from 2021/22 are captured in the step change. The AER's adjustment for the estimated change in opex between the base year and final year from which opex is trended does not capture changed insurance market conditions from 2021/22.

We have also supported our step change with independent expert advice from our insurance broker (Appendix 2.3.B). Our proposed insurance premium step change costs are shown in Table 5.

Table 5 Insurance premium step change ($ million, 2023/24)

	2024/25	2025/26	2026/27	2027/28	2028/29	Total
Insurance premium opex step change	0.65	0.86	1.03	1.17	1.28	**4.99**

In response to the changing circumstances of the insurance market conditions, Evoenergy has considered several ways to manage insurance premium increases (demonstrated in Table 3). However, additional insurance costs are required above the calculated base opex amount and rate of change to ensure that Evoenergy can continue to meet its operating requirements. Global insurance events are driving these increases and include a range of factors, including climate change resulting in increases in bushfires, weather and natural disaster events, pandemics and the ongoing implications from COVID-19, the increasing frequency of cyber threats and malicious events and record litigation losses, particularly class actions.

The Global Risks Report, produced by the World Economic Forum in January 2023, outlines the top risks in insurance markets. The top risks relate to natural disasters and extreme weather events,

[redacted]

failure to mitigate climate, widespread cybercrime insecurity. The risk outlook and the severity of the rankings show that the structural changes that have occurred in the global insurance markets will continue to negatively impact conditions and the cost of premiums over the next ten-year period.

Appendix 2.3.A – Options framework

2.3.A.1 Options framework

To manage rising insurance premiums, Evoenergy has considered three options for investment to optimise value for money. Evoenergy's objective is to obtain prudent and efficient insurance coverage at the lowest cost in accordance with our obligations, risk management framework, and community expectations. When assessing the options, we held a community panel meeting in mid-2022 to test consumer support for each option and understand participant reasons for supporting a chosen option.

Option 1 – Maintain current level of available cover

- The strategy for Option 1 is to maintain the existing insurance level of cover regardless of market forces, reflecting a likely increase in premium costs. With the changing conditions of insurance market, the financial value of maximum available cover is lower than value in the past. This means that Evoenergy must increase its level of self-insurance to maintain the current level of cover leading to higher overall costs.

- Option 1 reflects the 'doing more' scenario presented to the community panel, which was supported by 8 per cent of participants. The 'doing more' option involves additional work to procure the same coverage levels as many insurers have reduced capacity or exited the market due to significant losses in the context of climate disasters and higher costs in a tight economic environment.

- Option 1 is not considered prudent or efficient as it is not beneficial to maintain existing levels of cover without considering other influencing factors, including market forces and business requirements.

- This option is the most expensive of the three options but will result in the broadest insurance coverage and does not consider the commerciality of the insurance on offer. This option would not be prudent and efficient in the current hard insurance market, which requires a value-for-money assessment of the insurance on offer against the self-insurance risk and exposures consistent with Evoenergy's Statement on Risk and Opportunity and risk management framework.

Option 2 – Procure prudent and efficient insurance coverage

- The strategy for Option 2 is to 'Do proposed' by annually seeking efficient insurance products from the global insurance market through our insurance broker. Our brokers negotiate with insurers worldwide on our behalf and identify the best coverage, policy terms, and insurers available. This process ensures we receive the most competitive pricing from the global insurance market.

- Coverage limits, deductibles, and sub limits are continually reviewed to ensure we source appropriate policy limits for our business. Financial analysis is conducted on all our policies to ensure value for money is achieved, and the policy provides the required coverage.

- Option 2 was supported by 84 per cent of participants at the community panel sessions.
- This option is the most prudent and efficient option for procuring insurance and balances the benefits of risk transference provided by insurance policies with the self-insurance risk and exposure against Evoenergy's Statement on Risk and Opportunity, consistent with our risk management framework.

Option 3 – Reduce insurance coverage and maintain insurance at current cost

- The strategy for Option 3 is 'Do more' by maintaining existing insurance costs through reduction in capacity, retention levels, ventilation, self-insurance or by any of the levers. This approach requires a reduction in the insurance levels of cover year on year.
- Option 3 was supported by 8 per cent of participants at the community panel sessions.[9]
- This option is not considered prudent or efficient as it would place a higher level of financial risk exposure onto the business over time and would not align with the Evoenergy's Statement on Risk and Opportunity and our approved risk management framework.

2.3.A.2 Recommended option

Evoenergy recommends Option 2 – Procure prudent and efficient insurance coverage as the best option available. Option 2 strikes the balance between cost and risks associated with self-insurance, the insurance premium, and the benefit and value offered by these. Based on maintaining a balanced risk profile, Option 2 obtained the highest level of community support from Evoenergy's Community Panel session in 2022. This option is consistent with the existing insurance strategy and has been approved by the ActewAGL Joint Venture Board Safety & Risk Committee.

Compared to Option 1, Option 2 provides a more cost-effective option as it provides the best value-for-money in response to an acceptable level of self-insurance associated with Evoenergy's operating requirements and the current insurance market conditions. Option 1 is not considered the most prudent and efficient approach due to significantly higher costs.

Although Option 3 provides the lowest cost option, it offers an unacceptable level of financial risk exposure for Evoenergy. Option 3 is also overly reliant on self-insurance, and this may not be sustainable in the future and would require an additional level of opex expenditure to engage the required expertise to manage the ongoing increase in financial risk exposure.

[9] Community Panel member votes may not add to 100 per cent due to rounding (as there were 13 participants).

Appendix 2.3.B - Legislative requirements and consumer expectations

In reviewing Evoenergy's insurance coverage for the 2024–2020 regulatory period, we have ensured alignment with the legislative requirements and consumer expectations of the ACT.

The 2003 Canberra bushfires had a profound impact on the ACT and Canberrans that led to a fundamental shift in bushfire management, including the passage of the *Emergencies Act 2004*, and the creation of the ACT Emergency Services Agency (ESA), Australia's first unified emergency agency.[10] The Strategic Bushfire Management Plan sets out how bushfire risk is managed in the ACT and is a requirement of the *Emergencies Act 2004*.[11]

Evoenergy's Bushfire Management Strategy aligns with the requirements of the *Emergencies Act 2004*, whereby the ESA provides the guidance and requirements for utilities operating within the ACT to manage bushfire related risks from their operations and infrastructure through the Strategic Bushfire Management Plan.

Evoenergy's responsibilities under the ESA ACT Strategic Bushfire Management Plan and the Utilities Technical Regulator Vegetation Code is to prioritise the management of bushfire related risks for all assets and operations within the Bushfire Abatement Zone.

There are several legal obligations relating to the requirements to manage bushfire related risks and references to key documents and programs within Evoenergy related to meeting those obligations. These primary legal and code obligations include:

- *ACT Emergencies Act 2004* - Strategic Bushfire Management Plan – Emergency planning zones
- *ACT Utilities (Technical Regulation) Act 2014* - Utilities (Technical Regulation) Electricity Powerline Vegetation Management Code
- ACT Nature Conservation Act 2014
- ACT Public Safety Regulations 2001 (Clearances from electricity network assets)
- Electricity Supply (Safety and Network Management) Regulation 2014
- NSW ISSC3 Guide for the Management of Vegetation in the Vicinity of Electricity Assets.[12]

[10] Strategic Bushfire Management Plan 2019-2024
[11] Strategic Bushfire Management Plan 2019-2024
[12] Evoenergy Bushfire Management Strategy