Southern Response Earthquake Services Limited

(Formerly AMI Insurance Limited)

Statement of Performance Expectations

For the period from 1 July 2017 to 30 June 2018

Introduction

This Statement of Performance Expectations (SPE) has been prepared by the Board of Southern Response Earthquake Services Ltd ("Southern Response" or the "Company") (formerly AMI Insurance Ltd) in accordance with Part 4 of the Crown Entities Act 2004.

It sets out:

- The Statement of Service Performance which details classes of outputs forecast to be supplied by the Company in pursuit of its strategic objectives and for each class of output the standards of delivery performance for the period from 1 July 2017 to 30 June 2018.
- The prospective financial statements for the period 1 July 2017 to 30 June 2018 and the subsequent one year.

Statement of Responsibility

Southern Response is responsible for the Statement of Service Performance and the prospective financial statements and contained in this document, including the appropriateness of the assumptions underlying them. Southern Response is also responsible for internal control systems, which provide reasonable assurance as to the integrity and reliability of financial reporting.

Ross G Butler
Chairman

Anne J Urlwin
Deputy Chairman

29 June 2017

Prospective Statement of Service Performance 2017-18

Strategic Objective	**Key Initiatives**	**2017-18 proposed targets**
1. To operate a claims management business that: ▪ Settles customers claims in accordance with policy obligations and in a fair and consistent manner ▪ Adopts efficient and cost effective processes in the management of those claims ▪ Is focused on settlement of all remaining claims ▪ Works actively to resolve and reduce disputes with customers in a manner that delivers outcomes consistent with policy obligations, communicating openly and effectively with customers	▪ Continue to promote face-to-face negotiation with customers yet to settle with Southern Response and utilise third party independent resolution services to resolve differences between the company and policyholders. ▪ Continue to operate a dispute resolution system that is equitable and responsive to all customers while observing customers' entitlements from their AMI policy, recognising that the proportion of litigated and disputed claims will increase as a proportion of outstanding claims, and managing stakeholder expectations accordingly. ▪ Ensure the proposed class action, other litigated claims and legal risks generally, are appropriately managed and the implications of any judicial decisions are understood.	▪ *95% claims notified by 30 June 2017 settled by 30 June 2018* ▪ *Customer satisfaction maintained year-on-year as measured by customer survey results* ▪ *Formal disputes below 10% of all claims*
2. To proactively engage with EQC on its unresolved AMI policyholder claims.	▪ Share resources where appropriate to expedite the identification of potential over-cap claims and their hand over to Southern Response. ▪ Manage the settlement of remaining claims in an expeditious manner and in the best interest of the customer. Collaborate with EQC on both internal and external communications around claim handovers to mitigate public misinformation and ensure aligned understanding of any new processes for staff and customers.	▪ *95% of EQC claims by AMI policy holders as at 30 June 2017 identified and in the settlement process by 30 September 2017.*

Strategic Objective	Key Initiatives	2017-18 proposed targets
3. To manage the remaining claims in the building/repair programme to optimise quality and timely delivery while protecting the health and safety of workers in accordance with legislative responsibilities.	▪ Continue to monitor all build and professional services arrangements (repair, rebuild and shared property) through quantitative and qualitative metrics. ▪ Continue to monitor quality management of builds and repairs in the project and the health and safety of all involved in accordance with legislative responsibilities, while optimising timeliness.	▪ *An average of 80% per month of Practical Completion (PC) defects cleared within 90 days of notification* ▪ *A minimum score of 85% critical risks assessed as being adequately managed by contractors.*
4. To develop options for an orderly rundown of the Company in a manner that retains quality operations, adequate provisions for residual obligations and liabilities, and utilises opportunities to rationalise functions while maintaining a caring approach for employees and having reasonable pay and employment conditions.	▪ Firm up plans for the wind-down of Southern Response in its current form, towards the projected full run out date of December 2018[1], however with sufficient elasticity to recognise the inherent uncertainties which will continue to impact the company's operations[2]. ▪ Determine appropriate retention strategies for data and systems in use across the rebuild programme. ▪ Identify any intangible assets (including intellectual property) which might appropriately be transferred to other Crown entities prior to the eventual wind down of the company.	▪ *Annualised voluntary staff turnover rate below 25%* ▪ *Full systems (financial and administrative) closure of all settled claims to date.* ▪ *Agreement in place with the Crown and ready to operationalise as to the future shape of Southern Response operations.*
5. To manage its business and associated risks consistent with minimising the net cost to the Crown associated with running off of the existing claims portfolio, and operate the business within operational budgets	▪ Achieve cost and operational efficiencies by progressively integrating resources to achieve economies of scale, thereby ensuring an efficient claims management cost structure. ▪ Maintain of controls and scrutiny in place to manage the cost of Arrow International and other key suppliers, ensuring compliance with contractual obligations and effective operation of the risk management framework that balances risk with progress.	▪ *Build cost inflation less than the movement in Statistics NZ Canterbury CPI (Housing) index* ▪ *Audit rating of at least "good"* ▪ *Operational expenses within annual budget*

[1] Recognising there will be a small tail of claims, the majority of which will be in litigation, unresolved at that date.

[2] Such as uncertainty regarding ultimate overcap claims numbers, the timing and impact of the proposed class action and other potential litigation, and uncertainty about customer decision-making timelines.

Strategic Objective	Key Initiatives	2017-18 proposed targets
6. To regularly review the adequacy of its own resources and those available to the company through the Crown support agreements at an appropriate confidence level and manage resources consistent with the business run off model. To manage its liquidity in accordance with the investment management policy directed by the Crown for the time being including reporting of actual and projected shortfalls in a timely manner as provided for under the Crown support arrangements	▪ 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.	▪ *Shortfall forecasts submitted to the Treasury within the agreed timetable*
7. To maintain effective relationships with third parties.	▪ Maintain effective strategic and operational interaction with EQC, insurers, reinsurers and key community groups. ▪ Continue to use all opportunities to present key stakeholders and interested sections of the public generally with a transparent measure of its progress and issues in the way of that progress.	▪ *All OIA and Privacy Act requests responded to within statutory timeframes*

Forecast Financial Statements

Statement of Assumptions

Timelines
The forecast is based in the following claim processing milestones:

Item	Date
Forecast total number of overcap properties is 8,829, forecast rebuilds/repairs are 2,704	
Build programme close off date, customers wishing to enter the Southern Response build programme must have signed a build contract by this date	30 June 2017
Assessment of residual claims and distribution of assessments (target within 4 months of claims lodgement)	30 September 2017
Completion of build programme	30 June 2018
Administration/cash settlement of claims	To November 2018
Operational model sees Southern Response rundown as residual issues are cleared.	To December 2018
Claim closing/EQC reconciliation	To December 2018

Income Statement

- Investment income is based on 2.5% yield on all funds.
- Staff numbers reflect the immediate claims management workload to transition customers to cash settlements or build queues and through to completion recognising increasing input in areas such as repairs, and claims closure.

Balance Sheet

- The Crown has provided Southern Response with three tranches of Crown funding totalling $1,250 million under the Crown Support Deed and its subsequent amendments:
- A $500 million convertible preference share facility entered into in April 2011 which was fully drawn by June 2016
- A $500 million uncalled capital facility entered into in January 2013
- A $250 million extension to the uncalled capital facility entered into in October 2016
- A further $230 million of uncalled capital sought in April 2017 and confirmed in June 2017
- The majority of the capital expenditure relates to ICT costs.
- Investment funds are classified as cash and cash equivalents

Claims Liability and Reinsurance Receivable

- The Actuarial valuation at 31 March 2017 assessed the risk margin, with a 75% probability of sufficiency, at $95 million, being 14% of the outstanding Gross 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 provision is discounted to reflect the payment profile. This discount amounted to $12.9 million at 31 March 2017 and is amortised (debited) 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.
- Reinsurance Recoveries are discounted to reflect the forecast receipt profile. This discount amounted to $0.7m at 31 March 2017 and is amortised (debited) to the profit and loss account as recoveries are received.

Cash Flow

- The uncalled capital is drawn as required to meet claims payments and operating expenses. The Crown Support Deed stipulates a maximum $25 million buffer over projected quarterly cash requirements when requesting drawdowns.
- The Uncalled Capital facility forecasts drawdowns total $315m in the year ended 30 June 2017, $478m in the year ended 30 June 2018 and $142m in the year ended 30 June 2019.

Taxation

- Southern Response is a tax paying entity.
- Tax losses of some $849 million arising in the 2011 financial year and in the 2012 financial year prior 5 April 2012, when the Crown converted its preference shares to ordinary shares and assumed control of the company, were lost due to a breach of shareholding continuity rules.
- Further tax losses of approximately $843m arose in the 2012-2016 years post change in control and are available to offset assessable income arising in future years.

Going Concern

- The financial forecasts have been prepared using the going concern assumption.
- At 30 June 2012 the Company had a net asset deficit of $47million as a result of increases in the estimated level of claim liabilities which included a risk margin of $244 million. In addition cash flow forecasts prepared by the Company indicated that the assets of the Company might not have been sufficient to meet the claim payment obligations particularly if the full risk margin was required to settle claims.
- Consequently, the Crown subscribed to a further $500 million of uncalled capital to ensure the Company had sufficient cash and capital to meet the payment of claim obligations as they fall due. Cabinet approved the funding arrangement in principle on 24 October 2012 and an amended Crown Support Deed and Subscription Agreement were entered into on 30 January 2013. This funding arrangement is in addition to the Crown Support Deed and Subscription Agreement entered into on 5 April 2012.
- On 28 June 2016, following further increases in the estimated value of claims liabilities, the Crown agreed to subscribe to an additional $250 million of uncalled capital to ensure that Southern Response had sufficient resources available to meet its claims payment obligations. The capital was subscribed to in October 2016.
- At 31 March 2017 Southern Response has a net asset deficit of $703 million as a result of further increases in the estimated level of claim liabilities.
- A further $230 million of capital was requested from the Crown in April 2017 and was confirmed in June 2017.
- On the basis of the above the Directors concluded that it is appropriate to prepare the forecasts for the years ended 30 June 2017, 30 June 2018 and 30 June 2019 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 14% (increased from 10% from 31 March 2016), 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.

Forecast Financial Statements

Forecast Statement of Comprehensive Income	Year ending 30 June 2017 $000	Year ending 30 June 2018 $000	Year ending 30 June 2019 $000
Net Claims Incurred - Earthquake	(362,441)	(9,425)	(3,679)
Operating Costs	-	-	-
Net Claims Cost	**(362,441)**	**(9,425)**	**(3,679)**
Investment Income	6,597	1,925	957
Net Surplus/(Deficit) before Taxation	**(355,844)**	**(7,500)**	**(2,722)**
Less Taxation Benefit/(Expense)	-	-	-
Net Surplus/(Deficit) after Taxation	**(355,844)**	**(7,500)**	**(2,722)**

Forecast Statement of Financial Position	30 June 2017 $000	30 June 2018 $000	30 June 2019 $000
Shareholders' Equity			
Ordinary Shares	835,939	1,313,939	1,455,939
Opening Retained Surplus/(Deficit)	(1,089,787)	(1,445,632)	(1,453,132)
Transfer to Crown	-	-	(86)
Surplus /(Deficit)	(355,845)	(7,500)	(2,721)
Closing Retained Surplus/Deficit	(1,445,632)	(1,453,132)	(1,455,939)
Total Shareholders' (Deficit)/Equity	**(609,693)**	**(139,193)**	**0**
Represented by:			
Assets			
Financial Assets			
Cash and Cash Equivalents	30,168	30,636	-
Reinsurance Receivables	16,950	5,460	-
Other Receivables	7,049	3,525	-
Property, Plant and Equipment	554	289	-
Total Assets	**54,721**	**39,910**	**-**
Less:			
Liabilities			
Trade and Other Payables	4,305	3,524	-
Outstanding Claims	660,109	175,579	-
Total Liabilities	**664,414**	**179,103**	**-**
Net Assets	**(609,693)**	**(139,193)**	**-**

Forecast Statement of Cash Flows	Year ending 30 June 2017 $000	Year ending 30 June 2018 $000	Year ending 30 June 2019 $000
Cash Flows from Operating Activities			
Investment Income	2,787	2,340	1,129
Claim Costs - Earthquake	(508,665)	(477,597)	(170,551)
Reinsurance Recoveries	24,413	11,867	5,608
Payments to Suppliers and Employees	(17,772)	(13,746)	(8,737)
Net Cash Inflow from Operating Activities	**(499,238)**	**(477,136)**	**(172,551)**
Cash Flows from Financing Activities			
Proceeds from Crown Receivable	-	-	-
Proceeds from Uncalled Capital 1	315,000	142,000	-
Proceeds from Uncalled Capital 2	-	250,000	-
Proceeds from Uncalled Capital 3	-	86,000	142,000
Crown withdrawal			(85)
Net Cash Inflow/(Outflow) from Financing Activities	**315,000**	**478,000**	**141,915**
Cash Flows from Investing Activities			
Proceeds from Sale of fixed assets	7	-	-
Payments for Property, Plant and Equipment	(121)	(396)	-
Proceeds from Sale of Properties Held for Sale	2,000		
Net Cash Inflow/(Outflow) from Investing Activities	**1,886**	**(396)**	**-**
Net Increase/(Decrease) in Cash and Cash Equivalents	**(182,352)**	**468**	**(30,636)**
Add Opening Cash and Cash Equivalents	212,521	30,168	30,636
Ending Cash and Cash Equivalents	**30,168**	**30,636**	**0**

Abridged Statement of Accounting Policies

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 registered office for the Company is located at 6 Show Place, Addington, Christchurch.
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. It also manages an investment portfolio.

Basis of preparation
The forecast financial statements are for the years ended 30 June 2016, 30 June 2017, 30 June 2018 and 30 June 2019.
The forecast financial statements have been prepared in accordance with the Crown Entities Act 2004 which includes the requirement to comply with Generally Accepted Accounting Practice in New Zealand (NZ GAAP).
It is intended that the annual historical financial statements for the above periods will be prepared in accordance with NZ GAAP, New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable financial reporting standards as appropriate for profit oriented companies.
Actual financial results achieved for each forecast period are likely to vary from information presented and the variation may be material.
The forecast financial statements have been prepared on a historical cost basis, except for certain Financial Assets (including the Crown Receivable) which have been measured at fair value. All outstanding claims liabilities and reinsurance receivables have been measured in accordance with *NZ IFRS 4 Insurance Contracts.*
The forecast financial statements have been presented on a going concern basis, deemed appropriate given the funding arrangement provided under the Crown support deed.

Functional and presentation currency
The forecast financial statements are presented in New Zealand dollars and unless specifically stated otherwise are rounded to the nearest thousand dollars ($'000). The functional currency of the Company is New Zealand dollars (NZ$).

Significant accounting policies
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
The following items are recognised in profit or loss:

- interest is recognised using the effective interest method
- dividend income is recognised when the right to receive payment is established
- realised gains and losses
- unrealised gains and losses on Financial Assets at Fair Value through Profit or Loss (FVTPL), and
- realised and unrealised foreign exchange gains and losses on cash and cash equivalents and investments classified as FVTPL

Income Tax
The following policies apply to income tax:
Current income tax
The current income tax asset or liability for the current and prior periods is measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and laws used to compute this amount are those that are enacted or substantively enacted by the reporting date. Current tax attributable to amounts recognised directly in equity is also recognised directly in equity.
Deferred income tax
Deferred tax assets will be recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Goods and services tax (GST)
The statement of comprehensive income, statement of changes in equity and the statement of cash flows have been prepared so that all components are stated exclusive of GST. All items in the statement of financial position are stated exclusive of GST with the exception of receivables and payables which include GST invoiced.

Financial Assets
Financial assets are classified into the following specified categories: financial assets 'at fair value through profit or loss' (FVTPL) and 'measured at amortised cost'.
The classification depends on the business model for managing the financial asset and the cash flow characteristics of the financial asset and is determined at the time of initial recognition or when a change in the business model occurs.

Financial assets measured at amortised cost
The financial assets held in order to collect contractual cash flows that are solely payments of principal and interest on the principal outstanding are measured at amortised cost. Cash and cash equivalents, Treasury bills and receivables are classified in this category.

Financial assets at fair value through profit or loss
Financial assets are classified at FVTPL if they are not measured, or designated, as amortised cost. Gains and losses on a financial asset designated in this category are recognised in profit or loss.

Financial assets backing the outstanding claims liability
Financial assets deemed to back general insurance liabilities are designated at FVTPL.
As part of its investment strategy, the Company actively manages its investment portfolio to ensure that investments mature in accordance with the expected pattern of future cash flows arising from the outstanding claims liability.

Property held for sale
Property held for sale is measured at the lower of carrying value and fair value less costs to sell, by reference to external market valuations, with any resultant unrealised gains and losses recognised in profit or loss.
On disposal any related revaluation surplus remaining in the revaluation reserve is transferred directly to retained earnings.

Intangible assets
Intangible assets are initially measured at cost. Subsequent measurement is at cost less accumulated amortisation and impairment. Amortisation is charged on a straight-line basis over the estimated useful life of the intangible asset. The Company have no intangible assets with an indefinite useful life.
All software assets included in the financial statements have useful lives of between 1 and 4 years.

Property, plant and equipment
Property, plant and equipment assets are recorded at cost, including costs that are directly attributable to the acquisition of the asset. Depreciation is calculated using the straight-line method to allocate their cost, net of any residual value, over their useful lives.
The estimated useful lives of the major asset classes are:

- office furniture and equipment - 2 to 15 years
- leasehold improvements – 3 to 4 years
- motor vehicles - 5 years

Disposal
An item of property, plant and equipment is de-recognised when it is disposed of, or when no future economic benefits are expected from its use or disposal. Any gain or loss on de-recognition of the asset is included in profit or loss in the year the asset is de-recognised.

Cash and cash equivalents
Cash and cash equivalents includes cash at bank, deposits on call and other short-term, highly liquid investments with original maturities of three months or less which are readily convertible to known amounts of cash and are subject to insignificant risk of changes in value.

Foreign currency
Foreign currency transactions are translated into the functional currency of the Company, using the exchange rates prevailing at the dates of the transactions (spot exchange rate). Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-measurement of monetary items at year-end exchange rates are recognised in profit or loss.

Lease assets
Leases are classified as finance leases whenever the terms of the lease transfer substantially all of the risks and rewards of ownership to the lessee.
All other leases, both as lessee and lessor, are treated as operating leases. Rental income and expense are recognised on a straight line basis over the lease terms.

Provisions
A provision is recognised for a liability when the settlement amount or timing is uncertain; when there is a present legal or constructive obligation as a result of a past event; it is probable that expenditures will be required to settle the obligation; and a reliable estimate of the potential settlement can be made. Provisions are not recognised for future operating losses.
Provisions are measured at the estimated expenditure required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Provisions are discounted to their present values, where the time value of money is material.
All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

Employee benefits
Short-term employee benefits
Liabilities for salaries (including non-monetary benefits), annual leave and accumulated sick leave expected to be settled within 12 months of the reporting date are recognised in respect of employee services up to the reporting date. They are measured at the amount expected to be paid when the liabilities are settled.

Employer contributions to KiwiSaver
Where employees have elected to join a KiwiSaver superannuation scheme, the Company complies with all applicable legislation in making employer contributions to these schemes. Obligations for contributions are recognised in profit or loss as they become payable.

Share capital
Shares are classified as equity when there is no obligation to transfer cash or other assets to the holder. Transaction costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds.

Critical accounting judgements and estimates
The Company makes estimates and assumptions in respect of certain key assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key areas in which critical estimates and judgements are applied are described below.

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.

Valuation of the Crown receivable
The Crown receivable is recorded at the fair value of projected cash flows based on forecast payments of claim settlements and operating costs.