



Discussion paper

Insuring public assets





Office of the Auditor-General
PO Box 3928, Wellington 6140

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

Email: reports@oag.govt.nz
Website: www.oag.govt.nz

**2006 collapse of Mangamahu bridge.
Photograph supplied by the Ministry of Civil
Defence and Emergency Management.**

Insuring public assets

This is a discussion paper presented
to the House of Representatives
under section 20 of the Public Audit
Act 2001.

June 2013

ISBN 978-0-478-41027-3 (print)
ISBN 978-0-478-41028-0 (online)

Contents

Auditor-General's overview	5
Part 1 – Introduction	7
The insurance market	7
Main components of an insurance policy	10
Scope of our work	11
Outline of this paper	13
Part 2 – Analysis of insurance for public assets	15
Value of public assets	15
Extent of insurance cover for public assets	16
Reasons why some public assets have no insurance cover	18
Level of cover for insured public assets	20
Cost of insurance for public assets	21
Changes in insurance after 2010	23
Insuring public assets in Canterbury	24
Part 3 – Analysis of insurance for central government assets	27
Value of central government assets	27
Extent of insurance cover for central government assets	28
Reasons why some central government assets have no insurance cover	29
Level of cover for insured assets in central government	30
An alternative way to get insurance	31
Changes in insurance in central government after 2010	35
Part 4 – Analysis of insurance for local government assets	37
Value of local government assets	37
Extent of insurance cover for local government assets	38
Reasons why some assets in local government have no insurance cover	40
Level of cover for insured assets in local government	41
Commonly used insurance provider for local government entities	41
Changes in insurance in local government after 2010	43
Appendices	
1 – Information we sought from our auditors about insurance	45
2 – The number and types of public entities for which we collected insurance information	49
3 – Glossary	51
Figures	
1 – Percentage distribution of worldwide cost of insurance claims from natural catastrophes in 2011	8
2 – Insurance claims from natural disasters in New Zealand, 1968-2010, excluding claims relating to the Canterbury earthquakes	9
3 – Insurance claims from natural disasters in New Zealand, 1968-2011	10
4 – Main components of an insurance policy	11
5 – Carrying value of central government and local government assets, as percentage of total sample	15
6 – The prevalence of different types of assets without insurance cover	17
7 – Analysis of uninsured assets by entity	17
8 – Reasons why some public assets have no insurance cover	18
9 – Relative cost of insurance premiums in 2012, by region	22
10 – Percentage increase in premiums between 2011 and 2012 for all insurance policies.	23
11 – Carrying value of central government assets, in billions of dollars, by type of entity	27
12 – Types of central government asset without insurance and reasons why	28

13 – Number of central government assets without insurance cover, by type of asset	29
14 – Reasons why some central government assets have no insurance cover	30
15 – Central government entities having low insurance cover for some assets	31
16 – Percentage increase in premiums between 2011 and 2012 for insurance policies in central government	35
17 – Carrying value of local government assets, in billions of dollars, by type of entity	37
18 – Assets without insurance cover in local government, by type of asset	38
19 – Types of assets that Auckland Council, Christchurch City Council, and Watercare Services Limited hold without insurance and reasons why	39
20 – Reasons why some local government assets have no insurance cover	40
21 – Increase in premiums for insurance policies in local government, 2011 to 2012	44

Auditor-General's overview

This paper provides a high-level view of insurance for public assets and the main changes after 2010. It does not provide a comprehensive view of all types of insurance in the public sector. I hope that it will inform debate, and that public entities and others will find it helpful when considering insurance as part of risk management.

The Canterbury earthquakes have resulted in significant costs to New Zealand as a whole. Some of these costs relate to uninsured losses for assets in Canterbury and some relate to unanticipated costs that arise as a result of a major catastrophe. Further, many public entities throughout New Zealand have told me that one of their most significant cost pressures since the Canterbury earthquakes has been insurance.

The cost of the Canterbury earthquakes highlights the importance of good risk management, and the part insurance plays, for public assets. In many instances, public entities can provide services in the future only through the continuing use of their assets. Public entities have had to think carefully about how they are managing their risks and how they are using insurance.

In this context, I decided to find out more about the nature and extent of insurance cover for public assets and the extent of changes in insurance associated with those assets after 2010.

In late 2012, my staff got information about how more than 400 of the largest public entities insure their assets. This information shows that:

- These public entities spend about \$280 million on insurance premiums each year for assets of about \$97 billion.
- These public entities have assets of about \$128 billion without insurance cover. However, my staff estimate that land – for which insurance is generally not offered – makes up about one-third of these assets.
- The nature of insurance cover is changing.
- Nearly 40% of the insurance policies of these public entities included an increase in insurance premiums of more than 20% between 2011 and 2012.
- Many of these public entities are thinking about the risks to their assets, whether or not to insure them, the right insurance cover, and the most appropriate way to get that insurance.

We supplemented our analysis of this information with three examples of different approaches to insurance in the public sector. These examples included a public entity that self-insures, a sector that insures collectively, and a specialist insurer of local government assets. The purpose of these examples is to show what is happening and why, not to judge validity or appropriateness.

In response to recent events, reinsurance costs have increased substantially. Insurers have to manage these extra costs by increasing premiums. Recently, insurers have been using an increase in excess to ensure that insurance remains accessible. However, in some situations, the excess may be so high that the cover makes the cost of insurance difficult to justify. Some of these increases in excess have happened recently, so the information we collected in 2012 does not necessarily fully reflect this.

The nature of cover, especially cover for natural disasters, has also changed. There have been moves from replacement cost to indemnity value and increased restrictions on cover for buildings that are not earthquake-strengthened.

In looking at the analysis of the information that my staff collected, there are six questions that we are not in a position to answer, but that the public sector needs to consider. These are:

- What is the assessed risk of assets not being available to provide public services in the future, and what is the most appropriate way to manage it?
- How well are risk assessments being done to inform decisions about insurance, including assessments of the likely costs to replace assets?
- Is the right amount and nature of insurance cover being obtained to ensure that public services can continue to be delivered?
- Is insurance being acquired in the most cost-effective way?
- How much can be prudently borrowed to replace uninsured assets?
- Has the risk of all uninsured assets been assessed centrally, and is the risk being appropriately managed?

The questions arising from our analysis are worth asking when considering whether the public sector can provide the services required to meet our future needs. I encourage public entities, groups of public entities, and the Government to consider these questions.

I would like to thank my auditors, who provided the underlying information analysed in this paper, the public entities that provided examples of different approaches to insurance, and the Insurance Council of New Zealand for valuable advice and comment.



Lyn Provost
Controller and Auditor-General

19 June 2013

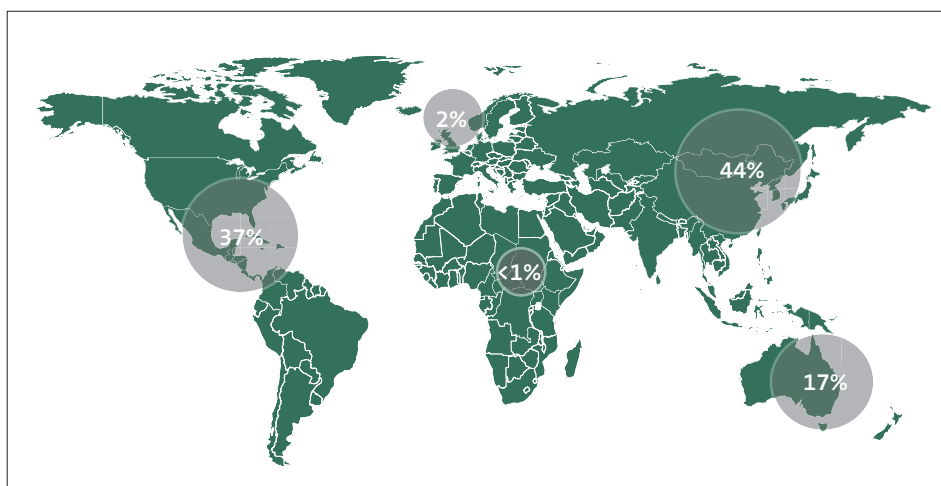
Part 1

Introduction

The insurance market

- 1.1 Insurance is one way to manage the risk of assets not being available in the future to provide services. It manages that risk by transferring some of it to an insurer (an insurance company). The insurance company then typically transfers some of that risk by getting reinsurance, often overseas.
- 1.2 Recently, the global insurance industry has been put under significant pressure. Natural disasters around the world have resulted in significant insured economic losses. New Zealand's insurance industry is not exempt from the pressure, which has affected New Zealand's reinsurance costs.
- 1.3 This is because the insurance industry around the world is interconnected. With more reinsurance being acquired from the international market, a disaster event anywhere in the world can affect the cost of insurance in New Zealand. If the cost of reinsurance goes up globally, then insurance companies in New Zealand will pass these costs on through higher premiums.
- 1.4 Before the Canterbury earthquakes, New Zealand insurers had been getting reinsurance cover at reinsurance rates that reflected the expected risks. Those rates have now increased to better reflect the known earthquake risk. In 2011, 17% of global insured losses were in Australasia/Oceania. This related mainly to the Canterbury earthquakes. Australasia/Oceania contributed less than 1% of premiums globally in 2011, with New Zealand's contribution about 0.2%.
- 1.5 Figure 1 shows the distribution of insurance losses throughout the world in 2011.

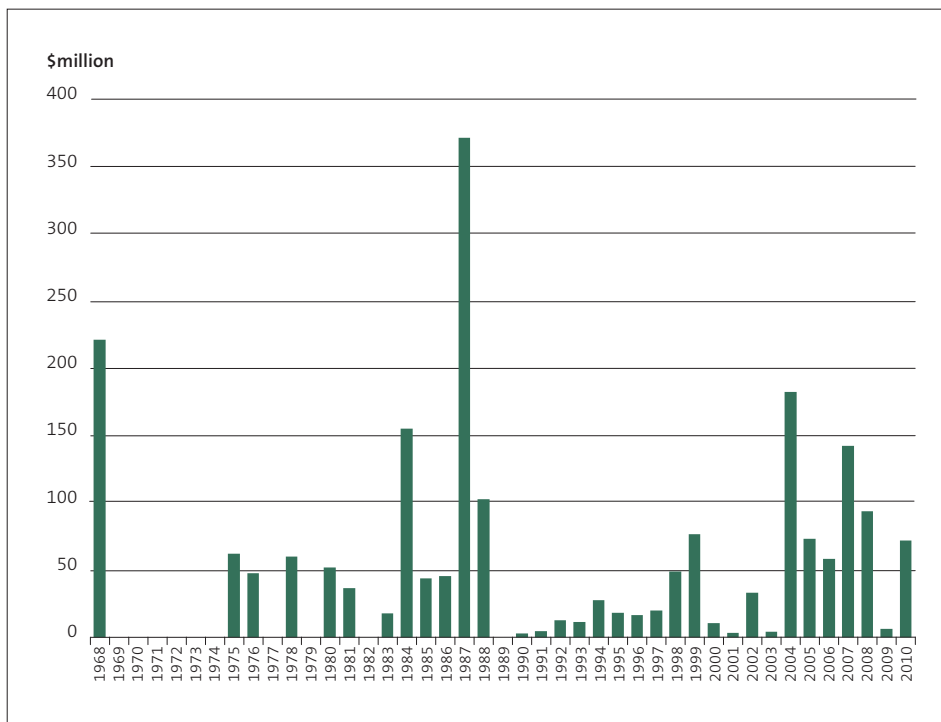
Figure 1
Percentage distribution of worldwide cost of insurance claims from natural catastrophes in 2011



Source: Munich RE NATCATSERVICE, available at www.munichre.com.

- 1.6 Figure 2 shows the historical level of claims for natural disasters from 1968 to 2010 (excluding claims relating to the Canterbury earthquakes). The claims amounts have all been inflation adjusted to 31 December 2011. Figure 2 has a few peaks. These include the Wahine storm of 1968, the Invercargill floods of 1984, the Bay of Plenty earthquakes of 1987, and the lower North Island floods of 2004.

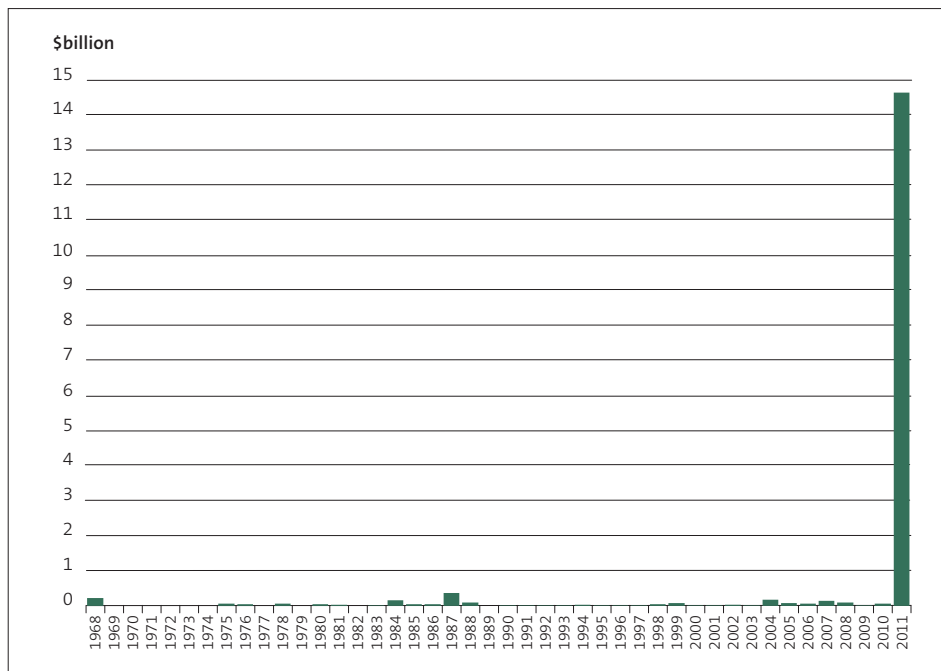
Figure 2
Insurance claims from natural disasters in New Zealand, 1968-2010, excluding claims relating to the Canterbury earthquakes



Note: The information is based on statistics compiled by the Insurance Council of New Zealand.

- 1.7 Figure 3 shows the level of claims for the same events as shown in Figure 2, but on a different scale. All claims relating to the Canterbury earthquakes, from 4 September 2010 to the end of 2011, are included in the 2011 bar.
- 1.8 When considered together, Figures 2 and 3 show that insurance claims from the Canterbury earthquakes dwarf insurance claims from all other natural disasters in New Zealand, using information going back as far as 1968. The insurance claims from natural disasters between 1968 and 2010 are barely visible in Figure 3.

Figure 3
Insurance claims from natural disasters in New Zealand, 1968-2011



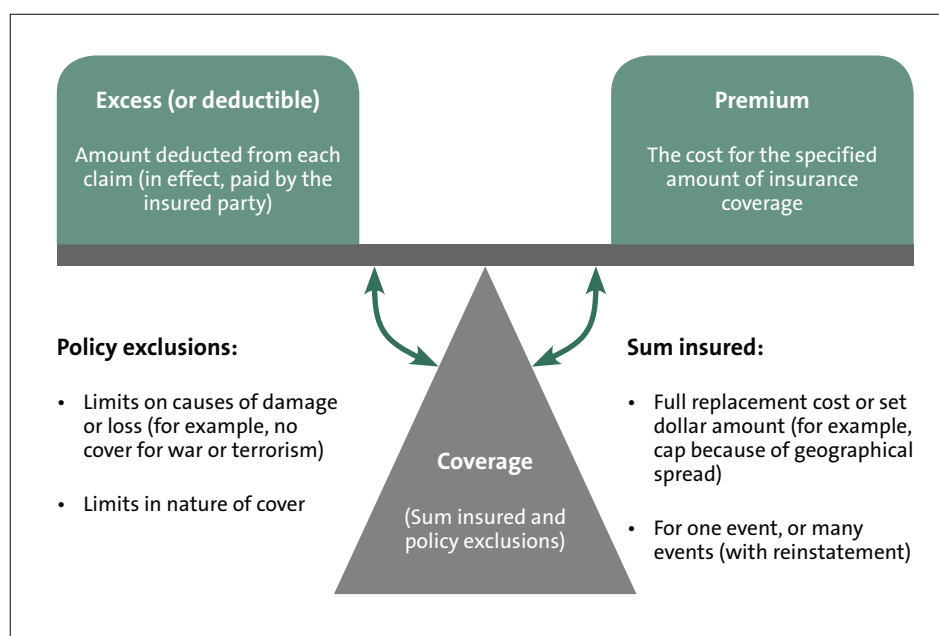
Note: All claims resulting from the Canterbury earthquakes from 4 September 2010 to the end of 2011 are included in the 2011 year. The information is based on statistics compiled by the Insurance Council of New Zealand.

Main components of an insurance policy

- 1.9 To help manage risks to assets, a public entity should carry out a risk assessment to decide whether to insure assets, and, if it does decide to insure them, the appropriate insurance cover. That assessment should use accurate, up-to-date valuations that consider matters such as indemnity value, replacement cost, maximum probable loss, demolition costs, and inflation.
- 1.10 After a risk assessment, a public entity may choose not to insure its assets – it may choose to self-insure. This is where the public entity chooses not to insure the asset because the cost of damage to, or loss of, its assets can be met from cash reserves, borrowings, the Government, or funds that a group of entities have pooled together to help meet such costs.
- 1.11 When getting insurance, several components to an insurance policy interact. Figure 4 shows the main components of an insurance policy. Changing one component will affect the others. The insurance premium depends on the

sum insured (replacement cost, indemnity value, or some other agreed value), the amount of excess, and any policy exclusions. Also, the insurance premium depends on the nature of the insurance policy.

Figure 4
Main components of an insurance policy



Scope of our work

1.12 The insurance of public assets is one of the topics that we decided to look at under our 2012/13 work programme theme of *Our future needs – is the public sector ready?* In many instances, public entities can provide services in the future only through the continuing use of their assets. In this paper, we use the term “assets” to mean physical assets used in providing services to the public.¹

1.13 In our *Annual Plan 2012/13*, we noted that we were interested in understanding better:

- the nature of insurance cover of public assets;
- the extent to which those assets are uninsured;
- any significant policy exclusions that mean assets are not covered for certain types of events (such as earthquakes and tsunamis);
- the proportion of claims that public entities will not be able to recover (that is, the “excess” or “deductible” under the insurance policy);

¹ Physical assets used to provide services are often referred to as property, plant, and equipment assets, or fixed assets.

- the cost of insurance; and
- the main changes in insurance during the past couple of years.

1.14 The purpose of this paper is to provide a high-level view of the extent of insurance for many of the assets in the public sector and the main changes since 2010. By doing this, we hope to encourage further discussion by provoking relevant questions about insurance of public assets.

1.15 We decided to focus our review on insurance against damage to physical assets used in providing services to the public. We acknowledge that other public assets may require insurance (for example, investments, investment property, and intangible assets), and other types of insurance may be obtained (for example business interruption, professional liability, and new construction insurance). However, we have excluded these other assets and types of insurance from the scope of our review.

1.16 This paper does not cover the Government's provision of insurance (for example, through the Earthquake Commission).

1.17 To find out more about insurance for assets held by public entities, we prepared a series of questions (as listed in Appendix 1). We asked our auditors to provide us with answers to these questions for a selection of public entities. Those answers provided us with information about the three largest insurance policies for each public entity selected.

1.18 Insurance is often complex, so our questions could not cover every aspect of a public entity's approach to insurance. We decided to limit our questions and so have gathered only a limited amount of information. This has given us some good insights and has also led us to further questions that the public sector could address.

1.19 We covered many central government and local government entities. Appendix 2 sets out the number and type of public entities in our analysis. We excluded small public entities such as administering bodies and boards, cemetery trustees, many small subsidiaries of public entities, and schools (but we did get information about school properties).

1.20 We supplemented our high-level findings with three examples. These examples gave us the opportunity to dig a little deeper into different approaches to insurance in the public sector. The examples show the issues that public entities face with insurance and the different approaches they take to addressing these issues.

Outline of this paper

- 1.21 Part 2 sets out an overview of insurance of assets and outlines our findings from the insurance information we collected for the whole public sector, including findings for Canterbury. Part 3 sets out our findings about insurance for central government, and Part 4 sets out our findings about insurance for local government.
- 1.22 Appendix 3 is a glossary that defines some of the terms used in this paper.

Part 2

Analysis of insurance for public assets

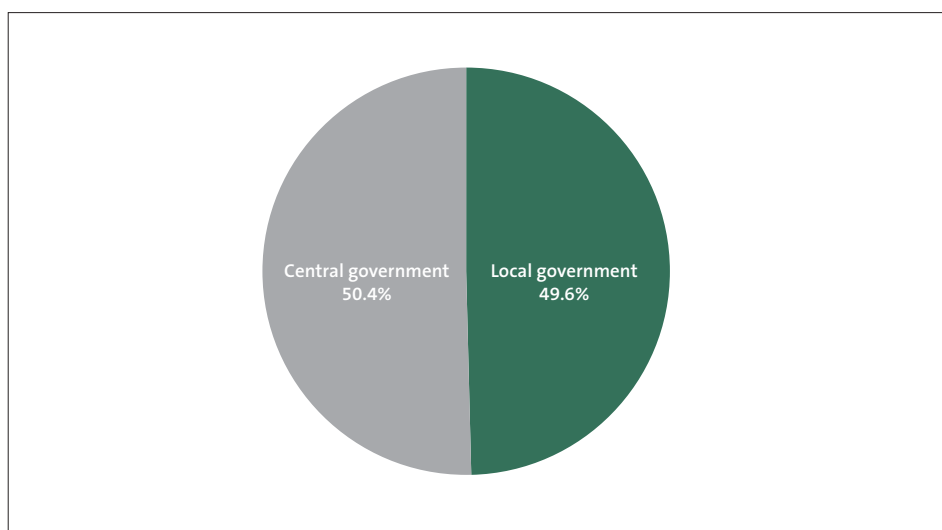
2.1 In this Part, we set out our analysis of the information we collected about the insurance of public assets. We look at:

- the value of public assets;
- the extent of insurance for those assets;
- why some assets are not insured;
- the level of cover for insured assets;
- the cost of insurance;
- changes in insurance after 2010; and
- insurance in Canterbury.

Value of public assets

2.2 We collected information about the insurance of assets for more than 400 of the largest public entities. In total, these public entities' financial statements have assets recorded at about \$225 billion. We refer to this as the carrying value of those assets. Figure 5 shows that these public assets are split fairly evenly between central government and local government, based on the information we collected.

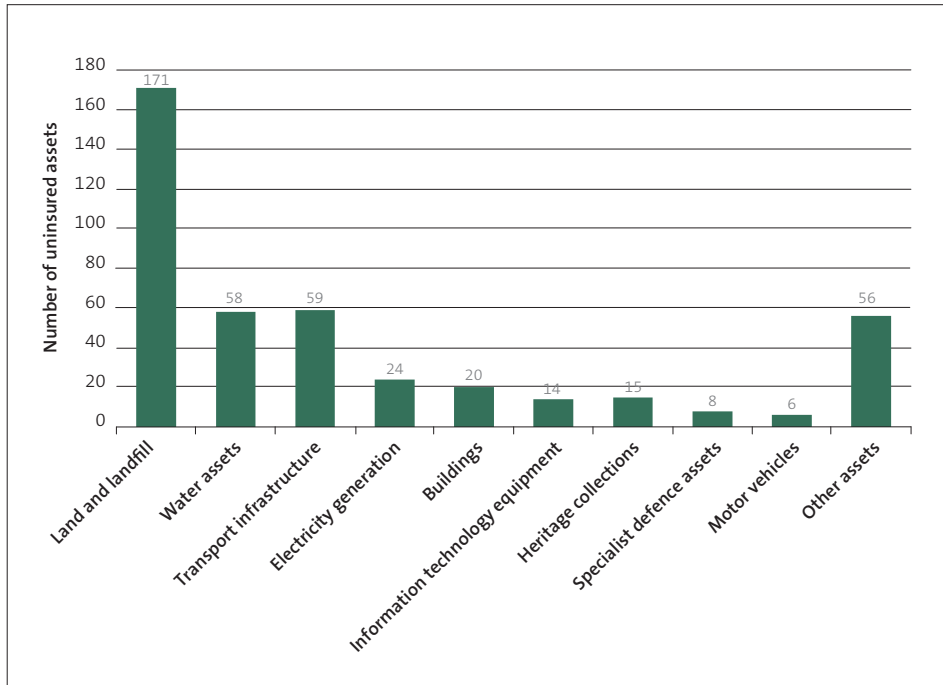
Figure 5
Carrying value of central government and local government assets, as percentage of total sample



Extent of insurance cover for public assets

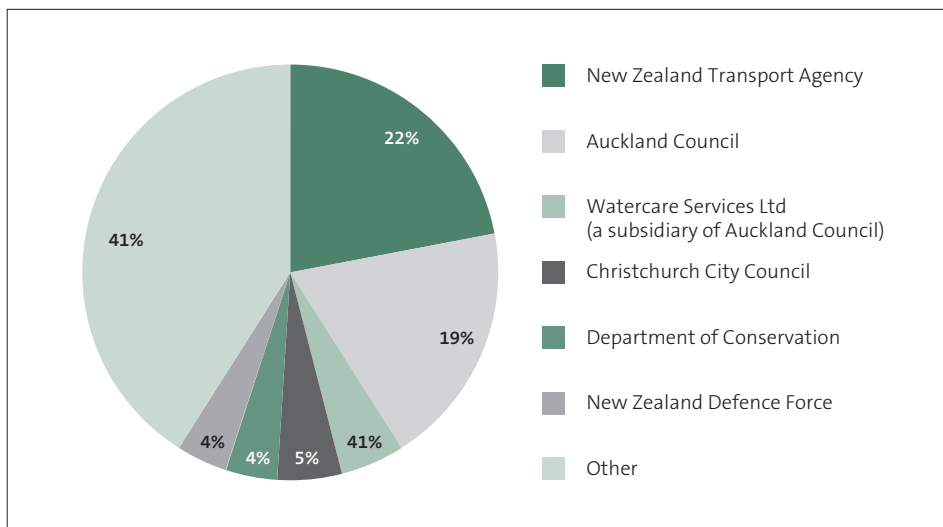
- 2.3 The information we collected shows that less than half of these public assets (based on their carrying value) have insurance cover. The cost of this insurance cover is about \$280 million each year.
- 2.4 Because of the Canterbury earthquakes, there are many uninsured assets in Canterbury. In some instances, the increase in insurance premiums has made the cost of obtaining insurance prohibitive. In others, the perceived risk of earthquakes has made insurance simply unobtainable.
- 2.5 Having more than half of these public assets without insurance cover might seem like cause for concern. It could suggest that a significant proportion of public assets might not be able to be replaced after a catastrophe and therefore that public services may not be able to be provided in the future.
- 2.6 However, having uninsured assets is not necessarily cause for concern. This is because public entities can mitigate the risk of damage to, or loss of, assets in other ways. After assessing risks, public entities can choose to self-insure, such as relying on either their capacity to borrow funds or their cash reserves. A number of State-owned enterprises (SOEs), local authorities and related entities, and electricity lines businesses have chosen to self-insure some or all of their assets.
- 2.7 It is important to distinguish between public entities that properly analyse their risks and choose to self-insure and public entities that choose to do nothing because they consider insurance too expensive. We have not assessed the risk analyses of public entities that do not insure assets, to work out whether any have not analysed risks properly.
- 2.8 In general, the most common type of asset without insurance cover is land. This is not surprising because insurance is generally not offered for land. Figure 6 shows the types of public assets that are not insured. Land and landfills, water assets (for water supply, stormwater, and wastewater), transport infrastructure, and other assets (such as tunnels; plant, and equipment; furniture and fittings; and parts of electricity generation and distribution systems) are the most common assets without insurance cover.

Figure 6
The prevalence of different types of assets without insurance cover



2.9 A few public entities account for most of the uninsured assets. Figure 7 shows that six public entities have nearly 60% of the assets (by value) without insurance cover.

Figure 7
Analysis of uninsured assets by entity

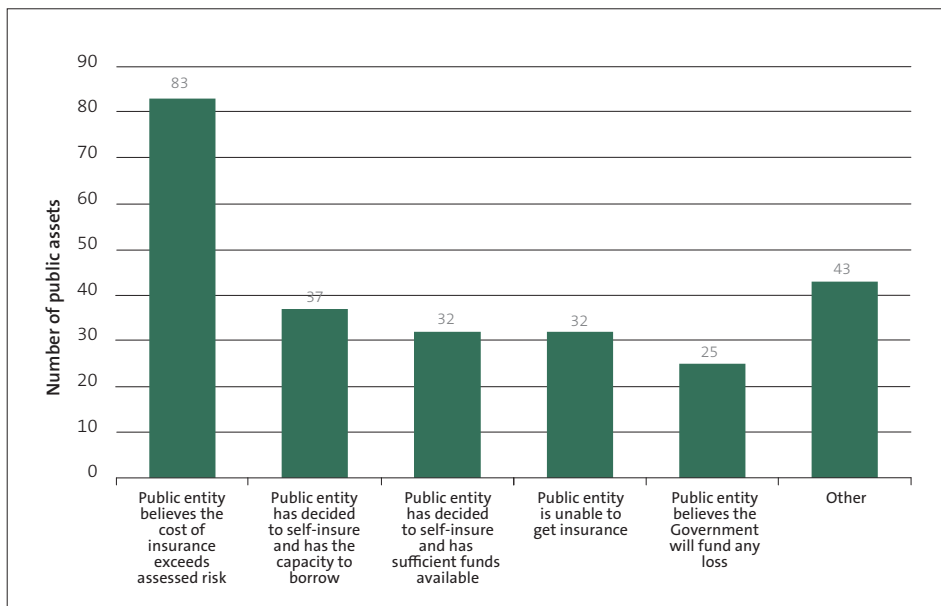


- 2.10 The six public entities identified in Figure 7 have a wide range of assets without insurance cover. They include land, landfill, transport infrastructure, water assets, flood protection assets, and buildings.
- 2.11 Further details about these six public entities are included in Part 3 (for central government entities) or Part 4 (for local government entities).

Reasons why some assets have no insurance cover

- 2.12 Commonly, the six public entities identified in Figure 7 do not have insurance cover for assets because:
 - the cost of insurance is higher than the assessed risk; or
 - the public entity could not get insurance cover.
- 2.13 Some public entities have concluded that the cost of insurance is too high for the risks being mitigated. In the last couple of years, several global disasters, including the Canterbury earthquakes, have changed the nature and cost of insurance cover in New Zealand, particularly in the short term.
- 2.14 Figure 8 shows the reasons why some public assets, other than land, have no insurance cover. The most common reasons are that the cost of insurance exceeds the assessed risk or that the public entity has decided to self-insure. There could be more than one reason, and different reasons may apply for different assets owned by any one entity.

Figure 8
Reasons why some public assets have no insurance cover



2.15 An example of a public entity that chooses to self-insure is the New Zealand Police.

What we found out from the New Zealand Police*

The New Zealand Police's approach to insurance

The New Zealand Police (the Police) have a strong risk-management culture and extensive experience in managing many assets. The Police's major assets are land, buildings, plant and equipment, and motor vehicles. At 30 June 2012, the Police had assets with a carrying value of \$845 million. Of this total, \$776 million was the value of land, buildings, and plant and equipment, and \$69 million was the value of motor vehicles and vessels.†

For many years, the Police have self-insured nearly all of their assets. The Police consider that self-insurance is the most appropriate and cost-effective option for their assets. Rather than relying on private insurance to cover any losses or damage to assets, the Police reprioritise funding available as part of their capital expenditure budget to cover any losses.

The Police have experienced very low levels of loss or damage to land, buildings, plant, and equipment. However, because of the nature of Police work, the Police's fleet of motor vehicles has experienced higher losses. The nature of the work means that privately insuring the Police's fleet of motor vehicles would be prohibitively expensive.

A number of factors have led the Police to choose to self-insure nearly all their assets.

Risk management

The Police have considered the risks to assets continuing to be available so that services can be delivered to the public. Various aspects of the Police's operations mean that the risk to assets is reduced. These are:

- The Police's **assets are spread throughout New Zealand**, which reduces the concentration of risk. Therefore, the effect of an event in any one area is likely to be relatively small compared to the value of all assets.
- **Strong risk management strategy and operations.** The Police have a detailed risk management strategy covering all aspects of their operations, which includes risks that may affect assets. The Police also have a detailed business continuity plan. The Police will continue delivering services even when assets become damaged or destroyed.
- If a major event happened, the Police consider that capital funding can be reprioritised to address losses.
- The Police **obtain market valuations of assets every three years**, which gives the Police relevant information to estimate their financial exposure after a loss.
- There are **few individual assets of large value compared to the value of all assets**. For example, land and buildings can range in value from around \$100,000 for a small community police station to \$40 million for a large metropolitan police station.
- **Other operational factors.** The Police operate 24 hours a day, seven days a week, which means that most buildings will have staff on-site all the time to address any risks that may arise. Also, short-term and long-term warranties from suppliers mitigate some risks of asset failure.

Although the Police self-insure nearly all of their assets, they draw on expertise from the private insurance market. For example, the Police use the services of a private insurance company when deciding whether to repair or replace motor vehicles.

* The purpose of this example is to provide some depth to the analysis by showing one entity's experience of self-insuring, not to judge the validity or appropriateness of self-insurance.

† The amounts are from the New Zealand Police's 2012 Annual Report.

Experience from the Canterbury earthquakes

In comparison to some public entities, the Police were fortunate that their assets were not significantly affected by the Canterbury earthquakes. The main Police Station in Christchurch was leased, so the Police did not have to fund the repairs. The Police's main asset loss from the earthquakes was a small Police Station in Lyttelton. The Police consider that, if they had owned a significant amount of land and buildings in Canterbury that were damaged by the earthquakes, they could have managed the repair process by reprioritising their capital funding.

Concluding comments

To manage risks to the availability of their assets, the Police have found self-insurance to be an appropriate, cost-effective option for their business. The Police's strong focus on risk management and business continuity planning, together with the geographical spread of their assets, has helped to make the self-insurance option viable.

Level of cover for insured public assets

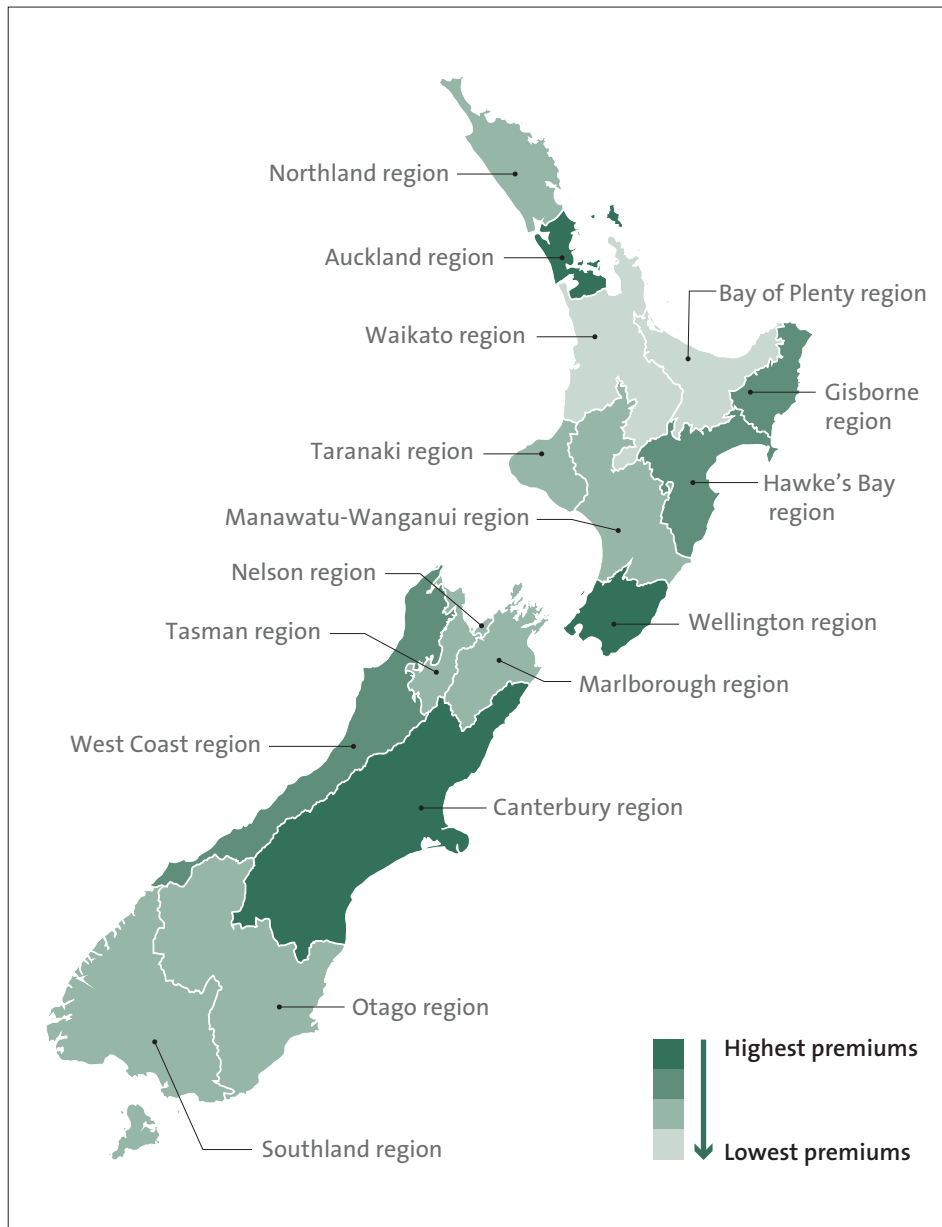
- 2.16 We collected information about assets that are insured and whether those assets had enough cover. When looking at the extent of insurance cover in place for public assets, we compared the total sum insured with the carrying value of assets covered by insurance policies. The results show that the total sum insured is about 80% of the carrying value of those assets covered by insurance policies. This shows that, potentially, public entities do not have enough insurance cover for assets.
- 2.17 It is worth noting that insuring the full carrying value of assets does not necessarily cover all risk. This is because the carrying value is typically lower than the full replacement cost, because the carrying value reflects the age and condition of assets. Therefore, even if insured for carrying value, a public entity is unlikely to have enough insurance cover to replace its assets. Even if the insurance cover is enough, the public entity will be required to pay the excess.
- 2.18 Further, the full replacement cost of an asset is likely to be only part of the costs to a public entity from losing an asset. Other costs include the costs of temporarily acquiring assets that are able to maintain services until a new asset can be acquired or built. The longer it takes to replace an asset, the greater these other costs are likely to be.
- 2.19 There are various reasons why public entities insure for a value lower than the carrying value. Some public entities have assets with a wide geographical spread and assess the likelihood of all their assets being destroyed at the same time as low. These public entities' risk assessment work concludes that a cap should be put on the insured value.
- 2.20 This shows how public entities might manage their insurance costs through a thorough assessment of risks to ensure that they do not pay for more insurance cover than they need.

- 2.21 Our findings suggest that some public entities have the capacity to borrow, and are able to self-insure some or all of their assets, or are able to have insurance that does not cover the full carrying value of assets. This is so for some State-owned enterprises and local government entities. However, we have not assessed the capacity of these public entities to borrow. Having the capacity to borrow provides some funding to cover the cost of an uninsured event.
- 2.22 A few central government entities have a sum-insured value that is significantly less than the carrying value of the assets insured. Some of this difference is offset by public entities where the sum insured value is more than the carrying value of assets.
- 2.23 Part 3 includes further details about public entities with a total insured sum that is significantly less than carrying value.

Cost of insurance for public assets

- 2.24 We estimate that about \$280 million was spent on insurance premiums in 2012. We decided to analyse premium costs geographically by looking at the ratio of premium costs to the value of the asset sum insured for 16 regions. That ratio provides an indicator of the relative cost of insurance premiums.
- 2.25 The analysis includes only some of the entities we collected information about, because we excluded entities that have assets spread throughout New Zealand. Nevertheless, the analysis gives us an indication of the relative cost of insurance for public entities in different regions.
- 2.26 Figure 9 shows that public entities in Wellington and Canterbury pay higher premiums than in other regions, while public entities in Bay of Plenty and Waikato pay lower premiums than in other regions.

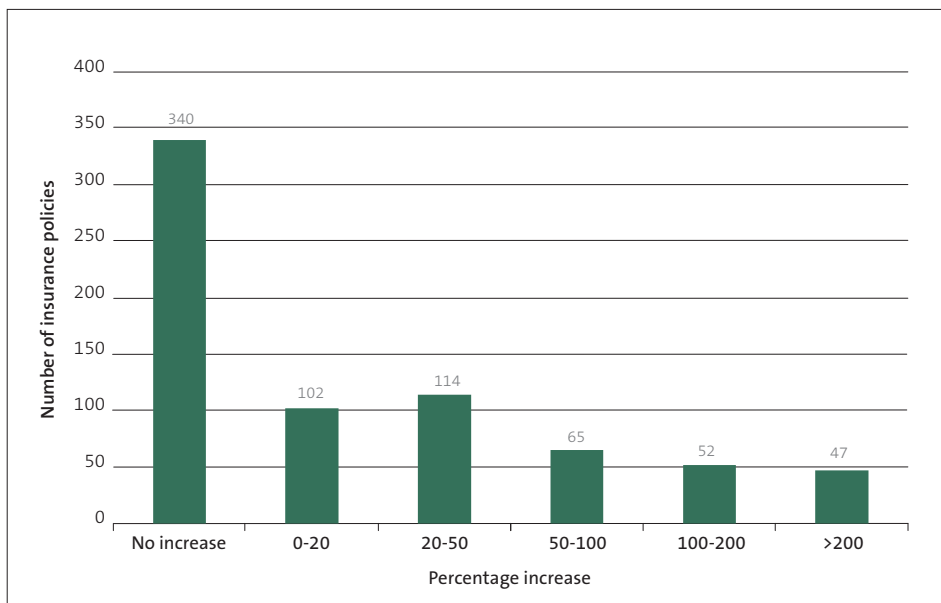
Figure 9
Relative cost of insurance premiums in 2012, by region



Changes in insurance after 2010

- 2.27 The insurance market has changed during the past couple of years. These changes mean that many public entities have had to change the way they use insurance to manage their risks.
- 2.28 Public entities have experienced higher premiums, higher excesses, and changes to insurance cover (often more policy exclusions). These changes have been experienced nationwide, not only in Canterbury. The changes have forced public entities to look closely at their insurance cover and costs, to ensure that their assets have the right insurance cover.
- 2.29 We sought information on the changes in insurance policies between 2011 and 2012. Figure 10 shows how much premiums increased between 2011 and 2012 for the 720 insurance policies that we collected information about.

Figure 10
Percentage increase in premiums between 2011 and 2012 for all insurance policies



- 2.30 Many insurance policies had significant premium increases in 2012. We found that about 40% of insurance policies had an increase of more than 20% in the insurance premium between 2011 and 2012, and about 14% of insurance policies had insurance premiums that more than doubled during that period. These increases are based on the absolute dollar value of premiums and do not reflect the effects of any reduction in insurance cover or increases in excesses.

- 2.31 Even where premiums have not increased by more than 20% (about 60% of insurance policies), public entities have often had to reduce the cover or increase the excess to hold premiums steady. In 2012, 10% of insurance policies had broad policy exclusions that were not there in 2011. There was also a significant increase in the level of excess for 13% of insurance policies. Public entities in Canterbury had more policy exclusions than public entities elsewhere.
- 2.32 The price and availability of insurance fluctuates as the insurance market responds to international and national events and other influences. There have been noticeable cycles in the movements of the insurance market after a costly event. Historical patterns show that insurance costs rise sharply after the event. However, they also show that, relatively soon after, insurance costs plateau and start to fall. Therefore, it is not surprising that, after the increases in insurance costs in 2012, most public entities did not expect insurance costs to continue to increase in 2013. Public entities did not expect a change in insurance premiums in 2013 for more than half of the insurance policies we collected information about.

Insuring public assets in Canterbury

- 2.33 As part of our analysis, we looked at public entities in Canterbury to see whether the information we collected contained any results that were different to the rest of the public sector. In particular, we wanted to see whether these public entities were able to obtain insurance, and whether the increase in insurance costs was higher than elsewhere.
- 2.34 We looked at 29 public entities in Canterbury that had about \$11 billion total assets reported in their 2012 financial statements. We found that only about 25% of these assets were insured, leaving about 75% of assets not insured. This proportion of uninsured assets is significantly higher than what we found for all of the other public entities that we collected information about.
- 2.35 Christchurch City Council owns many of these uninsured assets. Since the earthquakes, insurance has been difficult to get, especially where there are outstanding earthquake claims.
- 2.36 About 60% of the public entities in Canterbury have at least one type of asset that has no insurance cover. This is high compared to the results for the other entities in the public sector that we collected information about. Uninsured assets are mostly land, buildings, and transport infrastructure.
- 2.37 The main reasons for public entities in Canterbury having uninsured assets – other than land – were that the cost of insurance is higher than the assessed risk, and the public entity had tried but could not get insurance. This last reason

was not so common in other regions and suggests that insurance has been more difficult to obtain in Canterbury. In some instances, the increase in insurance premiums has made the cost of insurance prohibitive or simply unobtainable.

- 2.38 When comparing information for 2011/12 with 2010/11, there has been a significant increase in insurance premiums for nearly 60% of insurance policies covering assets in Canterbury. This percentage is fairly common in most sectors, which suggests that the increase in premium costs has been widely felt throughout New Zealand.
- 2.39 Also, the comparison showed that about 20% of entities in Canterbury had additional policy exclusions in 2011/12. This was higher than other regions, suggesting that, even where insurance was obtained, the cover was reduced.

Part 3

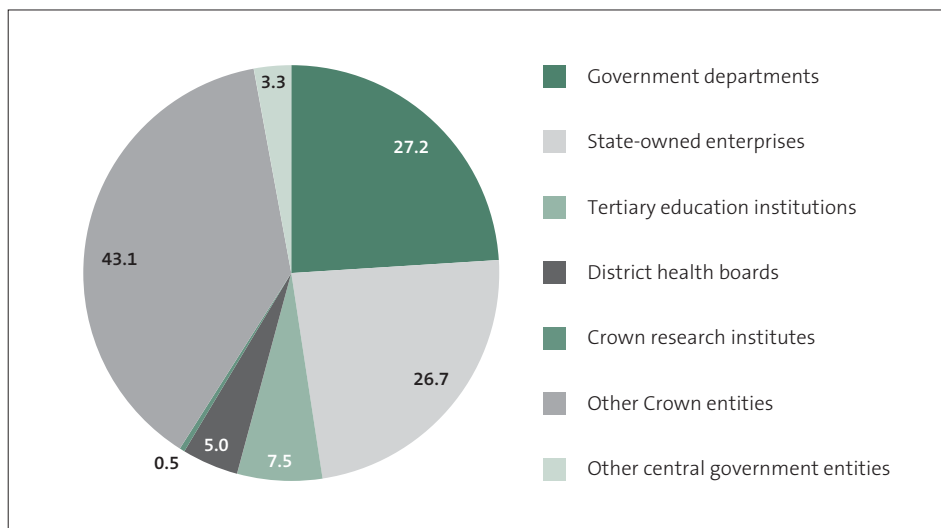
Analysis of insurance for central government assets

- 3.1 In this Part, we set out our analysis of the information about insurance of assets that we collected from central government entities. We look at:
- the value of assets in central government;
 - the extent of insurance for those assets;
 - why some assets are not insured;
 - the level of cover for insured assets;
 - alternative approaches for acquiring insurance; and
 - changes in insurance in central government after 2010.

Value of central government assets

- 3.2 We collected information about the insurance of assets for about 200 central government entities. Appendix 2 sets out the number and types of these entities. In total, these public entities' financial statements have assets recorded at about \$113 billion. We refer to this as the carrying value of those assets. Figure 11 shows that government departments, State-owned enterprises, and other Crown entities together hold most central government assets.

Figure 11
Carrying value of central government assets, in billions of dollars, by type of entity



Extent of insurance cover for central government assets

- 3.3 The information we collected indicates that about half of central government assets have insurance cover. If we exclude land, we estimate that about two-thirds of the remaining assets have insurance cover. Insurance cover on these assets costs about \$180 million a year in insurance premiums. Most public entities negotiate their insurance cover individually.
- 3.4 This leaves many central government assets without insurance cover. A few public entities hold most of these uninsured assets. They are the New Zealand Transport Agency, Department of Conservation, and New Zealand Defence Force. Figure 12 outlines for these public entities what types of asset are uninsured and why.

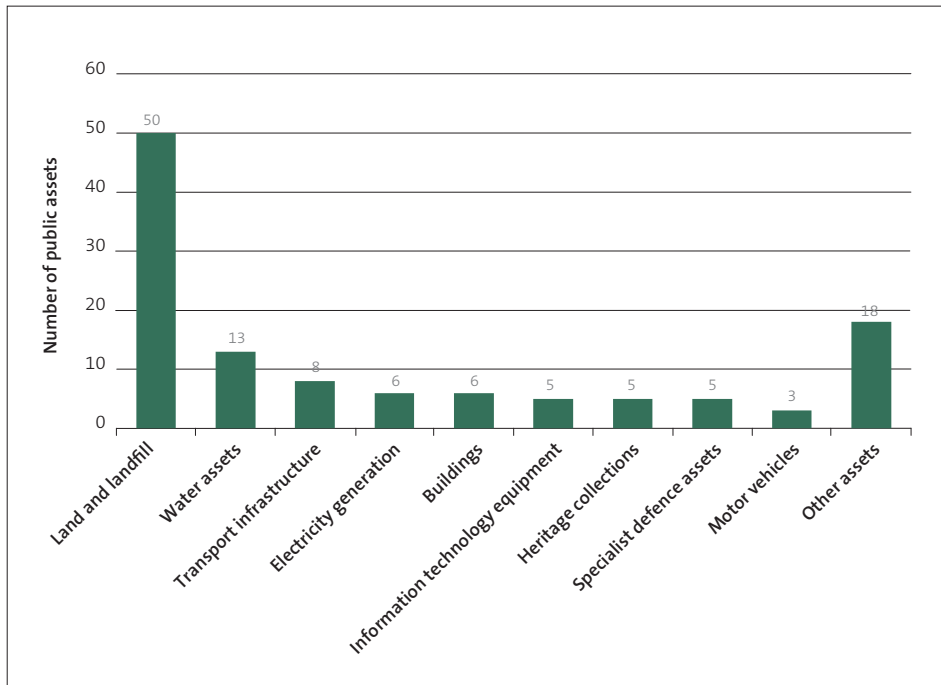
Figure 12

Types of central government assets without insurance and reasons why

Public entity	Types of asset not insured	Reason they are not insured
New Zealand Transport Agency	Land transport highway infrastructure.	Assessed that the cost of insurance exceeds the risks. Potential for reprioritising the programme of work, including emergency work. Possible one-off Government funding for loss or damage to assets caused by unlikely events.
Department of Conservation	Land, stormwater and flood protection systems, heritage collections.	Assessed that the cost of insurance exceeds the risks.
New Zealand Defence Force	Specialist defence assets (marine vessels and aircraft, while engines are on, are not insured).	Assessed that the cost of insurance exceeds the risks. Delay in obtaining replacement equipment. Insurance is generally not offered for war risk. The global practice is not to insure active military assets.

- 3.5 If we exclude the New Zealand Transport Agency, Department of Conservation, and New Zealand Defence Force, the percentage of central government assets without insurance reduces considerably.
- 3.6 The most common types of central government assets without insurance are land, cultural, and heritage collections and “other assets” – mainly fixtures and fittings and plant and equipment. Figure 13 shows which types of central government assets are most commonly not insured.

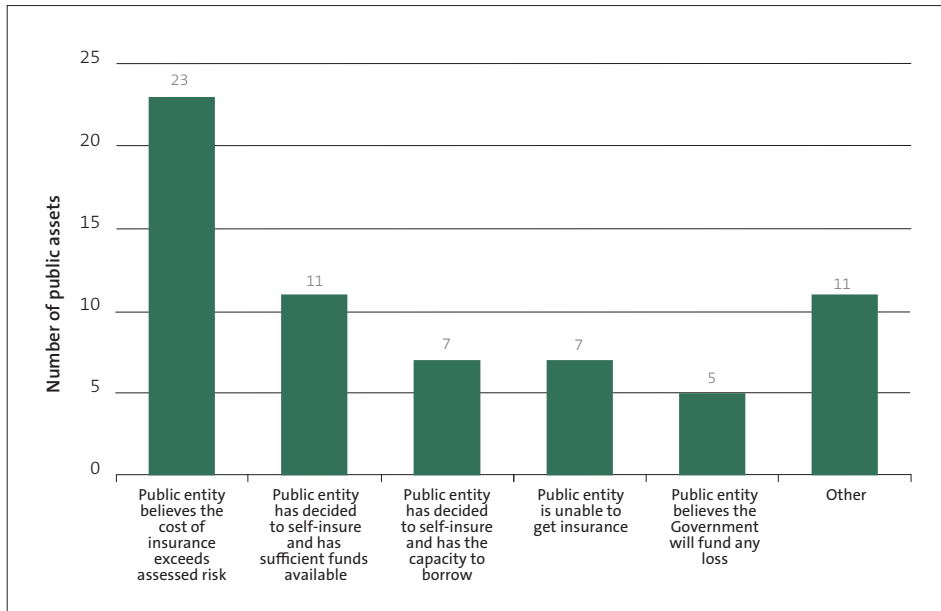
Figure 13
Number of central government assets without insurance cover, by type of asset



Reasons why some central government assets have no insurance cover

3.7 Central government assets, other than land, often have no insurance cover because the cost of insurance is higher than the assessed risk. This indicates that public entities are carrying out risk assessments to work out whether insurance is good value for money. It is good practice to carry out such assessments. We have not tested the quality of risk assessments for those public entities that believe the cost of insurance is higher than the assessed risk. Another common reason is that the public entity has decided to self-insure. Figure 14 shows the common reasons why some central government assets have no insurance cover.

Figure 14
Reasons why some central government assets have no insurance cover



3.8 We found that a particularly high percentage of State-owned enterprises (about 70%) have at least one type of asset without any insurance cover. These assets are mostly land and electricity generation and distribution systems. State-owned enterprises’ ability to borrow to fund any damage to, or loss of, assets was a common reason for having uninsured assets or for not having full insurance cover. This way of managing risk is not available to many other entities in central government.

3.9 Tertiary education institutions and other Crown entities have a low percentage of entities (compared with other sectors) with at least one type of asset that has no insurance cover (about 15% and 10% respectively). This indicates that most assets held by these public entities have some insurance cover.

Level of cover for insured assets in central government

3.10 The total sum insured for insured central government assets covers about 60% of the carrying value. This suggests that, potentially, public entities do not have enough insurance cover for assets. However, it could indicate that central government entities are assessing their risks before deciding which assets to insure.

- 3.11 There are various reasons why public entities might insure for a value lower than the carrying value. Our findings show that four central government entities make up many of the cases where a public asset is insured for less than the carrying value. These public entities are the Ministry of Education, Meridian Energy Limited, Housing New Zealand Corporation, and Health Benefits Limited. Excluding these four public entities, the sum-insured value covers the carrying value for the central government entities that we collected information about.
- 3.12 Figure 15 sets out the rationale that the Ministry of Education, Meridian Energy, Housing New Zealand Corporation, and Health Benefits Limited use for having insurance cover well below carrying value for some public assets.

Figure 15
Central government entities having low insurance cover for some assets

Public entity	Reasons for having low insurance cover for some assets
Ministry of Education	The Ministry of Education considers the amount of insurance cover to be enough because it does not expect a loss event to cause widespread damage throughout the country and its assets are widely dispersed. A special fund is maintained to meet the costs of damage below the annual aggregate excess.
Meridian Energy Limited	Meridian Energy has chosen not to insure the full value of assets because it can borrow funds if it incurs a loss on those assets greater than the amount covered by the insurance.
Housing New Zealand Corporation	Housing New Zealand Corporation considers the amount of insurance cover to be adequate because a loss event is not expected to cause widespread damage throughout the country, and its assets are widely dispersed. The sum insured is based on the largest expected losses from an earthquake in Wellington, which is viewed as the most significant damage event likely to happen.
Health Benefits Limited	Health Benefits Limited facilitates collective insurance for all district health boards. Collectively, its assets are widely dispersed nationally. A cap is put on the insured value based on the likelihood that all assets will not need replacing at the same time.

An alternative way to get insurance

- 3.13 With the drive for public entities to find ways to reduce costs, we have seen some different approaches to insurance. Three types of entity in central government have collective insurance in place: tertiary education institutions (TEIs), Crown research institutes (CRIs), and district health boards (DHBs). They provide examples of entities approaching insurance as a group of similar entities rather than as individual entities, as is most often done in New Zealand's decentralised system of public sector management.
- 3.14 When done collectively, a group of entities get insurance cover to secure more favourable insurance terms, including saving on cost. Savings in premiums can

also be obtained because assets may be more widely spread, reducing the overall risk.

- 3.15 There are two collective insurance programmes in place for TEIs: one for universities and one for polytechnics. Some TEIs make their own insurance arrangements.
- 3.16 The universities' collective covers all universities except the University of Canterbury, which recently opted out. The total policy limit is calculated by estimating the degree of damage likely in a maximum credible event, such as earthquake, fire, or volcanic eruption. Because no single event is expected to cause widespread damage throughout the country, the policy limit is set below the replacement value and carrying value of university assets. The policy also has a multi-million dollar excess for natural hazards, which reflects what insurers offer and the fact that, given their size, universities are able to absorb some of the risk.
- 3.17 The polytechnics' collective is based on a negotiated common set of terms and conditions that participating polytechnics can sign up to individually with an associated schedule of property. The policy limits are based on the total replacement value of assets, with the policy having a maximum claim ceiling closely in line with the assets of the largest participating polytechnic. Larger excesses have applied since the Canterbury earthquakes.
- 3.18 The main insurance policy for CRIs is a collective insurance policy. It covers a large range of asset types for most of the CRIs. The collective policy is based on a maximum foreseeable loss limit of \$150 million for each loss, with limits automatically reinstated after a loss. The loss limit is less than the total value of assets covered by the collective policy that might possibly be at risk. Such an approach is reasonable, given the spread of risk for the CRIs involved in the collective insurance policy.
- 3.19 DHBs also have collective insurance in place. Health Benefits Limited (HBL) has facilitated the collective insurance policy.

What we found out from Health Benefits Limited *

How Health Benefits Limited started

HBL was set up in July 2010 to reduce costs and deliver savings in administrative, support, and procurement services for the health sector. Before 2005, DHBs obtained insurance cover independently. During 2005, an independent consultant's report indicated that there were potential savings and efficiencies from DHBs working together to manage risks through insurance.† A brokerage firm was engaged to arrange collective insurance. We understand that the collective insurance resulted in significant savings in brokerage fees and policy premiums for DHBs. This collective arrangement has now been in place for eight years and involves all 20 DHBs.

How the collective arrangement works

The collective programme provides for a variety of different types of insurance cover, including material damage of assets. HBL, on behalf of the DHBs, tenders out a three-year broker contract to provide strategic financial risk advice, day-to-day claims support, and annual insurance policy renewal for DHBs.

Every year, reinsurance is obtained competitively from the Australasian, Asian, and London insurance markets. This has become more important for the material damage of assets cover since the Canterbury earthquakes. Once the programme of policies is secured, DHBs pay apportioned premiums. More than 20 insurance companies provide cover for the programme.

The total carrying value of assets for the 20 DHBs as at 30 June 2012 was about \$5.0 billion.‡ The total estimated cost to replace these assets is about \$12.4 billion. The sizeable difference between these amounts is essentially due to the carrying value taking into account the age and condition of DHB assets. It suggests that, on average, DHB assets are more than half way through their useful lives.

The sum insured value through HBL is capped at \$450 million a year. Until recently, this was an aggregate cover for a 12-month period. If DHBs used the whole amount within the period, they would go back to the market for more cover or decide to carry the remaining risk. Now, with changes in the reinsurance market, the \$450 million cap is the maximum cover for each event during the insurance period. DHBs consider cover of \$450 million adequate, given the geographical spread of DHBs and the results of each DHB's risk assessments. The \$450 million sum insured value is based on the largest expected losses from a single damage event, such as:

- a fire at Auckland DHB (which has a calculated maximum probable loss of \$450 million); and
- an earthquake affecting the Wellington region (which has a calculated maximum probable loss for DHBs of \$440 million).

Risk management

Risk management is a fundamental part of this arrangement. Together with brokers and insurance companies, HBL has been helping DHBs improve their risk management practices. DHBs, have, traditionally, been risk-averse and preferred low excesses. The Canterbury earthquakes caused DHBs to consider higher excesses to keep premiums at a more reasonable level. It also caused HBL, insurance brokers, and DHBs to look closer at the risks being managed, the nature of insurance cover, and the assets included in that cover.

* The purpose of this example is to provide some depth to the analysis by showing the experience of a sector that insures collectively, not to judge the validity or appropriateness of collective-insurance.

† The Business Development Club provided the report on behalf of District Health Boards of New Zealand.

‡ This amount has been worked out from each DHB's financial statements for the year ended 30 June 2012.

This has included a recent exercise to model risk for all DHBs. All regions have been assessed for their earthquake risk profile and high-value campuses have had independent underwriting reports; building, infrastructure, and equipment assessments, and revaluations completed. Asset valuation is an important part of assessing risks. This process has helped to identify important infrastructure in DHBs that was not included previously (such as retaining walls, bridges, and tunnels).

Advantages of insuring collectively

Insuring collectively has the following main advantages:

- DHBs have constant cover based on collective risks;
- DHBs have options for improved cover and management of premiums;
- DHBs have access to specialised skills for risk management;
- because insurance is technically complicated, it is efficient to arrange cover collectively; and
- some DHBs are able to obtain levels of insurance cover they might not have obtained as individual entities.

Challenges faced by HBL

One challenge faced by HBL has been juggling the needs of each DHB, given that they vary in size, location, and risk. How premiums are allocated between DHBs is another challenge. HBL recently asked the insurer to review the cost allocation and premium split. This led to some large swings for a number of DHBs. HBL recognises the importance of getting DHBs' buy-in, engagement, and involvement in the whole process, so has agreed with DHBs to develop a sector allocation model using the expertise of the current insurance broker.

Effects of the Canterbury earthquakes

The Canterbury earthquakes have resulted in:

- a significant increase in premiums;
- a significant increase in excesses; and
- changes in the nature of insurance cover.

A significant increase in premiums

The material damage component of the insurance premium increased by more than 500% after the Canterbury earthquakes. Most of this increase is likely to be attributed to the earthquakes, because the only substantive changes to the insurance arrangement were an increase in cover from \$320 million to \$450 million and a 25% increase in the underlying value of the assets.

A significant increase in excesses

A result of the earthquakes is that most agencies are taking on higher excesses so they can avoid premium cost escalation. Before the earthquakes, smaller low-risk DHBs had excesses of \$10,000. Now, much higher minimum site excesses, claim values, and geographical thresholds apply. To help address this, HBL facilitated a risk-sharing arrangement where, in the event of a major claim, all DHBs would contribute to cover the higher excess.

Changes in the nature of insurance cover

The capped sum insured value was increased to \$450 million in 2012 after taking into account new valuations and assessments of reasonable foreseeable losses. The latest valuations are based on independent building assessments that reflect usage and how the strength of buildings compares to new buildings built to current standards. The DHB insurers decided that, if buildings are below 33% of new building strength, they are willing to give indemnity value cover only, not replacement cost cover.

Being able to deal with the effects of the earthquakes as a collective, rather than as individual DHBs, was considered advantageous, and we understand that DHBs broadly have cover consistent with their requirements. Importantly, HBL and the broker believe that one or two DHBs might not have otherwise secured cost-effective insurance cover after the Canterbury earthquakes.

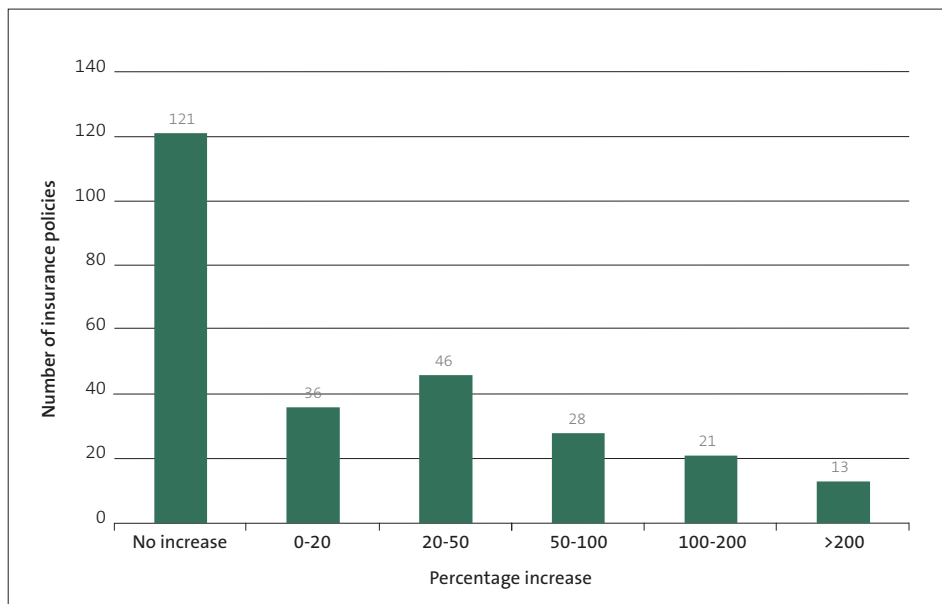
The future

HBL sees one potential next step as extending the collective risk share agreement to provide further self-insurance to augment cover for the DHB sector and to achieve savings on insurance premiums. However, this would require further work with the DHBs to work out costs and benefits.

Changes in insurance in central government after 2010

3.20 We collected information on the changes in insurance policies for public entities in central government between 2011 and 2012. We found that, for slightly more than 40% of insurance policies, there was an increase of more than 20% in the insurance premium. Figure 16 shows how much premiums have increased in central government.

Figure 16
Percentage increase in premiums between 2011 and 2012 for insurance policies in central government



- 3.21 More than half of the central government entities with insurance policies expected no significant changes for 2012/13. Public entities considered that the insurance market had mostly taken the effects of the Canterbury earthquakes and other global events into account.

Part 4

Analysis of insurance for local government assets

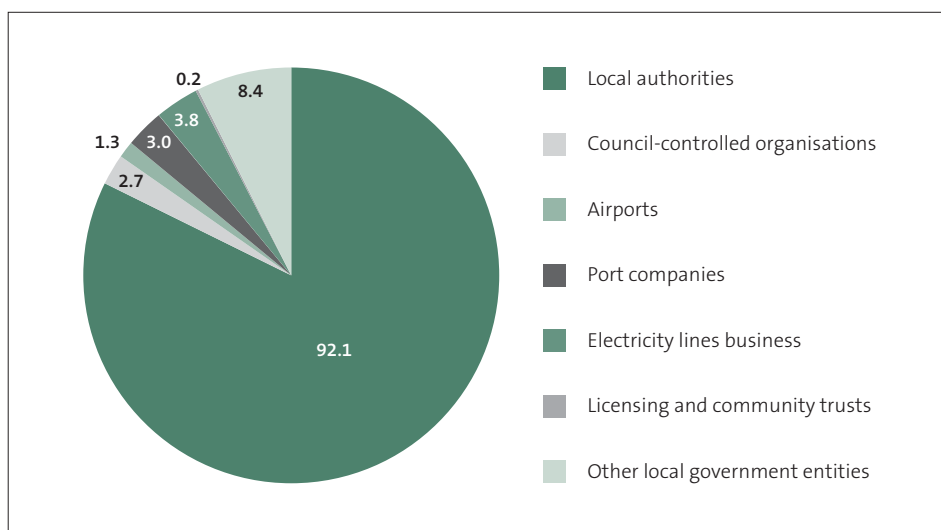
4.1 In this Part, we set out our analysis of the information that we collected about insurance of assets from local government entities. We look at:

- the value of assets in local government;
- the extent of insurance for those assets;
- why some assets are not insured;
- the level of insurance cover for insured assets in local government;
- commonly used insurance providers; and
- changes in insurance in local government after 2010.

Value of local government assets

4.2 We collected information about how 228 local government entities insure their assets. Appendix 2 sets out the number and types of these entities. These public entities' financial statements have assets recorded at about \$112 billion. We refer to this as the carrying value of those assets. As Figure 17 shows, various types of public entities hold these assets.

Figure 17
Carrying value of local government assets, in billions of dollars, by type of entity

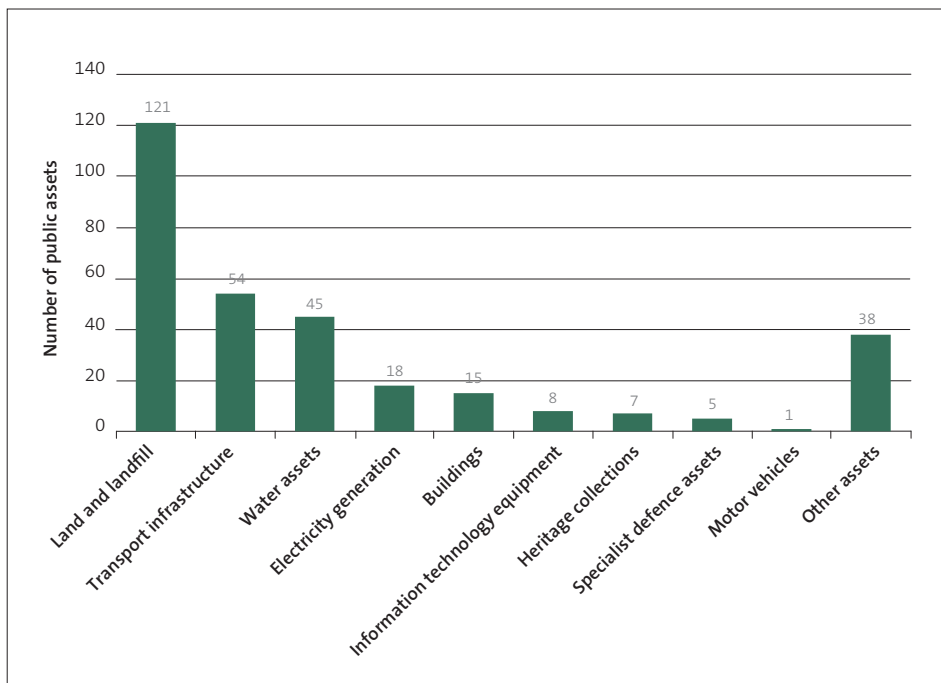


- 4.3 Figure 17 shows that local authorities own most local government assets. Local authorities own about 80% of the carrying value of assets. Local authorities have a unique arrangement with central government in terms of insurance. The 1991 Disaster Recovery Plan states that central government will pay up to 60% of restoration costs for water and sewerage services after a catastrophe.²
- 4.4 This arrangement is conditional on the local authority being able to show that the damaged assets had been properly maintained and that the local authority can meet the remaining 40% through other means (by setting aside reserves, insurance, or a mutual assistance scheme). We expected that many local authorities' assets would not have insurance cover in the traditional sense because the central government provides significant cover. Information from our auditors of local authorities supports this.

Extent of insurance cover for local government assets

- 4.5 We found that a high proportion of local government assets have no insurance cover. Slightly more than half of local government entities had at least one asset type without any insurance cover. Figure 18 shows that these asset types were most commonly land and landfill, transport infrastructure, and underground assets.

Figure 18
Assets without insurance cover in local government, by type of asset



² The 60/40 split between central and local government is set out in the *Guide to the National Civil Defence Emergency Management Plan*. The split excludes council-controlled organisations.

- 4.6 We found that about 60% of the carrying value of assets in local government does not have any insurance cover. The proportion of assets that are insured (around 40%) costs about \$100 million a year in insurance premiums.
- 4.7 Local authorities, electricity lines businesses, and other local government entities hold many uninsured assets. A particularly high number of electricity lines businesses have at least one asset type without insurance cover. In general, these are some of their electricity generation and distribution systems. The common reasons for this are that the cost of insurance outweighs the assessed risk and that they manage the risk with their capacity to borrow.
- 4.8 Three local government entities – Auckland Council, Christchurch City Council, and Watercare Services Limited – hold a significant proportion of the uninsured assets. Figure 19 outlines for these three public entities the types of asset without insurance and the reason why.

Figure 19
Types of assets that Auckland Council, Christchurch City Council, and Watercare Services Limited hold without insurance and reasons why

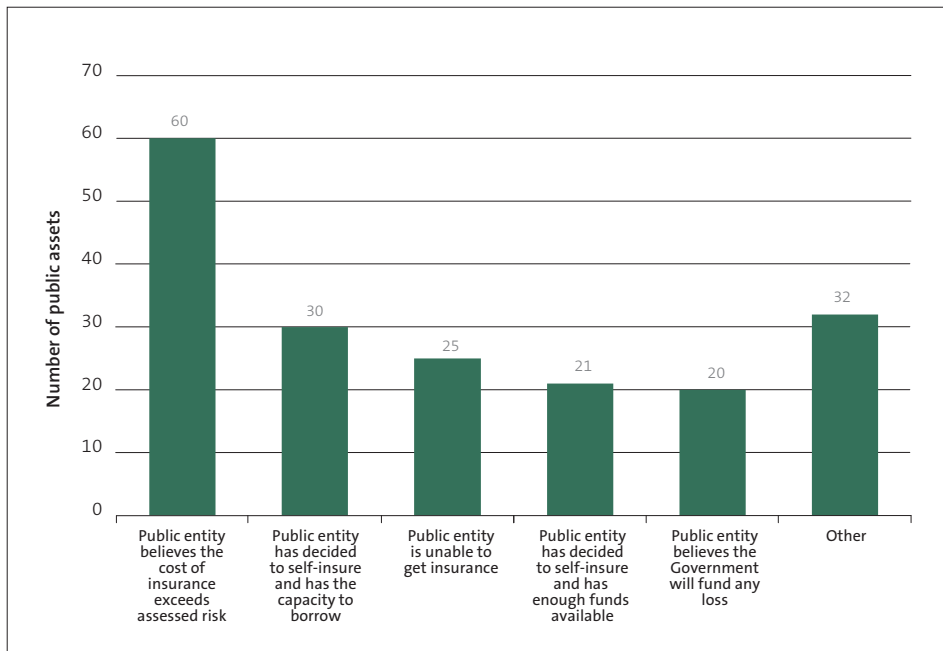
Public entity	Types of asset not insured	Reason they are not insured
Auckland Council (About \$20 billion of assets are not insured.)	Land, landfill, transport infrastructure, stormwater and flood protection schemes, playground equipment, streetscapes, lighting, monuments, and other non-building assets in the open.	Assessed that the cost of insurance exceeds the risks. Auckland Council has done a feasibility study and is looking at how to further self-insure assets. Auckland Council quantifies and assesses risks to assets and models the effects of natural disasters on assets. Therefore, decisions are influenced by scientific data, financial capability to retain risk, and risk management initiatives.
Christchurch City Council (Value of uninsured assets is difficult to work out because of complexities around the earthquakes.)	Land, transport infrastructure, stormwater and flood protection schemes, water supply systems, wastewater and sewerage systems, and some buildings.	Could not get insurance. Christchurch City Council has the capacity to borrow to fund any loss or damage.
Watercare Services Limited (About \$5 billion of assets are not insured.)	Land and underground infrastructure assets (water supply, wastewater, and sewerage systems).	Assessed that the cost of insurance exceeds the risks. Watercare Services Limited has the capacity to borrow to fund any loss or damage.

- 4.9 If we exclude Auckland Council, Christchurch City Council, and Watercare Services Limited, the percentage of local government assets that are uninsured drops significantly. However, about half of the carrying value of local government assets is not insured. Many local authorities do not have insurance cover for a significant proportion of their assets.
- 4.10 Having assets without insurance cover is not necessarily cause for alarm. There are other ways to manage risk. Therefore, it is important to look at the common reasons for not having insurance for assets.

Reasons why some assets in local government have no insurance cover

- 4.11 The most common reason why assets in local government, other than land, have no insurance cover was that the cost of insurance is higher than the assessed risk and the public entity has decided to self-insure, either because it has the capacity to borrow or has enough funds available. Figure 20 shows the common reasons why some local government assets have no insurance cover.

Figure 20
Reasons why some local government assets have no insurance cover



- 4.12 The cost of insurance exceeding assessed risk shows that public entities are carrying out risk assessments to work out whether insurance provides value for money. It is good practice to carry out such assessments. We have not tested the quality of risk assessments for those public entities that believe the cost of insurance is higher than the assessed risk.
- 4.13 A decision to self-insure because of the capacity to borrow is unique to public entities that can borrow. Public entities sometimes use this ability to help manage risks. Being able to borrow funds was a common reason why public entities got insurance that did not cover the full carrying amount of the assets.
- 4.14 Another reason for a public entity to have no insurance cover was that the government agreed to cover 60% of restoration costs for water and sewerage assets. Some information about this, along with how the Local Authority Protection Programme Disaster Fund started is set out in the box headed “What we found out from Civic Assurance”.

Level of cover for insured assets in local government

- 4.15 The results show that the total sum insured is slightly more than the carrying value of local government assets that insurance policies cover. This could mean that the total insurance cover for these assets is enough. However, it also might not, because the cost to replace these assets is likely to be significantly more than their carrying value.
- 4.16 Even though the sum insured value is greater than the carrying value of insured assets on a total basis, the opposite applied for about 20% of insurance policies. Some electricity lines businesses do not insure the full carrying value of their assets because they partly manage the risk with their ability to borrow, and the assets being widely dispersed means that the required insurance cover is assessed as lower.

Commonly used insurance provider for local government entities

- 4.17 We found that the insurer that local authorities most commonly used was New Zealand Local Government Insurance Corporation Limited, trading as Civic Assurance. Civic Assurance is owned by local government and supplies local government with a range of financial services,³ including insurance and the Local Authority Protection Programme Disaster Fund (LAPP).

³ These services include insurance, Riskpool (professional indemnity and public liability protection), KiwiSaver, and the LAPP.

What we found out from Civic Assurance*

Insurance

Civic Assurance and its predecessors have provided insurance and financial services to local authorities since 1941. Most local authorities are shareholders. Civic Assurance offers a range of insurance products to local authorities,[†] but does not offer material damage cover for above-ground property.

The Canterbury earthquakes had a significant effect on Civic Assurance. Before the earthquakes, Civic Assurance had built a sizeable insurance portfolio and reinsurance programme. After the earthquakes, more than 900 claims were submitted and, as at 31 December 2012, the outstanding claims liability was more than \$800 million. Most of this amount is covered by Civic Assurance's reinsurance arrangements, so the reinsurers bear a significant part of the earthquake claims costs.

However, after the earthquakes, Civic Assurance was not able to renew its property reinsurance programme or secure suitable reinsurance from any other source from 1 July 2011. As a consequence, Civic Assurance's claims payable credit rating was reduced in 2011 to "B+/-, negative watch" and it has been unable to offer material damage cover since then. The Civic Assurance group made a loss before tax of about \$1.6 million[‡] for the year ended 31 December 2012. Most of this loss was because of the cost of dealing with the Canterbury earthquake claims. More costs will be incurred in 2013 because of the Canterbury earthquake claims. Civic Assurance issued an offer to its shareholders and other local authorities in late 2012 to subscribe for shares in the company. This offer is to close in December 2013 unless extended.

Several matters need to be resolved before Civic Assurance can again provide material damage cover for local authorities.[▲]

Local Authority Protection Programme Disaster Fund

The LAPP is a "cash accumulation mutual pool" set up and administered by Civic Assurance. Several local authorities are members. It is not compulsory for local authorities to join. It is a choice based on their assessment of risks and the best way to mitigate those risks.

How the LAPP started

Until 1991, central government took full responsibility for all costs associated with the restoration of water and sewerage services after natural disasters. The 1991 Disaster Recovery Plan stated that central government would pay a maximum of 60% [□] of restoration costs in the event of a catastrophe and only if the local authority could show that the damaged assets had been properly maintained and the local authority could meet the remaining 40% through other means (such as reserves, insurance, or mutual assistance schemes). As a means to cover their 40% share, Civic Assurance formed the LAPP mutual assistance scheme on 1 July 1993 in the form of a charitable trust.

* The purpose of this example is to provide some depth to the analysis by showing the experience of a specialist insurer, not to judge the validity or appropriateness of specialist insurers.

[†] These products include Material Damage, Business Interruption, Motor Vehicle, Contractors All Risks, Marine Cargo and/or Hull, Electronic Equipment, Fidelity Guarantee, Personal Accident, Forest and Rural Fire Costs, Civil Defence Expenditure, Election Expenses, Machinery Breakdown, Boiler Explosion, Professional Indemnity, Public Liability, and Travel.

[‡] This amount is from the 2012 financial statements of New Zealand Local Government Corporation Limited, trading as Civic Assurance (rounded to the nearest \$100,000).

[▲] Note 24 to Civic Assurance's financial statements for the year ended 31 December 2012 explains some of those issues.

[□] The 60/40 split between central and local government is set out in the Guide to the National Civil Defence Emergency Management Plan. It excludes Council-controlled organisations.

How the LAPP works

Members make an annual contribution to the LAPP in return for cover for the cost of restoring their infrastructure as a result of a damaging event.

Contributions are set at a level that covers the expected risk, administration costs, and re-insurance premiums. In some years the annual contribution includes a significant component for building the LAPP. This allows the LAPP to do more self-insurance. Members pay an annual contribution based on factors such as the risk or exposure of the member to a damaging event in its region, the asset value of the member, and the state of repair, maintenance, and condition of the member's infrastructure.

Insurance claims (distributions) are met from a combination of assets in the LAPP and reinsurance purchased from the global market. Before making a distribution, it must be established that the loss or damage is to the infrastructure and that the loss or damage was caused by the damaging event.

The LAPP also provides a risk management programme. This means that each member is visited at least every four years for a review of their infrastructure assets covered by the LAPP.

Advantages of the LAPP

An assessment of key risks for local authorities for assets covered by the LAPP shows that the risk of asset damage or loss because of a disaster in New Zealand is very low, but with relatively high impact. Options to transfer some of this risk include joining the LAPP or using a private insurer or self-insurance through setting aside its own disaster reserves. According to Civic Assurance, some of the LAPP's advantages over the alternatives are:

- the LAPP has no profit motives or commissions, and has lower overheads;
- there are better opportunities for the sector for collection of risk management data and for improved risk management practices to be implemented; and
- management of the scheme's assets, their security, and control of the claims process is retained by local government.

Before the Canterbury earthquakes, member contributions and excesses had generally been falling while values covered had more than doubled.

Effects of the Canterbury earthquakes on the LAPP

The Canterbury earthquakes have had a significant effect on the LAPP. The LAPP had just the one automatic reinstatement, so although the September 2010 and February 2011 earthquakes were covered the 13 June 2011 earthquake was not covered by the LAPP's reinsurers. There are uncertainties surrounding the amount of claim liabilities and the related reinsurance recoveries arising from the Canterbury earthquakes. As at 30 June 2012, gross outstanding claims liabilities for Canterbury totalled \$454 million. This was before receiving any reinsurance recoveries for these claims. After reinsurance and other recoveries, the net outstanding claims liabilities amounted to \$24.2 million.

The future of the LAPP

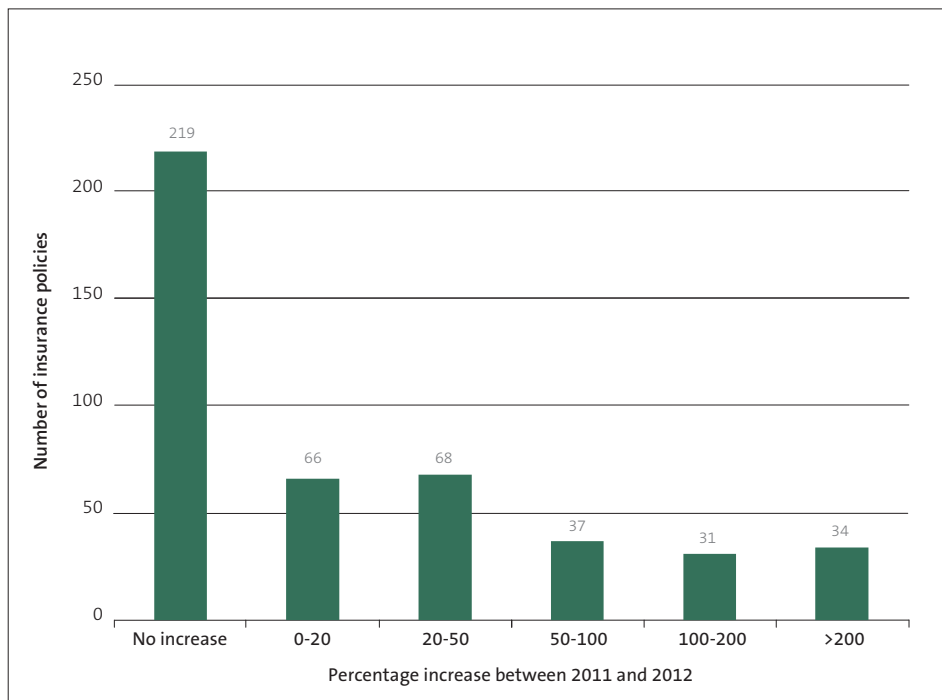
The LAPP is dependent on its ability to retain members and rebuild its fund. It agreed a significant increase in members' contributions for 2011/12, and has opted for a mix of self-reinsurance and reinsurance cover, at least for 2012/13.

Changes in insurance in local government after 2010

- 4.18 Local government entities have faced significant changes to their insurance because of changes in the insurance market during the past couple of years.

- 4.19 We collected information about the changes in insurance policies between 2011 and 2012. For slightly less than 40% of the insurance policies that we collected information about, there was an increase of more than 20% in the insurance premiums. Figure 21 shows how much premiums have increased in local government.

Figure 21
Increase in premiums for insurance policies in local government, 2011 to 2012



- 4.20 Between 2011 and 2012, increases in premiums were much more common than increases in excess or additional policy exclusions. Local authorities and airports had the highest proportion of insurance policies that had an increase in excess, compared with other local government entities. Local authorities also had the highest percentage of policies with additional policy exclusions. This shows that most local authorities have had to rearrange their insurance policies by paying more in premiums, accepting a higher excess, and/or accepting additional policy exclusions.
- 4.21 For more than half of the insurance policies in local government, public entities expected no significant changes for 2012/13. This showed that public entities believed that the insurance market had, for the most part, taken the effects of the Canterbury earthquakes and other global events into account.

Appendix 1

Information we sought from our auditors about insurance

To gather information on insurance of assets by public entities, we prepared a questionnaire for our auditors to complete for many public entities with more than \$100,000 of assets. The questionnaire was set out as follows:

1. Name of entity
2. The carrying value of assets as at the 2012 balance date
3. Do all types of assets have some level of insurance cover?
4. Select the types of assets that have no insurance cover:
 - Land (including parks and reserves)
 - Landfill
 - Buildings
 - Transport infrastructure (including road, rail, ports, and airports)
 - Stormwater and flood protection systems
 - Water supply systems
 - Wastewater and sewerage systems
 - Electricity generation and distribution systems
 - IT and other specialist equipment
 - Cultural and heritage collections
 - Specialist defence assets
 - Motor vehicles
 - Other
5. Why does the entity have no insurance cover for these types of assets?
 - The entity has tried but is unable to get insurance
 - The cost of insurance exceeds the entity's assessed risk
 - The entity has the capacity to borrow to fund any loss or damage
 - The entity has sufficient available funds to repair or replace those assets
 - The Government has agreed to fund any loss or damage to those assets
 - Other

We asked the following questions for up to three of the main insurance policies:

6. Name of insurer
7. Period of the insurance policy
8. Select the types of assets covered by this insurance policy:
 - Land (including parks and reserves)
 - Landfill
 - Buildings

- Transport infrastructure (including road, rail, ports, and airports)
- Stormwater and flood protection systems
- Water supply systems
- Wastewater and sewerage systems
- Electricity generation and distribution systems
- IT and other specialist equipment
- Cultural and heritage collections
- Specialist defence assets
- Motor vehicles
- Other

9. Sum insured value of assets

10. Amount of insurance premium

11. Amount of excess

12. Carrying value of the assets covered by the insurance policy as at the 2012 balance date.

13. If the 2012 sum insured value of these assets is less than the 2012 carrying value, how is the uninsured risk being managed?

- The entity has the capacity to borrow funds to manage the risk
- The entity has sufficient investments it could realise to manage the risk
- The Government has agreed to provide funding to cover the risk
- Other
- Not applicable: the 2012 sum insured value is greater than the 2012 carrying value

14. When comparing insurance information from the 2012 financial year to the 2011 financial year, which of the following apply?

- There was a significant increase in insurance premium by%
- There was a significant increase in insurance excess by%
- There were broad policy exclusions in the 2012 insurance policy that were not in the 2011 policy. These were
- None of these apply

15. Which of the following does the entity expect to affect its insurance of these assets during the 2013 financial year?

- The entity does not expect any significant changes
- The entity expects to self-insure against the loss or damage of these assets
- The entity expects a significant increase in insurance premium

- The entity expects a significant increase in insurance excess
- The entity expects more policy exclusions to be added to the insurance policy
- None of these apply

16. Are there any features of the entity's insurance arrangements that could make it suitable for a case study?

Appendix 2

The number and types of public entities for which we collected insurance information

		Number of public entities*
Central government	Government departments	40
	Crown entities – Tertiary education institutions	30
	Crown entities – Crown research institutes	8
	Crown entities – District health boards	20
	Other Crown entities	49
	State-owned enterprises	20
	Other central government entities	33
Local government	Local authorities	78
	Council-controlled organisations	59
	Airports	14
	Ports	16
	Electricity lines businesses	24
	Licensing and community trusts	18
	Other local government entities	19

We did not collect information from the following types of public entities because they are relatively small and do not own significant assets.

Excluded	Administering bodies and boards
	Cemetery trustees
	Māori trust boards
	Rural Education Activities Programme
	Many small subsidiaries of public entities
	Schools (but we did get information about school properties from our auditor of the Ministry of Education)

* The number of entities may include significant subsidiaries of the types of entities described.

Appendix 3

Glossary

Common terms used in this paper	
Carrying value	The amount at which an asset is recognised in an entity's financial statements after deducting any accumulated depreciation and accumulated impairment losses.
Cover	The scope of protection provided by an insurance policy.
Excess	A portion of an insurance claim that the insured party must pay. It is usually the first part of the loss claimed, up to a value set out in the insurance policy.
Indemnity value	The current value of an asset that takes into account its age and condition at the time of loss or damage.
Insurance broker	An independent agent who advises people wanting insurance, and arranges insurance cover for them.
Policy exclusion	A provision within an insurance policy that eliminates cover for certain circumstances or specific losses.
Premium	The amount required to be paid to obtain a specified amount of insurance cover for a set period.
Reinstatement	A provision within an insurance policy that results in insurance cover continuing to be provided following an event that results in a claim.
Reinsurance	Insurance purchased by an insurer that transfers a portion of their risk to other parties (the reinsurers). The risk is assumed by the reinsurer in return for a part of the premium the insurer receives.
Replacement cost	The amount that would be required currently to create an asset with the same service capacity as an existing asset.
Self-insurance	A way of managing risk by having access to funds, either cash or borrowings, for use when an unexpected loss happens, rather than having insurance.
Sum insured value	The maximum amount an insurer will pay out under an insurance policy. If there is a loss limit and the insurance pay-out is capped, this is taken into account.

Publications by the Auditor-General

Other publications issued by the Auditor-General recently have been:

- Evolving approach to combating child obesity
- Public sector financial sustainability
- Education for Māori: Implementing *Ka Hikitia – Managing for success*
- Statement of Intent 2013–2016
- Central government: Results of the 2011/12 audits
- Health sector: Results of the 2011/12 audits
- Transport sector: Results of the 2011/12 audits
- Local government: Results of the 2011/12 audits
- Crown Research Institutes: Results of the 2011/12 audits
- Inquiry into decision by Hon Shane Jones to grant citizenship to Mr Yang Liu
- Ministry for Primary Industries: Preparing for and responding to biosecurity incursions
- Inquiry into the Government's decision to negotiate with SkyCity Entertainment Group Limited for an international convention centre
- New Zealand Police: Enforcing drink-driving laws
- New Zealand Defence Force: The civilianisation project
- Effectiveness and efficiency: Stories from the public sector
- Department of Conservation: Prioritising and partnering to manage biodiversity
- Auckland Council: Transition and emerging challenges

Website

All these reports, and many of our earlier reports, are available in HTML and PDF format on our website – www.oag.govt.nz. Most of them can also be obtained in hard copy on request – reports@oag.govt.nz.

Notification of new reports

We offer facilities on our website for people to be notified when new reports and public statements are added to the website. The home page has links to our RSS feed, Twitter account, Facebook page, and email subscribers service.

Sustainable publishing

The Office of the Auditor-General has a policy of sustainable publishing practices. This report is printed on environmentally responsible paper stocks manufactured under the environmental management system standard AS/NZS ISO 14001:2004 using Elemental Chlorine Free (ECF) pulp sourced from sustainable well-managed forests. Processes for manufacture include use of vegetable-based inks and water-based sealants, with disposal and/or recycling of waste materials according to best business practices.



Office of the Auditor-General
PO Box 3928, Wellington 6140

Telephone: (04) 917 1500
Facsimile: (04) 917 1549

Email: reports@oag.govt.nz
Website: www.oag.govt.nz