

SP Energy Networks 2015–2023 Business Plan

Updated March 2014

Annex

Insurance Strategy

SP Energy Networks

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Insurance strategy

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Background

Scottish Power's corporate insurance function works with the business to ensure a thorough and consistent approach to mitigating an appropriate level of risk through transfer by insurance. A combination of the company's risk appetite, cost of insurance and statutory obligation dictates the level of insurance cover purchased.

Scottish Power is part of the Iberdrola group, Europe's 3rd largest utility and a world leader in renewable energy. Scottish Power's insurance function has been gradually combined with that of Iberdrola to provide economies of scale and consistent policy cover for its major exposures (property and general liability). Iberdrola's approach relied on higher retention levels within the businesses before transferring the remaining risk to the insurance markets. This also provides an incentive for improving levels of risk management and loss prevention within the organisation.

The changes included:

- The adoption of Aon as IBE/SP's main current global insurance adviser,
- The adoption of Iberdrola's Luxembourg-based reinsurance facility following a review of our risk financing arrangements by Aon;
- Global insurance policies incepted for Iberdrola's worldwide assets and liabilities.

Overall strategy

Iberdrola have appointed specialist global insurance brokers, Aon as their professional advisors and to place the required insurances in the market. The Corporate Insurance teams work closely with Aon (who service the Iberdrola Group companies from Bilbao and London) and the businesses to provide the necessary underwriting information for all classes of insurance, to allow insurers to evaluate the risk and price accordingly. In addition we also seek to retain the broadest scope of cover and where possible reduce exclusions and restrictions by promoting SP's investment and risk management philosophy to insurers.

The majority of insurance policies are global policies and are placed by the Iberdrola Insurance team in Bilbao. This allows us to achieve economies of scale in our premiums and Scottish Power is able to benefit from Iberdrola's purchasing power in the market. As a result we are confident we are driving the best value possible.

It is important that these global premiums are allocated effectively within the businesses as this can help to drive ownership within the company and a focus on improving the management of risk within the individual businesses. We also need to consider the regulatory nature of much of our Networks business and ensure that the allocation relates to the level of risk within that part of the organisation.

Local policies for Employer's Liability and Motor Third Party Liability insurance are placed in the UK to meet with the statutory requirements along with a local Terrorism policy covering our assets. The insurance team work closely with Health & Safety, Occupational Health and Fleet Business to demonstrate our risk management philosophy and minimise increases in insurance premiums that may result from a hardening market. In addition to the Group and Local UK policies, there are two stand-alone policies which are purchased for SP Power Systems - Professional Indemnity Insurance and Contractors All Risks Insurance. These policies are required to meet with contractual requirements faced by the Distribution

Connections business, and these policies are marketed by our brokers in order to achieve competitive premiums.

Occasionally stand-alone construction or liability policies are required for individual, larger projects carried out by the Networks business. The need for these will usually be dictated by the contractual arrangements of the project.

Outlook

The global insurance markets cycle between soft and hard phases, influenced by factors such as the global economy and the level of catastrophe losses experienced year on year (e.g. bad hurricane seasons, earthquakes etc). For example poor investment returns and high costs of losses impacting on reinsurance companies reduce the amount of capacity available in the market and leads to a rise in premium rates – which is known as a “hard market”.

Insurance market conditions in the last 10 years have tended to be, and remain, soft, meaning an excess of providers and capacity and therefore an ability to negotiate relatively cheaper insurance costs. There are signs that markets are showing initial signs of hardening in line with current difficult economic conditions – although this can take a number of years to manifest. Insurers are seeking increased rates in most instances and are giving preference to risks that can demonstrate above average management of risk. Aon monitor this situation closely and part of their remit is to keep client’s informed of trends and outlooks.

Hardening global property costs could have an impact on Iberdrola’s insurance spend, particularly our global property exposure. Our exposure to these market prices can be controlled through use of the Iberdrola captive facility which would allow us to smooth prices and large increases from year to year.

Conclusions

Insurance costs are subject to a constantly evolving market cycle as well as the changing nature of any business. Premium rates have remained fairly low and stable for the last 7 or 8 years however there are initial indications that costs could start to rise given favourable conditions in coming years. Iberdrola and Scottish Power’s insurance function tracks these movements to allow us to anticipate rises in premium rates and mitigate them through use of Iberdrola’s re-insurance captive, retaining more risk within the business and improving our management of occurring losses.

Iberdrola retains the services of Aon, one of the largest risk and insurance advisers in the world. Aon’s services assist us in assessing the risks that we are exposed to in all areas of the business and the most effective means of mitigation – through transfer or other control strategies.

Iberdrola’s global scale and presence allows us to exploit economies of scale in both the placing of the company’s insurance policies and our strategies for retaining risk within the business.