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Actuarial Report on the Transfer and Amalgamation of General Insurance Business within the Suncorp Group

Suncorp Insurance Holdings Limited and Subsidiary Companies

March 2013

25 March 2013

Mr Andrew Huszczo
Appointed Actuary, General Insurance
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Dear Andrew

Actuarial Report on the Transfer and Amalgamation of General Insurance Business within the Suncorp Group

We are pleased to enclose our actuarial report prepared for the transfer and amalgamation of the general insurance businesses within the Suncorp Group.

Please do not hesitate to contact us if you have any questions.

Yours sincerely

Tim Andrews

Estelle Pearson

Fellows of the Institute of Actuaries of Australia

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Actuarial Report on the Transfer and Amalgamation of General Insurance Business within the Suncorp Group

Part I Executive Summary

1 Introduction and Background

This report has been prepared at the request of Suncorp Insurance Holdings Limited (SIHL). SIHL wishes to consolidate its general insurance licences by reducing the number of authorised general insurers in the Suncorp general insurance group in Australia from five to one. The current insurers are:

- AAI Limited
- Suncorp Metway Insurance Limited (SMIL)
- GIO General Ltd (GIOG)
- Australian Associated Motor Insurers Limited (AAMI)
- Australian Alliance Insurance Company Ltd (Aust Alliance).

AAI Limited is proposing four separate but concurrent Schemes of Arrangement under Division 3A of Part III of the Insurance Act that will transfer the insurance liabilities of its subsidiaries SMIL, GIOG, AAMI, and Aust Alliance to AAI Limited effective from 1 July 2013 (referred to as the planned transfer date).

This report explains our understanding of the schemes and examines the impact of the schemes on the policyholders of SMIL, GIOG, AAMI, Aust Alliance, and AAI Limited.

This report has been prepared in accordance with our understanding of the provisions of APRA's prudential standard GPS 410. In our experience it is usual for such actuarial reports to provide an opinion as to whether or not the interests of policyholders are materially adversely affected by the proposed schemes. In our opinion this relates to the payment of claims when they fall due, both now and in future, with such payments being made reasonably promptly and efficiently once liability and quantum have been established. In forming an opinion on policyholder interests consideration has been given to:

- The contractual rights of existing policyholders
- The continuity of claims management procedures
- The financial security provided to policyholders before and after the transaction, having regard to:
  - the risks faced by the insurance entities
  - the capital position of the insurance entities.

The approach we have taken and detailed findings can be found in the attached report.

2 Overall Conclusion

Our opinion is that the interests of policyholders will not be adversely affected in a material way as a consequence of the schemes. In essence from a policyholder perspective, the only change will be the name of the licensed insurer appearing on the policy documentation.

Impacts on the Australian General Insurance Group

- The schemes are intra-group. The capital management approach, solvency level, and reinsurance arrangements for the Australian general insurance group will be unchanged following the schemes.
- Capital levels would be well in excess of the minimum regulatory level for AAI Limited post transfer. We are satisfied that the schemes provide adequate financial security to the policyholders; noting that there is always uncertainty with the outcome of insurance business and ongoing solvency cannot be guaranteed.
- The ultimate security currently provided to policyholders is from Suncorp Group Limited and this would be unchanged.
- Policyholders will have their policies and claims managed under the same practice and philosophy as before the transfer.
- Policy terms and conditions will remain unchanged as a result of the schemes, except for the name of the licensed insurer appearing on the policy documentation for policyholders of the transferring insurers.
- After the schemes the insurer will hold appropriate provisions for liabilities.
- The profitability of the insurance business of the Australian general insurance group is expected to be good (based on the assessment in the actuarial Financial Condition Report, which appears reasonable). This provides a further buffer in the event of adverse experience.

Impacts on Individual Insurers

- There are no material changes to the risk profile to which policyholders are exposed.
- The post transfer insurer is larger and more diversified than any of the individual insurers pre transfer.
- The post transfer capital adequacy position, as measured by coverage of APRA’s minimum requirements, is better than the pre transfer position for all the individual insurers besides AAI Limited. Whilst AAI Limited’s coverage ratio of minimum requirements would be lower post transfer, the expected capital will be significant in its own right. In addition the AAI Limited policyholders would benefit from being part of a larger and more diversified insurer, as would the policyholders of the other insurers. In our view there would not be any material increase in the risk to the policyholders of any of the insurers.

- The security provided to policyholders by reinsurance would, in effect, be unchanged.

To the extent that the likelihood of claims not being paid is remote we assess that post transfer AAI Limited will continue to provide an adequate level of protection to policyholders.

3 Reliances and Limitations

We understand that a copy of the full report will be available on the website www.schemesummary.com.au and for public inspection.

Third parties, whether authorised or not to receive this report, should recognise that Finity will not be liable for any losses or damages howsoever incurred by the third party as a result of them receiving, acting upon or relying upon any information or advice contained in the report.

Our report should be considered as a whole. Members of Finity staff are available to answer any queries, and the reader should seek that advice before drawing conclusions on any issue in doubt.

Section 7 sets out our reliances and limitations in more detail and these should be read in order to place our opinion in its appropriate context.

Part II Detailed Findings

1 Introduction

1.1 Purpose of Report

This report has been prepared at the request of Suncorp Insurance Holdings Limited (SIHL). SIHL is authorised by the Australian Prudential Regulation Authority (APRA) as the non-operating holding company (NOHC) for the Suncorp general insurance group. SIHL wishes to consolidate its general insurance licences by reducing the number of authorised general insurers in the Suncorp general insurance group in Australia from five to one.

AAI Limited is a wholly owned subsidiary of SIHL and is authorised by APRA as a general insurer. It has four wholly owned subsidiaries, each of which is an APRA authorised general insurer. These are:

- Suncorp Metway Insurance Limited (SMIL)
- SMIL's subsidiary GIO General Ltd (GIOG)
- Australian Associated Motor Insurers Limited (AAMI)
- Australian Alliance Insurance Company Ltd (Aust Alliance).

AAI Limited was formerly known as Vero Insurance Limited. The name was changed on 1 October 2012. Figure 2.1 in the next section shows the current corporate structure.

AAI Limited is proposing four separate but concurrent Schemes of Arrangement under Division 3A of Part III of the Insurance Act that will transfer the insurance liabilities of its subsidiaries SMIL, GIOG, AAMI, and Aust Alliance to AAI Limited effective from 1 July 2013 (referred to as the planned transfer date).

This report explains our understanding of the schemes and examines the impact of the schemes on the policyholders of SMIL, GIOG, AAMI, Aust Alliance, and AAI Limited. We understand that the report will be provided to APRA and to the Federal Court, and will be available on the website www.schemesummary.com.au, as part of the documentation supporting the transfers.

The report is based on the audited financial position of the insurers as at 30 June 2012. We have also had regard to certain relevant information available at a later date as listed in Appendix A. It is planned that following the finalisation of this report, but prior to the final hearing for confirmation of the schemes, we will be asked by SIHL to update our assessment based on the most up to date APRA returns available at that time, in order to confirm that our assessment remains appropriate.

We previously prepared a preliminary actuarial report on the transfer as set out in our report dated 28 September 2012 ("the preliminary actuarial report"). The preliminary actuarial report was prepared to assist SIHL with the case it presented to a dispensation hearing in October 2012 in relation to the schemes.

In preparing this report, we have liaised with and received assistance from Suncorp Group representatives, including its Appointed Actuary Andrew Huszczo. We have found the Suncorp Group to be open and available in its dealings with us, with all material requested made available to us. Suncorp Group has reviewed our report, and we understand it has no objections to the information as presented in relation to its business.

1.2 Prudential Standard GPS 410

This report has been prepared in accordance with our understanding of the provisions of APRA's prudential standard GPS 410, which sets out the procedural requirements for insurers transferring or amalgamating insurance business. While this standard provides no specific guidance on the content of actuarial reports on which insurance business transfers are based, in our experience it is usual for such actuarial reports to provide an opinion as to whether or not the interests of policyholders are materially adversely affected by the proposed schemes.

1.3 Authorship of Report

This report has been prepared by Tim Andrews of Finity Consulting (Fellow of the Institute of Actuaries of Australia) who has been appointed by SIHL as the Independent Actuary for the purpose of Division 3A of Part III of the Insurance Act. It has been subject to technical and peer review as part of Finity's standard internal control process. Estelle Pearson (Fellow of the Institute of Actuaries of Australia) conducted the peer review. Plural pronouns ('we' and 'our') have been used throughout this report, but as Tim Andrews is the Independent Actuary and the primary author of this report, they can equally be interpreted in the singular ('I' and 'my').

1.4 Policyholder Interests

In our opinion the interests of policyholders relate to the payment of claims when they fall due, both now and in future, with such payments being made reasonably promptly and efficiently once liability and quantum have been established. In forming an opinion on policyholder interests consideration has been given to:

- The contractual rights of existing policyholders
- The continuity of claims management procedures
- The financial security provided to policyholders before and after the transaction, having regard to:
  - the risks faced by the insurance entities
  - the capital position of the insurance entities.

1.5 Approach

The approach to forming this opinion has been to gain an understanding of:

1. The nature of the schemes being proposed.
2. The Suncorp Group's business operating model.
3. The business within each insurance entity, the reinsurance arrangements, and the size, nature and valuation of the liabilities.
4. The key risks or uncertainties relating to each entity that were identified in the Appointed Actuary's Financial Condition Report (FCR), the Risk Appetite Statement and/or the Risk Register
5. The capital management for the general insurance entities in the Suncorp Group, including review of the Internal Capital Adequacy Assessment Process (ICAAP) Process Document and ICAAP Summary Statement.
6. The capital adequacy of each insurance entity and the consolidated position under the regulatory regime as at 30 June 2012 by reference to the audited annual regulatory returns, and how those positions would change under the regime that came into force on 1 January 2013.
7. The approximate capital adequacy of the amalgamated business post transfer under the regulatory regime in force from 1 January 2013.

The purpose of item 1 is clear. Item 2 involves consideration of the interrelationships of the companies subject to the schemes and the way in which the policyholder interacts with the organisation/insurer. These issues are relevant due to the intra-group nature of the transfer. We explore whether the schemes will have an impact on the manner in which the entities are managed in the aggregate.

The purpose of items 3 and 4 is to assist consideration of whether the liabilities of the insurers are adequately provided for and also whether the schemes materially change the risk profile to which policyholders of any of the insurers are exposed in a manner that would be material to the interests of policyholders. Items 5 to 7 relate to the capital positions of the insurers, and enables consideration of whether the schemes would materially impact on the solvency protection provided to policyholders.

1.6 Information

The information used in preparing this report is set out in Appendix A.

We have also liaised with and received assistance from Suncorp Group representatives and their legal advisor on this matter, Allens.

1.7 Background and Definitions of Key Terms

Structure / Types of Entity

Suncorp general insurance group (Suncorp GI Group): The general insurance entities within the Suncorp Group which sit under SIHL (the APRA authorised Level 2 NOHC). This includes companies active in New Zealand as well as Australia.

Australian general insurance group (Aust GI Group): The general insurance entities within the Suncorp Group which operate in Australia. The APRA authorised Level 1 general insurance companies which comprise this group are AAI Limited, SMIL, GIOG, AAMI and Aust Alliance and any non-regulated subsidiaries of these companies.

Level 1 Insurer: For the purposes of APRA's prudential requirements, this is an individual insurer that is authorised under the Insurance Act 1973 and is part of a Level 2 insurance group.

Level 2 Insurance Group: Interpreting the standard for Suncorp, this refers to a group of companies comprising the authorised Non-Operating Holding Company and its controlled entities. For the purposes of prudential supervision of insurance groups at Level 2, all entities conducting insurance business, both regulated and unregulated, within the group must be consolidated.

Affected Policyholders: This refers to the policyholders of SMIL, GIOG, AAMI, and Aust Alliance.

Relevant Reports

Internal Capital Adequacy Assessment Process (ICAAP) Process Document and ICAAP Summary Statement: With effect from 1 January 2013 insurers are required by APRA to have an ICAAP in place, which provides an integrated process for managing risk and capital in line with an entity's risk appetite. The ICAAP Summary Statement sets out the basis and principles used to manage capital and risk, including target capital levels.

Financial Condition Report (FCR): The Appointed Actuary of an APRA authorised general insurance company is required to provide a report to the directors of the company annually which contains an overview of the financial condition of the company including recent trends and prospects. The financial condition of the company refers to the sustainability of the business – its continued ability to achieve financial objectives and meet its long term business aspirations.

Insurance liabilities: At least once a year the Appointed Actuary of an insurer is required to report on the company's insurance liabilities. The insurance liabilities include the outstanding claims liabilities (i.e. future payments on claims which have already occurred) and the premium liabilities (i.e. future payments from future claims arising from unexpired exposure on in-force policies). The liabilities include claim payments, associated expenses, and a risk margin which is intended to provide for the liability estimate to be sufficient three years in four.

Capital Adequacy

APRA capital requirements (to 31 December 2012): APRA sets risk based minimum capital requirements for insurers operating in Australia. Up until 31 December 2012 the Minimum Capital Requirement (MCR) consisted of the sum of % charges applied to investment holdings and insurance liabilities depending on the riskiness of the item and a Maximum Event Retention (MER) which for many insurers was the amount of loss from a major catastrophe after allowing for reinsurance arrangements.

APRA capital requirements (from 1 January 2013): APRA has recently reviewed the capital standards for life and general insurers (this process was called LAGIC). As a result new capital requirements took effect on 1 January 2013, and a further component will take effect from 1 January 2014. The changes make the minimum capital requirement more risk sensitive and introduce charges for operational risk and an allowance for diversification across the different risks faced. As part of the changes the MER has been replaced by the Insurance Concentration Risk Charge (ICRC). The ICRC represents the greater of the loss from a single large catastrophe and the cumulative losses from a series of smaller catastrophes.

The capital requirement determined by the new regulatory formula is called the Prescribed Capital Amount (PCA). In addition APRA may require a Supervisory Adjustment to be added to the PCA in respect of a particular insurer, giving the total capital requirement for that insurer - from 1 January 2013 the sum of the PCA and Supervisory Adjustment is called the Prudential Capital Requirement (PCR).

Capital Adequacy Ratio (CAR): This is the ratio of the insurer's capital base to the regulatory requirement (i.e. the MCR up to 31 December 2012 and the PCR since that time). An insurer aims to have its CAR at or exceeding its capital target.

Tier 1 Capital: Tier 1 Capital is defined by APRA in its Prudential Standard GPS 112. The full definition is long but in essence it refers to capital that provides a full and unrestricted commitment of funds and is freely available to absorb losses. Tier 1 Capital includes the value of paid up ordinary shares and retained earnings. Subordinated debt is not part of Tier 1 Capital.

Capital targets: Insurers hold capital in excess of the APRA capital requirement to withstand fluctuations in capital levels. Each company sets its own target capital taking into account the risk profile of the business and the ease of access to additional capital as well as any regulatory or rating agency requirements.

Reinsurance

Reinsurance terminology: An insurer may buy different types of reinsurance to cover more extreme risks and events. The following are the main types of reinsurance referred to in this report:

- Catastrophe cover – This covers an insurer for the accumulation of claims arising from a single event. The reinsurer pays claims in excess of a specified retention up to a specified limit. Aggregate catastrophe cover provides protection against claims arising from multiple events.
- Excess of loss cover – Under this arrangement the reinsurer pays any individual claim in excess of a specified retention usually up to a specified limit.
- Quota-share cover – Under this arrangement an insurer pays a percentage of premium received to the reinsurer, and the reinsurer pays the same percentage of all claims.
- Surplus cover – Under this arrangement the percentage of premium ceded to and claims paid by the reinsurer is determined for each risk depending on the size of the sum insured.
- Facultative arrangements – These are reinsurance contracts arranged for an individual risk or group of risks rather than all risks written in a particular portfolio.
- Drop down cover – Under this arrangement, the amount of the excess of loss retention is reduced for the second (and/or subsequent) loss.

1.8 Structure of this Report

The remainder of this report is structured as follows:

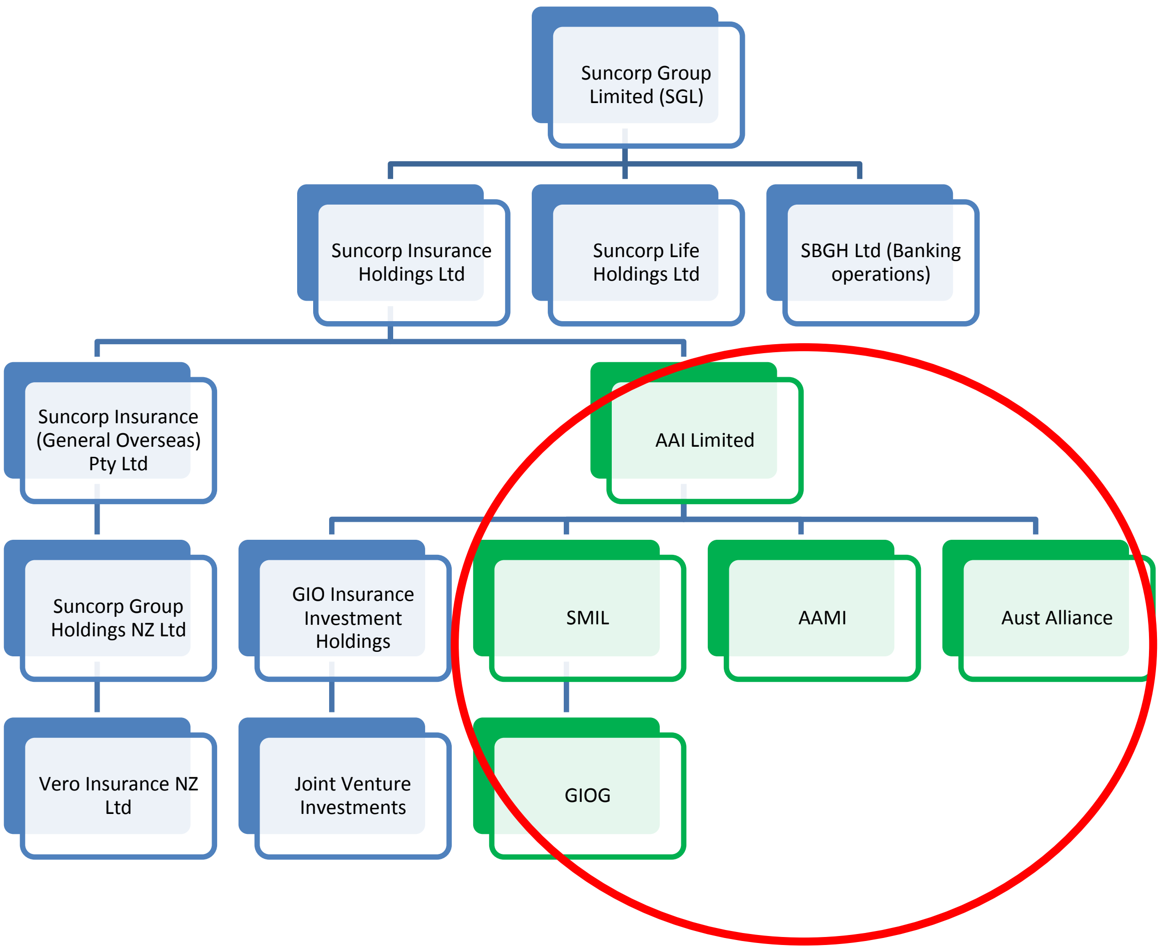
Section 2	describes our understanding of the schemes being proposed, based on our discussions with staff of the Suncorp Group and our review of the Scheme documents and Transfer Agreement. This section includes our findings on the impact of the schemes on the level of reinsurance protection provided to the insurers and the capital management practices.
Section 3	discusses the Suncorp Group's current operational model and the business within each of the five licensed general insurance entities. This section includes our findings on the impact of the schemes on the levels of risk faced by the insurers, which is relevant to the extent of financial protection provided to policyholders.
Section 4	documents the capital adequacy of each general insurance entity at 30 June 2012 (audited) and indicates the impact of APRA's new regulatory regime applying from 1 January 2013 on the capital position.
Section 5	discusses the projected capital adequacy of the single licensed entity following the transaction.
Section 6	contains our conclusion on the impact of the schemes on policyholder interests.
Section 7	sets out the reliances and limitations that apply to our advice.

2 Background to the Schemes

2.1 Business to be Transferred

The following diagram shows the simplified corporate structure of the Suncorp Group as at 30 June 2012 and highlights the Australian general insurance group which is the subject of the proposed transaction.

Figure 2.1 – Suncorp Group Corporate Structure at June 2012 (Simplified)



The Suncorp Group carries on Banking and Life Insurance business as well as general insurance business. The general insurance group sits under SIHL. The New Zealand general insurance businesses are subsidiaries of Suncorp Insurance (General Overseas) Pty Ltd. The Australian general insurance group consists of AAI Limited and its subsidiaries.

2.2 Nature of the Schemes

Our understanding of the proposed schemes is based on discussions with staff of Suncorp and review of the Scheme documents and Transfer Agreement. It is proposed that all insurance contracts, rights and obligations and insurance liabilities of the insurance entities SMIL, GIOG, AAMI and Aust Alliance will be transferred to

AAI Limited with effect from 1 July 2013. All assets relating to insurance business will be transferred from SMIL, GIOG, AAMI and Aust Alliance to AAI Limited equal to (at least)[1]:

- the value of the liabilities being transferred, measured on an APRA basis
- the APRA capital of the insurers on the date of transfer (which includes any risk margins held above APRA's minimum 75% probability of sufficiency level).

After the transfer SIHL intends to apply to APRA for revocation of the APRA authorisations of SMIL, GIOG, AAMI and Aust Alliance, leaving the Suncorp Group with a single Australian general insurance licensed entity.

2.3 Reinsurance Arrangements

Current

Most of the current reinsurance arrangements relevant to the liabilities of the five licensed general insurance entities are arranged at a Group level. The reinsurance cover applies to all claims arising from particular portfolios regardless of the specific insurer. From review of the FCR and from discussions with Suncorp staff we understand that the external reinsurance arrangements for 2012/13 include:

- A property catastrophe cover that provides $5.05 billion of cover per event with a retention of $250 million. In addition, a number of drop down covers are in place, reducing the maximum event retention to $200 million for the second loss, and to $50 million for the third and fourth losses. (Note that for the third and fourth losses, the $100 million excess of $50 million layers are only partially placed – at 81.5% and 89% respectively).
- A 30% quota share cover for Queensland domestic property exposures, which reduces Suncorp's exposure to natural hazards in Queensland.
- Various property per risk covers, including a surplus programme that limits the retained risk to $20 million per risk, a per risk excess of loss treaty which further limits individual losses to $10 million, and a clash cover which limits losses involving multiple policyholders to $10 million.
- Casualty per risk and event excess of loss covers which limit losses from large personal injury or third party damage claims to $10 million ($5 million for professional indemnity).
- Various facultative arrangements for more specialised lines of business purchased on a policy by policy basis.

In addition there is an internal catastrophe reinsurance arrangement provided by AAI Limited to the four other Australian general insurance entities to limit the aggregated property losses in each of these entities to $10 million per event (rather than

[1] Based on information as at 29 January 2013, subject to confirmation

$250 million). The purpose of the internal arrangement is to manage the APRA regulatory minimum capital in each licensed entity so that only one entity (AAI Limited) needs to hold capital to cover the $250 million Group retention. There is also a similar internal reinsurance arrangement provided by AAI Limited to Vero New Zealand (VNZ) which limits the aggregated property loss in VNZ to NZ$25 million per event.

In addition there are a number of legacy arrangements (reinsurance and indemnity), including reinsurance attaching to long tail claims from previous accident years.

After the Schemes

We have been advised that Suncorp does not currently intend to change the external reinsurance management approach subsequent to the schemes taking effect. Ongoing management of reinsurance arrangements will continue to be a key strategic activity within the general insurance operations. The internal catastrophe arrangement between AAI Limited and the other Australian entities would however no longer be required, as those entities would no longer be carrying on insurance. These internal arrangements will be terminated with effect from 1 July 2013.

We understand that AAI Limited will request that the court makes orders to transfer all reinsurances that relate to the transferring liabilities to AAI Limited. In addition, AAI Limited is seeking to novate the relevant reinsurance arrangements from the transferring insurers to AAI Limited. We note the following:

- As the Suncorp Group has numerous reinsurance contracts in place covering its general insurance business with a large number of reinsurers going back over many years (both treaty and facultative), it intends to contact the reinsurers in its records (and those identified through brokers) and to request that each reinsurer agrees to execute a single document to novate all of the reinsurance contracts covering one or more of the transferring insurers to AAI Limited.
- Where it is not possible to novate any reinsurance contract to AAI Limited (e.g. because the consent of all parties to the original reinsurance cannot be obtained), it is proposed that the transferring insurers will assign their rights and obligations under the reinsurance to AAI Limited and the reinsurer will recognise and give effect to that assignment.
- Suncorp has sought approval from APRA to treat the novated/assigned reinsurance arrangements as if AAI Limited were always a party at the original inception date of the reinsurance for the determination of capital treatment under GPS 114 Capital Adequacy: Asset Risk Charge (January 2013). That is, the higher default factors for recoveries from non-APRA-authorised reinsurers that apply to contracts incepting from 31 December 2008 will not be applied. APRA has granted in principle approval, with formal approval anticipated closer to the planned transfer date when novations have been executed.

In effect, it is Suncorp's current intention that the level of reinsurance protection provided to the Australian general insurance group immediately after the schemes are implemented will be unchanged.

Our Findings regarding the Post Schemes Reinsurance Position

When considered from the perspective of individual policyholders and noting SMIL, AAMI, AAI and GIOG currently benefit from intra-group reinsurance arrangements provided by AAI Limited:

- For policyholders of SMIL, GIOG or AAMI, the exposure of their insurer to catastrophes will be increased as a result of the scheme. This reflects the increased retention for these insurers (from \$10 million to \$250 million), expressed in proportion to their capital base. This would be especially significant in the event of multiple catastrophes in a year.
- For policyholders of Aust Alliance, the ratio of the retention to the capital base is similar before and after the scheme.

Nevertheless we assess that the effective risk to the policyholders of SMIL, GIOG and AAMI is effectively unchanged, for two reasons:

- Currently, in the event of multiple catastrophes in a year, the provider of the protection to SMIL, GIOG and AAMI is AAI Limited. Each entity is therefore reliant on AAI Limited's capital (and if this is not sufficient, ultimately the capital of SGL) to meet multiple catastrophe events.
- Post scheme, capital would be held by AAI Limited to cover the cost of the retention should an event occur, in the same way that AAI Limited holds this capital currently. If this capital is not sufficient – say in the case of multiple events – then SGL remains the ultimate source of capital as currently.

2.4 Capital Management

Overall Capital Targets and Triggers

The ICAAP Summary Statement outlines how the general insurance business actively manages risk and ensures adequate capital exists to meet current and future policyholder obligations. This requires setting internal capital targets and triggers at the Level 1 and Level 2 licensed entity level:

- The *internal target* capital is the amount of capital that is considered to be appropriate to hold over the longer term, in line with the risk appetite of the insurer and of the Australian General Insurance Group
- The *internal trigger* is the minimum point at which remedial action to improve the capital position by Suncorp is required.

The ICAAP Summary Statement states that the internal target is intended to be consistent with a risk appetite of a 1/100 chance of the capital falling below the minimum capital requirement for the general insurance group. For the individual insurers we have been advised that the capital triggers and targets have been established to cover 1.2 times the MCR (or PCR from 1 January 2013) plus the cost of a certain number of catastrophes. Where a company has insurance subsidiaries the target also recognises that the net tangible investment in the subsidiary may not be available to protect policyholders in the parent. This makes the target multiples for SMIL and AAI Limited, which have subsidiaries, somewhat higher than the other companies and reflects the fact that the capital in the subsidiaries is already being utilised to protect the subsidiaries' policyholders.

The internal capital triggers and targets for each entity as at November 2012, and as set out in the ICAAP Summary Statement, are shown in Table 2.1. The targets differ slightly from those shown in the FCR as applying at 30 June 2012. This reflects that the calculation of the targets is dynamic and the targets vary in response to changes in the level of MCR/PCR. This is most notable in SMIL and AAI Limited which have subsidiary general insurers.

Table 2.1 – Capital Triggers and Targets at November 2012 (as a ratio to the APRA regulatory requirement)

Entity	Internal Trigger	Internal Target
GIOG	1.23x	1.25x
SMIL	1.77x	1.78x
AAMI	1.24x	1.26x
Aust Alliance	1.33x	1.46x
AAI Limited	2.38x	2.53x
Australian GI Group	1.35x	1.45x
Suncorp GI Group (Level 2)	1.35x	1.45x
SGL (Level 3)		1.45-1.50x

The ICAAP Summary Statement has set a capital range for the Australian general insurance group of 1.35 to 1.45 times the APRA regulatory minimum requirement. The ultimate parent, SGL, holds additional capital (which may be more or less than 0.05 times the PCR) in respect of the general insurance group to ensure the general insurance group is capitalised to 1.50 times the PCR.

The buffer above the Internal Trigger is held to absorb 'business as usual' volatility including seasonal impacts. Capital rebalancing and internal dividends are normally considered on a semi-annual basis.

Some additional capital is kept in AAI Limited to allow greater flexibility of capital transfers within the Australian general insurance group, however this capital is not reflected in the internal capital targets. It is intended that the general insurance group be self-contained, with minimal capital transfer between the general insurance group and SGL.

Tier 1 Targets

APRA specifies that Tier 1 Capital must exceed 80% of the required regulatory capital, excluding the Supervisory Adjustment (i.e. 80% of the PCA). The ICAAP Summary Statement sets out the requirement for a buffer above this level, such that the target levels of Tier 1 Capital are:

Table 2.2 – Tier 1 Capital Targets at November 2012 (as a ratio to the PCA)

Entity	Internal Target
GIOG	125%
SMIL	178%
AAMI	126%
Aust Alliance	146%
AAI Limited	184%
Australian GI Group	110%
Suncorp GI Group (Level 2)	110%

The Tier 1 Target is the same as the overall capital target for each of the entities besides AAI Limited, and Level 2, Level 3 Groups. This reflects that only AAI Limited has any non-Tier 1 Capital.

Impact of the Schemes on the Targets

We have been advised by Suncorp management that the capital targets are not expected to change as a result of the schemes. Given no change in the underlying risk profile of AAI Limited or any of the transferring insurers (SMIL, GIOG, AAMI and Aust Alliance) the targets will be the same as for the Australian general insurance group – i.e. the internal capital target for AAI Limited after the transfer is expected to be 1.45 times the APRA regulatory requirement.

2.5 Queensland Government Guarantee

The statutory guarantee provided by the Queensland government in respect of policies issued by SMIL prior to its privatisation was continued under the legislation which created the Suncorp Metway Group of Companies. This government guarantee continues to apply to SMIL policies with inception dates before 1 December 1996. The guarantee would be triggered in the event that SMIL fails to meet its obligations to those policyholders. The Queensland government's obligation only extends to the amount which was, on 1 December 1996, the maximum actual or contingent liability of SMIL for a pre 1 December 1996 policy. We have been advised by the Suncorp Group that the guarantee may not remain in place following the transfer of SMIL's insurance business to AAI Limited.

The absence of the guarantee impacts a small number of policyholders – i.e. those holders of policies issued by SMIL prior to 1 December 1996. The outstanding claim liabilities in respect of those pre 1 December 1996 policies are currently estimated to be around $30 million. For the purpose of this report we have formed the view that the absence of the guarantee does not have a material adverse impact on these policyholders, noting that the possibility of it being triggered is remote.

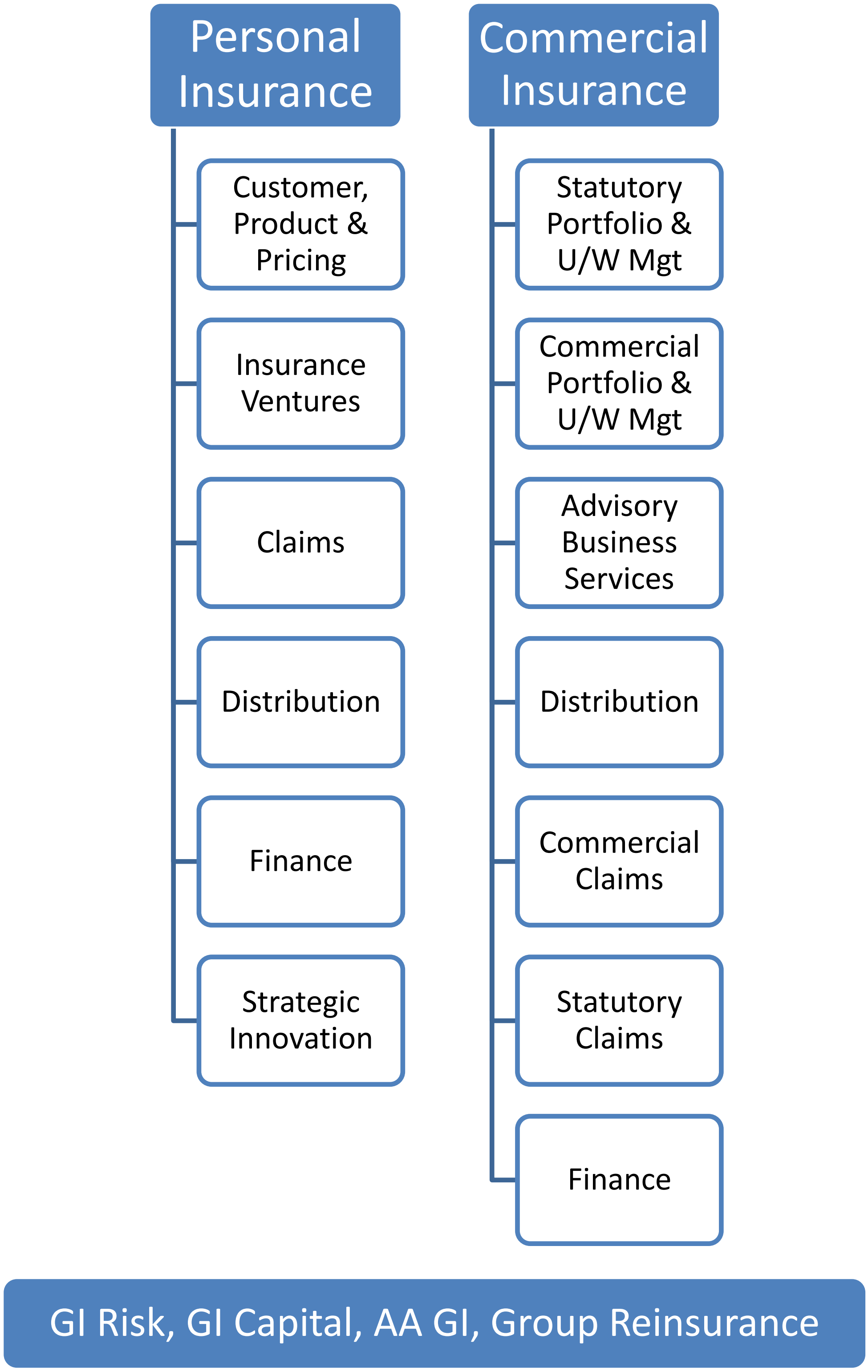
3 Description of Business

3.1 Operating Structure

The Suncorp Group operates the Australian general insurance group as two core businesses – Personal Insurance and Commercial Insurance – which are quite independent of the corporate structure. The Personal Insurance business includes domestic covers (such as home and motor) written under any of the general insurance licences under a variety of brands and distribution arrangements. The Commercial Insurance business includes commercial covers (such as property, liability and workers compensation) written under any of the general insurance licences under a variety of distribution arrangements as well as CTP written by AAMI, SMIL and GIOG.

Portfolio management and pricing, claims, distribution and finance are separate functions under each of Personal and Commercial Insurance as shown in the following diagram. For each of actuarial, capital, risk and reinsurance, one functional area spans the Personal and Commercial Insurance businesses. In Commercial Insurance there is a distinction between statutory classes (CTP and workers compensation) and commercial business (property, commercial motor, liability, professional indemnity, directors and officers and commercial packages).

Figure 3.1 – Australian General Insurance Group Operating Structure



This operating structure means that the policyholders' interface with the Suncorp Group will be unaffected by the transfer since operations are already independent of the individual licensed entities underwriting individual policies. In essence from a policyholder's perspective the only change will be the name of the licensed insurer appearing on the policy documentation.

3.2 Nature of Business

We have considered the nature of insurance risks facing each entity currently based on business currently being written. This assessment is based on information contained in the Financial Condition Report and the June 2012 annual APRA regulatory returns, supplemented by discussions with Suncorp. Later in this section we consider the risks emerging from business written in past years, as reflected in the current insurance liabilities.

Table 3.1 summarises the gross written premium for 2011/12 for each of GIOG, SMIL, AAMI, Aust Alliance, and AAI Limited. This summary has been produced from APRA returns. The table distinguishes the business between Personal Insurance and Commercial Insurance.

Table 3.1 – Gross Written Premium for 2011/12 ($ million)

Class	Insurer					
	GIOG	SMIL	AAMI	Aust Alliance	AAI Limited	Total
Householders	453	408	489	260	197	1,807
Domestic Motor	401	297	1,331	361	82	2,472
Travel	0	0	10	1	11	22
Marine	11	7	0	1	0	19
Other Accident	41	3	7	0	93	143
Total Personal Insurance	**906**	**716**	**1,836**	**623**	**383**	**4,463**
Commercial Motor	32	5	1	0	198	236
Fire and ISR	107	10	7	0	323	446
Marine	0	0	0	0	50	50
CTP	224	467	209	0	0	900
Public and Product Liability	128	11	28	10	115	291
Workers Compensation	235	0	0	0	6	241
Professional Indemnity	1	5	0	0	151	156
Other	0	0	0	0	37	37
Total Commercial Insurance	**727**	**498**	**245**	**10**	**879**	**2,359**
Total	**1,633**	**1,214**	**2,080**	**633**	**1,262**	**6,822**

Note: The AAI Limited premium excludes the $418 million premium for the intercompany catastrophe reinsurance provided to the other entities.

Gross written premium across the five general insurance entities (excluding the intra group catastrophe reinsurance) is $6.8 billion. Two thirds of total premium is in respect of Personal Insurance business.

The FCR includes an assessment of the adequacy of premium rate levels for key classes of business. The business plans for the Australian general insurance group are based on profit levels that are consistent with the Appointed Actuary's assessment of rate adequacy. The plans indicate good profitability in the next year and reflect an improvement over the performance in recent years. The improvement in performance is reasonable based on some hardening of premium rate levels and assuming weather claims revert to "average" levels.

The following sections give a brief overview of the main insurance exposures in each licensed entity.

GIOG

GIOG has $1.6 billion of gross written premium with 56% under Personal Insurance and 44% under Commercial Insurance. Within Personal Insurance, GIOG underwrites home, motor and marine insurance under the GIO brand largely in NSW and Victoria with market shares of 10% and 5% in these states respectively. GIOG also underwrites these products under the Resilium[2] brand. Business is sold directly or through authorised representatives or brokers for the Resilium brand.

GIOG underwrites a variety of commercial insurance products under the GIO brand mainly focused at small to medium sized businesses and sold through authorised representatives or directly. Products include property, motor and liability.

GIOG is licensed to underwrite workers compensation in WA, Tasmania, the ACT and Northern Territory providing cover to employers for personal injury to their workforce during the course of employment. GIOG is also a managed fund scheme agent in the NSW workers compensation scheme, collecting premiums and managing claims on behalf of NSW WorkCover and receiving a fee for these services (note that the premium collected on behalf of the scheme is not included in Table 3.1).

In addition GIOG is licensed to underwrite CTP business in NSW and has a 13% share of this market. This business involves payment of compensation for personal injuries to third parties injured in motor vehicle accidents. This is long tail business with claims on average not paid for a number of years following an accident. The GIOG CTP business is exposed to the personal injury legal environment (inflation risk) in NSW and to regulatory/political risk in that state.

SMIL

SMIL has $1.2 billion of gross written premium income with 59% of business within Personal Insurance and 41% of business (almost entirely CTP) under Commercial Insurance. SMIL is a major underwriter of home, motor and marine insurance in Queensland under the Suncorp brand (with a 25% share of this market). Business is sold on a direct basis, primarily by phone or the internet, and through motor dealers and bank branches. This business is predominantly short tail. Home business is exposed to weather events and the SMIL portfolio has a higher than average weather risk because of the concentration of business in Queensland. The 30% quota share acts as a partial mitigant to this exposure.

In addition SMIL is licensed to write CTP business in Queensland and has a 45% share of this market. This business involves payment of compensation for personal injuries to third parties injured in motor vehicle accidents. This is long tail business with claims on

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[2] Rebranded from AMP, November 2012.

average not paid for a number of years following an accident. The SMIL CTP business is exposed to the personal injury legal environment (inflation risk) in Queensland and to regulatory/political risk in that state.

Following licence consolidation AAI Limited will issue a Suncorp-branded CTP product in Queensland.

AAMI

AAMI has $2.1 billion of gross written premium, 88% under Personal Insurance and 12% under Commercial Insurance (mostly CTP). Within Personal Insurance, AAMI underwrites mainly home and motor insurance under the AAMI, Bingle and Just Car brands. Business is sold directly or through the Just Car underwriting agency. AAMI has 22% market share in Victoria, 15% in NSW, and 8% in Queensland.

AAMI is licensed to underwrite CTP business in NSW and Queensland. AAMI has a 9% share of the NSW CTP market and a 5% share of the Queensland market. This business involves payment of compensation for personal injuries to third parties injured in motor vehicle accidents. This is long tail business with claims on average not paid for a number of years following an accident. The AAMI CTP business is exposed to the personal injury legal environment (inflation risk) in Queensland and NSW and to regulatory/political risk in those states. Following licence consolidation the Queensland CTP business will be referred to the Suncorp-branded product underwritten by AAI Limited.

AAMI also writes a small amount of commercial package business on a direct basis, focussed on very small businesses.

Aust Alliance

Aust Alliance has $0.6 billion of gross written premium almost entirely within Personal Insurance. Aust Alliance underwrites home and motor business under the APIA, InsureMyRide (motorcycle specialist) and Shannons brands.

AAI Limited

Total gross written premium for AAI Limited is $1.3 billion (excluding internal reinsurance) with around 70% of the business under Commercial Insurance. Within Personal Insurance AAI Limited underwrites mostly home and motor through three brands Vero, CIL (caravans and RVs) and Terri Scheer (landlord's insurance). Distribution is largely via corporate partners and brokers. Business is short tail with claims usually finalised and paid within 12 months of the accident.

Under Commercial Insurance, AAI Limited underwrites commercial motor, corporate property, marine, construction & engineering, liability, professional indemnity and Directors & Officers (D&O) under the Vero brand. AAI Limited writes a large volume of SME business, packages of commercial insurance for small to medium sized businesses including property and liability covers. The Commercial Insurance business is distributed through brokers.

The property components of Commercial Insurance (motor and property) are short tail with claims largely being paid within 12 months of the accident. There is a greater level of volatility in claims costs than equivalent domestic covers however with larger, more complex risks and a greater exposure to large claims. Liability, professional indemnity and D&O are long tail classes where claims can take a number of years to be reported and for the claim costs to develop. This business is exposed to the legal environment (inflation risk) and (especially professional indemnity and D&O) to the economic environment. Unlike the Personal Insurance business, underwriting of individual risks plays a much larger role in Commercial Insurance, increasing in importance relative to technical pricing for risks that are larger and more complex in order to reflect the circumstances of the individual risk.

Our Findings regarding the Post Schemes Business Composition

In summary, AAI Limited is mainly a commercial risks underwriter including some larger, more complex individual risks while Aust Alliance is a personal risk underwriter. SMIL and AAMI are also mainly personal risk underwriters with CTP businesses while GIOG's business is spread across personal and commercial risks with the latter being focussed on small/medium sized businesses.

AAI Limited, SMIL, GIOG and AAMI each have significant long tail exposures while Aust Alliance underwrites mainly short tail risks.

SMIL's business is most concentrated from a geographic perspective and as a result has a high exposure to Queensland natural hazards (which has been partially mitigated by the 30% quota share), and to the Queensland legal and political environment.

For some policyholders the risk profile of their insurer will be increased post scheme. For example, Aust Alliance has no exposure to commercial insurance and limited exposure to long tail liabilities currently. We do not believe, however, that this has a material adverse impact on those policyholders, noting that the extra risks will be covered by capital under APRA's risk based capital regime and by the margin over the regulatory minimum capital that will be held.

In our opinion, all insurers would benefit from a greater level of diversification post transfer. The business has been profitable in recent years and performance is expected to improve in the short term, which provides a buffer in terms of the protection provided to policyholders in the event of deterioration in performance.

3.3 Insurance Liabilities and Uncertainty

We reviewed the Appointed Actuary's liability valuation report as at 30 June 2012 as well as the External Peer Review actuarial report at that date. The purpose of our review was to understand the nature of the liability risks faced by each entity, and overall.

Table 3.2 shows the APRA net insurance liabilities of each licensed entity at 30 June 2012 as estimated by the Appointed Actuary. These amounts are discounted and contain risk margins at an estimated 75% probability of sufficiency (PoS). This summary has been produced from APRA returns.

Table 3.2 – APRA Insurance Liabilities as at 30 June 2012 ($ million)

	Insurer					
	GIOG	SMIL	AAMI	Aust Alliance	AAI Limited	Total
Net Outstanding Claims						
CTP	725	1,609	962	-	12	3,307
Workers' Comp Underwritten	399	-	-	-	43	441
Workers' Comp Asbestos/Runoff	175	-	-	-	235	410
Public and Home Liability	217	61	42	15	223	558
Home Owners' Warranty	-	-	-	-	165	165
Professional Indemnity	0	22	-	-	231	254
Commercial Short Tail	54	13	4	0	165	237
Householders	121	84	163	80	51	498
Domestic Motor	48	29	127	38	19	262
Travel	-	-	2	-	2	3
Internal and Inwards Reinsurance	1	41	-	-	96	138
Total Outstanding Claims	**1,739**	**1,859**	**1,299**	**133**	**1,242**	**6,272**
Net Premium Liabilities						
CTP	133	231	125	-	-	490
Workers' Comp Underwritten	183	-	-	-	3	186
Public and Home Liability	36	4	8	5	46	99
Professional Indemnity	0	3	-	-	71	74
Commercial Short Tail	62	15	5	1	210	292
Householders	96	63	143	68	62	431
Domestic Motor	163	116	618	151	37	1,085
Travel	-	-	1	-	2	3
Internal and Inwards Reinsurance	-	-	-	-	179	179
Total Premium Liabilities	**673**	**431**	**901**	**225**	**609**	**2,838**
Total Insurance Liabilities	**2,412**	**2,290**	**2,200**	**358**	**1,851**	**9,111**

Total insurance liabilities amount to $9.1 billion across all five entities. Liabilities in respect of CTP exposures represent 42% of the total amount. The liabilities were estimated by internal valuation actuaries at a 'class of business' level, reviewed by the Appointed Actuary, and subject to External Peer Review by KPMG Actuaries. The liabilities have been subject to a considerable level of scrutiny and there were no significant issues raised in the Appointed Actuary report or the External Peer Review report.

Our Findings regarding the Insurance Liabilities

Our overview of the liabilities in each entity did not identify any issues relating to either the valuation or the transfer of the liabilities that we believe are material to policyholders. After the scheme:

- Transferring policyholders from SMIL, AAMI, and Aust Alliance will be newly exposed to asbestos liabilities (within AAI Limited and GIOG) which are particularly challenging to estimate. At 30 June 2012 the insurance liabilities in respect of asbestos totalled $235 million in AAI Limited (including a risk margin of

19%, at 75% PoS) and $175 million in GIOG (including a risk margin of 20%, at 75% PoS). This accounts for just 4.5% of total insurance liabilities.

- Transferring policyholders from GIOG, SMIL, AAMI, and Aust Alliance will be newly exposed to home owners warranty liabilities (in run-off) which are also challenging to estimate. At 30 June 2012, the insurance liabilities in AAI Limited in respect of home owners warranty totalled $165 million (including a risk margin of 18%, at 75% PoS). This accounts for just 1.8% of total insurance liabilities.

In our opinion, we do not believe that the extra risk to policyholders from exposure to these liabilities is material, noting the relative size of the liabilities and the risk margins and liability risk charges added to them to reflect the inherent uncertainty.

3.4 Risk Profile

We have reviewed the FCR, Risk Appetite Statement and Risk Register to understand the key risks faced by each entity. We have considered, in particular, instances where the risk profile to which policyholders of any of the insurers are exposed would change materially following the transfer.

For many of the risks faced by the insurers APRA specifies capital requirements intended to deliver a 99.5% probability of policyholder liabilities being met in full[3]. Hence we aim to focus on any potential situations where the risk profile of the insurer changes and that extra risk is not covered by capital requirements.

Our Findings regarding the Post Schemes Risk Profile

Our review of the FCR and Risk Register did not uncover any material changes in the risk profile, besides those relating to the profile of business and insurance liabilities as described earlier in this section. In our opinion, there are no changes in risk profile that would emerge from the schemes that adversely affect the interests of policyholders.

[3] See APRA’s prudential standard GPS 110 paragraph 25.

4 Capital Position Pre Transfer

This section looks at the balance sheet and APRA capital adequacy of each insurer and the Australian general insurance group at 30 June 2012. The balance sheet is shown as reported in the annual APRA returns. For the capital adequacy positions at 30 June 2012, we have included both the impact of known capital transfers since that date, and the impact of the changes to the regulatory capital framework under LAGIC. The derivation of the capital adequacy figures shown in this section is shown in full detail in Appendix C. The Appendix also shows how the capital levels compare to the target capital levels shown in Section 2.

In the next section we examine the solvency position that will apply post transfer, and compare it to the above pre transfer positions in order to assess the impact of the schemes on each entity.

4.1 Balance Sheet Position at 30 June 2012

Table 4.1 summarises the balance sheet position for the Level 1 insurers at 30 June 2012, produced from the 30 June 2012 annual APRA returns (GRF 300). APRA returns are not prepared for the Australian general insurance group and therefore the position has been provided by Suncorp. In any case in considering the capital position pre transfer we are only concerned with the capital positions of the individual entities (Level 1 insurers).

Table 4.1 – Balance Sheet at 30 June 2012 as per Regulatory Reporting GRF 300 ($ million)

	Level 1					
	GIOG	SMIL	AAMI	Aust Alliance	AAI Limited	Aust GI Group [1]
Assets						
Investments	2,605	2,885	2,513	262	2,903	11,101
Investments in Controlled Entities	-	1,385	-	-	1,822	(0)
Premium Receivables	607	211	365	245	460	-
Other Receivables	132	123	152	21	410	2,243
RI Recoveries on OSC	71	170	136	21	425	1,520
Non Reinsurance Recoveries	228	291	329	34	78	
Deferred Reinsurance Expense	145	223	143	70	224	1,177
Deferred Acquisition Cost	109	35	88	43	155	
Deferred Tax, Levies and Charges	59	3	42	19	33	119
Other Assets and Goodwill	5	1	2	7	13	1,461
Total Assets	**3,961**	**5,327**	**3,769**	**721**	**6,523**	**17,621**
Liabilities						
Creditors	103	88	92	9	95	-
Insurance Payable	148	168	134	64	247	-
Claims Liabilities	2,170	2,349	1,801	186	1,844	8,268
Unearned Premium & Unexpired Risk	956	606	1,120	355	981	3,827
GST Payable & Income Tax Liability	29	57	10	2	6	164
Other Liabilities	13	23	54	2	153	1,967
Total Borrowings	44	85	31	12	110	-
Loan Capital and Hybrid Sec	-	294	-	-	413	-
Total Liabilities	**3,463**	**3,671**	**3,241**	**630**	**3,849**	**14,226**
Net Assets	**497**	**1,656**	**528**	**91**	**2,675**	**3,395**

1 For most balance sheet items, the Aust GI Group figure is close to the sum of the individual entities for the relevant rows in the table, with adjustment for consolidation (for example, the internal catastrophe arrangement). The rows that cannot be added in this way include:
- Investments in Controlled Entities: These are not relevant to the Aust GI Group, which includes the underlying assets and liabilities of all the entities.
- Other Assets and Goodwill: The Aust GI Group includes all goodwill that arises on consolidation. For SMIL and AAI Limited the goodwill relating to acquisitions is reflected in Investment in Controlled Entities.
- Net Assets: These are complicated by the values of controlled entities and goodwill amounts.

The 'Investments in Controlled Entities' largely relate to SMIL's holding of GIOG and AAI Limited's holding of SMIL, AAMI and Aust Alliance.

Note that the balance sheet includes the outstanding claims provisions under Australian Accounting Standards which include risk margins at an estimated 90% probability of sufficiency. These provisions will not match the APRA outstanding claims liabilities shown in Table 3.2 since that table includes risk margins at an estimated 75% probability of sufficiency.

4.2 APRA Capital Adequacy Position at 30 June 2012

For the purpose of examining the capital adequacy of the insurers as at 30 June 2012 we have measured capital adequacy:

- based on the audited 30 June 2012 position, as reported in the annual APRA returns
- with adjustments for known capital transfers since that date as if they had occurred on 30 June 2012

- with adjustment to remove the value of subsidiary companies, noting that the assets of those subsidiaries may not be available to protect the policyholders of the parent, and
- with adjustments for the estimated changes to the regulatory minimum capital calculations under LAGIC, assuming they applied at 30 June 2012.

The resulting capital adequacy figures are shown in Table 4.2. The derivation of these figures is shown in Appendix C. Note that Table 4.2 also shows figures for the Australian general insurance group for reference, but we are only concerned at this stage with the capital adequacy of the individual insurers.

Table 4.2 – Pro-Forma Pre Transfer Capital Adequacy Position at 30 June 2012

	Pro-Forma LAGIC Basis			
	Capital Base	Prescribed Capital Requirement	Capital Surplus	Capital Adequacy Ratio
	$mil	$mil	$mil	
Pre Transfer Position				
GIOG	609	503	107	1.21
SMIL	634	485	149	1.31
AAMI	530	444	85	1.19
Aust Alliance	111	110	1	1.01
AAI Limited	1,238	740	498	1.67
Aust GI Group	3,239	2,058	1,182	1.57

Note: the figures may not appear to add due to rounding.

The Capital Adequacy Ratio (CAR) shown for each insurer represents the ratio of the Capital Base to the PCR. These will be used in the next section as a base for assessing the impact of the schemes on the level of capital protection for each insurer.

We note that the "as-if" CARs under LAGIC are lower than might have been expected and lower than the internal capital targets (e.g. Aust Alliance at only 1.01). This primarily reflects a strengthening of the minimum capital requirement under LAGIC, and in particular the impact of the ICRC. The proposed schemes consolidating general insurance licences is just one mitigation activity adopted by Suncorp to manage the impact of LAGIC on capital requirements. In the normal course of events Suncorp would, and will, consider a variety of other initiatives including the structure of the 2013/14 reinsurance arrangements and evaluate the requirements for mitigating the ICRC. As such the actual outcomes would be different from the "as-if" outcomes shown in Table 4.2. Nevertheless we believe the figures shown remain useful as a base for the considering the impact of the schemes on relative capital levels.

5 Capital Position Post Transfer

This section shows the post transfer balance sheet positions, and compares the expected post transfer capital adequacy position with the pre transfer position for each insurer from the previous section.

5.1 APRA Balance Sheet Position Post Transfer

Table 5.1 shows the pro-forma post transfer balance sheet for each insurer, assuming the transfer occurred on 30 June 2012. The figures were provided to us by Suncorp.

Table 5.1 – Pro-Forma Post Transfer Balance Sheet at 30 June 2012 ($ million)

	GIOG	SMIL	AAMI	Aust Alliance	AAI Limited (Consolid'd)
Assets					
Cash	5	5	25	5	(132)
Investment Securities	-	-	-	-	10,903
Loans, Advances & Other Rec	-	(0)	16	-	2,243
RI & Other Recoveries	-	-	-	-	1,520
Due from Controlled Entities	0	(76)	(3)	0	221
Deferred Tax Asset	-	5	11	-	119
Investment Property	-	96	-	-	127
Goodwill	-	-	-	-	55
Other	0	13	9	-	1,372
Total Assets	5	43	59	5	16,428
Liabilities					
Outstanding Claims Liability	-	-	-	-	8,268
UEP & Unexpired Risk	-	-	-	-	3,827
Subordinated Notes	-	-	-	-	708
Payables & Other Liabilities	0	27	7	-	1,032
Outside Beneficial Interests	-	-	-	-	14
Deferred Tax Liability	-	10	-	-	164
Employee Benefit Obligations	-	-	35	-	95
Other	-	-	-	-	118
Total Liabilities	0	37	42	-	14,226
Net Assets	5	6	16	5	2,202

In order to verify that the pro-forma post transfer balance sheet provided by Suncorp is appropriate we have undertaken the following reasonableness checks:

- We checked that the post transfer total liabilities of $14.2 billion are unchanged from the pre transfer total liabilities of the Australian general insurance group (see Table 4.1).
- The post transfer total assets are $1.2 billion lower than those shown for the Australian general insurance group in Table 4.1. We verified that this amount is consistent with the goodwill being transferred to SIHL in a related transaction as outlined in the Transfer Agreement and as shown in Table 5.2.

Table 5.2 – Reconciliation of Net Assets at 30 June 2012 ($ million)

Australian GI Group (Table 4.1)	3,395
Capital Injections	165
Dividends	(348)
Common Control Reserve	47
Transfer of Goodwill	(1,057)
Subtotal	(1,193)
AAI Limited (Consolidated) Post Transfer (Table 5.1)	2,202

Table 5.1 also shows that the pro-forma post transfer net assets of GIOG, SMIL, and Aust Alliance are all close to the minimum $5 million requirement for licensed insurers. For AAMI, the net assets are higher at $16 million as there are several assets and liabilities which are not insurance business and thus not moved by the proposed schemes. This includes certain employee and property/lease obligations. Note that the capital injections and the dividend payments, identified in Table 5.2, occurred in September 2012.

5.2 APRA Capital Adequacy Position Post Transfer

Table 5.3 compares pro-forma pre transfer and post transfer CARs, on the LAGIC basis, as if the transfer occurred on 30 June 2012. The pro-forma post transfer position was advised to us by Suncorp.

Table 5.3 – Pro-Forma Post Transfer Capital Adequacy Position at 30 June 2012

	Pro-Forma LAGIC Basis			
	Capital Base	Prescribed Capital Requirement	Capital Surplus	Capital Adequacy Ratio
	$mil	$mil	$mil	
Pre Transfer Position				
GIOG	609	503	107	1.21
SMIL	634	485	149	1.31
AAMI	530	444	85	1.19
Aust Alliance	111	110	1	1.01
AAI Limited	1,238	740	498	1.67
Aust GI Group	3,239	2,058	1,182	1.57
Post Transfer Position				
AAI Limited (Consolidated)[1]	3,286	2,058	1,229	1.60

1 The difference between the Post Transfer Net Assets of AAI Limited in Table 5.1 of $2,202 million and the Post Transfer Capital Base of $3,286 million shown above is primarily due to the inclusion of excess technical provisions and subordinated debt in the Capital Base.

Our Findings regarding the Post Schemes Capital Adequacy Position

The capital levels are well in excess of the minimum capital requirement for AAI Limited post transfer (i.e. the CAR is 1.60).

Considered from the perspective of the individual insurers, the capital position is strengthened following the transfer for four of the five insurers:

- GIOG (the CAR increases from 1.21 to 1.60)
- SMIL (the CAR increases from 1.31 to 1.60)
- AAMI (the CAR increases from 1.19 to 1.60), and
- Aust Alliance (the CAR increases from 1.01 to 1.60).

Whilst AAI Limited's CAR would be lower post transfer, the expected CAR of 1.60 represents a significant level of capital in its own right, and the capital surplus would increase by $47 million to $1,229 million. The AAI Limited policyholders would benefit from being part of a larger and more diversified insurer. In our view there would not be any material increase in the risk to AAI Limited policyholders.

In conclusion, in our opinion we have not identified any adverse capital adequacy impact to policyholders of any of the entities as a result of the schemes.

6 Conclusions

Our opinion is that the interests of policyholders will not be adversely affected in a material way as a consequence of the schemes. In essence from a policyholder perspective, the only change will be the name of the licensed insurer appearing on the policy documentation. This is based on the following:

Impacts on the Australian General Insurance Group

- The schemes are intra-group. The capital management approach, solvency level, and reinsurance arrangements for the Australian general insurance group (the aggregation of the insurers impacted by the schemes) will be unchanged following the schemes.
- Capital levels would be well in excess of the minimum regulatory level for AAI Limited post transfer, on the basis of the prudential arrangements that apply under LAGIC. We are satisfied that the schemes provide adequate financial security to the policyholders; noting that there is always uncertainty with the outcome of insurance business and ongoing solvency cannot be guaranteed. This view also reflects that the Group is not planning to change the capital targets after the transfer of the policyholders.
- The ultimate security currently provided to policyholders is from SGL and this would be unchanged.
- Policyholders will have their policies and claims managed under the same practice and philosophy as before the transfer.
- Policy terms and conditions will remain unchanged as a result of the schemes, except for the name of the licensed insurer appearing on the policy documentation for policyholders of the transferring insurers.
- After the schemes the insurer will hold appropriate provisions for liabilities.
- The profitability of the insurance business of the Australian general insurance group is expected to be good (based on the assessment in the actuarial Financial Condition Report, which appears reasonable). This provides a further buffer in the event of adverse experience.

Impacts on Individual Insurers

- There are no material changes to the risk profile to which policyholders are exposed.
- The post transfer insurer is larger and more diversified than any of the individual insurers pre transfer.
- The post transfer capital adequacy position, as measured by coverage of APRA's minimum requirements, is better than the pre transfer position for all the individual insurers besides AAI Limited. Whilst AAI Limited's CAR would be lower post transfer, the expected CAR of 1.60 represents a significant level of capital in its own right, and the capital surplus would increase by $47 million to

$1,229 million. The AAI Limited policyholders would benefit from being part of a larger and more diversified insurer. In our view there would not be any material increase in the risk to AAI Limited policyholders.

- The security provided to policyholders by reinsurance would, in effect, be unchanged. Whilst the individual insurers besides AAI Limited currently benefit from intra-group reinsurance provided to them by AAI Limited, the security of this cover is dependent on the financial position of AAI Limited and this position is, in effect, unchanged post transfer.

To the extent that the likelihood of claims not being paid is remote we assess that post transfer AAI Limited will continue to provide an adequate level of protection to policyholders.

7 Reliances and Limitations

This report has been prepared for the use of Suncorp for the stated purpose (i.e. to provide an independent actuarial report on the proposed schemes, in accordance with Division 3A of Part III of the Insurance Act). We understand that the report will also be provided to:

- Suncorp's legal advisers for the Scheme (Allens)
- APRA
- The Federal Court of Australia.

We understand that a copy of the full report will be available on the website www.schemesummary.com.au and for public inspection. No other use of, nor reference to, our report should be made without prior written consent from Finity, nor should the whole or part of our report be disclosed to any unauthorised person.

Third parties, whether authorised or not to receive this report, should recognise that Finity will not be liable for any losses or damages howsoever incurred by the third party as a result of them receiving, acting upon or relying upon any information or advice contained in the report.

Our report should be considered as a whole. Members of Finity staff are available to answer any queries, and the reader should seek that advice before drawing conclusions on any issue in doubt.

Reliance on Data

We have relied on the accuracy and completeness of the data and other information (qualitative, quantitative, written and oral) provided to us by Suncorp for the purpose of this report.

Unless stated otherwise, we have not independently verified or audited the data, but we have reviewed the information for general reasonableness and consistency. The reader of this report is relying on Suncorp and not Finity for the accuracy and reliability of the data. If any of the data or other information provided is inaccurate or incomplete, our advice may need to be revised and the report amended accordingly.

Uncertainty

It should be noted that there is a limitation on the accuracy of our report in that there is inherent uncertainty in any estimates of claim reserves. This uncertainty is due to the fact that the ultimate liability for a claim is subject to the outcome of events yet to occur.

Reinsurance

We have assumed that all reinsurance will be fully recoverable on a prompt basis. If any reinsurance proves not to be recoverable (either through insolvency of a reinsurer or contract dispute) the net liabilities of the affected entities could be significantly higher. We are not aware of any current reinsurer solvency issues or disputes over reinsurance recoveries. We note that the vast majority of the reinsurance assets are due from reinsurers with credit ratings of A or above.

Part III Appendices

A Data

A.1 Data Received

The information received in the process of preparing this report is set out below.

- Insurance Liability Valuation Report (ILVR)
  - Level 2 ILVR 30 June 2012: 'Suncorp Insurance Holdings Limited (and subsidiaries) Insurance Liabilities Valuation Report as at 30 June 2012', dated 2 August 2012
  - Level 1 ILVR 30 June 2011: 'Suncorp Metway Limited Insurance Liabilities Valuation Report as at 30 June 2011', dated 19 August 2011
  - Level 2 ILVR 30 June 2011: 'Suncorp Metway Limited Insurance Liabilities Valuation Report as at June 30, 2011', dated 17 October 2011
  - KPMG's External Peer Review of ILVR at 30 June 2012, dated 17 August 2012
  - KMPG's External Peer Review of ILVR at 30 June 2011, dated 22 August 2011.
- Financial Condition Report (FCR)
  - FCR 30 June 2012: 'Financial Condition Report, 30 June 2012, Suncorp Australian general insurers'
  - FCR 30 June 2011: 'Financial Condition Report, 30 June 2011, Suncorp Australia general insurers'.
- APRA returns
  - Annual Returns, 30 June 2012, Level 1: Aust Alliance, AAMI, GIOG, SMIL, AAI Limited
  - Annual Returns, 30 June 2011, Level 1: Aust Alliance, AAMI, GIOG, SMIL, AAI Limited
  - Annual Returns, 30 June 2012, Level 2
  - Annual Returns, 30 June 2011, Level 2
  - Quarterly Returns, 30 September 2012, Level 1: Aust Alliance, AAMI, GIOG, SMIL, AAI Limited.
- Statutory Accounts (AASB)
  - 30 June 2012: Aust Alliance, AAMI, GIOG, SMIL, AAI Limited, SIHL
  - 30 June 2011: Aust Alliance, AAMI, GIOG, SMIL, AAI Limited, SIHL, Suncorp Insurance Funding 2007 Limited
  - Summary of AASB balance sheets as at 30 June 2011: Single licences and estimated Australian general insurance group.

- Capital
  - Capital Adequacy Position for Level 1 and estimated Australian general insurance group consolidated position as at 30 June 2012
  - Capital Adequacy Position for Level 1 and estimated Australian general insurance group consolidated position as at 30 June 2011
  - Capital Management Plan: 'Suncorp General Insurance Capital Management Plan (CMP) 2012/3 – 2014/5', dated 1 May 2012
  - ICAAP:
    - 'Suncorp General Insurance Group ICAAP Summary Statement', dated November 2012
    - 'Suncorp General Insurance Group ICAAP Process Document', dated November 2012
    - 'Suncorp Group ICAAP Summary Statement', dated January 2013
    - 'Suncorp Group ICAAP Process Document', dated January 2013
  - Group ICAAP: 'Internal Capital Adequacy Assessment Process (ICAAP)' for Suncorp Group , dated July 2011 (updated January 2012)
  - Risk Appetite Statement – Suncorp Australian General Insurance (May 2012)
  - Determination of Suncorp Adequacy Multiples and Methodology: Letter to APRA, 'Level 1/Level 2 reporting for Suncorp's General Insurance Group Minimum Capital Requirement', dated 20 November 2008
  - Legal Entity Restructure December 2008: Letter from APRA, 'Suncorp Insurance Holdings Limited (SIHL), Legal Entity Restructure (LER) – Planned Capital Transactions', dated 1 December 2008
  - Capital Rebalancing in 31 December 2011
    - Letter to APRA, 'General Insurance Level 1 & 2 Rebalancing', dated 7 December 2011
    - Level 1 capital forecasts as at December 2011 following proposed rebalancing
  - Capital Reduction in April 2012: Letter from APRA, 'Suncorp Insurance Holdings Limited (SIHL), General Insurance Level 1 & 2 Rebalancing', dated 28 March 2012
  - Life and General Insurance Capital (LAGIC)
    - Forecasts under LAGIC - current state and single licence as at 30 June 2012
- Company Overview
  - Explanatory statement - business composition as at 30 June 2011

  - Suncorp Group General Insurance Structure (post NOHC), effective 15 May 2012
- Reinsurance Arrangements Statement, Suncorp Group, August 2012
- Risk Register
  - Personal Insurance Risk Register as at 9 September 2012
  - Commercial Insurance Risk Register as at 18 September 2012
  - Personal Insurance Risk Register as at 29 February 2012
  - Commercial Insurance Risk Register as at 29 February 2012
- Transfer Agreement, dated 3 March 2013
- Scheme documents, dated 1 March 2013.

We have also liaised with and received assistance from Suncorp Group representatives and their legal advisor on this matter, Allens.

B Insurance Liabilities

We have reviewed the Appointed Actuary's Insurance Liability Valuation Report in order to understand the nature of the insurance liability risk within each entity. Our main assessment of this aspect, as summarised below, was undertaken at the time that our preliminary actuarial report for the schemes was prepared and was based on the liability estimates as at 30 June 2011. The detailed assessment was not repeated for this final report, noting that the nature of the liabilities would not be expected to change to a material extent in one year. We did review the Appointed Actuary's valuation as at 30 June 2012 to verify that there had been no important developments in the year in the context of the liabilities.

B.1 Outstanding Claims Liabilities at 30 June 2011

AAI Limited

AAI Limited had total net outstanding claims liabilities of $1.3 billion ($1.0 billion excluding the internal reinsurance arrangement). 77% of AAI Limited's liabilities related to liability, asbestos, professional indemnity and home owner's warranty. There are significant challenges in estimating outstanding claim liabilities for all of these exposures but especially for asbestos and home owner's warranty.

The asbestos liability covers claims against AAI Limited's policyholders arising from exposure to asbestos dating back to the 1960s or earlier. Because of the long latency period for asbestos-related diseases there is always a risk of new sources of exposure coming to light. There is further complexity arising from allocation of claims to different periods of exposure to asbestos and therefore to different policies of insurance (and thus insurers). Claims arising from asbestos exposures will be paid out over the next forty years and there is considerable exposure to the prospective legal and inflationary environment. The actuarial valuation recognises the uncertainty in the estimate of asbestos liabilities in that a risk margin of 46% is applied to the central estimate compared with a margin of 14% for other workers compensation and 16% for liability business.

Home owners warranty insurance covers a home owner for incomplete or defective work where a builder is not in a position to rectify the issue through death, disappearance or insolvency. AAI Limited no longer underwrites home owners warranty insurance. While non-completion risk arises fairly quickly (i.e. during the construction period), defect risk can emerge for a number of years subsequent to completion. It is strongly impacted by the prospective economic and legal environment and has proved to have a longer and much larger tail of claims than predicted. Again the difficulties in estimating these claims is recognised in the liability valuation with a risk margin of 44% applied to the home owners warranty class compared with 21% for other professional indemnity business.

SMIL

SMIL had total net outstanding claims liabilities of $1.7 billion ($1.8 billion excluding the internal reinsurance arrangement). 86% of SMIL's liabilities related to CTP in Queensland. Over the last few years the CTP outstanding claims liability estimate has proved to be too high, i.e. has with the benefit of hindsight turned out to have overstated the actual claim amounts. This has given additional strength to SMIL's balance sheet which is not visible in the APRA balance sheet or capital adequacy figures.

GIOG

GIOG had total net outstanding claims liabilities of $1.4 billion ($1.5 billion excluding the internal reinsurance arrangement). 41% of SMIL's liabilities related to CTP in NSW. Similar to the Queensland liability this estimate has proved to be too high over the last few years giving additional strength to the GIOG balance sheet. A further 34% of the liabilities related to workers compensation with almost a third of this in relation to asbestos liabilities. The uncertainty in the estimate of these liabilities will be similar to that in AAI Limited and this liability also attracts a risk margin of 46%.

AAMI

AAMI has total net outstanding claims liabilities of $1.2 billion ($1.3 billion excluding the internal reinsurance arrangement). 77% of AAMI's liabilities relate to CTP in NSW. This estimate has proved to be too high over the last few years giving additional strength to the AAMI balance sheet.

Aust Alliance

Aust Alliance had total net outstanding claims liabilities of only $64 million ($83 million excluding the internal reinsurance arrangement). Most of the liabilities were for motor and home. The key uncertainty in estimating these liabilities relates to the cost of catastrophes which may have occurred prior to the balance date. At 30 June 2011 there remained outstanding claims from the floods and cyclone that occurred early in the year. Because of reinsurance protection the estimate of net liabilities was uncontroversial and the key risk was the recoverability of the reinsurance from the internal and external arrangements.

B.2 Premium Liabilities at 30 June 2011

AAI Limited

AAI Limited had total net premium liabilities of $0.6 billion ($0.7 billion excluding the internal reinsurance arrangement). The liabilities primarily related to commercial lines, including commercial property, public liability and professional indemnity. The actual outcome on these liabilities will depend on the emergence of future catastrophes and on the emerging tort environment. These risks are similar in each of the entities, although the proportions differ slightly.

SMIL

SMIL had total net premium liabilities of $0.4 billion (also $0.4 billion excluding the internal reinsurance arrangement). Around 50% of SMIL's liabilities related to CTP in Queensland, and will be dependent on the future claims environment in that state, with the remainder split between home and motor.

GIOG

GIOG had total net premium liabilities of $0.6 billion ($0.7 billion excluding the internal reinsurance arrangement). The liabilities are broadly spread between long tail and short tail classes and between personal lines and commercial lines. There are no material differences to the other entities.

AAMI

AAMI had total net premium liabilities of $0.8 billion ($0.9 billion excluding the internal reinsurance arrangement). 68% of AAMI's liabilities related to motor which tends to be reasonably predictable, reflected in the risk margin of only 4%. There is also some long tail risk associated with the CTP portfolios.

Aust Alliance

Aust Alliance had total net premium liabilities of $0.2 billion (also $0.2 billion excluding the internal reinsurance arrangement). Most of the liabilities were for motor and home. The key uncertainty in estimating these liabilities relates to the cost of catastrophes which may occur after the balance date.

C APRA Capital Adequacy at 30 June 2012 – Pre Transfer

This appendix shows the derivation of the capital adequacy figures shown in Section 4.

C.1 Pre LAGIC Basis

Table C.1 shows the APRA Capital Base and Minimum Capital Requirement (MCR) for the Level 1 entities at 30 June 2012, as reported in the audited annual APRA returns. The Capital Adequacy Ratio (CAR) shown for each insurer represents the ratio of the Capital Base to the MCR.

Table C.1 – APRA Capital Adequacy Position at 30 June 2012 – as per Audited Annual Returns ($ million)

	Level 1				
	GIOG	SMIL	AAMI	Aust Alliance	AAI Limited
Tier 1 Capital	631	1,752	597	117	2,794
Tier 1 Deductions	(96)	(1,115)	(80)	(20)	(1,178)
Tier 2 Capital	-	279	-	-	485
Capital Base	535	916	516	97	2,101
Risk Charges Constituting MCR					
Outstanding Claims Liabilities	248	272	177	13	172
Premium Liabilities	124	80	134	31	105
Maximum Event Retention	10	10	10	10	260
Asset Risk	106	223	101	23	341
Minimum Capital Requirement	488	585	422	77	877
Capital Surplus (Deficiency)	47	331	94	21	1,224
Capital Adequacy Ratio	1.10	1.57	1.22	1.27	2.40

As per APRA prudential standards these returns included expected September 2012 intra-group dividends. At the same time the Suncorp Board approved related capital injections to maintain subsidiary capital targets. These capital injections are **not** reflected in Table C.1.

To overcome this mismatch, we have adjusted capital adequacy calculations to include the capital injections. The capital injections were as follows:

- $165 million[4] from SIHL to AAI Limited
- $146 million[4] from AAI Limited to SMIL
- $74 million[4] from SMIL to GIOG
- $14 million[4] from AAI Limited to Aust Alliance, and
- $14 million[4] from AAI Limited to AAMI.

The capital adequacy positions assuming these capital injections occurred on 30 June 2012 are shown in Table C.2.

[4] Amount verified against the 30 September 2012 APRA returns

The figures in Table C.2 are also adjusted for a transfer of subordinated debt (i.e. assume the transfer took place on 30 June 2012). On 25 July 2012, $279 million[4] of subordinated debt was transferred from SMIL to AAI Limited following an arrangement approved by a majority of note-holders. AAI Limited injected the same amount of capital back into SMIL.

Table C.2 – APRA Capital Adequacy Position at 30 June 2012 – Adjusted for Capital Injections and Sub-Debt Transfer ($ million)

	Level 1					
	GIOG	**SMIL**	**AAMI**	**Aust Alliance**	**AAI Limited**	**Aust GI Group[1]**
Tier 1 Capital	705	2,178	610	131	2,959	3,736
Tier 1 Deductions	(96)	(1,115)	(80)	(20)	(1,178)	(1,112)
Tier 2 Capital	-	-	-	-	765	765
Capital Base	609	1,063	530	111	2,546	3,389
Risk Charges Constituting MCR						
Outstanding Claims Liabilities	248	272	177	13	172	864
Premium Liabilities	124	80	134	31	105	447
Maximum Event Retention	10	10	10	10	260	260
Asset Risk	106	238	101	23	431	544
Minimum Capital Requirement	488	600	422	77	967	2,115
Capital Surplus (Deficiency)	121	463	108	35	1,578	1,274
Capital Adequacy Ratio	1.25	1.77	1.26	1.45	2.63	1.60

1 Provided by Suncorp.
Note: the figures may not appear to add due to rounding.

In considering the effective capital available to protect policyholders within each entity, we have adjusted the SMIL and AAI Limited capital base and the minimum capital requirement to remove the investment in insurance subsidiaries. The value of the subsidiaries is not readily available to the policyholders of SMIL or AAI Limited. Specifically, we have *reduced* the parent's capital base by the net tangible investment in insurance subsidiaries (noting that any goodwill has already been deducted). We have also *reduced* the parent's MCR by the 20% risk charge on the net tangible amount. This is consistent with the LAGIC reporting basis introduced from 1 January 2013 (see Section C.2) and will allow the comparison of CARs across the entities. The result of these adjustments is shown in the highlighted rows in Table C.3. The CAR for SMIL reduces from 1.77 to 1.23 and the ratio for AAI Limited reduces from 2.63 to 1.87.

Table C.3 – APRA Capital Adequacy Position at 30 June 2012 – Adjusted for Insurance Subsidiaries ($ million)

	Level 1					
	GIOG	SMIL	AAMI	Aust Alliance	AAI Limited	Aust GI Group[1]
Capital Base	609	1,063	530	111	2,546	3,389
Adj't: NTI in Lic Subs [2]	-	*(429)*	-	-	*(1,181)*	-
Adjusted Capital Base	609	634	530	111	1,364	3,389
Minimum Capital Requirement	488	600	422	77	967	2,115
Adj't: Risk Charge on NTI in Lic Sub	-	*(86)*	-	-	*(236)*	-
Adjusted MCR	488	514	422	77	731	2,115
Capital Adequacy Ratio	1.25	1.77	1.26	1.45	2.63	1.60
Adjusted Capital Adequacy Ratio	1.25	1.23	1.26	1.45	1.87	1.60

1 Provided by Suncorp.
2 Net Tangible Investment in Licenced Subsidiaries.
Note: the figures may not appear to add due to rounding.

Note that internal targets and triggers are intended to be applied to the unadjusted capital adequacy position and hence **should not** be compared to the ratios in this table.

C.2 Impact of LAGIC

APRA has revised the regulatory capital framework, including the minimum capital requirements, applying to insurers (as explained in Section 1.7). In this report this is referred to as LAGIC.

As a result of LAGIC, the calculation of the regulatory minimum capital changed on 1 January 2013, with further changes effective from 1 January 2014.

In order to consider the impact of LAGIC on the capital adequacy of the insurers, Suncorp provided pro-forma values for the impact of the full introduction of LAGIC on the 30 June 2012 position (i.e. both the 1 January 2013 and 1 January 2014 changes implemented), as summarised in Table C.4. We have reviewed Suncorp's figures and conclude they are reasonable. We note this analysis is also based on the current reinsurance programme which may be subject to change in 2013/14.

As per Table C.3, the "pre LAGIC" capital position is shown on the adjusted basis removing holdings of subsidiary insurance entities, to be consistent with the LAGIC reporting basis in order to make comparisons more meaningful.

Table C.4 – Impact of LAGIC on 30 June 2012 Position ($ million)

	Capital Base			MCR or PCA			Capital Adequacy Ratio		
	Pre LAGIC	LAGIC	Change	Pre LAGIC	LAGIC	Change	Pre LAGIC	LAGIC	Change
GIOG	609	609	-	488	503	15	1.25	1.21	(0.04)
SMIL	634	634	-	514	485	(29)	1.23	1.31	0.07
AAMI	530	530	-	422	444	23	1.26	1.19	(0.06)
Aust Alliance	111	111	-	77	110	34	1.45	1.01	(0.44)
AAI Limited	1,364	1,238	(127)	731	740	9	1.87	1.67	(0.19)
Aust GI Group	3,389	3,239	(149)	2,115	2,058	(57)	1.60	1.57	(0.03)

Note: the figures may not appear to add due to rounding.

Regarding the changes to the capital base, the lower capital base for AAI Limited is the net impact of the following:

- Under LAGIC, the adjustment for insurance subsidiaries is the minimum of:
  - the net tangible investment in insurance subsidiaries, and
  - the PCA of the insurance subsidiaries.

  For AAI Limited, the insurance subsidiaries adjustment is $22 million lower under LAGIC, and so the capital base increases by this amount.
- The securitisation on certain direct property investments is excluded from the capital base under LAGIC, giving a $28 million reduction. These investments are currently held by SMIL and are in the process of being sold, however the analysis has assumed this is not concluded at the transfer date and instead the assets are transferred to AAI Limited.
- There is a requirement under LAGIC to amortise subordinated debt at 10% of the base amount per annum. APRA has determined the base amount for Suncorp is $715 million, down from $764 million. This gives a total reduction of $121 million (i.e. $764 million *less* 90% of $715 million).

The capital base of AAI Limited is therefore $127 million lower (i.e. $22 million *less* $28 million *less* $121 million). For the Australian general insurance group, the subsidiary impact (the first bullet above) does not apply so the change to the capital base is a $149 million reduction.

The CARs are lower under LAGIC for all insurers except SMIL. For Aust Alliance, the CAR is much lower (1.01 under LAGIC compared to 1.45 pre LAGIC), and this is primarily driven by the higher ICRC compared with the current MER. For the Australian general insurance group overall, the CAR falls slightly from 1.60 to 1.57.

While the apparent capital adequacy of most entities falls under LAGIC, this primarily reflects a strengthening of the minimum capital requirement rather than a real reduction in capital adequacy. We note further that the ICRC is only due for full implementation on 1 January 2014, rather than 1 January 2013. Suncorp will consider its 2013/14 reinsurance arrangements and will evaluate the requirements for mitigating the ICRC at the time in conjunction with all other reinsurance placement variables. The actual outcomes after these new reinsurance arrangements are placed may be different from the "as-if" outcomes shown in Table C.4.

Assumptions

We note the following assumptions underlying Suncorp's pro-forma capital position as at 30 June 2012 under LAGIC:

- Suncorp has assumed that APRA will allow the novated/assigned reinsurance arrangements to be treated as if AAI Limited were always a party at the original inception date of the reinsurance for the determination of capital treatment under

GPS 114. That is, the higher default factors for recoveries from non-APRA-authorised reinsurers have not been applied. Refer to discussion in Section 2.3.

- Suncorp has applied to APRA for an exemption from the part of the Operational Risk Charge (under GPS 118) that relates to changes in premium volumes. The premium volume of AAI Limited will increase dramatically, with offsetting reductions for the transferring insurers, as a result of the schemes. Any additional charges incurred as a result of the one-off jump in written premium revenue will be eliminated once 'steady-state' premium revenue is again established in 2014. On the basis that any potential additional Operational Risk Charge will be short term and the outcome of the exemption application is unknown at the time of writing, the Operational Risk Charge reflects that for a stable written premium revenue. Should the exemption not be granted in full by APRA, then the CAR for AAI Limited shown in Table 5.3, Table C.4 and Table C.5 will be lower by around 0.12.
- For the statutory businesses (CTP and workers compensation), Suncorp has assumed that all licences will be granted and all business will be transferred as planned.

C.3 Summary

In this appendix we have shown the derivation of the pre transfer capital adequacy of each insurer that we have used as a base for assessing the impact of the schemes. The capital adequacy was shown:

- based on the audited 30 June 2012 position, as reported in the annual APRA returns
- with adjustments for known capital transfers since that date, and
- with adjustments for the changes to the regulatory minimum capital calculations under LAGIC.

This analysis gives the following capital adequacy measures shown in Table C.5 and repeated in Table 4.2.

Table C.5 – Pro-Forma Pre Transfer Capital Adequacy Position at 30 June 2012

	Pro-Forma LAGIC Basis			
	Capital Base	Prescribed Capital Requirement	Capital Surplus	Capital Adequacy Ratio
	$mil	$mil	$mil	
Pre Transfer Position				
GIOG	609	503	107	1.21
SMIL	634	485	149	1.31
AAMI	530	444	85	1.19
Aust Alliance	111	110	1	1.01
AAI Limited	1,238	740	498	1.67
Aust GI Group	3,239	2,058	1,182	1.57

Note: the figures may not appear to add due to rounding.

We note that the “as-if” CARs under LAGIC are lower than might have been expected and lower than the internal capital targets (e.g. Aust Alliance at only 1.01). This primarily reflects a strengthening of the minimum capital requirement under LAGIC, and in particular the impact of the ICRC. The proposed schemes consolidating general insurance licences is just one mitigation activity adopted by Suncorp to manage the impact of LAGIC on capital requirements. In the normal course of events Suncorp would, and will, consider a variety of other initiatives including the structure of the 2013/14 reinsurance arrangements. As such the actual outcomes would be different from the “as-if” outcomes shown in Table C.5. Nevertheless we believe the figures shown remain useful as a base for the considering the impact of the schemes on relative capital levels.