

Actuarial Report on Scheme Transfer

Sunderland Marine Insurance Company
Limited (Australian Branch) and
The North of England Protecting and
Indemnity Association Limited

July 2018

13 July 2018

Mr Chris Owen
Group General Counsel
North Group
The Quayside
Newcastle upon Tyne
NE1 3DU

Dear Mr Owen

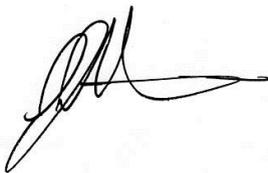
Actuarial Report on Scheme Transfer

I am pleased to enclose my actuarial report on the transfer of the insurance business of the Australian Branch of Sunderland Marine Insurance Company Limited to the Australian Branch of The North of England Protecting and Indemnity Association Limited.

The report finds that the transfer will not result in any material detriment to the interests of policyholders of SMI or North. In fact the transfer is one of the most straightforward from the perspective of policyholder interests that I have seen.

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

Yours sincerely



Geoff Atkins
Fellow of the Institute of Actuaries of Australia

Sydney

Tel +61 2 8252 3300
Level 7, 68 Harrington Street
The Rocks, NSW 2000

Finity Consulting Pty Limited

Melbourne

Tel +61 3 8080 0900
Level 3, 30 Collins Street
Melbourne, VIC 3000

ABN 89 111 470 270

Auckland

Tel +64 9 306 7700
Level 5, 79 Queen Street
Auckland 1010

finit.com.au / finitconsulting.co.nz

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1 Introduction and scope

1.1 Purpose of report

This report has been prepared at the request of The North of England Protecting and Indemnity Association Limited (North). North has applied for an insurance licence from the Australian Prudential Regulation Authority (APRA) to operate an Australian Branch (North Aus). This report relates to the proposed transfer of assets and liabilities of Sunderland Marine Insurance Company Limited (SMI), in respect of its Australian Branch (SMI Aus), to North Aus.

The proposed transfer will take place in accordance with a scheme prepared under Part III Division 3A of the Insurance Act 1973 (referred to in this report as the 'Insurance Scheme' or 'scheme').

This report provides my opinion on aspects of the scheme that the expert actuary would be expected to assess, and specifically whether the interests of policyholders would be materially adversely impacted by the scheme having particular regard to its nature. This includes the impact of the scheme on the capital position of the relevant entities.

I understand that this report will be provided to APRA and to the Court as part of the documentation supporting the transfer.

Readers of this report should note the reliances and limitations detailed in Section 5.

1.2 Compliance

1.2.1 Prudential Standard GPS 410

APRA's Prudential Standard GPS 410 sets out the procedural requirements for insurers transferring or amalgamating insurance business, which includes a requirement for an actuarial report on which the scheme is founded.

While GPS 410 provides no specific guidance on the content of actuarial reports on which insurance business transfers are based, in my 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 scheme.

1.2.2 Federal Court Practice Note

I acknowledge that I have read, understood and complied with the Federal Court of Australia's Expert Evidence Practice Note (GPN-EXPT).

1.3 Authorship of report

This report has been prepared by Geoff Atkins of Finity Consulting, who has been appointed by North as the Independent Actuary for the purpose of Division 3A of Part III of the Insurance Act.

1.4 Qualifications and independence

Geoff Atkins, the primary author of this report, has been a qualified actuary for more than thirty years and has prepared a number of reports on transfer schemes along with peer reviews of other reports.

Geoff Atkins and Finity Consulting have no commercial or other relationships with North or SMI other than an engagement to prepare this report on the Australian transfer and a similar report on the New Zealand branch transfer.

The Appointed Actuary of SMI Aus is Daniel Smith of Taylor Fry, and Daniel will continue in that role for North Aus. I have used Daniel's recent reports and consulted him during this project.

1.5 Policyholder interests

I consider that policyholder interests 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 a view on policyholder interests, I have considered:

- The contractual rights of existing policyholders
- The continuity of policy entitlements and claim management procedures
- The nature of the risks faced by policyholders before and after the transaction
- The capital position of the insurance entities before and after the transaction.

This report deals specifically with the interests of policyholders of SMI Aus and North Aus, as well as brief consideration of those policyholders of SMI and North outside Australia.

The relevant interests of policyholders in respect of marine insurance (as with other classes of general insurance business) do not extend to the availability or terms of any future renewal of a policy.

1.6 Approach

My approach involved the following steps:

- Review and understand the scheme documents and transaction documents
- Review the nature and valuation of the liabilities to be transferred
- Review the nature of the business written by SMI Aus, focussing on the financial position and any areas of particular risk which may be of relevance to my financial assessment of the impacts of the Insurance Scheme on policyholders of both organisations
- Assess the capital adequacy position pre and post transfer. This step included consideration of the latest APRA balance sheet and Prescribed Capital Amount (PCA) calculation as at 31 December 2017. I also considered the capital management approach of SMI Aus and (prospectively) North Aus, and the potential for capital support from group entities.
- Assess the impact of the Insurance Scheme on policyholders of SMI Aus and North Aus. This included consideration of the terms and conditions applying to policyholders and the claims handling procedures to be adopted.

1.7 Information

In preparing this report, I have liaised with, and received assistance from, management of SMI and North, as well as their advisers. I have found all parties to be open in their dealings with me, and all material requested has been made available to me. North has reviewed a draft of my report, and I understand that North has no objections to the information as presented. The information used in preparing this report is set out in Appendix A

2 Proposed scheme

2.1 Background

North and SMI are both longstanding marine insurers headquartered in the UK and operating globally. North is a mutual insurer and, prior to 2014, SMI was also.

North and SMI merged in 2014 and most aspects of the business have been consolidated. The present series of transactions will, when successfully completed, transfer all of the insurance business from SMI to North so that it is all in a single legal entity.

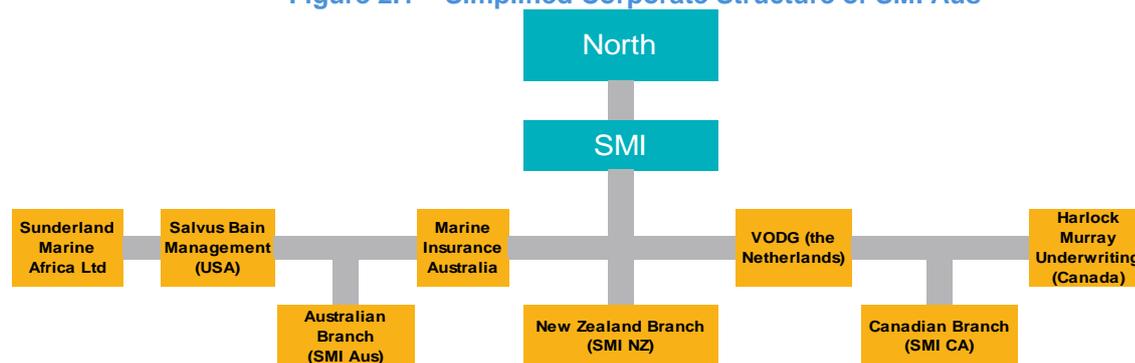
The main transaction is a scheme transferring insurance business under UK legislation, and North intends to complete transfers for the branches in Australia and New Zealand before the UK scheme is completed, anticipated to be in late 2019.

As a result of the business consolidation undertaken since 2014 the Insurance Scheme will involve virtually no change in business operations. It will be just as if the legal entity is changed from SMI (Australian Branch) to North t/a Sunderland Marine (Australian Branch). Even the Sunderland Marine brand will be retained.

2.2 Corporate structure of the business to be transferred

SMI Aus is the Australian Branch of Sunderland Marine Insurance Company Ltd (SMI), whose ultimate parent is North, a mutual insurer of protection and indemnity (P&I), freight demurrage and defence (FD&D), and war risks. North was established in 1860, and is headquartered in Newcastle upon Tyne, United Kingdom. Figure 2.1 shows a simplified corporate structure of SMI Aus as at 31 December 2017.

Figure 2.1 – Simplified Corporate Structure of SMI Aus



SMI Aus is one of three overseas branches of SMI, which also has six subsidiaries shown on the chart.

North is seeking to adopt a simplified and more cost effective group structure globally, through the transfer of SMI's employees and insurance business to North. It is proposed that the insurance business of SMI is transferred to North, and that the business continues operating under the Sunderland Marine brand, as a division of North. North Aus has applied to become an authorised insurer in Australia, to enable it to undertake the existing and future business of SMI Aus.

It is anticipated that coincident with the Insurance Scheme North Aus will be authorised to undertake insurance business in Australia as a branch of North; and SMI Aus will apply to APRA for revocation of its APRA authorisation. The authorisation of North Aus is a condition precedent and without it the Insurance Scheme cannot proceed.

Once the branch transfers and the UK Scheme are completed, the place of North Aus in the structure will be the same as in Figure 2.1, but without SMI between North and the Australian Branch.

2.3 Nature of the Insurance Scheme

The scheme will involve the following actions on the scheme transfer date, the first two of which are set out in the scheme document and the transfer agreement:

- All insurance contracts, rights and obligations and insurance liabilities of SMI Aus will be transferred to North Aus
- All other assets and liabilities in Australia will be transferred from SMI Aus to North Aus
- APRA's authorisation of North Aus to undertake insurance business in Australia will become effective
- APRA's authorisation of SMI Aus will be revoked.

There will be no changes to the terms and conditions of current and prior policies issued by SMI Aus as a result of the transfer, apart from North Aus being substituted for SMI Aus as the insurer.

There will be no change to staff or roles in SMI Aus or in the relevant interactions and responsibilities with SMI/North home office. The Senior Officer outside Australia will be the same person under the existing structure. I understand that branding and marketing will continue under the Sunderland Marine name (but not using the word 'Insurance') giving further confidence to policyholders about the continuity of their coverage.

In terms of claims, the staff, roles and procedures have already been integrated with North and there will be no changes.

SMI has an Australian subsidiary Marine Insurance Australia (MIA) which is authorised to distribute insurance products and is an Authorised Representative of SMI Aus. Business introduced by MIA will be written directly by North Aus post transfer.

2.4 Timing

The effective date of the Insurance Scheme is not known at this time. It will depend on approval by APRA and confirmation by the Federal Court.

Based on current information, the effective date is likely to be in the third or fourth quarter of 2018. It will be important to review the circumstances closer to that time to identify any changes in financial or other matters between the date of this report and the confirmation date.

3 Impact on policyholder security

This section describes the financial status of the SMI Aus business, the current security of policyholder interests and any changes to that security as a result of the Insurance Scheme.

3.1 Type of business

3.1.1 SMI Aus

Table 3.1 summarises the gross earned premium for SMI Aus (12 months to December 2017).

Table 3.1 – Gross Earned Premium (\$m)

	SMI Aus Dec-17
Hull & Machinery	12.7
Protection & Indemnity	2.7
Personal Accident	0.5
Aquaculture	2.1
Total	18.0

The nature of SMI Aus's business has been stable over time, with Hull & Machinery making up between 68% and 74% of gross earned premium since 2009. The first three lines shown in the table make up the Marine business – the first being property damage, the second being liability and the third accident insurance for employees of Marine insureds.

The aquaculture business is a speciality of SMI, including SMI Aus.

3.1.2 North Aus

North Aus does not currently operate and is expected to continue to undertake similar business to SMI Aus using the Sunderland Marine brand.

3.2 Summary of financial performance

3.2.1 SMI Aus

Table 3.2 summarises SMI Aus's financial performance for the four years to December 2017.

Table 3.2 – SMI Aus Operating Statistics (\$m)

	2014	2015	2016	2017
Gross Earned Premium	18.3	18.4	17.6	17.9
Reinsurance Premium	-	-	10.8	10.7
Net Earned Premium	-	-	6.7	7.2
Net Claims	-	-	2.6	5.8
Underwriting Expenses	-	-	-1.0	0.5
Underwriting Result	6.3	3.9	5.1	0.9
Investment Income	-	-	0.5	0.5
Other Income & Expenses	-	-	-3.3	-3.3
Profit before Tax	-	-	2.4	-1.9
Tax	-	-	0.8	0.2
Profit after Tax	3.7	0.7	1.6	-2.0
Return on net assets	34%	5%	11%	(15%)
Loss Ratio	37%	56%	38%	81%
Expense Ratio*	23%	39%	34%	52%
Combined Operating Ratio	61%	95%	72%	119%

* Includes LAT

The financial result for the branch has fluctuated from year to year, as is to be expected for the size and nature of the business. 2017 was the worst year for claims for a number of years, resulting in an after-tax loss for the branch following three years of profits.

On average over the four years shown the business has been profitable.

3.2.2 North Aus

North Aus has no financial history.

3.3 Reinsurance arrangements

3.3.1 SMI Aus

The reinsurance program for SMI Aus comprises two components;

- ▶ Participation in the global SMI reinsurance program (external, comprising Excess of Loss and Quota Share arrangements)
- ▶ Participation in the Group quota share reinsurance arrangement (intra-group treaties between SMI and North).

The 2017 program (we understand the 2018 program is similar) included specific Hull, Liability, and Aquaculture arrangements as shown in Table 3.3 below.

Table 3.3 – 2017 Reinsurance Program

	Excess of Loss		Quota Share	
	Contract	Placement	Contract	Placement
Hull	Unlimited XS £1m	Various incl Lloyd's	60%	North
Liability	USD \$500m XS USD \$2m	Various incl Lloyd's	60%	North
Aquaculture	£9m XS £0.5m	Various incl Lloyd's	80%	Various incl Lloyd's

In addition to the treaty program, SMI Aus has purchased facultative cover for one risk.

SMI Aus's maximum retention is £400,000 for Hull claims, USD \$800,000 for Liability claims, and £500,000 for Aquaculture claims. The Excess of Loss treaties apply before Quota Share for the Hull and Liability contracts but after Quota Share for Aquaculture.

The reinsurance program has been relatively stable over time, and the external program is well spread across a range of high quality reinsurers.

The situation with reinsurance after the transfer needs to be considered in two parts – the global program (external) and the group program (internal).

3.3.2 North Aus – global external programme

The treaties for the 2018 year explicitly recognise the impending transfer and cover North after the transfer date in the same way as SMI before the transfer.

When North acquired SMI in 2014 all existing and prior reinsurers of SMI gave consent for the acquisition. North is currently in the process of having reinsurance contracts amended so that North is named as a co-insured; at the date of this report liability treaties since 2015 are complete and other treaties (including older years) are in progress..

Once the UK scheme is complete all past reinsurance contracts of SMI are legally novated to North.

The chance of any reinsurance coverage issue arising during the short period before the UK scheme is finalised, in respect of any treaty that has not been amended, is extremely remote¹.

3.3.3 North Aus – group quota share

The 60% quota share for Hull and Liability is written by North for the protection of SMI. It covers all of SMI internationally (except aquaculture) as well as the local branch. When the relevant insurance business of SMI is transferred to North the quota share treaty will cease to have any application to that business and North Aus would, in the absence of any other change, have a liability for 100% of the Hull and Liability business (net of the external excess of loss program).

There is, however, a group reinsurance program that North has advised me will be used to limit the exposure of North Aus to no greater than 40% of the portfolio, the same as SMI's current exposure.

The North of England Mutual Insurance Association (Bermuda) Limited (NEMIA) is a 'cell captive' insurer domiciled in Bermuda that is owned by North's members. North has an open-ended reinsurance treaty with NEMIA, and 90% of the 60% quota share of SMI business is already ceded by North to NEMIA under that treaty. North and NEMIA have the same credit rating.

¹ It is unlikely that any claim from this period would exceed the reinsurance retentions. At 31 November 2017 SMI Aus has 13 open claims from policy years prior to 2014, with the largest claim being estimated to cost \$320,000

For the Australian branch, the quota share reinsurer will now be NEMIA rather than North. The reinsurance cover will continue to be a quota share of 60% of both outstanding claims and premium liabilities (at no additional cost to the Australian branch).. I have reviewed a draft amended treaty and specification of the Australian business coverage and I am satisfied that the amendments are suitable and that policyholders will be no worse off.

The impact of the current and future reinsurance coverage on the security of policyholders of North Aus is discussed further in sections 3.7.2 and 3.7.3 below, where I conclude that the security is unchanged from that currently provided.

In order to ensure that the appropriate regulatory arrangements in Australia continue to apply there are two further steps that need to be taken:

- Amend the North/NEMIA treaty to include appropriate provision for the Australian coverage being subject to Australian law (I have reviewed a draft)
- Ensure that a bank Letter of Credit in respect of reinsurance recoveries is available to North Aus on equivalent terms to that currently available to SMI Aus.

3.4 Insurance liabilities and uncertainty

3.4.1 SMI Aus

Table 3.4 summarises SMI Aus's insurance liabilities as at 31 December 2017.

Table 3.4 – SMI Aus Insurance Liabilities at 31 December 2017 (\$ 000)

	Outstanding Claims	Premium Liabilities	Total
Gross Central Estimate	14,120	5,385	19,505
Reinsurance Recoveries	9,592	3,350	
Net Central Estimate	4,527	2,035	6,562
Discounting	160	49	209
Discounted Net Central Estimate	4,367	1,986	6,353
Claims Handling Expenses	375	186	561
Risk Margin	849	636	1,485
Net Provision	5,591	2,808	8,399
CHE % (of Central Estimate)	2.7%	n/a	
PAE % (of Unearned Premium)	n/a	1.0%	
RM % (of Total before Risk Margin)	17.9%	29.3%	

¹ For the Premium Liabilities, the CHE allowance is included in the central estimate.

The SMI Aus liabilities are determined by the Appointed Actuary, Daniel Smith of Taylor Fry. I received a copy of the most recent Insurance Liabilities Valuation Report as at 31 December 2017. I have not independently estimated the liabilities. My high level review of the report included consideration of the methods adopted and the key assumptions selected. I was comfortable that these were reasonable.

The history of the run-off of provisions from past years has shown a consistent pattern of adequate reserving over a long period.

The relatively high risk margins (as a percentage) reflect the small and volatile nature of the business. The uncertainty highlights the importance of ensuring the reinsurance protection continues to be available.

3.4.2 North Aus

North Aus currently has no liabilities.

3.5 Financial security – Aus branch

3.5.1 Balance Sheet

Table 3.5 summarises the reported assets and liabilities of SMI Aus as at December 2017.

	Dec-16	Dec-17
Assets		
Cash	2,012	955
Investments	19,497	22,853
Premium and Other Receivables	5,118	6,972
Reinsurance Assets	7,947	10,696
Deferred Assets	5,849	5,647
Plant and Equipment	47	21
Other Assets	98	106
Current Tax Assets	145	223
Total Assets	40,713	47,473
Liabilities		
Creditors and Accruals	4,533	5,826
Claims Liabilities	9,830	13,096
Unearned Premium	8,665	9,201
Amounts Due to Reinsurers	2,098	5,660
Other Liabilities	303	542
Total Liabilities	25,429	34,325
Net Assets	15,284	13,148

The SMI Aus balance sheet is relatively straightforward in that it includes no assets or liabilities that would be unusual for an insurance entity. It shows net assets of \$13.1 million compared with net insurance liabilities of \$8.4m. North Aus will have the same balance sheet (but as at the current date) on the transfer date.

SMI Aus also has the benefit of a bank guarantee issued by ANZ at the request of North for \$12.5 million, providing additional security for the reinsurance recoveries. This guarantee also ensures that the APRA capital adequacy calculation does not penalise SMI Aus because its reinsurance is with insurers not authorised by APRA (except for Lloyd's).

3.5.2 APRA Capital Adequacy

Table 3.6 shows the APRA Prescribed Capital Amount (PCA) for SMI Aus at 31 December 2017.

Table 3.6 – APRA Prescribed Capital Amount at December 2017 (\$m)

	Dec-16	Dec-17
Insurance Risk Charge	0.8	1.1
Insurance Concentration Risk Charge	1.8	3.0
Asset Risk Charge	3.9	4.0
Asset Concentration Risk Charge	-	-
Operational Risk Charge	0.5	0.6
Aggregation Benefit	(1.4)	(1.8)
Prescribed Capital Amount (PCA)	5.6	6.8

Table 3.7 summarises the calculation of the APRA Capital Base, starting with the net assets from Table 3.5. This is then compared to the PCA from Table 3.6 to determine the Capital Adequacy Multiple (CAM) for SMI Aus at 31 December 2017.

Table 3.7 – APRA Capital Adequacy at December 2017 (\$m)

	Dec-16	Dec-17
Net Assets	15.3	13.1
Adjustments:		
Insurance Liability Surplus	0.8	1.2
Intangibles and Other Adjustments	(0.1)	-
APRA Capital Base	16.0	14.4
Prescribed Capital Amount (PCA)	5.6	6.8
Capital Adequacy Multiple (CAM)	2.86	2.11

The SMI Aus APRA capital base is slightly more than the net asset position shown in Table 3.5, due to a premium liability surplus. The 2.1 coverage multiple of the PCA is a very comfortable level.

3.6 Capital Management

3.6.1 SMI Aus

SMI Aus's capital management approach is set out in its Internal Capital Adequacy Assessment Process (ICAAP) report. The December 2016 ICAAP summary report states that the branch has adopted a buffer of 20% over the Prudential Capital Requirement (PCR), as defined by APRA. The December 2017 capital coverage of the PCR + Buffer is 168%.

The ICAAP report specifies a target level of capital between 160% and 200% of the PCA, which translates to capital of \$11.1m to \$13.8m as at December 2017. Monitoring is currently performed on a quarterly basis. Should the capital adequacy ratio fall below a benchmark of 180%, monthly reporting of the capital adequacy position is required until the ratio moves back above 180%. If the capital adequacy ratio falls below 140%, SMI will immediately inject capital into the branch and return the ratio to the benchmark level of 180%.

Not only are the target ranges and the current capital position at a comfortable level, but the commitment and ability of SMI to 'immediately inject capital into the branch' is positive for the security of policyholders.

3.6.2 North Aus

In its licence application to APRA, North has stated it will continue with the same capital management approach as SMI Aus, which I regard as reasonable for the business.

3.7 Ultimate security of policyholders

3.7.1 Finances of SMI and North

Table 3.8 shows the solvency position of SMI and North as at 20 February 2018. The figures are based on the Solvency II requirements applicable in the UK and Europe.

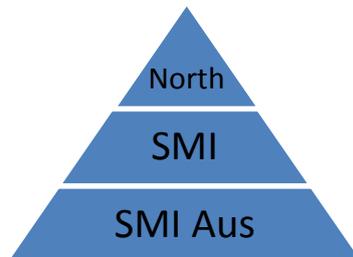
Table 3.8 – SMI UK and North Solvency Position (USDm)

	SMI (Solo)	North (Solo)	North (Group)	North Solo (Pro-forma)
Total Capital Resources Available	78.2	295.7	301.2	301.2
Total Capital Required	40.1	158.2	160.7	160.7
Solvency Ratio	195%	187%	187%	187%

This table shows that the capital adequacy position of the companies is sound. The last column of the table shows North's estimate of the pro forma position as if all of the transfers had taken place at 20 February 2018. It shows capital resources available (as measured under Solvency II) of USD300m, equivalent to 187% of the capital required. The ratios are very similar to the SMI and North solo positions at the present time.

3.7.2 Policyholder security

Based on the current corporate structure, SMI Aus policyholders enjoy various layers of security to meet their policyholder needs.



Australian policyholders of SMI benefit from the APRA regulations that require assets to be held in Australia. Those assets cannot be transferred out of Australia without APRA's approval. The security of reinsurance recoveries is also backed by the bank guarantee.

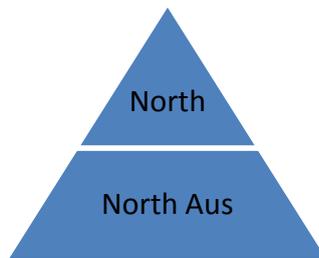
In the unlikely event of SMI Aus being unable to pay policyholder claims, the legal obligation resides with SMI, a UK corporation. This provides a second layer of security for SMI Aus policyholders.

SMI in turn has a guarantee from North which explicitly guarantees SMI's payment obligations to its policyholders. Therefore the assets of North provide a third layer of security.

Failure of these three elements of security (which would not necessarily be sequential) would be required for SMI Aus policyholders to lose their financial security regarding payment of claims.

There is a fourth and final line of security for SMI Aus policyholders in that under its constitution North can make a call on its mutual members that would in effect replenish capital.

Under the new proposed structure, SMI is removed from the equation but the ultimate security is unchanged.



The Australian policyholders of North (previously SMI) will have the security of the assets in Australia, the bank guarantee and the APRA regulatory regime. If for some reason the assets in Australia were not sufficient the liability remains with North (a UK Corporation) and if North was unable to meet its obligations it has the ability to make a call on its mutual members.

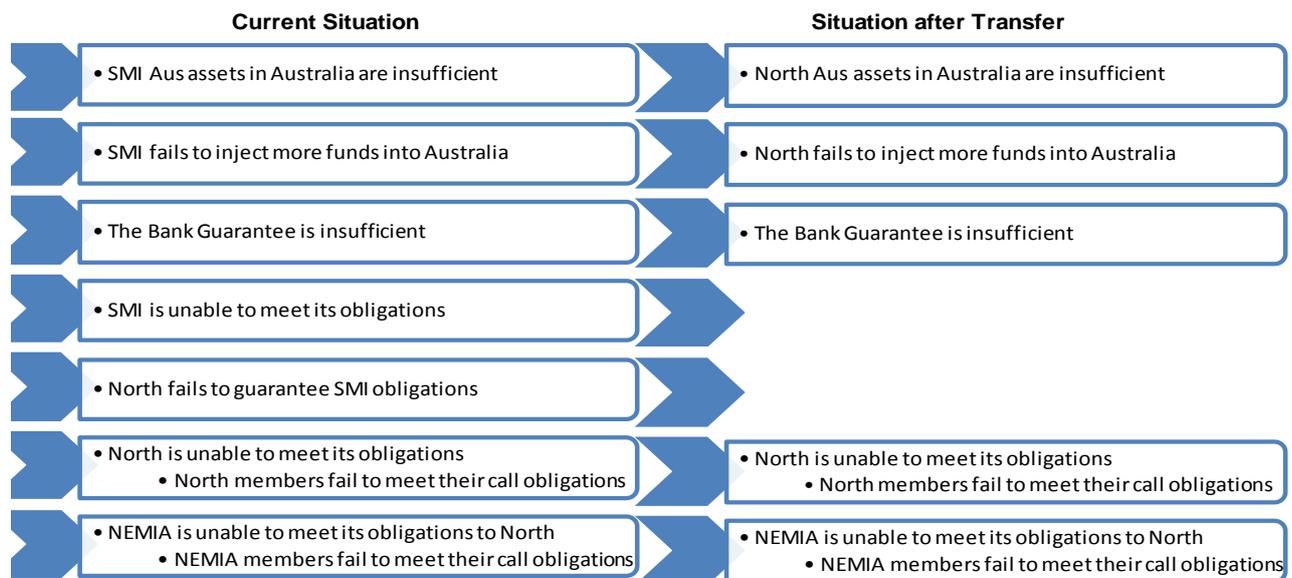
3.7.3 Relevance of the North/NEMIA reinsurance

As described in section 3.3.3 there is an open-ended reinsurance treaty between North and NEMIA, a Bermudan cell captive with the same membership as North.

At present NEMIA is an indirect reinsurer of SMI Aus – North reinsures SMI Aus and in turn NEMIA reinsures North. After the transfer, the relationship is direct in that NEMIA will reinsure North Aus.

Our conclusion regarding the impact on security of Australian policyholders can be demonstrated by looking at the combination of events that would be needed for Australian policyholders to be left without the insurance protection they have purchased.

Events needed to result in Australian Policyholder Losses



The first three events and the last two events in the diagram are the same before and after the transfer. The middle steps that place North between SMI and NEMIA are removed after the transfer. Noting that all of these events must occur for Australian policyholders to be impacted, this chart demonstrates that the impact of the NEMIA arrangement on policyholder security is unchanged.

As explained in section 3.3.3 North has committed to amending its reinsurance treaty with NEMIA so that Australian policyholders have the same reinsurance protection, in respect of both outstanding claims and premium liabilities, as they have at present as policyholders of SMI Aus.

3.8 Policyholders outside Australia

While the purpose of this report is to consider the interests of Australian policyholders of SMI and North, it may be helpful to outline a brief consideration of the impact on overseas policyholders.

Policyholders of SMI outside Australia have limited access to the assets in SMI Aus (being subject to APRA approval of asset transfers). Their immediate security depends on the assets of SMI, and in turn they benefit from the guarantee provided by North and (ultimately) the ability of North to make a call on its mutual members.

The security of North policyholders outside Australia derives directly from the assets of North (noting that SMI assets may be ring-fenced for the benefit of SMI policyholders). They also face some exposure to the guarantee issued by North, but have the benefit of the ability of North to make a call on its mutual members. A significant majority of the policyholders of North are mutual members who would be liable for a call.

Once the transfer of SMI business into North is complete (the branches and the UK schemes) all the policyholders will be in one pool, noting that SMI policyholders are not currently and will not be mutual members liable for a call.

This brief consideration of policyholders outside Australia demonstrates that the Insurance Scheme in Australia will have no material impact on those policyholders.

4 Conclusions

The main interest of policyholders is to have their valid claims paid when due. I have also examined a range of other likely effects of the proposed transfer, from the perspective of SMI Aus and North Aus policyholders. This section summarises my findings and conclusions.

4.1 Nature of the business to be transferred

The SMI Aus portfolio of Marine and Aquaculture business is specialised, and in the same specialty area that North has operated in during its existence. While North did not write aquaculture business prior to merging with SMI, it now has the benefit of SMI's longstanding expertise in this product.

4.2 Policy terms and conditions

There will be no changes to the terms and conditions of current and prior policies issued by SMI Aus as a result of the scheme. Policyholders therefore do not face any changes in the entitlements and obligations relating to their insurance coverage.

4.3 Claims handling

Claims management for SMI and North has already been consolidated. There will be no change to claims management staff, policies or procedures as a result of the Insurance Scheme.

4.4 Risk profile

Because North Aus is a new entity that will take on all of the assets and liabilities of SMI Aus there is no change in the risk profile of the Australian business that would be relevant to the interests of Australian policyholders.

4.5 Financial Security

Currently the financial security of SMI Aus policyholders is strong, with \$13.3 million of net assets in Australia, supporting net insurance liabilities of \$8.4 million. On the APRA basis the available capital in Australia is 2.1 times the prescribed minimum, which is a comfortable situation. The Australian policyholders also benefit from the security of all the assets of SMI and the guarantee provided by North.

After the Insurance Scheme the Australian policyholders (now being policyholders of North Aus) will have the same financial security that they had before the Scheme. The ultimate security of the assets of North and the ability of North to make a call on its mutual members remains unchanged.

4.6 Conclusion

My opinion is that the interests of the policyholders of SMI Aus and (prospectively) North Aus will not be adversely affected in a material way as a consequence of the Insurance Scheme.

4.7 Declaration as Expert Witness

I declare that I have made all the enquiries that I believe are desirable and appropriate and that no matters of significance that I regard as relevant have, to my knowledge, been withheld from my report.

5 Reliances and Limitations

5.1 Reliances on Information

In preparing this report, I have relied on the accuracy and completeness of the information provided by SMI and North (both qualitative and quantitative). In particular, reliance was placed on the APRA returns and insurance liability valuations of SMI Aus as at 31 December 2016 and 31 December 2017.

While I have reviewed the information for reasonableness and consistency, I have not independently verified or audited the data. The accuracy of my findings is dependent on the accuracy of this information; therefore, any material discrepancies may change the conclusions I have made in this report. The reader of this report is relying on SMI and North, and not Finity, for the accuracy and reliability of the data. If any of the data or other information provided is inaccurate or incomplete, my advice may need to be revised and the report amended accordingly.

I note that my report has been prepared based on draft scheme documents. While my understanding is that there are not expected to be any material changes between the draft and final documents, if any material changes are made, my analysis, conclusions and findings may need to be updated accordingly.

5.2 Uncertainty

Future financial security is subject to many external factors that are impossible to predict, including legislative, social and economic forces. In this report, I consider only the impact of the proposed scheme.

It is not possible to be certain about the impact of the proposed scheme on the affected policyholders. While I believe my conclusions are reasonable based on known information, there may be adverse impacts in future that I have not identified or evaluated.

5.3 Limitations on Use

This report has been prepared for the sole use of SMI Aus and North, for the purpose stated in Section 1. I understand that the report will also be provided to:

- North's legal advisers, Norton Rose Fullbright
- North and SMI regulatory authorities outside of Australia
- APRA
- The Federal Court of Australia.

Furthermore, I understand that a copy of the full report may be available for public inspection online. No other use of, or reference to, this report may be made without the prior written consent of Finity, nor should the whole or part of the report be disclosed to any unauthorised person.

Third parties, whether authorised or not to receive this report, should recognise that the furnishing of this report is not a substitute for their own due diligence and should place no reliance on this report or the data contained herein which would result in the creation of any duty or liability by Finity to the third party.

This 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. While due care has been taken in the preparation of this report, Finity accepts no responsibility for any action which may be taken based on its contents.

Part II Appendices

A Information Received

A great deal of information was provided to us about the businesses, the background, the restructuring process and other matters. The information most relevant to the preparation of this report was:

- SMI Aus Insurance Liability Valuation Report as at 31 December 2016 and 31 December 2017.
- SMI Aus Financial Condition Report as at 31 December 2016 and 31 December 2017.
- APRA Returns as at December 2016 and December 2017.
- North Aus business plan for 2017-2021.
- Reinsurance Arrangement Statement 2017 for SMI Aus.
- Reinsurance amendment and restatement agreement
- ICAAP Report & Summary Statement, dated March 2017.
- Insurer Profile document, produce by North, which accompanied its APRA licence application, dated 13 July 2017.