QBE LENDERS' MORTGAGE INSURANCE LIMI

10060539731

(A.B.N 70 000 511 071)

FINANCIAL REPORT – 31 DECEMBER 2011

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This financial report includes separate financial statements for QBE Lenders' Mortgage Insurance Limited ("the company") as an individual entity. The financial report is presented in Australian dollars.

QBE Lenders' Mortgage Insurance Limited is a company limited by shares, incorporated and domiciled in Australia. Its registered office is:

82 Pitt Street

Sydney

NSW 2000

The principal place of business is Level 21, 50 Bridge St, Sydney, NSW.

A description of the nature of the company's operations and its principal activities is included in the directors' report on pages 1 to 4, which is not part of this financial report.

The financial report was authorised for issue by the directors on 16 February 2012. The directors have the power to amend and reissue the financial statements.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

DIRECTORS' REPORT

For the year ended 31 December 2011

Your directors present their report on QBE Lenders' Mortgage Insurance Limited ("the company") for the year ended 31 December 2011.

Directors

The following directors held office during the year and up to the date of this report:

Director		
The Hon. NF Greiner		Chairman
IT Graham		Chief Executive Officer
C Fagen	Appointed 4 August 2011	
GJ Gilbert		
GP Hickey		
AG McGrath	Appointed 25 November 2011	
V McLenaghan	Resigned 29 July 2011	
JD Neal	Appointed 25 November 2011	
FM O'Halloran	Appointed 25 November 2011	
GB Thwaites	Resigned 25 November 2011	
VJ Walter	Resigned 25 November 2011	
Alternate Director		
VJ Walter	Appointed 25 November 2011	Alternate director for C Fagen

Principal activities

The principal activities of the company during the year were:

- To provide residential lenders' mortgage insurance, reinsurance to customer's captive lenders' mortgage insurance companies and insurance over residential mortgage backed securities programs in Australia and New Zealand.
- To manage, through a fund manager, the company's investments.
- To provide management services to lenders' mortgage insurance subsidiaries.

There were no significant changes to the principal activities during the year.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

DIRECTORS' REPORT

For the year ended 31 December 2011

<u>Results and review of operations</u>

Net profit after income tax for the financial year was $129.0M compared to a 2010 underlying profit of $165.4M and a 2010 reported profit of $253.5M. The $36.4M decline in 2011 compared to the 2010 underlying result was principally a result of lower net earned premium, higher claims incurred and reduced returns from investments.

	2011 $M	Underlying Result 2010 $M
Gross written premium	**270.5**	225.9
Net earned premium	**187.4**	205.4
Net claims incurred	**27.6**	10.0
Underwriting profit	**102.6**	141.8
Investment income	**80.3**	93.7
Profit before income tax	**182.9**	235.5
Income tax expense	**53.9**	70.1
Net profit after income tax	**129.0**	165.4

The 2010 reported profit of $253.5M was subject to significant one-off adjustments associated with a revision of earning patterns across all underwriting years to reflect the latest actuarial view of long term average risk emergence. The 2010 underlying result excludes increases of $132.8M in net earned premium, $7.0M in deferred insurance costs and $37.7M in income tax expense flowing from these changes.

2011 gross written premium of $270.5M represents a 20% increase on 2010. This growth reflects the success of the company's strategic partnerships with lenders in a generally flat real estate market.

Net earned premium of $187.4M was $18.0M lower than in 2010. This was primarily a result of a reduction in the level of policy terminations in 2011, which more than offset the growth in earned premium from new business written in 2011.

Claims incurred in 2011 of $27.6M were $17.6M higher than in 2010. This was primarily due to the impact of unfavourable economic conditions and softer housing markets in specific regional areas during the year. However, the company has only received a small number of claims as a result of the natural disaster events in Australia and New Zealand in December 2010 and January 2011.

Net investment income of $80.3M decreased $13.4M compared to 2010, principally due to unrealised losses on the company's investments. The company maintains a very conservatively managed portfolio, and continues to invest in highly rated securities.

<u>Controlling entities</u>

The controlling entity is QBE Holdings (AAP) Pty Limited ("QBE AAP"), a company limited by shares, incorporated and domiciled in Australia. The ultimate parent entity is QBE Insurance Group Limited, incorporated in Australia.

The controlling entity's registered office is at 82 Pitt Street, Sydney, NSW 2000.

Dividends

The directors recommend the payment of a dividend for the financial year ended 31 December 2011 of $Nil (2010: $75.0M).

$175.0M dividends have been paid during the financial year ended 31 December 2011 (2010: $125.0M).

Options

There were no options granted by the company during the year (31 December 2010: Nil).

Likely developments

Information on likely developments in the company's operations in future financial years and the expected results of those operations has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the company.

Significant changes

There were no significant changes to the company's state of affairs during the year.

Events subsequent to balance date

There is, at the date of this report, no matter or circumstance that has arisen since 31 December 2011 that has significantly affected, or may significantly affect:

the company's operations in future financial years;

the results of those operations in future financial years; or

the company's state of affairs in future financial years.

Environmental regulation

The company's operations are not subject to any significant environmental regulation under either Commonwealth or State legislation.

Directors' benefit

Since the end of the previous financial year, no director of the company has received or become entitled to receive a benefit (other than a remuneration or retirement benefit) by reason of a contract made or proposed by the company or a related entity with a director or with a firm of which the director is a member or with an entity in which the director has a substantial financial interest.

Indemnification and insurance

Under its constitution, the company has agreed to indemnify all the officers of the company for any liability (to the maximum extent permitted by the law), whether civil or criminal, for which they may be held personally liable.

No indemnity is given to present or former officers of the company or its subsidiaries against any liability incurred in their capacity as an officer unless the giving of the indemnity has been approved by the Board.

The company paid premiums in respect of a contract insuring officers of the company. The officers of the company covered by the insurance contract include the directors listed on page 1 and the company secretaries, KJ O'Loughlin, DAM Ramsay (until 26 October 2011) and P Smiles (from 26 October 2011). In accordance with normal commercial practice, disclosure of the total amount of premium payable and the nature of liabilities covered by the insurance contracts are prohibited by a confidentiality clause in the contract.

No premiums have been paid to indemnify the auditors in any capacity.

Rounding of amounts

The company is of a kind referred to in the ASIC class order 98/0100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the report of the directors. Amounts have been rounded off in the directors' report to the nearest one hundred thousand dollars in accordance with that class order.

Auditors

PricewaterhouseCoopers, Chartered Accountants, continues in office in accordance with Section 327B of the *Corporations Act 2001*.

Signed in accordance with a resolution of the directors made on 16 February 2012.

The Hon. NF Greiner
Chairman

IT Graham
Director

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Auditor's Independence Declaration

As lead auditor for the audit of QBE Lenders' Mortgage Insurance Limited for the year ended 31 December 2011, I declare that to the best of my knowledge and belief, there have been:

a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

b) no contraventions of any applicable code of professional conduct in relation to the audit.

This declaration is in respect of QBE Lenders' Mortgage Insurance Limited during the period.

J W Bennett
Partner
PricewaterhouseCoopers

Sydney
16 February 2012

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Independent auditor's report to the members of QBE Lenders' Mortgage Insurance Limited

Report on the financial report

We have audited the accompanying financial report of QBE Lenders' Mortgage Insurance Limited (the company), which comprises the balance sheet as at 31 December 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In Note 1, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with *International Financial Reporting Standards.*

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

Our procedures include reading the other information in the Annual Report to determine whether it contains any material inconsistencies with the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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Independence
In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001.*

Auditor's opinion
In our opinion:

(a) the financial report of QBE Lenders' Mortgage Insurance Limited is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the company's financial position as at 31 December 2011 and of its performance for the year ended on that date; and

(ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001;* and

(b) the company's financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

PricewaterhouseCoopers

J W Bennett
Partner

16 February 2012

QBE LENDERS' MORTGAGE INSURANCE LIMITED

DIRECTORS' DECLARATION

In the directors' opinion:

(a) the financial statements and notes set out on pages 9 to 51 are in accordance with the *Corporations Act 2001*, including:

(i) complying with accounting standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

(ii) giving a true and fair view of the company's financial position as at 31 December 2011 and of its performance, as represented by the results of its operations, changes in equity and its cash flows, for the financial year ended on that date; and

(b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable. Note 1(A) confirms that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Signed in Sydney, this 16th day of February 2012 in accordance with a resolution of the directors.

The Hon. NF Greiner
Chairman

IT Graham
Director

QBE LENDERS' MORTGAGE INSURANCE LIMITED

STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2011

	NOTES	2011 $M	2010 $M
Gross written premium		**270.5**	225.9
Unearned premium movement		**(58.4)**	136.6
Gross earned premium revenue	5(A)	**212.1**	362.5
Outward reinsurance premium		**(28.7)**	(44.4)
Deferred reinsurance premium movement		**4.0**	20.1
Outward reinsurance premium expense	5(B)	**(24.7)**	(24.3)
Net earned premium (a)		**187.4**	338.2
Gross claims incurred	5(B)	**(27.1)**	(11.2)
Non reinsurance recoveries revenue	5(A)	**(0.5)**	1.2
Net claims incurred (b)		**(27.6)**	(10.0)
Gross commission expense (c)	5(B)	**(7.0)**	(8.5)
Other acquisition costs (d)	5(B)	**(13.9)**	(16.6)
Underwriting and other expenses (e)	5(B)	**(36.3)**	(35.5)
Underwriting profit (a)+(b)+(c)+(d)+(e)		**102.6**	267.6
Investment income	6	**80.3**	93.7
Profit before income tax		**182.9**	361.3
Income tax expense	8	**(53.9)**	(107.8)
Profit after income tax		**129.0**	253.5
OTHER COMPREHENSIVE INCOME			
Net movement in foreign currency translation reserve		**-**	0.8
Income tax relating to components of other comprehensive income		**-**	-
Other comprehensive income after income tax		**-**	0.8
Total comprehensive income after income tax attributable to ordinary equity holders of the company		**129.0**	254.3

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

BALANCE SHEET
As at 31 December 2011

	NOTES	2011 $M	2010 $M
ASSETS			
Cash and cash equivalents	9	**16.5**	22.6
Investments	10	**1,616.4**	1,655.5
Trade and other receivables	11	**67.3**	77.7
Non-reinsurance recoveries on outstanding claims	16(A)	**3.2**	4.8
Deferred insurance costs	12	**70.2**	56.1
Property, plant and equipment	13	**1.1**	2.0
Shares in controlled entities		**75.3**	75.3
Deferred tax assets	14	**2.3**	-
Total assets		**1,852.3**	1,894.0
LIABILITIES			
Trade and other payables	15	**81.0**	121.1
Deferred tax liabilities	14	**-**	0.1
Outstanding claims	16(A)	**185.4**	199.3
Unearned premium	17	**566.4**	508.0
Total liabilities		**832.8**	828.5
Net assets		**1,019.5**	1,065.5
EQUITY			
Share capital	18(A)	**364.3**	364.3
Reserves	18(B)	**2.3**	2.3
Retained profits		**652.9**	698.9
Total equity		**1,019.5**	1,065.5

The above balance sheet should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2011

	Share Capital	Reserves	Retained Profits	Total Equity
	$M	$M	$M	$M
2011				
As at 1 January	**364.3**	**2.3**	**698.9**	**1,065.5**
Profit after income tax	-	-	**129.0**	**129.0**
Other comprehensive income	-	-	-	-
Total comprehensive income	-	-	**129.0**	**129.0**
Transactions with owners in their capacity as owners				
Dividends paid	-	-	**(175.0)**	**(175.0)**
As at 31 December	**364.3**	**2.3**	**652.9**	**1,019.5**
2010				
As at 1 January	364.3	6.4	565.5	936.2
Profit after income tax	-	-	253.5	253.5
Other comprehensive income	-	0.8	-	0.8
Total comprehensive income	-	0.8	253.5	254.3
Transactions with owners in their capacity as owners				
Transfer of share based payments reserve	-	(4.9)	4.9	-
Dividends paid			(125.0)	(125.0)
As at 31 December	364.3	2.3	698.9	1,065.5

The above statement of changes in equity should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

STATEMENT OF CASH FLOWS
For the year ended 31 December 2011

	NOTES	2011 $M	2010 $M
OPERATING ACTIVITIES			
Premium received		**268.5**	236.7
Outwards reinsurance paid		**(25.9)**	(30.2)
Claims paid		**(40.9)**	(37.3)
Non-reinsurance recoveries received		**1.7**	1.8
Insurance costs paid		**(36.9)**	(28.0)
Other underwriting costs paid		**(32.5)**	(36.4)
Interest and dividends received		**98.7**	70.5
Income taxes paid		**(68.5)**	(38.8)
Net cash flows from operating activities	9(A)	**164.2**	138.3
INVESTING ACTIVITIES			
Proceeds from sale of financial assets		**1,398.0**	2,820.3
Purchase of financial assets		**(1,376.8)**	(2,824.5)
Payments for purchase of property, plant and equipment		**-**	(0.5)
Net payments to related entity		**(17.8)**	-
Dividend received from controlled entity		**1.3**	1.5
Net cash flows from investing activities		**4.7**	(3.2)
FINANCING ACTIVITIES			
Dividends paid		**(175.0)**	(125.0)
Net cash flows from financing activities		**(175.0)**	(125.0)
Net movement in cash and cash equivalents		**(6.1)**	10.1
Cash and cash equivalents at the beginning of the financial year		**22.6**	12.5
Cash and cash equivalents at the end of the financial year	9	**16.5**	22.6

* Income taxes paid include amounts from / to related entities in Australia and New Zealand.

The above statement of cash flows should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2011

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated. This financial report includes financial statements for QBE Lenders' Mortgage Insurance Limited ("the company") as an individual entity.

(A) Basis of preparation

This general purpose financial report has been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board ("AASB"), Urgent Issues Group ("UIG") interpretations and the requirements of the *Corporations Act 2001*. The company has applied all new accounting standards and amendments that are mandatory for the first time in the current financial year. The adoption of these standards did not have any impact on the current period or any prior period and is not likely to affect future periods.

The presentation currency of these financial statements is Australian dollars.

The presentation of the statement of comprehensive income has been amended to provide a more detailed analysis of the results. This is considered more relevant information to users of the financial statements. Prior year comparatives have been adjusted for consistency with the new presentation standard.

Compliance with IFRS

The financial report complies with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by certain exceptions noted in the financial report, with the principal exceptions being the measurement of financial assets at fair value and the measurement of the outstanding claims liability and related recoveries at present value. The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions or estimates are significant, are disclosed in note 3.

Other

These financial statements are separate financial statements and the company is exempt from preparing consolidated financial statements. The ultimate parent company, QBE Insurance Group Limited ("QBE") (incorporated in Australia), produces consolidated financial statements in accordance with IFRS produced for public use, copies of which can be obtained at www.qbe.com or 82 Pitt Street, Sydney, NSW, 2000.

(B) Insurance contracts

All of the insurance products offered or utilised by the company meet the definition of insurance contracts under AASB 1023 "General Insurance Contracts", and are accounted for and reported in accordance with this standard. These products do not contain embedded derivatives or deposits that are required to be unbundled.

Insurance contracts that meet the definition of financial guarantee products are accounted for as insurance contracts under AASB 1023, rather than as financial instruments under AASB 139 "Financial Instruments: Recognition and Measurement".

(C) Premium revenue

Premium comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. The earned portion of premium received and receivable is recognised as revenue. Premium is treated as earned from the date of attachment of risk.

(D) Unearned premium

Unearned premium is calculated based on the term of the policies written and the likely pattern in which risk will emerge over that term.

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the business segment level, being a portfolio of contracts that are broadly similar and managed together as a single portfolio. If the present value of expected future cash flows relating to future claims plus the additional risk margin exceeds the unearned premium liability less deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The resulting deficiency is recognised immediately through profit and loss.

(E) Outward reinsurance

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Where applicable, a portion of outward reinsurance premium is deferred at the balance date.

(F) Claims

The provision for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not reported ("IBNR"), and estimated claims handling costs. Claims expense represents claim payments adjusted for movements in the outstanding claims liability.

The expected future payments are discounted to present value using a risk free rate.

A risk margin is applied to the central estimate, net of non-reinsurance recoveries, to reflect the inherent uncertainty in the central estimate.

(G) Non-reinsurance recoveries

Non-reinsurance recoveries receivable on paid claims, reported claims not yet paid and IBNR are recognised as revenue.

Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

(H) Acquisition costs

Acquisition costs (which includes commission costs) are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised when they relate to the acquisition of new business and are referred to as deferred acquisition costs. These costs are amortised on the same basis as the related premium is earned, in accordance with the premium income earning pattern adjusted for policy terminations. At the reporting date, deferred acquisition costs represent the capitalised costs that relate to the unearned premium. Acquisition costs are deferred in recognition of their future benefit and are measured at the lower of cost and recoverable amount.

(I) Commissions

Exchange commission is payable in accordance with the applicable reinsurance agreement on the basis of reinsurance premium written. Exchange commission is recognised as an expense in accordance with the premium income earning pattern adjusted for policy terminations.

Profit commission is payable in accordance with the applicable agreements and based on the profitability of the underlying portfolio, including the recognition of revenue and claims experience. An expense is recognised as the risk emerges in the underlying portfolio.

(J) Investment income

Interest income is recognised on an accruals basis. Dividends are recognised when the right to receive payment is established.

Investment income includes realised and unrealised gains or losses on financial assets which are reported on a combined basis as fair value gains or losses on financial assets.

(K) Taxation

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the company operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax liabilities and assets are not recognised for temporary differences between the carrying amount and tax bases of investments in foreign operations where the company is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

The company has implemented the tax consolidation legislation. All entities in the tax-consolidated group continue to account for their own current and deferred tax amounts. These tax amounts are measured as if each entity continues to be a stand-alone tax payer in its own right. The head entity of the tax-consolidated group recognises any current tax or deferred tax arising from unused tax losses and unused tax credits assumed from controlled entities in the tax-consolidated group. Details of the tax funding agreement are included in note 8(B) to the financial statements.

Current and deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

(L) Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

(i) Financial assets

The company has identified the following classes of financial asset: cash and cash equivalents, investments, and trade and other receivables.

(ii) Financial liabilities

The company has identified the following class of financial liability: trade and other payables.

(iii) Financial instruments designated as fair value through profit or loss.

The policy of management is to designate a group of financial assets or financial liabilities as fair value through profit or loss when that group is both managed and its performance evaluated on a fair value basis for both internal and external reporting in accordance with the company's documented investment strategy.

(M) Policyholders' funds

All cash and investments are held to back policyholders' funds, being the net insurance liabilities of the business.

(N) Cash and cash equivalents

Cash and cash equivalents include cash at bank and on hand and deposits at call which are readily convertible to cash on hand and which are used for operational cash requirements.

(O) Investments

All investments are designated as fair value through profit or loss on initial recognition. They are initially recorded at fair value, being the cost of acquisition excluding transaction costs, and are subsequently remeasured to fair value at each reporting date.

Fixed and floating rate securities are valued using independently sourced valuations that do not involve the exercise of judgement by management.

All purchases and sales of financial assets that require delivery of the asset within the timeframe established by regulation or market convention ("regular way" transactions) are recognised at trade date, being the date on which the company commits to buy or sell the asset.

Investments are derecognised when the right to receive future cash flows from the assets has expired, or has been transferred, and the company has transferred substantially all the risks and rewards of ownership.

(P) Receivables

Trade receivables are recognised at amounts receivable less a provision for impairment. A provision for impairment is established when there is objective evidence that the company will not be able to collect all amounts due according to the original term of the receivable. Any increase or decrease in the provision for impairment is recognised in the profit or loss within underwriting expenses. When a receivable is uncollectible, it is written off against the provision for impairment account. Subsequent recoveries of amounts previously written off are credited against underwriting expenses in the profit or loss.

(Q) Property, plant and equipment

Property, plant and equipment is stated at historical cost less accumulated depreciation and impairment.

Leasehold improvements, office equipment, fixtures and fittings are depreciated using the straight line method over the estimated useful life to the company of each class of asset. Estimated useful lives are between 3 to 10 years for all classes.

An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount – refer note 1(S).

(R) Shares in controlled entities

Shares in controlled entities were acquired prior to 1 January 2010, were initially recognised at cost (fair value of consideration provided plus directly attributable acquisition related costs) and are subsequently carried in the company's financial statements at the lower of cost and recoverable amount.

A revised AASB 3 "Business Combinations" became applicable to the company for any acquisitions subsequent to 1 January 2010. Purchase consideration will be recorded at fair value at the acquisition date, and acquisition related expenses will be expensed as incurred.

Investments in subsidiaries are subject to impairment review – refer note 1(S).

(S) Impairment of assets

Assets that have an indefinite useful life are tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped in cash generating units which are the lowest levels for which there are separately identifiable cash flows.

(T) Foreign currency translation

(i) Functional and presentation currency

The company's financial statements are presented in Australian dollars, being the functional and presentation currency of the company.

(ii) Translation of foreign currency transactions and balances

Items included in the financial statements are measured using the currency of the primary economic environments in which the entity operates (the functional currencies). Foreign currency transactions are translated into functional currencies at the rates of exchange at the dates of the transactions. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange prevailing at that date. Resulting exchange gains and losses are included in profit or loss.

(iii) Translation of overseas branch

The functional currency of the New Zealand branch operation of the company is New Zealand dollars (NZ$). The results and balance sheet of the New Zealand branch are translated into the presentation currency as follows:

- assets and liabilities are translated at the closing balance date rates of exchange;
- income and expenses are translated at average rates of exchange; and
- all resulting exchange differences are recognised as a separate component of equity.

(U) Employee Benefits

All persons engaged in the activities of the company are employed by a related parties, QBE Management Services Pty Limited ("QMS") in Australia and QBE Insurance (International) Limited ("QII") in New Zealand.

The company does not incur employment related expenses or provide or accrue for employee benefits, but is charged equivalent management fee expenses by QMS and QII.

(V) Equity

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction from the proceeds, net of tax.

(W) Dividends

Provision is made for dividends which are declared, being appropriately authorised and no longer at the discretion of the company, on or before the end of the financial year but not distributed at the balance date.

(X) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the profit or loss on a straight line basis over the period of the lease.

(Y) Goods and services tax ("GST")

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office ("ATO"). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of expense. Receivables and payables in the balance sheet are shown inclusive of GST.

Commitments are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

(Z) Comparative figures

Comparative figures have been adjusted, where necessary, to conform to the basis of presentation and the classification used in the current year.

(AA) Rounding of amounts

The company is of a kind referred to in the ASIC class order 98/100 dated 10 July 1998 (as amended by class order 04/667 dated 15 July 2004) relating to the "rounding off" of amounts in the financial statements. Amounts have been rounded off in the financial statements to the nearest hundred thousand dollars in accordance with that class order.

2. NEW ACCOUNTING STANDARDS AND INTERPRETATIONS

The AASB has issued the following amendments to Australian Accounting Standards:

Title		Operative Date
AASB 9	Financial Instruments	1 January 2015
AASB 1054	Australian Additional Disclosures	1 January 2012
2009-11	Amendments to Australian Accounting Standards arising from AASB 9	1 January 2015
2010-6	Amendments to Australian Accounting Standards – Disclosures on Transfers of Financial Assets	1 January 2012
2010-7	Amendments to Australian Accounting Standards arising from AASB 9 (December 2010)	1 January 2015
2010-8	Amendments to Australian Accounting Standards – Deferred Tax: Recovery of Underlying Assets	1 January 2012
2011-1	Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project	1 January 2012
2011-2	Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project - Reduced Disclosure Requirements	1 January 2014
2011-4	Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirements	1 January 2014

Title		Operative Date
2011-5	Amendments to Australian Accounting Standards - Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation	1 January 2012
2011-6	Amendments to Australian Accounting Standards - Extending Relief from Consolidation, the Equity Method and Proportionate Consolidation - Reduced Disclosure Requirements	1 January 2014
2011-7	Amendments to Australian Accounting standards arising from the Consolidation and Joint Arrangements standards	1 January 2013
2011-8	Amendments to Australian Accounting standards arising from AASB 13	1 January 2013
2011-9	Amendments to Australian Accounting standards – Presentation of items of other Comprehensive income	1 January 2013
2011-10	Amendments to Australian Accounting standards arising from AAsB 119 (September 2011)	1 January 2013
2011-11	Amendments to AASB 119 (September 2011) arising from reduced Disclosure requirements	1 January 2014
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 1 (revised)	Presentation of Financial Statements	1 January 2013
IAS 19 (revised)	Employee Benefits	1 January 2013
IAS 27 (revised)	Separate Financial Statements	1 January 2013
IAS 28	Investments in Associates and Joint Ventures	1 January 2013

The Australian Accounting Standards and amendments detailed in the table above are not mandatory until the operative dates stated; however, early adoption is permitted except for AASB 2011-4, where early adoption is not permitted.

The company will apply the standards and amendments detailed above for the reporting periods beginning on the operative dates set out above. The application of these standards is not expected to have a material impact on the company's financial statements.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The company makes estimates and judgements in respect of the reported amounts of certain assets and liabilities. These estimates and judgements are determined by qualified and experienced actuaries and management with reference to historical data and reasoned expectations of future events, and are continually updated. The key areas in which critical estimates and judgements are applied are described as follows.

(A) Ultimate liability arising from claims made under insurance contracts

Provision is made for the estimated cost of claims incurred but not settled at the balance date. This provision consists of estimates of both the expected ultimate cost of claims notified to the company as well as the expected ultimate cost of claims incurred but not reported to the company ("IBNR"). The estimated cost of claims includes direct expenses that are expected to be incurred in settling those claims.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the company, where more information about the claims is generally available. The longer the delay between the event giving rise to the claim and final claim settlement, the greater the variability between initial estimates of the loss to be incurred and the final settlement amount, as a result of additional financing and settlement costs incurred by the lender and changes in property valuations.

The estimation techniques and assumptions used in determining the outstanding claims provision and the associated non-reinsurance recoveries are described below.

(i) Insurance risk assumptions

The company's process for establishing the outstanding claims provision involves extensive consultation with actuaries, claims managers, and other senior management. This process includes regular internal claims review meetings attended by senior management and detailed review by an external actuary at least annually.

The determination of the amounts that the company will ultimately pay for claims arising under insurance and reinsurance contracts involves a number of critical assumptions. Some of the uncertainties impacting these assumptions are as follows:

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs during the time that elapses before a definitive determination of the ultimate claims cost can be made;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example house price inflation, unemployment and interest rates.

The potential impact of changes in key assumptions on the company's statement of comprehensive income and balance sheet are summarised in note 3(A)(vi).

(ii) Central estimates

The outstanding claims provision comprises the central estimate and a risk margin which is added to the central estimate to achieve the appropriate probability of adequacy. The outstanding claims provision is discounted at risk-free rates of return to reflect the time value of money.

A central estimate is an estimate of the level of claims provision that is intended to contain no intentional under or over estimation. As the company requires a higher probability that estimates will be adequate over time, a risk margin is added to the central estimate of outstanding claims.

Central estimates are determined by reference to a variety of estimation techniques, generally based on a statistical analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimate is based on a judgemental consideration of the results of each method and qualitative information, for example:

- Historical trends in the development and incidence of the numbers of defaults reported, numbers of defaults cured, numbers of properties taken into possession, numbers of such properties sold, numbers of claims arising from these sales, and the costs of those claims;
- Exposure details, including policy counts, sums insured and various other characteristics of the borrowers and loans; and
- Historical and likely future trends of expenses associated with managing claims to finalisation.

Central estimates are calculated gross of any non-reinsurance recoveries. Separate estimates are made of the amounts recoverable from reinsurers, borrowers and third parties based on the gross outstanding claims provision.

(iii) Risk margin

Risk margins are held to mitigate the potential for uncertainty in the outstanding claims estimation process. The determination of the appropriate level of risk margin takes into account the uncertainty or variability inherent in the company's business and the diversification benefits achieved by writing business in a number of geographic locations and with different lenders.

The measurement of variability uses techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. The use of a range of outcomes allows a determination of the risk margin required to provide an estimate at a given probability of adequacy, e.g. 9 times in 10 (a 90% probability of adequacy). These techniques use standard statistical distributions, and the measure of variability is referred to as the standard deviation or the coefficient of variation.

The directors and management have set an internal target for the probability of adequacy of the net outstanding claims provision to be 75% or above. The Australian Prudential Regulation Authority ("APRA") requires a probability of adequacy of 75% in the determination of minimum capital. For the actual probability of adequacy applied at the end of the financial year, refer to note 16(C).

(iv) Expected present value of future cash flows for future claims

The expected present value of future cash flows for future claims and risk margin used in the liability adequacy test (refer note 17(C)) are determined using the same methods described above.

(v) Assumptions used to determine the outstanding claims provision

Key variables

	2011	2010
Severity	**27.9%**	29.1%
Claim rates	**30.1%**	32.1%
Recovery rates	**0.3%**	1.0%
Risk margin (as a proportion of the central estimate)	**95.9%**	125.0%

Severity is a measure of the anticipated claims cost relative to the corresponding risk exposures.

Claim rate is the percentage of current defaults that are expected to become claims

Recovery rate is a measure of anticipated non-reinsurance recoveries in claims.

The percentages adopted in the actuarial model are determined based on an analysis of historical experience combined with actuarial and management judgement of future trends.

Discount rates

The outstanding claims provision is discounted to net present value using a risk free rate of return. Details of the risk free rates of return are summarised below:

	2011		2010	
	Average of succeeding year	**Average of subsequent years**	Average of succeeding year	Average of subsequent years
Discount factor	**3.7%**	**3.4%**	4.8%	5.4%

Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the outstanding claim provision, which is determined by the reference to a combination of historical analysis and current expectation of when claims will be settled.

The weighted average term to settlement of the company's net outstanding claims provision at the balance date is 1.2 years (2010: 1.2 years).

(vi) Impact of changes in key variables on the outstanding claims provision

The impact of changes in key outstanding claims variables is summarised in the following table. Each change has been calculated in isolation from the other changes and each change shows the after tax impact on profit and equity assuming that there is no change to:

- any of the other variables; and
- the probability of adequacy.

It is likely that if, for example, the central estimate was to increase by 5%, at least part of the increase would result in a decrease in the probability of adequacy.

		2011		2010	
Variable	Change in assumptions	**Revised Variable**	**Impact on Profit (Loss) and Equity** [1]	Revised Variable	Impact on Profit (Loss) and Equity [1]
			$M		$M
Severity	+20%	**33.4%**	**(15.6)**	34.9%	(14.6)
	-20%	**22.3%**	**15.6**	23.3%	14.6
Claim rates	+20%	**36.1%**	**(15.6)**	38.5%	(14.6)
	-20%	**24.0%**	**15.6**	25.6%	14.6
Recovery rates	+20%	**0.3%**	**0.1**	1.2%	0.3
	-20%	**0.2%**	**(0.1)**	0.8%	(0.3)
Discount factors	+20%	**4.6%**	**0.6**	6.7%	0.9
	-20%	**3.1%**	**(0.6)**	4.5%	(0.9)
Risk margin	+20%	**115.1%**	**(12.5)**	149.6%	(15.1)
	-20%	**76.7%**	**12.5**	99.7%	15.1

[1] Assumes taxation at prima facie rate of 30%.

(B) Unearned premium liabilities and deferred insurance costs

As highlighted in note 1(C), premium is earned based on the term of the policies written and the likely pattern in which risk will emerge over that term. An actuarial analysis of the emergence of risk over the life of a policy is performed annually and is used to derive an earning pattern for each underwriting year. Premium is earned and acquisition costs recognised in accordance with this pattern.

During the financial year ended 31 December 2010 the company formed the view that the risk of an extended period of claims emergence as a result of the Global Financial Crisis had abated. Consequently, the earning patterns adopted in 2008 were revised across all underwriting years to reflect the latest actuarial view of long term average risk emergence. This reduced the unearned premium liability by $132.8M and deferred insurance costs by $7.0M.

Given the unpredictable pattern of future policy terminations it was not practical to reliably estimate the impact of these changes in individual future periods.

4. RISK MANAGEMENT

The company's risk management policy, strategy and framework are embedded in its operations. The board annually approves a comprehensive risk management strategy ("RMS") and a reinsurance management strategy (REMS), both of which are lodged with the Australian Prudential Regulation Authority ("APRA").

The company's principal risk management policy objectives are to:

- achieve competitive advantage through better understanding the risk environment in which the company operates;
- optimise risk and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises by reducing uncertainty and volatility.

It is the company's policy to adopt a rigorous approach to managing risk. Risk management is a continuous process and an integral part of quality business management. The company's approach is to integrate risk management into its broader management processes. It is the company's philosophy to ensure that risk management is embedded in the business and that the risk makers or risk takers are themselves the risk managers. Specifically, the management of risk must occur at each point in the business management cycle.

Risk management forms a key part of the company's governance structure and strategic and business planning. It underpins the setting of limits and authorities and it is embedded in the monitoring and evaluation of performance. The company is also subject to the governance and risk management practices of its ultimate parent company.

The risk management framework defines the risks that the company is exposed to and sets out the framework to manage those risks and meet strategic objectives whilst taking into account the creation of value for the shareholders. The framework is made up of complementary elements that are embedded throughout the business management cycle and culture. Key aspects include: governance, risk appetite and tolerance, delegated authorities, risk policies, measurement and modelling, control completion monitoring, defined risk and issue escalation protocols, optimisation and ongoing improvement through management action plans and risk and performance monitoring.

A fundamental part of the overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows from insurance contracts. The company's operating activities expose it to risks such as market risk, credit risk and liquidity risk. The risk management framework recognises the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance. The company has established internal controls to manage risk in the key areas of exposure relevant to its business.

The company's risk profile is described under the following broad risk categories:

- Strategic risk
- Insurance risk
- Credit risk
- Market risk
- Liquidity risk
- Operational risk

Each of these is described more fully in sections (A) to (F) below.

(A) Strategic risk

Strategic risk refers to the current and prospective impact on earnings and or capital arising from strategic business decisions, implementation of decisions and responsiveness to external change. This includes risks associated with business strategy and change, tax planning, investment strategy and corporate governance. Of particular relevance is capital management risk.

(i) Capital management risk

The company is subject to extensive prudential regulation covering the jurisdictions in which it conducts business. Prudential regulation is generally designed to protect the policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations. The regulatory environments in Australia continue to evolve in response to economic, political and industry developments. The company works closely with regulators and monitors regulatory developments to assess their potential impact on its ability to meet solvency and other requirements. Refer note 18(C) for more details of the company's capital management procedures.

(B) Insurance Risk

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to the expectations at the time of underwriting. This includes underwriting, catastrophe claims concentration and claims provisioning risks. The risks inherent in any single insurance contract are the possibility of the insured event occurring and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, these risks are random and unpredictable. In relation to the pricing of individual insurance contracts and the determination of the level of the outstanding claims provision in relation to a portfolio of insurance contracts, the principal risks are that premiums charged do not adequately remunerate the company for the risks it assumes and that the ultimate claims payments will exceed the carrying amount of the provision established.

The company has established the following protocols to manage its insurance risk:

(i) Underwriting risks

Selection and pricing of risks

The company offers lenders' mortgage insurance ("LMI") in Australia and New Zealand. LMI insures the lender should the borrower default on repayment of the loan, and covers the remaining loan balance, plus selling costs and expenses, following the application of the proceeds from the sale of the security property.

In Australia, LMI is characterised by coverage of 100% of the loan amount. In New Zealand, insurance coverage may also be "top cover", where the total loss (including expenses) is paid up to a prescribed percentage of the original loan amount. Typical top cover in New Zealand ranges from 20% to 30% of the original loan amount.

Key risk mitigation policies and procedures comprise:

- the pricing model measures return on capital and reflects risks on a long term cyclical performance basis for both standard and new products. Pricing tables are set according to appropriate risk characteristics, such as type of product, loan amounts and loan valuation ratio.
- standard insurance agreements and documented underwriting policies and procedures are in place with allocation of delegated authority levels to approve applications.
- quality assurance reviews of underwriting and claims managements are conducted on a regular basis.

Concentration risk

Concentration risk is the risk of exposure due to concentration of activity in certain geographical locations, industries or counterparties. The company operates throughout all regions in Australia and New Zealand and therefore has limited geographic concentration risk on insurance contracts; exposures are monitored but not limited by region. Limits, such as those placed on maximum aggregate exposures to individual borrowers and per property, are contained in underwriting policies and are embedded in systems and processes.

The company is exposed to the possibility of very large losses from economic events such as a significant increase in regional or nationwide unemployment levels, weakening in house prices, or a significant increase in interest rates over a short period of time. The company calculates its maximum event retention ("MER") which is the estimated maximum net loss from significant economic events with an approximate return period of 250 years. The MER must be less than the company's concentration risk tolerance; otherwise, steps such as the purchase of additional reinsurance are taken to limit the exposure. As at 31 December 2011, the MER was $813.5M (2010: $732.2M) before tax benefit.

(ii) Claims management and claims provisioning risks

The company's approach to determining the outstanding claims provision and the related sensitivities are set out in note 3. The company seeks to ensure the adequacy of its outstanding claims provision by reference to the following controls:

- experienced claims managers operate within policy and within the levels of authority delegated to them in respect of the settlement of claims;

- processes exist to ensure that all defaults are captured and updated on a timely basis and with a realistic assessment of the ultimate claims cost;
- initial IBNR estimates are set by experienced internal actuaries in conjunction with management;
- the outstanding claims provision is assessed regularly by senior management and is reviewed by the external Appointed Actuary at least annually.

(C) Credit Risk

Credit risk is the risk that a loss will be incurred because mortgagees, customers or counterparties to financial instruments fail to discharge their contractual obligations.

The principal sources of credit risk to the company arise in respect of insurance and reinsurance contracts and financial instruments.

(i) Credit risk arising from insurance contracts

Credit risk arising from insurance contracts principally relates to the risk of default by the underlying borrowers.

As insurer or re-insurer, the company does not require access to the current credit quality of performing insured loans but is provided with data on loans in default by insured lenders. The relevant LMI master policy defines "default" as the borrower's failure to pay when due an amount equal to the scheduled monthly mortgage payment under the terms of the mortgage. Generally, however, the master policies require an insured to notify the insurer of a default within 14 days of the end of the month when the total amount due is unpaid and in arrears by more than 60 days. For reporting and internal tracking purposes, the company does not consider a loan to be in default until it has been delinquent for two consecutive monthly payments.

Credit risk on LMI contracts is therefore principally managed up-front through the underwriting process, prior to the acceptance of risk. The company has a centralised credit risk function that incorporates pricing, claims liability modelling, credit policy, portfolio performance reporting and analysis, and underwriting quality assurance.

Acceptance of credit risk is managed primarily using two scorecards, built on credit bureau data and company portfolio history. Credit rules are used to support these two scorecards. The centralised credit risk unit manages and maintains the scorecards and a centralised underwriting policy and procedure.

Lenders usually collect the single premium from a prospective borrower and remit the amount to the company; generally, under a standard LMI policy, premium payment is required before policy cover is incepted, which eliminates credit risk on premiums receivable.

The company does not hold any collateral as security against its exposures; however, in the event of a claim by the lender, the lender's rights as mortgagee are assigned to the company.

(ii) Reinsurance counterparty credit risk

Reinsurance risk management is the process of transferring insurance risk to another insurer for a price. The company reinsures a portion of risks underwritten to control exposure to insurance losses, reduce volatility and protect capital. The company's strategy in respect of the selection, approval and monitoring of reinsurance arrangements is addressed by the following protocols:

- reinsurance is placed in accordance with a reinsurance management strategy approved by the Board, which in turn is consistent with the QBE Group reinsurance management strategy and QBE Group security committee guidelines;
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical and potential future losses and the company's MER; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

The company's current reinsurance arrangements are disclosed within Note 25(C).

(iii) Investment counterparty credit risk

The company's principal exposure to credit risk from financial instruments arises from the company's holdings of fixed and floating interest rate securities and short term money market securities. Additional credit risk arises in respect of cash holdings and trade and other receivables.

The company maintains high credit quality, liquid investments managed in accordance with an investment mandate approved by the company's board. The company monitors credit risk in respect of its investments in terms of geographic, and sectoral / industry concentrations, as well as exposures to individual non-government issuers.

Maximum exposures to credit risk at balance date in relation to each class of recognised financial asset is the carrying amount of those assets as indicated in the balance sheet.

There are no significant credit enhancements or collateral held as security that reduce the exposure to credit risk (2010: Nil). The company has not taken possession of collateral or called upon credit enhancements during the year (2010: Nil).

The following tables provide information regarding the company's aggregate credit risk exposure at the balance sheet date in respect of the major classes of financial assets. The analysis classifes the assets according to Moody's counterparty credit ratings. Aaa is the highest possible rating. Rated assets falling outside the range of Aaa to Baa are classified as speculative grade.The credit quality of the company's holdings of investments is as follows:

	Credit Rating						
	Aaa $M	**Aa $M**	**A $M**	**Baa $M**	**Speculative Grade $M**	**Unrated $M**	**Total $M**
At 31 December 2011							
Cash and Cash Equivalents	**-**	**16.0**	**0.5**	**-**	**-**	**-**	**16.5**
Interest-bearing investments	**247.1**	**1,155.4**	**182.9**	**31.0**	**-**	**-**	**1,616.4**
At 31 December 2010							
Cash and Cash Equivalents	8.7	13.6	0.3	-	-	-	22.6
Interest-bearing investments	212.5	1,253.9	171.8	17.3	-	-	1,655.5

None of the company's financial assets are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2010: Nil).

All cash and cash equivalent balances are held with either Authorised Deposit-taking Institutions in Australia or registered banks in New Zealand.

(D) Market Risk

Market risk is the risk of variability in the value of, and returns on, investments and the risk associated with variability of interest rates, foreign exchange rates and market prices on assets and non-insurance liabilities.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Financial instruments with floating rate interest expose the company to cash flow interest rate risk, whereas fixed interest rate instruments expose the company to fair value interest rate risk.

The company's approach is to minimise interest rate risk by actively managing investment portfolios to achieve a balance between cash flow interest rate risk and fair value interest rate risk. The company invests in high quality, liquid interest bearing securities and cash and actively manages the duration of the fixed interest portfolio.

The maturity profile of the company's interest bearing financial assets and hence its exposure to interest rate risk, and the effective weighted average interest rate for interest bearing financial assets is analysed below:

		Fixed interest rate maturing in						
	Floating interest rate	**1 year or less**	**1 to 2 years**	**2 to 3 years**	**3 to 4 years**	**4 to 5 years**	**Over 5 years**	**Total**
At 31 December 2011								
Interest bearing financial assets ($M)	**1,202.5**	**272.0**	**62.7**	**22.6**	**26.1**	**2.8**	**44.2**	**1,632.9**
Weighted average interest rate (%)	**6.61%**	**4.82%**	**4.75%**	**5.24%**	**4.46%**	**13.0%**	**4.33%**	**6.14%**
At 31 December 2010								
Interest bearing financial assets ($M)	920.7	413.2	204.3	62.2	33.3	15.3	29.1	1,678.1
Weighted average interest rate (%)	6.38%	5.10%	5.84%	5.93%	5.63%	6.97%	7.26%	5.99%

All interest bearing financial assets are measured at fair value through profit or loss. Movements in interest rate impact the value of fixed interest rate securities and therefore impact the reported profit after tax. The impacts of given increases or decreases in interest rates on fixed interest securities owned by the company at the balance sheet date are as follows:

	Sensitivity		Profit (loss)	
	2011 %	2010 %	**2011 $M**	2010 $M
Interest rate movement:	**+0.5**	+1.0	**(3.5)**	(6.0)
Interest-bearing financial assets	**-0.5**	–1.0	**3.5**	6.0

The effect of interest rate risk on the company's provision for outstanding claims is included in note 3(A)(vi).

(ii) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

There is minimal currency risk on financial instruments, as the company's investments are predominantly held in Australian dollars.

The company is exposed to currency risk in respect of the translation of the New Zealand branch operations into its functional currency of Australian dollars and the investment in its subsidiary QBE Mortgage Insurance (Asia) Limited, which is based in Hong Kong. Management of this currency risk is performed at QBE Group level.

(iii) Price risk

Price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk).

The company was exposed to price risk during the current and prior year in respect of investments in equities; this risk was managed in accordance with the company's investment mandate, and by investing in high quality, liquid assets listed on the Australian Stock Exchange.

There was no price risk at the end of either the current or prior financial year as these investments had been sold.

(E) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial and insurance liabilities as and when they fall due. This includes risks associated with asset and liability management. The key objective of the asset and liability management strategy is to ensure sufficient liquidity is maintained at all times to meet the company's obligations, including its settlement of insurance liabilities, and within these parameters, to optimise investment returns.

The nature of the business is that cash is received by way of single premiums at the inception of insurance contracts and is invested to fund future claims on those contracts. The principal sources of funds are written premiums, investment maturities and sales, and net investment income. The principal uses of funds are the payment of operating expenses, claim payments, taxes and growth of investments.

Liquidity must be sufficient to meet both planned and unplanned cash requirements. The company is exposed to liquidity risk mainly through its obligations to make payments in relation to its insurance contracts.

The key elements of the liquidity risk management strategy are as follows:

- Cash requirements are monitored regularly by management.
- Sufficient cash and cash equivalents are set aside for operating requirements of the business.
- Surplus funds are invested in accordance with the investment mandate.

The company's investment strategies form a key part of liquidity risk management.

The following table summarises the contractual maturity profile of financial liabilities, including contingent liabilities and commitments, based on remaining contractual payment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately; however, it is not expected that all creditors will request payment on the earliest date the company could be required to pay.

	Note	1 Year or Less $M	1 to 3 Years $M	3 to 5 Years $M	Over 5 Years $M	Total $M
As at 31 December 2011						
Balance sheet financial liabilities:						
Trade and other payables	15	**62.6**	**16.7**	**1.7**	**-**	**81.0**
Total		**62.6**	**16.7**	**1.7**	**-**	**81.0**
Other:						
Commitments	24	**3.0**	**9.7**	**0.3**	**-**	**13.0**
Contingent liabilities	22	**48.9**	**-**	**-**	**-**	**48.9**
Total		**51.9**	**9.7**	**0.3**		**61.9**
As at 31 December 2010						
Balance sheet financial liabilities:						
Trade and other payables	15	112.0	7.6	1.5		121.1
Total		112.0	7.6	1.5	-	121.1
Other:						
Commitments	24	3.2	8.1	5.4	-	16.7
Contingent liabilities	22	49.0	-	-	-	49.0
Total		52.2	8.1	5.4	-	65.7

(F) Operational risk

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk). The company manages operational risk within the same robust risk management framework as its other risks. The risk assessment and monitoring framework involves on-going:

- identification and review of the key risks to the company;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks in terms of the acceptable level of risk (risk tolerance) and the residual risk remaining after having considered risk treatment;

- assessment of whether each risk is within the acceptable level of risk, or requires appropriate action be taken to mitigate any excess risk;
- transparent monitoring and reporting of risk management related matters on a timely basis; and
- alignment of internal audit programs with risks.

One of the cornerstones of the company's risk management framework is the recruitment and retention of high quality people who are entrusted with appropriate levels of autonomy within the parameters of disciplined risk management practices.

The company operates a system of delegated authorities based on expertise and proven performance, and compliance is closely monitored. Other controls include effective segregation of duties, access controls and authorisation and reconciliation procedures.

5. INCOME AND EXPENSES

(A) Income summary

	2011 $M	2010 $M
Gross written premium revenue		
Direct	**245.8**	217.5
Inward reinsurance	**24.7**	8.4
	270.5	225.9
Gross earned premium revenue		
Direct	**197.8**	333.8
Inward reinsurance	**14.3**	28.7
	212.1	362.5
Other Income		
Non-reinsurance recoveries	**(0.5)**	1.2
Interest, discount and dividend income	**105.1**	94.3
	104.6	95.5
Net fair value gains on financial assets	**-**	1.3
Revenue	**316.7**	459.3

(B) Expenses Summary

	2011 $M	2010 $M
Outward reinsurance premium expense	**24.7**	24.3
Gross claims incurred	**27.1**	11.2
Gross commission expense	**7.0**	8.5
Other acquisition costs	**13.9**	16.6
Underwriting and other expenses	**36.3**	35.5
Net fair value losses on financial assets	**22.9**	-
Investment expenses	**1.9**	1.9
Expenses	**133.8**	98.0

(C) Specific items

	2011 $M	2010 $M
Claims settlement expenses	**4.6**	4.1
Operating lease payments	**2.9**	3.1
Depreciation of plant and equipment	**0.9**	1.2

Related party transactions:

	2011 $M	2010 $M
(i) Revenue		
Inward reinsurance premium received or receivable from controlled entity	**1.4**	1.4
Dividends from controlled entity	**1.3**	1.5
Management fee received or receivable from controlled entities	**1.5**	1.8
(ii) Expenses		
Management fees and cost allocations paid or payable to related entities	**37.1**	33.4
Reinsurance premium paid or payable to related entities (net of no claims bonus)	**28.7**	44.4
Commissions paid or payable to controlled entity	**0.4**	0.7
Reinsurance claims paid to a controlled entity	**0.2**	-

6. INVESTMENT INCOME

	2011 $M	2010 $M
Dividend income	1.7	2.6
Income from short term money market securities	5.0	17.9
Interest received or receivable	98.4	73.8
Interest, discount and dividend income	105.1	94.3
Net fair value gains (losses) on interest rate securities	(22.3)	3.8
Net fair value losses on equities	(0.6)	(2.5)
Net fair value gains (losses) on financial assets	(22.9)	1.3
Investment expenses	(1.9)	(1.9)
Net investment income	80.3	93.7

7. CLAIMS INCURRED

(A) Claims analysis

	2011 $M	2010 $M
Gross claims incurred and related expenses		
Direct	28.4	12.2
Inward reinsurance	(1.3)	(1.0)
	27.1	11.2
Non-reinsurance recoveries		
Direct	0.5	(1.1)
Inward reinsurance	-	(0.1)
	0.5	(1.2)
Net claims incurred	27.6	10.0

(B) Claims development

Current year's claims relate to risks borne in the current reporting year. Prior year claims relate to a reassessment of the risks borne in all the previous reporting periods. and include release of risk margins as claims are paid. Refer to Note 7(C) below

	2011			2010		
	Current Year	**Prior Years**	**Total**	Current Year	Prior Years	Total
	$M	**$M**	**$M**	$M	$M	$M
Gross claims incurred and related expenses						
Undiscounted	**136.0**	**(110.4)**	**25.6**	124.9	(113.6)	11.3
Discount	**(2.5)**	**4.0**	**1.5**	(3.1)	3.0	(0.1)
	133.5	**(106.4)**	**27.1**	121.8	(110.6)	11.2
Non-reinsurance recoveries						
Undiscounted	**(2.3)**	**2.9**	**0.6**	(3.1)	1.8	(1.3)
Discount	**0.1**	**(0.2)**	**(0.1)**	0.1	-	0.1
	(2.2)	**2.7**	**0.5**	(3.0)	1.8	(1.2)
Net claims incurred						
Undiscounted	**133.7**	**(107.5)**	**26.2**	121.8	(111.8)	10.0
Discount	**(2.4)**	**3.8**	**1.4**	(3.0)	3.0	-
	131.3	**(103.7)**	**27.6**	118.8	(108.8)	10.0

(C) Reconciliation of net claims incurred to claims development table

The development of the net undiscounted central estimate of outstanding claims for the four most recent accident years is shown in note 16(E). This note is a reconciliation of the amounts included in the table above and the current financial year movements in the claims development table.

	2011			2010		
	Current Year	**Prior Years**	**Total**	Current Year	Prior Years	Total
	$M	**$M**	**$M**	$M	$M	$M
Net undiscounted claims development – central estimate (note 16(E))	**70.5**	**(30.2)**	**40.3**	56.1	(37.4)	18.7
Movement in claims settlement costs	**1.7**	**2.9**	**4.6**	0.6	3.5	4.1
Movement in discount	**(2.4)**	**3.8**	**1.4**	(3.0)	2.9	(0.1)
Movement in risk margin	**59.7**	**(78.4)**	**(18.7)**	63.7	(76.1)	(12.4)
Other movements	**1.8**	**(1.8)**	**-**	1.4	(1.7)	(0.3)
Net claims incurred - discounted	**131.3**	**(103.7)**	**27.6**	118.8	(108.8)	10.0

8. INCOME TAX

(A) Reconciliation of prima facie tax to income tax expense

	2011 $M	2010 $M
Profit before income tax	**182.9**	361.3
Prima facie tax payable at 30%	**54.9**	108.4
Tax effect of permanent differences:		
Untaxed dividends	**(0.5)**	(0.8)
Other, including non allowable expenses and non taxable income	**(0.1)**	0.1
Prima facie tax adjusted for permanent differences	**54.3**	107.7
Under (over) provision in prior year	**(0.4)**	0.1
Income tax expense	**53.9**	107.8
Analysed as follows:		
Current tax	**54.7**	69.1
Deferred tax	**(0.4)**	38.6
Under (over) provision in prior year	**(0.4)**	0.1
	53.9	107.8
Deferred tax expense comprises:		
Deferred tax assets recognised in profit or loss	**(0.5)**	45.5
Deferred tax liabilities recognised in profit or loss	**0.1**	(6.9)
	(0.4)	38.6

(B) Tax consolidation legislation

The accounting policy in relation to this legislation is set out in note 1(K).

The Company is a member of a tax consolidated group headed by QBE Insurance Group Limited.

On adoption of the tax consolidation legislation, the members of the tax consolidated group entered into a tax sharing and tax funding agreement that requires the members to fully compensate the head entity for current tax liabilities and to be fully compensated by the head entity for any current or deferred tax assets in respect of tax losses arising from external transactions occurring after the date of implementation of the tax consolidation legislation. The contributions are allocated by reference to the notional taxable income of each member.

(C) New Zealand Branch

The company operates a branch in New Zealand. Profits or losses generated by the branch are ignored for Australian income tax purposes, so the branch is effectively excluded from the Australian tax consolidated group. The branch qualifies as a permanent establishment for international tax purposes, and consequently lodges income tax returns and pays income tax in New Zealand as though it were a separate entity. Tax losses generated by the branch may be transferred to other New Zealand entities provided that the receiving entity shares 100% common ownership with the branch.

Effective to the branch 1 January 2011, the rate of corporate tax in New Zealand reduced from 30% to 28%. Deferred tax assets and liabilities of the branch at 31 December 2010 were restated in line with the lower rate.

9. CASH AND CASH EQUIVALENTS

	2011 $M	2010 $M
Cash at bank and on hand	7.7	3.0
Overnight money	8.8	10.9
Cash management trusts	-	8.7
Cash and cash equivalents	16.5	22.6

Cash and cash equivalents earn interest at floating rates based on daily bank deposit rates.

(A) Reconciliation of cash flows from operating activities to profit after income tax

	2011 $M	2010 $M
Cash flows from operating activities	164.2	138.3
Depreciation	(0.9)	(1.2)
Net fair value gains (losses) on financial assets	(23.0)	1.3
Income from short term money market securities	5.0	17.9
Dividends received from controlled entity	1.3	1.5
Decrease in outstanding claims	13.9	26.2
(Increase) decrease in unearned premiums	(58.4)	137.6
Increase in deferred insurance costs	14.1	17.2
Increase (decrease) in non-reinsurance recoveries	(1.6)	0.9
Increase in trade and other receivables	13.2	18.6
Increase in trade and other payables	(1.4)	(35.9)
(Increase) decrease in deferred tax liabilities / increase (decrease) in deferred tax assets	2.5	(39.5)
(Increase) decrease in amounts due to parent entity or tax authorities for current tax	0.1	(29.4)
Profit after income tax	129.0	253.5

10. INVESTMENTS

	2011 $M	2010 $M
Interest bearing		
Short term money	**97.4**	206.5
Government bonds	**126.1**	173.1
Corporate bonds	**207.3**	377.8
Floating rate notes	**1,185.6**	898.1
Total investments	**1,616.4**	1,655.5
Amounts maturing within 12 months	**331.7**	435.0
Amounts maturing in greater than 12 months	**1,284.7**	1,220.5
Total investments	**1,616.4**	1,655.5

(A) Valuation of investments

All investments are recorded at fair value. Investments traded in an active market are valued with reference to the closing bid price. The significant majority of investments, being fixed and floating rate securities, are valued using independently sourced valuations that do not involve the exercise of judgement by management. Any other investments are valued using accepted valuation practices such as discounted cash flow analysis or by reference to the fair value of recent arm's length transactions involving the same or similar instruments.

The investments of the company are disclosed in the following table using a fair value hierarchy which reflects the significance of inputs into the determination of fair value as follows:

Fair value hierarchy

- Level 1: valuation is based on quoted prices in active markets for the same instruments;
- Level 2: valuation is based on quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data (consensus price using broker quotes and valuation models with observable inputs); and
- Level 3: valuation techniques are applied for which any significant input is not based on observable market data.

2011	**Level 1 $M**	**Level 2 $M**	**Level 3 $M**	**Total $M**
Short term money	-	**97.4**	-	**97.4**
Government bonds	-	**126.1**	-	**126.1**
Corporate bonds	-	**207.3**	-	**207.3**
Floating rate notes	-	**1,185.6**	-	**1,185.6**
Total investments	-	**1,616.4**	-	**1,616.4**
2010				
Short term money	-	206.5	-	206.5
Government bonds	-	173.1	-	173.1
Corporate bonds	-	377.8	-	377.8
Floating rate notes	-	898.1	-	898.1
Total investments	-	1,655.5	-	1,655.5

(B) Movements in level 3 investments

There are no investments valued with reference to level 3 inputs (2010: Nil).

(C) Restrictions on use

The New Zealand branch of the company is required to have a security deposit with a face value of NZ$500,000 with the New Zealand Public Trust Office. There are no restrictions on use of the company's other investments.

11. TRADE AND OTHER RECEIVABLES

	2011 $M	2010 $M
Trade debtors		
Reinsurance premiums and related receivables		
Related entity	**2.2**	2.1
Non-related entity	**6.7**	4.8
Other recoveries receivable	**3.4**	4.1
	12.3	11.0
Amounts due from parent entity	**-**	23.6
Amounts due from controlled entity	**0.2**	0.2
Accrued investment income	**13.8**	13.7
Other debtors and prepayments	**41.0**	29.2
Trade and other receivables	**67.3**	77.7
Amounts maturing within 12 months	**43.6**	39.5
Amounts maturing in greater than 12 months	**23.7**	38.2
Trade and other receivables	**67.3**	77.7

(A) Fair value

The carrying values of receivables approximate their fair value.

(B) Risk

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables have been pledged by the company as collateral for liabilities or contingent liabilities. No receivables are past due or impaired (2010: Nil).

12. DEFERRED INSURANCE COSTS

	2011 $M	2010 $M
Deferred reinsurance premium	**24.1**	20.1
Deferred commission	**4.8**	4.6
Deferred acquisition costs	**41.3**	31.4
Deferred insurance costs	**70.2**	56.1
To be expensed within 12 months	**37.4**	30.4
To be expensed in greater than 12 months	**32.8**	25.7
Deferred insurance costs	**70.2**	56.1

	Deferred reinsurance premium $M	Deferred commission $M	Deferred acquisition costs $M	Total $M
Deferred costs at 1 January 2010	-	9.4	29.5	38.9
Costs deferred in financial year	20.1	0.7	16.7	37.5
Amortisation of costs deferred in previous financial years	-	(3.2)	(10.0)	(13.2)
Additional release (Note 3(B))	-	(2.3)	(4.7)	(7.0)
Foreign exchange	-	-	(0.1)	(0.1)
Deferred costs at 31 December 2010	**20.1**	**4.6**	**31.4**	**56.1**
Costs deferred in financial year	**24.1**	**2.1**	**20.7**	**46.9**
Amortisation of costs deferred in previous financial years	**(20.1)**	**(1.9)**	**(10.8)**	**(32.8)**
Deferred costs at 31 December 2011	**24.1**	**4.8**	**41.3**	**70.2**

13. PROPERTY, PLANT AND EQUIPMENT

	Leasehold Improvements	Office Equipment, Fixtures and Fittings	Total
	$M	$M	$M
2011			
Cost or valuation			
At 1 January	**2.4**	**3.0**	**5.4**
Disposals	**-**	**(1.2)**	**(1.2)**
At 31 December	**2.4**	**1.8**	**4.2**
Accumulated depreciation			
At 1 January	**(1.6)**	**(1.8)**	**(3.4)**
Disposals	**-**	**1.2**	**1.2**
Depreciation charge for the year	**(0.4)**	**(0.5)**	**(0.9)**
At 31 December	**(2.0)**	**(1.1)**	**(3.1)**
Carrying amount			
At 31 December	**0.4**	**0.7**	**1.1**
2010			
Cost or valuation			
At 1 January	3.4	3.3	6.7
Additions	-	0.5	0.5
Disposals	(1.0)	(0.8)	(1.8)
At 31 December	2.4	3.0	5.4
Accumulated depreciation			
At 1 January	(2.0)	(1.8)	(3.8)
Disposals	0.9	0.7	1.6
Depreciation charge for the year	(0.5)	(0.7)	(1.2)
At 31 December	(1.6)	(1.8)	(3.4)
Carrying amount			
At 31 December	0.8	1.2	2.0

14. DEFERRED INCOME TAX

	2011 $M	2010 $M
Deferred tax assets	**3.4**	5.6
Deferred tax liabilities	**(1.1)**	(5.7)
	2.3	(0.1)

(A) Deferred tax assets

(i) The balance comprises temporary differences attributable to:

	2011 $M	2010 $M
Amounts recognised in profit or loss		
Financial assets - fair value adjustments	**-**	2.3
Insurance assets and liabilities	**1.1**	0.9
Other	**2.3**	2.4
	3.4	5.6
Set-off deferred tax liabilities	**(1.1)**	(5.6)
	2.3	-

(ii) Movements:

	2011 $M	2010 $M
At 1 January	**5.6**	53.4
Amounts recognised in profit or loss	**0.5**	(45.5)
Prior year adjustments	**(0.3)**	(2.0)
TOFA transitional adjustment (Note 14(D))	**(2.4)**	-
Tax losses transferred to related entities	**-**	(0.3)
At 31 December	**3.4**	5.6

(B) Tax losses

Included in receivables is an amount of $nil (2010: $23.6M) relating to tax losses transferred to the head entity of the tax consolidated group.

The New Zealand branch made a tax loss in 2009. This loss was transferred to QII New Zealand branch during the 2010 financial year. The branch received consideration of $0.3M, being the tax value of the losses transferred.

(C) Deferred tax liabilities

(i) The balance comprises temporary differences attributable to:

	2011 $M	2010 $M
Amounts recognised in profit or loss		
Financial assets - fair value adjustments	-	0.6
Accrued income	-	4.1
Other provisions	0.7	0.6
Insurance assets	0.4	0.4
	1.1	5.7
Set-off deferred tax assets	(1.1)	(5.6)
	-	0.1

(ii) Movements:

	2011 $M	2010 $M
At 1 January	5.7	14.0
Amounts recognised in profit or loss	0.1	(6.9)
Prior year adjustments	-	(1.4)
TOFA transitional adjustment (note 14(D))	(4.7)	-
At 31 December	1.1	5.7

(D) TOFA transitional adjustment

Deferred tax balances at 31 December 2010 relating to financial instruments were transferred to QBE Insurance Group Limited as head entity of the tax consolidated group following the implementation of the Taxation of Financial Arrangements ("TOFA") legislation in 2011.

15. TRADE AND OTHER PAYABLES

	2011 $M	2010 $M
Trade payables	35.4	27.0
Amounts due to parent entity for current tax	14.9	68.3
Amounts due to related entities	5.8	4.8
Reinsurance and related payables		
Related entities	17.0	14.2
Controlled entities	0.3	0.6
Other payables	7.6	6.2
Trade and other payables	81.0	121.1
Amounts payable within 12 months	62.6	112.0
Amounts payable in greater than 12 months	18.4	9.1
Trade and other payables	81.0	121.1

Due to the short term nature of these payables, their carrying values approximate their fair value.

16. OUTSTANDING CLAIMS

(A) Net outstanding claims

	2011 $M	2010 $M
Gross outstanding claims	**185.3**	201.6
Claims settlement costs	**3.8**	2.9
	189.1	204.5
Discount to present value	**(3.7)**	(5.2)
Gross outstanding claims provision	**185.4**	199.3
Less than 12 months	**96.8**	107.2
Greater than 12 months	**88.6**	92.1
Gross outstanding claims provision	**185.4**	199.3
Non-reinsurance recoveries on outstanding claims	**3.3**	5.0
Discount to present value	**(0.1)**	(0.2)
Non-reinsurance recoveries on outstanding claims	**3.2**	4.8
Less than 12 months	**1.7**	2.6
Greater than 12 months	**1.5**	2.2
Non-reinsurance recoveries on outstanding claims	**3.2**	4.8
Net outstanding claims	**182.2**	194.5
Central estimate	**93.0**	86.6
Risk margin	**89.2**	107.9
Net outstanding claims	**182.2**	194.5

(B) Maturity profile of net outstanding claims

The expected maturity of the company's discounted net outstanding claims provision is analysed below:

	1 year or less $M	1 to 2 years $M	2 to 3 years $M	3 to 4 years $M	4 to 5 years $M	Total $M
At 31 December 2011	**95.1**	**56.8**	**20.9**	**6.5**	**2.9**	**182.2**
At 31 December 2010	104.6	59.7	21.6	6.2	2.4	194.5

(C) Risk margins

The process used to determine risk margins is explained in note 3(A)(iii).

The probability of adequacy at 31 December 2011 is 98% (2010: 99%).The risk margin included in net outstanding claims is 96% (2010: 125%) of the central estimate.

(D) Reconciliation of movement in discounted outstanding claims provision

	2011			2010		
	Gross	**Re-insurance & other recoveries**	**Net**	Gross	Re-insurance & other recoveries	Net
	$M	**$M**	**$M**	$M	$M	$M
At 1 January	**199.3**	**(4.8)**	**194.5**	225.5	(3.9)	221.6
Increase in net claims incurred in current accident year	**133.5**	**(2.2)**	**131.3**	121.8	(3.0)	118.8
Movement in prior year claims provision	**(106.4)**	**2.7**	**(103.7)**	(110.6)	1.8	(108.8)
Incurred claims recognised in profit or loss	**27.1**	**0.5**	**27.6**	11.2	(1.2)	10.0
Claims (payments) recoveries	**(41.0)**	**1.1**	**(39.9)**	(37.3)	0.3	(37.0)
Foreign exchange	**-**			(0.1)	-	(0.1)
At 31 December	**185.4**	**(3.2)**	**182.2**	199.3	(4.8)	194.5

(E) Claims development - undiscounted net central estimate

(i) Net undiscounted central estimate of outstanding claims for the company for the four most recent accident years.

	Prior Years $M	2008 $M	2009 $M	2010 $M	2011 $M	Total $M
Estimate of net ultimate claims cost:						
At end of accident year		110.7	75.2	56.1	70.5	
One year later		88.5	47.4	37.2		
Two years later		81.2	39.6			
Three years later		78.4				
Current central estimate cost for the four most recent accident years		**78.4**	**39.6**	**37.2**	**70.5**	
Cumulative net claims payments to date		(74.6)	(33.2)	(18.9)	(8.1)	
Net undiscounted central estimate	**1.9**	**3.8**	**6.4**	**18.3**	**62.4**	**92.8**
Discount to present value						**(3.6)**
Risk margin						**89.2**
Claims settlement costs						**3.8**
Net outstanding claims at December 2011						**182.2**
Net central estimate development Increase (decrease) in the year	**(0.7)**	**(2.8)**	**(7.8)**	**(18.9)**	**70.5**	**40.3**

A reconciliation of the net central estimate development to the net incurred claims in the income statement, analysed between current and prior accident years, is included in Note 7(C).

The higher central estimate for the 2011 accident year ($70.5M) relative to the comparative figure for the 2010 accident year ($56.1M) was primarily due to unfavourable economic conditions and softer housing markets in specific regional areas, leading to an increase in the number of defaults reported to the company.

However, experience in respect of the 2010 and prior accident years was better than expected, giving rise to a release of $30.2M in central estimates. Claims costs were settled or became more certain at a lower level than reflected in the 2010 central estimate.

Conditions and trends that have affected the development of the liabilities in the past may, or may not, occur in the future, and accordingly, conclusions about future results may not necessarily be derived from the information presented in the tables.

17. UNEARNED PREMIUM

(A) Unearned premium

	Note	2011 $M	2010 $M
At 1 January		**508.0**	645.6
Deferral of premium on contracts written in the period		**234.5**	197.6
Earning of premium on contracts written in previous periods		**(176.1)**	(201.4)
Additional release	3(B)	**-**	(132.8)
Foreign exchange		**-**	(1.0)
At 31 December		**566.4**	508.0
Amount to be earned within 12 months		**168.4**	150.7
Amount to be earned in greater than 12 months		**398.0**	357.3
Unearned premium		**566.4**	508.0

(B) Net premium liabilities

	Note	2011 $M	2010 $M
Unearned premium		**566.4**	508.0
Deferred insurance costs	12	**(70.2)**	(56.1)
Net premium liabilities		**496.2**	451.9

(C) Expected present value of net future cash flows for future claims

	2011 $M	2010 $M
Undiscounted central estimate	**224.3**	161.8
Risk margin	**62.4**	51.4
	286.7	213.2
Discount to present value	**(26.8)**	(35.3)
Expected present value of net future cash flows for future claims including risk margin	**259.9**	177.9

(D) Liability adequacy test

The probability of adequacy applied in the liability adequacy test differs from the probability of adequacy adopted in determining the outstanding claims provision. The reason for the difference is that the former is a benchmark used only to test the sufficiency of net premium liabilities whereas the latter is a measure of the adequacy of the outstanding claims provision actually carried by the company.

AASB 1023 requires the inclusion of a risk margin in insurance liabilities, but does not prescribe a minimum level of margin. Whilst there is established practice in the calculation of the probability of adequacy of the claims provision, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities. The company has adopted a risk margin for the purposes of the liability adequacy test to produce a 75% probability of adequacy in respect of total insurance liabilities. The 75% basis is a recognised industry benchmark in Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA.

The application of the liability adequacy test in respect of the net premium liabilities identified a surplus at 31 December 2011 and 2010.

(E) Risk Margin

The process used to determine the risk margin is explained in note 3(A)(iii).

The risk margin in expected net future cash flows for future claims as a percentage of the undiscounted central estimate is 28% (2010: 32%).

18. EQUITY

(A) Share capital

	2011 Shares '000	2010 Shares '000	**2011 $M**	2010 $M
Issued ordinary shares, fully paid	**327.8**	327.8	**364.3**	364.3

There were no movements in share capital during the year (2010: Nil).

Ordinary shares in the company have no par value and entitle the holder to participate in dividends and the proceeds on winding up of the company in proportion to the number of shares held. Ordinary shareholders rank after all creditors and are entitled to any residual proceeds.

(B) Reserves

	Share Based Payments $M	**Foreign Currency Translation $M**	**Total $M**
At 1 January 2010	4.9	1.5	6.4
Transfer to retained earnings	(4.9)	-	(4.9)
Currency translation differences	-	0.8	0.8
At 31 December 2010	**-**	**2.3**	**2.3**
Currency translation differences	-	-	-
At 31 December 2011	**-**	**2.3**	**2.3**

The share based payments reserve was used to record the value of share based payments provided to certain directors and senior executives under The TPG Equity Incentive Plan. Under this plan, eligible participants were granted non-transferable options and restricted stock units ("RSU's") in the then ultimate parent company, The PMI Group ("TPG"). Following the acquisition of the company's parent by QBE AAP on 23 October 2008, future participation in the plan ceased, all invested equity awards were forfeited and the expiry date of vested equity awards was reset to 22 October 2009. All options and RSU's expired on or before 22 October 2009.

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of the New Zealand branch.

(C) Capital risk management

The company's objectives when managing capital are to maintain an optimal balance of debt and equity in the capital structure to reduce the cost of capital whilst meeting capital adequacy requirements, providing security for policyholders and continuing to provide returns to shareholders. Where appropriate, adjustments are made to capital levels in light of changes in economic conditions and risk characteristics of the company's activities. In order to maintain or adjust the capital structure, the company has the option to adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or vary the level of outward reinsurance.

The company is subject to and in compliance with externally imposed capital requirements set and monitored by APRA. These requirements are in place to ensure sufficient solvency margins for the protection of policyholders. In addition the company aims to maintain a strong credit rating to support its business objectives.

The company has a capital management plan which is reviewed and approved by the Board on an annual basis. The plan supports the risk management strategy (refer Note 4) and is intended to meet the capital requirements of APRA and its ultimate parent entity.

Dedicated staff are responsible for understanding regulatory capital requirements. The quality of assets (particularly investments) and insurance risk is monitored on an ongoing basis to ensure issues are identified early and remedial action, where necessary is taken to restore effective capital performance and levels.

The company aims to have a mix of "hard" and "soft" capital that provides sufficient capital to satisfy APRA and ratings agencies of the company's financial strength, while at the same time avoids over capitalisation, which would unduly depress returns. Additional hard (share) capital is available from the QBE Group, subject to relevant approvals; reinsurance may be sourced externally or from within the QBE Group.

The company has a policy of paying dividends to shareholders to the extent that capital exceeds target levels and allowing for amounts required to support business growth and meet APRA and rating agency requirements.

The company manages its capital requirements against the following levels:

- Minimum levels set by APRA and the ratings agencies, which must be met at all times.
- "Trigger" levels set by management in consultation (where applicable) with APRA, as a guide to capital levels which require close monitoring, to ensure minimum standards are not breached.
- "Target" levels set by management in consultation (where applicable) with APRA, as a guide to capital levels, which if exceeded, may indicate the existence of surplus capital.

Regulatory capital	**2011 $M**	2010 $M
Capital		
Paid up ordinary shares	**364.3**	364.3
General reserves	**2.3**	2.3
Retained earnings (under APRA methodology)	**652.9**	698.8
Surplus on technical provisions net of tax	**215.0**	255.3
Tier 1 Capital - Total Capital Base	**1,234.5**	1,320.7
Minimum Capital Requirement	**929.8**	830.5
Capital Adequacy Multiple	**1.33**	1.59

The 2011 position reflects the December 2011 quarter APRA return (unaudited)

19. DIVIDENDS

	2011 $M	2010 $M
Dividends paid	**175.0**	125.0

A dividend payment of $Nil has been recommended by the directors for the year ended 31 December 2011 (2010: $75M).

20. KEY MANAGEMENT PERSONNEL

The names of persons who were directors of the company at anytime during the financial year are as stated in the directors' report.

Key management personnel are all the directors of the company and the executives with the greatest authority for the strategic direction and management of the company.

Key management personnel compensation for the years ended 31 December 2011 and 2010 is set out below:

	2011 $'000	2010 $'000
Short-term employment benefits	**3,426**	3,340
Post-employment benefits	**289**	257
Other long-term employment benefits	**63**	16
Termination benefits	**108**	-
Share-based payments	**337**	165
Total	**4,223**	3,778

21. REMUNERATION OF THE AUDITOR

	2011 $'000	2010 $'000
PricewaterhouseCoopers – Australian firm		
Assurance services		
Audit or review of financial reports of the company	**440**	406
Other services		
Audits of regulatory returns	**110**	107
	550	513
Related practices of PricewaterhouseCoopers – Australian firm (including overseas PwC firms)		
Other services		
Taxation services	**15**	8

22. CONTINGENT LIABILITIES

Contingent liabilities are disclosed when the possibility of a future settlement of economic benefits is considered to be less than probable but more likely than remote. Under accounting standards, no provision is required for such items if a future transfer of benefits is not probable or cannot be reliably measured. If settlement becomes probable, a provision is required.

In the normal course of business, the company may be exposed to the possibility of contingent liabilities in relation to litigation arising out of its insurance and reinsurance transactions. Provisions are made for obligations that are probable and quantifiable. There are no individually significant amounts not provided for and such transactions are not considered likely to have a material impact on the net assets of the company.

The company has given undertakings in respect of its 100% controlled entity, QBE Mortgage Insurance (Asia) Limited ("MI Asia"), that whilst MI Asia is a wholly owned controlled entity of the company, MI Asia statutory capital will not be less than US$50 million and that MI Asia will maintain sufficient liquid assets to meet maturing obligations at all times.

23. CAPITAL EXPENDITURE COMMITMENTS

The company had no capital commitments as at 31 December 2011 (31 December 2010: nil).

24. OPERATING LEASE COMMITMENTS

The company has entered into commercial leases on property, motor vehicles and IT equipment. These leases have remaining lives of up to 5 years, and do not have renewal options. There are no restrictions placed upon the lessee by entering into these leases.

	2011 $M	2010 $M
Operating lease commitments		
Within 1 year	**3.0**	3.2
After 1 year but not more than 5 years	**0.3**	3.8
Total future lease payments under non-cancellable operating leases	**3.3**	7.0
Commitments under other agreements		
After 1 year but not more than 5 years	**9.7**	9.7
	9.7	9.7

25. RELATED PARTIES

(A) Parent and ultimate parent

The company's immediate parent company is QBE Holdings (AAP) Pty Limited ("QBE AAP").

The company's ultimate parent company is QBE Insurance Group Limited ("QBE"), incorporated in Australia.

(B) The subsidiaries of the company are listed below:

	Country of Incorporation	**Equity Interest 2011**	**Equity Interest 2010**
Permanent LMI Pty Limited	Australia	50.1%	50.1%
QBE Mortgage Insurance (Asia) Limited	Hong Kong	100.0%	100.0%

(C) Related party transactions

(i) Controlled Entities

The company charges its controlled entities Permanent LMI Pty Limited ("Permanent") and MI Asia for management services under normal terms and conditions.

The company has a reinsurance agreement with Permanent under normal terms and conditions. Additionally, the company has guaranteed claim payments on certain loans insured by Permanent under normal terms and conditions; the possibility of outflows in respect of this guarantee has been assessed as remote.

(ii) Other related entities

The company has excess of loss outward reinsurance arrangements with Equator Reinsurances Limited and QII Singapore branch, members of the QBE Group.

Investment management services for the company are performed by QBE Investment Management Pty Limited (formerly Minster Court Asset Management Pty Limited), a member of the QBE Group.

All persons engaged in the activities of the company are employed by related parties, QBE Management Services Pty Limited ("QMS") in Australia and QBE Insurance (International) Limited ("QII") in New Zealand.

QMS and QII New Zealand branch charge the company management fees in respect of these arrangements for individuals directly supporting the company's activities. QMS additionally charges the company in respect of time and cost incurred in indirectly supporting the company's activities.

All arrangements were under normal terms and conditions.

All other material information required to be disclosed under AASB 124: Related Party Disclosures has been included in the financial statements as follows:

	Reference
Income and expenses	Note 5
Trade and other receivables	Note 11
Trade and other payables	Note 15

26. EVENTS OCCURRING AFTER REPORTING DATE

There is, at the date of this report, no matter or circumstance that has arisen since 31 December 2011 that has significantly affected, or may significantly affect:

(i) the company's operations in future financial years;

(ii) the results of those operations in future financial years; or

(iii) the company's state of affairs in future financial years.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

New Zealand Branch

FINANCIAL STATEMENTS – 31 December 2011

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This financial report includes separate financial statements for QBE Lenders' Mortgage Insurance Limited New Zealand Branch (the "branch") as an individual entity. The financial report is presented in New Zealand Dollars.

The branch is a branch of QBE Lenders' Mortgage Insurance Limited (the "company") and is a reporting entity for the purposes of the Financial Reporting Act 1993. Its principal place of business is:

Level 6, AMP Centre, 29 Customs Street West,

Auckland

New Zealand

QBE LENDERS' MORTGAGE INSURANCE LIMITED

New Zealand Branch

The Board of Directors present the financial statements of QBE Lenders' Mortgage Insurance Limited New Zealand Branch for the year ended 31 December 2011 and the auditor's statement thereon.

Signed in accordance with a resolution of the directors made on 16 February 2012.

For and on behalf of the board.

The Hon. NF Greiner
Chairman

IT Graham
Director

QBE LENDERS' MORTGAGE INSURANCE LIMITED

New Zealand Branch

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2011

	NOTES	**2011**	2010
		$	$
Gross written premium		**8,777,323**	9,015,274
Unearned premium movement		**(794,766)**	3,728,161
Gross earned premium revenue	4(A)	**7,982,557**	12,743,435
Outward reinsurance premium		**(1,194,256)**	(1,761,889)
Deferred reinsurance premium movement		**231,031**	765,164
Outward reinsurance premium expense	4(B)	**(963,225)**	(996,725)
Net earned premium (a)		**7,019,332**	11,746,710
Gross claims incurred	4(B)	**(1,560,935)**	(1,667,591)
Non-reinsurance recoveries revenue	4(A)	**59,455**	134,584
Net claims incurred (b)		**(1,501,480)**	(1,533,007)
Gross commission expense (c)	4(B)	**(14,945)**	(195,877)
Other acquisition costs (d)	4(B)	**(760,420)**	(1,208,542)
Underwriting and other expenses (e)	4(B)	**(1,739,397)**	(1,704,471)
Underwriting profit (a)+(b)+(c)+(d)+(e)		**3,003,090**	7,104,813
Investment income	5	**167,773**	122,850
Profit before income tax		**3,170,863**	7,227,663
Income tax expense	7	**(885,219)**	(2,135,297)
Net profit after income tax attributable to equity holders of the company		**2,285,644**	5,092,366
OTHER COMPREHENSIVE INCOME		-	-
Income tax relating to components of other comprehensive income		-	-
Other comprehensive income after income tax		-	-
Total comprehensive income after income tax attributable to equity holders of the company		**2,285,644**	5,092,366

The above statement of comprehensive income should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

New Zealand Branch

BALANCE SHEET

As at 31 December 2011

	NOTES	2011 $	2010 $
ASSETS			
Cash and cash equivalents	8	**6,915,513**	4,717,469
Investments	9	**558,145**	515,059
Trade and other receivables	10	**377,843**	529,523
Non-reinsurance recoveries on outstanding claims	14(A)	**11,003**	60,516
Deferred insurance costs	11	**2,945,209**	2,583,661
Total assets		**10,807,713**	**8,406,228**
LIABILITIES			
Trade and other payables	13	**645,322**	699,041
Current tax liabilities		**359,437**	527,117
Deferred tax liabilities	12	**637,510**	471,457
Outstanding claims	14(A)	**2,182,254**	2,805,833
Unearned premium	15(A)	**20,892,979**	20,098,213
Total liabilities		**24,717,502**	**24,601,661**
Net liabilities		**(13,909,789)**	**(16,195,433)**
RESIDUAL EQUITY			
Head office account		**(13,909,789)**	(16,195,433)
Total equity		**(13,909,789)**	**(16,195,433)**

The above balance sheet should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

New Zealand Branch

STATEMENT OF CHANGES IN HEAD OFFICE ACCOUNT

For the year ended 31 December 2011

	Head Office Account $
At 1 January 2011	**(16,195,433)**
Profit after income tax	**2,285,644**
Other comprehensive income	**-**
Total comprehensive income	**2,285,644**
Net funding movements	**-**
At 31 December 2011	**13,909,789**
At 1 January 2010	(21,287,799)
Profit after income tax	5,092,366
Other comprehensive income	-
Total comprehensive expense	5,092,366
Net funding movements	-
At 31 December 2010	(16,195,433)

The above statement of changes in Head Office Account should be read in conjunction with the accompanying notes.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

New Zealand Branch

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2011

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

The financial report includes financial statements for QBE Lenders' Mortgage Insurance Limited New Zealand Branch (the "branch") as an individual entity. The branch is a branch of QBE Lenders' Mortgage Insurance Limited ("QBE LMI" or the "company") and is a reporting entity for the purposes of the Financial Reporting Act 1993.

For a complete understanding of the financial position of the company refer to the company's full financial statements as lodged with the Australian Securities and Investment Commission.

(A) Basis of preparation

The financial statements have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards ("NZIFRS"), other applicable Financial Reporting Standards, as appropriate for profit-oriented entities that qualify for and apply differential reporting concessions, and the requirements of the Financial Reporting Act 1993.

The presentation currency of these financial statements is New Zealand dollars.

The presentation of the statement of comprehensive income has been amended to provide a more detailed analysis of the results. This is considered more relevant information to users of the financial statements. Prior year comparatives have been adjusted for consistency with the new presentation standard.

The shareholders of the company have exercised their right under section 211(3) of the Companies Act 1993 and unanimously agreed that these financial statements need not comply with paragraphs (a), and (e) to (j) of section 211(1) of the Act.

Compliance with IFRS

The financial report complies with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by certain exceptions noted in the financial report, with the principal exceptions being the measurement of financial assets at fair value and the measurement of the outstanding claims liability and related recoveries at present value. The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions or estimates are significant, are disclosed in Note 2.

Differential reporting

The branch qualifies for differential reporting as it is not publicly accountable and there is no separation between the owners and the governing body. The branch has taken advantage of all differential reporting exemptions.

Going concern

The directors of the company believe that the branch has access to sufficient resources to meet its future liabilities and commitments. For this reason the directors continue to adopt the going concern assumption in the preparation of the branch financial statements.

(B) Insurance contracts

All of the insurance products offered or utilised by the branch meet the definition of insurance contracts under NZIFRS, and are accounted for and reported in accordance with these standards. These products do not contain embedded derivatives or deposits that are required to be unbundled.

(C) Premium revenue

Premium comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. The earned portion of premium received and receivable is recognised as revenue. Premium is treated as earned from the date of attachment of risk.

(D) Unearned premium

Unearned premium is calculated based on the term of the policies written and the likely pattern in which risk will emerge over that term.

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the business segment level, being a portfolio of contracts that are broadly similar and managed together as a single portfolio. If the present value of expected future cash flows relating to future claims plus the additional risk margin exceeds the unearned premium liability less deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The resulting deficiency is recognised immediately through profit and loss.

(E) Outward reinsurance

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Where applicable, a portion of outward reinsurance premium is deferred at the balance date.

(F) Claims

The provision for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not reported ("IBNR"), and estimated claims handling costs. Claims expense represents claim payments adjusted for movements in the outstanding claims liability.

The expected future payments are discounted to present value using a risk free rate.

A risk margin is applied to the central estimate, net of non-reinsurance recoveries, to reflect the inherent uncertainty in the central estimate.

(G) Non-reinsurance recoveries

Non-reinsurance recoveries receivable on paid claims, reported claims not yet paid and IBNR are recognised as revenue.

Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

(H) Acquisition costs

Acquisition costs (which includes commission costs) are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised when they relate to the acquisition of new business and are referred to as a deferred acquisition costs. These costs are amortised on the same basis as the related premium is earned in accordance with the premium income earning pattern adjusted for policy terminations. At the reporting date, deferred acquisition costs represent the capitalised costs that relate to the unearned premium. Acquisition costs are deferred in recognition of their future benefit and are measured at the lower of cost and recoverable amount.

(I) Commissions

Exchange commission is payable in accordance with the applicable insurance agreement on the basis of insurance premium assumed. Insurance exchange commission is recognised as an expense in accordance with the premium income earning pattern adjusted for policy terminations.

Profit commission is payable in accordance with the applicable agreements and based on the profitability of the underlying portfolio including the recognition of revenue and claims experience. An expense is recognised as the risk emerges in the underlying portfolio..

(J) Investment income

Interest income is recognised on an accruals basis.

Investment income includes realised and unrealised gains or losses on financial assets which are reported on a combined basis as fair value gains or losses on financial assets.

(K) Taxation

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period . Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authority.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

(L) Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

(i) Financial assets

The company has identified the following classes of financial asset: cash and cash equivalents, investments, and trade and other receivables.

(ii) Financial liabilities

The company has identified the following class of financial liability: trade and other payables.

(iii) Financial instruments designated as fair value through profit or loss

The policy of management is to designate a group of financial assets or financial liabilities as fair value through profit or loss when that group is both managed and its performance evaluated on a fair value basis for both internal and external reporting in accordance with the company's documented investment strategy.

(M) Policyholders' funds

All cash and investments are held to back policyholders' funds, being the net insurance liabilities of the business.

(N) Cash and cash equivalents

Cash and cash equivalents include cash at bank and on hand and deposits at call which are readily convertible to cash on hand and which are used for operational cash requirements.

(O) Investments

All investments are designated as fair value through profit or loss on initial recognition. They are initially recorded at fair value, being the cost of acquisition excluding transaction costs, and are subsequently remeasured to fair value at each reporting date.

All purchases and sales of financial assets that require delivery of the asset within the timeframe established by regulation or market convention ("regular way" transactions) are recognised at trade date, being the date on which the branch commits to buy or sell the asset.

Investments are derecognised when the right to receive future cash flows from the assets has expired, or has been transferred, and the branch has transferred substantially all the risks and rewards of ownership.

(P) Receivables

Trade receivables are recognised at amounts receivable less a provision for impairment. A provision for impairment is established when there is objective evidence that the branch will not be able to collect all amounts due according to the original term of the receivable. Any increase or decrease in the provision for impairment is recognised in the profit or loss within underwriting expenses. When a receivable is uncollectible, it is written off against the provision for impairment account. Subsequent recoveries of amounts previously written off are credited against underwriting expenses in the profit or loss.

(Q) Impairment of assets

Assets that have an indefinite useful life are tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped in cash generating units which are the lowest levels for which there are separately identifiable cash flows.

(R) Employee Benefits

All persons engaged in the activities of the branch are employed by a related party, QBE Insurance (International) Limited ("QII") New Zealand branch.

The branch does not incur employment related expenses or provide or accrue for employee benefits, but is charged equivalent management fees by QII New Zealand branch.

(S) Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the profit or loss on a straight line basis over the period of the lease.

(T) Goods and services tax ("GST")

GST incurred is not recoverable from the Inland Revenue Department. GST is recognised as part of the cost of acquisition of an asset or as part of an item of expense. Receivables and payables in the balance sheet are shown inclusive of GST.

Commitments are disclosed inclusive of GST.

(U) Comparative figures

Comparative figures have been adjusted, where necessary, to conform to the basis of presentation and the classification used in the current year.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The branch makes estimates and judgements in respect of the reported amounts of certain assets and liabilities. These estimates and judgements are determined by qualified and experienced actuaries and management with reference to historical data and reasoned expectations of future events, and are continually updated. The key areas in which critical estimates and judgements are applied, are described as follows.

(A) Ultimate liability arising from claims made under insurance contracts

Provision is made for the estimated cost of claims incurred but not settled at the balance date. This provision consists of estimates of both the expected ultimate cost of claims notified to the branch as well as the expected ultimate cost of claims incurred but not reported to the branch ("IBNR"). The estimated cost of claims includes direct expenses that are expected to be incurred in settling those claims.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the branch, where more information about the claims is generally available. The longer the delay between the event giving rise to the claim and final claim settlement, the greater the variability between initial estimates of the loss to be incurred and the final settlement amount, as a result of additional financing and settlement costs incurred by the lender and changes in property valuations.

The estimation techniques and assumptions used in determining the outstanding claims provision and the associated non-reinsurance recoveries are described below.

(i) Insurance risk assumptions

The branch's process for establishing the outstanding claims provision involves extensive consultation with actuaries, claims managers, and other senior management. This process includes regular internal claims review meetings attended by senior management and detailed review by an external actuaries at least annually.

The determination of the amounts that the branch will ultimately pay for claims arising under insurance contracts involves a number of critical assumptions. Some of the uncertainties impacting these assumptions are as follows:

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs during the time that elapses before a definitive determination of the ultimate claims cost can be made;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example house price inflation, unemployment and interest rates.

The potential impact of changes in key assumptions on the branch's statement of comprehensive income and balance sheet are summarised in note 2(A)(vi)

(ii) Central estimates

The outstanding claims provision comprises the central estimate and a risk margin which is added to the central estimate to achieve the appropriate probability of adequacy. The outstanding claims provision is discounted at risk-free rates of return to reflect the time value of money.

A central estimate is an estimate of the level of claims provision that is intended to contain no intentional under or over estimation. As the branch requires a higher probability that estimates will be adequate over time, a risk margin is added to the central estimate of outstanding claims.

Central estimates are determined by reference to a variety of estimation techniques, generally based on a statistical analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimate is based on a judgemental consideration of the results of each method and qualitative information, for example:

- Historical trends in the development and incidence of the numbers of defaults reported, numbers of defaults cured, numbers of properties taken into possession, numbers of such properties sold, numbers of claims arising from these sales, and the costs of those claims;
- Exposure details, including policy counts, sums insured and various other characteristics of the borrowers and loans;
- Historical and likely future trends of expenses associated with managing claims to finalisation.

Central estimates are calculated gross of any non-reinsurance recoveries. Separate estimates are made of the amounts recoverable from reinsurers, borrowers and third parties based on the gross outstanding claims provision.

(iii) Risk margin

Risk margins are held to mitigate the potential for uncertainty in the outstanding claims estimation process. The determination of the appropriate level of risk margin takes into account the uncertainty or variability inherent in the branch's business and the diversification benefits achieved by writing business in a number of geographic locations and with different lenders.

The measurement of variability uses techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. The use of a range of outcomes allows a determination of the risk margin required to provide an estimate at a given probability of adequacy, e.g. 9 times in 10 (a 90% probability of adequacy). These techniques use standard statistical distributions, and the measure of variability is referred to as the standard deviation or the coefficient of variation.

The directors and management have set an internal target for the probability of adequacy of the net outstanding claims provision to be 75% or above. Both the Reserve Bank of New Zealand ("RBNZ") and the Australian Prudential Regulation Authority ("APRA") requires a probability of adequacy of 75% for the determination of minimum capital. For the actual probability of adequacy applied at the end of the financial year to the branch, refer to note 14(C).

(iv) Expected present value of future cash flows for future claims

The expected present value of future cash flows for future claims and risk margin used in the liability adequacy test (refer note 15(C)) are determined using the same methods described above.

(v) Assumptions used to determine the outstanding claims provision

Key variables

	2011	2010
Severity	**24.8%**	30.0%
Claim rates	**23.8%**	18.6%
Recovery rates	**0.3%**	1.0%
Risk margin (as a proportion of central estimate)	**26.0%**	26.0%

Severity is a measure of the anticipated claims cost relative to the corresponding risk exposures.

Claim rate is the percentage of current defaults that are expected to become claims.

Recovery rate is a measure of anticipated non-reinsurance recoveries in claims.

The percentages adopted in the actuarial model are determined based on an analysis of historical experience combined with actuarial and management judgement of future trends.

Discount rates

The outstanding claims provision is discounted to net present value using a risk free rate of return. Details of the risk free rates of return are summarised below:

	2011		2010	
	Average of succeeding year	**Average of subsequent years**	Average of succeeding year	Average of subsequent years
Discount factor	**3.7%**	**3.4%**	4.8%	5.4%

Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the outstanding claim provision, which is determined by the reference to a combination of historical analysis and current expectation of when claims will be settled.

The weighted average term to settlement of the branch's net outstanding claims provision at the balance date is 1.2 years (2010: 1.2 years).

(vi) Impact of changes in key variables on the outstanding claims provision

The impact of changes in key outstanding claims variables is summarised in the table below. Each change has been calculated in isolation from the other changes and each change shows the after tax impact on profit and equity assuming that there is no change to:

- any of the other variables; and
- the probability of adequacy

It is likely that if, for example, the central estimate was to increase by 5%, at least part of the increase would result in a decrease in the probability of adequacy.

		2011		2010	
Variable	Change in assumptions	**Revised Variable**	**Impact on Profit (Loss) and Equity [1]**	Revised Variable	Impact on Profit (Loss) and Equity [1]
			$		$
Severity	+20%	**29.8%**	**(312,660)**	36.0%	(395,324)
	-20%	**19.9%**	**312,660**	24.0%	395,324
Claim rates	+20%	**28.6%**	**(312,660)**	22.3%	(395,324)
	-20%	**19.0%**	**312,660**	14.9%	395,324
Recovery rates	+20%	**0.3%**	**1,651**	1.2%	8,834
	-20%	**0.2%**	**(1,651)**	0.8%	(8,834)
Discount factors	+20%	**4.6%**	**12,413**	6.7%	23,440
	-20%	**3.1%**	**(12,413)**	4.5%	(23,440)
Risk Margin	+20%	**31.2%**	**(84,742)**	31.2%	(107,083)
	-20%	**20.8%**	**84,742**	20.8%	107,083

[1] Assumes taxation at prima facie rate of 28% (2010: 30%).

(B) Unearned premium liabilities and deferred acquisition costs

As highlighted in note 1(C), premium is earned based on the term of the policies written and the likely pattern in which risk will emerge over that term. An actuarial analysis of the emergence of risk over the life of a policy is performed annually and is used to derive an earning pattern for each underwriting year. Premium is earned and acquisition costs recognised in accordance with this pattern.

During the financial year ended 31 December 2010, the risk of an extended period of claims emergence as a result of the Global Financial Crisis was considered to have abated. Consequently, the earning patterns adopted in 2008 were revised across all underwriting years to reflect the latest actuarial view of long term average risk emergence. This reduced the branch's unearned premium liability by $4,555,119, and deferred insurance costs by $530,455.

Given the unpredictable pattern of future policy terminations it was not practical to reliably estimate the impact of these changes in individual future periods.

3. RISK MANAGEMENT

The risk management policy, strategy and framework is determined for the company as a whole and embedded in the operations of the Australian head office and the branch. The board annually approves a comprehensive risk management strategy (RMS) and a reinsurance management strategy (REMS).

The company's principal risk management policy objectives are to:

- achieve competitive advantage through better understanding the risk environment in which the company operates;
- optimise risk and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises by reducing uncertainty and volatility.

It is the company's policy to adopt a rigorous approach to managing risk. Risk management is a continuous process and an integral part of quality business management. The company's approach is to integrate risk management into its broader management processes. It is the company's philosophy to ensure that risk management is embedded in the business and that the risk makers or risk takers are themselves the risk managers. Specifically, the management of risk must occur at each point in the business management cycle.

Risk management forms a key part of the company's governance structure and strategic and business planning. It underpins the setting of limits and authorities and it is embedded in the monitoring and evaluation of performance. The company is also subject to the governance and risk management practices of its ultimate parent company.

The risk management framework defines the risks that the company is exposed to and sets out the framework to manage those risks and meet strategic objectives whilst taking into account the creation of value for the shareholders. The framework is made up of complementary elements that are embedded throughout the business management cycle and culture. Key aspects include: governance, risk appetite and tolerance, delegated authorities, risk policies, measurement and modelling, control completion monitoring, defined risk and issue escalation protocols, optimisation and ongoing improvement through management action plans and risk and performance monitoring.

A fundamental part of the overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows from insurance contracts. The company's operating activities expose it to risks such as market risk, credit risk and liquidity risk. The risk management framework recognises the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance. The company has established internal controls to manage risk in the key areas of exposure relevant to its business.

The company's risk profile is described under the following broad risk categories:

- Strategic risk
- Insurance risk
- Credit risk
- Market risk
- Liquidity risk
- Operational risk

Each of these is described more fully in sections (A) to (F) below.

(A) Strategic risk

Strategic risk refers to the current and prospective impact on earnings and or capital arising from strategic business decisions, implementation of decisions and responsiveness to external change. This includes risks associated with business strategy and change, tax planning, investment strategy and corporate governance. Of particular relevance is capital management risk.

(i) Capital management risk

The company is subject to extensive prudential regulation covering the jurisdictions in which it conducts business. Prudential regulation is generally designed to protect the policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations.

In New Zealand, the Insurance (Prudential Supervision) Act 2010 provides the RBNZ regulatory authority over insurance companies. In 2011, the RBNZ introduced new licence conditions including solvency requirements and standards. The branch has been given an exemption from compliance with these standards on the basis of the company's compliance with the APRA solvency standards.

The regulatory environments in both countries continue to evolve in response to economic, political and industry developments. The company works closely with regulators and monitors regulatory developments to assess their potential impact on its ability to meet solvency and other requirements.

(B) Insurance Risk

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to the expectations at the time of underwriting. This includes underwriting, catastrophe claims concentration and claims provisioning risks. The risks inherent in any single insurance contract are the possibility of the insured event occurring and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, these risks are random and unpredictable. In relation to the pricing of individual insurance contracts and the determination of the level of the outstanding claims provision in relation to a portfolio of insurance contracts, the principal risks are that premiums charged do not adequately remunerate the company for the risks it assumes and that the ultimate claims payments will exceed the carrying amount of the provision established.

The company has established the following protocols to manage its insurance risk:

(i) Underwriting risks

Selection and pricing of risks

The company offers lenders' mortgage insurance ("LMI"). LMI insures the lender should the borrower default on repayment of the loan, and covers the remaining loan balance, plus selling costs and expenses, following the application of the proceeds from the sale of the security property.

LMI is characterised by coverage of 100% of the loan amount, however insurance coverage may also be "top cover", where the total loss (including expenses) is paid up to a prescribed percentage of the original loan amount. Typical top cover in New Zealand ranges from 20% to 30% of the original loan amount.

Key risk mitigation policies and procedures comprise:

- the pricing model measures return on capital and reflects risks on a long term cyclical performance basis for both standard and new products. Pricing tables are set according to appropriate risk characteristics, such as type of product, loan amounts and loan valuation ratio.
- standard insurance agreements and documented underwriting policies and procedures are in place with allocation of delegated authority levels to approve applications.
- quality assurance reviews of underwriting and claims managements are conducted on a regular basis.

Concentration risk

Concentration risk is the risk of exposure due to concentration of activity in certain geographical locations, industries or counterparties. The company operates throughout all regions of Australia and New Zealand and therefore has limited geographic concentration risk on insurance contracts. Exposures are monitored but not limited by region; the branch only insures New Zealand risks. Limits, such as those placed on maximum aggregate exposures to individual borrowers and per property, are contained in underwriting policies and are embedded in systems and processes.

The company is exposed to the possibility of very large losses from economic events such as a significant increase in regional or nationwide unemployment levels, weakening in house prices, or a significant increase in interest rates over a short period of time. The company calculates its maximum event retention ("MER") which is the estimated maximum net loss from significant economic events with an approximate return period of 250 years. The MER must be less than the company's concentration risk tolerance; otherwise, steps such as the purchase of additional reinsurance are taken to limit the exposure.

(ii) Claims management and claims provisioning risks

The company's approach to determining the outstanding claims provision and the related sensitivities are set out in note 2. The company seeks to ensure the adequacy of its outstanding claims provision by reference to the following controls:

- experienced claims managers operate within policy and within the levels of authority delegated to them in respect of the settlement of claims;
- processes exist to ensure that all defaults are captured and updated on a timely basis and with a realistic assessment of the ultimate claims cost;
- initial IBNR estimates are set by experienced internal actuaries in conjunction with management;
- the outstanding claims provision is assessed regularly by senior management and is reviewed by the external Appointed Actuary at least annually.

(C) Credit Risk

Credit risk is the risk that a loss will be incurred because mortgagees, customers or counterparties to financial instruments fail to discharge their contractual obligations.

The principal sources of credit risk to the branch and the company as a whole arise in respect of insurance and reinsurance contracts and financial instruments.

(i) Credit risk arising from insurance contracts

Credit risk arising from insurance contracts principally relates to the risk of default by the underlying borrowers.

As insurer the company does not require access to the current credit quality of performing insured loans but is provided with data on loans in default by insured lenders. The relevant LMI master policy defines "default" as the borrower's failure to pay when due an amount equal to the scheduled monthly mortgage payment under the terms of the mortgage. Generally, however, the master policies require an insured to notify the insurer of a default within 14 days of the end of the month when the total amount due is unpaid and in arrears by more than 60 days. For reporting and internal tracking purposes, the company does not consider a loan to be in default until it has been delinquent for two consecutive monthly payments.

Credit risk on LMI contracts is therefore principally managed up-front through the underwriting process, prior to the acceptance of risk. The company has a centralised credit risk function that incorporates pricing, claims liability modelling, credit policy, portfolio performance reporting and analysis, and underwriting quality assurance.

Acceptance of credit risk is managed primarily using two scorecards, built on credit bureau data and company portfolio history. Credit rules are used to support these two scorecards. The centralised credit risk unit manages and maintains the scorecards and a centralised underwriting policy and procedure.

Lenders usually collect the single premium from a prospective borrower and remit the amount to the company; generally, under a standard LMI policy, premium payment is required before policy cover is incepted, which eliminates credit risk on premiums receivable.

The company does not hold any collateral as security against its exposures; however, in the event of a claim by the lender, the lender's rights as mortgagee are assigned to the company.

(ii) Reinsurance counterparty credit risk

Reinsurance risk management is the process of transferring insurance risk to another insurer for a price. The company reinsures a portion of risks underwritten to control exposure to insurance losses, reduce volatility and protect capital. The company's strategy in respect of the selection, approval and monitoring of reinsurance arrangements is addressed by the following protocols:

- reinsurance is placed in accordance with a reinsurance management strategy approved by the Board, which in turn is consistent with the QBE Group reinsurance management strategy and QBE Group security committee guidelines;
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical and potential future losses and the company's MER; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

The company's current reinsurance arrangements are disclosed within Note 20(B).

(iii) Investment counterparty credit risk

The principal exposure to credit risk from financial instruments arises from cash and cash equivalents, interest bearing investments, and trade and other receivables.

The company as a whole maintains high credit quality, liquid investments managed in accordance with an investment mandate approved by the company's board. The company monitors credit risk in respect of its investments in terms of geographic and sectoral / industry concentrations, as well as exposures to individual non-government issuers.

All branch cash and cash equivalent balances are held with registered banks in New Zealand. Branch fixed interest securities are New Zealand government risk.

Maximum exposures to credit risk at balance date in relation to each class of recognised financial asset is the carrying amount of those assets as indicated in the balance sheet.

There are no significant credit enhancements or collateral held as security that reduce the exposure to credit risk (2010: Nil). The branch has not taken possession of collateral or called upon credit enhancements during the year (2010: Nil).

The following tables provide information regarding the branch's aggregate credit risk exposure at the balance sheet date in respect of the major classes of financial assets. The analysis classifes the assets according to Moody's counterparty credit ratings. Aaa is the highest possible rating. Rated assets falling outside the range of Aaa to Baa are classified as speculative grade. The credit quality of the branch's holdings of investments is as follows:

	Credit Rating						
	Aaa	Aa	A	Baa	Speculative Grade	Unrated	Total
	$	$	$	$	$	$	$
At 31 December 2011							
Cash and cash equivalents	**-**	**6,915,013**	**-**	**-**	**-**	**500**	**6,915,513**
Interest-bearing investments	**558,145**	**-**	**-**	**-**	**-**	**-**	**558,145**
At 31 December 2010							
Cash and cash equivalents	-	4,716,969	-	-	-	500	4,717,469
Interest-bearing investments	515,059	-	-	-	-	-	515,059

None of the branch's financial assets are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2010: Nil).

(D) Market Risk

Market risk is the risk of variability in the value of, and returns on, investments and the risk associated with variability of interest rates, foreign exchange rates and market prices on assets and non-insurance liabilities.

(i) Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Financial instruments with floating rate interest expose the branch to cash flow interest rate risk.

The company's approach is to minimise interest rate risk by actively managing investment portfolios to achieve a balance between cash flow interest rate risk and fair value interest rate risk. The company invests in high quality, liquid interest bearing securities and cash and actively manages the duration of the fixed interest portfolio.

The maturity profile of the branch's interest bearing financial assets and hence its exposure to interest rate risk, and the effective weighted average interest rate for interest bearing financial assets is analysed below:

		FIXED INTEREST RATE MATURING IN						
	Floating interest rate	1 year or less	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years	Total
At 31 December 2011								
Interest bearing financial assets ($)	**6,915,513**	**-**	**-**	**-**	**558,145**	**-**	**-**	**7,473,658**
Weighted average interest rate (%)	**2.40%**				**6.00%**			**2.67%**
At 31 December 2010								
Interest bearing financial assets ($)	4,717,469	515,059	-	-	-	-	-	5,232,528
Weighted average interest rate (%)	2.68%	6.00%						3.01%

The branch's sensitivity to movements in interest rates, in term of changes in net interest income, for one year for interest bearing financial assets (floating rate or fixed rate to be reset within 1 month) based upon year end balances is shown in the table below:

	Sensitivity		**Profit (loss)**	
Interest rate movement:	**2011** **%**	2010 %	**2011** **$**	2010 $
Interest-bearing financial assets	**+0.5**	+1.0	**24,896**	33,022
	–0.5	–1.0	**(24,896)**	(33,022)

All interest bearing financial assets are measured at fair value through profit or loss. Movements in interest rates impact the value of fixed interest rate securities and therefore impact the reported profit after tax. The impact of the above movements in interest rates on the fair value of the branch's fixed interest rate securities is not significant.

The effect of interest rate risk on the branch's provision for outstanding claims is included in note 2(A)(vi)

(ii) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The branch is exposed to currency risk in respect of amounts due from or payable to related parties denominated in Australian dollars.

Foreign currency balances are actively monitored and exposures kept to acceptable levels.

(E) Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial and insurance liabilities as and when they fall due. This includes risks associated with asset and liability management. The key objective of the asset and liability management strategy is to ensure sufficient liquidity is maintained at all times to meet the company's obligations, including its settlement of insurance liabilities, and within these parameters, to optimise investment returns.

The nature of the business is that cash is received by way of single premiums at the inception of insurance contracts and is invested to fund future claims on those contracts. The principal sources of funds are written premiums, investment maturities and sales, and net investment income. The principal uses of funds are the payment of operating expenses, claim payments, taxes and growth of investments.

Liquidity must be sufficient to meet both planned and unplanned cash requirements. The company is exposed to liquidity risk mainly through its obligations to make payments in relation to its insurance contracts.

The key elements of the liquidity risk management strategy are as follows:

- Cash requirements are monitored regularly by management.
- Sufficient cash and cash equivalents are set aside for operating requirements of the business.
- Surplus funds are invested in accordance with the investment mandate.

The company's investment strategies form a key part of liquidity risk management.

The branch aims to be self-sufficient in terms of cash flow. Surplus cash flows are transferred to the company in Australia, and conversely cash flow deficits, if any, are supported by the company.

The following table summarises the contractual maturity profile of the branch's financial liabilities, including contingent liabilities and commitments, based on remaining contractual payment obligations. Repayments which are subject to notice are treated as if notice were to be given immediately; however, it is not expected that all creditors will request payment on the earliest date the branch could be required to pay.

	Note	1 Year or Less	1 to 3 Years	3 to 5 Years	Over 5 Years	Total
		$	$	$	$	$
As at 31 December 2011						
Balance sheet financial liabilities:						
Trade and other payables	**13**	**645,322**	**-**	**-**	**-**	**645,322**
Total		**645,322**	**-**	**-**	**-**	**645,322**
As at 31 December 2010						
Balance sheet financial liabilities:						
Trade and other payables	13	599,041	100,000	-	-	699,041
Total		599,041	100,000	-	-	699,041

(F) Operational risk

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk). The company manages operational risk within the same robust risk management framework as its other risks. The risk assessment and monitoring framework involves on-going:

- identification and review of the key risks to the company;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks in terms of the acceptable level of risk (risk tolerance) and the residual risk remaining after having considered risk treatment;
- assessment of whether each risk is within the acceptable level of risk, or requires appropriate action be taken to mitigate any excess risk;
- transparent monitoring and reporting of risk management related matters on a timely basis; and
- alignment of internal audit programs with risks.

One of the cornerstones of the company's risk management framework is the recruitment and retention of high quality people who are entrusted with appropriate levels of autonomy within the parameters of disciplined risk management practices.

The company operates a system of delegated authorities based on expertise and proven performance, and compliance is closely monitored. Other controls include effective segregation of duties, access controls and authorisation and reconciliation procedures.

4. INCOME AND EXPENSES

(A) Income summary

	2011	2010
	$	$
Gross earned premium revenue		
Direct	**7,982,557**	12,743,435
Other Income		
Non-reinsurance recoveries	**59,455**	134,584
Interest income	**168,895**	128,421
	228,350	263,005
Net fair value gains on financial assets	**373**	-
Revenue	**8,211,280**	13,006,440

(B) Expenses summary

	2011 $	2010 $
Net outward reinsurance premium expense	**963,225**	996,725
Gross claims incurred	**1,560,935**	1,667,591
Gross commission expense	**14,945**	195,877
Other acquisition costs	**760,420**	1,208,542
Underwriting and other expenses	**1,739,397**	1,704,471
Net fair value losses on financial assets	**-**	3,968
Investment expenses	**1,495**	1,603
Expenses	**5,040,417**	5,778,777

(C) Specific Items

	2011 $	2010 $
Claims settlement expenses	**255,306**	307,541
Operating lease payments	**18,837**	37,138
Related party transactions:		
(i) Expenses		
Management fees paid or payable to Head Office	**1,698,136**	2,050,378
Management fees paid or payable to related entity	**800,718**	372,415
Reinsurance premiums paid or payable to related entities (net of no claims bonus)	**1,194,256**	1,761,889

5. INVESTMENT INCOME

	2011 $	2010 $
Interest received or receivable from non-related entities	**168,895**	128,421
Net fair value gains (losses) on fixed interest	**373**	(3,968)
Investment expenses	**(1,495)**	(1,603)
Net investment income	**167,773**	122,850

6. CLAIMS INCURRED

(A) Claims analysis

	2011	2010
	$	$
Gross claims incurred		
Direct	**1,560,935**	1,667,591
Non-reinsurance recoveries		
Direct	**(59,455)**	(134,584)
Net claims incurred	**1,501,480**	1,533,007

(B) Claims development

Current year's claims relate to risks borne in the current reporting year. Prior year claims relate to a reassessment of the risks borne in all the previous reporting periods.

	2011			2010		
	Current Year	Prior Years	Total	Current Period	Prior Years	Total
	$	$	$	$	$	$
Gross claims incurred and related expenses						
Undiscounted	**2,356,583**	**(857,316)**	**1,499,267**	3,178,617	(1,519,458)	1,659,159
Discount	**(48,220)**	**109,888**	**61,668**	(121,324)	129,756	8,432
	2,308,363	**(747,428)**	**1,560,935**	3,057,293	(1,389,702)	1,667,591
Non-reinsurance recoveries						
Undiscounted	**(8,909)**	**(48,045)**	**(56,954)**	(60,213)	(76,054)	(136,267)
Discount	**253**	**(2,754)**	**(2,501)**	2,706	(1,023)	1,683
	(8,656)	**(50,799)**	**(59,455)**	(57,507)	(77,077)	(134,584)
Net claims incurred						
Undiscounted	**2,347,674**	**(905,361)**	**1,442,313**	3,118,404	(1,595,512)	1,522,892
Discount	**(47,967)**	**107,134**	**59,167**	(118,618)	128,733	10,115
	2,299,707	**(798,227)**	**1,501,480**	2,999,786	(1,466,779)	1,533,007

The development of net undiscounted outstanding claims for the four most recent accident years is shown in note 14(E).

(C) Reconciliation of net claims incurred to claims development table

The development of the net undiscounted central estimate of outstanding claims for the four most recent accident years is shown in note 14(E). This note is a reconciliation of the amounts included in the table above and the current financial year movements in the claims development table.

	2011			2010		
	Current Year	**Prior Years**	**Total**	Current Year	Prior Years	Total
	$	**$**	**$**	$	$	$
Net undiscounted claims development – central estimate (note 14(E))	**1,884,773**	**(579,308)**	**1,305,465**	2,460,141	(1,085,977)	1,374,164
Movement in claims settlement costs	**180,720**	**74,586**	**255,306**	130,096	177,445	307,541
Movement in discount	**(47,967)**	**107,134**	**59,167**	(118,618)	128,733	10,115
Movement in risk margin	**282,181**	**(400,639)**	**(118,458)**	528,167	(686,980)	(158,813)
Net claims incurred - discounted	**2,299,707**	**(798,227)**	**1,501,480**	2,999,786	(1,466,779)	1,533,007

7. INCOME TAX

(A) Reconciliation of prima facie tax to income tax expense

	2011	2010
	$	$
Profit before income tax	**3,170,863**	7,227,663
Prima facie tax payable at 28% (2010:30%)	**887,841**	2,168,299
Tax effect of permanent differences:		
Non allowable expenses and non taxable income	**3,163**	674
Prima facie tax adjusted for permanent differences	**891,004**	2,168,973
Under-provision in prior year	**(5,785)**	-
Change in tax rate	**-**	(33,676)
Income tax expense	**885,219**	2,135,297
Analysed as follows:		
Current tax	**805,911**	982,910
Deferred tax	**85,093**	1,186,063
Under-provision in prior year	**(5,785)**	-
Change in tax rate	**-**	(33,676)
	885,219	2,135,297
Deferred tax (credit) expense comprises:		
Deferred tax assets charged to profit or loss	**(27,654)**	1,573,333
Deferred tax liabilities credited to profit or loss	**112,747**	(387,270)
	85,093	1,186,063

Effective to the branch 1 January 2011, the rate of corporate tax reduced from 30% to 28%. Deferred tax assets and liabilities at 31 December 2010 were restated in line with the lower rate.

8. CASH AND CASH EQUIVALENTS

	2011	2010
	$	$
Cash at bank and on hand	**412,797**	940,333
Overnight money	**6,502,716**	3,777,136
Cash and cash equivalents	**6,915,513**	4,717,469

Cash and cash equivalents earn interest at floating rates based on daily bank deposit rates.

9. INVESTMENTS

	2011	2010
	$	$
Interest bearing securities		
New Zealand Government bond	**558,145**	515,059
Interest bearing securities	**558,145**	515,059
Amounts maturing within 12 months	**-**	515,059
Amounts maturing in greater than 12 months	**558,145**	-
Interest bearing securities	**558,145**	515,059

(A) Valuation of investments

Investments are recorded at fair value. Interest bearing securities are valued using independently sourced valuations that do not involve the exercise of judgement by management.

The investments of the company are disclosed in the following table using a fair value hierarchy which reflects the significance of inputs into the determination of fair value as follows:

Fair value hierarchy

- Level 1: valuation is based on quoted prices in active markets for the same instruments;
- Level 2: valuation is based on quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data (consensus price using broker quotes and valuation models with observable inputs); and
- Level 3: valuation techniques are applied for which any significant input is not based on observable market data.

	Level 1	Level 2	Level 3	Total
	$	$	$	$
At 31 December 2011	**-**	**558,145**	**-**	**558,145**
At 31 December 2010	-	515,059	-	515,059

(B) Movements in level 3 investments

There are no investments valued with reference to level 3 inputs.

(C) Restrictions on use

The branch is required to have a security deposit with a face value of $500,000 with the New Zealand Public Trust Office. There are no restrictions on use of the branch's other assets.

10. TRADE AND OTHER RECEIVABLES

	2011	2010
	$	$
Amounts due from reinsurers - related entity	**93,755**	81,298
Prepayments	**277,777**	444,444
Accrued investment income	**6,311**	3,781
Trade and other receivables	**377,843**	529,523
Amounts maturing within 12 months	**266,732**	251,745
Amounts maturing in greater than 12 months	**111,111**	277,778
Trade and other receivables	**377,843**	529,523

(A) Fair value

The carrying values of receivables approximate their fair value.

(B) Risk

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables have been pledged by the company as collateral for liabilities or contingent liabilities. No receivables are past due or impaired (2010:Nil)

11. DEFERRED INSURANCE COSTS

	2011	2010
	$	$
Deferred reinsurance premium	**996,196**	765,164
Deferred commission	**-**	-
Deferred acquisition costs	**1,949,013**	1,818,497
Deferred insurance costs	**2,945,209**	2,583,661
To be expensed within 12 months	**1,582,981**	1,321,885
To be expensed in greater than 12 months	**1,362,228**	1,261,776
Deferred insurance costs	**2,945,209**	2,583,661

	Deferred reinsurance premium $	Deferred commission $	Deferred acquisition costs $	Total $
Deferred costs at 1 January 2010	-	183,351	2,278,886	2,462,237
Costs deferred in financial year	765,164	-	655,382	1,420,546
Amortisation of costs deferred in previous financial years	-	(105,886)	(662,781)	(768,667)
Additional release (note 2 (B))	-	(77,465)	(452,990)	(530,455)
Deferred costs at 31 December 2010	765,164	-	1,818,497	2,583,661
Costs deferred in financial year	**996,196**	**-**	**780,460**	**1,776,656**
Amortisation of costs deferred in previous financial years	**(765,164)**	**-**	**(649,944)**	**(1,415,108)**
Deferred costs at 31 December 2011	**996,196**	**-**	**1,949,013**	**2,945,209**

12. DEFERRED INCOME TAX

	2011 $	2010 $
Deferred tax assets	**7,177**	61,599
Deferred tax liabilities	**(644,687)**	(533,056)
	(637,510)	(471,457)

(A) Deferred tax assets – maturing in greater than 12 months

(i) The balance comprises temporary differences attributable to:

	2011 $	2010 $
Amounts recognised in profit or loss		
Other items	**7,177**	61,599
	7,177	61,599
Set-off deferred tax liabilities	**(7,177)**	(61,599)
	-	-

(ii) Movements:

	2011	2010
	$	$
At 1 January	**61,599**	1,895,399
Amounts recognised in profit or loss	**27,654**	(1,573,333)
Prior year adjustments	**(82,076)**	55,006
Change in tax rate	-	(4,400)
Tax losses transferred to related entities	-	(311,073)
At 31 December	**7,177**	61,599

(B) Tax losses

The branch qualifies as a permanent establishment for New Zealand tax purposes, and consequently lodges income tax returns and pays income tax in New Zealand as though it were a separate entity. Tax losses may be transferred to or from other New Zealand entities provided that the receiving entity shares 100% common ownership with the transferring entity. Tax losses were transferred from QII New Zealand branch during the 2011 financial year; the branch paid full consideration for the tax value of the losses transferred.

(C) Deferred tax liabilities – maturing in greater than 12 months

(i) The balance comprises temporary differences attributable to:

	2011	2010
	$	$
Amounts recognised in profit or loss		
Insurance assets	**545,724**	509,179
Other receivables	**98,963**	23,877
	644,687	533,056
Set-off of deferred tax assets	**(7,177)**	(61,599)
	637,510	471,457

(ii) Movements:

	2011	2010
	$	$
At 1 January	**533,056**	903,397
Amounts recognised in profit or loss	**112,747**	(387,270)
Prior year adjustments	**(1,116)**	55,005
Change in tax rate	-	(38,076)
At 31 December	**644,687**	533,056

13. TRADE AND OTHER PAYABLES

	2011	2010
	$	$
Amount due to Head Office	**212,812**	170,414
Amount due to related entities	**79,517**	39,597
Trade payables	**225,632**	261,504
Other payables	**127,361**	227,526
Trades and other payables	**645,322**	699,041
Amounts payable within 12 months	**645,322**	599,041
Amounts payable in greater than 12 months	**-**	100,000
Trades and other payables	**645,322**	699,041

Due to the short term nature of these payables, their carrying values approximate their fair value.

14. OUTSTANDING CLAIMS

(A) Net outstanding claims

	2011	2010
	$	$
Gross outstanding claims	**2,178,798**	2,859,823
Claims settlement costs	**69,458**	73,680
	2,248,256	2,933,503
Discount to present value	**(66,002)**	(127,670)
Gross outstanding claims provision	**2,182,254**	2,805,833
Less than 12 months	**1,139,665**	1,508,699
Greater than 12 months	**1,042,589**	1,297,134
Gross outstanding claims provision	**2,182,254**	2,805,833
Non-reinsurance recoveries on outstanding claims	**11,350**	63,364
Discount to present value	**(347)**	(2,848)
Non-reinsurance recoveries on outstanding claims	**11,003**	60,516
Less than 12 months	**5,746**	32,540
Greater than 12 months	**5,257**	27,976
Non-reinsurance recoveries on outstanding claims	**11,003**	60,516
Net outstanding claims	**2,171,251**	2,745,317
Central estimate	**1,723,216**	2,178,824
Risk margin	**448,035**	566,493
Net outstanding claims	**2,171,251**	2,745,317

(B) Maturity profile of net outstanding claims

The expected maturity of the branch's net outstanding claims provision is analysed below:

	1 year or less	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years	Total
	$	$	$	$	$	$	$
At 31 December 2011	**1,133,919**	**676,599**	**248,396**	**77,382**	**34,955**	**-**	**2,171,251**
At 31 December 2010	1,476,159	842,654	305,068	87,448	33,988	-	2,745,317

(C) Risk margins

The process used to determine risk margins is explained in note 2(A)(iii).

The probability of adequacy at 31 December 2011 is 75% (2010: 75%) - 75% is a recognised industry benchmark in New Zealand and Australia, being the minimum probability of adequacy required for licensed insurers by RBNZ and APRA. The risk margin included in net outstanding claims is 26% (2010: 26%) of the central estimate.

(D) Reconciliation of movement in discounted outstanding claims provision

	2011			2010		
	Gross	**Non-reinsurance Recoveries**	**Net**	Gross	Non-reinsurance Recoveries	Net
	$	**$**	**$**	$	$	$
At 1 January	**2,805,833**	**(60,516)**	**2,745,317**	3,544,508	(29,569)	3,514,939
Increase in net claims incurred in current accident year	**2,308,363**	**(8,656)**	**2,299,707**	3,057,293	(57,507)	2,999,786
Movement in prior year claims provision	**(747,428)**	**(50,799)**	**(798,227)**	(1,389,702)	(77,077)	(1,466,779)
Incurred claims recognised in profit or loss	**1,560,935**	**(59,455)**	**1,501,480**	1,667,591	(134,584)	1,533,007
Claims (payments) recoveries	**(2,184,514)**	**108,968**	**(2,075,546)**	(2,406,266)	103,637	(2,302,629)
At 31 December	**2,182,254**	**(11,003)**	**2,171,251**	2,805,833	(60,516)	2,745,317

(E) Claims development – undiscounted net central estimate

(i) Net undiscounted central estimate of outstanding claims for the company for the four most recent accident years.

	Prior Years	2008	2009	2010	2011	Total
	$	$	$	$	$	$
Estimate of net ultimate claims cost:						
At end of accident year		2,937,785	4,241,295	2,460,142	1,884,773	
One year later		2,628,628	3,054,397	1,464,696		
Two years later		2,720,403	3,519,182			
Three years later		2,703,930				
Current central estimate cost for the four most recent accident years		2,703,930	3,519,182	1,464,696	1,884,773	
Cumulative net claims payments to date		(2,686,093)	(3,398,427)	(1,140,045)	(628,602)	
Net undiscounted central estimate	**-**	**17,837**	**120,755**	**324,651**	**1,256,171**	**1,719,414**
Discount to present value						(65,655)
Risk margin						448,035
Claims settlement costs						69,458
Net outstanding claims at December 2011						2,171,252
Net central estimate development						
Increase(decrease) in the year	(32,174)	(16,473)	464,785	(995,446)	1,884,773	1,305,465

A reconciliation of the net central estimate development to the net incurred claims in the income statement, analysed between current and prior accident years, is included in Note 6(C).

Favourable arrears and claims experience in 2011 have given rise to an overall release of risk margins and central estimates for prior years, as ultimate claim costs were settled or became more certain at a lower level than previously expected. Despite this trend, there was a small increase in net ultimate claims cost for the 2009 accident year.

Conditions and trends that have affected the development of the liabilities in the past may, or may not, occur in the future, and accordingly, conclusions about future results may not necessarily be derived from the information presented in the tables.

15. UNEARNED PREMIUM

(A) Unearned premium

	Note	2011 $	2010 $
At 1 January		**20,098,213**	23,826,374
Deferral of premium on contracts written in the period		**7,647,994**	7,863,197
Earning of premium written in previous periods		**(6,853,228)**	(7,036,239)
Additional release	2(B)	**-**	(4,555,119)
At 31 December		**20,892,979**	20,098,213
Amounts to be earned within 12 months		**6,363,558**	6,195,007
Amounts to be earned in greater than 12 months		**14,529,421**	13,903,206
At 31 December		**20,892,979**	20,098,213

(B) Net premium liabilities

	Note	2011 $	2010 $
Unearned premium		**20,892,979**	20,098,213
Deferred insurance costs	11	**(2,945,209)**	(2,583,661)
Net premium liabilities		**17,947,770**	17,514,552

(C) Expected present value of net future cash flows for future claims

	2011 $	2010 $
Undiscounted central estimate	**2,009,221**	3,851,968
Risk margin	**771,714**	1,733,385
	2,780,935	5,585,353
Discount to present value	**(294,300)**	(946,519)
Expected present value of net future cash flows for future claims including risk margin	**2,486,635**	4,638,834

(D) Liability Adequacy Test

The liability adequacy test requires comparison of the unearned premium liability net of deferred insurance costs to the present value of net future cash flows relating to future claims arising under current general insurance contracts.

(E) Risk Margin

The process used to determine the risk margin is explained in note 2(A)(iii)

The risk margin in expected net future cash flows for future claims as a percentage of the undiscounted central estimate is 39% (2010: 45%). This is the risk margin required to give a probability of adequacy of 75% for total insurance liabilities.

The branch's net unearned premium liability exceeded the present value of net future claims as at 31 December 2011 and 2010.

16. CAPITAL RISK MANAGEMENT

The company's objectives when managing capital are to maintain an optimal balance of debt and equity in the capital structure to reduce the cost of capital whilst meeting capital adequacy requirements, providing security for policyholders and continuing to provide returns to shareholders. Where appropriate, adjustments are made to capital levels in light of changes in economic conditions and risk characteristics of the company's activities. In order to maintain or adjust the capital structure, the company has the option to adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or vary the level of outward reinsurance.

The company is subject to and in compliance with externally imposed capital requirements set and monitored by APRA. These requirements are in place to ensure sufficient solvency margins for the protection of policyholders. The branch has been granted an exemption from the New Zealand solvency standards by RBNZ on the basis of the company's compliance with the APRA solvency standards. In addition the company aims to maintain a strong credit rating to support its business objectives.

The company has a capital management plan which is reviewed and approved by the Board on an annual basis. The plan supports the risk management strategy (refer Note 3) and is intended to meet the capital requirements of APRA and its ultimate parent entity.

Dedicated staff are responsible for understanding regulatory capital requirements. The quality of assets (particularly investments) and insurance risk is monitored on an ongoing basis to ensure issues are identified early and remedial action, where necessary is taken to restore effective capital performance and levels.

The company aims to have a mix of "hard" and "soft" capital that provides sufficient capital to satisfy APRA and ratings agencies of the company's financial strength, while at the same time avoids over capitalisation, which would unduly depress returns. Additional hard (share) capital is available from the QBE Group, subject to relevant approvals; reinsurance may be sourced externally or from within the QBE Group.

The company has a policy of paying dividends to shareholders to the extent that capital exceeds target levels and allowing for amounts required to support business growth and meet APRA and rating agency requirements.

The company manages its capital requirements against the following levels:

- Minimum levels set by APRA and the ratings agencies, which must be met at all times.
- "Trigger" levels set by management in consultation (where applicable) with APRA, as a guide to capital levels which require close monitoring, to ensure minimum standards are not breached.
- "Target" levels set by management in consultation (where applicable) with APRA, as a guide to capital levels, which if exceeded, may indicate the existence of surplus capital.

The company's APRA capital adequacy multiple is at 31 December 2011 is 1.33 (2010: 1.59).

17. REMUNERATION OF THE AUDITOR

Audit fees for the company incorporate the New Zealand branch and are paid at Head Office level. Amounts received by the company's auditors are as follows:

	2011	2010
	$	$
PricewaterhouseCoopers – Australian firm		
Assurance services		
Audit or review of financial reports of the entity	**574,356**	516,376
Other services		
Special audits required by regulators	**143,716**	136,003
Total remuneration for audit services	**718,072**	652,379
Related practices of PricewaterhouseCoopers – Australian firm		
Other services		
Taxation services	**19,895**	9,731

18. CONTINGENT LIABILITIES

Contingent liabilities are disclosed when the possibility of a future settlement of economic benefits is considered to be less than probable but more likely than remote. Under accounting standards, no provision is required for such items if a future transfer of benefits is not probable or cannot be reliably measured. If settlement becomes probable, a provision is required.

In the normal course of business, the branch may be exposed to the possibility of contingent liabilities in relation to litigation arising out of its insurance transactions. Provisions are made for obligations that are probable and quantifiable.

The branch had no contingent liabilities as at 31 December 2011 (31 December 2010: nil)

19. CAPITAL EXPENDITURE COMMITMENTS

The branch had no capital commitments as at 31 December 2011 (31 December 2010: nil).

20. RELATED PARTY DISCLOSURES

(A) Parent and ultimate parent

The branch forms part of QBE LMI, a company incorporated and domiciled in Australia.

The company's ultimate parent is QBE Insurance Group Limited ("QBE"), incorporated in Australia.

(B) Related party transactions

(i) Australia Head Office

The Australia Head Office charges management fees in respect of time and costs incurred supporting the branch's activities.

(ii) Other related entities

The company has excess of loss outward reinsurance arrangements with Equator Reinsurances Ltd and QII Singapore branch, members of the QBE Group. The branch pays part of the company's premiums, proportionate to the level of its insurance risks.

All persons engaged in the activities of the branch are employed by a related party, QII New Zealand branch. QII New Zealand branch charges the branch management fees for individuals directly supporting the branch's activities in respect of this arrangement.

All other material information required to be disclosed under NZIAS 124: Related Party Disclosures has been included in the financial statements as follows:

Reference	
Income and expenses	Note 4
Trade and other receivables	Note 10
Trade and other payables	Note 13

21. EVENTS OCCURRING AFTER REPORTING DATE

There is, at the date of these statements, no matter or circumstance that has arisen since 31 December 2011 that has significantly affected, or may significantly affect:

(i) the branch's operations in future financial years;

(ii) the results of those operations in future financial years; or

(iii) the branch's state of affairs in future financial years.

Independent Auditors' Report to the Directors of QBE Lenders' Mortgage Insurance Limited New Zealand Branch

Report on the Financial Statements

We have audited the financial statements of QBE Lenders' Mortgage Insurance New Zealand Branch ("New Zealand Branch") on pages 2 to 36, which comprise the balance sheet as at 31 December 2011, the statement of comprehensive income and statement of changes in head office account for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The New Zealand Branch's Directors are responsible for the preparation of these financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate and for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the New Zealand Branch's preparation of financial statements that give a true and fair view of the matters to which they relate, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the New Zealand Branch's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Other than in our capacity as auditors we have no relationship with, or interests in, the New Zealand Branch.

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Opinion
In our opinion, the financial statements on pages 2 to 36:

(i) comply with generally accepted accounting practice in New Zealand; and

(ii) give a true and fair view of the financial position of the New Zealand Branch as at 31 December 2011, and its financial performance for the year then ended.

Restriction on Distribution or Use
This report is made solely to the New Zealand Branch's Directors, as a body. Our audit work has been undertaken so that we might state to the New Zealand Branch's Directors those matters which we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the New Zealand Branch's Directors, as a body, for our audit work, for this report or for the opinions we have formed.

PricewaterhouseCoopers
Chartered Accountants

I, John W Bennett, am currently a member of The Institute of Chartered Accountants in Australia and my membership number is 27653.

PricewaterhouseCoopers was the audit firm appointed to undertake the audit of QBE Lenders' Mortgage Insurance Limited – New Zealand Branch for the year ended 31 December 2011. I was responsible for the execution of the audit and delivery of our firm's auditors' report. The audit work was completed on 16 February 2012 and an unqualified opinion was issued.

J W Bennett
Partner

Sydney
16 February 2012