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QBE LENDERS' MORTGAGE INSURANCE LIM.
New Zealand Branch

FINANCIAL STATEMENTS – 31 December 2012

INDEX

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 1010 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 2012 and the auditor's statement thereon.

Signed in accordance with a resolution of the directors made on 14 February 2013.

For and on behalf of the board.

Director ....

Director ....

QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2012

	NOTE	2012 $	2011 $
Gross written premium		**4,183,655**	8,777,323
Unearned premium movement		**4,519,671**	(794,766)
Gross earned premium revenue	4(A)	**8,703,326**	7,982,557
Outward reinsurance premium		**(1,023,179)**	(1,194,257)
Deferred reinsurance premium movement		**(204,910)**	231,032
Outward reinsurance premium expense	4(B)	**(1,228,089)**	(963,225)
Net earned premium		**7,475,237**	7,019,332
Gross claims incurred	4(B)	**(3,041,194)**	(1,560,935)
Non-reinsurance recoveries revenue	4(A)	**145,287**	59,455
Net claims incurred	6(A)	**(2,895,907)**	(1,501,480)
Gross commission expense	4(B)	**(9,987)**	(14,945)
Other acquisition costs	4(B)	**(903,822)**	(760,420)
Underwriting and other expenses	4(B)	**(1,487,226)**	(1,739,397)
Underwriting profit		**2,178,295**	3,003,090
Investment income on policyholders funds	5	**163,076**	167,773
Insurance profit		**2,341,371**	3,170,863
Profit before income tax		**2,341,371**	3,170,863
Income tax expense	7	**(642,602)**	(885,219)
Profit after income tax		**1,698,769**	2,285,644
Other comprehensive income		**-**	-
Income tax relating to components of other comprehensive income		**-**	-
Other comprehensive income after income tax		**-**	-
Net profit after income tax attributable to:			
Ordinary equity holders of the company		**1,698,769**	2,285,644
		1,698,769	2,285,644
Total comprehensive income after income tax attributable to:			
Ordinary equity holders of the company		**1,698,769**	2,285,644
		1,698,769	2,285,644

The 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 2012

	NOTE	2012 $	2011 $
ASSETS			
Cash and cash equivalents	8	**3,245,059**	6,915,513
Investments	9	**544,669**	558,145
Trade and other receivables	10	**117,421**	377,843
Current tax assets		**147,339**	-
Non-reinsurance recoveries on outstanding claims	15(A)	**12,694**	11,003
Deferred insurance costs	11	**2,861,997**	2,945,209
Total assets		***6,929,179***	*10,807,713*
LIABILITIES			
Trade and other payables	13	**377,482**	645,322
Unearned premium	14	**16,373,308**	20,892,979
Outstanding claims	15(A)	**1,821,190**	2,182,254
Current tax liabilities		**-**	359,437
Deferred tax liabilities	12	**568,219**	637,510
Total liabilities		**19,140,199**	24,717,502
Net liabilities		**(12,211,020)**	(13,909,789)
RESIDUAL EQUITY			
Head office account		**(12,211,020)**	(13,909,789)
Total equity		**(12,211,020)**	(13,909,789)

The 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 2012

	HEAD OFFICE ACCOUNT $
2012	
As at 1 January	**(13,909,789)**
Profit after income tax	**1,698,769**
Other comprehensive income	**-**
Total comprehensive income	**1,698,769**
Net funding movements	**-**
As at 31 December	**(12,211,020)**
2011	
As at 1 January	(16,195,433)
Profit after income tax	2,285,644
Other comprehensive income	-
Total comprehensive expense	2,285,644
Net funding movements	-
As at 31 December	(13,909,789)

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

NOTES TO FINANCIAL STATEMENTS

For the year ended 31 December 2012

NOTES TO FINANCIAL STATEMENTS
For the year ended 31 December 2012

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 ("NZ IFRS"), 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 sole shareholder of the company has exercised its right under section 211(3) of the Companies Act 1993 and determined that these financial statements need not comply with paragraphs (a), and (e) to (j) of section 211(1) of the Act.

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

(ii) 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. Refer to note 2.

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.

(iii) 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.

(iv) 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) 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.

(C) 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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(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 sheet 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 from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of incidence of risk. Where applicable, a portion of outward reinsurance premium is treated as a prepayment at the balance sheet 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 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 earning pattern of the premium, 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) 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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(J) Taxation

The income tax expense for the period is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted for 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 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 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.

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, as appropriate.

(K) Policyholders' and shareholder's funds

Cash and fixed income securities are held to back policyholders' funds, being the net insurance liabilities of the company. Remaining financial assets, if any, are held to back shareholder's funds. Insurance profit is derived by adding investment income on assets backing policyholders' funds to the underwriting result.

(L) 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.

(M) Investments

Investments comprise interest-bearing assets. 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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(N) Trade and other 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.

(O) 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 its 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.

(P) Trade and other payables
Trade and other payables are measured at cost and are settled under standard terms and conditions. Intercompany payables are measured at amortised cost and are repayable on demand.

(Q) Functional and presentation currency
The company's financial statements are presented in New Zealand dollars, being the functional and presentation currency of the branch.

(R) 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.

(S) 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. Payables in the balance sheet and commitments are shown inclusive of GST.

(T) Comparative figures
Where appropriate, prior period comparatives have been reclassified in this financial report to ensure comparability in the current reporting period. The reclassification was necessary to provide the readers of the financial report with a greater understanding of the company's notes to the financial statements.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The company is a lenders' mortgage insurance company underwriting business in Australia and New Zealand. The branch underwrites all business in New Zealand and none in Australia.

As a member of the wholly owned group, the company has adopted the risk management policies and framework of the QBE Group. QBE Group has developed a strong, centralised risk management and policy framework, designed to ensure consistency of approach across a number of operational activities, subject to the specific requirements of the local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of claims provisions and investment management. In addition, assessment of the net outstanding claims provision set at a company level is subject to detailed head office review. The probability of adequacy of the company's insurance liabilities is determined by the company's senior actuaries.

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 employees 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 below.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(A) Outstanding claims provision

The branch's net outstanding claims provision comprises:

- the gross central estimate of expected future claims payments;
- amount recoverable from reinsurers, borrowers and third parties based on the gross central estimate;
- a reduction to reflect the discount to present value using risk-free rates of return to reflect the time value of money; and
- a risk margin that reflects the inherent uncertainty in the net discounted central estimate.

A net discounted central estimate is an estimate of the level of claims provision that is intended to contain no intentional under or over estimation; it is intended to represent the mean of the distribution of the future cash flows. As the branch requires a higher probability that estimates will be adequate over time, a risk margin is added to the net discounted central estimate to determine the outstanding claims provision.

(i) Central estimate

The provision for expected future payments includes those in relation to claims reported but not yet paid; claims incurred but not reported (IBNR); and estimated claims handling costs, being the expenses incurred in the settlement of 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 branch's process for establishing the outstanding claims provision involves extensive consultation with actuaries, claims managers, underwriters 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 risk management procedures related to the actuarial function are explained further in note 3.

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 used in the determination of the central estimate on the company's profit or loss are summarised in note 2(A)(iv).

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.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(i) Central estimate (continued)

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 central estimate.

The net central estimate is discounted at risk-free rates of return to reflect the time value of money. Details of the key assumptions applied in the discounting process are summarised in note 2(A)(iii).

(ii) Risk margin

Risk margins are determined by management and are held to mitigate the potential for uncertainty in the central estimate. The determination of the appropriate level of risk margin takes into account similar factors to those used to determine the central estimate, such as:

- prior accident year claims development; and
- the level of uncertainty in the net discounted central estimate due to actuarial estimation, data quality issues, variability of key discount and legislative uncertainty.

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. These techniques use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation. The potential impact of changes in the coefficient of variation assumptions on the company's profit or loss is summarised in note 2(A)(iv).

Both the Reserve Bank of New Zealand ("RBNZ") and the Australian Prudential Regulation Authority ("APRA") require 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 15(C).

The probability of adequacy is a statistical measure of the relative adequacy of the outstanding claims provision and is derived from the comparison of the risk margin with the net discounted central estimate. Using a range of outcomes, it allows a determination of the probability of adequacy represented by a risk margin. For example, a 90% probability of adequacy indicates that the outstanding claims provision is expected to be adequate nine times in ten. The appropriate level of risk margin is not determined by reference to a fixed probability of adequacy.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(iii) Financial assumptions used to determine the outstanding claims provision

Key variables

	2012	2011
Severity	**41.7%**	24.8%
Claim rates	**28.2%**	23.8%
Coefficient of variation	**48.0%**	50.0%

- 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
- 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 company generally uses risk-free rates to discount the outstanding claims provision.

The weighted average risk-free rates used to discount the outstanding claims provision are summarised below.

	2012 AVERAGE OF SUCCEEDING YEAR	2012 AVERAGE OF SUBSEQUENT YEARS	2011 AVERAGE OF SUCCEEDING YEAR	2011 AVERAGE OF SUBSEQUENT YEARS
Discount factor	**2.8%**	**2.9%**	3.7%	3.4%

Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the central estimate, including related recoveries, is determined by the reference to a combination of historical analysis and current expectations of when claims and recoveries will be settled.

The weighted average term to settlement of the branch's net outstanding claims provision at the balance sheet date is 1.1 years (2011: 1.2 years).

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

The impact of changes in key variables used in the calculation of the outstanding claims provision 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 assuming that there is no change to any of the other variables.

The impact of a change in interest rates on profit after tax due to market value movements in relation to fixed interest securities is shown in note 3(D)(ii).

	SENSITIVITY	PROFIT (LOSS) 2012	PROFIT (LOSS) 2011
	%	$	$
Severity	+20%	**(260,423)**	(312,660)
	-20%	**260,423**	312,660
Claim rates	+20%	**(260,423)**	(312,660)
	-20%	**260,423**	312,660
Discount factors	+5%	**1,948**	3,103
	-5%	**(1,948)**	(3,103)
Coefficient of variation	+20%	**(50,405)**	(64,517)
	-20%	**43,194**	59,316

[1] Assumes taxation at prima facie rate of 28%.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(B) Liability adequacy test

At each balance sheet date, the adequacy of the unearned premium liability is assessed against the present value of the expected future cash flows relating to potential future claims, plus a risk margin to reflect the inherent uncertainty of the central estimate (refer note 14(D)). Future claims are those claims expected to arise from claims events occurring after the balance sheet date.

NZ IFRS 4 requires that this test be carried out at the level of a "portfolio of contracts that are subject to broadly similar risks and are managed together in a single portfolio". As NZ IFRS 4 does not explicitly define "broadly similar risks" or "managed together as a single portfolio", and the branch is a monoline insurer, the branch has interpreted these terms to represent the entire portfolio.

(C) Unearned premium liabilities and deferred insurance costs

As highlighted in note 1, premium is earned and insurance costs recognised 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 insurance costs recognised in accordance with these patterns, adjusted for policy terminations.

3. RISK MANAGEMENT

QBE Group's risk management policy, strategy and framework are embedded in the head office function and in each of the divisional operations, ensuring a consistent approach to managing risk across the organisation. The board annually approves a comprehensive risk management strategy (RMS), including a Risk Appetite Statement, and a reinsurance management strategy (REMS), both of which are lodged with the Australian Prudential Regulation Authority (APRA).

Risk management for the branch is managed by the company.

As a member of the QBE Group, the company has adopted the risk management policy of QBE Group where applicable. The company's risk management 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 QBE's policy to adopt a rigorous approach to managing risk throughout the QBE Group. Risk management is a continuous process and an integral part of quality business management. QBE Group's approach is to integrate risk management into the broader management processes of the organisation. It is QBE Group'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 is 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. This holistic approach to risk management allows all of the QBE Group's risks to be managed in an integrated manner.

QBE Group's global risk management framework defines the risks that the QBE Group 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 our 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, risk and control self assessment, risk treatment, optimisation and ongoing improvement through management action plans and risk and performance monitoring.

3. RISK MANAGEMENT (CONTINUED)

A fundamental part of the QBE Group's 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 operating activities of the company expose it to risks such as market risk, credit risk and liquidity risk. The QBE Group's 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 and New Zealand continue to evolve in response to economic, political and industry developments. QBE Group works closely with regulators and monitors regulatory developments across its global operations to assess their potential impact on its ability to meet solvency and other requirements. Refer to note 16.

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

(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 is that the ultimate claims payments will exceed the carrying amount of the provision established.

QBE Group has established the following protocols to manage its insurance risk across the underwriting, claims and actuarial disciplines:

3. RISK MANAGEMENT (CONTINUED)

(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 in 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 risks in New Zealand. 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 2012, the MER was AUD955.1M (2011: AUD813.5M) before tax benefit.

(ii) Claims management and claims estimation risks

The company's approach to determining the outstanding claims provision and the related sensitivities are set out in note 2(A). 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 determination of the risk margin is performed by senior management and the Board with input from senior actuaries;
- the outstanding claims provision is assessed regularly by senior management and is reviewed by the external Appointed Actuary at least annually.

Despite the rigour involved in the establishment and review of the outstanding claims provision, the provision is subject to significant uncertainty for the reasons set out in note 2(A).

3. RISK MANAGEMENT (CONTINUED)

(C) Credit Risk

Credit risk is the risk of default by transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Exposure to credit risk results from transactions with securities issuers, customers, mortgagees and reinsurers.

The company's credit risk arises mainly from investment, insurance and reinsurance protection activities. The following policies and procedures are in place to mitigate the company's exposure to credit risk:

- a QBE Group-wide investment credit risk policy is in place which defines what constitutes credit risk for QBE Group and establishes tolerance levels. Compliance with the policy is monitored and exposures and breaches are reported to the QBE Group investment committee.
- net exposure limits are set for each counterparty or group of counterparties in relation to investments, cash deposits and forward foreign exchange exposures. The policy also sets out minimum credit ratings for investments. The branch did not enter into any forward foreign exchange contracts during the year.
- QBE Group has strict guidelines covering the limits and terms of net open derivative positions and the counterparties with which the company may transact. The branch did not invest in derivatives during the year.

(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.

3. RISK MANAGEMENT (CONTINUED)

(ii) 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 branch's principal exposures related to cash and fixed rate securities.

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 classifies 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.

	CREDIT RATING						
	Aaa $	Aa $	A $	Baa $	SPECULATIVE GRADE $	NOT RATED $	TOTAL $M
At 31 December 2012							
Cash and cash equivalents	**-**	**3,244,559**	**-**	**-**	**-**	**500**	**3,245,059**
Interest-bearing investments	**544,669**	**-**	**-**	**-**	**-**	**-**	**544,669**
At 31 December 2011							
Cash and cash equivalents	-	6,915,013	-	-	-	500	6,915,513
Interest-bearing investments	558,145	-	-	-	-	-	558,145

The carrying amount of the relevant asset classes in the balance sheet represents the maximum amount of credit exposure.

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 (2011: $nil).

(iii) 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 branch has no reinsurance recoveries receivable on paid or outstanding claims at 31 December 2012 (2011: $nil).

3. RISK MANAGEMENT (CONTINUED)

(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, credit spreads, foreign exchange rates and economy-wide inflation on both assets and liabilities, excluding insurance liabilities.

Market risk comprises three types of risk: currency risk (due to fluctuations in foreign exchange rates); interest rate risk (due to fluctuations in market interest rates); and price risk (due to fluctuations in market prices). Within each of these categories, risks are evaluated before considering the effect of mitigating controls. The existence and effectiveness of such mitigating controls are then measured to ensure that residual risks are maintained within the company's risk appetite and tolerance.

(i) Currency risk

The company's exposure to currency risk generally arises as a result of the translation of foreign currency amounts back to the functional currency. The branch's exposure to currency risk generally arises in respect of amounts due from or payable to related parities denominated in Australian dollars. Foreign currency balances are actively monitored and exposures kept to acceptable levels.

(ii) Interest rate risk

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.

QBE Group's risk management 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 claims provision is discounted to present value by reference to risk-free interest rates. The company is therefore exposed to potential underwriting result volatility as a result of interest rate movements. The company has a policy of maintaining a relatively short duration for assets backing policyholders' funds in order to minimise any further potential volatility affecting insurance profit.

The contractual 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 *in the table below. The table includes investments at the maturity date of the security.*

	INTEREST BEARING FINANCIAL ASSETS MATURING IN						
	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 2012							
Floating rate ($M)	**3,245,059**	**-**	**-**	**-**	**-**	**-**	**3,245,059**
Weighted average interest rate (%)	**2.12%**	**-**	**-**	**-**	**-**	**-**	**2.12%**
Fixed rate ($M)	**-**	**-**	**544,669**	**-**	**-**	**-**	**544,669**
Weighted average interest rate (%)	**-**	**-**	**6.00%**	**-**	**-**	**-**	**6.00%**
At 31 December 2011							
Floating rate ($M)	6,915,513	-	-	-	-	-	6,915,513
Weighted average interest rate (%)	2.40%	-	-	-	-	-	2.40%
Fixed rate ($M)	-	-	-	558,145	-	-	558,145
Weighted average interest rate (%)	-	-	-	6.00%	-	-	6.00%

3. RISK MANAGEMENT (CONTINUED)

(ii) Interest rate risk (continued)

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

	SENSITIVITY	PROFIT (LOSS) 2012	2011
	%	$	$
Interest rate movement -	+0.5	**11,682**	24,896
Interest-bearing financial assets	-0.5	**(11,682)**	(24,896)

(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), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market.

The branch had no price risk at the end of either the current or prior financial year.

(E) Liquidity risk

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due to policyholders and creditors. This includes the risk associated with asset and liability management. The key objective of the company's 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 for policyholders and shareholders.

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

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 tables summarise the contractual maturity profile of certain of the branch's financial liabilities based on the remaining contractual obligations.

	1 YEAR OR LESS	1 TO 3 YEARS	3 TO 5 YEARS	OVER 5 YEARS	TOTAL
	$	$	$	$	$
As at 31 December 2012					
Trade and other payables	**377,482**	**-**	**-**	**-**	**377,482**
As at 31 December 2011					
Trade and other payables	645,322	-	-	-	645,322

The branch has no significant concentration of liquidity risk.

The maturity profile of the branch's net outstanding claims provision is analysed in note 15(B).

3. RISK MANAGEMENT (CONTINUED)

(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 throughout the company 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 QBE Group'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

	2012 $	2011 $
Gross earned premium revenue		
Direct	**8,703,326**	7,982,557
	8,703,326	7,982,557
Other income		
Non-reinsurance recoveries	**145,287**	59,455
Net fair value gains on financial assets	**-**	373
Interest income	**178,047**	168,895
	323,334	228,723
Income	**9,026,660**	8,211,280

(B) Expenses

	2012 $	2011 $
Outward reinsurance premium expense	**1,228,089**	963,225
Gross claims incurred	**3,041,194**	1,560,935
Gross commission expense	**9,987**	14,945
Other acquisition costs	**903,822**	760,420
Underwriting expenses	**1,487,226**	1,739,397
Net fair value losses on financial assets	**13,476**	-
Investment expenses	**1,495**	1,495
Expenses	**6,685,289**	5,040,417
Profit before income tax	**2,341,371**	3,170,863

5. INVESTMENT INCOME

	2012 $	2011 $
Interest income		
Interest received or receivable	**178,047**	168,895
	178,047	168,895
Net fair value (losses) gains on financial assets		
Fixed interest	**(13,476)**	373
	(13,476)	373
Investment income	**164,571**	169,268
Investment expenses	**(1,495)**	(1,495)
Net investment income	**163,076**	167,773

6. CLAIMS INCURRED

(A) Claims analysis

	2012 $	2011 $
Gross claims incurred and related expenses		
Direct	**3,041,194**	1,560,935
Non-reinsurance recoveries		
Direct	**(145,287)**	(59,455)
Net claims incurred	**2,895,907**	1,501,480

(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 6(C) below

	2012			2011		
	CURRENT YEAR $	PRIOR YEARS $	TOTAL $	CURRENT YEAR $	PRIOR YEARS $	TOTAL $
Gross claims incurred and related expenses						
Undiscounted	**2,067,223**	**950,331**	**3,017,554**	2,356,583	(857,316)	1,499,267
Discount	**(32,658)**	**56,298**	**23,640**	(48,220)	109,888	61,668
	2,034,565	**1,006,629**	**3,041,194**	2,308,363	(747,428)	1,560,935
Non-reinsurance recoveries						
Undiscounted	**(36,528)**	**(108,718)**	**(145,246)**	(8,909)	(48,045)	(56,954)
Discount	**236**	**(277)**	**(41)**	253	(2,754)	(2,501)
	(36,292)	**(108,995)**	**(145,287)**	(8,656)	(50,799)	(59,455)
Net claims incurred						
Undiscounted	**2,030,695**	**841,613**	**2,872,308**	2,347,674	(905,361)	1,442,313
Discount	**(32,422)**	**56,021**	**23,599**	(47,967)	107,134	59,167
	1,998,273	**897,634**	**2,895,907**	2,299,707	(798,227)	1,501,480

6. CLAIMS INCURRED (CONTINUED)

(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 15(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.

	2012 CURRENT YEAR $	2012 PRIOR YEARS $	2012 TOTAL $	2011 CURRENT YEAR $	2011 PRIOR YEARS $	2011 TOTAL $
Net undiscounted claims development – central estimate (note 15(E))	**1,691,480**	**1,140,370**	**2,831,850**	1,884,773	(579,308)	1,305,465
Movement in claims settlement costs	**69,371**	**68,905**	**138,276**	180,720	74,586	255,306
Movement in discount	**(32,422)**	**56,021**	**23,599**	(47,967)	107,134	59,167
Movement in risk margin	**269,844**	**(367,662)**	**(97,818)**	282,181	(400,639)	(118,458)
Net claims incurred - discounted	**1,998,273**	**897,634**	**2,895,907**	2,299,707	(798,227)	1,501,480

7. INCOME TAX

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

	2012 $	2011 $
Profit before income tax	**2,341,371**	3,170,863
Prima facie tax payable at 28%	**655,584**	887,841
Tax effect of permanent differences:		
Non allowable expenses and non taxable income	**645**	3,163
Prima facie tax adjusted for permanent differences	**656,229**	891,004
Under-provision in prior year	**(13,627)**	(5,785)
Income tax expense	**642,602**	885,219
Analysed as follows:		
Current tax	**660,964**	805,911
Deferred tax	**(4,735)**	85,093
Under-provision in prior year	**(13,627)**	(5,785)
	642,602	885,219
Deferred tax (credit) expense comprises:		
Deferred tax assets recognised in profit or loss	**68,937**	(27,654)
Deferred tax liabilities recognised in profit or loss	**(73,672)**	112,747
	(4,735)	85,093

8. CASH AND CASH EQUIVALENTS

	2012 $	2011 $
Cash at bank and on hand	**762,468**	412,797
Overnight money	**2,482,591**	6,502,716
Cash and cash equivalents	**3,245,059**	6,915,513

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

Cash and cash equivalents include balances readily convertible to cash. All balances are held to service normal operational requirements.

9. INVESTMENTS

	2012 $	2011 $
Fixed interest rate		
Government bonds	**544,669**	558,145
Total investments	**544,669**	558,145
Amounts maturing within 12 months	**-**	-
Amounts maturing in greater than 12 months	**544,669**	558,145
Total investments	**544,669**	558,145

(A) Valuation of investments

All investments are initially recorded at fair value and are subsequently remeasured to fair value at each reporting date. Investments traded in an active market are valued with reference to the closing bid price, using independently sourced valuations that do not involve the exercise of judgement by management.

The investments of the branch 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, for example, consensus price using broker quotes and valuation models with observable inputs.

Level 3: Valuation techniques are applied for which any significant input is not based on observable market data.

	2012				2011			
	LEVEL 1 $	LEVEL 2 $	LEVEL 3 $	TOTAL $	LEVEL 1 $	LEVEL 2 $	LEVEL 3 $	TOTAL $
Government bonds	**-**	**544,669**	**-**	**544,669**	-	558,145	-	558,145
Total investments	**-**	**544,669**	**-**	**544,669**	-	558,145	-	558,145

(B) Movements in level 3 investments

There are no investments valued with reference to level 3 inputs (2011: $nil).

(C) Restrictions in use

The branch has 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 branch's other investments

10. TRADE AND OTHER RECEIVABLES

	2012 $	2011 $
Amounts due from reinsurers - related entity	**-**	93,755
Prepayments	**111,110**	277,777
Accrued investment income	**6,311**	6,311
Trade and other receivables	**117,421**	377,843
Amounts maturing within 12 months	**117,421**	266,732
Amounts maturing in greater than 12 months	**-**	111,111
Trade and other receivables	**117,421**	377,843

(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 branch as collateral for liabilities or contingent liabilities. No receivables are past due or impaired (2011: $nil)

11. DEFERRED INSURANCE COSTS

	2012 $	2011 $
Deferred reinsurance premium	**791,286**	996,196
Deferred acquisition costs	**2,070,711**	1,949,013
Deferred insurance costs	**2,861,997**	2,945,209
To be expensed within 12 months	**1,430,431**	1,582,981
To be expensed in greater than 12 months	**1,431,566**	1,362,228
Deferred insurance costs	**2,861,997**	2,945,209

	DEFERRED REINSURANCE PREMIUM		DEFERRED ACQUISITION COSTS	
	2012 $	2011 $	2012 $	2011 $
At 1 January	**996,196**	765,164	**1,949,013**	1,818,497
Costs deferred in financial year	**791,286**	996,196	**898,356**	780,460
Amortisation of costs deferred in previous financial years	**(996,196)**	(765,164)	**(776,658)**	(649,944)
At 31 December	**791,286**	996,196	**2,070,711**	1,949,013

12. DEFERRED INCOME TAX

	2012 $	2011 $
Deferred tax assets	**2,796**	7,177
Deferred tax liabilities	**(571,015)**	(644,687)
	(568,219)	(637,510)

(A) Deferred tax assets
(i) The balance comprises temporary differences attributable to:

	2012 $	2011 $
Amounts recognised in profit or loss		
Other	**2,796**	7,177
Set-off deferred tax liabilities	**(2,796)**	(7,177)
	-	-
Deferred tax assets before set-off analysed as follows:		
Recoverable within 12 months	**2,796**	7,177
Recoverable in greater than 12 months	**-**	-
	2,796	7,177

(ii) Movements:

	2012 $	2011 $
At 1 January	**7,177**	61,599
Amounts recognised in profit or loss	**(68,937)**	27,654
Prior year adjustments	**64,556**	(82,076)
At 31 December	**2,796**	7,177

(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 QBE Insurance (International) Limited ("QII") New Zealand branch during the 2012 and 2011 financial years; the branch paid full consideration for the tax value of the losses transferred.

(C) Deferred tax liabilities
(i) The balance comprises temporary differences attributable to:

	2012 $	2011 $
Amounts recognised in profit or loss		
Other receivables	**-**	98,963
Insurance assets	**571,015**	545,724
	571,015	644,687
Set-off deferred tax assets	**(2,796)**	(7,177)
	568,219	637,510
Deferred tax liabilities before set-off analysed as follows:		
Recoverable within 12 months	**178,640**	26,252
Recoverable in greater than 12 months	**392,375**	618,435
	571,015	644,687

12. DEFERRED INCOME TAX (CONTINUED)

(ii) Movements:

	2012 $	2011 $
At 1 January	**644,687**	533,056
Amounts recognised in profit or loss	**(73,672)**	112,747
Prior year adjustments	**-**	(1,116)
At 31 December	**571,015**	644,687

13. TRADE AND OTHER PAYABLES

	2012 $	2011 $
Amount due to Head Office	**69,068**	212,812
Amount due to related entities	**62,730**	79,517
Trade payables	**152,485**	225,632
Other payables	**93,199**	127,361
Trade and other payables	**377,482**	645,322
Amounts payable within 12 months	**377,482**	645,322
Amounts payable in greater than 12 months	**-**	-
Trade and other payables	**377,482**	645,322

14. UNEARNED PREMIUM

(A) Unearned premium

	2012 $	2011 $
At 1 January	**20,892,979**	20,098,213
Deferral of premium on contracts written in the period	**3,656,234**	7,647,994
Earning of premium written in previous periods	**(8,175,905)**	(6,853,228)
At 31 December	**16,373,308**	20,892,979
Amounts to be earned within 12 months	**5,125,154**	6,363,558
Amounts to be earned in greater than 12 months	**11,248,154**	14,529,421
At 31 December	**16,373,308**	20,892,979

(B) Net premium liabilities

	NOTE	2012 $	2011 $
Unearned premium		**16,373,308**	20,892,979
Deferred insurance costs	11	**(2,861,997)**	(2,945,209)
Net premium liabilities		**13,511,311**	17,947,770

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

	2012 $	2011 $
Undiscounted central estimate	**1,355,971**	2,009,221
Risk margin	**575,717**	771,714
	1,931,688	2,780,935
Discount to present value	**(204,539)**	(294,300)
Expected present value of net future cash flows for future claims including risk margin	**1,727,149**	2,486,635

14. UNEARNED PREMIUM (CONTINUED)

(D) Liability Adequacy Test

The probability of adequacy applied in the liability adequacy test may differ 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 branch.

The application of the liability adequacy test in respect of the net premium liabilities identified a surplus at 31 December 2012 and 2011.

(E) Risk Margin

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

The risk margin in expected net future cash flows for future claims as a percentage of the undiscounted central estimate is 42.5% (2011: 38.4%). This is the risk margin required to give a probability of adequacy of 75.0% (2011: 75.0%) of future claims.

15. OUTSTANDING CLAIMS

(A) Net outstanding claims

	2012 $	2011 $
Gross outstanding claims	**1,810,836**	2,178,798
Claims settlement costs	**52,716**	69,458
	1,863,552	2,248,256
Discount to present value	**(42,362)**	(66,002)
Gross outstanding claims provision	**1,821,190**	2,182,254
Less than 12 months	**1,061,287**	1,139,665
Greater than 12 months	**759,903**	1,042,589
Gross outstanding claims provision	**1,821,190**	2,182,254
Non-reinsurance recoveries on outstanding claims	**13,000**	11,350
Discount to present value	**(306)**	(347)
Non-reinsurance recoveries on outstanding claims	**12,694**	11,003
Less than 12 months	**7,397**	5,746
Greater than 12 months	**5,297**	5,257
Non-reinsurance recoveries on outstanding claims	**12,694**	11,003
Net outstanding claims	**1,808,496**	2,171,251
Central estimate	**1,458,465**	1,723,216
Risk margin	**350,031**	448,035
Net outstanding claims	**1,808,496**	2,171,251

(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 $	TOTAL $
At 31 December 2012	**1,053,890**	**500,068**	**162,495**	**53,982**	**38,061**	**1,808,496**
At 31 December 2011	1,133,919	676,599	248,396	77,382	34,955	2,171,251

15. OUTSTANDING CLAIMS (CONTINUED)

(C) Risk margins

The process used to determine risk margins is explained in note 2(A)(ii) and details of the risk-free discount rates adopted are set out in note 2(A)(iii).

The probability of adequacy at 31 December 2012 is 75.0% (2011: 75.0%) - 75.0% 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 24.0% (2011: 26.0%) of the central estimate.

(D) Reconciliation of movement in discounted outstanding claims provision

	2012 GROSS $	2012 RECOVERIES $	2012 NET $	2011 GROSS $	2011 RECOVERIES $	2011 NET $
At 1 January	**2,182,254**	**(11,003)**	**2,171,251**	2,805,833	(60,516)	2,745,317
Increase in net claims incurred in current accident year	**2,034,565**	**(36,292)**	**1,998,273**	2,308,363	(8,656)	2,299,707
Movement in prior year claims provision	**1,006,629**	**(108,995)**	**897,634**	(747,428)	(50,799)	(798,227)
Incurred claims recognised in profit or loss	**3,041,194**	**(145,287)**	**2,895,907**	1,560,935	(59,455)	1,501,480
Claims (payments) recoveries	**(3,402,258)**	**143,596**	**(3,258,662)**	(2,184,514)	108,968	(2,075,546)
At 31 December	**1,821,190**	**(12,694)**	**1,808,496**	2,182,254	(11,003)	2,171,251

(E) Claims development – undiscounted net central estimate

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

	PRIOR YEARS $	2008 $	2009 $	2010 $	2011 $	2012 $	TOTAL $
Estimate of net ultimate claims cost:							
At end of accident year		2,937,785	4,241,295	2,460,142	1,884,773	1,691,480	
One year later		2,628,628	3,054,397	1,464,696	1,751,606		
Two years later		2,720,403	3,519,182	2,116,685			
Three years later		2,703,930	3,972,012				
Four years later		2,882,638					
Current central estimate cost for the four most recent accident years		**2,882,638**	**3,972,012**	**2,116,685**	**1,751,606**	**1,691,480**	
Cumulative net claims payments to date		2,882,638	3,959,515	2,054,732	1,494,383	575,347	
Net undiscounted central estimate		**-**	**12,497**	**61,953**	**257,223**	**1,116,133**	**1,447,806**
Discount to present value							**(42,056)**
Risk margin							**52,716**
Claims settlement costs							**350,030**
Net outstanding claims at December 2012							**1,808,496**
Net central estimate development Increase(decrease) in the year	**(9,990)**	**178,708**	**452,830**	**651,989**	**(133,167)**	**1,691,480**	**2,831,850**

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

15. OUTSTANDING CLAIMS (CONTINUED)

(E) Claims development – undiscounted net central estimate (continued)

Development of claims from prior accident years was overall worse than expected at 31 December 2011, leading to an increase of the central estimate from prior years of $1,140,370. This outcome was primarily driven by the 2008, 2009 and 2010 accident years, which showed large increases, reflecting a soft housing market and settlement of more high-value claims than expected.

Uncertainty surrounding claims development is materially resolved within five years, and the 2008, 2009 and 2010 accident years are close to being fully developed - only $74,450 undiscounted central estimate is considered necessary at 31 December 2012 in respect of remaining defaults (2011: $445,406).

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.

16. CAPITAL RISK MANAGEMENT

Capital is managed at a company level.

As a member of the wholly owned group, the company has adopted the risk management policies and framework of the QBE Group. QBE Group's objective when managing capital is 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 complies with, various externally imposed regulatory capital requirements. These requirements are designed to ensure a sufficient solvency margin is maintained in order to provide adequate protection for policyholders. In addition, the company aims to maintain a strong credit rating and robust capital ratios in order to support its business objectives and maximise shareholder wealth.

Capital across the QBE Group is allocated to business units, divisions and ultimately to underwriting portfolios according to the associated risk. The minimum target risk adjusted return on capital is 15%. The business plans include net asset projections, dividends, issued share projections and solvency projections.

Management monitors the company's capital levels on an ongoing basis, with particular focus on the following:

- The company is subject to APRA Level 1 minimum capital requirements. Throughout 2012, the company actively managed the components of capital in order to achieve a target capital level that incorporated a margin in excess of APRA's minimum capital requirement for level 1 companies
- During 2012, the company also considered the implication of APRA's new capital requirements ("LAGIC") which became effective on 1 January 2013. Having considered the risk appetite criteria of the company, management has set the target level of regulatory capital for 2013 that similarly incorporates a margin in excess of Prescribed Capital Amount ("PCA").
- The company is subject to regulatory requirements that a minimum level of capital is maintained to meet obligations to policyholders. It is the company's policy to maintain a capital base appropriate to its size, business mix, complexity and risk profile which meets regulatory requirements.
- The company believes that insurer financial strength ratings provided by the major rating agencies are an important factor in demonstrating the financial strength and claims paying ability. Active management of the business and its capital has enabled the company to maintain its financial strength and credit rating.

16. CAPITAL RISK MANAGEMENT (CONTINUED)

Dedicated staff are responsible for understanding regulatory capital requirements. The quality of assets (particularly investments) held by the company is continuously monitored to ensure any potential issues are identified and remedial action, where necessary, is taken to restore effective capital performance and levels.

The company's APRA capital adequacy multiple is at 31 December 2012 is 1.29 (2011: 1.33).

From 1 January 2013 all APRA authorised insurers are subject to revised regulatory capital adequacy requirements. These requirements apply new standards to both the measurement of capital for regulatory purposes and the calculation of the required minimum level of capital known as the Prudential Capital Requirement (PCR). The PCR for an APRA regulated institution equals the sum of a publicly disclosed Prescribed Capital Amount (PCA) plus any supervisory adjustment determined by APRA. A regulated institution may not disclose any supervisory adjustment.

17. REMUNERATION OF THE AUDITOR

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

	2012 $	2011 $
PricewaterhouseCoopers (PwC) – Australian firm		
Audit or review of financial reports of the entity	**575,628**	574,356
Special audits required by regulators	**145,022**	143,716
	720,650	718,072
Related practices of PricewaterhouseCoopers (including overseas PricewaterhouseCoopers firms)		
Taxation services	**9,200**	19,895

The board believes some non-audit services are appropriate given the external auditor's knowledge of the Group. QBE may engage the external auditor for non-audit services other than the excluded services subject to the general principle that fees for non-audit services should not exceed 50% of all fees paid to the external auditor in any one financial year. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, PwC cannot provide the excluded services of preparing accounting records or financial reports, asset or liability valuations, acting in a management capacity, acting as a custodian of assets or acting as share registrar.

18. CONTINGENT LIABILITIES

The branch had no contingent liabilities as at 31 December 2012 (2011: $nil)

19. CAPITAL EXPENDITURE COMMITMENTS

The branch had no capital commitments as at 31 December 2012 (2011: $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) Transactions with related parties

The following material transactions occurred with related parties:

	2012 $	2011 $
Expenses		
Payments made for management fees and cost allocations to related entities	**841,775**	800,718
Payments made for management fees and cost allocations to Head Office	**1,473,998**	1,968,135
Outwards reinsurance premium (net of no claims bonus)	**1,023,179**	1,194,257

(C) Outstanding balances arising from transactions with related parties

The following balances are outstanding at the reporting date in relation to transactions with related parties:

	2012 $	2011 $
Assets		
Reinsurance premiums and related receivables	-	93,755
Deferred reinsurance premium	**791,286**	996,196
Liabilities		
Trade and other payables	**131,798**	292,329

(D) Terms and conditions

All transactions were made on normal commercial terms and conditions and at market rates.

Outstanding balances are unsecured and repayable in cash.

(E) Other related party disclosures

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

From 1 January 2013 all APRA authorised insurers are subject to revised regulatory capital adequacy requirements. These requirements apply new standards to both the measurement of capital for regulatory purposes and the calculation of the required minimum level of capital known as the Prudential Capital Requirement (PCR). The PCR for an APRA regulated institution equals the sum of a publicly disclosed Prescribed Capital Amount (PCA) plus any supervisory adjustment determined by APRA. A regulated institution may not disclose any supervisory adjustment.

There is, at the date of these statements, no other matter or circumstance that has arisen since 31 December 2012 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.

pwc

INDEPENDENT AUDITOR'S 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 Limited – New Zealand Branch ("the Branch") on pages 2 to 32, which comprise the balance sheet as at 31 December 2012, 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 Directors of the Branch are responsible for the preparation of these financial statements in accordance with generally accepted accounting practice in New Zealand and that gives a true and fair view of the matters to which they relate and for such internal control as the Directors determine are necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's 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 auditor's judgment, 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 Branch's preparation of the 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 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 Branch.

Opinion

In our opinion, the financial statements on pages 2 to 32:

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

(ii) comply with International Financial Reporting Standards; and

(iii) give a true and fair view of the financial position of the Branch as at 31 December 2012, and its financial performance for the year then ended.

pwc

INDEPENDENT AUDITOR'S REPORT TO THE DIRECTORS OF QBE LENDERS' MORTGAGE INSURANCE LIMITED – NEW ZEALAND BRANCH

Restriction on Distribution or Use

This report is made solely to the Directors of the Branch, as a body. Our audit work has been undertaken so that we might state to the Directors of the Branch those matters which we are required to state to them in an auditor's 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 Directors of the Branch, as a body, for our audit work, for this report or for the opinions we have formed.

PricewaterhouseCoopers
Chartered Accountants

I, J 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 2012. I was responsible for the execution of the audit and delivery of our firm's auditors' report. The audit work was completed on 14 February 2013 and an unqualified opinion was issued.

J W Bennett
Partner

Sydney
14 February 2013

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3 June 2013

Michael Savery on behalf of the QBE LMI Board
Chief Risk Officer
QBE Lenders Mortgage Insurance Limited
Level 8
82 Pitt Street
Sydney 2000 Australia

QBE Lenders Mortgage Insurance Limited Insurance Liabilities as at 31 December 2012

Dear Michael,

QBE Lenders Mortgage Insurance Limited ("QBE LMI") is an Australian authorised insurer regulated by the Australian Prudential Regulatory Authority ("APRA") and has a provisional licence issued by the Reserve Bank New Zealand ("RBNZ").

QBE LMI has appointed me, Warrick Gard, Ernst & Young to be QBE LMI's Appointed Actuary as described by the Insurance Act 1973 and related Prudential Standards and Guidance Notes current at 31 December 2012 and by the New Zealand Insurance (Prudential Supervision) Act 2010. I have no relationship with QBE LMI other than being its Appointed Actuary.

The prime responsibility of the Appointed Actuary is to provide advice to the Board of a general insurer on the value of its insurance liabilities and the preparation of the actuarial information contained in its financial statements. The Appointed Actuary must provide written advice to the Board of the insurer on the value of insurance liabilities in accordance with APRA's Prudential Standard GPS310 Audit and Actuarial Reporting and Valuation.

It is ultimately the responsibility of the Board of QBE LMI to place an appropriate valuation on QBE LMI's insurance liabilities, after considering actuarial and other advice. A report has been prepared and a formal recommendation of the value of the insurance liabilities at 31 December 2012 has been completed to assist the Board in meeting this responsibility.

The scope of the review includes all insurance and reinsurance run off liabilities owned by QBE LMI at 31 December 2012. There were no limitations placed on me in preparing the actuarial information.

I can confirm that I have obtained all information and explanations as required and in my opinion from an actuarial perspective,

- The actuarial information contained in the financial statements and any group financial statements has been appropriately included in these statements; and
- The actuarial information used in the preparation of the financial statements and any group financial statements has been used appropriately.

In my opinion and from an actuarial perspective, QBE LMI is maintaining the solvency margin that applies under a condition imposed under section 21(2)(b) of the Insurance (Prudential Supervision) Act 2010.

Yours sincerely,

Gard

Warrick Gard