# Actuarial Report on Scheme Transfer

## Gordian RunOff Limited and Zurich Australian Insurance Limited

November 2018



finity

finity
Actuarial and Insurance Consultants

13 November 2018

Ms Sandra O'Sullivan
Chief Executive and Chief Financial Officer
Gordian RunOff Limited
Level 9, 220 George Street
SYDNEY NSW 2000

Dear Sandra

# Actuarial Report on Scheme Transfer

I am pleased to enclose my actuarial report relating to the transfer of the NSW CTP insurance portfolio of Zurich Australian Insurance Limited to Gordian RunOff Limited.

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

Yours sincerely

Geoff Atkins
**Fellow of the Institute of Actuaries of Australia**

# Actuarial Report on Scheme Transfer

# Part I Report

## 1 Introduction

This report has been prepared at the request of Gordian RunOff Ltd (Gordian). Gordian is an insurance company in run-off and is authorised by the Australian Prudential Regulatory Authority (APRA). The report covers the proposed transfer of assets and liabilities relating to the NSW CTP insurance portfolio of Zurich Australian Insurance Limited (Zurich) to Gordian.

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

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

I understand that this report will be provided to APRA and the Court as part of the documentation supporting the scheme. I also understand that a copy of the full report will be made available to the public.

Readers of this report should note the reliances and limitations detailed in Section 6.

### 1.1 Compliance

#### 1.1.1 Prudential Standard GPS 410

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

While GPS 410 provides no specific guidance on the content of actuarial reports on which insurance business transfers are based, in my experience it is usual for such actuarial reports to provide an opinion as to whether or not the interests of policyholders are materially adversely affected by the proposed scheme.

#### 1.1.2 Federal Court Practice Note

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

### 1.2 Authorship of Report

This report has been prepared by Geoff Atkins of Finity Consulting, who has been appointed by Gordian to prepare the actuarial report on the scheme for the purpose of Division 3A of Part III of the Insurance Act.

### 1.3 Qualifications and Independence

Geoff Atkins, the author of this report, has been a qualified actuary for more than 30 years and has prepared a number of reports on transfer schemes along with peer reviews of other reports.

Geoff is currently the Appointed Actuary to Gordian. In addition, Finity prepared an independent valuation for Zurich of its liabilities for NSW CTP prior to the Enstar transaction[1] in 2017.

## 1.4 Policyholder and Claimant Interests

As mentioned in Section 1.1.1, this report provides an opinion as to whether or not the interests of policyholders are materially adversely affected by the proposed scheme. The Insurance Act[2] defines an affected policyholder to be a "holder of a policy affected by a scheme", in this case holders of NSW CTP insurance policies written by Zurich.

Due to the third party nature of cover, the NSW CTP insurance policyholders of Zurich have no continuing relationship with their insurer or any direct interest in the claims arising under the relevant policies. Their interest is to be properly indemnified under the policy. Those with the real interests to be protected are the claimants against those policies. The interests of the policyholders are therefore, indirectly, the interests of the claimants.

In parts of this report, I refer to the interests of claimants on the basis that, through the indemnity under the policy, those are also the interests of policyholders. I consider this to be a more prudent approach to assessing the scheme, rather than considering solely the interests of affected policyholders as strictly defined under the Insurance Act.

In forming a view on claimant/policyholder interests, I have considered:

- The contractual rights of claimants under existing policies
- The continuity of claim management procedures
- The nature of the risks faced by claimants before and after the transaction
- The financial security of claimants after the transaction.

This report deals specifically with the interests of policyholders and claimants in the transferring NSW CTP insurance portfolio, along with the interests of other policyholders of Gordian and Zurich as broad groups.

## 1.5 Approach

My approach involved the following steps:

- Review and understand the scheme documents and transaction documents.
- Review the nature and valuation of the liabilities to be transferred.
- Review the nature of the business written by Gordian and Zurich, focussing on the financial position of the two insurers and any areas of particular risk which may be of relevance to my financial assessment of the impacts of the Insurance Scheme on policyholders of both organisations.
- Assess the financial security offered to transferring policyholders. The focus here was the reinsurance established as part of the Enstar transaction. I also considered the capital adequacy position pre- and post-scheme, and the potential for capital support from group entities.

[1] Discussed in Section 3.2.
[2] Insurance Act 1973, Section 17C(1).

- Assess the other impacts of the Insurance Scheme on transferring policyholders, including consideration of the terms and conditions applying to the NSW CTP insurance policyholders and the claims handling procedures of Gordian and Zurich.
- Briefly consider any impacts on the other policyholders of Zurich and Gordian.

## 1.6 Information

In preparing this report, I have liaised with, and received assistance from, management of both Gordian and Zurich, as well as their advisers. I have found all parties to be open in their dealings with me, and all material requested has been made available to me. Both Gordian and Zurich have reviewed my report, and neither has advised me that the information provided by them is presented inaccurately.

While I have discussed this report and received assistance as noted above, all opinions and determinations contained within this report have been formed independently by me.

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

# 2 Background Information

## 2.1 NSW CTP Insurance

Compulsory Third Party (CTP) personal injury insurance covers injury to third parties when the driver of the insured vehicle is at fault in an accident. Third parties include passengers, drivers of other vehicles, cyclists, and pedestrians. I note that:

- Limited benefits (up to $5,000 for treatment expenses and lost earnings) were available to drivers at fault.
- Treatment and care costs for those severely injured in motor accidents were covered by the NSW Lifetime Care and Support Scheme (separate to the CTP scheme).

In 1989 the NSW CTP Scheme was changed to a competitive private underwriting model with a number of insurers. At December 2017, there were six insurers licensed to write NSW CTP insurance.

CTP is a 'statutory' class of insurance meaning that state legislation specifies the coverage, claim procedures and numerous obligations of the insurer[3].

## 2.2 Zurich

Zurich Australian Insurance Limited (Zurich) is an authorised Australian insurer, underwriting commercial and travel insurance in Australia and New Zealand. Zurich wrote CTP insurance in NSW from 1989 until it went into run-off in 2016. Most of Zurich's business is acquired through intermediaries (brokers for commercial insurance, Cover-More for travel insurance).

Zurich is ultimately owned by the Zurich Insurance Group, a publicly listed multi-line insurance group domiciled in Switzerland. The Zurich Insurance Group had a financial strength rating of AA-/stable from Standard & Poor's at 31 December 2017.

At 31 December 2017, Zurich had a net outstanding claims liability of $360 million (APRA basis, inclusive of a 6.5% risk margin[4]) in respect of its NSW CTP insurance business. The NSW CTP liabilities accounted for 27% of Zurich's total net insurance liabilities at December 2017.

## 2.3 Gordian

Gordian RunOff Limited (Gordian) is an authorised Australian insurer. It entered run-off in September 1999. It has two key portfolios:

- Gordian Direct – direct insurance policies written in the 1990s including Professional Indemnity, Directors & Officers, Public Liability, as well as several acquired portfolios.
- Gordian Re – assumed reinsurance treaties.

Gordian has no remaining unexpired policies or any unearned premiums. The only insurance liabilities are the outstanding claims liabilities.

[3] The relevant pieces of legislation in NSW are the Motor Accidents Compensation Act 1999 and the Motor Accidents Act 1988. The recent changes to the NSW CTP Scheme, which took effect from 1 December 2017, do not apply to the NSW CTP insurance business written by Zurich.
[4] Intended to secure a 75% probability of adequacy across all lines of business.

### 2.3.1 Gordian's Financial Performance

Table 2.1 summarises Gordian's financial performance for the two years to December 2017.

**Table 2.1 – Gordian's Income Statements ($ million)**

| | 2016 | 2017 |
|---|---|---|
| Gross Earned Premium | (0.5) | (0.2) |
| Reinsurance Premium | - | - |
| Net Earned Premium | (0.5) | (0.2) |
| Net Claims | 2.9 | (0.4) |
| Underwriting Expenses | - | - |
| Other Insurance Income | - | - |
| **Underwriting Result** | **2.4** | **(0.6)** |
| Investment Income | 3.5 | 1.5 |
| Other Income & Expenses | (4.5) | (2.5) |
| Profit before Tax | 1.4 | (1.6) |
| Tax | (0.4) | 0.5 |
| **Profit after Tax** | **1.0** | **(1.1)** |

Source: APRA Returns

Gordian's financial results have fluctuated, as is to be expected for the size and nature of its business.

### 2.3.2 Gordian's Reinsurance Arrangements

Gordian typically does not purchase new reinsurance protection unless business portfolios are transferred into Gordian. Any reinsurance (or retrocession in the case of Gordian Re) is limited to that purchased by the originating insurer at the time the business was written, provided it has not since been commuted.

### 2.3.3 Gordian's Insurance Liabilities and Uncertainty

Table 2.2 summarises Gordian's insurance liabilities at 31 December 2017.

**Table 2.2 – Gordian Insurance Liabilities at 31 December 2017 ($ million)**

| | Direct Business | Reinsurance Business | Total |
|---|---|---|---|
| Gross Central Estimate | 36 | 23 | 59 |
| Reinsurance Recoveries | (4) | (0) | (5) |
| Other Recoveries | (0) | (1) | (1) |
| Net Central Estimate | 31 | 22 | 54 |
| Risk Margin | 7 | 3 | 10 |
| **Net Provision** | **38** | **25** | **64** |
| | | | |
| Risk Margin % | 23% | 14% | 19% |

Source: APRA Return

Gordian's insurance liabilities of $64 million at 31 December 2017 all relate to outstanding claims (i.e. there are no premium liabilities).

I have reviewed the movements in Gordian's estimated ultimate claims since December 2013; the adequacy of Gordian's past estimates has been good. Analysis of the adequacy of earlier estimates has not been undertaken, due to the addition of acquired portfolios creating discontinuities in the data.

### 2.3.4 Gordian's Capital Management

Gordian's capital management approach is set out in its Run-Off Plan. Taking into account APRA's capital requirements, Gordian's Board has determined a target level of capital of 2.2 times the Prescribed Capital Amount (PCA)[5].

### 2.3.5 Gordian's Financial Security

*Balance Sheet*

Table 2.3 summarises the reported assets and liabilities of Gordian at December 2017.

**Table 2.3 – Balance Sheets at December 2017 ($ million)**

| | |
|---|---|
| **Assets** | |
| Cash | 3.6 |
| Investments | 504.7 |
| Premium and Other Receivables | 4.5 |
| Reinsurance Assets | 5.0 |
| Deferred Assets | 2.8 |
| Current Tax Assets | 0.0 |
| Total Assets | 520.7 |
| **Liabilities** | |
| Creditors and Accruals | 0.4 |
| Claims Liabilities | 69.3 |
| Unearned Premium | - |
| Amounts Due to Reinsurers | 2.4 |
| Provisions | - |
| Total Liabilities | 72.1 |
| **Net Assets** | 448.6 |

Source: APRA Return

Gordian's balance sheet is relatively straightforward. Note that:

- The claims liabilities of $69 million less the reinsurance assets of $5 million gives the net insurance liabilities of $64 million shown in Table 2.2.
- The $505 million of investments includes almost $400 million relating to intercompany loans, which (as shown later) is not admissible for regulatory capital purposes.

*APRA Capital Adequacy*

Table 2.4 shows Gordian's APRA Prescribed Capital Amount (PCA) at 31 December 2017.

[5] The **Prescribed Capital Amount** (PCA) is the minimum capital requirement defined under APRA's risk based capital requirements. Insurers hold capital in excess of the PCA in order to withstand fluctuations in capital levels.

**Table 2.4 – APRA Prescribed Capital Amount at December 2017 ($ million)**

| | |
|---|---|
| Insurance Risk Charge | 9.3 |
| Insurance Concentration Risk Charge | - |
| Asset Risk Charge | 9.3 |
| Asset Concentration Risk Charge | 0.2 |
| Operational Risk Charge | 1.4 |
| Aggregation Benefit | (4.2) |
| **Prescribed Capital Amount (PCA)** | **16.0** |

Source: APRA Return

Table 2.5 summarises the calculation of the APRA Capital Base, starting with the net assets from Table 2.3. This is then compared to the PCA from Table 2.4 to determine the Capital Adequacy Multiple (CAM) as at 31 December 2017.

**Table 2.5 – APRA Capital Adequacy at December 2017 ($ million)**

| | |
|---|---|
| Net Assets | 448.6 |
| Adjustments: | |
| Insurance Liability Surplus | - |
| Intangibles and Other Adjustments | (400.0) |
| APRA Capital Base | 48.6 |
| Prescribed Capital Amount (PCA) | 16.0 |
| **Capital Adequacy Multiple (CAM)** | **3.03** |

Source: APRA Return

Table 2.5 shows $400 million of adjustments to the net assets; the bulk of this relates to intercompany loans which are not admissible for regulatory capital purposes[6].

The CAM of 3.03 is a very comfortable level of capital adequacy, based on our experience of authorised general insurers in the Australian market.

### *Update at 30 September 2018*

Most of the information in Section 2.3.5 was sourced from Gordian's Annual APRA Return at 31 December 2017. Table 2.6 shows how the CAM has moved in the nine months to 30 September 2018[7].

[6] Following the Enstar Group's acquisition of Gordian in 2008, around $400 million was repatriated in the form of non-interest bearing non-callable loans to its immediate and ultimate Australian parent.
[7] The information at September 2018 was provided by Gordian in early November 2018.

**Table 2.6 – APRA Capital Adequacy: December 2017 v September 2018 ($ million)**

| | Dec-17 | Sep-18 | Change |
|---|---|---|---|
| Insurance Risk Charge | 9.3 | 7.9 | (1.4) |
| Insurance Concentration Risk Charge | - | - | - |
| Asset Risk Charge | 9.3 | 13.8 | 4.5 |
| Asset Concentration Risk Charge | 0.2 | - | (0.2) |
| Operational Risk Charge | 1.4 | 1.2 | (0.2) |
| Aggregation Benefit | (4.2) | (4.5) | (0.3) |
| **Prescribed Capital Amount (PCA)** | **16.0** | **18.5** | **2.5** |
| **Capital Base** | **48.6** | **47.0** | **(1.6)** |
| **Capital Adequacy Multiple (CAM)** | **3.03** | **2.54** | **(0.49)** |

Source: APRA Returns

This shows that:

- Gordian's PCA increased by $2.5 million since December. This was predominantly caused by changes in Gordian's asset mix increasing the Asset Risk Charge.
- The Capital Base fell by $1.6 million to $47.0 million. The net assets were unchanged but there was an increase in the deferred tax asset which is excluded from the Capital Base.
- The CAM fell from 3.03 at December 2017 to 2.54 at September 2018. I note that the CAM of 2.54 is above the target level of 2.20 (see Section 2.3.4).

In late 2017, the Gordian Board approved a revised investment strategy which included extending the duration of investments to match long tail liabilities, among other changes. The change was implemented by the investment manager slowly over six months to buy and sell the fixed interest securities necessary. The revised strategy was fully implemented by 30 June 2018. The mandate for the investment manager is specific regarding the implications for capital adequacy and the investment manager reports accordingly. The asset mix change has no negative impact on the security of policyholders.

## 2.4 The Enstar Group

Gordian's ultimate parent is Enstar Group Limited, a multi-faceted insurance group offering capital release solutions and specialty underwriting capabilities through its network of group companies. At 31 December 2017, the Enstar Group reported:

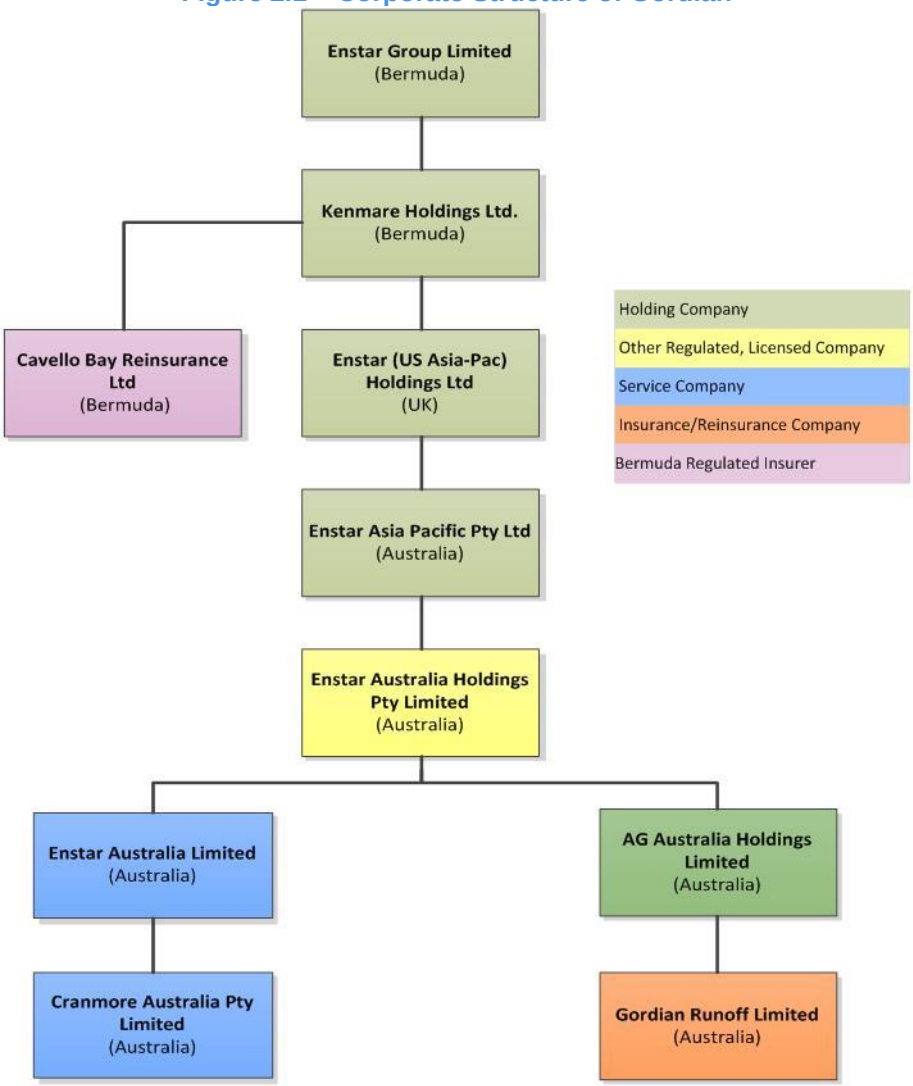
- Total assets of US$13.6 billion
- Total liabilities of US$10.0 billion
- Redeemable non-controlling interests of US$0.5 billion.

The resulting net assets of US$3.1 billion included a small amount of goodwill (US$0.2 billion).

Figure 2.1 presents the simplified corporate structure of the Enstar Group at 31 December 2017, showing the key companies involved in the transaction:

- Gordian
- Enstar Australia Limited (Enstar Australia)
- Cavello Bay Reinsurance Limited (Cavello Bay).

**Figure 2.1 – Corporate Structure of Gordian**




## *Cavello Bay*

Cavello Bay is domiciled in Bermuda and licensed as a Class 3B insurer by the Bermuda Monetary Authority. At 31 December 2017, Cavello Bay had total assets of US$3.5 billion, total liabilities of US$2.2 billion, giving net assets of US$1.4 billion[8].

## *Enstar Australia*

Gordian is managed locally by Enstar Australia Limited (Enstar Australia), a service company specialising in managing insurance and reinsurance companies in run-off.

[8] Totals may appear not to add due to rounding.

# 3 Proposed Scheme

## 3.1 The Business to Be Transferred

The transfer is of the NSW CTP insurance business of Zurich. Zurich decided in 2016 to cease writing CTP in NSW and the last policy expired on 31 March 2017[9][10]. The NSW CTP insurance business has therefore been in run-off since that time, and the remaining obligations of Zurich are those for claims against any of the relevant policies.

Zurich wrote CTP insurance in NSW from 1989 until the run-off.

## 3.2 Background to the Transaction

During 2017, Zurich took steps to divest itself of the run-off of its NSW CTP portfolio and reached agreement with the Enstar Group (of which Gordian is a member). Because the transfer of the policies is an extensive legal process requiring Court approval, there are three distinct steps in the process:

(i) Economic transfer of the business by way of a reinsurance agreement

(ii) Outsourcing of the claims handling function of Zurich to Enstar Australia

(iii) Legal transfer of the business by way of the scheme.

Step (i) was completed on 23 February 2018 and from that date, the financial risks and benefits of the NSW CTP insurance business have been with the Enstar Group (pursuant to the reinsurance provided by Cavello Bay).

There are two different approaches that could be taken to assess the interests of policyholders/claimants:

(a) Compare with their situation before the reinsurance agreement was put in place, i.e. as policyholders of Zurich with the NSW CTP insurance business in run-off

(b) Compare with their situation just prior to the scheme, where the obligations to them are subject to the reinsurance agreement and a series of other agreements between Enstar and Zurich.

As the actuary assessing the interests of policyholders/claimants, I regard approach (a) as being more relevant because the scheme is only the last step in the transfer process.

In considering approach (b), there is little to distinguish the interests of policyholders prior to and after the scheme. In each case, the insurer is APRA authorised, the principal security is the reinsurance provided by Cavello Bay along with the Australian trust fund, and the activities of the insurer (including claims management) are subject to the supervision of SIRA[11].

For this reason I have given limited attention in the report to the interim period (approach (b)), although in conducting my review I have considered all the material agreements in order to satisfy myself that I understand all the steps, and have had the opportunity to identify any potential issues affecting policyholder/claimant interests.

[9] Given the six month reporting requirement (other than for out-of-time exceptional matters), the claim period for Zurich's NSW CTP policies expired on 30 September 2017.
[10] As all the policies have expired, there is no unearned premium. Premiums are therefore not relevant to this report.
[11] The State Insurance Regulatory Authority, the regulator of CTP insurance in NSW.

## 3.3 Nature of the Scheme

Table 3.1 summarises the key stages involved in the transaction to transfer Zurich's NSW CTP insurance business to Gordian.

**Table 3.1 – Stages in the Transfer Transaction**

| | |
|---|---|
| **Stage 1** | Zurich's NSW CTP insurance business is 100% reinsured by Cavello Bay.<br>The reinsurance is fully collateralised via a Trust Fund held with NAB Trust Services Limited.<br>The reinsurance agreement was signed on 23 February 2018[12]. |
| **Stage 2** | Enstar Australia assumes responsibility for handling claims arising from Zurich's NSW CTP insurance business.<br>With SIRA's consent, Enstar Australia assumed claims handling responsibility on 15 June 2018[13]. |
| **Stage 3** | The legal transfer of the NSW CTP insurance business to Gordian, under Part III Division 3A of the Insurance Act 1973.<br>This is subject to SIRA granting a NSW CTP licence to Gordian.<br>The transfer is expected to occur by December 2018, pending approval by SIRA, the Treasurer[14], APRA and the Court. |

The proposed scheme (i.e. Stage 3 from Table 3.1) will implement the following actions on the effective date[15]:

- All rights, obligations, and insurance liabilities arising from NSW CTP insurance policies issued by Zurich will be transferred to Gordian.
- All rights, obligations and liabilities arising from the Transferring Contracts will be transferred to Gordian. The Transferring Contracts include:
  - The contract between Zurich and the State Transit Authority[16].
  - The reinsurance agreement between Zurich and Cavello Bay, and the associated Trust Deed used to establish the Trust Fund (i.e. the key components of Stage 1).
  - The CTP sharing agreements in NSW and with CTP insurers in the ACT and Queensland.

## 3.4 Timing

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

Based on current information, the effective date is likely to be before 31 December 2018. It will be important to review the circumstances closer to that time to identify any changes in financial or other matters between the date of this report and the confirmation date.

[12] SIRA consented to Zurich's signing of the reinsurance agreement, and APRA confirmed the capital treatment of the collateral.
[13] On 1 June 2018, SIRA consented to Zurich appointing Enstar Australia to provide claims handling services in respect of Zurich's NSW CTP insurance business pursuant to the terms of a Claims Handling Agreement between Zurich and Enstar Australia, and Enstar Australia commenced providing these services on 15 June 2018.
[14] The Treasurer applies a public interest test under the Insurance Acquisitions and Takeover Act 1991 (IATA). This approval is generally delegated to APRA.
[15] Referred to as the "Transfer Time" in the scheme document.
[16] Under this contract, dated 20 September 2011, the State Transit Authority may be entitled to a claims experience discount.

# 4 Impacts of Proposed Scheme

This section considers the impacts of the proposed scheme.

## 4.1 Policies

There will be no changes to the terms and conditions of the NSW CTP insurance policies issued by Zurich as a result of the scheme, apart from Gordian being substituted for Zurich as the insurer. The terms and conditions are specified by state legislation, and there are no separate policy documents.

## 4.2 Claims

Following the introduction of the reinsurance treaty with Cavello Bay (Stage 1 from Table 3.1), Zurich continued to manage the CTP insurance business, but the process of transferring knowledge to Enstar Australia began. Offers of employment were made to (and accepted by) existing Zurich NSW CTP claims staff, and Enstar Australia staff members spent time in Zurich's offices to understand the NSW CTP claims process.

With SIRA's consent, Enstar Australia assumed responsibility for handling claims arising from Zurich's NSW CTP insurance policies on 15 June 2018 (Stage 2). Enstar Australia and Zurich have worked closely to ensure that claimants are not adversely impacted by the changed claims handling arrangements. During Stage 2:

- The portfolio will initially be managed in accordance with Zurich's policies and guidelines, to the extent relevant.
- Some activities in the claim process (fraud, quality assurance, and claim payments) will be performed by both Zurich and Enstar Australia staff, with the remaining activities performed only by Enstar Australia staff.
- Claimants will still contact claims staff using Zurich contact details, and all claims staff will identify themselves as Zurich representatives.
- Legal and rehabilitation services will be provided by the same external suppliers that are both currently preferred suppliers to Zurich.
- Enstar Australia will continue to process claims through Zurich's IT systems.

I understand that SIRA reviewed the proposed arrangements in detail and consented to their implementation as part of Stage 2.

Following the scheme (Stage 3), all claims handling activities will be performed by Enstar Australia staff (which will include the former Zurich employees), and all processing will be moved onto Enstar Australia's IT systems.

I am satisfied that there is no reason to think that Enstar Australia's claims handling would present any threat to the interests of policyholders and claimants. This conclusion is based on the following:

- Enstar Australia has many years of experience in managing Gordian's claims, including long tail claims and in 2013 acquired a workers compensation portfolio in run-off for which it manages claims.

- CTP insurance business in NSW is tightly regulated through the Act, insurer guidelines and oversight by SIRA.
- Review of Enstar Australia's CTP claims manual, which is nearly identical to the Zurich manual.
- Review of Gordian's CTP business plan, correspondence with SIRA and an updated presentation on Stage 3 of the migration.
- Since 2008 there has been one complaint about claim handling, which was from an insured of Gordian unhappy that Gordian changed legal representatives part way through the claim.
- Gordian has not been sued for 'bad faith' handling of a claim or similar issues[17].

Having considered the transitional steps and the additional information, I am satisfied that there are no threats to the interests of policyholders or claimants arising from Enstar Australia's claim management following the scheme.

## 4.3 Financial Security

### 4.3.1 Before the Transaction

Prior to the transaction, the transferring policyholders were insured by Zurich. Zurich was a long-term insurer of NSW CTP, is a substantial insurer in the Australian market, and is part of a major listed international insurance group headquartered in Switzerland. I have reviewed relevant documents regarding Zurich prior to the transaction, mainly using reports and information as at 31 December 2017. At that date, Zurich reported a Prescribed Capital Amount of $325 million and a Capital Base of $685 million, giving a Capital Adequacy Multiple of 2.11.

I am satisfied that, prior to the transaction, policyholders enjoyed the protection of a substantial regulated company and any prospect of their interests not being satisfied was remote.

### 4.3.2 After the Scheme

After the scheme, policyholders will be insured by Gordian, a relatively small Australian insurer specialising in run-off business and owned by the Enstar Group (see Section 2.4[18]). The financial security of policyholders will be supported by a series of mechanisms, one primary mechanism and several back-ups.

The primary mechanism is the 100% reinsurance contract between Cavello Bay and Gordian (the same contract currently between Cavello Bay and Zurich[19], which will transfer to Gordian as part of the scheme). This is considered in more detail in Section 4.3.3. The critical part of this mechanism is that funds to pay claims are held in a trust fund in Australia so they are ring-fenced and protected for the NSW CTP insurance business. If the trust fund falls below 105% of the NSW CTP insurance liabilities, Cavello Bay must 'top up' the fund.

Should the trust fund be exhausted, or the funds not be available for any other reason, the back-up protections are:

(a) The other financial resources of Cavello Bay – net assets of US$1.4 billion (see Section 2.4)

[17] There have been no such cases for the past 10 years, and Gordian's CEO has confirmed to me that that she is not aware of any earlier cases.
[18] Enstar has net assets of US$3.1 billion at December 2017.
[19] Which provides 100% reinsurance protection for Zurich of its liabilities under the CTP insurance business.

(b) The other financial resources of Gordian (Gordian's APRA capital adequacy is considered in Section 4.3.4)

(c) The last-resort guarantee included in the Motor Accidents Compensation Act 1999, whereby unpaid claims of an insolvent insurer are assumed by the Nominal Defendant (this was called upon after HIH collapsed).

While item (c) gives ultimate security for claimants, I do not regard it as an integral part of my assessment, because it would not be appropriate to say that a government-mandated guarantee makes the financial security of the insurance arrangements less important.

### 4.3.3 Cavello Bay Reinsurance and the Trust Fund

Table 4.1 shows the value of the assets and liabilities associated with the trust fund in respect of Cavello Bay's reinsurance of the Zurich NSW CTP insurance business. The values at 23February 2018 are taken from Schedule 1 to the Reinsurance Agreement[20] and the estimates at 30 April 2018 were provided by Enstar Australia.

**Table 4.1 – Zurich NSW CTP Liabilities & Trust Fund ($ million)**

| | At 23 Feb 2018[1] | At 30 Apr 2018[2] |
|---|---|---|
| **Assets** | | |
| Trust Account | 361.0 | 350.1 |
| Withheld Account | 20.0 | 9.5 |
| Adjustments[3] | | (11.0) |
| Total Assets | 381.0 | 348.6 |
| **Liabilities** | | |
| Claims Liabilities | 362.9 | 329.5 |
| **Surplus** | **18.1** | **19.1** |

1 Taken from Schedule 1 of the Reinsurance Agreement.
2 Provided by Enstar Australia.
3 Payments for Jan18 and Feb18 not yet reimbursed to Zurich.

The claims liabilities for the NSW CTP insurance business are expected to run off reasonably quickly. In the first four months of 2018, liabilities reduced by a little over $30 million as claims were settled and payments made. Liabilities are expected to reduce to less than $50 million by December 2021 (see Appendix B).

### 4.3.4 Gordian's APRA Capital Adequacy

Table 4.2 shows the estimated post-scheme capital adequacy position of Gordian, with the pre-scheme position included for comparison (assuming the effective date was 31 December 2018). The position at December 2018 and the impact of the scheme were based on estimates provided by Enstar; I have reviewed those estimates.

[20] Table 4.1 shows claims liabilities at December 2017 of $362.9 million, based on a roll-forward from the APRA insurance liabilities at 31 December 2016. The liability of $360 million quoted in Section 2.2 is as reported in Zurich's annual APRA return at December 2017.

**Table 4.2 – Estimated Post-Transfer APRA Capital Adequacy of Gordian ($ million)**

| | At Sep18 (Actual) | At Dec18 (Projected) | | |
|---|---|---|---|---|
| | | Pre-Scheme | Post-Scheme | Impact |
| Insurance Risk Charge | 7.9 | 6.5 | 6.5 | - |
| Insurance Concentration Risk Charge | - | - | - | - |
| Asset Risk Charge | 13.8 | 13.5 | 27.5 | 14.0 |
| Asset Concentration Risk Charge | - | - | - | - |
| Operational Risk Charge | 1.2 | 1.0 | 1.0 | - |
| Aggregation Benefit | (4.5) | (3.9) | (4.5) | (0.6) |
| **Prescribed Capital Amount (PCA)** | **18.5** | **17.1** | **30.5** | **13.4** |
| **APRA Capital Base** | **47.0** | **52.5** | **52.5** | **-** |
| **Capital Adequacy Multiple (CAM)** | **2.54** | **3.07** | **1.72** | **(1.35)** |

As a result of the scheme:

- The Asset Risk Charge increases by $14.0 million, as Gordian will have additional reinsurance recoveries, equal to the value of the gross claims liabilities.
- There is no change to the other risk charges. The Insurance Risk Charge does not change, as there is no change in the *net* outstanding claims liabilities.

Based on current estimates, $14.5 million of additional capital will be needed at December 2018 to achieve the target CAM of 2.20[21]. From discussions with Enstar Australia, I understand that the capital required to meet the target CAM will be reassessed, and provided, prior to the final confirmation hearing of the scheme with the Federal Court. The result will be an increase in Gordian's capital from an estimated $53 million to $67 million.

I note that the post-scheme CAM of 2.20 (i.e. with the capital injection) is lower than the projected pre-scheme CAM of 3.07, because of the additional risk charges for the trust fund. This change does not pose a concern for the financial security of policyholders or claimants because that security comes principally from the trust fund, with Gordian's capital being just one of the back-up protections.

## 4.4 Capital Management Plan

No changes are expected to Gordian's capital management plan as a result of the scheme.

## 4.5 Reinsurance Arrangements

On the effective date, the 100% reinsurance provided by Cavello Bay of the NSW CTP insurance business will transfer from Zurich to Gordian[22]. No other changes are expected to Gordian's reinsurance arrangements.

As noted in Section 2.3.2, Gordian's existing reinsurance is limited to that purchased by the originating insurer at the time the business was written, provided it has not since been commuted.

[21] In accordance with Gordian's Capital Management Plan, see Section 2.3.4.
[22] It was a term of the reinsurance agreement and framework deed that the reinsurance would transfer by way of the scheme, and all parties have already agreed to this within these documents.

## 4.6 Other

In addition to considering the impact of the scheme on the Zurich NSW CTP insurance policyholders, I have also briefly considered the impact on other policyholders. I am not aware of any material adverse impacts on the interests of:

- Policyholders who will remain with Zurich following the scheme:
  - They remain insured by Zurich on the same terms as previously, and Zurich's security has not been reduced by transferring the NSW CTP insurance business to the Enstar Group.
- Existing policyholders of Gordian (i.e. before the scheme):
  - These policyholders should not be impacted by the scheme as the transferring liabilities are fully covered by the reinsurance with Cavello Bay and the trust fund. No claim payments will be made from Gordian funds except in the most extreme circumstances where both the trust fund and Cavello Bay have failed.
  - They will possibly be advantaged by the fact that Enstar Australia will be a larger organisation for at least the next few years thus retaining suitable staff and capability, along with a small increase in the capital in Gordian (see Section 4.3.4).

# 5 Conclusions

The main interest of policyholders (and claimants) is to have valid claims paid when due. I have also examined a range of other likely effects on policyholders of the proposed scheme. This section summarises my findings and opinions.

## 5.1 Nature of the Business to be Transferred

CTP insurance is a statutory class of insurance meaning that state legislation specifies the coverage, claim procedures and numerous obligations of the insurer. Meeting its legislative obligations will satisfy Gordian's obligations to claimants (and therefore policyholders).

## 5.2 Policy Terms and Conditions

There will be no changes to the terms and conditions of the NSW CTP insurance policies issued by Zurich as a result of the scheme. Policyholders (and claimants against the policies) do not face any changes in the entitlements and obligations relating to their insurance coverage, which are specified in legislation. All policies have now expired.

## 5.3 Claims Handling

The transition of claims handling responsibilities from Zurich to Enstar Australia is under way and has been carefully planned. It has considered, among other things, staffing requirements, privacy obligations and IT system requirements. I am satisfied that Enstar Australia's claims handling would not present any threat to the interests of policyholders and claimants. In addition to my own enquiries (described in Section 4.2), it is of comfort that SIRA has consented to the transition.

## 5.4 Financial Security

The primary source of financial security for NSW CTP insurance policyholders is the Cavello Bay reinsurance contract and the Australian trust fund. This agreement gives a sound level of security, and there are several back-ups should it fail for any reason (as discussed in Section 4.3.2).

The reinsurance and trust fund also ring-fence other Gordian policyholders from the potential for losses from the NSW CTP insurance business[23].

## 5.5 Conclusion

My opinion is that the interests of the affected policyholders – the NSW CTP insurance policyholders of Zurich transferring to Gordian – will not be adversely affected in a material way as a consequence of the Insurance Scheme.

## 5.6 Declaration as Expert Witness

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

[23] Except in the most extreme circumstances where both the reinsurance and the trust fund have failed (as mentioned in Section 4.6).

# 6 Reliances and Limitations

## 6.1 Reliances on Information

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

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

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

## 6.2 Uncertainty

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

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

## 6.3 Limitations on Use

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

- Gordian's legal advisers, HWL Ebsworth
- Zurich's legal advisers, King & Wood Mallesons
- APRA
- SIRA
- The Federal Court of Australia.

I understand that a copy of the full report will be made available to the public. Furthermore, policyholders and claimants may request a copy of the report be provided to them. No other use of, or reference to, this report may be made without the prior written consent of Finity, nor should the whole or part of the report be disclosed to any unauthorised person.

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

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

# Part II Appendices

## A Information Received

This appendix sets out the information received to prepare this report.

### Information for Enstar Group Companies

- APRA Returns at 31 December 2017 (annual) and 31 March 2018 (quarterly)
  - I also received capital calculations as at 30 September 2018[24]
- Risk Registers for Enstar (dated 1 May 2018) and Project Catapult (as at 8 May 2018)
- Reinsurance Arrangements Statement dated 27 February 2018
- Enstar's Corporate Structure
- Enstar Group's Annual Report 2017 (dated 26 April 2018)
- Cavello Bay's Consolidated Financial Statements at 31 December 2017
- Enstar Australia CTP Claim Manual, Version 1.0
- Gordian Business Plan for NSW CTP Licence, dated June 2018

In addition, as Appointed Actuary to Gordian, I had access to the Insurance Liability Valuation Report at 31 December 2017 (dated 23 March 2018) and the Run-Off Plan 2018-2020 (dated March 2018).

### Information for Zurich

- APRA Return at 31 December 2017 (annual)
- Financial Condition Report as at 31 December 2017, including the Insurance Liability Valuation Report, dated 20 March 2018

### Other Information

- Reinsurance Agreement between Zurich and Cavello Bay, dated 23 February 2018
- Cavello ZAIL Trust Deed (Cavello Bay, Zurich, NAB Trust Services Limited), dated 23 February 2018
- Specific Security Agreement (Cavello Bay, Zurich), dated 23 February 2018
- Framework Deed (Zurich, Gordian, Cavello Bay, Enstar Australia), dated 23 February 2018
- Enstar presentation "Catapult Migration Plan", dated April 2018
- Enstar presentation "Catapult Migration Plan – Stage 3", dated June 2018
- Enstar presentation to APRA "Project Catapult – Zurich Australian Insurance Limited's CTP Insurance portfolio in run-off", dated 28 September 2017
- Enstar presentation to SIRA "SIRA Approvals Framework – Project Catapult", dated 7 September 2017

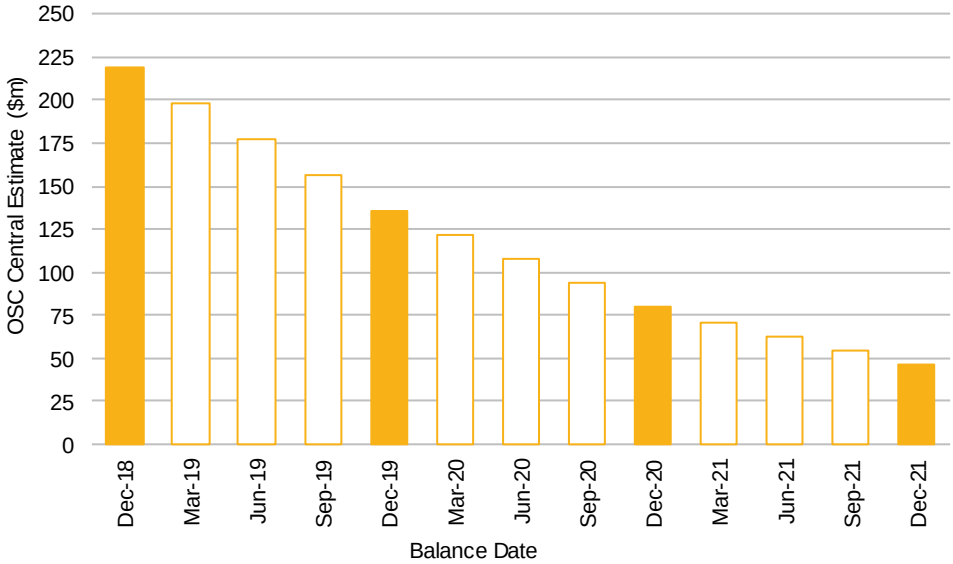
[24] This information was updated after the September 2018 quarterly return was submitted, following feedback from APRA.

I also liaised with, and received assistance from, representatives of Enstar Australia.

# B Forecast Liabilities

Gordian's NSW CTP Business Plan included a forecast of the outstanding claims central estimates required at future December balance dates in respect of the Zurich NSW CTP liabilities. The annual forecast is shown in Figure B.1. The estimates for the intervening quarters have been determined using interpolation.

**Figure B.1 – Zurich NSW CTP Forecast Liabilities (Gordian's Projection)**




I reviewed Gordian's forecasts and confirmed the reasonableness of the run-off forecast. I am not aware of any reason to expect a quarterly seasonal variation in the run-down of the liabilities or of the capital requirements.