25 January 2013

Mr Peter Rose
Chief Executive Officer
Southern Response Earthquake Services Ltd
6 Show Place
Christchurch 8149
NEW ZEALAND

Dear Peter

Earthquake Claim Liabilities as at 31 December 2012

We have been asked by Southern Response Earthquake Services Limited ("SRES") to make an assessment of its insurance liabilities as at 31 December 2012. SRES is the Crown-owned entity which emerged from a transaction whereby, with effect from 5 April 2012, the ongoing business of AMI Insurance Limited ("AMI") was separated from the existing AMI entity and sold to Insurance Australia Group.

The purpose of this letter is to provide an estimate of the earthquake claim liabilities for Southern Response Earthquake Services Limited ("SRES") as at 31 December 2012. This valuation is predominantly based on our 30 June 2012 valuation, with adjustments to valuation assumptions where emerging experience, or new information in respect of emerging issues, suggests changes are appropriate.

We understand that this advice will be used by SRES in preparing its accounts for the six months to 31 December 2012. This letter does not deal with the other non-earthquake retained events that were transferred from AMI Insurance Limited to SRES at the close of business on 5 April 2012.

Summary of Results

Table 1 shows the main components of cost underpinning our overall estimate of SRES' ultimate earthquake liabilities, with a comparison with the position estimated as at 30 September 2012.

[redacted]

Finity Consulting Pty Limited
ABN: 89 111 470 270
www.finity.com.au
www.finityconsulting.co.nz

Sydney
Level 7, 155 George Street
The Rocks NSW 2000
Ph: + 61 2 8252 3300
Fax: + 61 2 8252 3399

Melbourne
Level 3, 30 Collins Street
Melbourne VIC 3000
Ph: + 61 3 8080 0900
Fax: + 61 3 8080 0999

Auckland
Level 27, 188 Quay Street
Auckland 1010
Ph: + 64 9 363 2894
Fax: + 64 9 363 2895

Section 9(2)(b)(ii)

Table 1 – Estimated Ultimate EQ Liabilities at 31 December 2012

	31 Dec 12 $m	30 Sep 12 $m	Mov't $m	Primary Contributor to Movement
Ultimate Outflows				
Claims Cost (Excl Arrow)	2,933	2,919	14	Increase in OOS numbers, slowing of OOS payment pattern, small increase to minor events and other classes. A number of offsetting, and therefore net neutral, movements for Over Cap properties
Arrow's Costs	[redacted]	[redacted]	[redacted]	
SRES Claims Handling	128	125	3	Increase in SRES' forecast of CHE
	[redacted]	[redacted]	[redacted]	
Ultimate Inflows				
EQC Contributions	883	869	14	Formalisation of "at risk" EQC only claims allowance means we are now explicitly allowing for EQC contributions on these properties (at September only estimated net of EQC impact was shown)
Reinsurance Recoveries	1,254	1,256	-2	Minor re-allocation of costs from June 2011 event to February 2011
	2,137	2,125	12	
Gross Outflow (net EQC, ex CHE)	2,177	2,176	0	Difference due to rounding (underlying difference <$0.5 million)
Net Outflow (net of RI)	1,050	1,046	4	
Cum. paid (excl CHE)	576	485	91	Payments continue to be slower than projected, payment pattern has been slowed slightly Not material to net liability until R/I exhausted
Net Liability				
Central Estimate	944	949	-5	
Risk Margin	[redacted]	[redacted]	[redacted]	Risk margin maintained at 14.2%, release of margin on payments made in the quarter
Provision Required	[redacted]	[redacted]	[redacted]	

withheld pursuant to section (9)(2)(b)(ii)

These results show that our overall estimate of the ultimate liability, remarkably, remains unchanged from that advised in our valuation as at 30 September 2012. Note that, relative to September, our valuation allows for no change in Arrow's costs and a small increase in the estimated cost of SRES' claims handling expenses.

The overall result remains unchanged despite a number of changes to individual components in the valuation. Commentary is included below on the various changes we have made to the valuation basis.

Table 2 summarises our estimates of SRES' earthquake liabilities at 31 December 2012. The line below the table indicates our estimate of the total amount which will be ultimately paid once all claims are settled (including payments already made but excluding SRES CHE expenses, before discounting). This represents our central estimate of the ultimate liability which is recoverable under SRES's reinsurance treaties.

Our recommended provisions (which allow for discounting) incorporate an unchanged risk margin of [redacted]%, a level which we believe to be consistent with the requirements to establish provisions which incorporate at least a 75% probability of sufficiency.

withheld pursuant to section (9)(2)(b)(ii)

[redacted]

Table 2 – Recommended EQ Provisions at 31 December 2012

Provisions for Outstanding Claims as at 31 Dec 2012	Cat 93	Cat 106	Cat 112	Total		
	4-Sep-10 $m	22-Feb-11 $m	13-Jun-11 $m	Major $m	Minor $m	Overall $m
Gross Outstanding Claims						
In 31 Dec 2012 Values	322.1	1,025.5	44.1	1,391.7	26.8	1,418.5
Allowance for Future Inflation	43.0	127.9	8.2	179.1	3.4	182.5
Inflated Values	365.1	1,153.5	52.3	1,570.8	30.2	1,601.0
Discount to Present Value	-11.0	-38.7	-1.8	-51.5	-0.9	-52.4
OSC Discounted to 31 Dec 2012	**354.1**	**1,114.8**	**50.5**	1,519.3	29.3	1,548.6
Claims Handling	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Gross Central Estimate	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Catastrophe R/I Recoveries	-329.1	-299.6	-48.0	-676.7	-14.0	-690.7
Aggregate R/I Recoveries	0.0	0.0	0.0	0.0	0.0	0.0
Net Central Estimate	**44.6**	**876.9**	**5.3**	**926.7**	**16.9**	**943.6**
Risk Margin	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Recommended provision	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

withheld pursuant to section (9)(2)(b)(ii)

It is worth noting that the revisions to apportionment across events emerging through the endorsement and joint review processes continues to generate a small shift away from the September 2010 event to the February 2011 event and to other events.

We note that since finalising the results we have discovered an inconsistency in the way past EQC recoveries were being allocated against payments, for the purposes of determining future RI recovery cashflows. Correcting this inconsistency gives rise to an impact of around $3 million on the inflated gross central estimate. In the context of the overall valuation this not a material amount and therefore we have left the recommended provision unchanged, with a view to rectifying the issue at the 31 March 2013 valuation update.

Key Observations

The key observations on which we have formed our latest estimate include the following.

Volume of Over Cap Properties

We have firmed up our view on the ultimate volume of Over Cap properties likely to arise as a result of EQC ramping up its settlement processes. The net result of this analysis is reasonably consistent with the tentative view adopted at 30 September (for which a "macro" adjustment of about $26m was made in the September 2012 valuation). Table 3 summarises our latest estimates in regard to Over Cap claim volumes.

[redacted]

Table 3 – Over Cap Claim Volumes at 31 December 2012

	Dec-12	Sep-12	Diff.
Arrow Managed			
Rebuild	1,916	1,882	33
Repair	1,888	1,725	162
	3,803	3,608	196
Cash Settled	3,075	3,076	-1
Allowed for "surge"	included in above	200	
Total Over Cap	6,878	6,683	195

This shows that we have assessed that the majority of additional claims are likely to be repairs (consistent with properties with damage that is now being assessed by EQC as having gone over the EQC cap). At this point in time we have left the volume of cash settlements unchanged. Any additional volume of cash settlements which might arise from SRES' initiatives in this area (and the savings which might consequently emerge) represent a potential upside for the runoff experience.

Our assessment includes an allowance for 26 Hills properties which are subject to S.124 notices. The movement of these to Rebuild status added about $15m to our result.

Average Rebuild/Repair Cost

In the valuations we have conducted to date, we have based our average claim size assumptions on the full value implied by DRA's, including the contingency margins included in those estimates. This has been done on the basis that the margins contained in the DRA's allowed for the uncertainty surrounding foundations, additional building compliance costs etc. - which was over and above the uncertainty allowed for in our risk margin assessment.

On the basis that recent contracts awarded have continued to come in at a cost which is within the DRA estimate (inclusive of contingency margin), for this valuation we have continued this approach. Similar to the September valuation, we have also not made any explicit adjustment to DRA values for escalation in the December 2012 quarter, thus "releasing" the claims inflation assumed for that quarter. Our adopted average DRA claim size remains unchanged at $358k and is deemed to be in December 2012 values.

It should be noted, however, that the "gap" between the DRA estimate and the contracted value has narrowed noticeably – reflecting that costs are beginning to escalate (more details on this to be presented next week). We have retained future cost escalation at 8% per annum.

[redacted]

EQC Contributions

The emerging experience has not indicated the need for any changes to the assumed level of EQC contributions

Savings on Cash Settlements

As noted above, we have left our estimated volume of cash settlements unchanged. With further settlement activity having occurred we are now more confident about the average value of the savings likely to emerge on these cash settlements. Our latest analysis indicates a slightly higher level of savings, mostly for cash settlements for Hills properties. This produces total expected savings of $119m which compares to the $111m adopted at September.

In the valuation we have spread the remaining cash settlements over the next 18 months. In addition we have made a small allowance for potential cost escalation(2% per annum) to cover the risk of higher settlement amounts being required on those claims where the settlement basis is yet to be agreed.

Out of Scope Claims

Our estimate of the ultimate number of properties with Out of Scope damage has increased marginally from 20,691 to 20,936. Our estimated average claim size remains unchanged at around $13,000 per property. It should be noted that this follows comparing the profiles of those claims which have been assessed with those which are yet to be assessed.

Minor Events / Minor Classes

There have been minor changes to the estimated costs for minor events and for the minor classes. These added about $4.5m to the estimated ultimate cost.

Land Remediation

It should also be noted there remains additional uncertainty in regard to the division of responsibility (between EQC and the private insurer) for the costs involved in remediating land to a standard suitable for building on, particularly in TC3. The DRA estimates, on which our valuation is based, assume that the land has been remediated to a standard suitable to support the foundations as costed in the DRA's. If it came about that SRES needed to undertake some strengthening of the land prior to commencing construction, then there could be an increase in the ultimate cost of claims.

Uncertainty of our Estimates

It should be noted that considerable uncertainty still surrounds the projection and valuation of SRES' EQ liabilities. In this regard, some points to be noted include:

- while SRES has progressed most of the way through the damage assessment phase, only a relatively small proportion of the overall incurred cost has been settled. While we have allowed for a "surge" of Over Cap claims from the EQC we note that there is still uncertainty around the ultimate impact that this "surge" may have

- the base of reliable information and the understanding of how various aspects will ultimately play out is still developing

- the run-off is, of course, still exposed to the "normal" sources of variability in claims experience; in the case of Canterbury, the sheer scale of the construction programme across both residential and commercial sectors and the complexity introduced by the interplay with the cover provided by EQC act to magnify the potential variability of ultimate outcomes (as compared to 'normal' residential property claims).

In response to inherent uncertainties, we have maintained our risk margin at [redacted]% of the estimated liability (net of EQC contributions but gross of reinsurance recoveries). A number of aspects of the experience have begun to stabilise, hence reducing elements of the uncertainty. We would expect that by 30 June 2013, it would be appropriate for the risk margin to be revised (downwards). withheld pursuant to section 9(2)(b)(ii)

Reliances and Limitations

This letter has been prepared for the use of SRES for the stated purpose. We understand that a copy of the letter may be provided to the Board of SRES. No other use of, nor reference to, our letter other than as required by the Crown, should be made without prior written consent from Finity, nor should the whole or part of our letter be disclosed to any unauthorised person.

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

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

Yours sincerely

Withheld pursuant to section 9(2)(a)

[redacted]

[redacted]

Fellows of the New Zealand Society of Actuaries
Fellows of the Institute of Actuaries of Australia

Southern Response Earthquake Services

Valuation Results Earthquake Liabilities at 31 December 2012

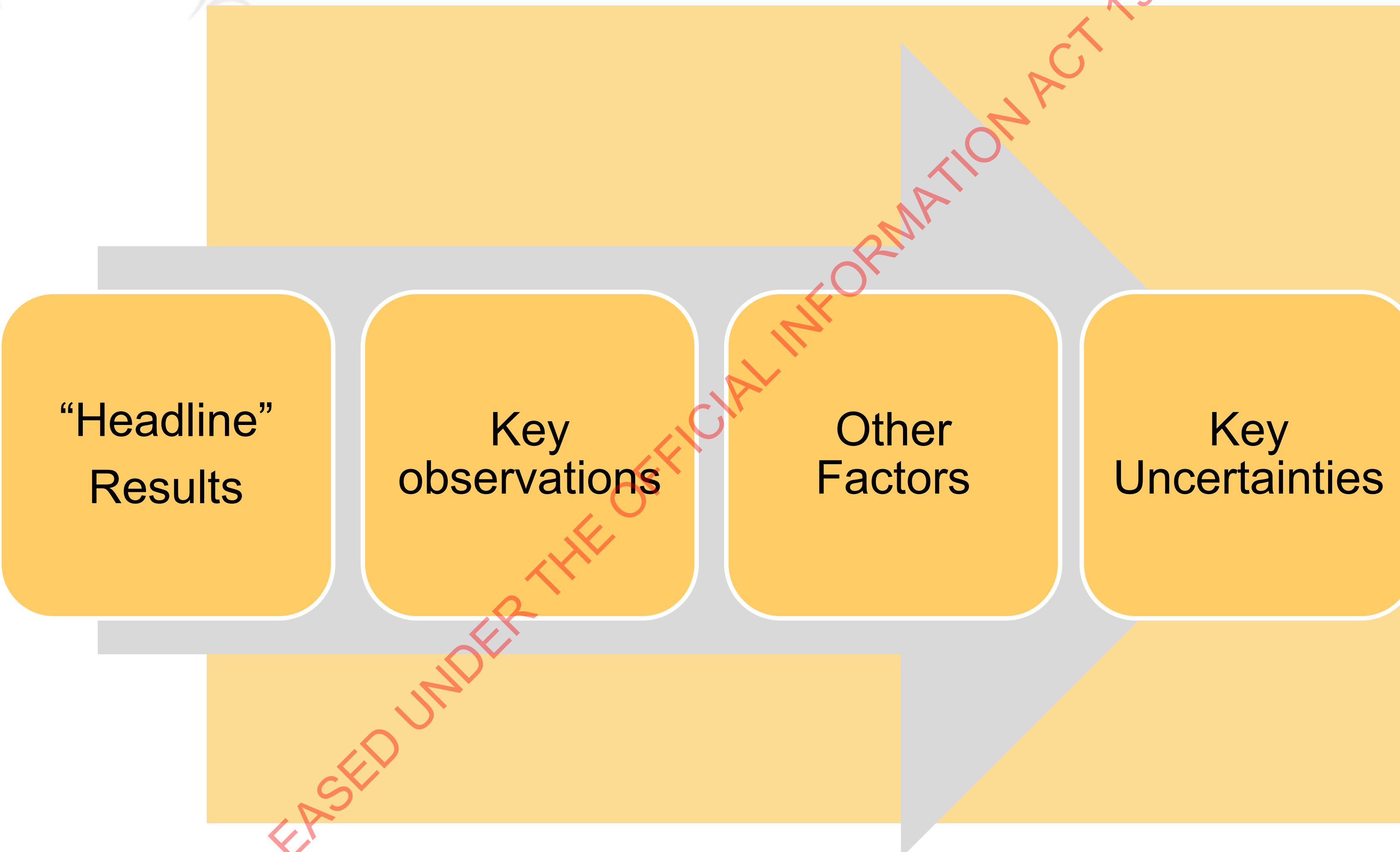
Presentation to Management

Withheld under Section 9(2)(a)

Presented by [redacted]

January 2013

Today's Presentation



The Headline Numbers

	31 Dec 12 $m	30 Sep 12 $m	Mov't $m	Primary Contributor to Movement
Ultimate Outflows				
Claims Cost (Excl Arrow)	2,933	2,919	14	Increase in OOS numbers, slowing of OOS payment pattern, small increase to minor events and other classes. A number of offsetting, and therefore net neutral, movements for Over Cap properties
Arrow's Costs	[redacted]	[redacted]	[redacted]	
SRES Claims Handling	128	125	3	Increase in SRES' forecast of CHE
	[redacted]	[redacted]	[redacted]	
Ultimate Inflows				
EQC Contributions	883	869	14	Formalisation of "at risk" EQC only claims allowance means we are now explicitly allowing for EQC contributions on these properties (at September only estimated net of EQC impact was shown)
Reinsurance Recoveries	1,254	1,256	-2	Minor re-allocation of costs from June 2011 event to February 2011
	2,137	2,125	12	
Gross Outflow (net EQC, ex CHE)	2,177	2,176	0	Difference due to rounding (underlying difference <$0.5 million)
Net Outflow (net of RI)	1,050	1,046	4	
Cum. paid (excl CHE)	576	485	91	Payments continue to be slower than projected, payment pattern has been slowed slightly Not material to net liability until R/I exhausted
Net Liability				
Central Estimate	944	949	-5	
Risk Margin	[redacted]	[redacted]	[redacted]	Risk margin maintained at 14.2%, release of margin on payments made in the quarter
Provision Required	[redacted]	[redacted]	[redacted]	

withheld pursuant to section (9)(2)(b)(ii)

Summary of Results

Provisions for Outstanding Claims as at 31 Dec 2012	Cat 93 4-Sep-10 $m	Cat 106 22-Feb-11 $m	Cat 112 13-Jun-11 $m	Total Major $m	Total Minor $m	Total Overall $m	Sep-12 Valn Overall $m	Overall Change
Gross Outstanding Claims								
In 31 Dec 2012 Values	322.1	1,025.5	44.1	1,391.7	26.8	1,418.5	1,492.9	-74.3
Allowance for Future Inflation	43.0	127.9	8.2	179.1	3.4	182.5	198.3	-15.8
Inflated Values	365.1	1,153.5	52.3	1,570.8	30.2	1,601.0	1,691.2	-90.2
Discount to Present Value	-11.0	-38.7	-1.8	-51.5	-0.9	-52.4	-52.6	0.2
OSC Discounted to 31 Dec 2012	**354.1**	**1,114.8**	**50.5**	1,519.3	29.3	1,548.6	1,638.6	-89.9
Claims Handling	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Gross Central Estimate	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Catastrophe R/I Recoveries	-329.1	-299.6	-48.0	-676.7	-14.0	-690.7	-778.8	88.1
Aggregate R/I Recoveries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Central Estimate	**44.6**	**876.9**	**5.3**	**926.7**	**16.9**	**943.6**	**949.0**	**-5.4**
Risk Margin	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Recommended provision	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Inflated Gross Central Estimate (Incl paid to date, excl CHE)	**627**	**1,452**	**62**	**2,141**	**36**	**2,177**	**2,176.5**	**0.6**
Change on 30 Sep 2012 Valuation	**-15**	**16**	**-1**	**-1**	**1**	**1**		

withheld pursuant to clause (9)(2)(b)(ii)

Building Claim Volumes

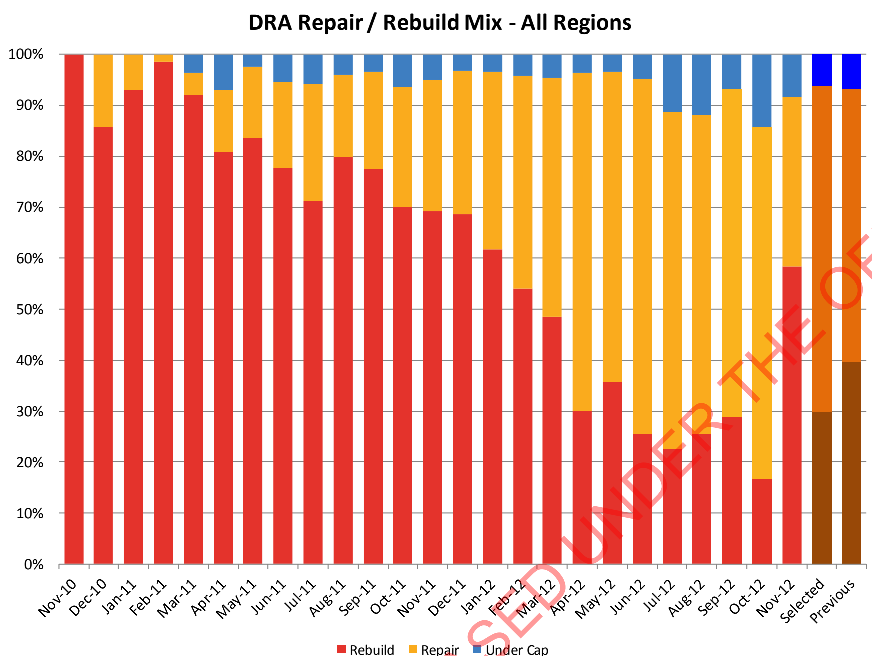
Properties with Buildings Claims	All Events Combined Valuation at 31 December 2012	Valuation at 30 September 2012	Movement Sep to Dec
Over Cap			
No Recorded in Data used for valuation	6,915	6,861	54
Future additions	293	125	168
Estimated Ultimate No to be assessed	7,208	6,986	222
No assessed as under cap	-330	-303	-27
Ultimate No with Over cap damage	6,878	6,683	195
Out of Scope Damage Only			
No in Database	20,383	19,968	415
Estimated further additions	553	723	-171
	20,936	20,691	244
Total No of Properties with Claims	27,813	27,375	439

Firmed up our view on the ultimate volume of Over Caps likely to arise from EQC ramp up of settlement process – reasonably consistent with the view adopted at 30 September

Over Cap Properties – Overall Trends in Repair/Rebuild Mix

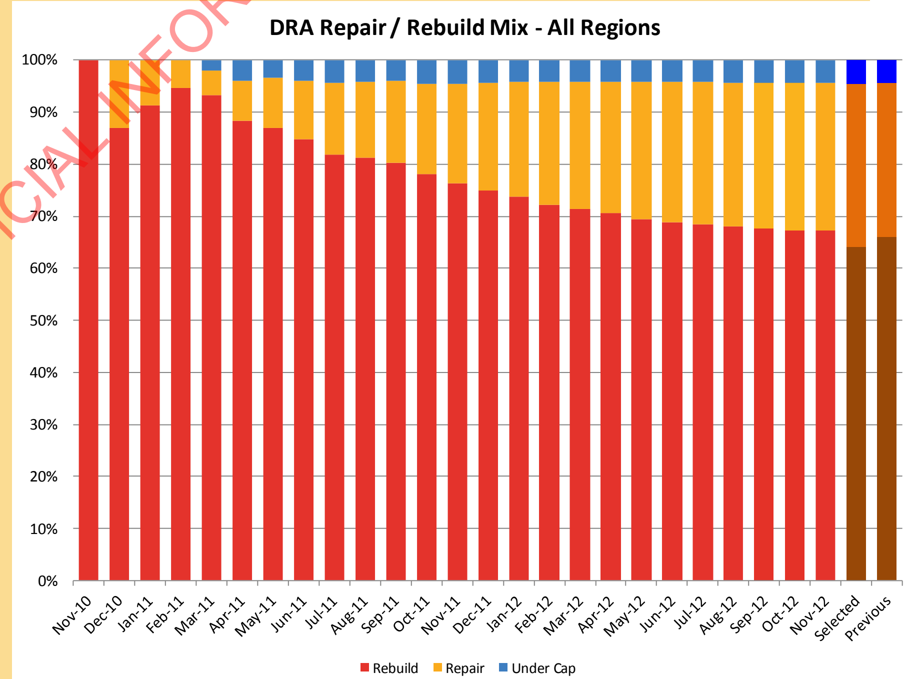
- Remaining DRAs relate predominantly to TC3 and Hills (and, to a lesser extent, TC2)
- Assumed higher mix of Repairs going forward, consistent with expectation in respect of "surge" claims from EQC settlement process. In line with this, future repair sizes also assumed to be lower

Incremental



Mix of DRAs completed in month

Cumulative



Mix of all DRAs completed up to month

Contract Outcomes – Rebuilds
Compared to Pre-RFP DRA Estimates

Rebuilds - Contract Outcomes Vs DRA Estimates ($ / Sq M)

[redacted]

Note: Costs only include those covered by building contract (i.e. excludes costs such as design and consent fees, Arrow costs)

Movement in contracted SqM for Rebuilds key signal for recent cost escalation Last 2 qtrs been [redacted] per quarter

withheld pursuant to sections (9)(2)(i)and 9(2)(j)

Across all areas, contract outcomes have moved much closer to DRA estimate (including contingency) as assessed just prior to RFP review of DRA

Other Elements

- Savings on Cash Settlements
  - Assumed levels slightly higher than adopted at 30 September 2012
- EQC Contributions
  - No change in average EQC contribution
- Out of Scope Claim Size
  - Latest assessments consistent with size adopted at September 2012
- Payment pattern
  - Slowed down to align with expected construction programme and completion of cash settlements
- Minor events and other classes
  - Small increase
- Discount Rate
  - Very very minor increase in discount rate

Risk and Uncertainty

Uncertainty across many aspects of the claims settlement process and outcomes has reduced. The “elephant in the room” is the future rate of cost escalation. Barring “surprises” in the next six months, we expect to revise downwards the current risk margin of [redacted]% at the 30 June 2013 valuation

withheld pursuant to section (9)(2)(b)(ii)

Events Covered
- Completion draws a line in the sand

Lodgement
- IBNR activity now modest
- Some uncertainty about impact of EQC settlement activity
- OOS dev’t still occurring

Actuarial Database
- Reasonably stable data structure now in place

Assessment
- Assessment data now very mature
- More reliable estimates for OOS claims

Customer Decision
- Sufficient patterns have developed to take confident views on savings

EQC contribution
- Access to reliable consistent data improving
- But still backlog in getting agreed outcomes into system

Settlement
- Volumes at building contract stage now allowing views of DRA assessments to be made
- Finalised OOS costs now emerging

Valuation
- Event allocation continues to drift
- Most payments remain in the future!
- Future claims escalation – remains the main area of uncertainty

Colour coding reflects our comfort level about each “step” and potential for adverse experience relative to valuation assumptions. Triangle colours reflect last time’s assessment

Distribution & Use

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