



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Case	07-C30732
Ins. Comm.	

DATE: May 14, 2007

TO: Roger A. Peterson, Director Financial Analysis and Examinations Bureau

FROM: Tim Vande Hey, Insurance Financial Examiner - Advanced

SUBJECT: TV In the Matter of the Acquisition of Control of General Casualty Company of Wisconsin, Blue Ridge Indemnity Company, Blue Ridge Insurance Company, MassWest Insurance Company, Inc., Regent Insurance Company, Southern Guaranty Insurance Company, Southern Pilot Insurance Company, and Southern Fire & Casualty Company (hereinafter Winterthur Wisconsin U.S. Holdings or Wisconsin Domestic) by QBE Insurance Group Limited and QBE Holdings, Inc. (hereinafter either the "QBE" or the "Applicants") (Case No. 07-C30732)

This memorandum is regarding the proposed Acquisition of Control of Winterthur Wisconsin U.S. Holdings by QBE.

BACKGROUND AND DELIBERATIONS

The QBE Insurance Group is an international general insurance and reinsurance group underwriting most major commercial and personal lines of business through operations in 44 countries. The QBE Insurance Group operates in all key insurance markets with more than 7,900 staff worldwide. Since 1973, QBE has been publicly traded on the Australian Stock Exchange.

The QBE Insurance Group's founding company, The North Queensland Insurance Company Limited, was established in Queensland, Australia in 1886. By 1890, it had established over 36 agencies throughout the Asia-Pacific Region and Europe providing general insurance services. In 1973, North Queensland merged with Bankers and Traders Insurance Company Limited and Equitable Life and General Securities Exchange on October 3, 1973. QBE Limited is domiciled in Australia, where its principal executive office and registered office is located at Level 2, 82 Pitt Street, Sydney, New South Wales 2000, Australia.

In 1986, the QBE Insurance Group commenced reinsurance operations with the acquisition of an Australian reinsurer, Sydney Reinsurance Company Limited (formerly Storebrand International Reinsurance), and expanded its reinsurance business in 1988 through the purchase of two European reinsurance companies.

In the past decade, the QBE Insurance Group has experienced substantial growth, largely through acquisitions, with gross written premium increases from approximately \$515 million for the year ended June 30, 1990 to approximately \$8.5 billion for the year ended December 31, 2006. Major acquisitions have included: Australian-based multiline underwriter Australian Eagle Insurance Company Limited, which was acquired in 1992, New York-based reinsurer American Royal Reinsurance Company, which has since been renamed QBE Reinsurance Corporation; London-based Allstate Reinsurance Company Limited, which was acquired in 1997. In

December 1999, QBE acquired Iron Trades, a United Kingdom direct insurer. In August 2000, QBE acquired Limit, which currently manages five active Lloyd's syndicates and makes QBE currently the second largest manager and third largest provider of capacity in the Lloyd's market. In June 2004, QBE purchased ING's 50% share in QBE Mercantile Mutual joint venture in Australia, including ING's Australian general insurance underwriting businesses. In 2005, QBE acquired National Farmers Union Property and Casualty Company, a Colorado domiciled insurer, and followed in the summer of 2006 with the acquisition of OneBeacon's agri-business division in Lenexa, Kansas. This was part of the implementation of a strategy to build a strong rural and Midwestern U.S. insurance presence. QBE was simultaneously pursuing a strategy of diversifying its business sources, by seeking to include independent agents in an existing framework of general and company agents. In December 2006, QBE announced the acquisition of Praetorian Financial Group, Inc. in the United States and this transaction is expected to close during the second quarter of 2007.

Today, QBE's presence in the Americas is comprised of four main streams of insurance and reinsurance business: (1) The U.S. specialty insurance program business which focuses on niche products and markets through managing agents; (2) QBE's general insurance business which comprises regional brands that focus on small to medium clients and distributes insurance products through independent and company agents; (3) the Latin American division comprised of general insurance operations in Argentina, Brazil and Colombia, and reinsurance business through its joint venture with QBE Del Istmo in Colombia, Mexico, Panama and Peru; and (4) QBE's reinsurance business, which supports predominately small to medium U.S. insurers with limited exposure to major catastrophes.

The acquisition of Winterthur U.S. Holdings (WUSH), including Winterthur Wisconsin U.S. Holdings, presented an opportunity to conclusively execute both strategies of building a stronger rural and Midwestern U.S. presence and the greater diversification of its business sources. WUSH writes business mainly through two well-known brand names, General Casualty and Unigard. The acquisition will add 1,700 independent agents in 33 states focusing on small to medium sized client business. QBE gains by obtaining new business distribution sources, greater geographic spread in less catastrophic exposed jurisdictions, and writing business with an attractive risk profile. Further, WUSH business provides QBE with excellent infrastructure, including IT, to grow the general insurance business through the independent agency system in the U.S. The acquisition will increase QBE's annualized general insurance gross written premium in the U.S. to close to \$2.2 billion.

DESCRIPTION OF THE TRANSACTION

January 24, 2007, QBE Reinsurance Corporation (QBE Re.) and QBE Insurance Group Limited (QBE Limited), filed a plan to acquire control (the Acquisition) of the Wisconsin Domestic by purchasing a 100% of the capital stock of WUSH, a Delaware corporation, which acts as the holding company for Winterthur's U.S. operations. WUSH is a wholly owned subsidiary of Winterthur Schweizerische Versicherungs-Gesellschaft (the Seller), a Swiss corporation. WUSH is the direct record and beneficial owner of all of the issued and outstanding capital stock of General Casualty Company of Wisconsin, which is the direct record and beneficial owner of all of the issued and outstanding capital stock of the remaining Wisconsin domestic insurers.

The total consideration for the Acquisition consists of a cash purchase price of approximately \$1.156 billion (the Purchase Price) and the repayment of approximately \$557 million in

intercompany loans, with the repayment of such intercompany loans to be financed by a capital contribution from QBE Holdings, Inc. to WUSH.

The purchase price will be funded from each source as follows: Excess Capital, approximately 30%; Dividend Reinvestment and Underwriting, approximately 10%; Short-term debt, approximately 7%; Long-term debt, approximately 40%; and capital raised through equity offerings, approximately 13%.

A "dividend reinvestment" involves shareholders electing to receive QBE stock in lieu of cash dividends. This retains cash in QBE Limited. In addition, where shareholders elect to receive cash dividends, QBE Limited can cash retain through "dividend underwriting". This replaces the cash paid to shareholders as dividends by securing an underwriting agreement from one or more investment bankers who agree to purchase QBE Limited shares for cash equal to the amount of proposed cash dividends.

QBE has also provided details of the short-term and long-term funding options available to the group that appears to provide adequate access if additional funding sources are required. The following reports the debt to equity ratio for the QBE group prior to and after the acquisition as projected by the QBE:

- As of December 31, 2006, net assets were \$5.026 billion and borrowings were \$1.891 billion, for a debt/equity ratio of 38%.
- As of December 31, 2007, net assets are projected as \$6.744 billion and borrowings are projected to be \$3.076 billion, for a debt/equity ratio of 46%.

There will be no changes to any assets or liabilities on the statutory statements related to the acquisition by QBE, and there will be no goodwill or acquisition expenses related to the acquisition that will be pushed down to any of the Wisconsin Domestic.

An amendment to the Form A, dated March 16, 2007, was filed as a result of QBE Reinsurance Corporation's transfer and assignment of its rights and obligations under the Stock Purchase Agreement to its immediate parent, QBE Holdings, Inc. QBE Reinsurance Corporation assigned its rights and obligations because of what would have been a restriction on its ability to pay dividends. Under U.S. statutory accounting principles, the goodwill would essentially have blocked QBE Reinsurance Corporation's ability to pay dividends out of the U.S, because on a statutory accounting basis QBE Reinsurance Corporation would have had negative unassigned funds and ordinary dividends may only be paid out of positive unassigned funds. As a result, QBE Reinsurance Corporation assigned its rights and obligations under the stock purchase agreement to QBE Holdings, Inc.

The nature and amount of the consideration were determined through negotiations on an arm's-length basis between unrelated parties.

FUTURE PLANS FOR WINTERTHUR WISCONSIN U.S. HOLDINGS

As discussed earlier, the acquisition of Winterthur Wisconsin U.S. Holdings complements the acquisitions of National Farmers in late 2005 and the OneBeacon agri-business in 2006. QBE gains by obtaining new business distribution sources, greater geographic spread in less catastrophic exposed jurisdictions, and writing business with an attractive risk profile. Further,

the Wisconsin Domestic business provides QBE with excellent infrastructure, including information technology, to grow the general insurance business through the independent agency system in the U.S. The acquisition will increase QBE's annualized general insurance gross written premium in the U.S. to close to \$2.2 billion.

QBE recognizes the key role played by Winterthur Wisconsin U.S. Holdings in the Wisconsin marketplace, which it views as a stable and attractive insurance jurisdiction, and in which QBE intends to remain as a significant writer. The general business plan for the Wisconsin Domestic business will not change following the transaction. Winterthur Wisconsin U.S. Holdings will continue to specialize in property and casualty insurance risks written through independent agents in states where the insurers are licensed, including Wisconsin.

QBE has no intentions of merging or redomesticating any insurers connected with this transaction, although it could be a possibility in the long term if it is in policyholder and stockholder interests.

QBE does not anticipate any name changes of any insurers connected with this transaction. "QBE" will replace the "Winterthur" name in certain companies in the holding company structure, and the Winterthur trademark and name will be disassociated from the insurers, being replaced with a QBE affiliation statement, such as "General Casualty Insurance Company of Wisconsin, a member of the QBE group".

QBE expects that by year-end, Winterthur Wisconsin U.S. Holdings will undergo integration into QBE's operations involving such actions as e-mail and data integration, establishment of reporting structures, integration of investment management with QBE's investment management division, roll out of QBE's OPENUPQBE program and code of conduct, and establishment of other corporate governance and enterprise risk management controls.

At present, QBE has not developed plans for the transfer of external operational and systems functions to Sun Prairie, although Sun Prairie's facilities leave that as an attractive future option. QBE confirmed that there are no plans to transfer functions from Sun Prairie. QBE also does not anticipate any employment impact in the State of Wisconsin as a result of the acquisition.

Scope of Wisconsin's Regulatory Concern

Section 611.72, Wis. Stat., requires the Office of the Commissioner of Insurance (OCI) to approve a plan for acquisition of control if it finds, after a hearing, that the plan would not violate the law or be contrary to the interests of the insureds of any domestic corporation or of the Wisconsin insureds of any participating nondomestic corporation.

OBSERVATIONS BASED ON REVIEW OF DOCUMENTS AND INQUIRIES

Format and Informational Sufficiency of the Form A

The Form A filing was prepared in a format that complies with s. Ins 40.02, Wis. Adm. Code. The information contained in the filing and in the supplementary information obtained by OCI in connection with review of this filing is sufficient for OCI to make a decision concerning the proposed plan.

Legality and Fairness of the Proposed Plan

My review of the Form A included a review of the following items:

1. Stock Purchase Agreement dated January 4, 2007
2. The Applicants' Organizational Chart of the Group and Regional Structure
3. Officers and Directors Biographical Information
4. Annual financial reports for the years ended December 31, 2001 through December 31, 2006 of key affiliated companies
5. Amendment No. 1 to the Form A regarding the Assignment and Assumption Agreement dated March 14, 2007
6. Financial projections and funding sources available to the group post-merger
7. Post-Acquisition Organizational Chart

Stock Purchase Agreement

Pursuant to the Stock Purchase Agreement dated January 4, 2007, among Winterthur Schweizerische Versicherungs-Gesellschaft, a Swiss stock corporation (Seller), QBE Reinsurance Corporation, a Pennsylvania stock corporation (Buyer) and QBE Insurance Group Limited, an Australian stock corporation (Buyer Parent), agreed to acquire control (the Acquisition) of the Wisconsin Domestic Insurers by purchasing a 100% of the capital stock of WUSH, a Delaware corporation, which acts as the holding company for Winterthur's U.S. operations. WUSH is a wholly owned subsidiary of Winterthur Schweizerische Versicherungs-Gesellschaft (the Seller), a Swiss corporation. WUSH is the direct record and beneficial owner of all of the issued and outstanding capital stock of General Casualty Company of Wisconsin, which is the direct record and beneficial owner of all of the issued and outstanding capital stock of the remaining Wisconsin domestic insurers.

The total consideration for the Acquisition consists of a cash purchase price of approximately \$1.156 billion (the Purchase Price) and the repayment of approximately \$557 million in intercompany loans, with the repayment of such intercompany loans to be financed by a capital contribution from QBE Holdings, Inc. to WUSH.

An amendment to the Form A, dated March 16, 2007, was filed as a result of QBE Reinsurance Corporation's transfer and assignment of its rights and obligations under the Stock Purchase Agreement to its immediate parent, QBE Holdings. QBE Reinsurance Corporation assigned its rights and obligations because of what would have been a restriction on its ability to pay dividends. Under U.S. statutory accounting principles, the goodwill would essentially have blocked QBE Reinsurance Corporation's ability to pay dividends out of the U.S., because ordinary dividends may only be paid out of positive unassigned funds. As a result, QBE Reinsurance Corporation assigned its rights and obligations under the stock purchase agreement to QBE Holdings.

This review of the Form A and the Share Purchase Agreement, with due consideration to supplementary information filed in response to examiner inquiries, discloses no basis for denial of the application on a point of law.

I can find no basis on which execution of the proposed transactions disclosed in the Form A should not be regarded as reasonable and fair to each participating insurer and to each participating insurer's policyholders, within the scope of Wisconsin's regulatory concern. This conclusion cannot and does not apply to agreements that have not been provided for OCI's review.

Satisfaction of Licensing Requirements Maintained

Execution of the acquisition disclosed in the Form A according to the plan would have no effect on the ability of Winterthur Wisconsin U.S. Holdings or any other participating insurer to maintain their existing licenses to write the lines of insurance for which they are presently licensed.

Effect on Competition within the Wisconsin Insurance Marketplace

QBE Reinsurance Corporation, QBE Insurance Corporation, National Farmers and United Security Insurance Company are each licensed as foreign insurers in the State of Wisconsin. QBE Reinsurance Corporation did not write any direct premiums in 2006 in Wisconsin. United Security Insurance Company wrote \$13,713 in direct premiums, QBE Insurance Corporation wrote \$4,095,696 in direct premiums and National Farmers wrote \$1,193,509 in direct premiums in Wisconsin in 2006. QBE Specialty Insurance Company is an eligible surplus lines insurer in Wisconsin and did not write direct premiums in Wisconsin in 2006. Major classes of business in the State of Wisconsin in 2006 were condominium associations, regional telecommunication companies, and stop loss coverage on employer health insurance programs. Given this limited presence in the state, it is evident that the effect of this transaction will not be to create a monopoly or substantially lessen competition in any type or line of business in Wisconsin.

Future Plans after the Change in Control

The Applicants have no present plan or proposals for any of the Domestic Insurers to declare an extraordinary dividend, to liquidate any of the Domestic insurers, to sell their assets or merge any of them with any person or persons or to make any other changes in the business operations or corporate structure of any of the Domestic Insurers.

Following the acquisition, management of the Domestic Insurers will consist of certain current officers and directors of the Domestic Insurers together with certain current officers and directors from QBE Reinsurance Corporation and its affiliated U.S. insurance subsidiaries.

Financial Soundness of Prospective Affiliates

As of December 31, 2006, the QBE Insurance Group Annual Report indicated consolidated assets of \$25.080 billion, liabilities of \$20.066 billion, total equity of \$5.014 billion and \$9.199 billion of gross revenues.

As of December 31, 2006, the financial benchmark data for the core U.S. operating insurance subsidiaries for QBE are as follows:

QBE The Americas	A.M. Best Rating	RBC Ratio
QBE Reinsurance Corporation	A	487.8%
QBE Insurance Company	A	510.9%
QBE Specialty Insurance Company	A	2,493.9%
National Farmers Union Property and Casualty Company	A-	582.9%
United Security Insurance Company	A-	7,220.6%

Although the A.M. Best ratings and risk-based capital ratios are listed side-by-side, the function of each is quite different. The A.M. Best ratings are that nationally recognized statistical rating organization's independent opinion, based on a comprehensive quantitative and qualitative evaluation, of the companies' balance sheet strength, operating performance and business profile. The risk-based capital ratios indicate whether certain thresholds that are commonly accepted among the states for regulatory intervention or inquiry have been reached. For example, a risk-based capital ratio of 200% or below will generally prompt the insurance department of a company's state of domicile to request a business plan outlining how the company intends to improve its financial position. The fact that one company's risk-based capital ratio is higher than another's is not an indication of relative financial strength. The foregoing financial ratings and risk-based capital ratios reflect favorably on the Group.

The financial condition of QBE, individually, and the holding company system taken as a whole, is unlikely to jeopardize the financial stability of Winterthur Wisconsin U.S. Holdings or to prejudice the interests of their respective Wisconsin policyholders.

Competence and Integrity of Prospective Management

QBE provided copies of biographical reports for their officers and directors. Review of the composition of the board and management of QBE discloses no basis for disapproval of the Form A.

Summary of Observations

1. The Form A filing was prepared in a format that complies with s. Ins 40.02, Wis. Adm. Code. The information contained in the Form A filing and its supplements are sufficient to the transaction.
2. The plan would not violate the law or be contrary to the interests of any member of Winterthur Wisconsin U.S. Holdings or its policyholders.
3. After the acquisition of control, no member of Winterthur Wisconsin U.S. Holdings will experience a change that would cause them to become unable to satisfy the licensure requirements for any member to write the lines of insurance business for which they are presently licensed.

4. It is evident that this transaction will not create a monopoly or substantially lessen competition in any type or line of insurance in Wisconsin.
5. The financial condition of the QBE Group is unlikely to jeopardize the financial stability of any member of Winterthur Wisconsin U.S. Holdings, or to prejudice the interests of their respective Wisconsin policyholders.
6. The plan results in a change in control for Winterthur Wisconsin U.S. Holdings. The Applicants have no present plan or proposals for any of the Domestic Insurers to declare an extraordinary dividend, to liquidate any of the Domestic insurers, to sell their assets (other than in the ordinary course of business or merge any of them with any person or persons or to make any other changes in the business operations or corporate structure of any of the Domestic Insurers. Following the acquisition, management of the Domestic Insurers will consist of certain current officers and directors of the Domestic Insurers together with certain current officers and directors from QBE Reinsurance Corporation and its affiliated U.S. insurance subsidiaries.
7. The competence and integrity of the persons who would control the operation of the Domestic Insurers are such that it is in the interest of their respective policyholders and of the public to permit the proposed plan.

RECOMMENDATION

It is recommended that the plan for the acquisition of control of General Casualty Company of Wisconsin, Blue Ridge Indemnity Company, Blue Ridge Insurance Company, MassWest Insurance Company, Inc., Regent Insurance Company, Southern Guaranty Insurance Company, Southern Pilot Insurance Company, and Southern Fire & Casualty Company by QBE be approved.