American Income Life Insurance Company - New Zealand Branch

Financial Statements as of and for the Year Ended December 31, 2017, and Independent Auditor's Report

TABLE OF CONTENTS

Independent Auditor's Report

To the Shareholders of American Income Life Insurance Company – New Zealand Branch

Opinion

We have audited the financial statements of American Income Life Insurance Company – New Zealand Branch (the 'Branch'), which comprise the balance sheet as at 31 December 2017, and the statement of comprehensive income, statement of movements in the home office account and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements, on pages 6 to 27, present fairly, in all material respects, the financial position of the Branch as at 31 December 2017, and its financial performance and cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS').

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing ('ISAs') and International Standards on Auditing (New Zealand) ('ISAs (NZ)'). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

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

We are independent of the Company in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Other than in our capacity as auditor and provider of other assurance services, we have no relationship with or interests in the Branch, except that partners and employees of our firm may deal with the Branch on normal terms within the ordinary course of trading activities of the business of the Branch.

Emphasis of matter - branch

The New Zealand branch is part of American Income Life Insurance Company Limited. As described in Note 16, the assets of the branch, other than those held in custodial fund are legally available for the satisfaction of debts of the entire company, not solely those appearing on the accompanying balance sheet and its debts may result in claims against assets not appearing thereon. Our opinion is not modified in respect of this matter.

Other information

The directors are responsible on behalf of the Branch for the other information. The other information comprises the information in the Annual Report that accompanies the financial statements and the audit report. The Annual Report is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

Our responsibility is to read the other information when it becomes available and consider whether it is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

When we read the other information in the Annual Report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to the directors and consider further appropriate actions.

Directors' responsibilities for the financial statements

The directors are responsible on behalf of the Branch for the preparation and fair presentation of the financial statements in accordance with NZ IFRS and IFRS Standards, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible on behalf of the Branch for assessing the Branch's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Branch or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs and

ISAs (NZ) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the External Reporting Board's website at:

https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-6

This description forms part of our auditor's report.

Restriction on use

This report is made solely to the Branch's shareholders, as a body. Our audit has been undertaken so that we might state to the Company's shareholders those matters 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 Company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

Deloitte Limited

Mike Hoshek, Partner
for Deloitte Limited
Auckland, New Zealand
27 April 2018

AMERICAN INCOME LIFE INSURANCE COMPANY
NEW ZEALAND BRANCH

Financial Statements
As of and for the year ended December 31, 2017

APPROVAL BY DIRECTORS

The directors are pleased to present the financial statements of American Income Life Insurance Company - New Zealand Branch as of and for the year ended December 31, 2017.

The shareholders of the Company have exercised their rights under Section 211(3) of the Companies Act 1993 and unanimously agred that the annual report need not company with any of the Sections (a) and (e) to (j) of Section 211(1) and of Section 211(2) of the Act.

Director

M. Shane Henrie

Director

Joel P. Scarborough

For and on behalf of the Directors

Date: April 27, 2018

STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES
For the Year Ended December 31, 2017

1. GENERAL ACCOUNTING POLICIES

General Information - The reporting entity is American Income Life Insurance Company - New Zealand Branch (the "Branch"). American Income Life Insurance Company (the "Company") is registered under the Companies Act 1993.

Effective 31 July 2013, the Company established a statutory fund in accordance with the Insurance (Prudential Supervision) Act 2010 ("IPSA-2010"). Note 16 to the financial statements provides further information in relation to the Statutory Fund. The Company was granted a full license by the Reserve Bank of New Zealand under IPSA-2010 on 23 August 2013. The life insurance operations of the Branch are conducted as required by the IPSA - 2010 and are reported in aggregate in the statement of comprehensive income, balance sheet, statement of cash flows and statement of movements in the home office account of the Branch. The life insurance operations of the Branch comprise the selling and administration of life insurance contracts. All contracts are non-investment linked business. All business written by the Branch is non-participating and all profits and losses are allocated to the statutory fund.

Life insurance contracts involve the acceptance of significant insurance risk. Insurance contracts include those where the insured benefit is payable on the occurrence of a specified event such as death, injury or disability caused by accident or illness.

The principal place of business is American Income Life Insurance Company, 1200 Wooded Acres, Waco, Texas, United States of America. The contact address for the Branch is c/o AIL New Zealand Limited (an independently owned company and independent contractor), AIL House, 2165 Great North Road, Avondale, Auckland, New Zealand.

Basis of Preparation - The financial statements presented are those solely for the Branch and are prepared on the basis of historical costs except for certain assets and liabilities as noted. The financial statements comprise statements of the following: significant accounting policies, statement of comprehensive income, statement of movements in the home office account, balance sheet, statement of cash flows, as well as notes to these statements contained on pages 6 to 27.

Statement of Compliance - The Branch is a profit-oriented entity and has applied all applicable standards for profit-oriented entities.

The Branch is an FMC reporting entity under the Financial Markets Conduct Act 2013. These financial statements have been prepared in accordance with the requirements of the Financial Markets Conduct Act 2013.

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP). They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards as appropriate for profit-oriented entities. The financial statements comply with International Financial Reporting Standards.

Presentation and Functional Currency of the Branch - These financial statements have been prepared in New Zealand dollars, which is the functional currency of the branch.

Overview of Insurance Risk - The financial assets and liabilities are subject to market and insurance risk and other changes of experience assumptions that may have a material effect on NZ IFRS basis profit or loss and equity. Market risk is the risk that the fair value or future cash flows of a financial instrument, or liability of insurance contracts will vary because of changes in market prices. Market risk involves three types of risk:

Currency Risk - is the risk of loss resulting from changes in exchange rate when applied to assets and liabilities or future transactions denominated in a currency that is not the Branch's functional currency. The Branch sets limits for the management of currency risk arising from the Branch's investments based on prudent international asset management practice.

Interest Rate Risk - is the risk that the value or future value of cash flows of a financial instrument will fluctuate because of changes in interest rates. The Branch manages interest rate risk arising from its interest bearing investments in accordance with Branch policies.

Other Price Risk - is the risk of loss resulting from the decline in prices of equity securities or other assets. The price risk is managed by diversification of the investment portfolio.

Policyholder liabilities and reserves are subject to the effects of changes in experience, or expected future experience, such as for mortality and rates of discontinuance.

Standards and Interpretations Not Yet Effective - NZ IFRS 9 "Financial Instruments" is effective for balance dates beginning on or after 1 January 2018. The standard replaces NZ IAS 39. NZ IFRS 9 requires the financial assets to be classified into two measurement categories, being those measured at fair value and those measured at amortised cost. The determination is made when the instruments are initially recognised. The method of classification is dependent on the entity's business model and how it manages its financial instruments. For financial liabilities, the standard maintains most of the requirements set out in NZ IAS 39. NZ IFRS 9 introduces a new expected credit loss model for calculating the impairment of financial assets. NZ IFRS 16 "Leases" is effective for balance dates beginning after 1 January 2019. The standard replaces NZ IAS 17. NZ IFRS 16 eliminates the distinction between operating and finance leases for lessees and will result in lessess bringing most leases onto their balance sheets. NZ IFRS 17 "Insurance Contracts" is effective for balance dates beginning 1 January 2021. The standard replaces NZ IFRS 4. NZ IFRS 17 requires entities to identify portfolios of insurance contracts which are subject to similar risk and managed together. Each portfolio, at minimum shall be divided into three groups, a group of contracts that are onerous at initial recognition, a group of contracts that at initial recognition have no significant possibility of becoming onerous, and a group of the remaining contracts in the portfolio. The standard measures insurance contracts either under the gernal model or a simplified version of this called the Premium Allocation Approach. An entity shall apply the standard retrospectively unless impracticable, in which case entities have the option of using either the modified retrospective approach or the fair value approach. Management has yet to perform an analysis to assess the impact of these new standards on the financial statements.

Adoption of New and Revised Standards and Interpretations - The Branch has adopted all Standards, Interpretations and Amendments which have become effective in the current year which have not led to any changes in the Branch's accounting policies with measurement or recognition impact on the periods presented in these financial statements.

2. PARTICULAR ACCOUNTING POLICIES

a) **Recognition of Premium Income and Policy Expenses** - Premiums on life insurance policies are reported as revenues when due. Premiums on accident and health policies are reported as revenue when earned. Unearned premiums on accident and health policies are calculated on a pro rata basis.

Policy acquisition costs are the fixed and variable costs of acquiring new business, including commission. Policy maintenance costs include all operating and management costs other than acquisition and investment management costs.

All expenses that are not directly attributable to the acquisition of life insurance contracts are classified as maintenance expenses.

b) **Investments** - The government and other debt securities are stated at fair values, which were obtained from third party pricing services, with any resultant gain or loss recognised in profit or loss.

c) **Taxation** - Income tax expense represents the sum of the tax currently payable and deferred tax.

Current Tax - The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in profit or loss because it excludes items of income or expenses that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Branch's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred Tax - Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized.

d) **Financial Instruments** - Assets and liabilities of the Branch are primarily financial instruments and are recognised in the Balance Sheets.

The Branch has determined that cash and bonds in the custodial account are the assets held in relation to insurance contracts for backing insurance contract liabilities. The branch has provided additional protection for its New Zealand policy holders by ring-fencing a significant proportion of its financial assets in a trust structure, sufficient to cover it's solvency liabilities in New Zealand.

The accounting policies applying to financial assets held to back life insurance activities are:

Financial assets are stated at fair value, with any resulting gain or loss recognised in profit or loss. All purchases or sales of financial assets classified as fair value through profit or loss that require delivery within the timeframe established by regulation or market convention ("regular way" purchase and sales) are recognised at trade date, which is the date the Company commits to purchase or sell the assets.

Loan and deposits are recognised at settlement date, which is the date that the assets are delivered or received.

Short term deposits and cash and cash equivalents are classified as loans and receivables and are recorded at amortized cost using the effective interest method, with revenue recognised on an effective yield basis. The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is that rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period to the net carrying amount of the financial asset.

Accrued investment income and receivables from affiliates are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate. Receivables from affiliates primarily represent claw back commission, advances to agents and interest accrued on these amounts. Where considered necessary the asset has been written down to its estimated recoverable amount.

e) **Trade and Other Liabilities** - Trade payables and other liabilities are recognised when the entity becomes obliged to make future payments resulting from the purchase of goods and services and are measured at amortized cost.

f) **Statement of Cash Flows** - The statement of cash flows has been prepared using the direct approach modified by the netting of certain items disclosed below.

Operating activities are the principal revenue producing activities of the Branch and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long‑term assets and other investments not included in cash and cash equivalents.

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the Branch.

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day‑to‑day cash management.

g) **Impairment of Financial Assets** - Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognised.

h) **Policy Liabilities** - Policy liabilities consist of life insurance contract liabilities.

i) *Life Insurance Contract Liabilities* - The value of life insurance contract liabilities is calculated using the Margin on Services (MoS) methodology in accordance with New Zealand Society of Actuaries Professional Standard 20, *Determination of Life Insurance Policy Liabilities* (PS20). Under this methodology, planned profit margins and an estimate of future liabilities are calculated separately for each related product group using best estimate assumptions at each reporting date, and acquisition costs are deferred over the life of the contract. Profit margins are released over each reporting period in line with the services that have been provided. The balance of the planned profits is deferred by including them in the value of policy liabilities. Further details of the actuarial assumptions used in these calculations are set out in Note 15.

MoS profit can be analysed into the following categories:

(i) *Planned Margins of Revenues over Expenses* - At the time of writing a policy and at each balance date, best estimate assumptions are used to determine all expected future payments and premiums. Where actual experience replicates best estimate assumptions, the expected profit margin will be released to profit over the life of the policy.

(ii) *The Difference Between Actual and Assumed Experience* - Experience profits/(losses) are realized where actual experience differs from best estimate assumptions. Instances giving rise to experience profits/(losses) include variations in claims, expenses, mortality, discontinuance and investment returns. For example, an experienced profit will emerge when the expenses of maintaining all in-forcebusiness in a year are lower than the best estimate assumption in respect of those expenses.

(iii) *Changes to Underlying Assumptions* - The financial statement effect of all changes to underlying assumptions (other than the discount rate) used for measuring policy liabilities are reviewed each year. Where the review leads to a change in assumptions, the change is deemed to have occurred from the

end of the year, except for changes in discount rates which are recognised in the year that the rates are changed.
The financial effect of all other changes to the assumptions underlying the measurement of policy liabilities made during the reporting period is recognised in profit or loss over the future reporting periods during which services are provided to policyholders.

(iv) *Loss Recognition on Groups of Related Products* - If based on best estimate assumptions, written business for a group of related products is expected to be unprofitable, the total expected loss for that related product group is recognised in profit or loss immediately. When loss-making business becomes profitable, it is necessary to reverse previously recognised losses.
(v) *Investment Earnings on Assets in Excess of Policy Liabilities* - Profits are generated from investment assets, which are in excess of those required to meet policy liabilities. Investment earnings are directly influenced by market conditions and as such this component of MoS profit will vary from year to year.

3. SIGNIFICANT JUDGMENTS, ESTIMATES, AND ASSUMPTIONS

In the application of NZ IFRS management is required to make judgments, estimates and assumptions about the carrying values of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis of making the judgments. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Significant judgments, estimates and assumptions made by management in the preparation of these financial statements are outlined below:

a) **Estimation of Insurance Contract Liabilities** - Insurance contract liabilities for life insurance contracts are computed using statistical or mathematical methods. The computations are made by suitably qualified personnel on the basis of recognised actuarial methods, with due regard to relevant actuarial principles. The methodology takes into account the risks and uncertainties of the particular classes of life insurance business written. Deferred policy acquisition costs are connected with the measurement basis of life insurance liabilities and are equally sensitive to the factors that are considered in the liability measurement.

The key factors that affect the estimation of these liabilities and related assets are:

- Mortality and morbidity experience on life insurance products, including enhancements to policyholder benefits;

- Discontinuance experience, which affects the Branch's ability to recover the cost of acquiring new business over the lives of the contracts;

- The cost of providing benefits and administering these insurance contracts;

- The discount rate applied to calculate the present value of future benefits;

In addition, factors such as regulation, inflation, interest rates, taxes, investment market conditions and general economic conditions affect the level of these liabilities. Refer to Note 15 for disclosure of assumptions.

Policy and Contract Claims - Policy and contract claims include provisions for reported claims and claims incurred but not reported. The provision for claims incurred but not reported is estimated based on the Branch's experience.

Since this liability is based on estimates, the ultimate settlement of losses may vary from the amounts included in the financial statements. Although it is not possible to measure the degree of variability inherent in such estimates, the Branch believes the liability for claims is reasonable.

STATEMENT OF COMPREHENSIVE INCOME
For the Year Ended December 31, 2017

	2017	2016
INCOME:		
Premiums (Note 1)	$ 22,572,609	$ 24,267,133
Interest income on investments (Note 2)	1,607,964	1,223,371
Unrealized surplus (deficit) on revaluation of debt security investments to fair value	1,307,542	(105,070)
Other interest	757,112	786,603
	26,245,227	26,172,037
EXPENDITURE:		
Claims (Note 3)	5,528,032	5,285,859
Change in liability for future policy benefits (Note 15)	8,287,909	4,219,594
Commissions (Note 4)	6,104,540	7,333,907
Management expenses (Note 5)	3,581,837	3,598,220
	23,502,318	20,437,580
PROFIT BEFORE TAXATION	2,742,909	5,734,457
TAXATION (Note 13)	(353,210)	575,817
PROFIT AFTER TAXATION ATTRIBUTABLE TO HEAD OFFICE (Note 6)	$ 3,096,119	$ 5,158,640
TOTAL COMPREHENSIVE PROFIT	$ 3,096,119	$ 5,158,640

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

AMERICAN INCOME LIFE INSURANCE COMPANY
NEW ZEALAND BRANCH

STATEMENT OF MOVEMENTS IN THE HOME OFFICE ACCOUNT
For the Year Ended December 31, 2017

	2017	**2016**
BALANCE — Beginning of the year	$ 72,803,893	$ 64,635,654
Contributions from the home office:		
General advances (Note 9) received / (made)	(14,499,784)	453,255
Expenses paid on behalf of the Branch (Note 9)	2,361,156	2,556,344
	(12,138,628)	3,009,599
Income after tax	3,096,119	5,158,640
Total comprehensive income	3,096,119	5,158,640
BALANCE — End of the year	63,761,384	72,803,893

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

AMERICAN INCOME LIFE INSURANCE COMPANY
NEW ZEALAND BRANCH

BALANCE SHEET
As of December 31, 2017

	2017	2016
ASSETS		
CASH AND CASH EQUIVALENTS	21,640,708	27,612,198
INVESTMENTS (Note 8)	40,732,159	35,642,608
POLICY LOANS	3,021,339	2,602,471
OUTSTANDING PREMIUMS	117,163	103,370
ACCRUED INVESTMENT INCOME	565,631	514,186
RECEIVABLE FROM AFFILIATES	9,704,556	11,055,761
PREPAYMENTS	1,458,704	1,458,758
TOTAL	$ 77,240,260	$ 78,989,352
LIABILITIES AND HOME OFFICE ACCOUNT		
POLICY AND CONTRACT CLAIMS	1,681,370	1,757,730
UNEARNED PREMIUMS	39,036	43,946
TRADE AND OTHER LIABILITIES	802,329	1,179,683
NET RESERVE FOR FUTURE POLICY BENEFITS (Note 15)	10,280,023	1,992,114
CURRENT TAX LIABILITIES (Note 13)	676,119	1,211,986
Total liabilities	13,478,877	6,185,459
ADVANCES FROM HOME OFFICE (Note 9)	28,391,652	40,530,279
ACCUMULATED SURPLUS	35,369,731	32,273,614
Total home office account	63,761,383	72,803,893
TOTAL	$ 77,240,260	$ 78,989,352

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

AMERICAN INCOME LIFE INSURANCE COMPANY
NEW ZEALAND BRANCH

STATEMENT OF CASH FLOWS
For the Year Ended December 31, 2017

	2017	**2016**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Premiums and other considerations received from policyholders	$ 22,139,948	$ 23,786,012
Interest income	1,730,621	1,290,879
Other interest	757,112	786,603
Payment of claims	(5,609,302)	(4,877,888)
Payments of taxes	(189,306)	(539,963)
Payments of commissions	(4,753,335)	(5,307,904)
Payments to suppliers, agents etc.	(3,952,487)	(4,284,363)
Net cash provided by operating activities (Note 12)	10,123,251	10,853,376
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in short term investments		
Cash received for matured long-term investments		
Cash paid for long term investments	(3,956,114)	(8,014,046)
Net cash used in investing activities	(3,956,114)	(8,014,046)
CASH FLOWS FROM FINANCING ACTIVITIES — Advances provided by related parties	(12,138,627)	3,009,598
Net cash provided by financing activities	(12,138,627)	3,009,598
NET (DECREASE)/INCREASE IN CASH ON HAND	(5,971,490)	5,848,928
CASH ON HAND — Beginning of year	27,612,198	21,763,270
CASH ON HAND — End of year	$ 21,640,708	$ 27,612,198

The Statements of Significant Accounting Policies and Notes to the Financial Statements form part of, and should be read in conjunction with, these financial statements.

AMERICAN INCOME LIFE INSURANCE COMPANY
NEW ZEALAND BRANCH

NOTES TO THE FINANCIAL STATEMENTS
For the Year Ended December 31, 2017

1. PREMIUMS

	2017	2016
Individual life	$ 18,975,646	20,493,498
Accident and health	3,596,963	3,773,635
	$ 22,572,609	$ 24,267,133

2. INTEREST INCOME ON INVESTMENTS

	2017	2016
Government securities	$ 1,162,179	1,170,963
Other debt securities	445,785	52,408
	$ 1,607,964	$ 1,223,371

3. CLAIMS

	2017	2016
Individual life	4,288,671	$ 3,745,727
Accident and health	1,239,361	1,540,132
	$ 5,528,032	$ 5,285,859

4. COMMISSIONS (POLICY ACQUISITION EXPENSES)

	2017	2016
In respect of new policies:		
Individual life - First Year	$ 2,984,693	$ 4,027,534
Individual life - Renewal	2,429,531	2,532,780
Accident and health - First Year	293,212	370,013
Accident and health - Renewal	397,104	403,580
	$ 6,104,540	$ 7,333,907

5. MANAGEMENT EXPENSES

	2017	2016
Home office charges:		
General expenses	871,375	1,113,132
Salaries	1,489,780	1,443,211
General office expenses	802,981	549,464
Remuneration for services provided:		
Audit and assurance fees paid to Deloitte	162,341	131,478
Taxation Services - Other firms	117,113	132,204
Other expenses	117,412	134,016
Investment expenses	20,385	94,715
	$ 3,581,387	$ 3,598,220

6. PROFIT AFTER TAX

The profit for the year has arisen as follows:

	2017	2016
Planned margins	2,473,664	2,044,631
Actual and assumed experience	2,449,782	2,837,184
Basis change*	(5,131,782)	(1,635,140)
Investment earnings on assets in excess of policy liabilities	3,304,454	1,911,965
	$ 3,096,118	$ 5,158,640

* The basis change is the impact of changes to the discount rates used in valuation of policy liabilities.

CAPITAL COMMITMENTS

7. There are no commitments for capital expenditure entered into at December 31, 2017 and 2016.

8. INVESTMENTS

	2017	2016
Bonds		
Governments	28,522,994	27,946,028
Corporates	12,209,165	7,696,580
Total Bonds	40,732,159	$ 35,642,608

These securities mature from 2021 to 2027 and carry an effective yield of approximately 4.39% (2016 - 4.35%).

9. RELATED PARTY TRANSACTIONS

American Income Life Insurance Company incurs expenses for the Branch at the Home Office in Waco, Texas. Those expenses, as well as additional start-up costs are shown as advances from the Home Office to the Branch. Additionally, there are no members of management located at the branch in New Zealand, therefore the Home Office bears the cost of management. The advance payable to the Home Office as at December 31, 2017 was $28,391,652 (2016: $40,530,279). The total value of these expenses for the year were $2,361,156 (2016: $2,556,344) and a general advance was paid during the year of $(14,499,784) (2016: $453,255). These amounts are repayable on demand, however the Home Office has no plans to demand settlement in the next 12 months. The advance has no priorities attached and is interest free to the Branch.

10. LOANS TO DIRECTORS OR EMPLOYEES

None (2016: Nil)

11. FINANCIAL INSTRUMENTS

The financial condition and operating results of the Branch are affected by a number of financial and non-financial risks. Financial risks include interest rate risk, credit risk, and liquidity risk. Non-financial risks include insurance risks.

The Branch's objective is to prudently manage these risks.

Financial risks are managed via a conservative investment management strategy, with assets concentrated in liquid, investment grade. The asset mix includes medium-term investments in government securities, aimed at immunizing the policy liabilities against interest rate fluctuations.

Insurance risks are managed via prudent underwriting of new business applications from prospective policyholders and via thorough selection of appropriate sales staff to act as the Branch's intermediaries.

Insurance Risks - Terms and conditions that affect the timing of cash-flows

The Branch's products are predominantly long-term policies providing death and disablement benefits. The policy liabilities are calculated on the basis that the assumed rate of investment returns are able to be realized on policy reserves and on net cash-flows in future. If these returns are not achieved then the projected surpluses will be lower than expected.

The Branch's products provide death and disablement benefits that are significantly in excess of the policy liabilities. Consequently if claim levels are higher than expected then the projected surpluses will be lower than expected.

The Branch's products provide surrender values on product cancellation, and if more clients surrender than expected then the projected cash out-flows will be accelerated.

The policy liabilities are based on the assumption that policies are able to be maintained for a certain level of administration costs. If these costs are exceeded there will be a resulting reduction in emerging profits.

The Branch does not write any group business, where there could be concentrations of lives insured in one work-place.

The total individual Life and Accident and Hospital claims paid in 2017 for claims incurred before 2017 is $1,210,294 which is lower by $536,529 compared to claim liabilities estimate of $1,746,823 provided in 2016.

Insurance risk can be quantified by showing the sensitivity of policy liabilities and future profit margins to changes in the main assumptions that affect insurance business risks. The table below shows the impact of variations to assumptions concerning discount rates, the major types of claims, policy discontinuances and administration costs.

2017

	Life		Life (Accident & Hospital Indemnity)	
Assumption variation	**Policy Liabilities**	**Margins**	**Policy Liabilities**	**Margins**
Discount rate 1% higher	(7,650,766)	(1,369,699)	(408,344)	(145,360)
Discount rate 1% lower	11,136,645	1,638,278	613,249	172,784
Deaths and disablements 10% higher		(4,915,779)		(1,735,404)
Deaths and disablements 10% lower		5,222,213		1,736,556
Annual surrenders 10% higher		398,139		122,043
Annual surrenders 10% lower		(550,018)		(187,649)
Administration costs 10% higher		(1,669,932)		(354,203)
Administration costs 10% lower		1,669,932		354,203

2016

	Life		Life (Accident & Hospital Indemnity)	
Assumption variation	**Policy Liabilities**	**Margins**	**Policy Liabilities**	**Margins**
Discount rate 1% higher	(5,805,787)	(1,858,962)	(250,507)	(124,187)
Discount rate 1% lower	8,603,611	2,213,946	386,090	146,071
Deaths and disablements 10% higher		(4,119,402)		(1,547,430)
Deaths and disablements 10% lower		4,349,160		1,548,340
Annual surrenders 10% higher		(226,679)		22,805
Annual surrenders 10% lower		130,634		(65,557)
Administration costs 10% higher		(1,616,098)		(328,025)
Administration costs 10% lower		1,616,098		328,025

Interest Rate Risk - Invested assets are subject to the customary risks of defaults, downgrades, and changes in market values. Factors that may affect these risks include interest rate levels, financial market performance, and general economic conditions. Significant increases in interest rates could cause a material temporary decline in the fair value of the fixed investment portfolio, reflecting unrealized fair value losses. This risk is mitigated by the Branch's operating strategy to generally hold investments to maturity recognizing the long-term nature of the life policy reserve liabilities supported by investments. The high credit quality of investments held, which are all NZ Government direct obligations and bonds of NZ agencies, municipals and corporates (refer to Note 8), greatly diminishes the need to liquidate investments prior to maturity.

The following table illustrates the market risk sensitivity of our interest-rate sensitive fixed-maturity portfolio at December 31, 2017 and 2016. This table measures the effect of a change in interest rates on the profit or loss and equity of the Branch. The data measures the effect on profit or loss and equity arising from an immediate and sustained change in interest rates in increments of 100 basis points.

	Increase (Decrease) in Profit and Equity For the Year	
	2017	**2016**
Change in interest rate (bps):		
-200	$ 4,543,029	$ 4,483,514
-100	2,192,704	2,155,641
0		
+100	(2,047,610)	(1,998,297)
+200	(3,961,514)	(3,852,681)

Credit Risk - The Branch's major categories of asset comprise the following:

Investments in government securities, corporate bonds, and registered banks total $62.4 million as of December 31, 2017 (2016 - $63.3 million).

The Branch recorded outstanding premiums of $0.1 million and $0.1 million at December 31, 2017 and 2016. There is a possibility that a proportion of these premiums will not be received. Receivables from affiliates of $9.7 million (2016 - $11.1 million) represent unexpensed agent commissions, which have been purchased from an affiliated party and have not been settled. The recoverability of unexpensed commissions depends on the continuation of the policies on which the commissions have been accrued. The recoverability of clawback amounts will be affected by whether the agent continues to write new business with the Branch, and whether the agent has assets that are able to contribute to any commission recovery.

Outstanding premiums and receivables from affiliates are relatively illiquid assets and are subject to a degree of credit risk. The risk is monitored by management for collectability.

The Branch does not have any significant credit risk exposure to any single counter-party or any group of counter-parties having similar characteristics.

Liquidity Risk - The Branch maintains adequate cash and short-term investments on an ongoing basis to meet anticipated liquidity needs. Long term securities are NZ government and corporate securities which are readily marketable in the event of unforeseen extraordinary liquidity needs.

The Branch's government long-term securities mature from 2021 and 2027.

The average term of the Branch's liabilities for notified and unnotified claims, unearned premiums, premium taxes, and trade liabilities, totalling $2.6 million , is less than 12 months.

The average term of the Branch's policy liabilities is in excess of five years. Annual claim payments are expected to exceed $1 million per year, however these claims are expected to be met out of projected future net cash-flows, and policy liabilities are projected to increase rather than reduce over the next five years.

Fair Values - The Branch measures the fair value of its financial assets based on a hierarchy of three levels that indicate the quality of the fair value measurements as described below:

- Level 1 - fair values are based on quoted prices in active markets for identical assets or liabilities that the Branch has the ability to access as of the measurement date.

- Level 2 - fair values are based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, or inputs that can otherwise be corroborated by observable market data.

- Level 3 - fair values are based on inputs that are considered unobservable where there is little, if any, market activity for the asset or liability as of the measurement date. In this circumstance, the Branch has to rely on values derived by independent brokers or internally-developed assumptions. Unobservable inputs are developed based on the best information available to the Company which may include the Branch's own data or bid and ask prices in the dealer market.

All of the fair values reported at December 31, 2017 were determined using data provided by third-party pricing services. Prices provided by third-party services are not binding offers but are estimated exit values. They are based on observable market data inputs which can vary by security type. Such inputs include benchmark yields, available trades, broker/dealer quotes, issuer spreads, benchmark securities, bids, offers and other market data.

As part of the Branch's controls over pricing, management reviews and analyzes all prices obtained to insure the reasonableness of the values, taking all available information into account. One very important control is the corroboration of prices obtained from third-party sources against other independent sources. When corroborated prices produce small variations, the close correlation indicates observable inputs, and the median value of the available prices is used as the Branch's final valuation. When corroborated prices present greater variations, additional analysis is required to determine which value is the most appropriate. When one price is available, management evaluates observable inputs and performs additional analysis to confirm that the price is appropriate. All fair value measurements based on prices determined with observable market data are reported as Level 1 or Level 2 measurements. As of December 31, 2017 and 2016, all securities were classified as Level 2.

Fair value measurements at December 31, 2017

Description	**Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Fair Value**
Bonds: Fair Value through Profit and Loss				
Governments	—	$ 28,522,994	—	$ 28,522,994
Corporates		12,209,165		12,209,165
Total Bonds	—	$ 40,732,159	—	$ 40,732,159

Fair value measurements at December 31, 2016

Description	**Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Fair Value**
Bonds: Fair Value through Profit and Loss				
Governments	—	$ 27,946,028	—	$ 27,946,028
Corporates		7,696,580		7,696,580
Total Bonds	—	$ 35,642,608	—	$ 35,642,608

12. RECONCILIATION OF NET CASH FLOW FROM OPERATING ACTIVITIES TO OPERATING SURPLUS AFTER TAXATION

	2017	2016
Operating surplus after taxation	3,096,119	5,158,640
Add (less) non cash items:		
Change in reserve for future policy benefits	8,287,909	4,219,594
Unrealized fair value change	(1,307,542)	105,070
Change in current and deferred taxes	—	—
Other	174,105	167,722
Total non cash items	7,154,472	4,492,386
	10,250,591	9,651,026
Movements in working capital:		
Decrease in receivables from affiliates	1,351,205	2,026,003
Increase in accrued investment income	(51,445)	(100,215)
Increase in policy loans	(418,868)	(495,121)
Decrease in outstanding premiums	(13,793)	14,000
Decrease in prepayments	54	(838,120)
Increase in policy claims and unearned premiums	(81,270)	407,971
Change in premium taxes due	—	—
Decrease in other liabilities	(377,355)	151,978
Change in current tax liability	(535,867)	35,854
	(127,339)	1,202,350
Net cash provided by operating activities	10,123,252	10,853,376

13. INCOME TAXES

	2017	2016
Income taxes:		
Current tax expense/(benefit)	$ 199,451	$ 204,786
Deferred tax expense/(benefit)	(364,424)	599,401
Prior period adjustment	(188,237)	(228,370)
Total expense	$ (353,210)	$ 575,817

The income tax expense on pre-tax accounting profit from operations reconciles to the income tax expense in the financial statements as follows:

	2017	2016
Profit before taxation	$ 2,742,909	$ 5,734,457
Income tax expense calculated at 28% in 2017 and 2016	768,014	1,605,648
Effect of life insurance business - shareholder gain on savings business	371,122	463,242
Effect of non-life insurance business - non-deductible claims and commissions and other non-taxable items	(203,256)	(416,884)
Transition adjustment for new life tax regime		
Current year losses utilized against policyholder base	(191,452)	(369,002)
Schedular income permanent differences	(445,734)	
Tax rate difference on schedular income	(451,276)	(464,903)
Unused losses recognised as deferred tax assets	0	—
Prior period adjustment	(188,236)	(228,371)
Policyholder base loss/(profit) not recognized	(12,392)	(13,913)
	$ (353,210)	$ 575,817

	2017	2016
Deferred tax balances:		
Deferred tax asset comprise — tax losses	12,031,149	$ 11,014,135
Deferred tax liability comprise — net reserve for future policy benefits	$ (12,365,149)	$ (11,714,419)
Other	$ 19,091	$ (170,838)
Net deferred tax balance	$ (314,909)	$ (871,122)

Unrecognised Deferred Tax Balances - The following deferred tax assets have not been brought to account as assets:

	2017	2016
Shareholder base:		
Losses		—
Tax effect at 28%	0	—

The availability of the income tax losses is subject to statutory (including minimum shareholder continuity) requirements being met.

Income Tax Payable	2017	2016
Opening balance	$ (340,864)	$ (693,916)
Prior period adjustment	(3,552)	17,872
Provisional tax paid	182,658	539,966
Current year charge	(199,451)	(204,786)
Total income tax payable for the year	$ (361,210)	$ (340,864)

14. CONTROLLING ENTITIES

The controlling entity of American Income Life Insurance Company is Torchmark Corporation, a Company incorporated in the U.S.A

15. ACTUARY'S STATEMENT

The effective date of the actuarial report on policy liabilities and reserves is December 31, 2017. The actuarial policy liabilities and reserves were calculated by Mr. John T. Daly, ASA, of American Income Life Insurance Company.

Mr. Peter Davies of Davies Financial and Actuarial Services, a Fellow of the New Zealand Society of Actuaries, has certified that the amount of policy liabilities has been determined in accordance with Professional Standard No. 20 of the New Zealand Society of Actuaries. The actuarial report was prepared by Mr. Peter Davies.

The actuary is satisfied as to the nature, sufficiency, and accuracy of the data from which the policy liabilities have been determined.

	2017	2016
Policy liabilities:		
Balance at beginning of year	1,992,114	(2,227,480)
Movement in current year	8,287,909	4,219,594
Net reserve for future policy benefits	10,280,023	1,992,114

Policy liabilities comprises the following:

	2017	2016
Value of future claims	$ 119,603,321	$ 100,165,697
Value of future expenses	36,314,776	36,093,896
Value of future profit margins	17,802,156	24,401,322
Less value of future premiums	(163,440,230)	(158,668,801)
Net reserve for future policy benefits	$ 10,280,023	$ 1,992,114

The actuary has performed a liability adequacy test in accordance with NZ IFRS 4 and is satisfied as to the accuracy of the data using the assumptions below.

Disclosure of Assumptions - Policy liabilities were computed using a projection approach. Two separate projections were created for the Life business, Life plans and Accident and Hospital Indemnity plans.

Discount Rate - The 2017 discount rate is based on December 31, 2017 annual risk-free forward rates published by New Zealand Treasury. The 2016 discount rate is based on December 31, 2016 annual risk-free forward rates published by New Zealand Treasury.

Profit Carrier - The premium payable under each contract is the profit carrier. Future profits equal approximately 12% of the value of future premiums for Life plans and 7% of the value of future premiums for Accident & Hospital Indemnity plans.

Initial Expenses - For Life plans, 38% of issued premium plus 20% of first year commission. For Accident & Hospital Indemnity plans, 38% of premium.

Management Expenses - For Life plans, $35 per policy per annum plus 3% of premium. For Accident & Hospital Indemnity plans, $10 per policy per annum plus 3% of premium. These expenses are inclusive of maintenance and investment management expenses. The rate of inflation is assumed to be 2%.

All calculations have been computed gross of tax, with a deferred tax liability held in respect of the difference between published policy liabilities and policy tax reserves.

Mortality Rates - The mortality rates are based on 2001 VBT table with applicable factors.

Morbidity - The morbidity rates for 2011 issues and below have a sliding scale of 75% in first year reducing to 0% in year 10 and multiple factors ranging from 105% to 140%. The morbidity rates for issues after 2011 are not subject to the sliding scale but are subject to multiple factors ranging from 64% to 89%.

Rates of Discontinuance - Variable scales per expected portfolio experience. The Life plans and Accident & Hospital plans discontinuance rates were updated based on recent experience study.

Surrender Values - All Whole Life plans except “Permanent Life” plans have surrender values which are guaranteed upon issue and expressed in terms of unit of coverage. The surrender values are tabular and were calculated upon issue based on certain non-forfeiture interest rates, non-forfeiture factors and mortality tables.

The impact of change in discount rate on future profit martin is $1.4 million. The impact of change in demographic and expense assumptions on future profit margin is $-7.1 million.

Sensitivity analyses for other assumptions were performed (refer to Note 11).

16. SOLVENCY

The solvency position has been calculated in accordance with the Reserve Bank of New Zealand (RBNZ) Solvency Standard for Life Insurance Business 2014, issued under the Insurance (Prudential Supervision) Act 2010, effective up to and including December 31, 2017.

	2017			2016		
	Custodial Fund	Other	Total Statutory Fund	Custodial Fund	Other	Total Statutory Fund
Actual Solvency Capital	$ 32,461,109	$ 31,300,274	$ 63,761,383	$ 36,818,106	$ 35,985,787	$ 72,803,893
Minimum Solvency Capital	12,475,018	10,377,718	22,852,736	19,169,093	11,747,226	30,916,319
Solvency Margin	$ 19,986,091	$ 20,922,556	$ 40,908,647	$ 17,649,013	$ 24,238,561	$ 41,887,574
Solvency Ratio	260%	302%	279%	192%	306%	235%

Assets held in the Custodial Fund are only available to meet the liabilities of American Income Life Insurance Company - New Zealand Branch. Assets held in the Other Account are legally available for the satisfaction of debts of the American Income Life Insurance Company, not solely those appearing on the balance sheet of the branch and its debts may result in claims against assets not appearing thereon.

17. CONTINGENT LIABILITIES

There are no contingent liabilities at December 31, 2017 and 2016.

18. New Zealand custody account

Assets (Cash and Securities) in the amount of $45.9 million (2016 - $43.0 million) are held in the Public Trust Custody account. This balance is sufficient to meet the solvency requirements set forth in ISPA 2010.

19. CREDIT RATING

American Income Life Insurance Company has an A+ credit rating from AM Best.