

***FM Insurance Company Limited***  
***(New Zealand Branch)***

*Financial statements*  
*for the year ended 31 December 2012*

***FM Insurance Company Limited (New Zealand Branch)***

***Financial statements  
for the year ended 31 December 2012***

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## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Directors' report for the year ended 31 December 2012***

The directors present their report, together with financial statements of FM Insurance Company Limited (New Zealand Branch) for the financial year ended 31 December 2012.

No disclosure has been made in respect of Section 211(1)(a) and (e) to (j) of the Companies Act 1993 in accordance with Section 211(3) of the Act.

#### **Corporate Information**

The Registered Office of the Branch is:  
C/-KPMG Centre  
18 Viaduct Harbour Avenue  
Auckland 1010

The Branch is a part of FM Insurance Company Limited (the "Company"). The Company is incorporated in the United Kingdom.

The Company is a wholly owned subsidiary of Factory Mutual Insurance Company (FMIC), the registered office of which is 270 Central Avenue, Johnston, RI 02919-4949, USA.

FMIC has a financial strength rating of A+ (Superior) issued by A M Best and AA (Very Strong) issued by Fitch Ratings.

#### **Principal activities**

The Branch's principal activities during the year continued to be the underwriting of property insurance risks and the provision of related engineering and loss prevention services to large and medium sized clients.

#### **Results**

The results of the Branch's operations for the financial year are set out on page 6 and the financial position of the Branch at the end of the financial year is set out on page 7.

#### **Dividends**

The directors do not recommend the payment of a dividend (2011: \$Nil).

#### **Review of the business**

Gross premium income increased to \$37,558,467 from \$22,368,484 during the year. The Branch made a post tax loss of \$(1,561,540) during the year.

The loss for the year, and other movements described in the Statement of changes in equity, resulted in an overall decrease in Total Deemed Equity to \$(5,677,815) as at 31 December 2012.

#### **Significant changes in state of affairs**

There were no changes to the executive management team.

#### **Events subsequent to reporting date**

No transactions or events occurred after the reporting date which significantly affected, or may significantly affect, the results of the Branch, the operations of the Branch, or the state of affairs of the Branch.

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Directors' report for the year ended 31 December 2012***

#### **Future developments**

Insurance and investment operations are, by their nature, volatile due to the exposure to natural perils and industry cycles and thus, profit predictions are difficult.

The Company anticipates:

- Market conditions will be such during 2013 that premiums will increase from 2012 levels, reflecting industry trends;
- Operating results will improve in 2013 from 2012 levels, subject to claims levels.

The Company was granted a provisional license in 2012 by the Reserve Bank of New Zealand under the Insurance (Prudential Supervision) Act 2010. The new licensing regime commenced from 7 March 2012, requiring all insurers to operate under a provisional or full license. All insurers must be operating under a full license by 7 September 2013.

#### **Going concern**

The directors believe the Company is able to manage its business risks successfully in any economic environment. Furthermore, the directors have a high expectation that the Company has adequate resources to continue in existence for the foreseeable future. The New Zealand Branch is currently in a negative net asset position, however it continues to receive funding from the Australian branch of FM Insurance Company Limited. As such, they continue to adopt the going concern basis in preparing the Branch annual financial statements.

#### **Directors**

The names of the Company's directors in office at any time during or since the end of the financial year are as follows:

Director	Title	Date Changed
Kenneth Davey	Executive Director	
Omar Hameed	Executive Director	
Kevin Ingram	Executive Director	
Ian Berg	Executive Director	Resigned effective 19 December 2012
Christopher Johnson	Executive Director	Appointed effective 1 June 2012
Shivan Subramaniam	Non executive Director	
Jeffery Burchill	Non executive Director	
Thomas Lawson	Non executive Director	
Ruud Bosman	Independent Non executive Director	Retired 14 March 2013
Kenneth Lever	Independent Non executive Director	
Thomas Keevil	Independent Non executive Director	
Peter Charles Wilson	Independent Non executive Director	

Directors were in office for the entire period unless otherwise stated.

No directors had any interest in the shares of the Company during the year.

**FM Insurance Company Limited (New Zealand Branch)**

**Directors' report  
for the year ended 31 December 2012**

**Insurance of directors**

Insurance is maintained for the directors in respect of their duties as directors of the Company.

**Disclosure of information to the auditors**

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware.

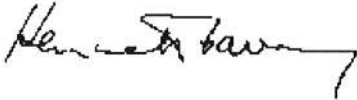
**Non audit services**

During the financial year, Ernst & Young were not engaged to perform any services with respect to the Branch, other than their statutory duties.

**Re-appointment of auditors**

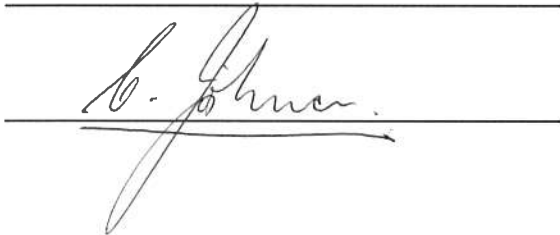
Pursuant to a shareholders' resolution, the Company is not obliged to reappoint its auditor annually and Ernst & Young will therefore continue in office.

**On behalf of the board**



Director

Dated: 31 May 2013



Director

Dated: 31 May 2013

## Independent Auditor's Report

### To the Shareholders of FM Insurance Company Limited (New Zealand Branch)

#### Report on the Financial Statements

We have audited the financial statements of the New Zealand branch of FM Insurance Company Limited (New Zealand Branch) Limited on pages 6 to 32, which comprise the statement of financial position of the New Zealand branch of FM Insurance Company Limited (New Zealand Branch) Limited as at 31 December 2012, for the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

This report is made solely to the company's shareholders, as a body, in accordance with Section 19(3) of the Financial Reporting Act 1993. 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 New Zealand branch of the company and the company's shareholders as a body, for our audit work, for this report, or for the opinions we have formed.

#### Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of the financial statements, in accordance with generally accepted accounting practice in New Zealand, and that give a true and fair view of the matters to which they relate 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.

#### Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). These auditing standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we have considered the internal control relevant to the New Zealand branch of the company's preparation of the financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the New Zealand branch of the company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

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

Other than in our capacity as auditor we have no relationship with, or interest in the New Zealand branch of the company.

Partners and employees of our firm may deal with the New Zealand branch of the company on normal terms within the ordinary course of trading activities of the business of the New Zealand branch of the company.

#### Opinion

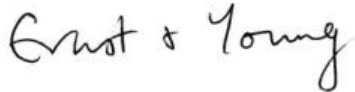
In our opinion, the financial statements on pages 6 to 32:

- ▶ comply with generally accepted accounting practice in New Zealand;
- ▶ comply with International Financial Reporting Standards; and
- ▶ give a true and fair view of the financial position of the New Zealand branch of the company as at 31<sup>st</sup> December 2012 and its financial performance and cash flows for the year then ended.

### **Report on Other Legal and Regulatory Requirements**

In accordance with the Financial Reporting Act 1993, we report that:

- ▶ We have obtained all the information and explanations that we have required.
- ▶ In our opinion proper accounting records have been kept by the New Zealand branch of FM Insurance Company Limited (New Zealand Branch) Limited as far as appears from our examination of those records.

A handwritten signature in black ink that reads 'Ernst & Young' in a cursive, flowing script.

Ernst & Young

31May 2013  
Melbourne

***FM Insurance Company Limited (New Zealand Branch)***

***Statement of comprehensive income  
for the year ended 31 December 2012***

	<i>Note</i>	2012 \$	2011 \$
Gross Premium Revenue	8	37,558,467	22,368,484
Outwards Reinsurance Expense	9	(26,784,243)	(16,066,458)
<b>Net Premium Revenue</b>		<b>10,774,224</b>	<b>6,302,026</b>
Gross Claims Expense	9	(57,014,893)	(358,042,221)
Reinsurance and Other Recoveries Revenue	8	48,256,153	351,763,666
<b>Net Claims Expense</b>		<b>(8,758,740)</b>	<b>(6,278,555)</b>
<b>Net Acquisition and Underwriting Revenue</b>	9	<b>3,573,595</b>	2,758,294
<b>UNDERWRITING PROFIT</b>		<b>5,589,079</b>	<b>2,781,765</b>
General and Administration Expenses	9	(7,163,522)	(4,357,271)
Investment Income	8	12,903	38,947
<b>OPERATING LOSS BEFORE INCOME TAX</b>		<b>(1,561,540)</b>	<b>(1,536,559)</b>
Income Tax Expense		0	0
<b>OPERATING LOSS AFTER INCOME TAX</b>		<b>(1,561,540)</b>	<b>(1,536,559)</b>
Other Comprehensive Income / (Expense), net of tax		0	0
<b>TOTAL COMPREHENSIVE LOSS FOR THE YEAR</b>		<b>(1,561,540)</b>	<b>(1,536,559)</b>
<b><i>Operating loss for the year attributable to:</i></b>			
Non-controlling Interest		0	0
Owners of the Parent		(1,561,540)	(1,536,559)
<b>Operating loss after income tax</b>		<b>(1,561,540)</b>	<b>(1,536,559)</b>
<b><i>Total comprehensive loss for the year attributable to:</i></b>			
Non-controlling Interest		0	0
Owners of the Parent		(1,561,540)	(1,536,559)
<b>Total comprehensive loss after tax</b>		<b>(1,561,540)</b>	<b>(1,536,559)</b>

*The above Statement of comprehensive income should be read in conjunction with the notes to the financial statements.*



***FM Insurance Company Limited (New Zealand Branch)***

***Statement of financial position  
at 31 December 2012***

	<i>Note</i>	<b>2012</b>	2011
		\$	\$
<b>Assets</b>			
<i>Current Assets</i>			
Intercompany account	7	<b>33,531,057</b>	0
Trade and other receivables	13	<b>24,832,547</b>	102,529,352
Deferred reinsurance expense	15	<b>14,360,596</b>	9,705,413
Reinsurance and other recoveries on outstanding claims	14	<b>132,710,069</b>	94,974,933
<i>Non-Current Assets</i>			
Reinsurance and other recoveries on outstanding claims	14	<b>40,684,523</b>	66,679,897
Investments	12	<b>505,718</b>	525,315
<b>TOTAL ASSETS</b>		<b><u>246,624,510</u></b>	<b><u>274,414,910</u></b>
<b>Liabilities</b>			
<i>Current Liabilities</i>			
Intercompany account	7	<b>0</b>	40,312,801
Trade and other payables	16	<b>8,116,174</b>	8,156,924
Unearned premium reserve	15	<b>20,323,675</b>	13,387,842
Deferred reinsurance commission		<b>1,112,963</b>	915,217
Unexpired risk liability	15	<b>705,921</b>	349,571
Outstanding claims provision	14	<b>169,964,069</b>	127,537,933
<i>Non-Current Liabilities</i>			
Outstanding claims provision	14	<b>52,079,523</b>	87,870,897
<b>TOTAL LIABILITIES</b>		<b><u>252,302,325</u></b>	<b><u>278,531,185</u></b>
<b>NET ASSETS</b>		<b><u>(5,677,815)</u></b>	<b><u>(4,116,275)</u></b>

*The above Statement of financial position should be read in conjunction with the notes to the financial statements.*

*FM Insurance Company Limited (New Zealand Branch)*

*Statement of changes in equity  
for the year ended 31 December 2012*

<b>2011</b>	<b>Retained Earnings</b>	<b>Other</b>	<b>Total Deemed Equity: Head Office Account</b>
	\$	\$	\$
<b>Balance at the beginning of the financial year</b>	<b>(2,579,716)</b>	<b>0</b>	<b>(2,579,716)</b>
Loss for the year	(1,536,559)	0	(1,536,559)
Other comprehensive income / (expense), net of tax	0	0	0
<b>Total comprehensive expense for the year</b>	<b>(4,116,275)</b>	<b>0</b>	<b>(4,116,275)</b>
Transactions with owners	0	0	0
<b>Balance at the end of the financial year</b>	<b>(4,116,275)</b>	<b>0</b>	<b>(4,116,275)</b>
<b>2012</b>	<b>Retained Earnings</b>	<b>Other</b>	<b>Total Deemed Equity: Head Office Account</b>
	\$	\$	\$
<b>Balance at the beginning of the financial year</b>	<b>(4,116,275)</b>	<b>0</b>	<b>(4,116,275)</b>
Loss for the year	(1,561,540)	0	(1,561,540)
Other comprehensive income / (expense), net of tax	0	0	0
<b>Total comprehensive expense for the year</b>	<b>(5,677,815)</b>	<b>0</b>	<b>(5,677,815)</b>
Transactions with owners	0	0	0
<b>Balance at the end of the financial year</b>	<b>(5,677,815)</b>	<b>0</b>	<b>(5,677,815)</b>

*The above Statement of changes in equity should be read in conjunction with the notes to the financial statements.*

***FM Insurance Company Limited (New Zealand Branch)***

***Statement of cash flows  
for the year ended 31 December 2012***

		<b>2012</b>	2011
	<i>Note</i>	\$	\$
<b>Cash flows from operating activities</b>			
Reinsurance and other recoveries received		<b>117,530,615</b>	151,028,926
Premium received		<b>41,176,881</b>	29,180,326
Other operating receipts		<b>4,127,691</b>	3,162,457
Interest received		<b>32,500</b>	38,790
Other operating payments		<b>(7,163,164)</b>	(4,354,924)
Outwards reinsurance expense paid		<b>(31,480,534)</b>	(15,005,371)
Gross claims expense paid		<b>(50,380,131)</b>	(203,305,830)
<b><i>Net cash used in operating activities</i></b>	<b>22</b>	<b><u>73,843,858</u></b>	<b><u>(39,255,626)</u></b>
<b>Cash flows from investing activities</b>			
<b><i>Net cash used in investing activities</i></b>		<b><u>0</u></b>	<b><u>0</u></b>
<b>Cash flows from financing activities</b>			
<b><i>Net cash from financing activities</i></b>		<b><u>0</u></b>	<b><u>0</u></b>
<b>Net increase / (decrease) in cash and cash equivalents</b>		<b><u>73,843,858</u></b>	<b><u>(39,255,626)</u></b>
Cash and cash equivalents at the beginning of the reporting period		<b>(40,312,801)</b>	(1,057,175)
Effect of exchange rate fluctuations on cash and cash equivalents held		<b>0</b>	0
<b>Cash and cash equivalents at the end of the reporting period</b>	<b>22</b>	<b><u>33,531,057</u></b>	<b><u>(40,312,801)</u></b>

*The above Statement of cash flows should be read in conjunction with the notes to the financial statements.*

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

#### **1 Reporting entity**

The Registered Office of the Branch is:  
C/-KPMG Centre  
18 Viaduct Harbour Avenue  
Auckland 1010

The Branch is a part of FM Insurance Company Limited (the “Company”). The Company is incorporated in the United Kingdom.

The Company is a wholly owned subsidiary of Factory Mutual Insurance Company (FMIC), the registered office of which is 270 Central Avenue, Johnston, RI 02919-4949, USA. FMIC (the “Parent”) is the largest Group in which the financial results of the Company are included. Copies of the Group accounts are available to the public either at the above address or from [www.fmglobal.com](http://www.fmglobal.com).

FMIC has a financial strength rating of A+ (Superior) issued by A M Best and AA (Very Strong) issued by Fitch Ratings.

The Branch’s principal activities during the year continued to be the underwriting of property insurance risks and the provision of related engineering and loss prevention services to large and medium sized clients.

The financial statements were authorised for issue by the board of directors on 31 May 2013.

#### **2 Basis of preparation**

##### ***(a) Statement of compliance***

These financial statements have been prepared in accordance with the requirements of the Financial Reporting Act 1993 (as amended by the Financial Reporting Amendment Act 2011) and the Companies Act 1993.

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

##### ***(b) Basis of measurement***

The consolidated financial statements have been prepared on the historical cost basis except for the following material items in the Statement of financial position:

- Measurement of investments at fair value; and
- Measurement of the outstanding claims liability and related reinsurance and other recoveries at present value.

##### ***(c) Fair value***

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction on the measurement date.

##### ***(d) Present value***

Present value is the amount of an asset or liability using appropriate risk free discount rates.

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

#### ***(e) Functional and presentation currency***

The financial statements are presented in New Zealand dollars (\$), which is the Branch's functional currency.

#### ***(f) Use of estimates and judgements***

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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 and in any future periods affected.

The areas where estimates and assumptions involve a high degree of judgement or complexity and are considered significant to the financial statements are:

- Claims; and
- Reinsurance and other recoveries on outstanding claims.

#### ***(g) Changes in accounting policies***

There were no changes in accounting policies during the current reporting period.

#### ***(h) Rounding***

Except as otherwise indicated, financial information presented in New Zealand dollars has not been rounded.

#### ***(i) Recently issued standards (effective for years beginning from 1 January 2013)***

We are not aware of any standards in issue but not yet effective which would materially impact the amounts recognised or disclosed in the financial statements in future periods.

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

#### **3 Significant accounting policies**

##### ***(a) Premiums***

Premium revenue comprises amounts charged for insurance contracts. Premium is recognised as earned from the date of attachment of risk (generally the date a contract is agreed to but may be earlier if persuasive evidence of an arrangement exists) over the period of the related insurance contracts in accordance with the pattern of the incidence of risk accepted under the contracts. The pattern of the risks underwritten is generally matched by the passing of time. Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date) is recognised as revenue.

The unearned portion of premium is recognised as an unearned premium reserve on the Statement of financial position. Unearned premiums are deferred over the term of the underlying direct insurance policies.

Premium receivable is recognised as the amount due and is normally settled between 60 days and 120 days. The recoverability of premium receivable is assessed and provision is made for impairment based on objective evidence and having regards to past default experience. Premium receivable is presented on the Statement of financial position net of any provision for impairment.

##### ***(b) Outwards reinsurance***

Gross reinsurance premiums are recognised as an expense on the earlier of the date when premiums are payable or when the policy becomes effective.

Gross reinsurance premiums written comprise the total payable for the whole cover provided by contracts entered into during the period and are recognised on the date on which the policy incepts. Premiums include any adjustments arising in the accounting period in respect of reinsurance contracts incepting in prior accounting periods.

Unearned reinsurance premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned reinsurance premiums are deferred over the term of the underlying direct insurance policies.

##### ***(c) Claims***

The outstanding claims liability is measured as the central estimate of the present value of expected future payments relating to claims incurred at the reporting date with an additional risk margin to allow for the inherent uncertainty in the central estimate. The liability is measured based on valuations performed by, or under the direction of, the Appointed Actuary. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims incurred but not enough reported (IBNER), claims incurred but not reported (IBNR) and the anticipated direct and indirect claims handling costs. The liability is discounted to present value using a risk free rate.

The estimation of the outstanding claims liability involves a number of key assumptions and is the most critical accounting estimate. All reasonable steps are taken to ensure that the information on paid claims exposures is appropriate. However, given the uncertainty in establishing the liability, it is likely that the final outcome will be different from the original liability established. Changes in claims estimates are recognised in profit or loss in the reporting period in which the estimates are changed.

Claims expense represents claim payments adjusted for the movement in the outstanding claims liability.

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

#### ***(d) Reinsurance and other recoveries***

Reinsurance and other recoveries received or receivable on paid claims and on outstanding claims (notified and not yet notified) are recognised as income. Reinsurance recoveries on paid claims are presented as part of receivables net of any provision for impairment based on objective evidence for individual receivables. Reinsurance and other recoveries on outstanding claims are measured as the present value of the expected future receipts calculated on the same basis as the outstanding claims liability. Reinsurance does not relieve the originating insurer of its liabilities to policyholders and is presented separately on the Statement of financial position.

#### ***(e) Liability adequacy test***

The liability adequacy test is an assessment of the carrying value of the unearned premium liability and is conducted at each reporting date. If current estimates of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate, exceed the unearned premium liability (net of reinsurance) less relevant deferred acquisition costs (if any), then the unearned premium liability is deemed to be deficient. The test is performed at the level of a portfolio of contracts that are subject to broadly similar risks and that are managed together as a portfolio. In these accounts, this represents the overall New Zealand portfolio of contracts. Any deficiency arising from the test is recognised in the profit or loss with the corresponding impact on the Statement of financial position recognised first through the write down of deferred acquisition costs (if any) for the relevant portfolio of contracts, with any remaining balance being recognised on the Statement of financial position as an unexpired risk liability.

#### ***(f) Investments***

All investments are designated as fair value through profit or loss upon initial recognition. They are initially recorded at fair value (being the cost of acquisition excluding transaction costs) and are subsequently re-measured to fair value at each reporting date. Investments presently comprise of New Zealand government bonds.

#### ***(g) Creditors and accruals***

Creditors and accruals are carried at cost, which is the fair value of the consideration to be paid in the future for the goods and services received. The amounts are discounted where the effect of the time value of money is material.

#### ***(h) Investment Income***

Interest income is accounted for on an accrual basis and recognised in the Statement of comprehensive income.

Changes in the fair value of investments from the previous reporting date (or cost of acquisition excluding transaction costs if acquired during the financial period) are recognised as realised or unrealised gains or losses in profit or loss.

#### ***(i) Foreign currency***

Transactions in foreign currencies are translated into the functional currency of the Branch at average exchange rates for the months in which the transactions occur.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated into the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on translation are recognised in profit or loss.

## *FM Insurance Company Limited (New Zealand Branch)*

### *Notes to the financial statements for the year ended 31 December 2012*

#### **4 Risk management**

##### *(a) Risk management framework*

###### Group framework

The broader FMIC Group objectives and strategies are consistent worldwide with each operation conducting business the same way, regardless of location, within the constraints of local law and regulations. This applies particularly to underwriting, capacity utilization, risk engineering and claims handling, for which comprehensive standards apply group-wide. To this extent the Branch risk management framework is based on the global business model.

At the Group level, FMIC has a Business Risk Management Executive Committee. This is linked by direct participation or reporting to the strategic planning and risk management processes undertaken by the following leadership groups;

- Global Planning Committee;
- Global Integration Committee;
- FMI Board of Directors;
- FMI Risk Management Committee; and
- Individual Operations, including the Branch Risk Management sub-committee and Business Risk Team.

###### Company framework

The Board of FM Insurance Company Limited (FMI) has primary responsibility for oversight of the risk management framework within FMI. The Board consists of executive directors, non-executive directors and independent non-executive directors.

In order to support the Board in this responsibility, two sub committees of the Board have been established. The first is the Risk and Compliance Committee (RCC) which provides independent oversight of the Company's risks and risk management framework. The other is in the FMI Risk Management Committee (RMC) which is an executive committee and has the power to take decisions regarding the Company's risk management policies and practice.

###### Branch framework

The Operations Manager is primarily responsible for the risk management function in Australia and New Zealand, and the development of the risk management framework. Assistance is provided by the FMI Risk Management Committee. The framework is designed to address risks arising out of the Branch operations and Business Plan. Any risks which have been identified as of particular significance to the Branch would be identified in the Branch Risk Register.

##### *(b) Insurance risk*

###### Background

A key risk from operating in the general insurance industry is the exposure to insurance risk arising from underwriting general insurance contracts. The insurance contracts transfer risk to the insurer by indemnifying the policyholders against adverse effects arising from the occurrence of specified uncertain future events. There is a risk that the actual amount of claims to be paid in relation to contracts will be different to the amount estimated at the time a product was designed and priced. The Branch is exposed to this risk because the price for a contract



## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

must be set before the losses relating to the product are known. Hence the insurance business involves inherent uncertainty.

A fundamental part of the Company's overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows arising from insurance contracts.

#### **Mitigating insurance risk**

The insurance activities primarily involve the underwriting of risks and the management of claims.

The policies and procedures for the management of insurance risk are applied consistently across the Company with certain allowances made for local circumstances. Key policies and processes include the following:

- Reinsurance
  - Reinsurance is used to limit exposure to large single claims and accumulation of claims that arise from the same event or the accumulation of similar events;
  - While a large portion of the business ceded by the Branch is reinsured with the Parent, the Branch can, and does, purchase additional external reinsurance protection. This generally relates to facultative reinsurance covers; and
  - The use of reinsurance introduces credit risk. The management of reinsurance includes the monitoring of reinsurers' credit risk and controls the exposure to reinsurance counterparty default.
- Claims management and provisioning
  - Initial claims determination is managed by claims officers with the requisite degree of experience and competence with the assistance, where appropriate, of a loss adjustor or other party with specialist knowledge. It is the Company's policy to respond to and settle all genuine claims quickly whenever possible and to pay claims fairly, based on policyholders' full entitlements; and
  - Claims provisions are established using actuarial valuation models and include a risk margin for uncertainty (refer to the claims note).

#### ***(c) Market risk***

Market risk is the risk that changes in market prices, such as interest rates and foreign exchange rates will affect the Branch's interest income, claims expense or the value of its holdings of financial instruments.

Policies and procedures designed to address this risk include various measures contained within the Branch's Capital Management Strategy (CMS).

#### ***(d) Credit risk***

Credit risk is the risk of financial loss to the Branch if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Branch's premium receivables from brokers or policy holders, reinsurance receivables from reinsurers and investments.

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

Policies and procedures designed to address this risk include premium debtor follow-up and monitoring processes, reinsurer counterparty rating requirements and concentration limits, and investment counterparty rating requirements and concentration limits.

#### ***(e) Liquidity risk***

Liquidity risk is the risk that the Branch will encounter difficulty in meeting obligations associated with its financial liabilities as they fall due, or can only secure such resources at a prohibitive cost.

Policies and procedures designed to address this risk include maintaining high solvency levels in excess of regulator requirements, holding of highly liquid investments, access to capital of the Company, access to funding of reinsurance recoveries from the Parent.

#### ***(f) Operational risk***

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes, including business processes, personnel, technology and infrastructure, and from external factors.

The Branch's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Branch's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity. The primary responsibility for the development and implementation of controls to address this risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Company standards for the management of operational risk.

#### ***(g) Compliance risk***

Compliance risk is the risk of either ineffective relationships with our insurance regulators or non-compliance with various laws, regulations and codes to which the Branch is required to adhere.

Policies and procedures designed to address this risk include regular meetings with regulators, engagement of consultants and advisors as required, filings & returns calendars, and periodic reviews undertaken by Legal & Compliance.

#### ***(h) Group risk***

Group risk is the risks the Branch is exposed to as a member of the Factory Mutual Insurance Company (FMIC) Group. These may deplete or divert financial resources held by the Branch to meet liabilities arising from Group.

## **5 Regulatory capital**

The lead regulator is the *Australian Prudential Regulation Authority* (APRA) which sets and monitors capital requirements for the combined Australian and New Zealand Branches as a whole. The regulatory capital base of the Branch is derived from the net assets of the Branch as at the reporting date, calculated using APRA standard GPS 110.

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

The combined Australian and New Zealand Branches are compliant with all externally imposed capital requirements, including the requirement to have in place have in place an Internal Capital Adequacy Assessment Process (ICAAP) appropriate to the size, business mix and complexity of the Branch's operations and group structure.

The Company is supervised by the *Financial Services Authority* (FSA) in the United Kingdom.

The Company's policy is to maintain a strong capital base so as to ensure creditor and market confidence and to sustain future development of the business.

The lead regulator for the New Zealand Branch is expected to change in 2013 to the *Reserve Bank of New Zealand* (RBNZ) following approval of a full license under new licensing rules in that country. The Branch presently operates under a provisional license in New Zealand.

#### **6 Operating segments**

The whole of the Branch is considered to be an operating segment for the purposes of segment reporting.

## *FM Insurance Company Limited (New Zealand Branch)*

### *Notes to the financial statements for the year ended 31 December 2012*

#### **7 Financial assets & liabilities**

##### *(a) Table of financial assets and liabilities*

The table below sets out the carrying amounts and fair values of the Branch's financial assets and liabilities:

<b>2011</b>		Fair value through profit and loss \$	Amortised cost \$	Total carrying amount \$	Fair Value \$
	<i>Note</i>				
<b>Assets</b>					
Investments	12	525,315	0	525,315	<b>525,315</b>
Trade and other receivables	13	0	102,529,352	102,529,352	<b>102,529,352</b>
Total Assets		<u>525,315</u>	<u>102,529,352</u>	<u>103,054,667</u>	<b>103,054,667</b>
<b>Liabilities</b>					
Intercompany account		0	40,312,801	40,312,801	<b>40,312,801</b>
Trade and other payables	16	0	8,156,924	8,156,924	<b>8,156,924</b>
Total Liabilities		<u>0</u>	<u>48,469,725</u>	<u>48,469,725</u>	<b>48,469,725</b>
<b>2012</b>					
		Fair value through profit and loss \$	Amortised cost \$	Total carrying amount \$	Fair Value \$
<b>Assets</b>					
Intercompany account		0	33,531,057	33,531,057	<b>33,531,057</b>
Investments	12	505,718	0	505,718	<b>505,718</b>
Trade and other receivables	13	0	24,832,547	24,832,547	<b>24,832,547</b>
Total Assets		<u>505,718</u>	<u>58,363,604</u>	<u>58,869,322</u>	<b>58,869,322</b>
<b>Liabilities</b>					
Trade and other payables	16	0	8,116,174	8,116,174	<b>8,116,174</b>
Total Liabilities		<u>0</u>	<u>8,116,174</u>	<u>8,116,174</u>	<b>8,116,174</b>

##### *(b) Financial instrument disclosures*

Financial instruments, consisting of New Zealand Government bonds held by the Public Trustee on behalf of the Branch, are maintained for the purpose of compliance with the requirements of the Insurance Companies' Deposits Act 1953.

In terms of both size and nature, these financial instruments are considered to be significant to neither the financial position of the Branch or the financial performance of the Branch. Analysis has been performed which shows that a material movement in the rate of return on financial instruments held by the branch would have an immaterial impact on the financial performance of the Branch.

Given the financial rating of New Zealand government issued bonds, financial instruments held by the Branch are not considered to be subject to significant credit risk.

***FM Insurance Company Limited (New Zealand Branch)***

***Notes to the financial statements  
for the year ended 31 December 2012***

**8 Analysis of Income**

	<i>Note</i>	<b>2012</b>	2011
		\$	\$
<b>Premium Revenue</b>			
Gross written premium		<b>44,494,300</b>	28,948,746
Movement in unearned premium reserve		<b>(6,935,833)</b>	(6,580,262)
Premium revenue		<u><b>37,558,467</b></u>	<u>22,368,484</u>
<b>Reinsurance Revenue</b>			
Reinsurance and other recoveries on paid claims		<b>36,516,391</b>	240,969,912
Movement in reinsurance and other recoveries on outstanding claims		<b>11,739,762</b>	110,793,754
Reinsurance and other recoveries revenue	<i>11</i>	<u><b>48,256,153</b></u>	<u>351,763,666</u>
<b>Investment Income</b>			
Interest on government stock		<b>32,500</b>	32,500
Other interest		<b>0</b>	6,290
Interest income		<u><b>32,500</b></u>	<u>38,790</u>
Realised net gains/(losses)		<b>0</b>	0
Unrealised net gains/(losses)		<b>(19,597)</b>	157
Net changes in fair value of investments		<u><b>(19,597)</b></u>	<u>157</u>
Total investment income		<u><b>12,903</b></u>	<u>38,947</u>
Total Income		<u><b>85,827,523</b></u>	<u>374,171,097</u>

***FM Insurance Company Limited (New Zealand Branch)***

***Notes to the financial statements  
for the year ended 31 December 2012***

**9 Analysis of expenses**

	<i>Note</i>	<b>2012</b>	2011
		\$	\$
<b>Outwards Reinsurance Expense</b>			
Outwards reinsurance paid		<b>31,439,426</b>	20,986,171
Movement in deferred reinsurance expense		<b>(4,655,183)</b>	(4,919,713)
Outwards reinsurance expense		<b><u>26,784,243</u></b>	<u>16,066,458</u>
<b>Gross Claims Expense</b>			
Claims paid, including external loss adjustment expense		<b>49,311,748</b>	202,602,668
Movement in outstanding claims		<b>6,634,762</b>	154,736,076
Internal loss adjustment expense		<b>1,068,383</b>	703,477
Gross claims expense	<i>11</i>	<b><u>57,014,893</u></b>	<u>358,042,221</u>
<b>Net Acquisition and Underwriting Revenue</b>			
Reinsurance commission received		<b>(4,127,691)</b>	(3,162,457)
Movement in deferred reinsurance commission		<b>197,746</b>	54,592
Movement in unexpired risk liability	<i>15</i>	<b>356,350</b>	349,571
Net Acquisition and underwriting revenue		<b><u>(3,573,595)</u></b>	<u>(2,758,294)</u>
<b>General and Administration Expense</b>			
Auditor remuneration	<i>10</i>	22,705	22,347
Other general and administration expense		<b>8,209,200</b>	5,038,401
Internal loss adjustment expense		<b>(1,068,383)</b>	(703,477)
General and administration expense		<b><u>7,163,522</u></b>	<u>4,357,271</u>
Total expenses		<b><u>87,389,063</u></b>	<u>375,707,656</u>

***FM Insurance Company Limited (New Zealand Branch)***

***Notes to the financial statements  
for the year ended 31 December 2012***

**10 Auditor remuneration**

	<b>2012</b>	2011
	\$	\$
<b>Assurance Services - Ernst &amp; Young</b>		
Audit of the financial statements	<u><u>22,705</u></u>	<u><u>22,347</u></u>

**11 Net Claims expense**

	<b>2012</b>	2011
	\$	\$
	<i>Note</i>	
Gross claims expense - undiscounted	52,033,131	345,509,391
Discount to present value	<u>2,540,000</u>	<u>(3,298,000)</u>
Gross claims expense - discounted	54,573,131	342,211,391
Risk margin	<u>2,441,762</u>	<u>15,830,830</u>
Gross claims expense	<u>57,014,893</u>	<u>358,042,221</u>
Reinsurance and other recoveries revenue - undiscounted	43,827,391	342,709,836
Discount to present value	<u>1,872,000</u>	<u>(2,342,000)</u>
Reinsurance and other recoveries revenue - discounted	45,699,391	340,367,836
Risk margin	<u>2,556,762</u>	<u>11,395,830</u>
Reinsurance and other recoveries revenue	<u>48,256,153</u>	<u>351,763,666</u>
Net claims expense - undiscounted	8,205,740	2,799,555
Net discount to present value	<u>668,000</u>	<u>(956,000)</u>
Net claims expense - discounted	8,873,740	1,843,555
Net risk margin	<u>(115,000)</u>	<u>4,435,000</u>
Net claims expense - discounted including risk margin	<u><b>8,758,740</b></u>	<u><b>6,278,555</b></u>

*FM Insurance Company Limited (New Zealand Branch)*

*Notes to the financial statements  
for the year ended 31 December 2012*

**12 Investments**

	2012	2011
	\$	\$
<b>Interest bearing investments</b>		
Government bond	<u>505,718</u>	<u>525,315</u>

**13 Trade and other receivables**

The receivables are non-interest bearing and are normally settled between 30 days and 12 months. The balance has not been discounted because the effect of the time value of money is not material. The net carrying amount of the receivables is a reasonable approximation of the fair value of the assets because of the short term nature of the assets.

The following table provides the total amount of trade and other receivables at the reporting date for the relevant financial year:

	2012	2011
	\$	\$
<b>Premium receivables</b>		
Premium receivable	4,527,238	1,209,819
Provision for doubtful debts	0	0
Net premium receivable	<u>4,527,238</u>	<u>1,209,819</u>
<b>Reinsurance receivables</b>		
Reinsurance and other recoveries on paid claims	20,305,309	101,319,533
Provision for doubtful debts	0	0
Net reinsurance recoveries on paid claims	<u>20,305,309</u>	<u>101,319,533</u>
Total trade and other receivables	<u>24,832,547</u>	<u>102,529,352</u>



***FM Insurance Company Limited (New Zealand Branch)***

***Notes to the financial statements  
for the year ended 31 December 2012***

**14 Net outstanding claims provision**

***(a) Composition of net outstanding claims provision***

	2012	2011
	\$	\$
<b>Gross outstanding claims</b>		
Gross outstanding claims	188,140,000	186,873,000
Loss adjustment expenses	6,479,000	6,245,000
Claims administration expenses	7,376,000	7,224,000
Gross outstanding claims - undiscounted	<u>201,995,000</u>	<u>200,342,000</u>
Discount to present value	<u>(3,740,000)</u>	<u>(6,280,000)</u>
Gross outstanding claims - discounted	198,255,000	194,062,000
Risk margin	<u>23,788,592</u>	<u>21,346,830</u>
Gross outstanding claims - discounted including risk margin	<u>222,043,592</u>	<u>215,408,830</u>
<b>Reinsurance and other recoveries receivable on outstanding claims</b>		
Reinsurance and other recoveries receivable on outstanding claims	152,543,000	145,631,000
Loss adjustment expenses	5,283,000	4,884,000
Claims administration expenses	0	0
Reinsurance and other recoveries receivable on outstanding claims - undiscounted	<u>157,826,000</u>	<u>150,515,000</u>
Discount to present value	<u>(3,008,000)</u>	<u>(4,880,000)</u>
Reinsurance and other recoveries receivable on outstanding claims - discounted	154,818,000	145,635,000
Risk margin	<u>18,576,592</u>	<u>16,019,830</u>
Reinsurance and other recoveries receivable on outstanding claims - discounted including risk margin	<u>173,394,592</u>	<u>161,654,830</u>
<b>Net outstanding claims</b>		
Net outstanding claims	35,597,000	41,242,000
Loss adjustment expenses	1,196,000	1,361,000
Claims administration expenses	7,376,000	7,224,000
Net outstanding claims - undiscounted	<u>44,169,000</u>	<u>49,827,000</u>
Net discount to present value	<u>(732,000)</u>	<u>(1,400,000)</u>
Net outstanding claims - discounted	43,437,000	48,427,000
Net risk margin	<u>5,212,000</u>	<u>5,327,000</u>
Net outstanding claims - discounted including risk margin	<u>48,649,000</u>	<u>53,754,000</u>

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

#### ***(b) Process to determine net outstanding claims provision***

##### Overview

The effective date of the actuarial report on the insurance liabilities is 31 December 2012. The actuarial report was prepared by Martin Fry (Fellow of the New Zealand Society of Actuaries, Institute of Actuaries of Australia, and Institute of Actuaries (London)) of Taylor Fry Consulting Actuaries. Taylor Fry Consulting Actuaries are satisfied with the nature, sufficiency and accuracy of data provided for the purpose of estimating insurance liabilities.

The outstanding claims provision is determined based on three building blocks being:

- An estimate of future cash flows;
- Discounting for the effect of the time value of money; and
- Adding a risk margin for uncertainty.

The process for determining each of the above is described below.

##### Future cash flows

The estimation of the outstanding claims provision is based on actuarial techniques that analyse experience, trends and other relevant factors. The actuarial claims estimate process commences with the projection of the future payments relating to claims incurred at the reporting date. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims incurred but not enough reported (IBNER), claims incurred but not reported (IBNR) and the anticipated direct and indirect claims handling costs.

The Branch's claims are characterised by low frequency and high variability in claim size. Accordingly, it is not considered appropriate to rely on aggregate payment pattern to project future claims costs. Instead, estimates are based on analysis of incurred costs, and the performance of estimates, over time.

The different components of the outstanding claims provision are subject to different levels of uncertainty. The estimation of the cost of claims reported but not yet paid or not yet paid in full is made on a case by case basis by claims personnel having regard to the facts and circumstances of the claims as reported, any information available from loss adjusters/consultants and information on the cost of settling based on past experience with the accuracy of initial claims estimates. With IBNR, the estimation is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified, as no information is currently available about the claim. IBNR claims may often not be apparent until some time after the events giving rise to the claim having occurred.

Reserves are not established for catastrophes in advance of such events and so these events may cause volatility in the results for a period and in the level of the outstanding claims provision, subject to the effects of reinsurance recoveries.

The valuation of the outstanding claims provision is performed by the Appointed Actuary who does not have any role in the pricing function, so as to ensure that an objective and independent assessment of the outstanding claims liability is maintained.

##### Discounting

A projection of future claims payments both gross and net of reinsurance and other recoveries is undertaken. Projected future claims payments and associated claims handling costs are discounted to a present value as required, using appropriate risk free discount rates.

## *FM Insurance Company Limited (New Zealand Branch)*

### *Notes to the financial statements for the year ended 31 December 2012*

#### Risk margin

The central estimate of the outstanding claims liability is an estimate which is intended to contain no deliberate or conscious over or under estimation and is commonly described as providing the mean of the distribution. It is considered appropriate for the measurement of the claims liability to represent a higher degree of certainty regarding the sufficiency of the liability over time, and so a risk margin is added to the central estimate. The risk margin refers to the amount by which the liability recognised in the financial statements is greater than the actuarial central estimate of the liability. The risk margin added to the central estimate increases the probability that the net outstanding claims provision will ultimately prove to be adequate to 75%.

Risk margins are held to allow for uncertainty surrounding the outstanding claims provision estimation process. Potential uncertainties include those relating to the actuarial model and assumptions, the quality of the underlying data used in the model, general statistical uncertainty, and the general insurance environment.

#### *(c) Assumptions made*

##### Adopted assumptions

<b>Item</b>	<b>2012</b>	<b>2011</b>
Loss adjustment expenses rate (to net incurred claims)		
- FM Insurance (FM) Lines	<b>4.80%</b>	4.50%
- Affiliated FM (AFM) Lines	<b>3.20%</b>	3.00%
Indirect claim management expenses rate (to gross outstanding claims provision)	<b>4.00%</b>	4.00%
Inflation rate	<b>3.25%</b>	3.75%
Discount rate	<b>2.75%</b>	3.25%
Risk margin rate	<b>12.00%</b>	11.00%

##### Description of the assumptions

###### Loss adjustment expenses rate

- In respect of claims incurred up to the reporting date, it is known that loss adjustment expenses will be incurred in the management of claims to finalisation. An estimate of these costs is incorporated into the outstanding claims provision using the loss adjustment expense rate. The rate incorporates assumptions about the future costs to be incurred based on past experience of such costs for both the FM and AFM business lines adopted from the Australian liability valuation.

###### Indirect claim management expenses rate

- In respect of claims incurred up to the reporting date, it is known that administration costs will be incurred in the management of claims to finalisation. An estimate of these costs is incorporated into the outstanding claims provision using the indirect claim management expenses rate. The rate incorporates assumptions about the future costs to be incurred based on past experience of the cost per transaction.

###### Inflation rate

- Insurance costs are subject to inflationary pressures. Economic inflation assumptions are set by reference to current economic indicators. When making assumptions about the future claim inflation, assumptions have been made around the causative link between the type of claim and the expected growth. Fire claims may be expected, on average, to be driven by construction costs, which in turn may be expected to be driven by some factors that increase with average weekly earnings (AWE) inflation and some that increase with the consumer price index (CPI). Business interruption claims may be expected, on average, to be driven by Company profits for which the most appropriate

## *FM Insurance Company Limited (New Zealand Branch)*

### *Notes to the financial statements for the year ended 31 December 2012*

measure is gross operating surplus (GOS) forecasts. A weighted average of all of these measures has been adopted in determining the inflation rate.

#### Discount rate

- Because the outstanding claims provision represents payments that will be made in the future, they are discounted to reflect the time value of money, effectively recognising that the assets held to back insurance liabilities will earn a return during that period. Discount rates represent a risk free rate derived from market yields on Australian government securities.

#### Risk margin rate

- Due to the short term nature of the provisions, and the level of reinsurance cover, the approach adopted for determining the risk inherent in the provision, involved review of statistical variation in the incremental cost movement of gross incurred costs net of facultative reinsurance recoveries, allowing for additional variation in the excess of loss reinsurance recoveries, loss adjustment expenses and claims handling costs.

#### *(d) Sensitivities*

##### Modelled sensitivities

The impact of changes in key outstanding claims variables is summarised below. Each change has been calculated in isolation of the other changes.

It is not possible to quantify the sensitivity of certain assumptions such as legislative changes or uncertainty in the estimation process.

The impact on the net outstanding claims provision is disclosed for each of the key assumption. The movements are stated in absolute terms where the base assumption is a percentage, for example, if the base inflation rate assumption was 3.5%, a 1% increase would mean assuming a 4.5% inflation rate. All movements would be recognised directly through the Statement of comprehensive income.

<b>Item</b>	<b>Effect</b>
Increase discount rate by 0.5%	Reduce outstanding claim liabilities by NZ\$0.178 million (0.4% of outstanding claim central estimates)
Increase inflation rate by 0.5%	Increase outstanding claim liabilities by NZ\$0.178 million (0.4% of outstanding claim central estimates)
Increase risk margin by 0.5%	Increase outstanding claim liabilities by NZ\$0.217 million (0.4% of outstanding claim central estimates)
Change incremental incurred cost movement for most recent accident quarter to the average incurred cost of small incurred cost quarters (<\$10m)	Reduce outstanding claim liabilities by NZ\$0.402 million (0.8% of outstanding claim central estimates)
Change incremental incurred cost movement for most recent accident quarter to the average incurred cost of large incurred cost quarters (>\$10m)(includes Christchurch)	Increase outstanding claim liabilities by NZ\$18.046 million (37.1% of outstanding claim central estimates)
Reduce expected XoL recovery for OSC claims to 40% for March 2011 quarter	Increase outstanding claim liabilities by NZ\$6.870 million (14.1% of outstanding claim central estimates)
Increase XoL recovery for OSC claims to 70% for December 2012 quarter	Reduce outstanding claim liabilities by NZ\$0.276 million (0.6% of outstanding claim central estimates)

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

#### Description of the sensitivities

##### General impact of changes

- Sensitivity analysis is conducted to quantify the exposure to changes in the key underlying variables. The valuation included in the reported results is calculated using certain assumptions about these variables as disclosed above. The movement in any key variable will impact the financial position and performance for a period. The information below describes how a change in each assumption will affect claims provisions and provides an analysis of the sensitivity of the net outstanding claims provision to changes in these assumptions.
- Impact to the outstanding claims liabilities as a consequence of any adverse scenarios will be limited by application of the stop loss provisions of the intercompany reinsurance policy with FMIC.

##### Incremental incurred cost movement

- These sensitivities show the significance of incurred cost development assumptions. These are assumptions that have a very significant influence on the results of the valuation.

##### XoL

- These sensitivities show the significance of reinsurance assumptions. Due to the stop loss clause in the Branch's key XoL reinsurance treaty with FMIC, a significant change in the mix of estimated liabilities would be required in order to reduce the level of recoveries to 40%. Such a change in mix would likely also result in a reduction in the estimated cost net of facultative recoveries only. An increase to 70% is a more likely scenario.

##### Inflation rate

- Expected future payments are inflated to take account of inflationary increases. An increase or decrease in the assumed levels of inflation would have a corresponding impact on claims expense. Given the short tail nature of the Branch's provisions, the impact of a change in the inflation rate would not be material.

##### Discount rate

- The outstanding claims provision is calculated by reference to expected future payments. These payments are discounted to adjust for the time value of money. An increase or decrease in the assumed discount rate will have an opposing impact on total claims expense. Given the short tail nature of the Branch's provisions, the impact of a change in the inflation rate would not be material.

##### Risk margin

- An increase or decrease in the risk margin would have a corresponding impact on claims expense.

***FM Insurance Company Limited (New Zealand Branch)***

***Notes to the financial statements  
for the year ended 31 December 2012***

**15 Net unearned premium reserve**

***(a) Reconciliation of movements***

	2012	2011
	\$	\$
<b>Gross unearned premium reserve</b>		
Gross unearned premium reserve at the beginning of the financial year	13,387,842	6,807,580
Gross deferral of premiums on contracts written	44,494,300	28,948,746
Gross earning of premiums on contracts written	<u>(37,558,467)</u>	<u>(22,368,484)</u>
Gross unearned premium reserve at the end of the financial year	<u>20,323,675</u>	<u>13,387,842</u>
<b>Deferred reinsurance expense</b>		
Deferred reinsurance expense at the beginning of the financial year	9,705,413	4,785,700
Deferral of reinsurance	31,439,426	20,986,171
Expensing of reinsurance	<u>(26,784,243)</u>	<u>(16,066,458)</u>
Deferred reinsurance expense at the end of the financial year	<u>14,360,596</u>	<u>9,705,413</u>
<b>Net unearned premium reserve</b>		
Net unearned premium reserve at the beginning of the financial year	3,682,429	2,021,880
Net deferral of premiums on contracts written	13,054,874	7,962,575
Net earning of premiums on contracts written	<u>(10,774,224)</u>	<u>(6,302,026)</u>
Net unearned premium reserve at the end of the financial year	<u>5,963,079</u>	<u>3,682,429</u>

***(b) Liability adequacy test***

The liability adequacy test has been conducted using the central estimate of the premium liabilities, together with an appropriate margin for uncertainty. The test is based on prospective information and so is heavily dependent on assumptions and judgements. The liability adequacy test at the reporting date resulted in a deficit (2011: deficit) for the Branch. The deficiency is recognised as an unexpired risk liability in the Statement of financial position.

The following table provides the net deficiency calculated under the liability adequacy test at the reporting date for the relevant financial year:

***FM Insurance Company Limited (New Zealand Branch)***

***Notes to the financial statements  
for the year ended 31 December 2012***

	2012	2011
	\$	\$
<b>Premium reserve</b>		
Gross unearned premium reserve	20,323,675	13,387,842
Deferred reinsurance expense	14,360,596	9,705,413
Net unearned premium reserve	<u>5,963,079</u>	<u>3,682,429</u>
Deferred acquisition costs	<u>0</u>	<u>0</u>
Net unearned premium reserve less DAC	<u><b>5,963,079</b></u>	<u>3,682,429</u>
<b>Premium liability</b>		
Gross central estimate of expected future cash flows for future claims	<b>16,480,000</b>	10,847,000
Reinsurance recoveries	<u><b>11,145,000</b></u>	<u>7,487,000</u>
Net central estimate of expected future cash flows for future claims	5,335,000	3,360,000
Risk margin	<u><b>1,334,000</b></u>	<u>672,000</u>
Net premium liability, including risk margin	<u>6,669,000</u>	<u>4,032,000</u>
Net deficiency	<u><b>(705,921)</b></u>	<u><b>(349,571)</b></u>
<b>Assumptions</b>		
Risk margin %	<b>25.0%</b>	20.0%
Probability of adequacy %	<b>75.0%</b>	75.0%
Policy administration % (to gross unearned premium reserve)	<b>5.0%</b>	5.0%

## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

#### **16 Trade and other payables**

The payables are unsecured, non-interest bearing and are normally settled between 7 days and 90 days. The balance has not been discounted because the effect of the time value of money is not material. The net carrying amount of the payables is a reasonable approximation of the fair value of the liabilities because of the short term nature of the liabilities.

The following table provides the total amount of trade and other payables at the reporting date for the relevant financial year:

	2012	2011
	\$	\$
<b>Trade and other payables</b>		
Reinsurance creditors	<b>8,093,469</b>	8,134,577
Auditor fee payable	<b>22,705</b>	22,347
Total trade and other payables	<b><u>8,116,174</u></b>	<b><u>8,156,924</u></b>

#### **17 Related parties**

The Branch is a part of FM Insurance Company Limited (the “Company”).

The Company is a wholly owned subsidiary of Factory Mutual Insurance Company (FMIC), (the “Parent”).

The following table provides the total amount of transactions that were entered into with related parties for the relevant financial year:

	2012	2011
	\$	\$
<b>FM Insurance Company (Australia) Ltd</b>		
General and administration expenses	<b>7,163,522</b>	4,357,271
<b>Factory Mutual Insurance Company</b>		
Reinsurance expense	<b>14,955,265</b>	8,341,159
Reinsurance recoveries	<b>28,785,058</b>	269,465,497

Unless otherwise stated, related parties are members of the FMIC Group.

*Terms and conditions of transactions with related parties:*

- Reinsurance transactions to/from related parties are made in arm's length transactions both at normal market prices and on normal commercial terms.
- Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

#### **18 Equity retained for purposes of financial soundness**



## ***FM Insurance Company Limited (New Zealand Branch)***

### ***Notes to the financial statements for the year ended 31 December 2012***

The Australian Branch retains a level of equity and retained reserves which enable it to maintain an adequate solvency margin for ongoing ability to pay clients. Its assets are available to support the liabilities of the company outside of New Zealand. The New Zealand operations of FM Insurance Company Ltd are included within the Australian Branch.

#### **19 Contingent liabilities**

There were no known contingent liabilities as at the reporting date requiring disclosure in these financial statements.

Contingent liabilities are not recognised on the Statement of financial position but are required to be disclosed in the notes to the financial statements where the possibility of settlement is less than probable but more than remote. Provisions are not required with respect to such matters as it is not probable that a future sacrifice of economic benefits will be required or the amount cannot be reliably measured.

#### **20 Commitments**

##### ***(a) Capital commitments***

The Branch has no capital expenditure contracted for at the reporting date but not recognised in the financial statements.

##### ***(b) Software license and/or rental commitments***

The Branch has no current software license and/or rental commitments.

##### ***(c) Operating lease commitments***

The Branch has no current non-cancellable operating lease commitments.

##### ***(d) Finance lease commitments***

The Branch has no current finance lease commitments.

#### **21 Subsequent events**

No transactions or events occurred after the reporting date which significantly affected, or may significantly affect, the results of the Branch, the operations of the Branch, or the state of affairs of the Branch.

***FM Insurance Company Limited (New Zealand Branch)***

***Notes to the financial statements  
for the year ended 31 December 2012***

**22 Notes to the cash flow statement**

***(a) Cash and cash equivalents***

	<b>2012</b>	2011
	\$	\$
Intercompany account	<b>33,531,057</b>	(40,312,801)
Total cash and cash equivalents	<u><b>33,531,057</b></u>	<u><b>(40,312,801)</b></u>

***(b) Reconciliation of profit / (loss) for the year to net cash flows from operating activities***

	<b>2012</b>	2011
	\$	\$
Loss for the year	<b>(1,561,540)</b>	(1,536,559)

***Non-cash items***

Net unrealised (gains)/ losses on revaluation of investments	<b>19,597</b>	(157)
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***Movement in operating assets and liabilities***

**Decrease / (Increase) in operating assets**

Trade and other receivables	<b>77,696,805</b>	(89,709,406)
Deferred reinsurance expense	<b>(4,655,183)</b>	(4,919,713)
Reinsurance and other recoveries on outstanding claims	<b>(11,739,762)</b>	(110,793,754)

**Increase / (Decrease) in operating liabilities**

Trade and other payables	<b>(40,750)</b>	5,983,147
Unearned premium reserve	<b>6,935,833</b>	6,580,262
Deferred reinsurance commission	<b>197,746</b>	54,592
Unexpired risk liability	<b>356,350</b>	349,571
Outstanding claims provision	<b>6,634,762</b>	154,736,391
Net cash flows from operating activities	<u><b>73,843,858</b></u>	<u><b>(39,255,626)</b></u>



## Appointed actuary's report to the Directors of FM Insurance Co., Ltd. – New Zealand Branch

Report in respect of a review of actuarial information in, or used in the preparation of, financial statements

This report is provided under section 78 of the *Insurance (Prudential Supervision) Act 2010* ("the Insurance Act"), and relates to a review of the actuarial information in, or used in the preparation of, the financial statements of FM Insurance Company Limited (New Zealand) ("FMI (NZ)") for the year ended 31 December 2012.

The financial statements were authorised for issue by the Board of Directors of FM Insurance Company Limited ("FMI") on 31 May 2013 and the accompanying independent auditors' report was issued on 31 May 2013.

### Name of appointed actuary conducting the review

I, Martin Fry, of Taylor Fry Consulting Actuaries ("Taylor Fry") am a Fellow of the New Zealand Society of Actuaries. This review has been conducted by me in my role as appointed actuary to FMI (NZ).

Other than that of actuary, I confirm that I have no relationship with, or any other interests in, FMI (NZ).

### Exemption from solvency standard

FMI (NZ) has been granted a Section 59 exemption under the Insurance Act, which applies to overseas insurers of approved jurisdictions. This provides an exemption from compliance with the New Zealand Solvency Standard for Non-life Insurance Business and was dated 14 February 2012. I understand that under this exemption, the Reserve Bank of New Zealand considers the solvency of FMI (NZ) based on the solvency ratio of FMI under the UK Financial Services Authority ("FSA") requirements. I have been provided with FMI's solvency margin, calculated under FSA requirements, which I note comfortably exceeds the UK regulatory minimum. I have not reviewed these calculations but have relied on their accuracy, noting that they have been provided to the FSA in the UK.

### Work done in relation to actuarial information used in the financial statements

The actuarial information used in the financial statements comprises the outstanding claims liability as at 31 December 2012 shown in the statement of financial position. This amount was determined in accordance with the New Zealand Equivalent to International Financial Reporting

#### Sydney

Level 11, 55 Clarence Street  
Sydney NSW 2000

P 02 9249 2900

F 02 9249 2999

#### Melbourne

Level 6, 52 Collins Street  
Melbourne VIC 3000

P 03 9658 2333

F 03 9658 2344

ACN 087 047 809

ABN 29 087 047 809

W [www.taylorfry.com.au](http://www.taylorfry.com.au)



Standard 4 ("NZ IFRS 4"), and represents the net central estimate plus a risk margin to provide a 75% probability of sufficiency. I confirm that this amount was calculated by me and advised to FMI (NZ) in a Financial Condition Report dated 27 May 2013.

I have carried out a Liability Adequacy Test, and confirm that the unearned premium less deferred acquisition costs plus unexpired risk liability is not less than my actuarial estimate of the net premium liability.

In carrying out this review, I confirm that I have been provided with all required information and explanations from FMI (NZ).

### Opinion

In my opinion:

- The actuarial information contained in the financial statements for FMI (NZ) has been appropriately included in those statements, and
- The actuarial information used in the preparation of the financial statements for FMI (NZ) has been used appropriately.

### Scope and limitations of review

This report is prepared for the Directors of FMI (NZ), solely for the purposes set out in section 78 of the Insurance Act and for no other purpose.



Martin H Fry  
Fellow of the New Zealand Society of Actuaries

31 May 2013

