SUNDERLAND MARINE MUTUAL INSURANCE COMPANY LIMITED

NEW ZEALAND BRANCH

FINANCIAL STATEMENTS

31ST DECEMBER 2013

Independent auditor's report

To the directors of Sunderland Marine Mutual Insurance Company Limited - New Zealand Branch

Report on the financial statements

We have audited the accompanying financial statements of Sunderland Marine Mutual Insurance Company Limited - New Zealand Branch ("the Branch") on pages 4 to 22. The financial statements comprise the statement of financial position as at 31 December 2013, the statements of comprehensive income, changes in head office account and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and International Financial Reporting Standards 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 these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (New Zealand). Those standards require that we comply with 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 the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Branch'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 Branch'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 presentation of the financial statements.

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

Our firm has also provided other services to the Branch in relation to general accounting services. Subject to certain restrictions, partners and employees of our firm may also deal with the Branch on normal terms within the ordinary course of trading activities of the business of the Branch. These matters have not impaired our independence as auditor of the Branch. The firm has no other relationship with, or interest in, the Branch.

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Opinion

In our opinion the financial statements on pages 4 to 22:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards;
- give a true and fair view of the financial position of the Branch as at 31 December 2013 and of its financial performance and cash flows for the year then ended.

Report on other legal and regulatory requirements

In accordance with the requirements of sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993, we report that:

- we have obtained all the information and explanations that we have required; and
- in our opinion, proper accounting records have been kept by Sunderland Marine Mutual Insurance Company Limited - New Zealand Branch as far as appears from our examination of those records.

KPMG

31 May 2014
Auckland

Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Annual Report

For the year ended 31 December 2013

The Board of Directors is pleased to present the financial statements of its New Zealand Branch for the year ended 31 December 2013 and the auditor's report thereon.

In the Directors' opinion, the financial statements and notes set out on pages 4-22:

a) comply with New Zealand generally accepted accounting practice and give a true and fair view of the financial position of the Branch as at 31 December 2013 and the results of operations of the year ended on that date.

b) have been prepared using the appropriate accounting policies, which have been consistently applied and supported by reasonable judgements and estimates.

The Directors believe that proper accounting reports have been kept which enable, with reasonable accuracy, the determination of the financial position of the Branch and facilitate compliance of the financial statements with the Financial Reporting Act 1993 and the Companies Act 1993. There are reasonable grounds to believe that, as at the time this statement is made, the Branch will be able to pay all debtors or claims as and when they are due.

The shareholders of the Company have exercised their right under Section 211(3) of the Companies Act 1993 and unanimously agreed that this Annual Report need not comply with any of paragraphs (a) and (e) to (j) of Section 211(1) of the Act.

Signed in Durham on 31 May, 2014 in accordance with a resolution of the Directors.

For and on behalf of the Board of Management:

G.C. PARKINSON
Director

31 May, 2014

T.F. HART
Director

31 May, 2014

Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Statement of comprehensive income

For the year ended 31 December 2013

	Note	2013 $NZ	2012 $NZ
Revenue			
Premium	3(a)	4,961,213	4,636,883
Investment income	3(b)	22,556	33,930
Total operating revenue		4,983,769	4,670,812
Expenses			
Claims	3(a)	(1,309,913)	(2,314,858)
Underwriting expenses	3(a)	(404,235)	(166,708)
Administration expenses		(1,026,107)	(1,274,052)
Operating surplus before taxation		2,243,514	915,194
Income tax	10	(629,245)	(253,625)
Profit from operating activites after tax attributable to members of SMMI Co Ltd.		1,614,269	661,570

The Statement of Financial Performance is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 22.

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Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Statement of changes in Head Office Account

For the year ended 31 December 2013

HEAD OFFICE ACCOUNT	Note	2013 $NZ	2012 $NZ
Head office account at the beginning of the year		1,227,330	1,438,217
Net surplus for the year		1,614,269	661,570
Transfer to head office on settlement of head office account		(942,095)	(872,457)
Head office account at the end of year		1,899,504	1,227,330

The Statement of Movements in Head Office Account is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 22.

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Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Statement of Financial Position

As at 31 December 2013

	Note	2013 $NZ	2012 $NZ
Assets			
Land and buildings	5	786,196	790,722
Fixed assets		36,926	39,294
Total non-current assets		823,122	830,016
Current assets			
Cash on hand		212,385	91,096
Short term bank deposits		1,996,310	1,154,408
Financial assets	7	517,242	537,717
Debtors		5,098,969	4,655,875
Reinsurance receivable	8	1,006,348	1,055,849
Deferred tax asset		24,918	21,455
Total current assets		8,856,172	7,516,400
Total assets		9,679,294	8,346,416
Current liabilities			
Payables		524,058	216,297
Unearned premium		4,911,318	4,655,115
Provision for outstanding claims	9	2,344,414	2,247,674
Total current liabilities		7,779,790	7,119,086
Total liabilities		7,779,790	7,119,086
Head office current account		1,899,504	1,227,330
Total liabilities and head office account		9,679,294	8,346,416

The Statement of Financial Position is to be read in conjunction with the notes to the financial statements set out on pages 8 to 22.

Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Statement of Cashflows

As at 31 December 2013

	2013 $'000	2012 $'000
Cash flows provided (used in) by operating activities:		
Net income	1,614,269	661,570
Changes in non-cash operating accounts:		
Receivables arising out of direct insurance operations	(109,624)	(161,261)
Deferred policy acquisition costs	(25,116)	(10,521)
Outstanding claims, net of reinsurers' share	138,142	(383,022)
Unearned premiums, net of reinsurers' share	(214,566)	235,327
Unearned reinsurance commissions	178,200	(117,907)
Unrealised (gains) / loss on investments	20,475	13,333
Fixed Assets Amortisation	2,368	56,509
Investment Property Depreciation	4,526	4,525
Other, net	296,612	1,346,150
	1,905,286	1,644,703
Cash flows (used in) provided by investing activities:		
	-	-
Cash flows provided by financing activities:		
Due to Head Office	(942,095)	(872,457)
(Decrease) in cash and cash equivalents	963,191	772,245
Cash and cash equivalents, beginning of year	1,245,504	473,259
Cash and cash equivalents, end of year	2,208,695	1,245,504

The Statement of Cashflows is to be read in conjunction with the notes to the financial statements set out on pages 8 to 22.

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1 Summary of Significant Accounting Policies

Sunderland Marine Mutual Insurance Company Limited - New Zealand branch ("the Branch") is registered to carry on inward insurance business in New Zealand for a foreign company. The Branch's principal activity is general insurance.

The financial report was authorised for issue by the directors on 31 May 2014.

a) Reporting entity

Sunderland Marine Mutual Insurance Company Limited is a company registered under the Companies Act 1993. These are the financial statements of the Branch of the Company. The financial statements of the Branch have been prepared in accordance with NZ IFRS.

The financial statements comprise the following: statement of accounting policies, Statement of Financial Performance, Statement of Movements in Head Office Account, Statement of Cash Flows, Statement of Financial Position as well as the notes to the statements contained on pages 8 to 22 of this annual report. The financial report has been prepared in accordance with generally accepted accounting practice in New Zealand and on the basis of historical cost.

Fitch Ratings have assigned an A- rating to Sunderland Marine Mutual Insurance Company Limited New Zealand Branch.

b) Measurement base

The accounts of the Branch have been drawn up in accordance with applicable New Zealand accounting standards and are expressed in New Zealand dollars.

c) Statement of compliance

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). They comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards as appropriate to profit generating entities. The Branch is a profit oriented entity. The Branch is a reporting entity for the purposes of the Financial Reporting Act 1993 ("the Act") and its financial statements comply with that Act.

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1 Summary of Significant Accounting Policies (continued)

d) Basis of operation

The financial report is presented in New Zealand Dollars.

The financial report is prepared in accordance with the fair value basis accounting unless otherwise stated below.

The accounting policies set out below have been applied consistently by the Branch to all periods presented in the financial statements.

e) Premium revenue

Premiums have been brought to account as income from the date of attachment. The earned portion of premiums received and receivable is recognised as revenue. Unearned premiums are calculated by apportioning the premium income written in the year over the periods of risk from the dates of attachment based on the pattern of risk.

f) Accounts receivable

Accounts receivable are stated at their estimated realisable value after providing against debts where collection is doubtful. Bad debts are written off in the period in which they are identified.

g) Financial assets backing insurance contract liabilities

The Branch has determined that all financial assets are deemed to back insurance contract liabilities and are measured at fair value through the Statement of Financial Performance at each balance date as they meet the criteria under NZ IAS 39 *Financial Instruments: Recognition and Measurement.* Unrealised profits and losses on subsequent measurement to fair value are recognised in the Statement of Financial Performance.

h) Impairment of assets

All assets other than those which are set outside the scope of NZ IAS 36 *Impairment of Assets* are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purposes assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

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Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the year ended 31 December 2013

1 Summary of Significant Accounting Policies (continued)

i) Leases

Operating lease payments, where the lesser effectively retains substantially all the risks and benefits of ownership of the leased item, are included in the determination of operating surplus in equal instalments over the lease term.

j) Income tax

The income tax expense charged to the Statement of Financial Performance includes both the current year's provision and the income tax effects of timing differences calculated using the liability method. Tax effect accounting is applied on a comprehensive basis to all timing differences. A debit balance in the deferred tax account, arising from timing differences or income tax benefits from income tax losses, is only recognised if there is virtually certainty of realisation.

k) Goods and services tax

Revenues and expenses are stated net of goods and services tax (GST). Trade receivables and trade payables are stated inclusive of GST to the extent that GST is recoverable or payable.

l) Claims

Claims expense and liability for outstanding claims are recognised in respect of direct business. The liability covers claims reported and outstanding, incurred but not reported claims ("IBNR") and the anticipated direct and indirect costs of settling those claims. Claims outstanding are assessed by review of individual claim files and estimating the ultimate cost of settling claims which includes IBNR's and settlement costs using statistics based on past experience and trends. The outstanding claims reserve is estimated using internal management models and no actuarial valuation is explicitly performed on the Branch. A liability for outstanding claims has been recognised in respect of direct business as there are policies in default as at 31st December 2013.

m) Acquisition costs

A portion of acquisition costs relating to unearned premium revenue is recognised as an asset in recognition that it represents a future benefit. Deferred acquisition costs are amortised over the financial years expected to benefit from the expenditure and are stated at the lower of cost and recoverable value. As at 31 December 2013, the Branch had not deferred any costs.

1 Summary of Significant Accounting Policies (continued)

n) Reinsurance

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance service received.

2 Summary of Significant Actuarial Methods and Assumptions

Provision is made at the end of the year for the estimated cost of claims incurred but not settled at balance date. These reserves include estimates for claims that have been reported, claims that have been incurred but not reported (IBNR), and claims that have been incurred but not enough reported (IBNER), and include estimates of expenses associated with processing and settling these claims.

The process of establishing reserves is subject to considerable variability as it requires the use of informed estimates and judgements. These estimates and judgements are based on numerous factors, and may be revised as additional experience and other data become available or as regulations change.

Outstanding claims provision is estimated by class of business. Historical experience and other statistical information are used to estimate the ultimate claim costs. To determine the outstanding claims provision for a particular line of business, more than one method may be used to estimate ultimate losses and loss expenses and thus selecting a single point estimate. These methods may include, but are not necessarily limited to; extrapolations of historical reported and paid loss data, application of industry loss developments patterns to the reported or paid losses, expected loss ratios developed by management, or historical industry loss ratios. Underlying judgements and assumptions that may be incorporated into these actuarial results include, but are not necessarily limited to, adjustments to historical data used in models to exclude aberrations in claims data such as catastrophes that are typically analysed separately, adjustments to actuarial models and related data for known business changes, such as changes in claims covered under insurance contracts, and the effect of recent or pending litigation on future claims settlements.

The reserves as at 31 December 2013 were valued by Daniel Smith FIAA who was satisfied as to the nature, sufficiency and accuracy of the data provided.

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Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the year ended 31 December 2013

	2013 $NZ	2012 $NZ
3 Operating Results		
(a) Underwriting result		
Gross premium income	7,587,915	8,567,350
(Decrease) in unearned premium	(281,695)	(465,377)
Reinsurance ceded	(2,345,007)	(3,465,090)
Net premium	4,961,213	4,636,883
Claims expense		
Claims paid	1,946,287	17,586,967
Claims settlement expenses	196,001	222,117
Increase/(decrease) in outstanding claims provision	95,584	694,333
Reinsurance recoveries	(927,960)	(16,188,559)
Total claims expense	1,309,913	2,314,858
Underwriting expenses		
Net commissions	386,266	334,916
Other income deductions	17,969	(168,209)
Total underwriting expenses	404,235	166,708
Underwriting result	3,247,065	2,155,317
(b) Investment income		
Interest	22,556	33,930
4 Auditor's Remuneration		
Amounts received, or due and receivable, by the auditors KPMG *	-	-

* Note: Audit fees are paid on behalf of the branch by Head Office

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Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the year ended 31 December 2013

5 Land and Buildings

	$NZ
Balance at 31 December 2013	
Cost/Revaluation	800,000
Accumulated depreciation	(9,279)
Carrying value	790,721
Current year depreciation	(4,525)
Net Carrying Value	786,196
Balance at 31 December 2012	
Cost/Revaluation	800,000
Accumulated depreciation	(4,753)
Carrying value	795,247
Current year rise	(4,526)
Net Carrying Value	790,721

Land and Buildings (at fair value) were independently valued on 2 September 2010 by Duke & Cooke Limited, a firm registered with the Institute of Valuers of New Zealand, at $813,273.

6 (a) Net Claims Expense

	2013 $NZ	2012 $NZ
Current		
Gross claims incurred	2,041,872	18,281,300
Reinsurance and other recoveries	(927,960)	(16,188,559)
Net claims incurred	1,113,912	2,092,741
Claims settlement expenses	196,001	222,117
Net claims expense	1,309,913	2,314,858

(b) Net Claims Expense

Current year claims relate to risks borne in the current financial year. Prior period claims relate to a reassessment of the risks borne in all previous periods.

	Current year $NZ	Prior periods $NZ	2013 Total $NZ	2012 Total $NZ
Gross claims incurred and related expenses - undiscounted	4,477,826	(2,239,953)	2,237,873	18,503,417
Reinsurance and other recoveries - Undiscounted	(2,534,516)	1,606,557	(927,960)	(16,188,559)
Net claims incurred - undiscounted	1,943,310	(633,397)	1,309,913	2,314,858
Discount and discount movement- gross claims incurred	-	-	-	-
Net discount movement	-	-	-	-
	1,943,310	(633,397)	1,309,913	2,314,858

7 Financial Assets	2013 $NZ	2012 $NZ
(a) Financial assets - fair value through profit or loss		
Debt securities - unsecured	517,242	537,717
Total financial assets - fair value through profit or loss	517,242	537,717
Current financial assets	517,242	537,717
Non-current financial assets	-	-
Total financial assets - fair value through profit or loss	517,242	537,717

Changes in the fair value of financial assets through the income statement are recorded as revenue/expense in the income statement.

8 Reinsurance & Other Recoveries Receivable		
Reinsurance and other recoveries - current	1,006,348	1,055,849
Total reinsurance and other recoveries receivables	1,006,348	1,055,849

9 Outstanding Claims

	2013 $NZ	2012 $NZ
a) Outstanding claims liability		
Outstanding claims (gross)	1,965,235	2,025,557
Claims handling cost	196,001	222,117
Risk margin	183,178	-
Total outstanding claims liability - undiscounted	2,344,414	2,247,674
Currrent	2,344,414	2,247,674
Total	2,344,414	2,247,674

No discounting has been applied to claims on the basis that the majority of claims are expected to be settled within one year.

b) Risk margins

Due to IBNR's now being calculated on a best estimate basis, a risk margin of 23.58% for Hull, 24.87% for P&I and 19.73% for Aquaculture has been applied in order to achieve the probabilty of adequacy at a minimum confidence level of 75%. These risk margins are based on the previous years actuarial report. No risk margin was applied in 2012.

c) Liability adequecy test

The liability adequecy test has been conducted using the central estimate of the present value of expected future cash flows and has identified a surplus.

	$NZ	$NZ
Central estimate of the present value of expected future cash flows	2,445,792	2,507,404
Risk margin	-	-

Adequacy has been reviewed at a Group and Branch level, and failure in liability adqueacy is not envisaged.

The principal risk the Group faces under insurance contracts is that actual claims payments or the timing thereof, differ from expectations. This is influenced by the frequency and severity of claims and the subsequent development of long-tailed claims. The objective of the Group is to ensure that sufficient technical provisions are available to cover these liabilities.

This risk exposure is mitigated by diversification across a large portfolio of insurance contracts and geographical areas. The variability of risks is also reduced by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements.

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10 Income Tax

	2013 NZ$	2012 NZ$
a) Income tax expense		
Current taxes	634,733	271,242
Adjustments in respect of prior periods	(2,025)	(1,010)
Total current taxes	632,708	270,232
Deferred taxes		
Origination of timing differences	(3,463)	(16,607)
Income tax expense	629,245	253,625
b) Reconciliation of prima facie tax payable to income tax expense		
Profit from operating activities before income tax	2,243,514	915,195
Prima facie income tax payable (2012: 28%/ 2011: 28.5%)	628,184	256,255
Tax effect of amounts which are not deductible (taxable) in calculating taxable		
Non taxable income	3,209	(1,673)
Non deductible expenses	1,167	2,279
Timing differences	2,173	14,382
Prior year adjustments	(2,025)	(1,010)
Income tax expense	632,708	270,233
c) Income tax receivable/(payable)		
Opening balance at 1 January	(1,258)	(151,163)
Additional provisions recognised	(629,053)	(262,591)
Liabilities paid	373,334	261,333
Prior years recognised	1,258	151,163
Closing balance at 31 December	(255,719)	(1,258)
d) Deferred tax provision		
Opening balance at 1st January	21,455	4,848
Adjustments in respect of prior years	1,290	2,225
Adjusted opening balance at 1 January	22,745	7,073
Movement during the year	2,173	14,382
Closing balance at 31st December	24,918	21,455
Excess of taxation allowances over depreciation on fixed assets	4,357	(53)
Other timing differences	20,561	21,508
	24,918	21,455

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11 Contingencies

There are no contingencies in respect of the Board existing at the year end other than those already included in the Statement of Financial Position.

The Branch has no known contingent liabilities or contingent assets at the reporting date or the previous reporting date.

12 Commitments

a) Capital commitments
There have been no capital commitments contracted for at the reporting date or the prior year reporting date that have not been recognised as a liability.

b) Lease commitments
There have been no lease commitments contracted for at the reporting date or the prior year reporting date that have not been recognised as a liability.

13 Events Occurring after the Balance Sheet Date

Subsequent Events are events or transactions that occur after the balance sheet date but before financial statements were issued that provide additional evidence about conditions that existed at the date of the balance sheet. In preparing the financial statements, the Branch has evaluated events that occurred after December 31, 2013, up until the financial statements were available to be issued, which occurred on May 31, 2014.

On 28th February 2014 The North of England Protecting and Indemnity Association Limited acquired the company by becoming the sole member limited by guarantee.

From 28th February 2014 the company's immediate parent undertaking will be The North of England Protecting and Indemnity Association Limited which will be the ultimate parent company, incorporated in England.

Sunderland Marine Mutual Insurance Company will operate as a subsidiary of North of England, but it is not envisaged that it will affect the activity of the Branch for the foreseeable future.

14 Related Party Transactions

The Branch is part of Sunderland Marine Mutual Insurance Company Limited, a company incorporated in United Kingdom with Limited liability.

No guarantees have been given to or received from any related parties that are outside the normal trading arrangements involving the retrocession of reinsurance contracts.

15 Credit Ratings

The Company is rated by three rating agencies. At the time of signing this report, the ratings were; Standard and Poor's (A), AM Best (A-) and Fitch (A-).

16. Risk Management

The Branch's management of insurance risk and financial risk is a critical aspect of the business. The Branch has exposure to the following risks from its use of financial instruments and its insurance contracts:

- Insurance risk
- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Branch's exposure to each of the above risks, the objectives and policies and processes for measuring and managing risk.

(a) Risk management framework

(i) *Governance framework*

The primary objective of the risk management framework is to protect the policyholders from events that hinder the achievement of financial performance objectives. A policy framework, put in place at the Company level, sets out the risk profiled for the Branch and the Board regularly approves the Company's risk management policies.

(ii) *Regulatory framework*

One of the objectives of the Company's primary regulator is to protect the rights of the policyholders. The regulator monitors the Company closely to ensure that it is satisfactorily managing its affairs for the policyholders' benefit. At the same time the regulator is also interested in ensuring that the Company maintains an appropriate solvency position to meet unforeseen liabilities.

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The operations of the Branch are also subject to regulatory requirements. Such regulations not only prescribe approval and monitoring activities, but also impose certain requirements, such as capital adequacy, to minimize the risk of default and insolvency.

(iii) *Asset or liability management framework*

The Branch has limited exposure to risks arising from movements in interest rates and other prices which are exposed to general and specific market movements. The principal technique used by the Branch is to ensure that there is sufficient cash flow available to meet liabilities as they fall due.

Specific risks that the Branch is exposed to, and how they are managed, are explained below.

(b) Insurance risk

The Branch issues contracts that transfer significant insurance risk. This section outlines the specific insurance related risks the Branch is exposed to and how these are managed.

(i) *Underwriting risk*

Underwriting risk is the risk that the total cost of claims, claims adjustment expenses and premium acquisition expenses will exceed the premiums received. This can arise as a result of numerous factors, including pricing risk, reserving risk and catastrophe risk.

Pricing risk arises because actual claims experience can differ adversely from the assumptions included in pricing calculations. Reserving risk arises because actual claims can differ adversely from the assumptions included in setting reserves, Catastrophe risk is the risk that a single event or series of events, of major magnitude leads to a significant deviation in actual claims from the total expected claims.

Underwriting risk will be influenced by the frequency of claims, severity of claims, and subsequent development of long-tail claims. The objective of the Branch is to ensure that sufficient insurance contract provisions are available to cover these liabilities.

Strict claim review handling policies to assess all new and on-going claims, regular detailed review of claims handling procedures and frequent investigation of possible fraudulent claims are all policies and procedures put in place to reduce the insurance risk exposure of the Branch.

The Branch further enforces a policy of actively managing claims in order to reduce its exposure to unpredictable future developments that can adversely impact the Branch.

(ii) *Concentration risk*

This risk exposure is mitigated by diversification across a large portfolio of insurance contracts and geographical areas. The variability of risks is also reduced by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements. This serves to reduce the exposure to concentration risk, the risk of exposure to increased losses associated with inadequately diversified portfolios or assets and/or obligations.

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(iii) *Reinsurance risk*

The Branch reinsures a portion of the risks it writes in order to control its exposure to losses (including catastrophic losses) and protect capital resources. The Branch buys a combination of proportional and non-proportional reinsurance to reduce the net exposure of the Branch on any one risk. Amounts recoverable from reinsurers are estimated in a manner consistent with the provision for unpaid claims and are in accordance with the reinsurance contracts.

Although the Branch has reinsurance arrangements, it is not relieved of its direct obligation to its policyholders and thus a credit risk exposure exists with respect to ceded insurance to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements. The Branch's placement of reinsurance is diversified such that it is not dependent on a single reinsurer.

(c) **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. It arises principally from reinsurance receivables, direct insurance receivables, and investments. The following policies and procedures are in place to mitigate the Branch's exposure to credit risk.

(i) *Reinsurance receivables*

Reinsurance is only placed with counterparties that have a good credit rating. The Company's security committee ensures that all the Branch's reinsurers' are rated as 'A' or above by Standard & Poor's.

(ii) *Direct insurance receivables*

The Branch's exposure to credit risk from receivables arising out of direct insurance operations is influenced by the individual characteristics of each policyholder and their payment of premiums. Each policyholder is required to pay the premiums in the period specified in their respective policy agreement.

The Branch manages the impact of credit risk by cancelling policies with balances outstanding after the relevant payment period has expired, subject to the terms of the individual policy agreement. If a policy is cancelled, the policyholder has ceased to be insured by the Branch and the Branch will no longer be liable for any claims occurring before or after the cancellation of insurance. This is in accordance with the Branch's general conditions.

(iii) *Investments*

The Branch holds Debt Securities with a fair value of $0.5 million (2012 - $0.5 million) which is a short term government bond and Cash and Short Term bank deposits of $2.2m (2012 - $ 1.2m). These are deemed to have minimal credit risk.

(d) Liquidity Risk

Liquidity risk is the risk that the Branch will encounter difficulty in meeting its financial obligations as they fall due.

The Branch's approach to managing liquidity risk is to ensure, as far as possible, that it will always have sufficient liquidity in meeting its liabilities when due. The Branch monitors its forecast liquidity position by estimating cash outflows from its insurance contracts and placing cash on deposit with similar durations to meet those obligations. All financial liabilities at December 31, 2013 and 2012 are due on demand.

(e) Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.

Currency risk

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

All the Branch's transactions and all balances are held in New Zealand dollars. The Branch participates in SMMI's global reinsurance program. SMMI's reinsurance program is denominated in Sterling and US Dollars and is managed by SMMI's head office in the UK. The Branch pays its proportion of the costs of the reinsurance program in New Zealand Dollars and also receives any recoveries from the program in New Zealand Dollars. SMMI in the UK is exposed to currency risk on the reinsurance program rather than the Branch.

The Branch is exposed to currency risk only to the extent that the calculation of the reinsurance premium charged and recoveries receivable in New Zealand Dollars vary due to exchange rates used in the calculations by SMMI head office for the Branch.

At December 31, 2013, exchange rate risk for the Branch is limited to recoveries due when an excess of loss contract for unpaid claims is in excess of £250,000. At December, 31, 2013 there were no provisions for unpaid claims in excess of £250,000 and therefore no recoveries were due to the Branch. To test the sensitivity of recoveries becoming due under this contract, a theoretical movement in the exchange rate of 20% was used to recalculate recoveries. This generated a recovery on a single claim amounting to just $1,000. Therefore, management of the Branch concludes that movements in the exchange rate do not have a material impact upon recoveries due from this contract.

Interest rate risk

This is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Sunderland Marine Mutual Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the year ended 31 December 2013

The Branch's exposure to changes in market interest rates is concentrated in its investment portfolio, where there is only one short term government bond investment made.

The Branch manages its investment portfolio in accordance with an investment framework. The framework is used to determine both the investment policy and to establish the investment risk appetite. In this context, the overall risk is reviewed on a regular basis and the asset allocation is adjusted as necessary.

Other price risk

This is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest risk or currency risk, whether those changes are cause by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Branch is exposed to minimal other price risk as its investment portfolio is principally in debt securities guaranteed by the New Zealand Government or issued by New Zealand Provinces and has no exposure to equity investments or commodities prices.

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