Insurance Industry financial statements all in one place

And an analysis of TOWER's 2016 results

February 2017

Insurance industry financial statements

MJW has compiled a library of all the financial statements for every insurer licensed to operate in New Zealand.

The library serves two purposes:

- A list of licensed insurers, categorised by license status and major sectors (general, life, health, reinsurance and captive).
- A convenient quick reference source of financial statements for every insurer, including those no longer licensed.

The insurance industry library is available to view at mjw.co.nz/insurance-industry-data.

We are currently working on some interactive tools to allow users to compare key figures across industry participants – watch this space.

To recognise the establishment of the list, we thought we'd take a look at one of the latest set of accounts available, TOWER Insurance Limited, as they have been in the media regarding a takeover.

Fairfax to purchase TOWER Limited

Fairfax Financial Holdings Limited – a Canadian based insurance group – recently made an offer to purchase TOWER Limited at $1.17 per share. This represents a 48% premium on the share price at the time of the announcement of $0.79. If successful, Fairfax would acquire Tower for a total of $197 million.

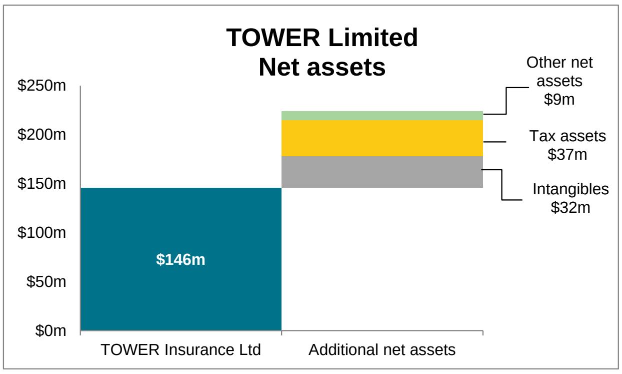
Despite the considerable premium over the current market price, Fairfax would still acquire Tower for less than their net assets based on their latest set of accounts.

TOWER Group's net assets

TOWER Limited had net assets of $224 million as at 30 September 2016. This includes the insurance company – TOWER Insurance Limited – as well as some other large items. The net assets of the insurer were $146 million. On top of this TOWER Limited held:

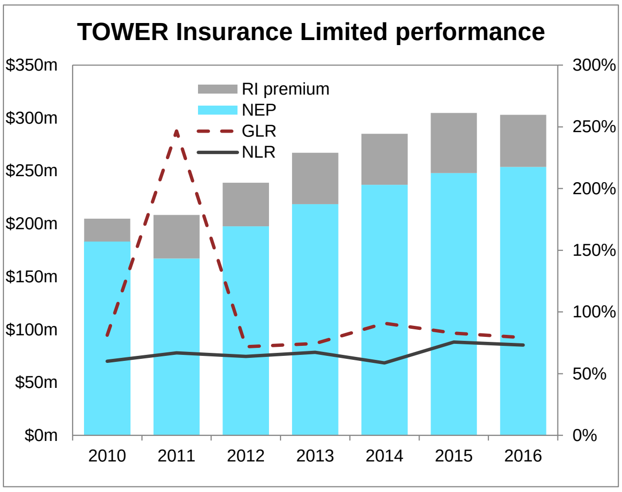
- $37 million in tax assets
- $32 million in intangible assets (broadly half/half software and goodwill)
- $9 million for some other items (mostly cash).

An additional $6 million in tax assets were held within the insurer, making a total of $43 million in tax assets for TOWER Limited. It is unclear whether a new owner would be able to utilise these assets.

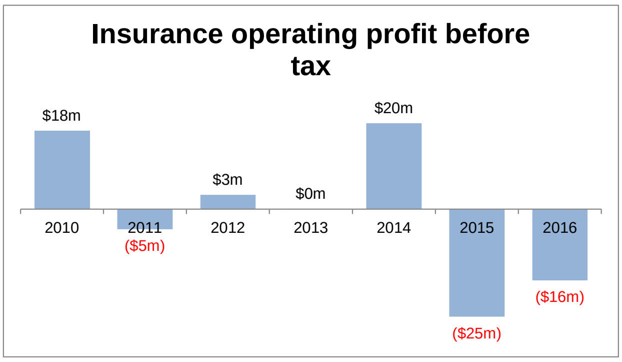


TOWER Insurance Limited

Let's take a closer look at the insurer.



Tower saw steady growth in premium volume from 2011 to 2015, presumably in part helped by the considerable increase in rates after the earthquakes. The increased cost of reinsurance post Canterbury is evident, as is the impact of the earthquakes on gross loss ratios, both in 2011 and later.



Simpl House 40 Mercer Street
PO Box 11330 Wellington 6142 New Zealand
T: 64 4 499 0277
wgtn@mjw.co.nz

www.mjw.co.nz

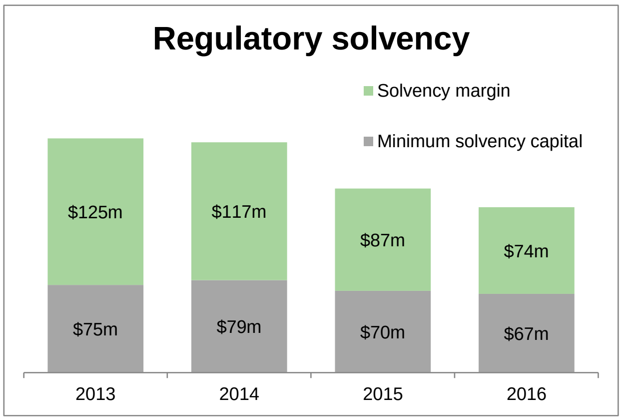
MELVILLE JESSUP WEAVER LIMITED

57 Fort Street
PO Box 4014 Auckland 1140 New Zealand
T: 64 9 300 7155
akld@mjw.co.nz

Insurance profits (i.e. excluding investment or other income) remained positive or near zero from 2010 to 2014 as reinsurers bore the brunt of the earthquakes. It wasn't until the true cost of the earthquakes started to emerge in subsequent years that this impacted profits, eventually moving well into the red in 2015 and 2016.

Solvency position

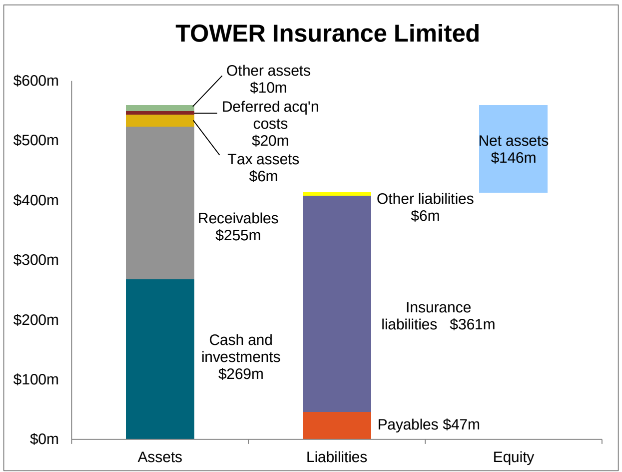
The Reserve Bank started regulating the insurance sector in 2010 and Tower progressed to a full license in August 2013.



Since 2013 Tower has been required to hold at least a minimum amount of capital, calculated according to a prescribed methodology. This number has varied between $67-79 million. In addition to this the Reserve Bank required Tower to hold a margin of at least $80 million in 2013, reducing to $50 million in 2014 and remaining at that figure to date. Tower has maintained a margin in excess of the Reserve Bank requirement, although the margin has been decreasing.

Net assets

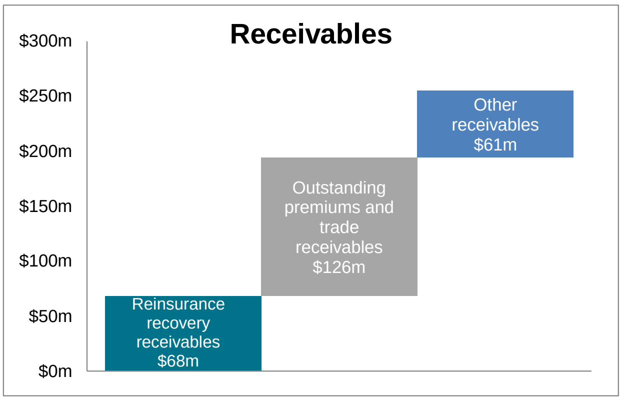
What about the net assets of the insurer?



Tower holds $255 million in receivables. Note 12 breaks this down as:

- $68 million from reinsurers
- $126 million in outstanding premiums and trade receivables
- $61 million in other receivables.

The $68 million includes a component related to recoveries under the Adverse Development Cover with Peak Re. The maximum amount recoverable under the ADC is $43.75 million and this has been fully recognised in the accounts. The sensitivity analysis in note 6 states that a 100% reduction in ADC receivables would have a $38.8 million impact on Tower's profits.



The $126 million for outstanding premiums and trade receivables includes a component for EQC recoveries which note 6 identifies as $57.6 million (note 6 doesn't explicitly state that the $57.6 million is all due from EQC, but the results announcement of 29 November 2016 says this and notes that the recovery is disputed).

Note 22 discusses how the EQC recoveries have been allocated to tiers according to their likelihood of recovery. However, note 12 identifies only $1 million allowance for credit losses and impairment within the entire $126 million. This suggests that either:

- There is minimal allowance in the $57.6 million EQC recoveries for potential impairment, or
- There is a more significant allowance, but for some reason this has not been disclosed within note 12.

EQC recoveries

So what exactly does this $57.6 million EQC recovery asset relate to? The sensitivity analysis in note 6 might give some indication.

The analysis states that a 10% increase in respect of land damage recoveries would increase Tower's profit by $0.7 million. This only shows an impact on Tower's position for the Feb-2011 event, most likely because the other events still have reinsurance cover and therefore the impact on profit is constrained. This suggests something of the order of $7 million is held for EQC recoveries in respect of land damage for the Feb-2011 event.

Similarly, the analysis shows that a 10% movement in EQC building cost recoveries would impact the Feb-2011 position by $0.1 million, indicating that around $1 million is held for building recoveries for Feb-2011.

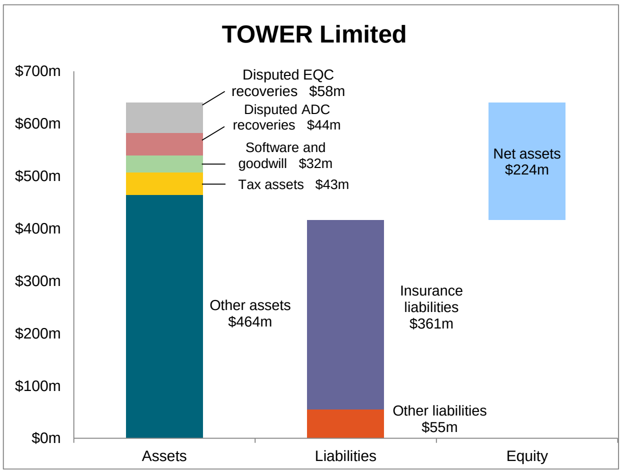
So if only around $8 million or so out of the $57.6 million relates to the Feb-2011 event then that leaves a considerable amount allocated to the Sep-2010 and other events.

Canterbury earthquakes

Note 6 includes some interesting disclosures around the Canterbury earthquake events. There is a provision of $149 million for outstanding claims, of which $109 million is expected to be recovered from other parties (including the ADC and EQC recoveries discussed earlier). That leaves net outstanding claims of $41 million.

Within the $109 million recoveries is $7 million for other reinsurance recovery receivables which is most likely in respect of catastrophe cover still remaining on the Sep-2010 or Jun-2011 events. The note also discloses that there is reinsurance 'headroom' of only $7.7 million remaining on the Sep-2010 event, meaning that a deterioration of more than $7.7 million for Sep-2010 would see Tower exceed their catastrophe cover for the event. For context, the total gross ultimate position for the four main earthquakes deteriorated by $78 million over the preceding 12 months.

Summary



In summary TOWER Limited has net assets of $224 million, comprised of:

- $43 million in tax assets
- $32 million in software and goodwill
- $43.75 million and $57.6 million in disputed recovery assets with Peak Re and EQC
- $47 million for other assets less liabilities.

The intended purchase price of $197 million is less than the net assets. This is not the case if we remove the tax assets which could be lost as part of the intended takeover.

ABOUT MELVILLE JESSUP WEAVER

Melville Jessup Weaver is a New Zealand firm of consulting actuaries providing advice on superannuation, insurance and asset consulting. The firm, established in 1992, has offices in Auckland and Wellington and is an alliance partner of Willis Towers Watson, a leading global services company and is located on the web at willistowerswatson.com.

For further information please contact:

Craig Lough 09 300 7151 *craig.lough@mjw.co.nz*	*Jeremy Holmes 09 300 7318* *jeremy.holmes@mjw.co.nz*	*David Chamberlain 04 830 0117* *david.chamberlain@mjw.co.nz*