

AIG INSURANCE NEW ZEALAND LIMITED

ANNUAL REPORT

For the financial year ended 31 December 2013

AIG INSURANCE NEW ZEALAND LIMITED

ANNUAL REPORT

For the financial year ended 31 December 2013

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AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

DIRECTORS' REPORT

The directors of AIG Insurance New Zealand Limited (the "Company") present their report to the shareholder together with the audited financial statements of the Company for the financial year ended 31 December 2013.

Directors

The directors of the Company in office at the date of this report are as follows:

C E Knell	
T E Elisara	(resigned 26 August 2013)
G R Bunkall	(resigned 17 February 2012)
D E Wilson	(appointed 17 February 2012; resigned 1 July 2013)
C G Townsend	(appointed 17 February 2012; resigned 8 May 2012)
C H Stobo	(appointed 1 December 2012)
J M McPhee	(appointed 1 December 2012)
J A Dawson	(appointed 1 July 2013)
C J Ryan	(appointed 1 July 2013)
S K Farquharson	(appointed 26 August 2013)

Nature of operations and principal activities

The principal activities of the Company during the year were the underwriting of various classes of general insurance and reinsurance of risks.

Dividends

No dividends were paid or declared for the year ended 31 December 2013 (2012: Nil).

Review and result of operations

The operating profit after tax of the Company for the year ended 31 December 2013 was \$5,444k (13 months ended 31 December 2012: operating profit after tax of \$6,139k). According to the register of directors' shareholdings, none of the directors holding office at the end of the financial year had any interest in the shares or debentures of the Company or its related corporations, except as follows:

Directors' use of Company information

During the reporting period the Board received no notices from Directors of the Company requesting to use Company information received in their capacity as Directors, which would not otherwise have been available to them.

Disclosures

Pursuant to Section 211 (3) of the Companies Act 1993, the shareholder has agreed that the annual report of the Company need not comply with Sections 211 (1) (e) to (h) and (j) of the Companies Act 1993.

Auditor

PricewaterhouseCoopers were appointed to undertake the audit of the financial statements for the year ended 31 December 2013.

This report is made in accordance with a resolution of the directors.

In the opinion of the directors,

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

DIRECTORS' REPORT

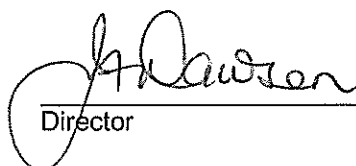
- (a) the statement of financial position of the Company as set out on page 8 are drawn up so as to give a true and fair view of the state of affairs of the Company as at 31 December 2013 and of the results of the business, changes in equity and cash flows of the Company for the financial year then ended; and
- (b) at the date of this statement, there are reasonable grounds to believe that the Company will be able to pay its debts as and when they fall due.

On behalf of the directors



Director

24 March 2014



Director



Independent Auditors' Report

to the shareholder of AIG Insurance New Zealand Limited

Report on the Financial Statements

We have audited the financial statements of AIG Insurance New Zealand Limited on pages 7 to 58, which comprise the statement of financial position as at 31 December 2013, the statement of comprehensive income and the statement of changes in equity and the statement of cash flows for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The Directors are responsible for the preparation of these 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 controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' 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) and International Standards on Auditing. These 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 the auditors' 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 auditors consider the internal controls relevant to the Company's preparation of 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 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 that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Other than in our capacity as auditors we have no relationship with, or interests in, AIG Insurance New Zealand Limited.

Opinion

In our opinion, the financial statements on pages 7 to 58:

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



Report on Other Legal and Regulatory Requirements

We also report in accordance with Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993. In relation to our audit of the financial statements for the year ended 31 December 2013:

- (i) we have obtained all the information and explanations that we have required; and
- (ii) in our opinion, proper accounting records have been kept by the Company as far as appears from an examination of those records.

Restriction on Distribution or Use

This report is made solely to the Company's shareholder in accordance with Section 205(1) of the Companies Act 1993. Our audit work has been undertaken so that we might state to the Company's shareholder those matters which we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's shareholder, for our audit work, for this report or for the opinions we have formed.

PricewaterhouseCoopers

Chartered Accountants
24 March 2014

Auckland

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2013***STATEMENT OF COMPREHENSIVE INCOME**

\$ '000	Notes	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Income			
Insurance premium revenue	4	174,773	171,725
Insurance premium ceded to reinsurers	4	(112,714)	(97,843)
Net earned insurance premium revenue	4	62,059	73,882
Fee and commission income	5	29,175	19,046
Net investment income	6	11,681	12,409
Other net losses	7	(3,384)	(4,666)
Other income	8	159	17,276
Total income		99,690	117,947
Expenses			
Insurance claims	9	(146,809)	(169,418)
Insurance claims recovered from reinsurers	9	97,555	93,265
Net insurance claims	9	(49,254)	(76,153)
Acquisition costs		(20,824)	(14,987)
Net operating expenses	10	(21,095)	(20,691)
Total expenses		(91,173)	(111,831)
Profit before tax		8,517	6,116
Income tax expense	11	(3,073)	23
Profit and total comprehensive income for the period		5,444	6,139

The accompanying notes form an integral part of these financial statements.

AIG INSURANCE NEW ZEALAND LIMITED
For the financial year ended 31 December 2013

STATEMENT OF FINANCIAL POSITION

\$ '000	Notes	As at 31 Dec 2013	As at 31 Dec 2012
ASSETS			
Cash and cash equivalents	12	83,105	40,489
Trade and other receivables	14	56,082	68,743
Other receivables	18	4,516	4,568
Reinsurance recoverables	15	5,640	16,456
Current tax asset		-	130
Deferred tax assets	22	934	1,261
Financial assets at fair value through profit or loss	13	182,556	203,339
Deferred acquisition costs	16	15,859	14,347
Provision for reinsurance on unearned premiums	20	66,071	49,507
Provision for reinsurance on outstanding claims	21	342,821	376,583
Property, plant and equipment	17	2,008	2,250
Total assets		759,592	777,673
LIABILITIES			
Trade and other payables	19	37,778	26,479
Deferred reinsurance commission	16	14,419	10,348
Current tax liabilities		3,070	-
Provision for gross unearned premiums	20	106,683	100,367
Provision for gross claims outstanding	21	491,038	538,672
Deferred tax liabilities	22	487	1,134
Total liabilities		653,475	677,000
EQUITY			
Share capital	24	158,250	158,250
Acquisition reserves	25	(63,721)	(63,721)
Retained earnings		11,588	6,144
Equity attributable to owners of the company		106,117	100,673
Non-controlling interest		-	-
Total equity		106,117	100,673
Total liabilities and equity		759,592	777,673

On behalf of the directors

Director

24 March 2014

Director

The accompanying notes form an integral part of these financial statements.

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

STATEMENT OF CHANGES IN EQUITY

\$ '000	Notes	Share capital	Other reserves	Retained earnings	Total
At 1 December 2011	24	60,000		5	60,005
Total comprehensive income					
Profit for the period		-	-	6,139	6,139
Other comprehensive income for the period		-	-	-	-
Total comprehensive income for the period		-	-	6,139	6,139
Issue of ordinary shares	24	98,250	-	-	98,250
Acquisition reserve	25	-	(63,721)	-	(63,721)
At 31 December 2012		158,250	(63,721)	6,144	100,673
Total comprehensive income					
Profit for the year		-	-	5,444	5,444
Other comprehensive income for the year		-	-	-	-
Total comprehensive income for the year		-	-	5,444	5,444
At 31 December 2013		158,250	(63,721)	11,588	106,117

The accompanying notes form an integral part of these financial statements.

AIG INSURANCE NEW ZELAND LIMITED

For the financial year ended 31 December 2013

STATEMENT OF CASH FLOWS

\$ '000	Notes	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Cash flow from operating activities:			
Premiums received		185,144	179,629
Reinsurance claim recoveries		142,133	178,240
Interest received		11,769	12,038
Claims paid		(194,443)	(260,042)
Outwards reinsurance premiums paid		(112,405)	(97,735)
Net commission income received		10,910	4,009
General operating expenses		(14,868)	(36,602)
Income tax		(3,393)	(236)
Subvention payment received		-	17,144
Net cash provided by / (used in) operating activities	27	24,847	(3,552)
Cash flow from investing activities:			
Purchase of financial assets		(110,637)	(141,455)
Maturities and disposal of financial assets		128,508	22,000
Proceeds from sale of plant and equipment		-	11
Purchases of property, plant, equipment and software		(102)	(2,336)
Cash transferred from transfer of insurance portfolio		-	91,127
Net cash provided by / (used in) investing activities		17,769	(30,653)
Cash flow from financing activities:			
Proceeds from issuance of ordinary shares		-	15,250
Net cash provided by financing activities		-	15,250
Cash and cash equivalents:			
Beginning of year	12	40,489	59,444
Net increase/(decrease) in cash and cash equivalents		42,616	(18,955)
End of year	12	83,105	40,489

The accompanying notes form an integral part of these financial statements.

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

These notes form an integral part of and should be read in conjunction with the accompanying financial statements.

1 General information

AIG Insurance New Zealand Limited ("the Company") is a limited liability company and is domiciled in New Zealand. The company changed its name to Chartis New Zealand Insurance Limited on 1 December 2011. On 30 November 2012 the Company changed its name to AIG Insurance New Zealand Limited. The sole shareholder of the Company is AIG Asia Pacific Insurance Pte Ltd (formerly Chartis Singapore Insurance Pte. Ltd) incorporated in Singapore. The ultimate parent company is American International Group Inc, ("AIG") is registered in the state of Delaware, USA. The nature of the operations and principal activities are outlined in the directors' report.

The registered office of the Company is Level 19, The AIG Building, 41 Shortland Street, Auckland.

The financial statements have been authorised for issue by the Board of Directors on 24 March 2013. The directors do not have the power to amend these financial statements after issue.

2 Significant accounting policies

2.1 Basis of preparation

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice equivalents to International Financial Reporting Standards ("NZIFRS") and International Financial Reporting Standards ("IFRS") as appropriate for profit oriented entities. The Company is registered under the Companies Act 1993. The Company is classified as an issuer under the Insurance (Prudential Supervision) Act 2010 and the Financial Reporting Act 1993. The financial statements comply with the requirements of the Companies Act 1993 and the Financial Reporting Act 1993. They have been prepared under the historical cost convention, as modified by the revaluation of certain assets as identified in specific accounting policies below. AIG Insurance New Zealand Limited is a profit oriented entity.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 3.

These financial statements have been prepared for a twelve month period covering 1 January 2013 through to 31 December 2013, although comparatives are for a thirteen month period following a change in balance date last year to align with the parent company, AIG Asia Pacific Insurance Pte Ltd.

All amounts in the financial statements and notes are shown in thousands of New Zealand dollars, rounded to the nearest thousand, unless otherwise stated.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.2 Changes in accounting policy and disclosures

The following standards have been adopted by the Company for the first time for the financial year beginning on or after 1 January 2013 and have a material impact on the Company:

Amendment to IAS 1, 'Financial statement presentation' regarding other comprehensive income. The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments).

Amendment to IFRS 7, 'Financial instruments: Disclosures', on assets and liability offsetting. This amendment includes new disclosures to facilitate comparison between those entities that prepare IFRS financial statements to those that prepare financial statements in accordance with US GAAP. The impact to the Company is not material.

IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs. The impact to the Company is not material.

New standards and interpretations not yet adopted

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2013, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Company, except the following set out below:

IFRS 9, 'Financial instruments', addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Company is yet to assess IFRS 9's full impact. The Company will also consider the impact of the remaining phases of IFRS 9 when completed by the Board.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Company.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.3 Premiums earned

Direct and inwards reinsurance premiums comprise amounts charged to the policyholder, excluding fire service and earthquake levies collected on behalf of statutory bodies. The earned portion of premiums received and receivable, including unclosed business is recognised on a straight line basis as revenue. Premium revenue is treated as earned from the date of attachment of risk over the period of the contract for direct business and over the period of indemnity for reinsurance contracts. Premiums on unclosed business, known as pipeline premiums, are brought to account by reference to historic patterns of premium processing delays, with due allowance for any changes in the pattern of new business and renewals.

The pattern of recognition of revenue over the policy or indemnity periods is based on time, which closely approximates the patterns of risks underwritten. The proportion of premiums received and receivable not earned in the Statement of Comprehensive Income at the reporting date is recognised in the Statement of Financial Position as an Unearned Premium Reserve. The unearned portion of commissions and other acquisition costs are also deferred and are shown as Deferred Acquisition Costs in the Statement of Financial Position.

2.4 Outwards reinsurance premium expense

Reinsurance contracts are entered into during the normal course of business for the purpose of limiting net loss potential through the diversification of risk. Reinsurance arrangements do not affect direct obligations to policyholders. Premiums ceded to reinsurers are recorded as an outward reinsurance expense and recognised in the Statement of Comprehensive Income in accordance with the indemnity period of the relevant reinsurance contract.

2.5 Commission income

Reinsurance contracts are entered into during the normal course of business for the purpose of limiting net loss potential through the diversification of risk. Reinsurance arrangements do not affect direct obligations to policyholders. Commission income is received from reinsurers for the placement of this reinsurance and is recorded as reinsurance commission income and is recognised in the Statement of Comprehensive Income.

The unearned portions of commissions are deferred and are shown as part of Deferred Acquisition Costs and Deferred Reinsurance Commissions in the Statement of Financial Position.

2.6 Net investment income

Interest income and expenses for all interest-bearing financial instruments including financial instruments measured at fair value through profit or loss, are recognised within investment income in the Statement of Comprehensive Income using the effective interest rate method. When a receivable is impaired, the Company reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income.

2.7 Net realised gains/(losses)

Net realised gains and losses are determined by specific identification of individual investments sold. The net realised gains and losses are generated primarily from the following sources:

- Sales of investments, and other invested assets.
- Exchange gains and losses resulting from foreign currency transactions.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.8 Insurance claims

Claims expense represents payment for claims, claims related expenses and the movement in outstanding claims liabilities. Claims represent the benefits paid or payable to the policyholder on the occurrence of an event giving rise to a loss or accident according to the terms of the policy. Claims expenses are recognised in the Statement of Comprehensive Income as losses are incurred, which is the point in time when the event giving rise to the claim occurs.

Reinsurance and other recoveries received or receivable on paid claims and on outstanding claims (notified and not yet notified) are recognised as income. Reinsurance and other recoveries receivable 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.

2.9 Net operating expenses

Net operating expenses includes salaries, depreciation, amortisation of deferred acquisition costs, costs of employee retention awards, impairment of non-financial assets and other operating expenses. Net operating expenses are included in the Statement of Comprehensive Income and are recognised in an accrual basis.

2.10 Taxation

Current Tax

Current income tax for current and prior periods is recognised at the amount expected to be paid to or recovered from the tax authorities, using tax rates and tax laws that have been enacted or substantively enacted by the reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred Tax

Deferred tax is provided in full, using the balance sheet method in respect of temporary differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items. Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities settled, based on the tax rates enacted or substantively enacted at the time. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of the other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Goods and Services Tax ("GST")

Revenue, expenses and assets are recognised net of the amount of goods and services tax ("GST"), unless the GST incurred is not recoverable from the Inland Revenue Department. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated inclusive of GST. The net amount of GST recoverable from, or payable to, the Inland Revenue Department is included as other receivables or other payables in the Statement of Financial Position

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.11 Financial assets

The Company classifies its financial assets into the following categories: financial assets at fair value through profit or loss and loans and receivables. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at the initial recognition and re-evaluates this designation at every reporting date. Financial assets are classified as current assets if they are expected to be settled within 12 months, otherwise they are classified as non-current.

Financial Assets at fair value through profit or loss

Financial assets are designated at fair value through profit or loss in accordance with NZ IAS 39 when they are deemed to be backing the insurance liabilities of the Company, as set out under NZ IFRS 4.

Purchases and sales of investments are recognised on trade date - the date on which the Company commits to purchase or sell the asset. Unrealised gains and losses arising from changes in the fair value of securities are recognised in the profit or loss component of the Statement of Comprehensive Income.

For financial instruments traded in active markets, the determination of fair values of financial assets is based on quoted market prices or dealer price quotations.

Financial assets at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the profit and loss component of the Statement of Comprehensive Income. They are subsequently carried at fair value.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured initially at fair value plus transaction costs and subsequently carried at amortised cost using the effective rate of interest method, less provision for impairment. A provision for impairment is established when there is objective evidence that the Company will not be able to collect all amounts due as to their original terms.

2.12 Cash and cash equivalents

Cash and cash equivalents comprises cash on hand and demand deposits with banks together with short-term highly liquid investments that are readily convertible into known amounts of cash and that are not subject to a significant risk of a change in value. Such investments are classified as cash equivalents where they have maturity dates of three months or less from the date of acquisition.

The Company has applied the indirect method for preparing the Statement of cash flows. This statement shows the movement in cash and cash equivalents for the period including bank overdrafts.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.13 Trade and other receivables

Trade and other receivables are initially recognised at fair value, being the amounts due and generally have credit terms of 30-90 days. They are subsequently measured at amortised cost using the effective interest rate method, less provision for impairment.

A provision for doubtful debts is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of the estimated future cash flows. The impairment charge is recognised in the profit and loss component of the Statement of Comprehensive Income.

When there is objective evidence that an impairment loss has been incurred, the carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit and loss component of the Statement of Comprehensive Income. Any subsequent recoveries of amounts previously written off against the allowance account are credited against net operating expenses in the profit and loss component of the Statement of Comprehensive Income.

Other receivables include accrued investment income, prepaid expenses and third party claim floats.

2.14 Reinsurance recoverables

Reinsurance recoverables include the balances due from reinsurance and insurance companies under the terms of the Company's reinsurance agreements for unpaid claims, claim adjustment expenses and prepaid reinsurance premiums.

2.15 Deferred acquisition costs (DAC)

A portion of acquisition costs relating to premiums written in the year is deferred and recognised as an asset where it can be reliably measured and it is probable that it will give rise to a future benefit in subsequent periods. Included in deferred acquisition costs is deferred commission provision.

Deferred acquisition costs are amortised over the financial years expected to benefit from the expenditure. The provision has been calculated to represent the proportion of brokerage paid net of commission's receivable for treaty and facultative reinsurance contracts unexpired at year end.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.16 Properties, plant and equipment

Properties, plant and equipment is stated at historical cost less accumulated depreciation and any accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items of property, plant and equipment.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. Expenditures for repairs and maintenance are charged to profit or loss during the reporting period in which they are incurred.

Depreciation is calculated on a straight line basis over the estimated useful life of the assets as follows:

- Leasehold improvement over the term of the lease
- Furniture and fittings 5 years
- Office equipment 5 years
- Computer equipment 3 years

The assets' residual values, length of the economic lives and depreciation methods applied are reviewed on a regular basis, and at least at every reporting date, an adjusted as appropriate.

An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are included in profit or loss and are determined by comparing proceeds with carrying amount.

2.17 Intangible assets

Intangible assets include capitalised software costs.

Capitalised software costs represent costs directly related to obtaining, developing or upgrading internal use software. Such costs are capitalised and amortised on a straight-line method over the software's useful life which is a period generally not exceeding five years. Certain software is amortised over a longer period.

2.18 Impairment of assets

Impairment of financial assets

The Company assesses at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired.

If there is objective evidence that an impairment loss has been incurred on loans and receivables, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate. The loss is recognised in the profit and loss component of the Statement of Comprehensive Income.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.18 Impairment of non-financial assets (continued)

Impairment of non-financial assets

The Company reviews at each reporting date the carrying amounts of its tangible and intangible assets to determine whether there is any indication that an asset may be impaired. If any such indication exists, an impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

An impairment loss is recognised in the profit and loss component of the Statement of Comprehensive Income whenever the carrying amount of the asset exceeds its recoverable amount. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying value does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. A reversal of an impairment loss is recognised in the profit and loss component of the Statement of Comprehensive Income.

2.19 Insurance liabilities

Insurance liabilities comprise of a provision for outstanding claims and a provision for unearned premiums.

Claims and claims adjustment expenses are charged to income as incurred. The provision for outstanding claims represents the accumulation of estimates for unpaid reported claims and loss adjustment expenses and includes provisions for claims incurred but not reported.

The liability for outstanding claims is measured as the central estimate of expected future claim payments and related settlement costs against claims incurred at the reporting date under general insurance contracts issued by the Company.

The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not reported ('IBNR'), claims incurred but not enough reported ('IBNER') and their associated allocated costs as well as anticipated claims handling costs.

Claims handling costs include those costs that cannot be directly associated with individual claims, such as claims administration costs.

The methods of determining such estimates and establishing resulting reserves are regularly reviewed and updated. If the existing liability is determined to be inadequate or redundant, the liability is adjusted and the increase or decrease is reflected in income in the period in which the estimates are changed.

The expected future payments are discounted to present value using a risk free rate.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.20 Trade and other payables

Trade and other payables are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. These amounts represent liabilities for goods and services provided to the Company prior to the end of the financial year and which are unpaid.

2.21 Provisions and contingent liabilities

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. A provision is measured at the best estimate that the Company would pay to settle the obligation or transfer it to a third party.

A contingent liability is an obligation where it is not more likely than not that an outflow of resources will be required or the amount of the obligation cannot be reasonably estimated. Contingent liabilities are disclosed if there is more than a remote possibility that an outflow of resources will be required to settle the obligation.

In many cases, it is not possible to determine whether a liability has been incurred or to estimate the ultimate or minimum amount of that liability until years after the contingency arises, in which case, no accrual is made until that time.

2.22 Foreign currency translation

Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the Company operates ('the functional currency'). The financial statements are presented in New Zealand dollars, which is the Company's functional and presentation currency.

Translation of foreign currency transactions and balances

Foreign currency transactions during the year are translated into the functional currency using the rates of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rates of exchange ruling at the reporting date. Non-monetary assets and liabilities are translated into functional currency at the rates of exchange prevailing at the date of the transaction or most recent date of valuation where they are held at fair value.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and the translation of foreign currency denominated monetary assets and liabilities at year end exchange rates are recognised in the Statement of Comprehensive Income.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.23 Employee benefits and share-based payments

The costs associated with employee benefits for services rendered during the reporting period are recognised in the Statement of Comprehensive Income. An associated liability is recognised to the extent that any amount of employee benefit remains unpaid at balance date.

Short-term employee benefits

Short-term employee benefits, including compensated absences, are benefits to be paid within one year after the end of the reporting period in which the related services are rendered. A liability and expense are recognised for the undiscounted amount expected to be paid for short-term employee benefits in the period in which the employee renders services in exchange for the benefits.

Bonus plans

Bonuses awarded in respect of service in the past, are spread over the period of services rendered to the vesting date. Guaranteed bonuses awarded in respect of services to be provided in the future, are expensed over the vesting period.

Long service leave

The liability for long service leave is recognised in the provision for employee benefits and measured as the present value of the payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to salary levels and years of service.

2.24 Operating leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Operating lease payments, where the lessors effectively retain substantially all of the risk and benefits of ownership of the leased items, are recognised as an expense in the Statement of Comprehensive income on a straight line basis over the lease term. Any lease incentives, such as rent free periods, are amortised on a straight line basis over the lease term.

The cost of improvements to or on leasehold property is capitalised, disclosed as leasehold improvements, and amortised over the unexpired period of the lease.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.25 Liability adequacy

At each reporting date, the Company assesses whether the unearned premium liability is sufficient to cover all expected future cash flows relating to future claims covered by current insurance contracts. This assessment is referred to as the liability adequacy test and is performed at a portfolio level of contracts that are subject to broadly similar risks and managed together as a single portfolio.

If the present value of the expected future cash flows relating to future claims plus an additional risk margin to reflect the inherent uncertainty in the central estimate exceeds the unearned premium liability less the related deferred acquisition costs, future reinsurance premium and prepaid reinsurance expense then the unearned premium liability is deemed to be deficient.

The deficiency is recognised immediately in the Statement of Comprehensive Income. The deficiency is recognised first by writing down any related deferred acquisition costs, with any excess being recorded in the statement of financial position as an unexpired risk liability.

2.26 Offsetting of financial assets and liabilities

Financial assets and liabilities are offset and the net amount reported in the Statement of Financial Position when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

2.27 Assets backing insurance business

The Company has determined that all assets are held to back insurance liabilities, with the exception of property, plant and equipment.

2.28 Changes in accounting policies

There have been no changes in accounting policies during the year.

NOTES TO THE FINANCIAL STATEMENTS

3. Critical accounting estimates and judgements

In preparing the financial statements, the Company makes estimates and assumptions that affect the reported amounts of certain assets and liabilities. These estimates and judgements are continually assessed and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The major areas where such estimates and assumptions are applied are as follows:

3.1 Liability arising from claims made under insurance contracts

At the end of the year a provision is made for the estimated cost of claims incurred but not paid at balance date, as well as the cost of claims incurred but not reported (IBNR) to the Company.

The estimation of outstanding claims incurred but not paid takes into account all expected future gross claim payments and associated claim handling costs. The Company takes all reasonable steps to ensure that it has the most appropriate and up-to-date information available when making these estimates. However, whilst the Company considers that the provision for outstanding claims is fairly stated on the basis of information currently available to them, the ultimate liability may vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided.

When estimating the future claims liability each class of business is examined separately and some or all of the following will be considered in the projections:

- Previous periods claims statistics
- Impact of large losses
- Inflationary measures
- Changes in regulatory environment
- Historical and likely future trends of recoveries from third parties
- Relevant industry data.

The estimation of claims IBNR is generally subject to a higher degree of uncertainty than those claims already notified. IBNR claims may not be apparent to the insured until many years after the event that gave rise to the claims.

In estimating the liability for IBNR the Company makes use of models. Through analysis of all available past experience with respect to numbers of claims, claim payments and changes in estimates of outstanding liabilities, patterns can be detected. Using these patterns and past experiences, future payments on outstanding claims can be projected. Data is examined for potential distortions of any abnormal losses, and where abnormal losses do exist these are assessed separately to relieve any possible distortive effect from the projections.

3.2 Assets arising from contracts with reinsurers

Assets arising from contracts with reinsurers are determined using the same methods described above. Impairment is recognised when there is objective evidence that the Company may not receive amounts due to it, and these amounts can be measured reliably.

3.3 Actuarial assumptions

The actuarial services for the valuation of the outstanding claims were provided by Eric Lew B.Com (Hons.) LLB (Hons.) FIAA, Actuary, employed within the regional actuarial department of AIG Australia Limited. Eric Lew is our appointed actuary pursuant to the Insurance (Prudential Supervision) Act 2010 and is satisfied as to the nature, sufficiency and accuracy of the data used to determine the outstanding claims liability.

NOTES TO THE FINANCIAL STATEMENTS

3. Critical accounting estimates and judgements (continued)**3.3 Actuarial assumptions (continued)**

The outstanding claims liability has been determined in accordance with Professional Standard 300 issued by the Actuaries of Australia, and is consistent with Professional Standard No. 4.1 of the New Zealand Society of Actuaries and NZ IFRS 4: Insurance Contracts issued by the NZ Accounting Standards Board of the XRB pursuant to section 24 (1)(a) of the Financial Reporting Act 1993 and incorporates the following assumptions:

	As at 31 Dec 2013	As at 31 Dec 2012
Weighted average term to settlement	1.5 years	1.8 years
Discount rate for succeeding and subsequent years	3.33%	2.53%
Claim inflation for succeeding and subsequent years	Implicit based on historical experience	
Risk margins were applied by line ranging	12-24%	12-24%
Indirect claim management expenses	3.40%	3.20%
Probability of sufficiency	75.00%	75.00%

3.4 Probability of sufficiency

The statistical estimates of outstanding claims are "central estimates". Risk margins over and above the central estimates have been included, such that there is a 75% level of probability that the resulting estimates will be sufficient to meet the eventual insurance liabilities.

3.5 Methodology

The methodology is based on the paper 'A Framework for Assessing Risk Margins', as presented to the 2008 Australian Institute of Actuaries General Insurance Seminar which considers the following components of risk explicitly:

- Independent risk reflects uncertainty associated from purely random effects.
- Systemic risk – Internal refers to uncertainty stemming from the actuarial valuation model's imperfect representation of the insurance process.
- Systemic risk – External refers to the uncertainty arising from non-random risks external to the actuarial modelling process. It covers future episodes of systemic risk e.g. from unexpected economic inflation or the emergence of new classes of claims.

3.6 Risk margin classes

For this current valuation, risks have been grouped broadly into six risk margin classes so each class contains sufficient data.

3.7 Adaptive reserve modelling system software ("ARMs")

In the assessment of independent risk management uses the Adaptive Reserve Modelling System software (ARMs). This tool fits Generalized Linear Models (GLMs) to the paid and incurred claim ladder models. In the previous year's valuation, a stochastic chain ladder model was used.

- Between valuation classes; and
- Between premium liabilities and outstanding claims liabilities for a particular valuation class.

NOTES TO THE FINANCIAL STATEMENTS

3. Critical accounting estimates and judgements (continued)

3.8 Diversification benefits

As the correlations between different classes of business are less than perfect, i.e. the correlation coefficients are less than 1, the risk margin for all classes as a total will be less than the sum of the risk margin for each class. The diversification benefit allows for this reduction in the overall risk margin.

The following correlation effects need to be considered for each risk category for the following relationships:

Based on the correlation structure assumed, this year's valuation assumes a total diversification benefit of approximately 21% gross and 17% net of reinsurance (2012: 20% gross and 17% net of reinsurance).

NOTES TO THE FINANCIAL STATEMENTS

4 Net earned insurance premium revenue

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Premium revenue from insurance contracts issued:		
Gross written premium in the year	181,089	181,987
Change in unearned premium provision	(6,316)	(10,262)
	174,773	171,725
Premium revenue ceded to reinsurers on insurance contracts issued:		
Premium ceded to reinsurers in the year	(129,278)	(106,217)
Change in unearned premium provision	16,564	8,374
	(112,714)	(97,843)
Net earned insurance premium revenue	62,059	73,882

5 Fee and commission income

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Reinsurance commission income	29,175	19,046
Fee and commission income	29,175	19,046

6 Net investment income

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Cash and fixed interest securities interest income	11,720	12,537
Investment expenses	(39)	(128)
Net investment income	11,681	12,409

7 Other net losses

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Financial assets at fair value through profit or loss		
- Fair value losses	(3,160)	(3,710)
- Fair value gains	248	1,287
Foreign exchange losses	(472)	(2,243)
Other net losses	(3,384)	(4,666)

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2013***NOTES TO THE FINANCIAL STATEMENTS****8 Other income**

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Other fee income	159	132
Tax subvention	-	17,144
Other income	159	17,276

On 30 August 2012 AIG New Zealand Ltd received NZD17,143,922 from American Home Assurance Company – New Zealand branch for compensation of tax losses.

9 Net insurance claims

Claims and claim liabilities include loss adjustment expenses and provision for loss adjustment expenses.

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Insurance claims		
Gross claims incurred	145,294	175,926
Discount movement	1,515	(6,508)
	146,809	169,418
Insurance claims recovered from reinsurers		
Reinsurance recoveries	95,244	99,621
Discount movement	2,311	(6,356)
	97,555	93,265
Net insurance claims	49,254	76,153

2013 Incurred claims

\$'000

	2013	2012 & prior	Total
Gross claims incurred	60,422	84,872	145,294
Discounted claims incurred	58,087	88,722	146,809
Less: discount movement	(2,335)	3,850	1,515
Reinsurance and other recoveries	28,194	67,050	95,244
Discounted claims incurred	26,553	71,002	97,555
Less: discount movement	(1,641)	3,952	2,311
Net claims incurred (undisc)	32,228	17,822	50,050
Net claims incurred (disc)	31,534	17,720	49,254

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2013***NOTES TO THE FINANCIAL STATEMENTS****10 Net operating expenses**

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Employee benefits expenses (see below)	13,702	13,242
Operating lease rentals	978	1,929
Depreciation of furniture, fittings and leasehold improvements	269	93
Depreciation of computer and office equipment	75	79
Auditors' remuneration – audit services only	162	141
Auditors' remuneration – solvency return	16	16
Bank charges	104	124
AIG Group service fees	5,883	4,011
Other expenses	(94)	1,056
Net operating expenses	21,095	20,691

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Wages and salaries	11,609	10,739
Superannuation	486	410
Other employee benefit expenses	1,607	2,093
Employee benefits expenses	13,702	13,242

11 Income tax

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Current income tax	(3,393)	-
Total current tax	(3,393)	(104)
Prior period adjustment	(662)	-
Deferred tax	982	127
Total deferred tax (note 22)	320	127
Income tax (expense)/benefit	(3,073)	23

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2013***NOTES TO THE FINANCIAL STATEMENTS****11 Income tax (continued)**

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Profit before tax	8,517	6,116
Tax calculated at the current rate 28%	(2,384)	(1,712)
Effects of:		
Non deductible expenses	(27)	(25)
Deductible claims reserve adjustment on transfer	-	44,213
Non-taxable subvention income from other related party	-	4,800
Loss offset to other related party	-	(17,551)
Tax losses not recognised during the period	-	(29,598)
Prior period adjustment	(662)	-
Other	-	(104)
Income tax (expense)/benefit	(3,073)	23

12 Cash and cash equivalents

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Cash in hand and at bank	16,156	18,729
Deposits at call	66,949	21,760
Cash and cash equivalents	83,105	40,489

Cash at bank earns interest at floating rates based on daily deposit rates. Cash deposits are made for varying periods of between one day and 90 days and earn interest at the respective short term deposit rates. Cash and cash equivalents are all expected to be realised within 12 months of the reporting period.

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

13 Financial assets at fair value through profit or loss

The Company's financial investments are summarised by measurement category in the table below.

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
At fair value through profit or loss		
Fixed interest securities	99,367	105,870
Floating rate notes	28,189	11,011
Long term cash deposits	55,000	86,458
Financial assets at fair value through profit or loss	182,556	203,339

There are no non-derivative financial assets held for trading.

Changes in fair value of financial assets at fair value through profit or loss are recorded in net other losses.

The movement in the Company's financial assets at fair value through profit or loss is summarised in the table below by measurement category.

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Balance at the beginning of the period	203,339	550
Transfer of insurance business at 1 December 2011	-	85,758
Purchases	110,637	141,454
Disposals and maturities	(128,508)	(22,000)
Fair value net losses	(2,912)	(2,423)
Financial assets at fair value through profit or loss	182,556	203,339

14 Trade and other receivables

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Premium debtors receivables	52,551	51,050
Less: Provision for impairment from premium	-	(1)
Amount due from related companies	3,280	11,889
Less: Provision for impairment from related parties	-	(9)
Sundry debtors	251	5,814
Less: Provision for impairment for sundry debtors	-	-
Trade and other receivables	56,082	68,743

Trade receivables are non-interest bearing and are generally on 30-90 day credit terms. An allowance for doubtful debts is made when there is objective evidence that a trade receivable is impaired. The fair value of other receivables does not differ from their amortised cost.

NOTES TO THE FINANCIAL STATEMENTS

15 Reinsurance recoverables

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Due from reinsurers	5,640	16,460
Less: Provision for impairment for reinsurers	-	(4)
Total reinsurance recoverables	5,640	16,456

16 Deferred acquisition costs

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Opening deferred acquisition costs	14,347	-
Assets acquired in business transfer	-	12,236
Acquisition costs deferred	15,859	14,347
Amortisation charged to income	(14,347)	(12,236)
Deferred acquisition costs at 31 December	15,859	14,347

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Opening deferred reinsurance commissions	10,348	-
Assets acquired in business transfer	-	8,288
Reinsurance commission costs deferred	14,419	10,348
Amortisation charged to income	(10,348)	(8,288)
Reinsurance commission costs at 31 December	14,419	10,348
Net deferred acquisition costs at 31 December	1,440	3,999

NOTES TO THE FINANCIAL STATEMENTS

17 Properties, plant and equipment

Movements in the properties, plant and equipment assets are as follows:

\$ '000	Computer Software	Furniture & Fittings & Leasehold Improvements	Office Equipment	Total
Cost				
Balance 1 December 2011	-	-	-	-
Transfer of insurance business	391	1,055	155	1,601
Additions	-	2,060	202	2,262
Disposals	(152)	(980)	(47)	(1,179)
At 31 December 2012	239	2,135	310	2,684
Additions	-	36	66	102
Disposals	-	-	-	-
At 31 December 2013	239	2,171	376	2,786
Accumulated Depreciation				
Balance 1 December 2011	-	-	-	-
Transfer of insurance business	(283)	(980)	(155)	(1,418)
Depreciation charge	(49)	(93)	(30)	(172)
Disposals	129	980	47	1,156
At 31 December 2012	(203)	(93)	(138)	(434)
Depreciation charge	(18)	(269)	(57)	(344)
Disposals	-	-	-	-
At 31 December 2013	(221)	(362)	(195)	(778)
Carrying Amount				
At 1 December 2011	-	-	-	-
At 31 December 2012	36	2,042	172	2,250
At 31 December 2013	18	1,809	181	2,008

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2013***NOTES TO THE FINANCIAL STATEMENTS****18 Other receivables**

At 31 December

	As at 31 Dec 2013	As at 31 Dec 2012
\$ '000		
Accrued investment income	2,771	2,820
Prepayments	98	101
Third party administration – claim floats	1,647	1,647
Other receivables	4,516	4,568

19 Trade and other payables

At 31 December

	As at 31 Dec 2013	As at 31 Dec 2012
\$ '000		
Trade payables	6,812	6,326
Reinsurance payables	3,390	6,655
Amount due to related companies	20,421	9,842
Withholding taxes	6,315	3,001
Provision for holiday pay	840	655
Trade and other payables	37,778	26,479

20 Provision for net unearned premium

At 31 December

	As at 31 Dec 2013	As at 31 Dec 2012
\$ '000		
Gross unearned premium reserve	106,683	100,367
Less: Reinsurance unearned premium reserve	(66,071)	(49,507)
Provision for net unearned premium	40,612	50,860
Unearned premium at beginning of year	50,860	-
Transfer of insurance business 1 December 2011	-	48,972
Deferral of premiums on contracts written in period	30,409	41,356
Earning of premiums written in previous period	(40,657)	(39,468)
Provision for net unearned premium	40,612	50,860

The liability adequacy test is used to assess the sufficiency of the unearned premium liability to cover all expected future cash flows relating to future claims against in-force insurance contracts. The liability adequacy test is applied at a level of portfolios of contracts that are subject to broadly similar risks and that are managed together as a single portfolio.

As with outstanding claims, the overall risk margin is intended to achieve a 75% probability of adequacy in 2013. The process for determining the overall risk margin, including the way in which diversification of risks has been allowed for, is discussed in note 3.8.

NOTES TO THE FINANCIAL STATEMENTS

20 Provision for net unearned premium (continued)

The application of the liability adequacy test in respect of the net premium liabilities identified a surplus at December 2013.

For the purposes of loss adequacy test, the present value of expected future cash flows for future claims (including risk margin) is equal to \$26.1 million, made up as follows:

- Discounted central estimate (net of reinsurance) of \$21.7 million;
- Indirect claims expense provision of \$1.4 million; and
- Risk margins at the 75th percentile probability of sufficiency (after allowing for diversification benefit) of \$3.0 million.

21 Provision for net claims outstanding

The Company establishes claim reserves, which are estimates of future payments of reported and unreported claims for claims and claim adjustment expenses, with respect to insured events that have occurred. Reserving is a complex process dealing with uncertainty, requiring the use of informed estimates and judgments. Any changes in estimates or judgments are reflected in the results of operations in the period in which estimates and judgments are changed.

Significant delays may occur in the notification and settlement of claims, and a substantial measure of experience and judgment is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty as of the financial position date. The reserves for claims and claims adjustment expenses are determined on the basis of information currently available; however, it is inherent in the nature of the business written that the ultimate liabilities may vary as a result of subsequent developments.

At 31 December		
\$ '000	2013	2012
Central estimate	443,033	485,944
Undiscounted risk margin	69,154	75,531
Undiscounted indirect expenses	3,151	3,013
Outstanding claims reserve	515,338	564,488
Discount to present value	(24,300)	(25,816)
Provision for gross outstanding claims	491,038	538,672

At 31 December		
\$ '000	2013	2012
Gross reinsurance and other recoveries	358,682	394,756
Less: discount to present value	(15,861)	(18,173)
Provision for reinsurance outstanding claims	342,821	376,583
Net outstanding claims	148,217	162,089

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

21 Provision for claims outstanding (continued)

Reconciliation of movements in discounted outstanding claims liability

As at 31 December

	2013			2012		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Balance brought forward	538,672	376,583	162,089	627,864	470,135	157,729
Unwind of interest	15,715	11,110	4,605	18,706	14,150	4,556
Claims incurred in the current year	58,331	26,980	31,351	59,197	22,841	36,356
Claims cost paid during the year	(188,774)	(131,318)	(57,456)	(255,618)	(186,817)	(68,801)
Claims handling expenses during the year	(2,646)	-	(2,646)	(2,745)	-	(2,745)
Total effect of change in assumptions:	(6,139)	(3,891)	(2,248)	5,375	4,815	560
- indirect claims expenses	(176)	-	(176)	(270)	-	(270)
- interest rate	(5,963)	(3,891)	(2,072)	0	-	-
- risk margin	-	-	-	5,645	4,815	830
- methodology	-	-	-	-	-	-
Development on prior year outstanding liability	73,118	63,357	9,761	86,652	51,459	35,193
FX difference	2,761	-	2,761	(759)	-	(759)
Balance carried forward	491,038	342,821	148,217	538,672	376,583	162,089

Please note the net undiscounted ultimate claims costs above do not include the Travel and Warranty classes since these classes are characterised by claims that are typically resolved within one year.

Policy Liability Maturity profile

	1 year or less \$'000	1 to 3 years \$'000	3 to 5 years \$'000	Over 5 years \$'000	Total \$'000	Carrying Amount \$'000
Gross Policy liability						
Outstanding claims liabilities	219,011	220,168	43,937	7,922	491,038	491,038
Unearned premium liabilities	44,611	43,822	13,411	2,973	104,817	104,817
RI Policy liability						
Outstanding claims liabilities	156,891	157,193	26,395	2,342	342,821	342,821
Unearned premium liabilities	22,527	29,677	10,129	2,271	64,604	64,604
Net Policy liability						
Outstanding claims liabilities	62,120	62,975	17,542	5,580	148,217	148,217
Unearned premium liabilities	22,084	14,145	3,282	701	40,212	40,212

NOTES TO THE FINANCIAL STATEMENTS

21 Provision for claims outstanding (continued)

Net undiscounted ultimate claims costs for the nine most recent accident years from 2005 to 2013

As at 31 December

Inflated value										Net undiscounted outstanding claims for the nine most recent accident years (inflated, undiscounted, w/without margins)	
November Y.E.	Nov 2005	Nov 2006	Nov 2007	Nov 2008	Nov 2009	Nov 2010	Nov 2011	Dec 2012	Dec 2013	Cumulative net payments to date	
2005	19,297	15,306	15,072	13,523	13,152	13,544	12,478	12,505	12,649	12,128	521
2006		15,325	14,465	14,377	12,703	16,142	18,946	25,118	37,135	14,783	22,352
2007			23,284	18,384	18,635	20,847	27,861	53,664	54,643	28,016	26,629
2008				29,454	47,251	73,631	95,273	99,007	95,940	66,257	29,682
2009					20,624	29,630	19,965	18,619	18,670	16,764	1,904
2010						48,018	51,248	55,512	63,703	39,572	24,131
2011							20,446	20,701	21,520	16,179	5,341
2012								8,779	8,061	5,128	2,933
2013									8,703	2,614	6,089
										Total	119,582
										From prior years	1,199
										Travel	4,057
										Warranty	25
											124,863
										Net undiscounted outstanding claims for the 2013/12 loss month	2,010
										Effect of discounting	(6,790)
										Net undiscounted outstanding claims (without margins)	120,083
										Indirect expenses	2,988
										Risk margins	25,146
										Net undiscounted outstanding claims (with margins)	148,217

Key observations

- Financial lines: reserve strengthening of \$12.0 million from the 2006 accident year and \$4.9 million from the 2010 accident year were mainly due to further deterioration of the legacy claims. This was partially offset by the reserve release of \$3.0 million from the 2008 accident year; and
- Earthquakes: Reserve strengthening of \$3.3 million from 2010 was due to further deterioration of September 2010 earthquake Property losses.

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

22 Deferred tax

'\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Provision for doubtful debts	-	4
Provision for bonus payments	404	376
Provision for holiday pay	235	183
Accruals not currently deductible	295	698
Deferred tax assets	934	1,261

'\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Other	(84)	(14)
Deferred acquisition costs	(403)	(1,120)
Deferred tax liabilities	(487)	(1,134)

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

23 Contingencies and commitments

In the normal course of business, various commitments and contingent liabilities are entered into by the Company or asserted by third parties.

Litigation and Investigations

The Company provides reinsurance support to Civic Assurance ("Civic"), insurer of local councils throughout New Zealand. The Company has assumed 32.5% of Civic's risk for certain named Councils. As a result of the Canterbury earthquake of 22 February 2011, Civic's client, Christchurch City Council has suffered losses that could go as high as \$750 million. The Company for its part has capped its liability for any single event per Council at \$97.5m. Civic has contested this position, and maintains that the Company is liable to pay its 32.5% share of all losses on the Christchurch City Council's claim without limit. Civic has sought resolution of this dispute via contractually-mandated arbitration, and the two companies are continuing to address the procedural aspects of this arbitration. Therefore total losses have not yet been quantified to the Company.

Capital Commitments

The Company had no capital commitments for leasehold improvement or furnishings as at 31 December 2013 (31 December 2012: Nil).

Operating Lease Commitments

The Company has property and equipment subject to lease arrangements. There are two operating leases for commercial premises in Auckland and Wellington. The Auckland lease is for a period of 10 years with an option to terminate the lease on the seventh anniversary. There is no right of renewal. The Wellington lease is for a period of 3 years with a right of renewal for a further 3 years.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

\$ '000

At 31 December	As at 31 Dec 2013	As at 31 Dec 2012
Not later than one year	1,159	967
Later than one year and not later than five years	3,987	3,464
Later than five years	2,779	3,114
Total	7,925	7,545

AIG INSURANCE NEW ZEALAND LIMITED

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NOTES TO THE FINANCIAL STATEMENTS

24 Share capital

On 1 December 2011, 83,000,000 shares were issued for \$1 consideration per share to extinguish the promissory note (refer note 25) following the transfer of the insurance operations of American Home Assurance Company - New Zealand Branch.

On 5 October 2012, 15,250,000 shares were issued \$1 consideration per share to AIG Asia Pacific Insurance Pte Ltd.

As at 31 December 2012 and 2013, the Company had 158,250,001 authorised ordinary shares that were issued for \$1 per share. All shares are fully paid. There is one class of ordinary shares. All shares issued carry equal voting rights.

Movement in Issued share capital

\$ '000

At 1 December 2011	60,000
Issue of shares on 1 December 2011 to AIG Asia Pacific Pte Ltd	83,000
Issue of shares on 5 October 2012 to AIG Asia Pacific Pte Ltd	15,250
At 31 December 2012	158,250
Shares issued	-
At 31 December 2013	158,250

NOTES TO THE FINANCIAL STATEMENTS

25 Acquisition reserve

On 1 December 2011 the operations of American Home Assurance Company New Zealand Branch (the "Branch") was transferred to the Company. The Branch is a branch of American Home Assurance Company ("AHAC"), a company incorporated in the state of New York in the United States of America. AHAC is a member entity in the American International Group, Inc ("AIG") group of companies.

In exchange for the business of the Branch, the Company issued a Promissory Note to the Branch for the purchase price of \$83m. An external independent firm was engaged to provide a fair value for the business as at 30 November 2011. A true up payment of the purchase price was structured by Promissory Note. The Promissory Note was distributed to the respective owners of AHAC. The Company received the Promissory Note as a capital contribution from its immediate parent company, thereby extinguishing the Promissory Note.

All the insurance contracts, insurance rights, insurance liabilities, business assets and business liabilities on the branch were transferred to Company as a going concern. The Company assumes all of the Branch's obligations and there is no recourse to the Branch or AHAC. As the Branch and Company are entities under common control of AIG, the transfer of the business will be accounted for using the predecessor values method.

The assets and liabilities were transferred to the Company at the Branch's carrying values on 1 December 2011 as follows:

Assets	\$000's
Cash and cash equivalents	91,127
Trade and other receivables	61,709
Deferred acquisition costs	12,236
Investments	85,758
Property, plant, equipment and Intangible assets	108
Reinsurance on unearned premiums	41,133
Reinsurance and other recoveries	470,135
Total assets	762,206
Liabilities	
Cash and cash equivalents	16,670
Trade and other receivables	8,288
Deferred acquisition costs	90,105
Investments	627,864
Total liabilities	742,927
Total identifiable assets	19,279
Acquisition reserve	63,721
Total purchase consideration	83,000

AIG INSURANCE NEW ZEALAND LIMITED

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NOTES TO THE FINANCIAL STATEMENTS

26 Ownership and transactions with related parties

The parent entity of the Company is AIG Asia Pacific Insurance Pte Ltd, incorporated in Singapore. The ultimate controlling entity is American International Group Inc, ("AIG"), incorporated in the State of Delaware, USA.

The Company is party to various cost sharing arrangements with entities within the AIG Group. Generally, these agreements provide for the allocation of corporate costs based upon a proportional allocation of costs to all AIG entities. AIG performs certain services including legal, tax, investment management and investment accounting. In addition, the Company has transactions within the AIG Group such as claims management services and information management services.

Service and Expense Agreements:

The Company receives a number of services from AIG Group, which include:

- Consulting and other services associated with restructuring programs
- Corporate wide services related to marketing and information systems
- Legal services
- Facilities Management
- Financial advisory services including tax consulting, treasury, financial reporting and risk management
- Investment Portfolio Management
- Computer and communications services
- Corporate stewardship services, which include public relations, internal audit and executive services.

The costs of these services and other costs incurred by AIG Group have been directly charged or allocated to the Group, using methods management believes are reasonable, and are included in other expenses in the statement of comprehensive income. These methods include various measures of direct usage and corporate formulas involving proportionate measures of assets, revenues and employee headcount.

Reinsurance:

In the ordinary course of business, the Company reinsures certain risks with affiliated entities, predominately Chartis Overseas Association. Such arrangements serve to limit the Group's maximum loss on catastrophes and other large and unusually hazardous risks. The Company also has assumed written premiums generated by affiliated entities of AIG Group and for these reinsurance transactions they have agreements related to reinsurance, cost sharing, administrative services and marketing.

Related party transactions

At 31 December	As at 31 Dec 2013	As at 31 Dec 2012
\$ '000		
Expenses with parent		
- AIG (services provided for NZ operations)	(5,883)	(4,011)
Expenses with other related parties		
- Chartis Overseas Association	119,095	66,188
- Chartis Overseas Association	(116,161)	(137,029)
- AIG Australia Insurance Ltd	(758)	(928)
- AIG Asia Pacific Pte Ltd	(521)	-
- AIGGS – technology	(518)	(297)
- Other	(189)	(475)
Related party transactions	(4,935)	(76,552)

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

26 Ownership and transactions with related parties (continued)

Key Management Compensation

At 31 December

\$ '000	Year ended 31 Dec 2013	Period ended 31 Dec 2012
Salaries and other short-term employee benefits	1,725	1,680
Post-employment benefits	-	-
Other long-term benefits	38	28
Total	1,763	1,708

Loans to directors

No loans were advanced to directors or key management personnel during the year, (2012: nil).

Other related party balances receivable

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Chartis Overseas Association	2,781	11,181
AIUI Japan	-	2
AIG Hong Kong Ltd	-	174
AIG Thailand	2	-
AIG Global Reinsurance Operations	82	204
AIG Europe UK	2	11
Chartis Worldwide Source	413	317
Related party receivables	3,280	11,889

Other related party balances payable

At 31 December

\$ '000	As at 31 Dec 2013	As at 31 Dec 2012
Chartis Overseas Association	20,137	9,584
AIG Australia Insurance Ltd	79	55
Chartis Memsu UAE	-	2
AIG Europe UK	2	10
AIG Global Reinsurance Operations	127	73
Chartis Bermuda	-	67
AIG Global Services	59	23
Chartis International LLC Inc	17	28
Related party payables	20,421	9,842

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2013***NOTES TO THE FINANCIAL STATEMENTS**

27 Reconciliation of profit after tax to net cash flows from operating activities

At 31 December	As at 31 Dec 2013	As at 31 Dec 2012
\$ '000		
Operating profit after income tax	5,444	6,139
<i>Investment revenue – net changes in market value</i>	2,912	2,423
Loss on disposal of plant and equipment	-	11
Depreciation expense	344	172
<i>Change in operating assets and liabilities</i>		
Decrease/(increase) in trade and other receivables	17,661	(34,099)
Decrease in other receivables	5,868	6,657
Decrease in reinsurance and other recoveries	33,762	93,552
Increase in deferred reinsurance premiums	(16,564)	(8,374)
Increase/(decrease) in net deferred acquisition costs	2,559	(51)
Increase in net deferred tax asset	(320)	(127)
Increase in trade and other payables	11,299	9,203
Increase in tax liability	3,200	(132)
Increase in provision for unearned premiums	6,316	10,262
Decrease for provision in gross claims outstanding	(47,634)	(89,188)
Net cash flow from operating activities	24,847	(3,552)

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

28 Fair value measurement

The Company classifies all financial assets as either financial assets at fair value through profit or loss or loans and receivables.

The following tables present the estimate fair values of the Company's financial assets and financial liabilities.

\$ '000	Amortised cost	Fair value	Carrying value	Fair value
At 31 December 2013				
Cash and cash equivalents	83,105	-	83,105	83,105
Trade and other receivables	56,082	-	56,082	56,082
Financial assets at fair value through profit or loss	-	182,556	182,556	182,556
Reinsurance recoverable	5,640	-	5,640	5,640
Accrued income	2,771	-	2,771	2,771
Financial assets	147,598	182,556	330,154	330,154
Insurance payables	23,811	-	23,811	23,811
Other payables	13,967	-	13,967	13,967
Financial liabilities	37,778	-	37,778	37,778

\$ '000	Amortised cost	Fair value	Carrying value	Fair value
At 31 December 2012				
Cash and cash equivalents	40,489	-	40,489	40,489
Trade and other receivables	68,743	-	68,743	68,743
Financial assets at fair value through profit or loss	-	203,339	203,339	203,339
Reinsurance recoverable	16,456	-	16,456	16,456
Accrued income	2,820	-	2,820	2,820
Financial assets	128,508	203,339	331,847	331,847
Insurance payables	17,119	-	17,119	17,119
Other payables	6,359	-	6,359	6,359
Financial liabilities	23,478	-	23,478	23,478

The carrying amount of assets included in the above tables represents the maximum credit exposure. The carrying value of financial instruments expected to be settled within 12 months (after taking into account impairments, where applicable) is not considered to be materially different from the fair value.

NOTES TO THE FINANCIAL STATEMENTS

28 Fair value measurement (continued)

Fair value measurements on a recurring basis

The Company carries certain of its financial instruments at fair value. The fair value of a financial instrument is the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between willing, able and knowledgeable market participants at the measurement date.

The degree of judgement used in measuring the fair value of financial instruments generally correlates with the level of observable valuation inputs. Financial instruments with quoted prices in active markets generally have

more pricing observability and less judgment is used in measuring fair value. Conversely, financial instruments traded in other than active markets or that do not have quoted prices have less observability and are measured at fair value using valuation models or other pricing techniques that require more judgement.

An active market is one in which transactions for the asset or the liability being valued occurs with sufficient frequency and volume to provide pricing information on an on-going basis. An other than active market is one in which there are few transactions, the prices are not current, price quotations vary substantially either over time or among market makers, or in which little information is released publicly for the asset or liability being valued. Pricing observability is affected by a number of factors, including the type of financial instrument, whether the financial instrument is new to the market and not yet established, and the characteristics specific to the transaction, liquidity and general market conditions.

The following methods and assumptions were used by the Company to estimate the fair value of financial instruments.

Valuation Methodology

Cash and cash equivalents

The carrying amount of cash and cash equivalents approximates its fair value.

Debt securities at fair value through profit or loss

- **Fixed Maturity Securities**

Whenever available, the Company obtains quoted prices in active markets for identical assets at the financial position date to measure fixed maturity securities at fair value in its available-for-sale portfolio. Market price data is generally obtained from dealer markets.

Management is responsible for the determination of the value of the investments carried at fair value and the supporting methodologies and assumptions. The Group employs independent third-party valuation service providers to gather, analyze, and interpret market information and derive fair values based upon relevant methodologies and assumptions for individual instruments.

Valuation service providers typically obtain data about market transactions and other key valuation model inputs from multiple sources and, through the use of widely accepted valuation models, provide a single fair value measurement for individual securities for which a fair value has been requested under the terms of service agreements. The inputs used by the valuation service providers include, but are not limited to, market prices from recently completed transactions and transactions of comparable securities, benchmark yields, interest rate yield curves, credit spreads, currency rates, quoted prices for similar securities and other market-observable information, as applicable. The valuation models take into account, among other things, market-observable information as of the measurement date as well as the specific attributes of the security being valued, including its term, interest rate, credit rating, industry sector, and when applicable, collateral quality and other security or

NOTES TO THE FINANCIAL STATEMENTS

28 Fair value measurement (continued)

Debt securities at fair value through profit or loss (continued)

issuer-specific information. When market transactions or other market observable data is limited, the extent to which judgment is applied in determining fair value is greatly increased.

Other financial assets

The carrying amount of other financial assets is not materially different to their fair value. The fair values of deposits with banks are generally based on quoted market prices or, if unquoted, on estimates based on discounting future cash flows using available market interest rates offered for receivables with similar characteristics.

Receivables

The carrying amount of amounts receivable from policyholders, agents, broker, intermediaries and reinsurer is not considered materially different to their fair value.

Other financial liabilities

The fair value of other unquoted liabilities is estimated by discounting expected future cash flows using current market rates applicable to their yield, credit quality and maturity, except for those with no stated maturity, where the carrying value approximates the fair value.

Fair Value Hierarchy

Financial assets and liabilities recorded at fair value in the Statement of Financial Position are measured and classified in a hierarchy for disclosure purposes consisting of three levels based on the characteristic of inputs available in the marketplace that are used to measure the fair values as noted below:

- *Level 1:* Fair value measurements that are quoted prices (unadjusted) in active markets that the Company has the ability to access for identical assets or liabilities. Market price data generally is obtained from exchange or dealer markets. The Company does not adjust the quoted price for such instruments. Assets and liabilities measured at fair value on a recurring basis and classified as Level 1 include certain government and agency securities, corporate bonds, listed equities.
- *Level 2:* Fair value measurements based on inputs other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. Assets and liabilities measured at fair value on a recurring basis and classified as Level 2 could include certain government and agency securities, most investment-grade and high-yield corporate bonds, certain listed equities, state, municipal and provincial obligations, hybrid securities, mutual fund investments.

NOTES TO THE FINANCIAL STATEMENTS

28 Fair value measurement (continued)

Fair Value Hierarchy (continued)

- **Level 3:** Fair value measurements based on valuation techniques that use significant inputs that are unobservable. Both observable and unobservable inputs may be used to determine the fair values of positions classified in Level 3. These measurements include circumstances in which there is little, if any, market activity for the asset or liability. Therefore, the Company must make certain assumptions as to the inputs a hypothetical market participant would use to value that asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment. In making the assessment, the Company considers factors specific to the asset or liability. Assets and liabilities measured at fair value on a recurring basis and classified as Level 3 include certain corporate bonds, certain municipal, sovereign and provincial obligations, private equity and real estate fund investments, and direct private equity investments. The Company's non-financial instrument assets that are measured at fair value on a non-recurring basis generally are classified as Level 3.

The following table presents information about assets carried fair value hierarchy and indicates the level of the fair value measurement based on the levels of the input used:

\$ '000	Fair value hierarchy			Total
	Level 1	Level 2	Level 3	Fair value
At 31 December 2013				
Debt securities	-	127,556	-	127,556
Long term deposits	-	55,000	-	55,000
Total	-	182,556	-	182,556
At 31 December 2012				
Debt securities	-	116,881	-	116,881
Long term deposits	-	86,458	-	86,458
Total	-	203,339	-	203,339

The fair values of other financial assets and liabilities are the same as their carrying amounts.

NOTES TO THE FINANCIAL STATEMENTS

29 Risk management framework

The Company's operations are exposed to a number of key risks including insurance risk and financial risk. The Company's risk management framework includes policies and procedures in respect of managing these risks which are set out below.

The managed acceptance of risk is fundamental to the Company's insurance business model. The Company's risk management framework seeks to effectively manage, rather than eliminate, the risks the Company faces.

In accordance with the Insurance (Prudential Supervision) Act 2010, the Company has developed and implemented a prudent Risk Management Strategy ('RMS').

The objective of the RMS is to identify the Company's policies and procedures, processes and controls that comprise its risk management and control systems. These systems address all material risks, financial and non-financial, likely to be faced by the Company. Quarterly, the Company certifies to the Board that adequate strategies have been put in place to monitor those risks, that the Company has systems in place to ensure compliance with legislative and prudential requirements, and that the Board has satisfied itself as to compliance with the RMS.

The Company's RMS has been developed in accordance with AIG's global approach to the management of risk. As such, the RMS aligns with the key global risk management policies and strategies per the AIG risk management framework, and are formulated to take account of the local legislative, regulatory and business environment.

The Company's risk management framework requires all operations to establish processes for identifying, evaluating and managing the key risks faced by the organisation. The risk management framework has evolved in recent years and encompasses an established risk governance structure with clear oversight and assignment of responsibility for the monitoring and management of financial, operational and strategic risks.

The Audit and Risk Committees oversee the risk management framework and process. It also ensures the implementation of the RMS, and the reporting of outcomes to the Board of Directors.

The RMS has been approved by the Board. The Company's underlying underwriting philosophy is designed to ensure underwriters address all aspects of a risk before offering terms including rating, deductible level, extent of coverage, the insured's risk management/loss control practices, financial condition and prior loss experience. Key aspects of the processes embedded within the business to mitigate risk arising from insurance contracts include:

- The maintenance and use of appropriate management information systems, which provide up to date reliable data, thus ensuring integrity of data to management and financial models.
- Formally delegated authorities and documented guidelines are followed for underwriting and accepting insurance risks.
- Reinsurance is used to limit the Company's exposure to large scale single claims and catastrophes. When selecting a reinsurer only those companies that provide high security are considered. Procedures are in place to ensure that all reinsurers are approved and that authorised liability limits are adhered to.
- Comprehensive documented claims guidelines and procedures are followed, supported by training and workshops on regulatory and legal requirements.

The Company's investment strategy is governed by Board approved investment guidelines, reflecting a low appetite for investment risk. The mix of assets in which the Company invests is driven by the nature and term of the insurance liabilities. The management of assets and liabilities is closely monitored to broadly align the maturity dates of assets compared to the expected pattern of claim payments.

NOTES TO THE FINANCIAL STATEMENTS

30 Insurance risk

Terms and conditions of insurance and inwards reinsurance business

The terms and conditions attaching to insurance contracts affect the level of insurance risk accepted by the Company. The majority of direct insurance contracts and inwards reinsurance business written are entered into on a standard form basis. Any non-standard terms and conditions are signed off by appropriately experienced underwriters within a framework, which includes delegated authorities, in line with the RMS.

Concentration of insurance risk

Concentration of insurance risk can be a cause of elevated claims volatility risk and refers to the possibility of significant financial losses arising from a lack of diversification, either geographical or by product type, of the Company's portfolio. Certain events may give rise to higher levels of adverse development and exhibit geographical concentrations.

The Company's exposure to concentration of insurance risk is mitigated by a diverse portfolio of business written across a broad range of locations and industries. Concentrations of risk are managed within each market through the monitoring of product sales and size of the in-force book by product.

The Company has a specific concentration risk associated with natural catastrophes. The Company mitigates this risk by adhering to underwriting and claims management policies and procedures that have been developed based on extensive historical experience. Reinsurance is used to help reduce concentration risk.

Claims volatility risk

Claims volatility refers to the possibility that the frequency or severity of claims arising from insurance contracts exceeds the level assumed when the products were priced.

Insurance liabilities are difficult to predict and may exceed the related reserves for losses and loss expenses. Although the Company regularly reviews the adequacy of the established liability for unpaid claims and claims adjustment expense and conduct an extensive analysis of reserves at each year end, there can be no assurance that our loss reserves will not develop adversely and have a material adverse effect on our results of operations. Estimation of ultimate net losses, loss expenses and loss reserves is a complex process for long-tail lines of business, which include excess liability, D&O, professional liability, medical malpractice, workers' compensation, general liability, products liability and related classes. Generally, actual historical loss development factors are used to project future loss development. However, there can be no assurance that future loss development patterns will be the same as in the past.

The Company seeks to mitigate claims volatility risk by conducting regular experience studies reviewing internal and external data, and considering the impact of these on product design, pricing and reinsurance needs. As a result of the Company's history and scale, a substantial volume of experience data has been accumulated which assists in evaluation and pricing of insurance risk.

Key assumptions

The principal assumption underlying the liability estimates is that the Company's future claims development will follow a similar pattern to past claims development experience. This includes assumptions in respect of average claim costs, claim handling costs, claim inflation factors and claim number for each accident year. Additional qualitative judgements are used to assess the extent to which past trends may not apply in the future, for example: one-off occurrence, changes in market factors such as public attitude to claiming, economic conditions, as well as internal factors such as portfolio mix, policy conditions and claims handling procedures. Judgement is further used to assess the extent to which external factors such as judicial decisions and government legislation affect the estimates.

Other key circumstances affecting the reliability of assumptions include variation in interest rates, delays in settlement and changes in foreign currency rates.

NOTES TO THE FINANCIAL STATEMENTS

30 Insurance Risk (continued)Sensitivity Analysis

A sensitivity analysis has been performed on the outstanding claims liabilities.

The impact of the changes net of tax in key outstanding claims variables are summarised below. Each change has been calculated in isolation of the other changes and each change shows the relevant impact assuming that there is no change to any other variables.

Variables	Movement in variables	Impact	Financial impact Profit/(Loss) NZD '000
Discount rates	+1%	2,344	1,688
	-1%	-2,405	-1,732
Inflation rates	+1%	-2,405	-1,732
	-1%	2,344	1,688
Claims expense ratio	+1%	-1,059	-763
	-1%	1,059	763
Duration	+0.5 year	2,411	1,736
	-0.5 year	-2,451	-1,764

31 Financial risk

The Company's operations are exposed to a variety of financial risks including credit risk, liquidity risk and market risk. The Company manages its exposure to key financial risks in accordance with the Company's RMS. The RMS focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Company.

The Company's principal financial instruments comprise cash and cash equivalents, financial assets at fair value through profit or loss, premiums receivable, interest receivable, reinsurance recoveries on paid claims, trade payables and other payables.

The following financial risks are considered and addressed as part of the Company's financial risk management policies and procedures.

Credit risk

Credit risk arises from the possibility of financial loss arising from default by borrowers and transactional counterparties and the decrease in the value of financial instruments due to deterioration in credit quality. The key areas where the Company is exposed to credit risk include repayment risk in respect of:

- Cash and cash equivalents
- Financial assets at fair value through profit or loss
- Trade and other receivables
- Reinsurance recoverables

The maximum exposure of credit risk for cash and cash equivalents, financial assets at fair value through profit or loss, trade and other receivables and reinsurance recoverables is the carrying value (net of allowances) in the Statement of Financial Position.

NOTES TO THE FINANCIAL STATEMENTS

31 Financial risk (continued)

All credit exposures are subject to AIG's global limits and requirements. The RMS outlines the framework and procedures in place to ensure an adequate and appropriate level of monitoring and management of credit quality throughout the Company.

Most premium revenue is derived from brokers operating in the New Zealand market who are subject to industry credit terms. Credit risk arising from reinsurance recoveries is managed by collecting the majority of reinsurance recoveries within 90 days following payment by the Company of the direct claim, and monitoring the credit rating of reinsurers on a continual basis.

Reinsurance is used to manage insurance risk. This does not however discharge the Company's liability as primary insurer. If a reinsurer fails to pay a claim for any reason, the Company remains liable for the full payment to the policyholder.

Through a centralised process AIG worldwide identifies, approves and monitors all credit exposures relating to reinsurance through its Reinsurance Security Department. The primary function of the Reinsurance Security Department is to review the financial stability of the reinsurance companies that AIG uses in both its treaty and facultative programmes. This is achieved through analysis of financial information gathered on both the industry and the reinsurer. Information is gathered through rating agencies and other reliable publicly available sources.

Using this information AIG compiles a list of approved reinsurers and a list of approved reinsurance intermediaries which must be adhered to by all AIG offices around the world. Reinsurance placements must be confirmed by the underwriter against these lists before binding. If an underwriter wishes to use a reinsurer or reinsurance intermediary that is not on the list, they must seek approval from the Reinsurance Security Department before binding the reinsurance.

The Company further manages its exposure to credit risk by accepting business from intermediaries that meet the Company's corporate guidelines. New intermediaries are accepted on a case by case basis and are only accepted after having gone through an internal screening process. All intermediaries are subject to the Company's credit terms.

Credit exposure

The table below shows the maximum exposure to credit risk for the components of the statement of financial position and items such as future commitments. The maximum exposure is shown gross, before the effect of mitigation through the use of master netting or collateral agreements.

As 31 December	As at 31 Dec 2013	As at 31 Dec 2012
\$ '000		
Assets:		
Cash and cash equivalents	83,105	40,489
Financial assets at fair value through profit or loss	182,556	203,339
Trade and other receivables	56,082	68,743
Reinsurance recoverables	5,640	16,456
Total	327,383	329,027

NOTES TO THE FINANCIAL STATEMENTS

31 Financial risk (continued)

Credit exposure by credit rating

The tables below provide information regarding the credit risk exposure of the Group by classifying assets according to the Group's credit ratings of counterparties:

As 31 December 2013

\$ '000	Neither past-due nor impaired	Past-due but not impaired	Past-due and impaired	Total
Assets:				
Cash and cash equivalents	83,105	-	-	83,105
Financial assets at fair value through profit or loss	182,556	-	-	182,556
Trade and other receivables	55,121	961	-	56,082
Reinsurance recoverables	5,098	542	-	5,640
Total	325,880	1,503	-	327,383

As 31 December 2012

\$ '000	Neither past-due nor impaired	Past-due but not impaired	Past-due and impaired	Total
Assets:				
Cash and cash equivalents	40,489	-	-	40,489
Financial assets at fair value through profit or loss	203,339	-	-	203,339
Trade and other receivables	67,624	1,109	10	68,743
Reinsurance recoverables	15,808	644	4	16,456
Total	327,260	1,753	14	329,027

Age analysis of financial assets past due but not impaired

As 31 December 2013

\$ '000	0 - 90 days	91 - 180 days	181 - 360 days	> 1 year	Total past-due but not impaired
Assets:					
Trade and other receivables	-	663	215	83	961
Reinsurance recoverables	-	391	148	3	542
Total	-	1,054	363	86	1,503

AIG INSURANCE NEW ZEALAND LIMITED

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31 Financial risk (continued)

Age analysis of financial assets past due but not impaired (continued)

As 31 December 2012

\$ '000	0 - 90 days	91 - 180 days	181 - 360 days	> 1 year	Total past-due but not impaired
Assets:					
Trade and other receivables	-	1,086	14	9	1,109
Reinsurance recoverable	-	637	6	1	644
Total	-	1,723	20	10	1,753

The tables below provide information regarding the credit risk exposure of the Company at 31 December 2013 by classifying assets according to Standard and Poor's equivalent credit rating of the counterparties. AAA is the highest possible rating. Assets that fall outside the range of AAA to BBB are classified as speculative grade.

As 31 December 2013

\$ '000	AAA	AA	A	BBB	BB	Not rated	Total
Assets:							
Cash and cash equivalents	-	83,105	-	-	-	-	83,105
Financial assets at fair value	10,150	148,513	14,544	9,349	-	-	182,556
Trade and other receivables	-	-	-	-	-	56,082	56,082
Reinsurance recoverable	-	-	-	-	-	5,640	5,640
Total	10,150	231,618	14,544	9,349	-	61,722	327,383

As 31 December 2012

\$ '000	AAA	AA	A	BBB	BB	Not rated	Total
Assets:							
Cash and cash equivalents	-	18,728	21,761	-	-	-	40,489
Financial assets at fair value	10,413	135,844	51,809	5,273	-	-	203,339
Trade and other receivables	-	-	-	-	-	68,743	68,743
Reinsurance recoverable	-	-	-	-	-	16,456	16,456
Total	10,413	154,572	73,570	5,273	-	85,199	329,027

NOTES TO THE FINANCIAL STATEMENTS

31 Financial risk (continued)**Liquidity risk**

Liquidity risk primarily refers to the possibility of having insufficient cash available to meet the payment obligations to counterparties when they become due.

The Company's cash position is monitored daily and funding requirements are managed through a structured investment portfolio that allows flexibility in funding and includes suitable floats of readily realisable assets. Liquidity risk controls include regular actuarial reviews of insurance reserves, matching asset and liability duration and cash flow monitoring.

A maturity analysis of the Company's financial liabilities and financial assets is provided below.

As 31 December 2013

\$ '000	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years through 10 years	Due after 10 years	Total	Carrying Amount
Financial assets:						
Cash and cash equivalents	83,105	-	-	-	83,105	83,105
Trade and other receivables	55,979	103	-	-	56,082	56,082
Accrued income	2,771	-	-	-	2,771	2,771
Reinsurance recoverables	5,637	3	-	-	5,640	5,640
Financial assets at fair value through profit or loss	98,182	79,574	4,800	-	182,556	182,556
Total	245,674	79,680	4,800	-	330,154	330,154
Financial liabilities:						
Insurance payables	23,795	16	-	-	23,811	23,811
Other payables	7,053	6,477	-	437	13,967	13,967
Total	30,848	6,493	-	437	37,778	37,778

NOTES TO THE FINANCIAL STATEMENTS

31 Financial risk (continued)

As 31 December 2012

\$ '000	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years through 10 years	Due after 10 years	Total	Carrying Amount
Financial assets:						
Cash and cash equivalents	40,489	-	-	-	40,489	40,489
Trade and other receivables	68,724	19	-	-	68,743	68,743
Accrued income	2,820	-	-	-	2,820	2,820
Reinsurance recoverables	16,451	5	-	-	16,456	16,456
Financial assets at fair value through profit or loss	114,721	79,676	8,942	-	203,339	203,339
Total	243,205	79,700	8,942	-	331,847	331,847
Financial liabilities:						
Insurance payables	16,878	104	137	-	17,119	17,119
Other payables	7,853	1,507	-	-	9,360	9,360
Total	24,731	1,611	137	-	26,479	26,479

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2013

NOTES TO THE FINANCIAL STATEMENTS

31 Financial risk (continued)

b. Liquidity risk (continued)

As 31 December	<u>2013</u>			<u>2012</u>		
\$ '000	Current	Non-current	Total	Current	Non-current	Total
Assets:						
Cash and cash equivalents	83,105	-	83,105	40,489	-	40,489
Trade and other receivables	55,979	103	56,082	68,724	19	68,743
Accrued income	2,771	-	2,771	2,820	-	2,820
Reinsurance recoverable	5,637	3	5,640	16,451	5	16,456
Financial assets at fair value through profit or loss	99,856	82,700	182,556	114,721	88,618	203,339
Total	247,348	82,806	330,154	243,205	88,642	331,847
Liabilities:						
Trade and other payables	30,848	6,930	37,778	21,719	4,760	26,479
Deferred reinsurance commissions	14,419	-	14,419	10,348	-	10,348
Total	45,267	6,930	52,197	32,067	4,760	36,827

NOTES TO THE FINANCIAL STATEMENTS

31 Financial risk (continued)**Market risk**

Market risk represents the risk that the fair value or cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk reflects interest rate risk, foreign currency risk and other price risks. The extent of the Company's exposure to market risk is mitigated by the formulation of, and adherence to, strict investment guidelines, as approved by the Board of Directors and the utilisation of appropriately qualified and experienced personnel to manage the Company's portfolio.

Foreign exchange rate risk

Foreign currency risk is the risk of the Company's asset values changing as a result of changes in currency exchange rates. The Company may be exposed to foreign currency risk as a result of premium collection, claim payment, reinsurance payment and recovery and intercompany expense transactions.

The Company seeks to mitigate its exposure to foreign currency risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency, where there is material exposure to currency movements.

A sensitivity analysis showing the impact on profit or loss after tax and equity for changes in foreign exchange rate for exposure as at the reporting date is shown below. The analysis is based on the assumption that the movement in foreign currencies had increased/(decreased) by 10% with all variables held constant. The Company's exposure to other foreign exchange movements is not material.

2013

Change in FX Rate %	Profit (Loss) after tax \$'000	Equity \$'000
+10%	(377)	(377)
-10%	377	377

2012

Change in FX Rate %	Profit (Loss) after tax \$'000	Equity \$'000
+10%	(352)	(352)
-10%	352	352

Interest rate risk

The Company's exposure to interest rate risk relates primarily to the impact of market interest rates on the market value of financial assets at fair value through profit or loss and on interest earned on cash and cash equivalents and these financial assets.

Interest rate risk exposure arises mainly from investment in interest-bearing securities and from ongoing valuation of insurance liabilities. The investment portfolios hold significant interest-bearing securities in support of corresponding outstanding claims liabilities and are invested in a manner consistent with the expected duration of claims payments. The Company manages its exposure to interest rate risk primarily through investing funds in securities with maturity dates which are appropriate to the liabilities.

The sensitivity of profit or loss after tax and equity to movements in interest rates in relation to interest-bearing financial assets held at the reporting date is shown in the table below. The analysis is based on the assumption that the movement in interest rates had increased/decreased by 1.75% (absolute change) with all other variables

NOTES TO THE FINANCIAL STATEMENTS

31 Financial risk (continued)

held constant. It is assumed that all residual exposures for the shareholder after tax are included in the sensitivity analysis, that the percentage point change occurs at the reporting date and there are concurrent movements in the interest rates and parallel shifts in yield curves.

2013

Change in interest rate %	Profit (Loss) after tax \$'000	Equity \$'000
+1.75%	1,010	1,010
-1.75%	(1,102)	(1,102)

2012

Change in interest rate %	Profit (Loss) after tax \$'000	Equity \$'000
+1%	927	927
-1%	(735)	(735)

Price Risk

Price risk is the risk of loss resulting from the decline in prices of equity securities or other assets. Price risk is managed through diversification of the investment portfolio in accordance with investment guidelines established under the governance of the various investment committees which the Company operates locally and reports into at regional and global levels.

The Company has minimal exposure to price risk as the investment portfolio does not currently include equity securities. (2012: Nil).

Operational risk

Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risk can cause damage to reputation, have legal or regulatory implications or can lead to financial loss. The Company cannot expect to eliminate all operational risks, but by initiating a rigorous control framework and by monitoring and responding to potential risks the Company is able to manage the risks. Controls include effective segregation of duties, access controls, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit. Business risks such as changes in environment, technology and the industry are monitored through the Group's strategic planning and budgeting process.

NOTES TO THE FINANCIAL STATEMENTS

32 Events occurring after balance sheet date

There has been no matter or circumstance that has arisen since the end of the financial year that has significantly affected, or may significantly affect the Company's operations, or state of affairs in future financial years.

33 Capital Adequacy

The Company manages its capital to ensure that it will be able to continue to operate as a going concern and comply with capital requirements imposed by the relevant legislation, Insurance (Prudential Supervision) Act 2010, and the industry regulator the Reserve Bank of New Zealand.

The Company maintains a capital management policy that provides guidance on the level of capital maintained in accordance with regulatory requirements and is approved by the Directors. The objective of this policy is to hold sufficient levels of capital that is commensurate with the Company's overall risk profile and to maintain a level of capital that enables efficient use of the capital.

The capital objectives are achieved through ongoing management of the Statement of Financial Position and capital mix. The Company uses a range of strategies to effectively manage capital including continual refinement of business plans, ongoing reviews of solvency levels based on actuarial analysis, movement in asset valuations and profitability and capital planning in conjunction with budget and financial projections. The Company works with the regulator and monitors regulatory developments across its operations to assess their potential impact on its ability to meet solvency and other requirements.

The audited capital adequacy ratio of the Company at the reporting date is as follows:

	\$000's
• Actual solvency capital	\$105,653
• Minimum solvency capital	\$56,503
• Solvency margin	\$49,149
• Solvency margin expressed as a percentage	187%

INSURANCE (PRUDENTIAL SUPERVISION) ACT 2010

("Act")

APPOINTED ACTUARY'S REPORT

Pursuant to section 78 of the Act

Name of Licensed Insurer: **AIG Insurance New Zealand Limited**

I, Eric Hans Soo Lew of Melbourne in the state of Victoria, Australia report as follows:

1. I am the Appointed Actuary of the Licensed Insurer (*Actuary*).
2. This report is given in accordance with section 78 of the Act and relates to my review of the actuarial information contained in, or used in the preparation of, the financial statements of the Licensed Insurer for the 12 months ending 31 December 2013 (*Review*).
- 2.1 The Work done by me in relation to the Review was:
 - (i) The Premium Liabilities as defined in the Standard;
 - (ii) The Net Outstanding Claims Liability as defined in the Standard;
 - (iii) The reinsurance and any other recovery asset(s) relevant to the Reinsurance Recovery Risk Capital Charge; and
 - (iv) Application of the Liability Adequacy Test and any deferred acquisition cost or deferred fee revenue relevant to the Premium Liabilities.
- 2.2 The Scope and Limitations of the Review was: None
- 2.3 There is no relationship (other than that of actuary) that I have with, or any interests that I have in, the Licensed Insurer
- 2.4 I have obtained all information and explanations that I have required.
- 2.5 In my opinion and from an actuarial perspective:
 - (i) The actuarial information contained in the financial statements has been appropriately included in those statements;
 - (ii) The actuarial information used in the preparation of the financial statements has been used appropriately.
- 2.6 In my opinion and from an actuarial perspective the Licensed Insurer is maintaining the solvency margin that applies under a condition imposed under section 21(2)(b) of the Act (as at the balance date of the Licensed Insurer).

Dated: 19 March 2014



Signed: Eric Hans Soo Lew

