

AIG INSURANCE NEW ZEALAND LIMITED

ANNUAL REPORT

For the financial year ended 31 December 2018

AIG INSURANCE NEW ZEALAND LIMITED

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AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2018

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 2018.

Directors

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

C H Stobo
J A Dawson
C J Ryan
N E Condon
D A Wilson
E R G Hill

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

Dividends totalling \$15.0m were paid during the financial year ended 31 December 2018 (2017: \$14.0m).

Review and result of operations

The operating profit after tax of the Company for the year ended 31 December 2018 was \$8.6m (2017: \$13.1m). 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.

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 2018.

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

In the opinion of the directors,

- (a) the Statement of Financial Position of the Company as set out on page 11 is drawn up so as to present fairly in all material respects, the state of affairs of the Company as at 31 December 2018 and of the results of the business, changes in equity and cash flows of the Company for the financial year then ended; and

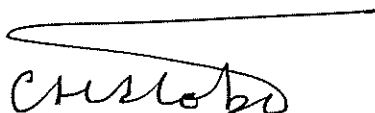
AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2018

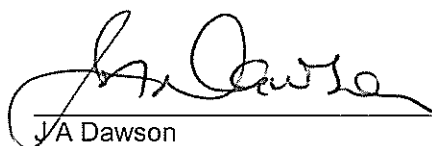
DIRECTORS' REPORT

- (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



C H Stobo
Director



J A Dawson
Director

29 March 2019



Independent auditor's report

To the shareholder of AIG Insurance New Zealand Limited

AIG Insurance New Zealand Limited's financial statements comprise:

- the statement of financial position as at 31 December 2018;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies.

Our opinion

In our opinion, the financial statements of AIG Insurance New Zealand Limited (the Company), present fairly, in all material respects, the financial position of the Company as at 31 December 2018, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Basis for opinion

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

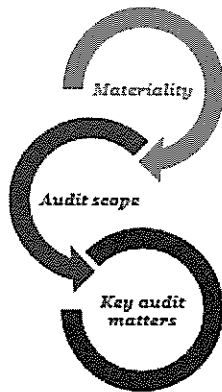
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

Other than in our capacity as auditor we have no relationship with, or interests in, the Company.

Our audit approach

Overview



An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement.

Overall materiality: \$2.117 million, which represents 1% of insurance premium revenue.

We chose insurance premium revenue as the benchmark because, in our view, it is a key metric used in assessing the performance of the Company and is a generally accepted benchmark for insurance companies.

We selected 1% based on our professional judgement, noting that it is also within the range of commonly accepted revenue-related benchmarks.

We have determined that the valuation of gross claims outstanding is a key audit matter.

Materiality

The scope of our audit was influenced by our application of materiality.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out above. These, together with qualitative considerations, helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Audit scope

We designed our audit by assessing the risks of material misstatement in the financial statements and our application of materiality. As in all of our audits, we also addressed the risk of management override of internal controls including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Company, the accounting processes and controls, and the industry in which the Company operates.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current year. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters

| Key audit matter | How our audit addressed the key audit matter |
|--|--|
| <p data-bbox="277 392 821 436">Valuation of gross claims outstanding</p> <p data-bbox="277 436 821 481">2018 \$247,006,000, 2017 \$230,892,000</p> <p data-bbox="277 481 821 660">We considered the valuation of gross claims outstanding a key audit matter because of the complexity involved in the estimation process and the significant judgements the Company makes in determining the balance.</p> <p data-bbox="277 660 821 795">Claim reserves are a best estimate of all claims incurred but not settled at a given date, regardless of whether these have been reported to the Company.</p> <p data-bbox="277 795 821 1131">Reserving is a complex process dealing with uncertainty, and there are varying methods which can be adopted in the determination of these reserves which are underpinned by a series of assumptions selected by the Company. These require the use of informed estimates and can rely on a large degree of judgement and relatively small changes in these assumptions can lead to significant movements in claim reserves.</p> <p data-bbox="277 1131 821 1758">In particular, judgement arises over the estimation of payments for claims that have been incurred at the reporting date but have not yet been reported to the Company as there is generally less information available in relation to these claims, and for claims that have been reported there is uncertainty over the amount which will be settled. Particular attention has been given to large losses, as for these losses case estimates are taken as being the best estimate of the ultimate loss unless there is specific other information available, against which specific manual allowance for claims incurred but not enough reported (IBNER) is applied on case to case basis. Large losses are defined differently for classes of business. This approach applies to claims in respect of large property, earthquakes and financial lines.</p> <p data-bbox="277 1758 821 1960">The estimate of expected future payments is discounted to present value using a risk free rate of return in order to reflect the time value of money. Judgement is involved in estimating the period over which claims are expected to settle.</p> | <p data-bbox="821 392 1498 638">Our audit procedures included obtaining an understanding of key claims and actuarial controls, including key data reconciliations and the Company's review of the actuarial estimates.</p> <p data-bbox="821 638 1498 705">Historical claims data is a key input to the actuarial estimates. Accordingly, we:</p> <ul data-bbox="821 705 1498 1064" style="list-style-type: none"> • Evaluated the design effectiveness and tested controls over claims processing; • Re-performed key actuarial data reconciliations; • Assessed a sample of claim case estimates at the year end to check that they were supported by appropriate documentation; and • Inspected a sample of claims paid during the year to confirm that they were supported by appropriate documentation and approved within delegated authority limits. <p data-bbox="821 1064 1498 1108">Together with PwC actuarial experts we:</p> <ul data-bbox="821 1108 1498 1960" style="list-style-type: none"> • Considered the work and findings of the Company's actuary; • Evaluated the actuarial models and methodologies used by comparing with generally accepted models and methodologies applied in the sector and with the prior year. We sought justification for any significant differences; • Evaluated the appropriateness of the projection of large loss claims payments; • Assessed key actuarial judgements and assumptions including discount rates, inflation rates, claim management expenses, weighted average term of settlement, and challenged these by comparing with our expectations based on the Company's historical experience, our own sector knowledge and independently observable trends; • Tested the discount rates applied for classes of business where there is a greater length of time between the initial claim event and settlement; and • Assessed the risk margin, by comparing to known industry practices and the New Zealand Society of Actuaries recommended framework. In particular we focused on the assessed level of uncertainty in the central estimate. |

| Key audit matter | How our audit addressed the key audit matter |
|--|--|
| <p>Outstanding claims (other than large losses noted above) include a risk margin that allows for the inherent uncertainty in the central estimate of the future claim payments. In determining the risk margin, the Company takes into account various factors, such as portfolio mix, previous periods claims statistics and the level of uncertainty in the net discounted central estimate.</p> <p><i>Relevant references in the financial statements</i></p> <p>Refer to notes 2.20, 3 and 21 of the financial statements, which also describe the elements that make up the balance.</p> | |

Information other than the financial statements and auditor's report

The Directors are responsible for the annual report. Our opinion on the financial statements does not cover the other information included in the annual report and we do not express any form of assurance conclusion on the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.



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

<https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-2/>

This description forms part of our auditor's report.

Who we report to

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

The engagement partner on the audit resulting in this independent auditor's report is Lisa Crooke.

For and on behalf of:

A handwritten signature in dark ink that reads 'PricewaterhouseCoopers'.

Chartered Accountants
29 March 2019

Auckland

Auditors report

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***STATEMENT OF COMPREHENSIVE INCOME**

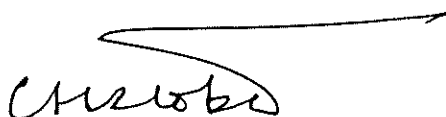
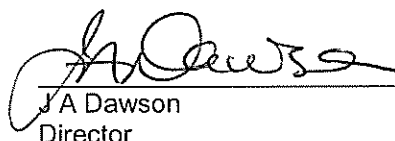
| \$ '000 | Notes | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|-------|---------------------------|---------------------------|
| Income | | | |
| Insurance premium revenue | 5 | 211,723 | 187,222 |
| Insurance premium ceded to reinsurers | 5 | (148,537) | (129,319) |
| Net earned insurance premium revenue | 5 | 63,186 | 57,903 |
| Reinsurance commission income | | 55,315 | 43,127 |
| Total income | | 118,501 | 101,030 |
| Expenses | | | |
| Insurance claims | 8 | (139,095) | (127,839) |
| Insurance claims recovered from reinsurers | 8 | 90,293 | 92,204 |
| Net insurance claims | 8 | (48,802) | (35,635) |
| Acquisition costs | | (28,789) | (21,049) |
| Net operating expenses | 9 | (33,025) | (30,728) |
| Total expenses | | (110,616) | (87,412) |
| Underwriting result | | 7,885 | 13,618 |
| Net investment income | 6 | 5,234 | 4,923 |
| Other net (losses)/gains | 7 | (1,086) | (396) |
| Profit before tax | | 12,033 | 18,145 |
| Income tax expense | 10 | (3,400) | (5,050) |
| Profit and total comprehensive income for the year | | 8,633 | 13,095 |

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

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***STATEMENT OF FINANCIAL POSITION**

| \$ '000 | Notes | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|-------|----------------------|----------------------|
| ASSETS | | | |
| Cash and cash equivalents | 11 | 38,375 | 57,583 |
| Trade receivables | 13 | 109,627 | 97,107 |
| Other receivables | 18 | 4,009 | 3,756 |
| Reinsurance recoverables | 14 | 208 | 7,543 |
| Financial assets at fair value through profit or loss | 12 | 108,097 | 79,152 |
| Deferred acquisition costs | 15 | 22,952 | 22,681 |
| Provision for reinsurance on unearned premiums | 20 | 94,072 | 86,652 |
| Provision for reinsurance on outstanding claims | 21 | 191,436 | 193,163 |
| Property, plant and equipment | 16 | 656 | 832 |
| Deferred tax assets | 22 | 4,212 | 4,050 |
| Intangible assets | 17 | 4,817 | 4,760 |
| Total assets | | 578,461 | 557,279 |
| LIABILITIES | | | |
| Trade and other payables | 19 | 64,017 | 57,361 |
| Deferred reinsurance commission | 15 | 33,266 | 33,740 |
| Current tax liabilities | | 276 | 5,498 |
| Provision for gross unearned premiums | 20 | 133,408 | 122,933 |
| Provision for gross claims outstanding | 21 | 247,006 | 230,892 |
| Total liabilities | | 477,973 | 450,424 |
| EQUITY | | | |
| Share capital | 24 | 105,250 | 105,250 |
| Retained earnings | | (4,762) | 1,605 |
| Total equity attributable to owners of the company | | 100,488 | 106,855 |
| Total liabilities and equity | | 578,461 | 557,279 |

On behalf of the directors


C H Stobo
Chair

J A Dawson
Director

29 March 2019

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

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***STATEMENT OF CHANGES IN EQUITY**

| \$ '000 | Note | Share capital | Retained earnings | Total |
|--|------|----------------|-------------------|----------------|
| At 1 January 2017 | | 105,250 | 2,510 | 107,760 |
| Total comprehensive income | | | | |
| Profit for the year | | - | 13,095 | 13,095 |
| Total comprehensive income for the year | | - | 13,095 | 13,095 |
| Dividend to equity holders | 24 | - | (14,000) | (14,000) |
| At 31 December 2017 | | 105,250 | 1,605 | 106,855 |
| Total comprehensive income | | | | |
| Profit for the year | | - | 8,633 | 8,633 |
| Total comprehensive income for the year | | - | 8,633 | 8,633 |
| Dividend to equity holders | 24 | - | (15,000) | (15,000) |
| At 31 December 2018 | | 105,250 | (4,762) | 100,488 |

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

AIG INSURANCE NEW ZELAND LIMITED*For the financial year ended 31 December 2018***STATEMENT OF CASH FLOWS**

| \$ '000 | Notes | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|--|--------------|-----------------------------------|-----------------------------------|
| Cash flow from operating activities: | | | |
| Premiums received | | 221,516 | 190,307 |
| Reinsurance claim recoveries | | 87,518 | 116,186 |
| Interest received | | 4,793 | 4,873 |
| Claims paid | | (122,708) | (166,001) |
| Outwards reinsurance premiums paid | | (153,194) | (143,245) |
| Net acquisition costs | | (28,182) | (24,220) |
| Net reinsurance commission | | 54,841 | 52,401 |
| General operating expenses | | (28,484) | (29,306) |
| Income tax (paid) / received | | (8,784) | 2,371 |
| Net cash provided by operating activities | 4 | 27,316 | 3,366 |
| Cash flow from investing activities: | | | |
| Purchases of financial assets | | (47,866) | - |
| Maturities and disposal of financial assets | | 17,753 | 19,628 |
| Purchases of property, plant, equipment and software | | (1,411) | (728) |
| Net cash (used in) / provided by investing activities | | (31,524) | 18,900 |
| Cash flow from financing activities: | | | |
| Dividend paid | 24 | (15,000) | (14,000) |
| Net cash used in financing activities | | (15,000) | (14,000) |
| Net (decrease)/increase in cash and cash equivalents | | (19,208) | 8,266 |
| Cash and cash equivalents | | | |
| Beginning of year | 11 | 57,583 | 49,317 |
| End of year | 11 | 38,375 | 57,583 |

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

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 is rated "A" (strong) by Standard & Poors (2017: "A" strong). The sole shareholder of the Company is AIG Asia Pacific Insurance Pte Ltd incorporated in Singapore. The ultimate parent company is American International Group Inc, ("AIG") and is registered in the state of Delaware, USA. The nature of the operations and principal activities of the Company during the year were the underwriting of various classes of general insurance and reinsurance risks.

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 29 March 2019. 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 Generally Accepted Accounting Practice in New Zealand (NZGAAP). The financial statements comply with New Zealand Equivalents to International Financial Reporting Standards ("NZIFRS") and International Financial Reporting Standards ("IFRS") as appropriate for for-profit entities. The financial statements have been prepared in accordance with the Financial Markets Conduct Act 2013 and the Companies 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 for-profit entity for the purposes of complying with NZ GAAP.

The preparation of financial statements in conformity with NZ 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.

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

2.2 New standards and interpretations adopted

The Company has applied the following standards and amendments for the first time in the accounting period commencing January 1, 2018.

- NZ IFRS 9 Financial Instruments

NZ IFRS 9 replaces the provisions of NZ IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

The Company has updated the accounting policy for financial assets following the adoption of NZ IFRS 9. This is disclosed in note 2.13.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

The transition to NZ IFRS 9 had no financial impact to the financial statements.

In accordance with the transitional provisions in NZ IFRS 9 (7.2.15), comparative figures have not been restated.

New standards and interpretations applicable to the Company not yet adopted

The following are new standards, amendments and interpretations issued but which are not effective for the financial year beginning on 1 January 2018 and have not been adopted early by the Company.

NZ IFRS 16: Leases

NZ IFRS 16 "Leases" (effective from 1 January 2019). It will result in almost all leases being recognised on the Statement of Financial Position, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised. The only exceptions are short-term and low-value leases. The accounting for lessors will not significantly change. The Company is assessing the impact of adopting NZ IFRS 16 on its Financial Statements and initial assessments indicate the treatment of office buildings, motor vehicles and other equipment leases will change. The potential impact of changes will result in the creation of a 'right-of-use asset' with a corresponding lease liability amount to be recognised in the Statement of Financial Position. The expected impact of the changes to the Company's financial statements is an increase to assets of approximately \$2.9m and an increase to liabilities of approximately \$2.9m.

The Company will apply the standard from its mandatory adoption date of 1 January 2019. The Company intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. Right-of-use assets for property leases will be measured on transition as if the new rules had always been applied. All other right-of-use assets will be measured at the amount of the lease liability on adoption (adjusted for any prepaid or accrued lease expenses).

NZ IFRS 17: Insurance Contracts

NZ IFRS 17 "Insurance Contracts" (effective from 1 January 2021) replaces the current guidance in NZ IFRS 4. It establishes the principles for recognition, measurement, presentation and disclosure of insurance contracts. The implementation date for the Company will be for the year ending 31 December 2022. The Company is assessing the impact of NZ IFRS 17 on its financial statements and this assessment is conducted in conjunction with AIG's Office of Accounting Policy. The Office of Accounting Policy is responsible for setting corporate financial accounting policies for AIG offices. The Company is still assessing what the financial impact of the change will be.

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

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

earned in the Statement of Comprehensive Income at the reporting date is recognised in the Statement of Financial Position as an unearned premium reserve.

2.4 Insurance contracts

An insurance contract is defined as a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (insured event) adversely affects the policyholders.

Insurance contracts involve the acceptance of significant insurance risk. Insurance risk is defined as significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction).

Insurance contracts include those where the insured benefit is payable on the occurrence of a specified event or loss. The insured benefit is either not linked or only partly linked to the market value of the investment held by the insurer, and the financial risks are substantially borne by the insurer.

2.5 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.

2.6 Commission income

Commission income is received from reinsurers for the placement of reinsurance and is recorded as reinsurance commission income and is recognised in the Statement of Comprehensive Income.

The earned portion of reinsurance commission received and receivable, including unclosed business is recognised on a straight line basis as revenue.

The unearned portions of commission income are deferred and shown as deferred reinsurance commissions in the Statement of Financial Position.

2.7 Deferred acquisition costs (DAC)

Policy acquisition costs represent those costs, including commissions, premium taxes and other underwriting expenses that vary with and are primarily related to the acquisition of new and renewal of existing insurance contracts.

Policy acquisition costs are deferred and amortised over the period in which the related premiums written are earned. DAC is grouped consistent with the manner in which the insurance contracts are acquired, serviced and measured for profitability and is reviewed for recoverability based on the profitability of the underlying insurance contracts.

The unearned portion of commission expense and other acquisition costs are deferred and shown as deferred acquisition costs and deferred reinsurance commission in the Statement of Financial Position.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

There has been a change in assumption for deferred acquisition costs in prior year to take into consideration recent changes in actual costs incurred that previously were not included in the deferred acquisition costs model. Costs that have been deferred are directly associated with the acquisition of new and or existing business. Any expenses that are not directly associated with the acquisition of business have not been deferred.

2.8 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 net 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.

2.9 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.

2.10 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.

2.11 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 on an accrual basis.

2.12 Taxation

Current and Deferred Tax

The income tax expense or credit for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the company's subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

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.

2.13 Financial assets

Classification and measurement

From 01 January 2018 the Company classifies its financial assets into the following measurement categories:

- those to be measured subsequently at fair value through profit or loss (FVPL); and
- those to be measured subsequently at amortised cost.

The classification depends on the Company's business model for managing its financial assets and the contractual terms of the cash flows. The assessment of the Company's business model was made as of the date of initial application, 01 January 2018. A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as measured at fair value through profit or loss.

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

Management designates its financial assets at fair value through profit or loss upon initial recognition when the designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them, on a different basis.

Financial assets are designated at fair value through profit or loss when they are deemed to be backing insurance liabilities of the Company.

For assets measured at fair value, gains and losses will either be recorded in profit or loss. The Company reclassifies financial assets when, and only when its business model for managing those assets changes.

Regular purchases and sales of investments are recognised on the trade date – the date on which the Company commits to purchase or sell the investment.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

At initial recognition the Company measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVPL are expensed in profit or loss.

Interest income from financial assets at amortised cost is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss and presented in other gains/(losses) together with foreign exchange gains and losses. Impairment losses are presented as a separate line item in the statement of profit or loss.

A gain or loss on a financial asset that is subsequently measured at fair value through profit or loss is recognised in profit or loss and presented net within other gains/(losses) in the period in which it arises.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The fair value of financial assets and liabilities traded in active markets are based on quoted market prices at the close of trading. The fair value of financial assets and liabilities that are not traded in an active market (for example, fixed interest securities) is determined using valuation techniques.

The output of a model is always an estimate or approximation of a value that cannot be determined with certainty, and valuation techniques employed may not fully reflect all factors relevant to the positions the Company holds. Valuations are therefore adjusted, where appropriate, to allow for additional factors including model risk, liquidity risk and counterparty risk.

The fair value hierarchy has the following levels:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Valuation techniques used include:

Debt securities at fair value through profit or loss: Whenever available, the Company obtains quoted prices in active markets for identical assets at the reporting date to measure fixed maturity securities at fair value. 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 Company uses market information and derives fair values based upon relevant methodologies and assumptions for individual instruments.

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.

- The fair value of financial instruments that are not traded in an active market is determined using valuation techniques which maximise the use of observable market data and rely as little as possible on entity-specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

The Company recognises all debt securities at Level 2.

Impairment of financial assets

From 01 January 2018, the Company assesses on a forward looking basis the expected credit losses associated with its financial assets carried at amortised cost which are subject to NZ IFRS 9. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

Majority of the Company's financial assets represent rights and obligations arising under insurance contracts as defined in NZ IFRS 4 Insurance Contracts which are out of scope and therefore not subject to NZ IFRS 9 impairment model.

Company's financial assets subject to NZ IFRS 9 (interest accrued and sundry debtors) are considered to have low credit risk, and as such the impairment provision recognised during the period was limited to 12 months expected losses. Management consider 'low credit risk' for interest accrued to be an investment grade credit rating with at least one major rating agency. Sundry debtors are considered to be low credit risk when they have a low risk of default and the counterparty has a strong capacity to meet its contractual cash flow obligations in the near term. The impairment charge is recognised in the profit and loss component of the Statement of Comprehensive Income.

Accounting policies applied until 31 December 2017

The Company has applied NZ IFRS 9 retrospectively, but has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the Company's previous accounting policy.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

Classification

Until 31 December 2017, the Company classified its financial assets into the following categories: financial assets at fair value through profit or loss and loans and receivables. The classification depended on the purpose for which the investments were acquired. Financial assets were designated at fair value through profit or loss when they were deemed to be backing insurance liabilities of the Company. Management determined the classification of its investments at the initial recognition and re-evaluated this designation at every reporting date. Financial assets were classified as current assets if they were expected to be settled within 12 months, otherwise they were classified as non-current.

Measurement

The measurement at initial recognition did not change on adoption of NZ IFRS 9, see description above.

Subsequent to initial recognition, loans and receivables were carried at amortised cost using the effective interest method. Financial assets and financial liabilities at FVPL were subsequently carried at fair value. Gains and losses arising from changes in the fair value were recognised in the profit or loss within other net losses / gains in the period in which they arose.

There has been no change to fair value determination methods. Details on how the fair value of financial instruments was determined is disclosed above.

Impairment of financial assets

The Company assessed at each reporting date whether there was objective evidence that a financial asset or group of financial assets was impaired. A financial asset or a group of financial assets was impaired and impairment losses were incurred only if there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated.

For loans and receivables, the amount of the loss was 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 carrying amount of the asset was reduced and the amount of the loss was recognised in profit or loss within net operating expenses.

If, in a subsequent period, the amount of the impairment loss decreased and the decrease could be related objectively to an event occurring after the impairment was recognised, the reversal of the previously recognised impairment loss was recognised in profit or loss.

2.14 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 direct method for preparing the Statement of Cash Flows. This statement shows the movement in cash and cash equivalents for the period including bank overdrafts.

2.15 Trade and other receivables

From 01 January 2018, policies for accrued investment income and sundry debtors in scope of NZ IFRS 9 are described in note 2.13.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

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.

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. 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.

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

2.16 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.

2.17 Property, plant and equipment

Property, 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, and adjusted as appropriate.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

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.

2.18 Intangible assets

Intangible assets include capitalised software costs and work in progress.

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.

Work in Progress represents development costs for internal software and is stated at historical cost. No amortisation is charged for assets in this category. The costs will be transferred from work in progress to capitalised software costs once the software is in use and amortisation will start.

2.19 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 or 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 or loss component of the Statement of Comprehensive Income within net operating expenses.

2.20 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 expenses 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, with an additional risk margin to allow for the inherent uncertainty in the central estimate.

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.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

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.

2.21 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.

2.22 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.

2.23 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)

2.24 Employee benefits

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 reporting 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 an 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.

Leave obligations

The liability for long service leave and annual 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. For long service leave consideration is given to salary levels and years of service.

2.25 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.

2.26 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.

NOTES TO THE FINANCIAL STATEMENTS

2 Significant accounting policies (continued)

2.27 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.

2.28 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.

2.29 Changes in accounting policies

Note 2.2 explains the impact of the adoption of NZ IFRS 9 Financial Instruments on the Company's financial statements. There have been no other changes in accounting policies during the year.

2.30 Other comparatives

Other comparative information has been reclassified or restated to ensure consistency with presentation in the current year. These reclassifications and restatements have no impact on net profit after taxation.

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 the reporting date, including 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.

The Company recognises large claims based on case estimates on the basis that these case estimates represent best estimates and does not hold Incurred But Not Enough Reported ("IBNER") provision. Large claims are defined differently for classes of business and this approach applies to large property claims, earthquakes and financial lines.

Gross claim estimates in respect of Kaikoura earthquake are subject to a higher degree of uncertainty and may vary materially from that disclosed in the financial statements. However due to the reinsurance arrangements in place any adverse development will not impact the net profit or loss of the Company.

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 claims incurred but not paid at report date 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.

NOTES TO THE FINANCIAL STATEMENTS

3. Critical accounting estimates and judgements (continued)

The Company has extensive reinsurance in place since December 2011. The Company is satisfied that appropriate layers of reinsurance are in place in respect of the Kaikoura earthquake.

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.

The outstanding claims liability has been determined in accordance with Professional Standard No. 30 of the New Zealand Society of Actuaries and NZ IFRS 4: Insurance Contracts and incorporates the following assumptions:

| | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|---|-------------------|
| Weighted average term to settlement | 0.9 years | 0.9 years |
| Discount rate for succeeding and subsequent years | 1.71% | 1.79% |
| Claim inflation for succeeding and subsequent years | Implicit based on historical experience | |
| Risk margins were applied by line ranging | 11-21% | 11-21% |
| Indirect claim management expenses | 5.5% | 6.2% |
| Probability of sufficiency | 75.00% | 75.00% |

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 numbers 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 occurrences, 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.

During the prior year the Company adopted the group's global benchmark reserving assumptions for the Excess Casualty segment within the Casualty class of business. The change in assumptions resulted in a \$2m gross reduction in IBNR for this line of business.

3.4 Probability of adequacy

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 for determining risk margins is based on 'A Framework for Assessing Risk Margins', as issued to the 2008 Australian Institute of Actuaries General Insurance Seminar. This is considered appropriate for New Zealand. The methodology 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.

NOTES TO THE FINANCIAL STATEMENTS

3. Critical accounting estimates and judgements (continued)

- 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

The valuation risks have been grouped broadly into six risk margin classes so each class contains sufficient data. These classes are Accident & Health, Casualty, Financial Lines, Other Commercial Lines, Other Consumer Lines and Property and Energy.

3.7 Adaptive reserve modelling system software ("ARMs")

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. This is consistent with the previous valuation.

The regional reserving policy requires the risk margins to be updated once every three to five years unless a substantial change in the underlying risk profile requires an earlier update. The last review of the risk margins was done as at 31 December 2015. In line with the regional reserving policy, the risk margin is currently scheduled to be updated in 2019 / 2020.

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.

In this year's valuation, the assumed total diversification benefit was approximately 30% (2017: 30%) for outstanding claims liabilities (gross and net) and 40% (2017: 40%) for premium liabilities (gross and net).

3.9 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.

2018

| Variables | Movement in variables | Profit (Loss) before tax NZD '000 | Equity NZD '000 |
|-------------------------------------|-----------------------|--------------------------------------|--------------------|
| Discount rates | +1% | 476 | 343 |
| | -1% | -485 | -349 |
| Inflation rates | +1% | -485 | -349 |
| | -1% | 476 | 343 |
| Indirect claim management expenses | +1% | -934 | -673 |
| | -1% | 934 | 673 |
| Weighted average term to settlement | +0.5 year | 469 | 338 |
| | -0.5 year | -473 | -341 |

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***NOTES TO THE FINANCIAL STATEMENTS**

3. Critical accounting estimates and judgements (continued)

2017

| Variables | Movement in variables | Profit (Loss) before tax NZD '000 | Equity NZD '000 |
|-------------------------------------|-----------------------|--------------------------------------|--------------------|
| Discount rates | +1% | 329 | 237 |
| | -1% | -335 | -241 |
| Inflation rates | +1% | -335 | -241 |
| | -1% | 329 | 237 |
| Indirect claim management expenses | +1% | -701 | -505 |
| | -1% | 701 | 505 |
| Weighted average term to settlement | +0.5 year | 334 | 240 |
| | -0.5 year | -337 | -243 |

NOTES TO THE FINANCIAL STATEMENTS

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

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|---------------------------|---------------------------|
| Profit after income tax | 8,633 | 13,095 |
| Investment revenue – net changes in market value | 1,168 | 80 |
| Loss on disposal of plant and equipment | - | 4 |
| Depreciation and amortisation expense | 1,530 | 1,283 |
| Change in operating assets and liabilities | | |
| (Increase) in trade receivables | (12,520) | (2,379) |
| (Increase) in deferred reinsurance premiums | (7,420) | (6,949) |
| (Decrease) / Increase in tax liability | (5,222) | 9,308 |
| Increase in provision for unearned premiums | 10,475 | 5,356 |
| (Increase) in other receivables | (253) | (228) |
| Increase in net acquisition costs | (271) | (3,171) |
| (Decrease) / Increase in net reinsurance commission | (474) | 9,274 |
| (Increase) in net deferred tax asset | (162) | (1,973) |
| Increase / (decrease) in trade and other payables | 6,656 | (6,427) |
| Decrease in reinsurance and other recoveries | 9,062 | 24,090 |
| Increase / (decrease) for provision in gross claims outstanding | 16,114 | (37,997) |
| Net cash inflow/(outflow) from operating activities | 27,316 | 3,366 |

5 Net earned insurance premium revenue

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|---------------------------|---------------------------|
| Premium revenue from insurance contracts issued: | | |
| Gross written premium in the year | 222,198 | 192,578 |
| Change in unearned premium provision | (10,475) | (5,356) |
| | 211,723 | 187,222 |
| Premium revenue ceded to reinsurers on insurance contracts issued: | | |
| Premium ceded to reinsurers in the year | (155,957) | (136,268) |
| Change in unearned premium provision | 7,420 | 6,949 |
| | (148,537) | (129,319) |
| Net earned insurance premium revenue | 63,186 | 57,903 |

Gross written premium in the year includes \$1.7m of reinsurance risks. (2017: \$3m)

6 Net investment income

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|--|---------------------------|---------------------------|
| Cash and fixed interest securities interest income | 5,358 | 5,017 |
| Investment expenses | (124) | (94) |
| Net investment income | 5,234 | 4,923 |

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***NOTES TO THE FINANCIAL STATEMENTS****7 Other net (losses)/gains**

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|---------------------------|---------------------------|
| Financial assets at fair value through profit or loss | | |
| - Fair value losses | (1,501) | (998) |
| - Fair value gains | 80 | 666 |
| Realised capital gain on sale of financial asset | 20 | - |
| Foreign exchange gains / (losses) | 315 | (64) |
| Other net (losses) | (1,086) | (396) |

8 Net insurance claims

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

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|---------------------------|---------------------------|
| Insurance claims | | |
| Gross claims incurred | 138,403 | 120,532 |
| Discount movement | 692 | 7,307 |
| | 139,095 | 127,839 |
| Insurance claims recovered from reinsurers | | |
| Reinsurance recoveries | 89,465 | 85,391 |
| Discount movement | 828 | 6,813 |
| | 90,293 | 92,204 |
| Net insurance claims | 48,802 | 35,635 |

2018 Incurred claims

| \$'000 | 2018 | 2017 & prior | Total |
|---|---------|--------------|---------|
| Gross claims incurred | 105,469 | 32,934 | 138,403 |
| Discounted claims incurred | 104,420 | 34,675 | 139,095 |
| Discount movement | (1,049) | 1,741 | 692 |
| Reinsurance and other recoveries | 64,258 | 25,207 | 89,465 |
| Discounted reinsurance and other recoveries | 63,595 | 26,698 | 90,293 |
| Discount movement | (663) | 1,491 | 828 |
| Net claims incurred (undiscounted) | 41,211 | 7,727 | 48,938 |
| Net claims incurred (discounted) | 40,825 | 7,977 | 48,802 |

NOTES TO THE FINANCIAL STATEMENTS

8 Net insurance claims (continued)

2017 Incurred claims

| \$'000 | 2017 | 2016 & prior | Total |
|---|---------|--------------|---------|
| Gross claims incurred | 96,342 | 24,190 | 120,532 |
| Discounted claims incurred | 95,144 | 32,695 | 127,839 |
| Discount movement | (1,198) | 8,505 | 7,307 |
| Reinsurance and other recoveries | 57,709 | 27,682 | 85,391 |
| Discounted reinsurance and other recoveries | 56,960 | 35,244 | 92,204 |
| Discount movement | (749) | 7,562 | 6,813 |
| Net claims incurred (undiscounted) | 38,633 | (3,492) | 35,141 |
| Net claims incurred (discounted) | 38,184 | (2,549) | 35,635 |

9 Net operating expenses

| \$ '000 | Note | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|------|---------------------------|---------------------------|
| Employee benefits expenses (see below) | | 15,675 | 14,895 |
| Operating lease rentals | | 1,167 | 1,250 |
| Depreciation of property, plant and equipment | 16 | 192 | 283 |
| Amortisation of intangible assets | 17 | 1,338 | 1,000 |
| Auditors' remuneration – audit services only | | 212 | 199 |
| Auditors' remuneration – taxation compliance services | | - | 22 |
| Third party claims administrators | | 4,518 | 3,903 |
| AIG Group service fees | 25 | 4,866 | 5,949 |
| AIG APAC Holdings service fees | 25 | 1,722 | - |
| AIG Shared services charges | 25 | 891 | 1,325 |
| AIG Global services charges | 25 | 967 | 898 |
| Other expenses | | 1,477 | 1,004 |
| Net operating expenses | | 33,025 | 30,728 |

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|-----------------------------------|---------------------------|---------------------------|
| Wages and salaries | 11,515 | 11,444 |
| Other employee benefit expenses | 4,160 | 3,451 |
| Employee benefits expenses | 15,675 | 14,895 |

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***NOTES TO THE FINANCIAL STATEMENTS****10 Income tax**

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---------------------------|---------------------------|---------------------------|
| Current income tax | (3,562) | (7,023) |
| Total current tax | (3,562) | (7,023) |
| Deferred tax | 162 | 1,973 |
| Total deferred tax | 162 | 1,973 |
| Income tax expense | (3,400) | (5,050) |

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|--|---------------------------|---------------------------|
| Profit before tax | 12,033 | 18,145 |
| Tax calculated at the current rate 28% | (3,369) | (5,081) |
| Effects of: | | |
| Non deductible expenses | (31) | (27) |
| Over (under) provision from prior year | - | 58 |
| Income tax expense | (3,400) | (5,050) |

Imputation Credits

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|--|----------------------|----------------------|
| Imputation credits available for use in subsequent reporting periods | 24,842 | 26,355 |

The above amounts represent the balance of the imputation account as at the end of the reporting period, adjusted for:

- Imputation credits that will arise from the payment of the amount of the provision for income tax
- Imputation debits that will arise from the payment of dividends recognised as a liability at the reporting date; and
- Imputation credits that will arise from the receipt of dividends recognised as receivables at the reporting date.

NOTES TO THE FINANCIAL STATEMENTS

11 Cash and cash equivalents

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|----------------------------------|----------------------|----------------------|
| Cash at bank | 18,375 | 12,583 |
| Short term deposits | 20,000 | 45,000 |
| Cash and cash equivalents | 38,375 | 57,583 |

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.

12 Financial assets at fair value through profit or loss

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

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|--|----------------------|----------------------|
| At fair value through profit or loss | | |
| Fixed interest securities | 108,097 | 71,128 |
| Floating rate notes | - | 8,024 |
| Financial assets at fair value through profit or loss | 108,097 | 79,152 |

There are no financial assets held for trading.

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

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|--|---------------------------|---------------------------|
| Balance at the beginning of the year | 79,152 | 98,860 |
| Purchases | 47,866 | - |
| Disposals and maturities | (17,500) | (19,376) |
| Fair value net losses | (1,421) | (332) |
| Financial assets at fair value through profit or loss | 108,097 | 79,152 |

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***NOTES TO THE FINANCIAL STATEMENTS****13 Trade receivables**

| \$ '000 | Note | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|------|----------------------|----------------------|
| Premium debtors receivables | | 70,865 | 70,180 |
| Less: Provision for impairment from premium debtors | | (89) | (86) |
| Amount due from related parties | 25 | 38,851 | 27,013 |
| Total trade receivables | | 109,627 | 97,107 |
| Movement in provision for impairment | | | |
| Opening balance | | (86) | (253) |
| Provisions added during the year | | (3) | - |
| Provisions released during the year | | - | 167 |
| Closing Balance | | (89) | (86) |
| Current | | 109,627 | 97,107 |
| Non-Current | | - | - |
| Total trade receivables | | 109,627 | 97,107 |

Trade receivables are non-interest bearing and are generally on 90-120 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 trade receivables does not differ from their amortised cost.

14 Reinsurance recoverables

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|----------------------|----------------------|
| Due from reinsurers excluding related parties | 1,207 | 7,696 |
| Less: Provision for impairment for reinsurers | (999) | (153) |
| Total reinsurance recoverables | 208 | 7,543 |
| Movement in provision for impairment | | |
| Opening balance | (153) | (391) |
| Provisions added during the year | (846) | (106) |
| Provisions released during the year | - | 344 |
| Closing Balance | (999) | (153) |
| Current | 208 | 7,543 |
| Non-Current | - | - |
| Total reinsurance recoverables | 208 | 7,543 |

Reinsurance recoverables 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 reinsurance recoverables does not differ from their amortised cost.

NOTES TO THE FINANCIAL STATEMENTS

15 Deferred acquisition costs

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|--|---------------------------|---------------------------|
| Opening deferred acquisition costs | 22,681 | 19,510 |
| Acquisition costs deferred | 39,545 | 34,200 |
| Amortisation charge | (39,274) | (31,029) |
| Deferred acquisition costs at 31 December | 22,952 | 22,681 |
| Current | 21,335 | 21,018 |
| Non-Current | 1,617 | 1,663 |
| Deferred acquisition costs | 22,952 | 22,681 |

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|---------------------------|---------------------------|
| Opening deferred reinsurance commissions | 33,740 | 24,466 |
| Reinsurance commission costs deferred | 54,841 | 52,517 |
| Amortisation charge | (55,315) | (43,243) |
| Deferred reinsurance commission at 31 December | 33,266 | 33,740 |
| Current | 29,788 | 30,675 |
| Non-Current | 3,478 | 3,065 |
| Deferred reinsurance commission | 33,266 | 33,740 |

NOTES TO THE FINANCIAL STATEMENTS

16 Property, plant and equipment

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

| \$ '000 | Furniture & Fittings & Leasehold Improvements | Office Equipment | Total |
|---------------------------------|--|---------------------|----------------|
| Cost | | | |
| Balance 1 January 2017 | 2,425 | 126 | 2,551 |
| Additions | 26 | 30 | 56 |
| Disposals | (47) | - | (47) |
| At 31 December 2017 | 2,404 | 156 | 2,560 |
| Additions | 16 | - | 16 |
| Disposals | - | - | - |
| At 31 December 2018 | 2,420 | 156 | 2,576 |
| Accumulated Depreciation | | | |
| Balance 1 January 2017 | (1,407) | (81) | (1,488) |
| Depreciation charge | (250) | (33) | (283) |
| Disposals | 43 | - | 43 |
| At 31 December 2017 | (1,614) | (114) | (1,728) |
| Depreciation charge | (168) | (24) | (192) |
| Disposals | - | - | - |
| At 31 December 2018 | (1,782) | (138) | (1,920) |
| Carrying Amount | | | |
| At 1 January 2017 | 1,018 | 45 | 1,063 |
| At 31 December 2017 | 790 | 42 | 832 |
| At 31 December 2018 | 638 | 18 | 656 |

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***NOTES TO THE FINANCIAL STATEMENTS****17 Intangible Assets**

Movements in capitalised software and work in progress are as follows:

| \$ '000 | Computer Software | Work in Progress | Total |
|---------------------------------|-------------------|------------------|----------------|
| Cost | | | |
| Balance 1 January 2017 | 5,204 | 1,196 | 6,400 |
| Additions | - | 673 | 673 |
| Transfers | 1,661 | (1,661) | - |
| At 31 December 2017 | 6,865 | 208 | 7,073 |
| Additions | 10 | 1,385 | 1,395 |
| Disposals | (125) | - | (125) |
| Transfers | 801 | (801) | - |
| At 31 December 2018 | 7,551 | 792 | 8,343 |
| Accumulated Amortisation | | | |
| Balance 1 January 2017 | (1,313) | - | (1,313) |
| Amortisation charge | (1,000) | - | (1,000) |
| Transfers | - | - | - |
| At 31 December 2017 | (2,313) | - | (2,313) |
| Amortisation charge | (1,338) | - | (1,338) |
| Disposals | 125 | - | 125 |
| At 31 December 2018 | (3,526) | - | (3,526) |
| Carrying Amount | | | |
| At 1 January 2017 | 3,891 | 1,196 | 5,087 |
| At 31 December 2017 | 4,552 | 208 | 4,760 |
| At 31 December 2018 | 4,025 | 792 | 4,817 |

18 Other receivables

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|----------------------|----------------------|
| Accrued investment income | 1,306 | 974 |
| Prepayments | 116 | 133 |
| Third party administration – claim floats | 1,940 | 1,940 |
| Sundry debtors | 647 | 709 |
| Other receivables | 4,009 | 3,756 |
| Current | 4,009 | 3,756 |
| Non-Current | - | - |
| Other receivables | 4,009 | 3,756 |

NOTES TO THE FINANCIAL STATEMENTS

19 Trade and other payables

| \$ '000 | Note | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---------------------------------|------|----------------------|----------------------|
| Trade payables | | 5,800 | 4,369 |
| Reinsurance payables | | 4,234 | 1,556 |
| Amount due to related companies | 25 | 46,198 | 44,657 |
| Taxes and levies payable | | 6,725 | 5,838 |
| Provision for holiday pay | | 1,060 | 941 |
| Trade and other payables | | 64,017 | 57,361 |
| Current | | 63,824 | 57,082 |
| Non-Current | | 193 | 279 |
| Trade and other payables | | 64,017 | 57,361 |

20 Provision for net unearned premium

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|----------------------|----------------------|
| Gross unearned premium reserve | 133,408 | 122,933 |
| Less: Reinsurance unearned premium reserve | (94,072) | (86,652) |
| Provision for net unearned premium | 39,336 | 36,281 |
| Unearned premium at beginning of year | 36,281 | 37,874 |
| Deferral of premiums on contracts written in period | 34,480 | 30,608 |
| Earning of premiums written in previous period | (31,425) | (32,201) |
| Provision for net unearned premium | 39,336 | 36,281 |
| Current | 34,573 | 31,916 |
| Non-Current | 4,763 | 4,365 |
| Provision for net unearned premium | 39,336 | 36,281 |

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 2018 (2017: 75%). 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.

The application of the liability adequacy test in respect of the net premium liabilities identified a surplus at December 2018 (2017: Surplus).

For the purposes of the liability adequacy test at 31 December 2018, the present value of expected future cash flows for future claims (including risk margin) is equal to \$33.4 million (2017: \$31.9m), made up as follows:

- Discounted central estimate (net of reinsurance) of \$20.4 million (2017: \$19.5m);

NOTES TO THE FINANCIAL STATEMENTS

20 Provision for net unearned premium (continued)

- Indirect claims expense provision of \$8.5 million (2017: \$8.2m); and
- Risk margins at the 75th percentile probability of sufficiency (after allowing for diversification benefit) of 15% or \$4.4million (2017: \$4.2m).

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 reporting 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 | 2018 | 2017 |
| Central estimate | 214,142 | 202,217 |
| Undiscounted risk margin | 34,465 | 31,629 |
| Undiscounted indirect expenses | 4,454 | 3,794 |
| Outstanding claims reserve | 253,061 | 237,640 |
| Discount to present value | (6,055) | (6,748) |
| Provision for gross outstanding claims | 247,006 | 230,892 |
| | | |
| At 31 December | | |
| \$ '000 | 2018 | 2017 |
| Gross reinsurance and other recoveries | 196,665 | 199,220 |
| Less: discount to present value | (5,229) | (6,057) |
| Provision for reinsurance on outstanding claims | 191,436 | 193,163 |
| | | |
| Net outstanding claims | 55,570 | 37,729 |

AIG INSURANCE NEW ZEALAND LIMITED

For the financial year ended 31 December 2018

NOTES TO THE FINANCIAL STATEMENTS

21 Provision for net claims outstanding (continued)

Reconciliation of movements in discounted outstanding claims liability

As at 31 December

| NZD '000 | 2018 | | | 2017 | | |
|---|-----------|-------------|----------|-----------|-------------|----------|
| | Gross | Reinsurance | Net | Gross | Reinsurance | Net |
| Balance brought forward | 230,892 | 193,163 | 37,729 | 268,889 | 221,332 | 47,557 |
| Unwind of interest | 3,455 | 2,880 | 575 | 4,041 | 3,375 | 666 |
| Claims incurred in the current year (last year's basis) | 104,635 | 63,545 | 41,090 | 94,887 | 56,845 | 38,042 |
| Claims cost paid during the year | (118,993) | (92,020) | (26,973) | (161,089) | (120,372) | (40,717) |
| Claims handling expenses during the year | (3,989) | 0 | (3,989) | (4,747) | 0 | (4,747) |
| Total effect of change in assumptions: | (151) | 447 | (598) | 1,359 | 1,122 | 237 |
| - indirect claims expenses | (654) | 0 | (654) | 140 | 0 | 140 |
| - interest rate | 503 | 447 | 56 | 1,219 | 1,122 | 97 |
| - risk margin | 0 | 0 | 0 | 0 | 0 | 0 |
| - methodology | 0 | 0 | 0 | 0 | 0 | 0 |
| Development on prior year outstanding claims liability | 31,157 | 23,421 | 7,736 | 27,552 | 30,861 | (3,309) |
| Balance carried forward | 247,006 | 191,436 | 55,570 | 230,892 | 193,163 | 37,729 |

Future expected cash flows for the outstanding claims liability

As at 31 December 2018

| Outstanding Claims Liabilities | 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 | 126,817 | 106,993 | 17,256 | 1,995 | 253,061 | 253,061 |
| Reinsurance | 83,392 | 96,515 | 15,171 | 1,587 | 196,666 | 196,666 |
| Net (undiscounted) | 43,425 | 10,478 | 2,085 | 408 | 56,396 | 56,396 |

NOTES TO THE FINANCIAL STATEMENTS

21 Provision for net claims outstanding (continued)

Net undiscounted ultimate claims costs for the nine most recent accident years from 2010 to 2018

As at 31 December 2018

| Ultimate indemnity Inflated value | | | | | | | | | | Net undiscounted outstanding claims for the nine most recent accident years (inflated, undiscounted, without margins) | |
|--|----------|----------|----------|----------|----------|----------|----------|----------|----------|---|--------|
| November Y.E. | Nov 2010 | Nov 2011 | Dec 2012 | Dec 2013 | Dec 2014 | Dec 2015 | Dec 2016 | Dec 2017 | Dec 2018 | Cumulative net payments to date | |
| 2010 | 48,018 | 51,248 | 55,512 | 63,703 | 72,011 | 70,902 | 72,486 | 72,261 | 72,203 | 71,595 | 608 |
| 2011 | | 20,446 | 20,701 | 21,520 | 20,843 | 19,872 | 21,672 | 21,505 | 21,553 | 20,976 | 577 |
| 2012 | | | 8,779 | 8,061 | 7,710 | 7,256 | 7,187 | 6,794 | 7,672 | 7,576 | 96 |
| 2013 | | | | 8,703 | 6,926 | 7,635 | 7,803 | 7,559 | 7,499 | 7,352 | 147 |
| 2014 | | | | | 6,861 | 7,180 | 7,466 | 6,738 | 6,736 | 6,359 | 377 |
| 2015 | | | | | | 14,252 | 14,081 | 13,267 | 12,150 | 11,102 | 1,048 |
| 2016 | | | | | | | 28,920 | 29,057 | 29,057 | 29,057 | 0 |
| 2017 | | | | | | | | 22,306 | 21,753 | 15,215 | 6,538 |
| 2018 | | | | | | | | | 26,001 | 11,946 | 14,055 |
| Total | | | | | | | | | | 23,446 | |
| From prior years | | | | | | | | | | 16,352 | |
| Travel | | | | | | | | | | 801 | |
| Warranty | | | | | | | | | | 36 | |
| | | | | | | | | | | 40,635 | |
| Net undiscounted outstanding claims for the 2018/12 loss month | | | | | | | | | | 2,669 | |
| Effect of discounting | | | | | | | | | | (619) | |
| Net discounted outstanding claims (without margins) | | | | | | | | | | 42,685 | |
| Indirect expenses | | | | | | | | | | 4,369 | |
| Risk margins | | | | | | | | | | 8,516 | |
| Net discounted outstanding claims (with margins) | | | | | | | | | | 55,570 | |

22 Deferred tax

| '\$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|----------------------|----------------------|
| Provision for doubtful debts | 304 | 67 |
| Provision for bonus payments | 514 | 457 |
| Provision for holiday pay | 443 | 349 |
| Deferred acquisition costs and RI commissions | 2,887 | 3,096 |
| Fixed assets | 5 | 22 |
| Accruals not currently deductible | 59 | 59 |
| Net Deferred Tax | 4,212 | 4,050 |

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***NOTES TO THE FINANCIAL STATEMENTS****22 Deferred Tax (continued)**

The movement in deferred income tax assets and liabilities is as follows:

| | Opening Balance at 01 January | (Charged) credited to Income Statement | Closing balance at 31 December |
|---|----------------------------------|--|-----------------------------------|
| At 31 December 2018 | | | |
| Movement in deferred tax assets | | | |
| Provision for doubtful debts | 67 | 237 | 304 |
| Provision for bonus | 457 | 57 | 514 |
| Provision for holiday pay | 349 | 94 | 443 |
| Deferred acquisitions costs - exps | 9,447 | (133) | 9,314 |
| Other accruals | 59 | - | 59 |
| Fixed assets | 22 | (17) | 5 |
| Total deferred tax assets | 10,401 | 238 | 10,639 |
| Movement in deferred tax liabilities | | | |
| Deferred acquisition costs | 6,351 | 76 | 6,427 |
| Total deferred tax liabilities | 6,351 | 76 | 6,427 |
| Net deferred tax | 4,050 | 162 | 4,212 |

| | Opening Balance at 01 January | (Charged) credited to Income Statement | Closing balance at 31 December |
|---|----------------------------------|--|-----------------------------------|
| At 31 December 2017 | | | |
| Movement in deferred tax assets | | | |
| Provision for doubtful debts | 180 | (113) | 67 |
| Provision for bonus | 37 | 420 | 457 |
| Provision for holiday pay | 339 | 10 | 349 |
| Deferred acquisitions costs - exps | 6,850 | 2,597 | 9,447 |
| Other accruals | 106 | (47) | 59 |
| Fixed assets | 28 | (6) | 22 |
| Total deferred tax assets | 7,540 | 2,861 | 10,401 |
| Movement in deferred tax liabilities | | | |
| Deferred acquisition costs | 5,463 | 888 | 6,351 |
| Total deferred tax liabilities | 5,463 | 888 | 6,351 |
| Set-off of deferred tax liabilities pursuant to NZ IAS 12 | - | - | - |
| Net deferred tax | 2,077 | 1,973 | 4,050 |

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.

Contingent liabilities as at 31 December 2018 were nil (2017: Nil).

Capital Commitments

The Company has capital commitments of \$0.597m for IT development costs as at 31 December 2018 (31 December 2017: \$0.983m).

Operating Lease Commitments

The Company has property and equipment subject to lease arrangements. There were 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 terminated in August 2018.

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

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|----------------------|----------------------|
| Not later than one year | 1,081 | 1,187 |
| Later than one year and not later than five years | 2,252 | 3,299 |
| Later than five years | - | - |
| Total | 3,333 | 4,486 |

24 Share capital

As at 31 December 2018, the Company had 105,250,001 (2017: 105,250,001) ordinary shares that were issued for \$1 per share (2017: \$1 per share). All shares are fully paid. There is one class of ordinary shares. All shares issued carry equal voting rights.

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|-----------------|----------------------|----------------------|
| Opening Balance | 105,250 | 105,250 |
| Total | 105,250 | 105,250 |

On 25 June 2018 a dividend of \$15,000,000 (14.25 cents per share) was declared. The dividend was paid to AIG Asia Pacific Pte Ltd on 31 July 2018. (2017: \$14m; 13.3 cents per share).

NOTES TO THE FINANCIAL STATEMENTS

25 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 Company, using methods management believes are reasonable, and are included in net operating 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 American International 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. The Company receives reinsurance commission from affiliated entities of AIG Group for the placement of reinsurance.

NOTES TO THE FINANCIAL STATEMENTS

25 Ownership and transactions with related parties (continued)

Related party transactions

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|---------------------------|---------------------------|
| Expenses with parent | | |
| - AIG (services provided for NZ operations) | (4,866) | (5,949) |
| Income/(expenses) with other related parties | | |
| - American International Overseas Association | (142,133) | (127,669) |
| - American International Overseas Association | 143,672 | 155,956 |
| - National Union Fire Insurance Co Ltd | (3,357) | (5,318) |
| - National Union Fire Insurance Co Ltd | 990 | 2,963 |
| - AIG Employee Services | 447 | 574 |
| - AIG Analytics & Services | (179) | - |
| - AIG Bermuda | (1,334) | (1,747) |
| - AIG Australia Insurance Ltd | (654) | (1,713) |
| - AIG Asia Pacific Pte Ltd | - | (55) |
| - AIG US (Global Claims) | (464) | (790) |
| - AIG Shared Services – Philippines | (482) | (681) |
| - AIG Shared Services – Malaysia | (409) | (644) |
| - AIG APAC Holdings Pte Ltd | 932 | 1,112 |
| - AIG APAC Holdings Pte Ltd | (1,790) | - |
| - AIG Travelguard | (244) | (623) |
| - AIG Global Services (web billing services) | (967) | (898) |
| - Other | (193) | (399) |
| Related party transactions | (11,031) | 14,119 |

Key Management Compensation

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|---|---------------------------|---------------------------|
| Salaries and other short-term employee benefits | 1,045 | 1,666 |
| Termination benefits | - | 112 |
| Other long-term benefits | 43 | - |
| Post-employment (retirement) benefits | 1,329 | 643 |
| Total | 2,417 | 2,421 |

AIG INSURANCE NEW ZEALAND LIMITED*For the financial year ended 31 December 2018***NOTES TO THE FINANCIAL STATEMENTS****25 Ownership and transactions with related parties (continued)**Loans to directors and key management personnel

No loans were advanced to directors or key management personnel during the year (2017: nil).

Other related party balances receivable

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|----------------------|----------------------|
| American International Overseas Association | 37,699 | 25,761 |
| National Union Fire Insurance Co | - | 291 |
| AIG China | 15 | - |
| AIG Australia Ltd | - | 18 |
| AIG Europe UK Limited | 75 | 51 |
| AIG Global Reinsurance | 71 | - |
| AIG Bermuda | 26 | 77 |
| AIG APAC Holdings Pte. Ltd | 213 | 350 |
| AIG Europe Limited (France) | 57 | 29 |
| AIG Europe Limited (Belgium) | 61 | 39 |
| AIG Europe Ireland | 32 | - |
| AIG other | 109 | 56 |
| AIG Worldsource | 493 | 341 |
| Related party receivables | 38,851 | 27,013 |

Other related party balances payable

| \$ '000 | As at 31 Dec 2018 | As at 31 Dec 2017 |
|---|----------------------|----------------------|
| American International Overseas Association | 40,018 | 40,086 |
| National Union Fire Insurance Co | 1,038 | 973 |
| AIG APAC Holdings Pte. Ltd | 1,030 | - |
| AIG Australia Insurance Ltd | 56 | 300 |
| AIG Shared Services Philippines | 208 | 198 |
| AIG Shared Services Malaysia | - | 58 |
| AIG Global Reinsurance Operations | 93 | 18 |
| AIG Global Services | 80 | 35 |
| AIG Global Claims Services | 26 | 93 |
| AIG Travelguard | 19 | 60 |
| AIG Bermuda | 1,687 | 726 |
| AIG Property Casualty International | 1,896 | 2,107 |
| Other | 47 | 3 |
| Related party payables | 46,198 | 44,657 |

All balances are unsecured, non-interest bearing and repayable on demand.

NOTES TO THE FINANCIAL STATEMENTS

26 Fair value measurement

The Company classifies all financial assets as either financial assets at fair value through profit or loss or at amortised cost.

The following tables present the carrying amounts of the Company's financial assets and financial liabilities.

| At 31 December 2018 | Carrying amount | | | Fair Value | |
|---|--|---|----------------|------------------|----------------|
| | Fair value through profit or loss \$000 | Financial assets/liabilities at amortised cost \$000 | Total \$000 | Level 2 \$000 | Total \$000 |
| Financial assets measured at fair value | | | | | |
| Financial assets at fair value through profit or loss | 108,097 | - | 108,097 | 108,097 | 108,097 |
| Financial assets not measured at fair value | | | | | |
| Cash and cash equivalents | - | 38,375 | 38,375 | - | - |
| Trade receivables and sundry debtors | - | 110,274 | 110,274 | - | - |
| Reinsurance recoverables | - | 208 | 208 | - | - |
| Third Party Administration Claim Floats | - | 1,940 | 1,940 | - | - |
| Accrued investment income | - | 1,306 | 1,306 | - | - |
| | 108,097 | 152,103 | 260,200 | 108,097 | 108,097 |
| Financial liabilities not measured at fair value | | | | | |
| Insurance payables | - | 50,432 | 50,432 | - | - |
| Other payables | - | 5,522 | 5,522 | - | - |
| | - | 55,954 | 55,954 | - | - |

| At 31 December 2017 | Carrying amount | | | | Fair Value | |
|---|--------------------------------|--|--|----------------|------------------|----------------|
| | Loans and receivables \$000 | Designated at Fair value through profit or loss \$000 | Financial liabilities at amortised cost \$000 | Total \$000 | Level 2 \$000 | Total \$000 |
| Financial assets measured at fair value | | | | | | |
| Financial assets at fair value through profit or loss | - | 79,152 | - | 79,152 | 79,152 | 79,152 |
| Financial assets not measured at fair value | | | | | | |
| Cash and cash equivalents | 57,583 | - | - | 57,583 | - | - |
| Trade receivables and sundry debtors | 97,816 | - | - | 97,816 | - | - |
| Reinsurance recoverables | 7,543 | - | - | 7,543 | - | - |
| Third Party Administration Claim Floats | 1,940 | - | - | 1,940 | - | - |
| Accrued investment income | 974 | - | - | 974 | - | - |
| | 165,856 | 79,152 | - | 245,008 | 79,152 | 79,152 |
| Financial liabilities not measured at fair value | | | | | | |
| Insurance payables | - | - | 46,213 | 46,213 | - | - |
| Other payables | - | - | 4,004 | 4,004 | - | - |
| | - | - | 50,217 | 50,217 | - | - |

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

27 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

28 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.

29 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, insurance payables, 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.

NOTES TO THE FINANCIAL STATEMENTS

29 Financial risk (continued)

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 (on non-equity instruments)
- Trade receivables and sundry debtors
- Reinsurance recoverables
- Accrued investment income
- Third party administration claim floats

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

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.

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 maximum exposure to credit risk is the carrying amount of the financial assets on the Statement of Financial Position. Past due and impaired as at reporting date are \$1.088m and are fully provided for (2017: \$0.239m).

NOTES TO THE FINANCIAL STATEMENTS

29 Financial risk (continued)

Credit risk (continued)

Age analysis of financial assets past due but not impaired

As at 31 December 2018

| \$ '000 | 0 - 90 days | 91 - 180 days | 181 - 360 days | > 1 year | Total past-due but not impaired |
|--------------------------------------|----------------|------------------|-------------------|------------|------------------------------------|
| Assets: | | | | | |
| Trade receivables and sundry debtors | - | 1,105 | 219 | 147 | 1,471 |
| Reinsurance recoverable | - | 4 | 124 | - | 128 |
| Total | - | 1,109 | 343 | 147 | 1,599 |

As at 31 December 2017

| \$ '000 | 0 - 90 days | 91 - 180 days | 181 - 360 days | > 1 year | Total past-due but not impaired |
|--------------------------------------|----------------|------------------|-------------------|-----------|------------------------------------|
| Assets: | | | | | |
| Trade receivables and sundry debtors | - | 6,097 | 396 | 56 | 6,549 |
| Reinsurance recoverable | - | - | 2,393 | - | 2,393 |
| Total | - | 6,097 | 2,789 | 56 | 8,942 |

The tables below provide information regarding the credit risk exposure of the Company at 31 December 2018 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 at 31 December 2018

| \$ '000 | AAA | AA | A | BBB | Not rated | Total |
|--|---------------|---------------|---------------|----------|----------------|----------------|
| Assets: | | | | | | |
| Cash and cash equivalents | - | 18,161 | 20,214 | - | - | 38,375 |
| Financial assets at fair value | 43,495 | 56,347 | 8,255 | - | - | 108,097 |
| Trade receivables and sundry debtors | - | - | - | - | 110,274 | 110,274 |
| Third party administration claims floats | - | - | - | - | 1,940 | 1,940 |
| Reinsurance recoverable | - | 82 | 116 | 9 | 1 | 208 |
| Accrued investment income | 497 | 623 | 186 | - | - | 1,306 |
| Total | 43,992 | 75,213 | 28,771 | 9 | 112,215 | 260,200 |

NOTES TO THE FINANCIAL STATEMENTS

29 Financial risk (continued)

As at 31 December 2017

| \$ '000 | AAA | AA | A | BBB | Not rated | Total |
|--|---------------|---------------|---------------|----------|---------------|----------------|
| Assets: | | | | | | |
| Cash and cash equivalents | - | 27,448 | 30,135 | - | - | 57,583 |
| Financial assets at fair value | 15,546 | 55,187 | 8,419 | - | - | 79,152 |
| Trade receivables and sundry debtors | - | - | - | - | 97,816 | 97,816 |
| Third party administration claims floats | - | - | - | - | 1,940 | 1,940 |
| Reinsurance recoverable | - | 377 | 7,156 | - | 10 | 7,543 |
| Accrued investment income | 264 | 535 | 175 | - | - | 974 |
| Total | 15,810 | 83,547 | 45,885 | - | 99,766 | 245,008 |

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 is provided below.

As at 31 December 2018

| \$ '000 | Due in 1 year or less | Due after 1 year through 5 years | Due after 5 years through 10 years | Total | Carrying Amount |
|-------------------------------|-----------------------|----------------------------------|------------------------------------|---------------|-----------------|
| Financial liabilities: | | | | | |
| Insurance payables | 50,432 | - | - | 50,432 | 50,432 |
| Other payables | 5,522 | - | - | 5,522 | 5,522 |
| Total | 55,954 | - | - | 55,954 | 55,954 |

As at 31 December 2017

| \$ '000 | Due in 1 year or less | Due after 1 year through 5 years | Due after 5 years through 10 years | Total | Carrying Amount |
|-------------------------------|-----------------------|----------------------------------|------------------------------------|---------------|-----------------|
| Financial liabilities: | | | | | |
| Insurance payables | 46,213 | - | - | 46,213 | 46,213 |
| Other payables | 4,004 | - | - | 4,004 | 4,004 |
| Total | 50,217 | - | - | 50,217 | 50,217 |

NOTES TO THE FINANCIAL STATEMENTS

29 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 net open position at balance date for AUD is \$0.053m (2017: \$0.639m) and USD is \$1.148m (2017: \$1.047m). Other foreign currency movements are not material.

2018

| Change in FX Rate % | Profit (Loss) before tax \$'000 | Equity \$'000 |
|---------------------|---------------------------------|---------------|
| +10% | (120) | (86) |
| -10% | 120 | 86 |

2017

| Change in FX Rate % | Profit (Loss) before tax \$'000 | Equity \$'000 |
|---------------------|---------------------------------|---------------|
| +10% | 41 | 29 |
| -10% | (41) | (29) |

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.

NOTES TO THE FINANCIAL STATEMENTS

29 Financial risk (continued)Interest rate risk (continued)

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 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

2018

| Change in interest rate % | Profit (Loss) before tax \$'000 | Equity \$'000 |
|---------------------------|---------------------------------|---------------|
| +1.75% | (1,253) | (902) |
| -1.75% | 1,710 | 1,231 |

2017

| Change in interest rate % | Profit (Loss) before tax \$'000 | Equity \$'000 |
|---------------------------|---------------------------------|---------------|
| +1.75% | (630) | (453) |
| -1.75% | 1,107 | 797 |

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 (2017: 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.

30 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.

NOTES TO THE FINANCIAL STATEMENTS

30 Capital Adequacy (continued)

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

| \$ '000 | Year ended 31 Dec 2018 | Year ended 31 Dec 2017 |
|-------------------------|---------------------------|---------------------------|
| Actual solvency capital | 91,460 | 98,044 |
| Minimum solvency | 36,907 | 34,297 |
| Solvency margin | 54,553 | 63,747 |
| Solvency ratio | 2.48 | 2.86 |

31 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.

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 Han 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 2018 (*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;
 - (iv) Application of the Liability Adequacy Test and any deferred acquisition cost or deferred fee revenue relevant to the Premium Liabilities;
 - (v) Disclosures made in the financial statements in relation to actuarial valuation methodologies, and assumptions; and
 - (vi) Claims development tables.
- 2.2 The Scope and Limitations of the Review: 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 The required opinions are from an actuarial perspective and are not intended to alter the scope or role of the auditor in respect of audited financial statements or group financial statements.
- 2.7 The Licensed Insurer has an established policy to seek the advice of the appointed actuary in respect of part or all of the actuarial information and to always adopt that advice in its financial statements or group financial statements. I have verified that my advice has been adopted in

the relevant financial statements and note the reliance on this provision within the associated report.

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.

- (i) The Licensed Insurer is not required to maintain a statutory fund and so no opinion is required.

Dated: 22 March 2019

A handwritten signature in black ink, appearing to read 'Eric Han Soo Lew', with a stylized, flowing script.

Signed: Eric Han Soo Lew