**BUDDLE**FINDLAY
NEW ZEALAND LAWYERS

*10063668107*

**To**
Registrar of Financial Service Providers
National Processing Centre
Companies Office
Level 18, 135 Albert Street
Auckland 1010

**From**
Frank Porter
Benjamin Sutton
Grace Alexander

**Date**
18 April 2016

**Hallmark General Insurance Company Limited – Financial Statements for the year ended 31 December 2015**

1. We act for Hallmark General Insurance Company Limited (company number 3346111) ("**Hallmark General**").

2. We **enclose** for registration the following documents in respect of Hallmark General for the year ended 31 December 2015:

   (a) audited financial statements for Hallmark General, a copy of the independent auditor's report and a copy of the appointed actuary's report (as required by section 78 of the Insurance (Prudential Supervision) Act 2010) in relation to the same; and

   (b) audited financial statements for Hallmark General's New Zealand branch, a copy of the independent auditor's report and a copy of the appointed actuary's report (as required by section 78 of the Insurance (Prudential Supervision) Act 2010) in relation to the same;

Yours faithfully
**Buddle Findlay**

**Benjamin Sutton**
Senior Associate

BUSINESS & REGISTRIES
BRANCH, AUCKLAND
19 APR 2016
RECEIVED

**AUCKLAND //** PricewaterhouseCoopers Tower, 188 Quay Street, PO Box 1433, Auckland 1140, New Zealand, DX [illegible] // P. 64 9 [illegible] 2555 // F. 64 9 3[illegible] 2055
**WELLINGTON //** State Insurance Tower, 1 Willis Street, PO Box 2694, Wellington 6140, New Zealand, DX [illegible] // P. 64 [illegible] // F. 64 [illegible] 499 414[illegible]
**CHRISTCHURCH //** 83 Victoria Street, PO Box 322, Christchurch 8140, New Zealand, DX WX11135 // P. 64 3 379 1747 // F. 64 3 379 5659



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# Hallmark General Insurance Company Ltd

ABN 82 008 477 647

# Annual financial statements for the year ended 31 December 2015

# Hallmark General Insurance Company Ltd ABN 82 008 477 647
# Financial report - 31 December 2015

## Contents

The directors present their report together with the financial statements of Hallmark General Insurance Company Ltd (the Company) for the year ended 31 December 2015 and the auditor's report thereon.

**Directors**
The following persons were directors of the Company at any time during the financial year and up to the date of this report:

JoAnne Maree Stephenson (Chairman)
Duncan Gerald West
Rachel Emma Cobb
Anna Elizabeth Gladman
Christopher Paul Knoblanche

**Principal activities**
The principal activity of the Company during the year was that of a general insurer, operating both in Australia and New Zealand. There has been no significant change in the nature of this activity during the year.

**Review of operations**
Total comprehensive income of the Company was $14,673,000 (2014: $18,689,000).

This result was driven by a decline in premium revenue of $2,129,000 across all channels in Australia and New Zealand. Investment income has decreased by $3,474,000 impacted by lower investment holdings and yields. The overall decline in income was offset by a decrease in underwriting expenses of $2,896,000.

**Significant changes in the state of affairs**
On 19 March 2015, KVD Australia Pty Ltd entered into a share sale agreement with GE Capital Finance Australasia Pty Ltd, to purchase 100% share capital of GE Capital Australia Holdings Pty Ltd and indirectly its six subsidiaries. The sale was executed on 24 November 2015 following regulatory approval. The subsidiaries acquired include Hallmark Life Insurance Company Ltd and Hallmark General Insurance Company Ltd.

**Dividends**
No dividends were paid or declared by the Company in respect of the financial year 31 December 2015 (2014: $103,000,000).

**Matters subsequent to the end of the financial year**
No matter or circumstance has arisen since 31 December 2015 that has significantly affected, or may significantly affect:

(a) the Company's operations;
(b) the results of those operations; or
(c) the Company's state of affairs.

**Likely developments and expected results of operations**
The Company will continue to operate in its existing business, being General Insurance, in the next financial year.

**Environmental regulation**
The Company's operations are subject to environmental regulations under Commonwealth and State legislation. The board believes the Company has adequate systems in place for the management of its environmental obligations, and is not aware of any material breach of those environmental obligations as they apply to the Company.

**Indemnification and insurance of officers and auditors**

***Indemnification***

*Mandatory indemnification and legal costs*

To the maximum extent permitted by law, the Company:

(a) shall indemnify any current or former officer of the Company who was or is made or is threatened to be made a party or is otherwise involved in any proceeding by reason of the fact he or she is or was an officer of the Company against all liability and loss suffered and expenses reasonably incurred by that officer (except a liability for legal costs); and

(b) shall indemnify an officer against legal costs incurred by that officer in defending any proceeding for which that officer is entitled to be indemnified pursuant to (a) above, in advance of its final disposition provided however that such payment of legal costs shall only be made in advance of final disposition of the proceeding upon receipt of an undertaking by the officer to repay all amounts advanced if it should be ultimately determined that the officer is not entitled to be indemnified

*Permissive indemnification and legal costs*

To the maximum extent permitted by law, the Company:

(a) may indemnify any person who is not an officer of the Company (non-officer) against any liability or loss incurred by that non-officer in their performance of, or in connection with, the role undertaken by them for or on behalf of the Company (except a liability for legal costs); and

(b) may indemnify a non-officer against legal costs incurred by that non-officer in defending any proceeding for which such non-officer is entitled to be indemnified pursuant to (a) above, in advance of its final disposition provided however that, to the extent required by law, such payment of legal costs shall only be made in advance of final disposition of the proceeding upon receipt of an undertaking by the non-officer to repay all amounts advanced if it should be ultimately determined that the non-officer is not entitled to be indemnified.

Any such permissive indemnity must be evidenced by way of written agreement by any officer designated by the board of directors for such purpose.

***Insurance***

During the financial year ended 31 December 2015 General Electric Company has paid premiums on behalf of the Company in respect of directors' and officers' liability insurance (non-indemnifiable coverage only) in respect of the period up to 24th November 2015.

Subsequently, the ultimate parent entity, KVD Australia Holdco Pty Ltd, has agreed to pay premiums on behalf of the Company, in respect of directors' and officers' liability insurance (non-indemnifiable coverage only) in respect of the period ending 25 November 2016.

Such insurance policies insure directors and officers against certain limited liabilities.

Directors have not included details of the nature of the liabilities covered or the amount of the premium paid as such disclosure is prohibited under the terms of the insurance policy.

The Company has not during or since the end of the financial year paid or agreed to pay any premiums in respect of any person who has been an auditor of the Company for the purposes of indemnifying them against any claims by third parties arising from their audit report.

**Proceedings on behalf of the company**
No person has applied to the Court under section 237 of the *Corporations Act 2001* for leave to bring proceedings on behalf of the Company, or to intervene in any proceedings to which the Company is a party, for the purpose of taking responsibility on behalf of the Company for all or part of those proceedings.

No proceedings have been brought or intervened in on behalf of the Company with leave of the Court under section 237 of the *Corporations Act 2001*.

**Lead Auditor's independence declaration**
The lead auditor's independence declaration is required under section 307C of the *Corporations Act 2001*, forms part of the directors' report for the year ended 31 December 2015 and is set out on page 4.

**Rounding of amounts**
The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 (as amended) and in accordance with that class order, amounts in this report and the accompanying financial statements have been rounded to the nearest thousand dollars unless otherwise indicated.

Signed in accordance with a resolution of directors.

JoAnne Maree Stephenson (Chairman)
Director
Sydney
17 March 2016

Anna Elizabeth Gladman (Managing Director)
Director
Sydney
17 March 2016

KPMG

***Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001***

To: the Directors of Hallmark General Insurance Company Ltd

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2015 there have been:

(i) no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and

(ii) no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

Andrew Reeves
*Partner*

Sydney

17 March 2016

**Hallmark General Insurance Company Ltd**
**Statement of Profit or Loss and Other Comprehensive Income**
**For the year ended 31 December 2015**

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| Insurance premium revenue | | 61,165 | 63,373 |
| Outwards reinsurance premium revenue/(expense) | | 37 | (42) |
| Net insurance premium revenue | 1(a) | 61,202 | 63,331 |
| Claims expenses | | 12,203 | 12,040 |
| Net claims incurred | 1(b) | 12,203 | 12,040 |
| Acquisition costs | | 12,327 | 12,255 |
| Administration expenses | | 20,050 | 23,018 |
| Underwriting expenses | | 32,377 | 35,273 |
| **Underwriting result** | | 16,622 | 16,018 |
| Investment income | 1(c) | 4,363 | 7,837 |
| Investment expenses | | (214) | (406) |
| Other (expenses)/income | | (52) | 538 |
| **Profit before income tax** | 1(d) | 20,719 | 23,987 |
| Income tax expense | 1(e) | 5,605 | 5,566 |
| **Profit for the year** | | 15,114 | 18,421 |
| **Other comprehensive income** | | | |
| ***Items that may be reclassified subsequently to profit or loss*** | | | |
| Exchange differences on translation of foreign operations | | (441) | 268 |
| ***Total items that may be reclassified subsequently to profit or loss*** | | (441) | 268 |
| **Other comprehensive income for the year, net of tax** | | (441) | 268 |
| **Total comprehensive income for the year** | | 14,673 | 18,689 |
| **Profit is attributable to:** | | | |
| Owners of Hallmark General Insurance Company Ltd | | 15,114 | 18,421 |
| | | 15,114 | 18,421 |
| **Total comprehensive income for the year is attributable to:** | | | |
| Owners of Hallmark General Insurance Company Ltd | | 14,673 | 18,689 |
| | | 14,673 | 18,689 |

*The above Statement of Profit or Loss and Other Comprehensive Income should be read in conjunction with the accompanying notes.*

**Hallmark General Insurance Company Ltd**
**Statement of Financial Position**
**As at 31 December 2015**

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 2(a) | 172,644 | 170,517 |
| Trade and other receivables | 2(b) | 954 | 1,399 |
| Current tax assets | | 18 | - |
| Deferred acquisition costs | 2(c) | 7,541 | 9,486 |
| **Total current assets** | | 181,157 | 181,402 |
| **Non-current assets** | | | |
| Deferred acquisition costs | 2(c) | 7,236 | 8,756 |
| Deferred tax assets | 3(a) | 1,060 | 1,531 |
| **Total non-current assets** | | 8,296 | 10,287 |
| **Total assets** | | 189,453 | 191,689 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 2(d) | 346 | 1,299 |
| Current tax liabilities | | - | 636 |
| Provisions | 3(b) | 864 | 828 |
| Unearned commission income | 2(e) | - | 2 |
| Outstanding claims liability | 2(f) | 8,509 | 9,034 |
| Unearned premium liability | 2(g) | 36,143 | 44,379 |
| **Total current liabilities** | | 45,862 | 56,178 |
| **Non-current liabilities** | | | |
| Trade and other payables | 2(d) | 71 | 359 |
| Provisions | 3(b) | 35 | 11 |
| Outstanding claims liability | 2(f) | 4,638 | 4,685 |
| Unearned premium liability | 2(g) | 34,683 | 40,965 |
| **Total non-current liabilities** | | 39,427 | 46,020 |
| **Total liabilities** | | 85,289 | 102,198 |
| **Net assets** | | 104,164 | 89,491 |
| **EQUITY** | | | |
| Contributed equity | 4(a) | 2,000 | 2,000 |
| Reserves | 4(b) | 55,669 | 56,110 |
| Retained earnings | | 46,495 | 31,381 |
| **Total equity** | | 104,164 | 89,491 |

*The above Statement of Financial Position should be read in conjunction with the accompanying notes.*

| | Notes | Attributable to owners of Hallmark General Insurance Company Ltd | | | |
|---|---|---|---|---|---|
| | | **Contributed equity $'000** | **Reserves $'000** | **Retained earnings $'000** | **Total equity $'000** |
| **Balance at 1 January 2014** | | 2,000 | 53,402 | 115,960 | 171,362 |
| Profit for the year | | - | - | 18,421 | 18,421 |
| Other comprehensive income | | - | 268 | - | 268 |
| **Total comprehensive income for the year** | | - | 268 | 18,421 | 18,689 |
| Dividends paid | | - | - | (103,000) | (103,000) |
| Tax consolidation reserve | | - | 2,440 | - | 2,440 |
| **Balance at 31 December 2014** | | 2,000 | 56,110 | 31,381 | 89,491 |
| **Balance at 1 January 2015** | | 2,000 | 56,110 | 31,381 | 89,491 |
| Profit for the year | | - | - | 15,114 | 15,114 |
| Other comprehensive income | | - | (441) | - | (441) |
| **Total comprehensive income for the year** | | - | (441) | 15,114 | 14,673 |
| **Balance at 31 December 2015** | | 2,000 | 55,669 | 46,495 | 104,164 |

*The above Statement of Changes in Equity should be read in conjunction with the accompanying notes.*

**Hallmark General Insurance Company Ltd**
**Statement of Cash Flows**
**For the year ended 31 December 2015**

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net premium received | | 46,163 | 58,311 |
| Outward reinsurance expense | | 37 | (42) |
| Claims paid | | (12,895) | (10,857) |
| Payments to suppliers and employees | | (32,184) | (38,360) |
| Interest received | | 4,501 | 8,905 |
| Income taxes allocated from tax consolidated group | | (5,282) | (2,602) |
| **Net cash inflow from operating activities** | 5(a) | 340 | 15,355 |
| **Cash flows from investing activities** | | | |
| Proceeds from sale of financial assets | | - | 45,952 |
| **Net cash inflow from investing activities** | | - | 45,952 |
| **Cash flows from financing activities** | | | |
| Dividends paid to company's shareholders | | - | (103,000) |
| **Net cash (outflows) from financing activities** | | - | (103,000) |
| **Net increase/(decrease) in cash and cash equivalents** | | 340 | (41,693) |
| Cash and cash equivalents at 1 January | | 170,517 | 211,363 |
| Effects of exchange rate changes on cash and cash equivalents | | 1,787 | 847 |
| **Cash and cash equivalents at 31 December** | 2(a) | 172,644 | 170,517 |

*The above Statement of Cash Flows should be read in conjunction with the accompanying notes.*

## Contents of the notes to the financial statements

# Financial performance

This section provides additional information about those individual line items relating to financial performance that management considers most relevant in the context of the operations of the Company.

## 1 Profit or loss information

### (a) Net insurance premium revenue

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Gross written premium | **46,810** | 52,519 |
| Movement in unearned premiums | **14,355** | 10,854 |
| Outwards reinsurance premium revenue/(expense) | **37** | (42) |
| **Net premium revenue** | **61,202** | 63,331 |

### (b) Net claims incurred

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Current Year $'000** | **Prior Years $'000** | **Total $'000** | **Current Year $'000** | **Prior Years $'000** | **Total $'000** |
| Gross claims incurred and related expenses - undiscounted | 13,397 | (1,242) | 12,155 | 13,521 | (1,517) | 12,004 |
| Discount and discount movement - gross claims incurred | (170) | 218 | 48 | (210) | 246 | 36 |
| | 13,227 | (1,024) | 12,203 | 13,311 | (1,271) | 12,040 |
| **Net claims incurred** | **13,227** | **(1,024)** | **12,203** | **13,311** | **(1,271)** | **12,040** |

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

# 1 Profit or loss information (continued)

## (c) Investment income

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Interest income | 4,363 | 8,275 |
| Realised net gains | - | 155 |
| Unrealised net (losses) | - | (593) |
| **Total investment income** | **4,363** | 7,837 |

## (d) Profit before income tax

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| ***Profit before income tax includes the following specific expenses:*** | | |
| *Employee costs* | | |
| Personnel cost | 6,843 | 8,093 |
| Contribution to superannuation fund | 534 | 640 |
| Change in annual and long service leave provision | 18 | (139) |
| *Other administrative expenses* | | |
| Marketing fees | 820 | 176 |
| Management fees | 9,324 | 10,328 |

## (e) Income tax expense

*(i) Income tax expense*

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Current tax expense | 4,555 | 5,719 |
| Deferred tax expense (note 3(a)) | (11) | 52 |
| Adjustments for current tax of prior years | 58 | (205) |
| Additional exit payment adjustment | 1,003 | - |
| **Income tax expense** | **5,605** | 5,566 |

## 1 Profit or loss information (continued)

### (e) Income tax expense (continued)

*(ii) Reconciliation of income tax expense to prima facie tax payable*

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Profit from continuing operations before income tax expense | 20,719 | 23,987 |
| Tax at the Australian tax rate of 30% (2014: 30%) and tax at the New Zealand tax rate of 28% (2014: 28%) | 6,081 | 7,074 |
| Tax effect of amounts which are not deductible/(taxable) in calculating taxable income: | | |
| Entertainment | - | 5 |
| Non taxable income | (1,537) | (1,512) |
| | 4,544 | 5,567 |
| Adjustments for current tax of prior periods | 58 | (1) |
| Additional exit payment adjustment | 1,003 | - |
| Income tax expense | 5,605 | 5,566 |

# Balance sheet management

This section provides additional information about those individual line items in the statement of financial position that management considers most relevant in the context of the operations of the entity.

## 2 Financial assets and financial liabilities

### (a) Cash and cash equivalents

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Current assets** | | |
| Cash at bank | 8,943 | 9,699 |
| Short term deposits | 163,701 | 160,818 |
| **Total cash and cash equivalents** | **172,644** | 170,517 |

### (b) Trade and other receivables

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Current assets** | | |
| Other receivables | 954 | 1,399 |

These balances include amounts receivable from related parties (note 13(b)).
The carrying value disclosed above approximates fair value at end of the reporting period.

## 2 Financial assets and financial liabilities (continued)

### (c) Deferred acquisition costs

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Current assets** | | |
| Deferred acquisition costs | 7,541 | 9,486 |
| **Non-current assets** | | |
| Deferred acquisition costs | 7,236 | 8,756 |

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| *Reconciliation of changes in deferred acquisition costs:* | | |
| Opening balance at 1 January | 18,242 | 20,499 |
| Acquisition costs incurred during the year * | 2,843 | 3,515 |
| *Amortisation charged to income* * | (6,308) | (5,772) |
| Closing balance at 31 December | 14,777 | 18,242 |

* Acquisition costs incurred during the year and Amortisation charged to income relate to the Personal loans portfolios (excludes Cards portfolios) as there were no deferred amortisation costs as at 31 December 2015 and 31 December 2014 for Cards portfolios.

### (d) Trade and other payables

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Current liabilities** | | |
| Trade payables | 19 | 7 |
| Other payables | 327 | 1,292 |
| | 346 | 1,299 |
| **Non-current liabilities** | | |
| Other payables | 71 | 359 |

The carrying value disclosed above approximates fair value at end of the reporting period.
These balances include amounts payable to related parties (note 13(b)).

### (e) Unearned commission income

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Opening balance at 1 January | 2 | 2 |
| Commission income on premium earned during the year | (2) | - |
| Closing balance at 31 December | - | 2 |

## 2 Financial assets and financial liabilities (continued)

### (f) Outstanding claims liability

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Central estimate | **9,654** | 10,571 |
| Risk margin | **2,386** | 1,743 |
| Claims handling expense | **1,369** | 1,724 |
| | **13,419** | 14,038 |
| Discount to present value | **(272)** | (319) |
| Gross outstanding claims liability | **13,147** | 13,719 |
| Current | **8,509** | 9,034 |
| Non-current | **4,638** | 4,685 |
| **Total outstanding claims liability** | **13,147** | 13,719 |

*(i) The following ranges of discount rates were used in the measurement of outstanding claims and reinsurance recoveries.*

**Australia**
The current year discount rate is 2.0% (2014: 2.3%).
The subsequent years discount rate is 2.0% - 4.4% (2014: 2.0% - 3.8%).
The weighted average expected term to settlement of the outstanding claims from the end of the reporting period is estimated to be 1.08 years (2014: 1.02 years).

**New Zealand Branch**
The current year discount rate is 2.65 % (2014: 3.54%)
The subsequent years discount rate is 2.65% (2014: 3.54%)
The weighted average expected term to settlement of the outstanding claims from the end of the reporting period is estimated to be 0.64 years (2014: 0.70 years)

*(ii) Risk margin*

**Process for determining risk margin**

The risk margin is an additional allowance for uncertainty in the ultimate cost of claims. The overall margin adopted is determined by the board after considering the uncertainty in the portfolio, industry trends and the Company's risk appetite.

To determine the margin adopted the appointed actuary has reviewed the factors impacting the portfolio to establish a recommended margin at the level required by the board. Factors considered include:

- variability of claims experience of the portfolio;
- quality of historical data;
- diversification between different classes within the portfolio; and
- increase in uncertainty due to future economic environment and legislative changes.

The level of uncertainty varies between classes of business, as such the adopted risk margin varies between business classes. The risk margin is applied to the gross central estimate.

The aggregate risk margin, after diversification allowance, is intended to achieve a 90% (2014: 90%) probability of sufficiency.

The risk margins applied to the major segments of the portfolio for 90% (2014: 90%) level of adequacy are:

## 2 Financial assets and financial liabilities (continued)

**(f) Outstanding claims liability (continued)**

**Process for determining risk margin (continued)**

| | 2015 % | 2014 % |
|---|---|---|
| ***Australia*** | | |
| Consumer credit insurance - disability | **19.0** | 12.0 |
| Consumer credit insurance - unemployment | **46.9** | 30.6 |
| **New Zealand** | | |
| Consumer credit insurance - disability | **26.7** | 19.7 |
| Consumer credit insurance - unemployment | **60.7** | 45.9 |

*(iii) Reconciliation of movement in discounted outstanding claims liability*

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Gross $'000** | **Reinsurance $'000** | **Net $'000** | Gross $'000 | Reinsurance $'000 | Net $'000 |
| Balance at 1 January | **13,719** | **-** | **13,719** | 12,481 | - | 12,481 |
| Current year claims incurred | **13,227** | **-** | **13,227** | 13,310 | - | 13,310 |
| Change in previous years claims | **(1,024)** | **-** | **(1,024)** | (1,282) | - | (1,282) |
| Current year claims paid / reinsurance recovered | **(4,631)** | **-** | **(4,631)** | (4,034) | - | (4,034) |
| Previous year claims paid / reinsurance recovered | **(8,144)** | **-** | **(8,144)** | (6,879) | - | (6,879) |
| | **13,147** | **-** | **13,147** | 13,596 | - | 13,596 |
| Effect of change in discount rate | **-** | **-** | **-** | 123 | - | 123 |
| Closing balance at 31 December | **13,147** | **-** | **13,147** | 13,719 | - | 13,719 |

*(iv) Claims development tables*

Claims development tables are disclosed in order to put the claims estimates included in the financial statements into context, allowing comparison of those claims estimates with the claims results seen in previous years. In effect, the table highlights the Company's ability to provide a reliable estimate of the total value of claims. The top part of the table provides a review of current estimates of cumulative claims and demonstrates how the estimated claims have changed at subsequent reporting or accidents year-ends. The lower part of the table provides a reconciliation of the total reserve included in the statement of financial position and the estimates of cumulative claims.

## 2 Financial assets and financial liabilities (continued)

**(f) Outstanding claims liability (continued)**

***Gross***

| Reporting Year | 2011 and prior* $'000 | 2012* $'000 | 2013 $'000 | 2014 $'000 | 2015 $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Estimate of gross ultimate claims cost** | | | | | | |
| At end of reporting year | 43,250 | 8,707 | 11,542 | 12,742 | 12,187 | |
| One year later | 39,094 | 10,132 | 10,575 | 11,532 | - | |
| Two years later | 39,863 | 10,247 | 10,884 | - | - | |
| Three years later | 40,743 | 10,554 | - | - | - | |
| Four years later | 41,515 | - | - | - | - | |
| Current estimate of cumulative claims | 41,515 | 10,554 | 10,884 | 11,532 | 12,187 | 86,672 |
| Cumulative payments to date | (41,331) | (10,098) | (9,877) | (9,040) | (4,405) | (74,751) |
| Undiscounted claims handling expenses | 23 | 56 | 123 | 299 | 997 | 1,498 |
| **Gross outstanding claims - undiscounted** | 207 | 512 | 1,130 | 2,791 | 8,779 | 13,419 |
| Discount impact | (3) | (11) | (24) | (64) | (170) | (272) |
| **Gross outstanding claims - discounted** | **204** | **501** | **1,106** | **2,727** | **8,609** | **13,147** |

***Net***

| Reporting Year | 2011 and prior* $'000 | 2012* $'000 | 2013 $'000 | 2014 $'000 | 2015 $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Estimate of net ultimate claims cost** | | | | | | |
| At end of reporting year | 43,250 | 8,707 | 11,542 | 12,742 | 12,187 | |
| One year later | 39,094 | 10,132 | 10,575 | 11,532 | | |
| Two years later | 39,863 | 10,247 | 10,884 | - | | |
| Three years later | 40,743 | 10,554 | - | - | | |
| Four years later | 41,515 | - | - | - | | |
| Current estimate of cumulative claims | 41,515 | 10,554 | 10,884 | 11,532 | 12,187 | 86,672 |
| Cumulative payments to date | (41,331) | (10,098) | (9,877) | (9,040) | (4,405) | (74,751) |
| Undiscounted claims handling expenses | 23 | 56 | 123 | 299 | 997 | 1,498 |
| **Net outstanding claims - undiscounted** | 207 | 512 | 1,130 | 2,791 | 8,779 | 13,419 |
| Discount impact | (3) | (11) | (24) | (64) | (170) | (272) |
| **Net outstanding claims - discounted** | **204** | **501** | **1,106** | **2,727** | **8,609** | **13,147** |

* All actuarial data relating to the New Zealand Branch of the Company, prior to the 5th March 2012 , relates to the Insurance portfolio of Simply Insurance New Zealand Limited, and is disclosed to reflect the historical actuarial profile of the insurance portfolio, which was transferred to the Branch on the 5th March 2012.

*(v) Liability adequacy test*

The liability adequacy test (LAT) is an assessment of the carrying amount of unearned premium liabilities and is conducted at the end of each reporting period. The test is calculated separately for each portfolio of contracts that are subject to broadly similar risks and are managed together as a single portfolio.

For the purposes of the liability adequacy test, the net premium liabilities at a 75% probability of sufficiency as at 31 December 2015 is $46,969,651 (2014: $57,321,986), therefore the liability adequacy test at reporting date resulted in a surplus for the company.

## 2 Financial assets and financial liabilities (continued)

**(g) Unearned premium liability**

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Balance as at 1 January | **85,344** | 95,658 |
| Premiums written during the year * | **15,551** | 20,792 |
| Premiums earned during the year * | **(30,069)** | (31,106) |
| Closing balance as at 31 December | **70,826** | 85,344 |
| Current | **36,143** | 44,379 |
| Non-current | **34,683** | 40,965 |
| **Total unearned premium liability** | **70,826** | 85,344 |

* Premiums written and earned during the year relate to the Personal loans portfolios (excludes Cards portfolios) as there were no unearned premium liabilities as at 31 December 2015 and 31 December 2014 for Cards portfolios.

**(h) Fair value measurements**

*(i) Fair value hierarchy*

This section explains the judgements and estimates made in determining the fair values of the financial instruments that are recognised and measured at fair value in the financial statements. To provide an indication about the reliability of the inputs used in determining fair value, the Company has classified its financial instruments into the three levels prescribed under the accounting standards. An explanation of each level follows underneath the table.

There are no financial assets at fair value as at 31 December 2015 and 31 December 2014.

## 2 Financial assets and financial liabilities (continued)

### (h) Fair value measurements (continued)

**Level 1**: Quoted prices (unadjusted) for identical assets or liabilities in active markets.

**Level 2**: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices), including quoted prices for similar assets and liabilities in active markets.

**Level 3**: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

*(ii) Valuation techniques used to determine fair values*

Specific valuation techniques used to value financial instruments include:

- The use of quoted market prices or dealer quotes for similar instruments; and
- The fair value of the remaining financial instruments is determined using discounted cash flow analysis.

## 3 Non-financial assets and liabilities

### (a) Deferred tax assets

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| ***The balance comprises temporary differences attributable to:*** | | |
| Employee entitlements | **464** | 423 |
| Operating accruals | **108** | 624 |
| Indirect claims handling expense | **411** | 422 |
| Other | **77** | 62 |
| **Total deferred tax assets** | **1,060** | 1,531 |

*(i) Movements in deferred tax assets*

Movements in deferred tax assets were as follows:

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Opening balance at 1 January | **1,531** | 1,742 |
| Charged to profit or loss (note 2(e)) | **11** | (52) |
| Over provision in prior years | **6** | (159) |
| Additional exit payment adjustment | **(488)** | - |
| Closing balance at 31 December | **1,060** | 1,531 |

## 3 Non-financial assets and liabilities (continued)

### (b) Provisions

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Employee entitlements - current** | | |
| Annual leave | 401 | 402 |
| Long service leave | 463 | 426 |
| Total employee entitlements - current | 864 | 828 |
| | | |
| **Employee entitlements - non current:** | | |
| Long service leave | 35 | 11 |
| Total employee entitlements - non current | 35 | 11 |

Total number of employees as at 31 December 2015: 60 (2014: 57)

## 4 Equity

### (a) Contributed equity

*Share capital*

| | 2015 No. of Shares | 2014 No. of Shares | 2015 $'000 | 2014 $'000 |
|---|---|---|---|---|
| Paid up ordinary shares | 10,001 | 10,001 | 2,000 | 2,000 |

*(i) Ordinary shares*

The Company does not have authorised capital or par value in respect of its issued shares. All issued shares are fully paid.

Ordinary shares entitle the holder to participate in dividends and the proceeds on winding up of the Company in proportion to the number of and amounts paid on the shares held.

On a show of hands every holder of ordinary shares present at a meeting in person or by proxy, is entitled to one vote, and upon a poll each share is entitled to one vote.

*(ii) Parent entities*

Hallmark General Insurance Company Ltd is owned by Hallmark Life Insurance Company Ltd with 100% majority interest, which is incorporated in Australia. The Company's ultimate parent entity is KVD Australia Holdco Pty Ltd, which is incorporated in Australia.

## 4 Equity (continued)

**(b) Reserves**

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Foreign currency translation reserve | 944 | 871 |
| Tax consolidation reserve | 54,725 | 55,239 |
| **Total reserves** | 55,669 | 56,110 |

*(i) Movements in reserves*

Movements in each class of reserves were as follows:

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Reserves** | | |
| *Foreign currency translation reserve* | | |
| Opening balance at 1 January | 871 | 603 |
| Exchange differences on translation of foreign operations | 73 | 268 |
| Closing balance 31 December | 944 | 871 |
| *Tax consolidation reserve* | | |
| Opening balance at 1 January | 55,239 | 52,799 |
| Current tax provision transferred to head entity | (514) | 2,440 |
| Closing balance 31 December | 54,725 | 55,239 |

## 5 Cash flow information

### (a) Reconciliation of profit after income tax to net cash flows from operating activities

| | 2015<br>$'000 | 2014<br>$'000 |
|---|---|---|
| Profit for the year | 15,114 | 18,421 |
| Adjustments | | |
| Realised (gains)/losses on sale of financial assets | - | (155) |
| Unrealised loss/(gains) in value of financial assets | - | 593 |
| Effect of foreign exchange on cash and cash equivalents | (1,787) | (847) |
| Change in operating assets and liabilities: | | |
| (Increase)/decrease in trade debtors | 319 | 5,684 |
| Increase/(decrease) in trade and other payables | (1,241) | (4,805) |
| (Increase)/decrease in other receivables | 126 | 624 |
| Decrease/(increase) in deferred acquisition costs | 3,463 | 2,257 |
| (Decrease)/increase in employees entitlements | 60 | (198) |
| (Decrease)/increase in outstanding claim liability | (572) | 1,238 |
| (Decrease)/increase in unearned premium liability | (14,518) | (10,314) |
| (Decrease)/increase in tax consolidation reserve | (513) | 2,440 |
| (Decrease)/increase in foreign currency translation reserve | 72 | 268 |
| (Increase)/decrease in net deferred tax assets | 471 | 211 |
| (Decrease)/increase in current tax liability | (654) | (62) |
| **Net cash inflow from operating activities** | 340 | 15,355 |

# Risk

This section of the notes discusses the Company's exposure to various risks and shows how these could affect the Company's financial position and performance.

## 6 Actuarial assumptions and methods

The Company writes consumer credit insurances. These classes of business can be classified as follows:

**Consumer credit insurance**

The risks covered in this group include:

- Involuntary unemployment
- Disability
- Gap
- Merchandise and price protection
- Stolen card cover

**Process used to determine outstanding claims liabilities (actuarial methods)**

The general approach to actuarial estimation of insurance liabilities is to analyse all available past experience, including the number of reported and finalised claims, timing and amounts of claim payments. This analysis allows patterns to be identified in the past experience. Based on this, development patterns associated with the run-off of outstanding claims and premium liabilities at the balance date can be estimated.

The determination of outstanding claims liabilities involves two steps:

## 6 Actuarial assumptions and methods (continued)

**Process used to determine outstanding claims liabilities (actuarial methods) (continued)**

(i) The determination of the central estimate of outstanding claims at the balance date. The central estimate of outstanding claims includes an allowance for claims incurred but not reported (IBNR) and the further development of reported claims, also known as incurred but not enough reported (IBNER).

The central estimate has no deliberate bias towards either over or under estimation. Generally speaking, this means that the central estimate is assessed to have a 50% chance of adequacy.

(ii) The determination of a risk margin and claims handling expense provision to be added to the central estimates of outstanding claims.

*Involuntary unemployment and disability - branch*

In determining the central estimate of the outstanding claims liabilities, separate analyses were performed on the open (including pending) and IBNR claims.

The individual claimant projection method was adopted for the open and pending claims. This method examines the likelihood of claimants remaining on benefit from month to month and applies an expected future claim duration to the actual level of monthly benefits for individual claims. For pending claims, an additional assumption was made on the probability of the claim being accepted in the first place (claims acceptance rate).

For IBNR claims, the central estimate of the outstanding claims liabilities is estimated by assuming a number of IBNR claims to be reported by insurance term, underwriting period, accident period and reporting period. The individual claimant projection method is then applied with an assumed average monthly benefit and claims acceptance rate.

*Involuntary unemployment and disability - non branch*

Aggregate projection methods such as payment per claim incurred (PPCI) and payment per claim open (PPCO) are adopted for assessing the outstanding claims of non branch portfolios.

*GAP, stolen card cover, merchandise and price protection*

The standard actuarial projection technique of payment per claim finalised (PPCF) was adopted in the determination of the central estimate of the outstanding claims liability for this risk, where claims are generally finalised with the payment of a single lump sum amount.

**Actuarial assumptions**

The personal line insurances are currently in run off and the outstanding claims liability is immaterial. The key actuarial assumptions for the determination of the outstanding claims liabilities of the consumer credit insurances are as follows:

| | 2015 Unemployment* | 2015 Disability* | 2015 GAP/Price protection | 2014 Unemployment* | 2014 Disability* | 2014 GAP/Price Protection |
|---|---|---|---|---|---|---|
| Average weighted term to settlement* | 2.8-4.5 months | 10.4 months | 5.3 months | 2.9-4.7 months | 8.7 months | 4.2 months |
| Average monthly benefits/average claim size* | $250-$750 per month | $250-$750 per month | $100 | $250-$750 per month | $250-$750 per month | $110 |
| Expense rate | 13% | 13% | 13% | 15% | 15% | 15% |
| Discount rate | 2.0%pa-4.4%pa | 2.0%pa-4.4%pa | 2.0%pa-4.4%pa | 2.0%pa-3.8%pa | 2.0%pa-3.8%pa | 2.5%pa-5.6%pa |

* varies depending on the insurance terms of the policy and underwriting period

## 6 Actuarial assumptions and methods (continued)

**Process used to determine actuarial assumptions**

A description of the processes used to determine the above key actuarial assumptions is provided below:

- *Average weighted term to settlement from the end of the reporting period*
  For unemployment and disability claims, the average weighted term to settlement represents the amount of time needed for the outstanding claims liability to run off completely, taking into account future claim terminations. This is based on claim termination analysis performed on the historical claims experiences. The claim termination analysis is performed separately for unemployment and disability.

  Termination rates by duration from the date of incident are adopted and these are used to derive the probability of payment on each claim for each month into the future. This projection produces the average weighted term to settlement.

- *Average monthly benefits / Average claim size*
  The average monthly benefit and average claim size assumption is used in the estimation of the outstanding claims liability relating to IBNR claims. For disability and unemployment claims the average monthly benefit assumption is determined after analysing the historical relativity of the average monthly benefit for claims to the average monthly benefit for all policies underwritten (from the same period as those that result in claims).

- *Expense rate*
  The adopted claims handling expense rate of 13% (2014:15%) of the projected gross claim payments, was determined based on the results of an expense investigation carried out in 2015.

- *Discount rate*
  The central estimates of the outstanding claims liabilities were discounted to allow for future investment income attributable to the liabilities during the run off period. The future investment earnings assumptions are estimates of the future annual risk free rates of return. They have been derived from the yield curve on Australian Government Bonds as at 31 December 2015.

**Sensitivity analysis**

The outstanding claims liabilities included in the reported results are calculated based on the key actuarial assumptions as disclosed above. The movement in any of the above key actuarial assumptions will impact the performance and equity of the Company. The table below describes how a change in each of the assumptions will affect the outstanding claims liabilities.

| Key actuarial assumptions | Changes | Impact on net outstanding claims liabilities ($000's) | Impact on total outstanding claims liabilities (%) |
|---|---|---|---|
| ***2015*** | | | |
| Claim termination rate* | Reduce the branch credit termination rates by 10% | 877 | 10.3 |
| Average monthly benefits* | Increase the branch credit insurances IBNR average monthly benefits by 10% | 350 | 4.1 |
| Number of IBNR claims* | Increase the number of branch credit insurances IBNR claims by 10% | 350 | 4.1 |
| Claims handling expense rate | Increase from 13% to 17% | 327 | 3.8 |

## 6 Actuarial assumptions and methods (continued)

**Sensitivity analysis (continued)**

| | | | |
|---|---|---|---|
| ***2014*** | | | |
| Claim termination rate* | Reduce the branch credit termination rates by 10% | 1,017 | 11.5 |
| Average monthly benefits* | Increase the branch credit insurances IBNR average monthly benefits by 10% | 373 | 4.2 |
| Number of IBNR claims* | Increase the number of branch credit insurances IBNR claims by 10% | 373 | 4.2 |
| Claims handling expense rate | Increase from 15% to 19% | 306 | 3.4 |

* Branch credit insurance only

**New Zealand Branch**

The Company writes the following lines of business in New Zealand:

**Consumer credit insurances**

The risks covered in this group include:

- Involuntary unemployment
- Disability
- Merchandise and price protection
- Stolen card cover

During 2007, the New Zealand Branch ceased writing policies categorised as hire purchase insurance and personal loan insurance ("old products") and commenced writing a new consumer credit insurance product ("new products", from August 2007). As of 31 December 2013, no liability has been projected for old products with all policies expired. From May 2011, the New Zealand Branch started offering a new credit card balance protection product called GEM Visa, which provides cover for disability, unemployment and merchandise protection, price protection and stolen cards cover.

Effective 5 March 2012, the insurance business of Simply Insurance New Zealand Limited ("SINZ"), a partner company within the GE Capital Group, was transferred into Hallmark General Insurance Company Ltd . This business now operates as a branch in New Zealand.

**Process used to determine outstanding claims liabilities (actuarial methods)**

The general approach to actuarial estimation of insurance liabilities is to analyse all available past experience, including numbers of reported and finalised claims, amounts of claim payments, changes in case estimates and incurred loss ratios. This analysis allows patterns to be identified in the past experience. Based on this, development patterns associated with the run-off of outstanding claims and premium liabilities at the balance date can be estimated.

The determination of outstanding claims liabilities involves two steps:

(i) The determination of the central estimate of outstanding claims at the balance date. The central estimate of outstanding claims includes an allowance for incurred but not reported (IBNR) claims and the further development of reported claims.

The central estimate has no deliberate bias towards either over or under estimation. Generally speaking, this means that the central estimate is assessed to have a 50% chance of adequacy.

(ii) The determination of a risk margin and claims handling expense provision to be added to the central estimates of outstanding claims.

## 6 Actuarial assumptions and methods (continued)

The estimation of outstanding claims liabilities has been performed separately for each of the claim types arising under the different policies, namely: death, disability, material damage, unemployment and merchandise protection, price protection and stolen cards.

**Disability and unemployment (except credit cards)**

In determining the central estimate of the outstanding claims liabilities, separate analyses were performed on the open (including pending) claims and IBNR claims.

The individual claimant projection method was adopted for the open and pending claims. Claim payments have been projected from the valuation date until the end of the policy term, taking into account the probability of termination and limits to claim payments as stipulated in the policy. The claim payments are based on the monthly loan instalments for each individual claim. For pending claims, an acceptance rate assumption is also applied in the valuation.

For IBNR claims, the central estimate of the outstanding claims liability was based on an estimated number of IBNR claims and average claim sizes. The number of IBNR claims was based on analysis of claim numbers for lines of business in runoff and analysis of claim frequency for line of business currently underwritten. The average claim size is estimated from expected average total duration and average monthly benefits, with policy design taken into account. For example, the consumer credit insurance has a maximum unemployment payment period of three months, which was reflected in the analysis.

**Disability, unemployment and merchandise protection, price protection and stolen cards (credit cards only)**

The standard actuarial projection technique of payment per claim finalised (PPCF) was adopted in the determination of the central estimate of the outstanding claims liability for this risk, where claims are generally finalised with the payment of a single lump sum amount. This involves estimating the number of future claim finalisations and average claim sizes. The number of future finalisations was based on analysis of claim reports, finalisations. The average claim size was based on the payments made on claims finalised.

**Actuarial assumptions**

The key actuarial assumptions for the determination of the outstanding claims are as follows:

| | **2015 Disability** (excl credit cards)** | **2015 Unemployment** (excl credit cards)** | 2014 Disability** (excl credit cards) | 2014 Unemployment** (excl credit cards) |
|---|---|---|---|---|
| Termination rates | **4.5-14.0%*** | **10.0-22.0%*** | 4.5-14.5%* | 10.0-25.0%* |
| Average weighted term to settlement | **10.1 months** | **2.5-3.8 months**** | 10.9 months | 2.5-3.8 months** |
| Number of IBNR claims accepted (total) | **59** | **67** | 77 | 62 |
| Average Claim Size for IBNR claims | **$5,000** | **$1,100-$1,700** | $5,300 | $1,200-$1,800 |
| Discount rate | **2.65%** | **2.65%** | 3.54% | 3.54% |

* Assumption varies according to the future claim duration

** Varies depending on underwriting period

## 6 Actuarial assumptions and methods (continued)

**Actuarial assumptions (continued)**

| | 2015 Disability (credit cards) | 2015 Unemployment (credit cards) | 2015 Merchandise protection, price protection and stolen cards (credit cards) | 2014 Disability (credit cards) | 2014 Unemployment (credit cards) | 2014 Merchandise protection, price protection and stolen cards (credit cards) |
|---|---|---|---|---|---|---|
| Average settlement size | **$2,500-$2,800** | **$1,700-$2,500** | **$250** | $2,500-$2,800 | $1,700-$2,500 | $300 |
| Number of future finalisations | **56** | **90** | **19** | 61 | 115 | 31 |

**Other assumptions**

The outstanding claims provision includes a claim handling expense of 15% and an additional 1% for medical expenses, with a prudential margin calculated at a 90% probability of adequacy.

**Process used to determine actuarial assumptions**

A description of the processes used to determine the above key actuarial assumptions is provided below:

- *Termination rates*
  Termination rates by claim duration from the date of incident are adopted and these are used to derive the probability of payment on each claim for each month into the future.

- *Average weighted term to settlement from the end of the reporting period*
  The average term to settlement from reporting date is based on claim termination analysis performed on the historical claims experiences. The claim termination analysis is performed separately for unemployment and disability.

  Termination rates by duration from the date of incident are adopted and these are used to derive the probability of payment on each claim for each month into the future. This projection produces the average weighted term to settlement.

- *Average claim size for IBNR claims (new products only)*
  For disability and unemployment, the adopted average claim size was based on two types of analysis: the expected average total duration for each claim type and benefit duration (only for unemployment) multiplied by the average monthly payment amount for each claim type, and the historical average claim size. The average duration was based on the assumed termination rates.

- *Number of IBNR claims (new products only)*
  The number of IBNR claims was based on an analysis of historical claim numbers for policies in runoff and an analysis of claim frequency for lines of business currently underwritten.

- *Average claim size for settlements (credit cards only)*
  For credit cards policies, the adopted average claim size was based on historic ratios of claim payments to numbers of claims finalised.

- *Number of future finalisations (credit cards only)*
  For credit cards policies, the number of future finalisations is based on an analysis of historical claim reports and finalisation rates. This then enables the future numbers of reports, handled claims and finalisations to be projected.

## 6 Actuarial assumptions and methods (continued)

**Process used to determine actuarial assumptions (continued)**

- *Expense rate*
  The adopted claims handling expense rate of 13% of the projected gross claim payments, was determined based on the results of an expense investigation carried out in 2015. An additional 1% for medical expenses is applied to disability claims.

- *Discount rate*
  The central estimates of the outstanding claims liabilities for the periodic benefits were discounted to allow for future investment income attributable to the liabilities during the run off period. The discount factor was based on the annual risk free rates of return from the yield curve on New Zealand Government Bonds.

**Sensitivity analysis**

The outstanding claims liabilities included in the reported results are calculated based on the key actuarial assumptions as disclosed above. The movement in any of the above key actuarial assumptions will impact the performance and equity of the Company. The table below describes how a change in each of the assumptions will affect the outstanding claims liabilities. The outstanding claims liabilities are on a discounted basis and include claim handling expenses and a risk margin at the 90% probability of adequacy.

Impact of changes in assumptions for old and new products on total outstanding claims liability:

| *Key actuarial assumptions* | Changes | Impact on net outstanding claims liabilities ($000's) | Impact on total outstanding claims liabilities (%) |
|---|---|---|---|
| Claim termination rate* | Reduce all termination rates by 10% | 134 | 4.5 |
| IBNR | Increase IBNR ACS by 10% / Increase number of IBNR claim by 10% | 116 | 3.9 |
| Claims handling expense rate | Increase the claims handling expense rate from 13% to 17% | 77 | 2.6 |

Impact of changes in assumptions for credit cards on total outstanding claims provision:

| *Key actuarial assumptions* | Changes | Impact on net claims provision ($000's) | Impact on total net claims provision (%) |
|---|---|---|---|
| Claim development | Increase chain ladder factors by 10% | +44 | +1.5% |
| Average settlement size | Increase average settlement size by 10% | +40 | +1.3% |
| Claims handling expense rate | Increase the claims handling expense rate from 13% to 17% | +37 | +1.2% |

**Changes to key assumptions**

At the December 2015 valuation, risk margin assumptions were increased based on:

- APRA's new Industry Review Report as at 30 September 2013 (issued 17 February 2015);
- The current uncertainty regarding unemployment at a macro level; and
- The impact of the Green Belt claims management program.

## 7 Financial risk management

This note explains the Company's exposure to financial risks and how these risks could affect the Company's future financial performance. Current year profit or loss information has been included where relevant to add further context.

### (a) Transition Risk

Following completion of the sale of GE's consumer business to KVD Australia Pty Ltd, operational risk exposures are higher as services provided under the Transitional Services Agreement (TSA) with GE are transferred to Latitude. This will result in significant change across the business and Hallmark General Insurance Company Ltd is actively monitoring and managing these risks.

### (b) Credit risk

Credit risk is the risk of financial loss due to a counterparty failing to perform their contractual obligations and principally arises through the Company's investment in financial instruments, receivables from related or other parties, and claims on reinsurance contracts.

The following policies and procedures are in place to mitigate the Company's exposure to credit risk:

*(i) Financial assets*

The Company's investment mandate sets out the investment management guidelines approved by the board. The guidelines establish credit approval authorities, concentrations limits, and approved investment portfolio parameters, these guidelines comply with the GE Capital Corporation Financial Institutions Credit Standards (GECC FICS) policy which sets out concentration limits and additional portfolio parameters. The Company will continue to adopt the GECC FICS policy until a new Investment Policy is approved by the Board in 2016. Management conducts a regular review of the investment holdings, compliance is monitored and exposures or breaches are reported to the board. The mandate is reviewed regularly for pertinence and for changes in the risk environment.

The Company only invests with counterparties that have a credit rating of at least A1/A from Standard & Poor's (S&P). The Company further limits its exposure to credit risk by setting individual exposure limits. There is no significant concentration of credit risk and management does not expect any counterparty to fail to meet its obligations.

*(ii) Reinsurance assets*

Reinsurance is placed with counterparties within the guidelines of the reinsurance management strategy (ReMS) . Counterparties must have an S&P credit rating of at least A. The Company further sets its exposure to credit risk by setting individual exposure limits. At the end of each reporting period, the management performs an assessment of creditworthiness of reinsurers and updates the reinsurance management strategy (ReMS).

*(iii) Trade and other receivables*

The Company's maximum credit risk exposure at balance date is limited to the carrying amount of the financial assets as stated in the statement of financial position. The Company does not have a significant concentration of credit risk with any counterparty, other than related parties (See note 13).

## 7 Financial risk management (continued)

### (b) Credit risk (continued)

The table below shows the Company's maximum exposure to credit risk at balance date.

| 2015 | Investment grade $'000 | Non-investment grade satisfactory * $'000 | Non-investment grade unsatisfactory $'000 | Total neither past due nor impaired $'000 | Past due or impaired $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 172,644 | - | - | 172,644 | - | 172,644 |
| Trade and other receivables | - | 954 | - | 954 | - | 954 |
| Financial assets at fair value through profit or loss | | | | | | |
| **Total credit risk exposure** | **172,644** | **954** | **-** | **173,598** | **-** | **173,598** |

| 2014 | Investment grade $'000 | Non-investment grade satisfactory * $'000 | Non-investment grade unsatisfactory $'000 | Total neither past due nor impaired $'000 | Past due or impaired $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 170,517 | - | - | 170,517 | - | 170,517 |
| Trade and other receivables | - | 1,399 | - | 1,399 | - | 1,399 |
| Financial assets at fair value through profit or loss | | | | | | |
| **Total credit risk exposure** | **170,517** | **1,399** | **-** | **171,916** | **-** | **171,916** |

* A receivable is deemed satisfactory when management is satisfied the obligor has the capacity to meet its financial obligations.

The table below classifies the financial assets of the Company by counterparty credit rating:

| 2015 | AAA $'000 | AA $'000 | A $'000 | BBB $'000 | Not rated $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | - | - | 172,644 | - | - | 172,644 |
| Trade and other receivables* | - | - | - | - | 954 | 954 |
| Financial assets at fair value through profit or loss | | | | | | |
| **Total credit risk exposure** | **-** | **-** | **172,644** | **-** | **954** | **173,598** |

# 7 Financial risk management (continued)

**(b) Credit risk (continued)**

| 2014 | AAA $'000 | AA $'000 | A $'000 | BBB $'000 | Not rated $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | - | 1,357 | 169,160 | - | - | 170,517 |
| Trade and other receivables* | - | - | - | - | 1,399 | 1,399 |
| Financial assets at fair value through profit or loss | | | | | | |
| **Total credit risk exposure** | - | 1,357 | 169,160 | - | 1,399 | 171,916 |

* The receivables are largely with related parties (see note 13(b)).

No receivables are past due or impaired at balance date (2014: Nil).

**(c) Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's objective and funding strategy seeks to ensure liquidity and diversity of funding sources to meet actual and contingent liabilities in both stable and adverse market conditions.

The Company's liquidity is primarily monitored through the production of statement of cash flows for board review. Periodic review of the maturity profile of the Company's financial assets and liabilities is performed to ensure sufficient liquidity is maintained.

The following is an analysis of the maturity profile of undiscounted contractual cash flows associated with the Company's financial liabilities at balance date, excluding insurance liabilities:

| 2015 | Up to a year $'000 | 1-2 years $'000 | 2-5 years $'000 | Over 5 years $'000 | No term $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| Trade and other payables | 346 | 71 | - | - | - | 417 |
| Outstanding claims liabilities | 8,509 | 2,825 | 1,777 | 36 | - | 13,147 |
| **Net principal liabilities** | 8,855 | 2,896 | 1,777 | 36 | - | 13,564 |

| 2014 | Up to a year $'000 | 1-2 years $'000 | 2-5 years $'000 | Over 5 years $'000 | No term $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| Trade and other payables | 1,299 | 359 | - | - | - | 1,658 |
| Outstanding claims liabilities | 9,034 | 2,843 | 1,802 | 40 | - | 13,719 |
| **Net principal liabilites** | 10,333 | 3,202 | 1,802 | 40 | - | 15,377 |

The Company's financial assets and liabilities are carried in the statement of financial position at amounts that approximate fair value.

## 7 Financial risk management (continued)

**(d) Market risk**

Market risk is the risk that the fair value of its financial instruments or future cash flows will decrease due to changes in external economic variables such as interest rates, currency rates and equity prices.

The board is responsible for developing and monitoring the risk management policies of the Company in relation to market risk. The Company's investment activities follow the GECC FICS policy. The GECC FICS policy document outlines the level of acceptable market risk, including counterparty ratings and exposure levels that apply to the investment activities of companies within the GECC Group. The Company will continue to adopt the GECC FICS policy until a new Investment Policy is approved by the Board in 2016.

*(i) Currency risk*

Currency risk is the risk that the value of recognised assets and liabilities or the cash flows from possible future transactions, that are denominated in a currency, other than that of the functional currency, will decrease due to changes in market exchange rates.

The Company has no foreign currency exposure at balance date that is considered material.

*(ii) Interest rate risk*

Interest rate risk is the risk that the value of financial instruments will fluctuate as a result of changes in market interest rates.

The following table analyses the impact of a reasonable possible movement in market interest rates on the Company's operating results.

| | Carrying Amount | Change in variables | Impact on profit before tax | Impact on Equity | | | | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | Up to a year | 1-2 years | 2-5 years | Over 5 years | |
| **2015** | **$'000** | **%** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** |
| **Financial assets** | | | | | | | | |
| Short term deposits | 163,701 | -1 | (1,637) | (1,146) | - | - | - | (1,146) |
| | 163,701 | | (1,637) | (1,146) | - | - | - | (1,146) |

| | Carrying Amount | Change in variables | Impact on profit before tax | Impact on Equity | | | | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | Up to a year | 1-2 years | 2-5 years | Over 5 years | |
| **2014** | **$'000** | **%** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** |
| **Financial assets** | | | | | | | | |
| Short term deposits | 160,818 | -1 | (1,608) | (1,126) | - | - | - | (1,126) |
| | 160,818 | | (1,608) | (1,126) | - | - | - | (1,126) |

The analysis is performed on the same basis for 2014 and assumes that all other variables remain the same.

## 8 Capital management

Capital consists of ordinary shares and retained earnings.

The Company's capital management strategy plays a central role in managing capital risk arising from the business activities of the Company, providing an appropriate level of capital to protect policyholders' interests and satisfy regulators. The strategy seeks to ensure sufficient capital levels are maintained in both stable and adverse market conditions.

The Company has adopted a target surplus policy to assist the board and management to manage its capital position. The target surplus level has been set with reference to a range of risks and possible adverse scenarios faced by the Company.

The Company has net assets in excess of the adopted target surplus requirement, reflecting its current strong capital position.

In addition to the Company's target surplus policy, external capital requirements are set and regulated by the Australian Prudential Regulation Authority (APRA). The Company calculates its capital position according to the relevant Prudential standards which ensures sufficient capital is maintained to meet policyholder obligations. An insurer's capital base is expected to be adequate for the size, business mix, complexity and risk profile of its business.

It is the Company's policy to hold capital levels in excess of those required by APRA according to its target surplus policy, the capital level is regularly monitored to minimise the risk of a regulatory breach.

For detailed information on the Company's capital position and the capital requirements of APRA, refer to note 8(b).

### (a) Risk management

#### Insurance contracts

An insurance contract is a contract under which the insurer accepts significant insurance risk from the policyholder by agreeing to compensate the policy holder for a specified uncertain future event that will adversely affect them. Insurance risk is other than financial risk.

The significance of insurance risk under any one contract is determined by the uncertainty surrounding the probability and timing of the insured event occurring, and the magnitude of its effect. Insurance risk is assessed by the Company at a contract level on its inception and is periodically reassessed as the risk may vary during the period of insurance cover.

The majority of direct insurance contracts written are entered into on a standard form basis. There are no special term and conditions in any non-standard contracts that have a material impact on the financial statements.

The business written consists mainly of consumer credit insurance.

## 8 Capital management (continued)

### (a) Risk management (continued)

**Insurance risk management**

Insurance risk management is the assessment and quantification of the likelihood and financial impact of events that may require settlement by the insurer; and the ability of the Company to mitigate the financial impact of these events on its operating results.

In accordance with Prudential Standards CPS 220 Risk Management and GPS 230 Reinsurance Management for General Insurers issued by APRA, the board and senior management of the Company have developed, implemented and maintained a sound and prudent risk management strategy (RMS) and a reinsurance management strategy (ReMS).

The RMS and ReMS identify the Company's policies, procedures, processes and controls that address all known material risks, financial and non-financial, arising from the business. Annually, the board certifies to APRA 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 the compliance with the RMS and ReMS.

Specific key components of the RMS and ReMs are detailed further below.

*(i) Underwriting strategy*

The board has developed an underwriting strategy to ensure that the Company has the ability to meet the insurance needs of the policy holders and to ensure the ability to pay benefits and claims when due. The strategy involves the identification of risks by type, impact and likelihood and involves the application of mathematical modeling to determine that products are appropriately priced.

*(ii) Reinsurance strategy*

A conservative approach is taken in determining the level of risk appetite appropriate for the Company and where deemed appropriate will spread the risk associated with the insured events according to its ReMS. All reinsurance treaties are subject to analytical and statistical modeling to ensure that they offer a sufficient level of cover for the identified exposures whilst in alignment with the ReMs of the Company.

There are three immaterial reinsurance policies relating to accidental death and warranty products. Given the capital position of the Company and estimated insurance concentration risk charge of $18.10 million (NZ Branch $5.24 million) at 31 December 2015 (2014: $20.68 million, NZ Branch $6.25 million), the Company has adopted the position that catastrophe cover is not required.

*(iii) Claims management*

Strict claims management procedures ensure the timely and accurate payment of claims in accordance with policy conditions. Claim outcomes are monitored to track the actual versus expected experience of the portfolio, with feedback delivered to underwriting and product development.

*(iv) Concentration of insurance risk*

The Company's portfolio of products and policy holders is sufficiently diversified such that there is no material concentration of insurance risk.

## 8 Capital management (continued)

### (b) Capital adequacy

The Company is required to hold prudential reserves, over and above the general insurance contract liabilities, as a buffer against adverse future experience and poor investment returns. Life and General Insurers are required to follow the relevant Prudential Standards as prescribed by APRA. The required level of capital for regulatory purposes (the prudential capital amount, or PCA) is intended to take account of the full range of risks to which a general insurer is exposed and a general company must ensure that the general company has, at all times, a capital base in excess of its PCA (plus any additional amount as required by APRA).

The excess of the Company's capital base over the PCA as at 31 December 2015 was $79.8 million (2014: $60.0 million).

In addition to the regulatory capital requirements, the Company maintains a target surplus providing an additional capital buffer against adverse events.

| | **2015 $'000** | 2014 $'000 |
|---|---|---|
| (a) Capital base | **110,361** | 95,440 |
| (b) Prescribed capital amount | **30,599** | 35,434 |
| Capital in excess of prescribed capital amount = (a) - (b) | **79,762** | 60,006 |
| Capital adequacy multiple = (a)/(b) | **3.61** | 2.69 |

| | **2015 $'000** | 2014 $'000 |
|---|---|---|
| **Capital base:** | | |
| Net assets | 104,164 | 89,491 |
| Regulatory adjustment applied in the calculation of tier 1 capital | 6,197 | 5,949 |
| Common equity Tier 1 Capital | 110,361 | 95,440 |
| | | |
| **Prescribed capital amount:** | | |
| Insurance risk charge | 9,055 | 10,868 |
| Insurance concentration risk charge | 17,924 | 20,678 |
| Asset risk charge | 5,018 | 4,090 |
| Asset concentration risk charge | - | - |
| Operational risk charge | 2,188 | 2,823 |
| Aggregation benefit | (3,586) | (3,025) |
| Prescribed capital amount | 30,599 | 35,434 |

# Unrecognised items

This section of the notes provides information about items that are not recognised in the financial statements as they do not (yet) satisfy the recognition criteria.

## 9 Contingent assets and contingent liabilities

No contingent assets or contingent liabilities existed as at 31 December 2015 (2014: $nil).

## 10 Matters subsequent to the end of the financial year

No matter or circumstance has arisen since 31 December 2015 that has significantly affected or may significantly affect:

- the Company's operations; or
- the results of those operations; or
- the Company's state of affairs.

# Other information

This section of the notes includes other information that must be disclosed to comply with the accounting standards and other pronouncements, but that is not immediately related to individual line items in the financial statements.

## 11 Remuneration of auditors

During the year the following fees were paid or payable for services provided by the auditor of the Company:

### (a) Audit and other assurance services

| | 2015<br>$ | 2014<br>$ |
|---|---|---|
| Amounts received or due and receivable by auditors of the Company (KPMG Australia) for: | | |
| Audit and review of financial statements | **92,015** | 99,020 |
| Other assurance services: | | |
| APRA Return | **22,971** | 31,585 |
| AFSL Audit | **4,113** | 5,655 |
| Total remuneration for audit and other assurance services | **119,099** | 136,260 |

### (b) Non-audit services

| | 2015<br>$ | 2014<br>$ |
|---|---|---|
| Amounts received or due and receivable by auditors of the Company (KPMG Australia) for: | | |
| Actuarial External Peer Review | **-** | 44,920 |
| Total remuneration for non-audit services | **-** | 44,920 |

Audit fees in 2015 and 2014 were paid by Latitude Financial Services Australia Holdings Pty Ltd. and GE Capital Finance Australia Pty Ltd. respectively.

## 12 Key management personnel disclosures

The following persons were key management personnel of the Company at any time during the reporting period.

*(i) Directors*

Duncan Gerald West
JoAnne Maree Stephenson
Christopher Paul Knoblanche
Anna Elizabeth Gladman
Rachel Emma Cobb

## 12 Key management personnel disclosures (continued)

*(ii) Other executives*

Allessa Pritchard
Alexandra Yaniv (resigned 31 May 2015)
Rachel Perry
Drossos Haramantas (resigned 24 November 2015)
Ryan Kiss (resigned 17 September 2015)
Kevin Smith (resigned 17 April 2015)
Emma Robinson (resigned 30 January 2015)
Julie Taylor
Karen Parkin (appointed 12 October 2015)
Cath Mortlock (appointed 13 June 2015)
Shelly Slater (appointed 15 March 2015)
Mercedes Colla (appointed 29 September 2015)

**Key management personnel compensation**

In addition to their salaries, the Company and related parties also provided non-cash benefits which included long service leave and an employee share option plan.

| | 2015 $ | 2014 $ |
|---|---|---|
| Short-term employee benefits* | **3,013,252** | 2,209,404 |
| Long-term employee benefits | **249,804** | 209,423 |
| Equity compensation benefits | **1,420** | 24,471 |
| | **3,264,476** | 2,443,298 |

There are no other transactions with key management personnel (2014: $nil).

* The 2015 amount includes termination benefits of $265,999 (2014: $132,600)

## 13 Related party transactions

### *(a) Transactions with related parties*

The following transactions occurred with related parties:

| | 2015 $ | 2014 $ |
|---|---|---|
| *Management fees paid to/(received from):* | | |
| GE Capital Finance Australasia Pty Ltd | **12,031,497** | 12,623,501 |
| Latitude Financial Services Australia Holdings Pty Ltd | **76,020** | - |
| Hallmark Life Insurance Company Ltd | **(2,289,035)** | (2,650,153) |
| GE Capital Corporation | **-** | 266,587 |
| *Cross charges paid to:* | | |
| GE Personal Finance Pty Ltd | **-** | 233,150 |
| GE Capital Finance Australasia Pty Ltd | **3,462,567** | 4,656,470 |

# 13 Related party transactions (continued)

## (a) Transactions with related parties (continued)

| | 2015<br>$ | 2014<br>$ |
|---|---|---|
| *Transactional sales costs paid to:* | | |
| GE Capital Finance Australasia Pty Ltd | **1,461,538** | 1,783,883 |
| Latitude Financial Services Australia Holdings Pty Ltd | **330,791** | - |
| *Commission paid to:* | | |
| Avco Access Pty Ltd | - | 204 |
| GE Personal Finance Pty Ltd | **2,185,504** | 2,896,619 |
| Latitude Personal Finance Pty Ltd | **387,195** | - |
| GE Capital Finance Australia | **3,150,097** | 3,780,168 |
| Latitude Finance Australia | **310,485** | - |
| GE Finance and Insurance (NZ) | **2,095,321** | 2,939,008 |
| Latitude Financial Services Ltd - NZ | **217,432** | - |
| *Royalty paid:* | | |
| GE Capital Registry, Inc. | **135,753** | 303,071 |
| *Dividend paid/(received)* | | |
| Hallmark Life Insurance Company Ltd - shareholder | - | 103,000,000 |

## (b) Outstanding balances with related parties

| | 2015<br>$ | 2014<br>$ |
|---|---|---|
| *Receivables/(payables)* | | |
| Avco Access Pty Ltd | - | 193 |
| GE Capital Finance Australasia Pty Ltd | - | (1,375,347) |
| Latitude Financial Services Australia Holdings Pty Ltd | **(2,103,840)** | - |
| GE Personal Finance Pty Ltd | - | 589,298 |
| Latitude Personal Finance Pty Ltd | **1,219,945** | - |
| Hallmark Life Insurance Company Ltd | **179,073** | 3,052,220 |
| GE Capital Finance Australia | - | 2,344,651 |
| Latitude Finance Australia | **1,583,296** | - |
| GE Finance and Insurance (NZ) | - | 389,256 |
| Latitude Financial Services Ltd - NZ | **1,185,874** | - |
| GE Capital Holdings Partnership | - | (2,488,485) |

No provisions for doubtful debts have been raised in relation to any outstanding balances, and no expense has been recognised in respect of bad or doubtful debts due from related parties.

At 31 December 2015, there are no amounts outstanding owed by Hallmark General Insurance Company Ltd to Latitude Financial Services Australia Holdings Pty Ltd or to other related parties which are not reflected in the accounts, and there are no further amounts to be charged by Latitude Financial Services Australia Holdings Pty Ltd or by other related parties in relation to services provided to Hallmark General Insurance Company Ltd during 2015 or prior years.

## 14 Summary of significant accounting policies

Hallmark General Insurance Company Ltd is a company limited by shares, incorporated and domiciled in Australia.

The Company is registered under the Insurance Act 1973.

Its registered office and principal place of business is:
Level 4
99 Walker Street
North Sydney NSW 2060
Australia

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

These financial statements are presented in Australian dollars, which is the Company's functional currency.

The financial statements were authorised for issue by directors on 17 March 2016.

### (a) *Basis of preparation*

**Statement of compliance**

These general purpose financial statements cover the Company and its New Zealand branch and has been prepared in accordance with Australian Accounting Standards (AASBs) and interpretations issued by the Australian Accounting Standards Board (AASB), and the *Corporations Act 2001*. The financial statements also comply with International Financial Reporting Standards (IFRSs) and interpretations adopted by the International Accounting Standards Board (IASB).

For the purposes of the financial statements, the Company is a for-profit entity.

**Changes in accounting policies and disclosures**

There has been no change in accounting policies for the current financial period that would have a material impact on these financial statements.

***Basis of measurement***

These financial statements have been prepared on a fair value basis with certain exceptions as described in the accounting policies below.

**Critical estimates, judgements and errors**

The Company makes estimates and assumptions that affect the reported amounts of assets and liabilities at year end. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The areas in which accounting estimates are applied are described below.

**Key sources of estimation uncertainty**

The key area of estimation uncertainty for the Company is in its estimation of outstanding claims and reinsurance recoveries. These are discussed in detail in note 2(f).

**The ultimate liability arising from claims made under insurance contracts**

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the end of the reporting period, including the cost of claims incurred but not reported (IBNR) to the Company.

## 14 Summary of significant accounting policies (continued)

### (a) Basis of preparation (continued)

**The ultimate liability arising from claims made under insurance contracts (continued)**

The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposure. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim event is generally available. In calculating the estimated cost of unpaid claims the Company uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in the economic environment
- changes in the mix of business
- medical and technological developments
- changes in benefit structures
- changes in claims management practice

Provisions are calculated gross of all recoveries. A separate estimate is made of the amounts that will be recoverable from decreasing adjustments and from reinsurers based upon the gross provisions. The decreasing adjustments are estimated as 1/11th of gross outstanding claims liability.

The methods used to analyse past claims experience and to project future claims experience are largely determined by the available data and the nature and maturity of the portfolio.

The determination of an appropriate outstanding claims liability and the specific assumptions used are detailed in note 6.

### (b) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. The Company recognises revenue from non-insurance activities when it is probable that the economic benefits will flow to the Company and the revenue amount can be reliably measured. The Company bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement. In addition, the following specific recognition criteria apply to revenue streams:

*(i) Premium revenue*

Premium revenue comprises amounts charged to policyholders (direct premium) for insurance contracts, excluding stamp duties and taxes collected on behalf of third parties, including the goods and services tax in Australia.

Premium revenue is recognised in the profit or loss when it has been earned. It is recognised as earned from the date of attachment of risk (generally the date a contract is agreed to but may be earlier if persuasive evidence of an arrangement exists) over the period of the related insurance contracts in accordance with the pattern of the incidence of risk expected under the contracts. The pattern of the risks underwritten is generally matched by the passing of time but where time does not approximate the pattern of risk, previous claims experience is used to derive the incidence of risk.

Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought to account based on previous experience with due allowance for any changes in the pattern of new business and renewals.

The unearned portion of premium is recognised within unearned premium liability in the Statement of Financial Position.

## 14 Summary of significant accounting policies (continued)

### (b) Revenue recognition (continued)

*(ii) Investment income*

All investment income is recognised as revenue on an accruals basis. Interest income is recognised on a time proportion basis using the simple interest method. Dividends are brought to account as declared and are recognised net of franking credits. Assets are designated at fair value through profit or loss and the related net realised and unrealised gains and losses are included in the profit or loss as investment revenue.

### (c) Claims expenses

The Company's claims liability is measured as the present value of expected future payments relating to claims incurred at the reporting date. The expected future payments include those estimates in relation to claims incurred but not enough reported (IBNER's) and claims incurred but not reported (IBNR's) based on past experience.

Claims incurred all relate to providing services, including the bearing of risk, and are accordingly treated as expenses in the profit or loss. Claims expenses represent total claim payments made during the year adjusted for the movement in the outstanding claims liability.

The claims liability is measured based on the advice of valuations performed by the appointed actuary whose key assumptions are outlined in note 6.

### (d) Other expenses

Other expenses are recognised in the profit or loss on an accrual basis.

### (e) Outwards reinsurance premium

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of outwards reinsurance premium is treated at the reporting date as deferred reinsurance expense. Reinsurance recoveries on claims incurred are recognised as revenue.

### (f) Deferred acquisition costs

Costs, which vary with and are primarily related to the production of new business, have been deferred to the extent such costs are deemed recoverable from future profits. Such costs primarily include commissions. These costs are amortised in proportion to premiums over the estimated lives of the policies. A write down to recoverable amount is recognised where the present value of expected future claims (including settlement costs) in relation to business written to the end of the reporting period exceeds related unearned premiums less the deferred acquisition costs.

### (g) Income tax

**Australian company**

Income tax in the profit or loss for the periods presented comprises current and deferred tax. Income tax is recognised in the profit or loss except to the extent that it relates to items recognised directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

## 14 Summary of significant accounting policies (continued)

### (g) Income tax (continued)

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are recognised on a gross basis, and presented net if the Company has a legally enforceable right to set off current tax assets and liabilities. 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.

**Tax consolidation**

On 24 November 2015, the Company exited from the GE Capital Holdings Partnership income tax consolidated group. Prior to its exit from the GE Capital Holdings Partnership income tax consolidated group, the Company paid to GE Capital Holdings Partnership a clear exit payment which was determined in accordance with the group's Tax Sharing Agreement.

On 25 November 2015, the Company joined the KVD Australia Holdco Pty Ltd income tax consolidated group. The KVD Australia Holdco Pty Ltd income tax consolidated group incorporates the Company, Hallmark General Insurance Company Ltd and several other related entities.

The current and deferred tax amounts for the consolidated group are allocated amongst the entities in the group using a separate taxpayer within the group approach whereby each entity in the income tax consolidated group measures its current and deferred taxes as if it continued to be a separate taxable entity in its own right, after deducting intercompany dividends, the benefit of any capital losses brought forward and intercompany debt forgiveness transactions.

The members of the KVD Australia Holdco Pty Ltd income tax consolidated group have entered into a tax funding agreement which sets out the funding obligations of the members of the income tax consolidated group in respect of tax amounts. The tax funding agreement was executed on 23 November 2015 and the Company was subsequently added. Under the tax funding agreement, where the member of the income tax consolidated group recognises a taxable loss, the funding amount is nil with no compensation for the tax losses unless the member is subject to prudential regulation by APRA, in which case the regulated entity will be compensated for its tax losses.

The liabilities arising for the member under a tax funding agreement are recognised as amounts payable to KVD Australia Holdco Pty Ltd income tax consolidated group. Any difference between the net tax amounts recognised on a separate taxpayer within the group approach and the actual tax funding agreement amount payable is treated as an equity transaction.

The members of the KVD Australia Holdco Pty Ltd income tax consolidated group have entered into a tax sharing agreement under the tax consolidation legislation which sets out the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations and removes the exposure of the Company to joint and several liability in the event of such default. The tax sharing agreement was executed on 23 November 2015 and the Company was subsequently added.

**New Zealand branch**

Tax-effect accounting is applied using the liability method whereby tax is recognised as an expense and is calculated after allowing for permanent differences. To the extent that differences occur between the time items are recognised in the financial statements and when items are taken into account in determining taxable income (timing differences), the related future taxation benefit and deferred income tax liability are disclosed as a deferred tax asset and a deferred tax liability, respectively.

**Taxation basis**

## 14 Summary of significant accounting policies (continued)

**(g) Income tax (continued)**

**New Zealand branch (continued)**

**Taxation basis (continued)**

As the Branch is a non-resident, for tax purposes, general insurer in New Zealand it is taxed on 10% of its New Zealand sourced gross premium income. Deductions for expenditure are not allowed. A non-resident withholding tax of 10% or approved issuer levy of 2% applies to any New Zealand sourced interest income on investments.

**(h) Cash and cash equivalents**

For the purpose of the statement of cash flows, cash and cash equivalents include cash on hand, deposits held at call with financial institutions and other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash.

**(i) Trade and other receivables**

All premium and other receivables are recognised at the amounts receivable as these amounts are generally due for settlement within 30 days and less, where applicable, any provision for doubtful debts. Collectability of premium and other receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off in the period in which they are identified.

**(j) Reinsurance and other recoveries receivable**

Reinsurance and other recoveries receivable on paid claims, reported claims not yet paid and IBNR's are recognised as revenue. Recoveries receivable are assessed in a manner similar to the assessment of the liability for outstanding claims and policy liabilities.

**(k) Classification of insurance contracts**

Contracts under which the Company accepts significant insurance risk from the policyholder or another party by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event adversely affects the policyholder or other beneficiary, are classified as insurance contracts. The risks associated with insurance contracts are detailed further in note 8(a).

**(l) Assets backing general insurance liabilities**

The Company currently maintains a significant capital surplus. The Company has established a target capital to ensure assets are available to meet insurance liabilities.

**(m) Financial assets**

The Company has elected to designate all its financial assets backing insurance policies at fair value through profit or loss consistent with the provisions of AASB 139 Financial Instruments: Recognition and Measurement.

Financial assets designated at fair value through profit or loss and are initially recognised at fair value, excluding transaction costs, which are expensed in the profit or loss in the period in which they arise. Financial assets are subsequently measured at fair value at each reporting date with realised and unrealised gains and losses arising from changes in the fair value recognised in the profit or loss in the period in which they arise.

*Classification*

*(i) Short term deposits*

Short term deposits are carried at the face value of the amounts deposited as their carrying amounts approximate to their fair value.

## 14 Summary of significant accounting policies (continued)

**(m) Financial assets (continued)**

*(ii) Unlisted fixed interest securities*

Unlisted fixed interest securities are recorded at amounts based on valuations using rates of interest equivalent to the yields obtainable on comparable investments at the end of the reporting period.

All financial instruments are required to be further categorised under AASB 7 Financial Instruments: Disclosures, according to the availability of observable market inputs used in the measurement of their fair values, which is detailed further in note 2(h).

**(n) Impairment of assets**

The carrying amount of the Company's non-financial assets, other than deferred tax assets, are assessed annually for indicators of impairment, if any such indicator exists, then the asset's recoverable amount is estimated.

An impairment loss is recognised when the carrying amount of an asset exceeds its recoverable amount. Recoverable amount is the higher of an asset's fair value less cost of disposal and value in use. Impairment losses are recognised in the profit or loss, unless an asset has previously been re-valued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the profit or loss.

Where an impairment loss subsequently reverses, the carrying amount is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment been recognised for the asset in prior years. A reversal of an impairment is recognised immediately in the profit or loss.

**(o) Trade and other payables**

Trade and other payables represent liabilities for goods and services provided to the Company prior to the end of the financial year, which are unpaid. The amounts are unsecured and are usually paid within 90 days of recognition.

**(p) Outstanding claims liability**

The liability for outstanding claims covers the expected future payments for claims including IBNR and IBNER claims and the anticipated direct and indirect costs of settling these claims.

The liability for outstanding claims is subject to yearly actuarial review. The general approach to the actuarial estimation of outstanding claims is to analyse all available past experience. Based on this, the expected future payments are determined and discounted to present value using a risk free rate.

The provision for the outstanding claims liability also contains a risk margin to reflect the inherent uncertainty in the central estimate. The risk margin increases the probability that the net liability is adequately provided for to a 90% (2014: 90%) confidence level.

**(q) Liability adequacy test**

The adequacy of the insurance contract liabilities are evaluated each year. The insurance contract test considers current estimates of all contractual and related cash flows. If it is determined using best estimate assumptions that a shortfall exists, it is immediately recognised in the profit or loss. Refer to note 2(f)(v).

## 14 Summary of significant accounting policies (continued)

**(r) Unexpired risk liability**

Provision is made for unexpired risks arising from general insurance business where the expected value of claims and expenses attributed to the unexpired periods of policies in force at the end of the reporting period exceeds the unearned premiums provision in relation to such policies after the deduction of any deferred acquisition costs. The provision for unexpired risk is calculated separately by reference to separate classes of business, which are managed together, after taking into account the relevant investment return.

Unexpired risk liability, if any, remaining after writing off deferred acquisition costs is recognised immediately in the profit or loss. Refer to note 2(f)(v).

**(s) Employee benefits**

*(i) Short term employee benefits*

The provisions for employee entitlements to wages, salaries and annual leave expected to be settled wholly within 12 months of year end represents the amount which the Company has a present obligation to pay resulting from employees' services provided up to the balance date. The provisions have been calculated at undiscounted amounts based on wage and salary rates that the Company expects to pay including related on-costs.

*(ii) Other long-term employee benefit obligations*

The liability for employees entitled to long service leave represents the present value of the estimated future cash outflows to be made by the Company resulting from employees' services provided up to the balance date.

Liabilities for employee entitlements, which are not expected to be wholly settled within 12 months, are discounted using the rates attaching to Australian Commonwealth Government securities at balance date, which most closely match the terms of maturity of the related liabilities.

In determining the liability for employee entitlements, consideration has been given to future increases in wage and salary rates, and the Company's experience with staff tenure. Related on-costs have also been included in the liability.

*(iii) Defined contribution plans*

For defined contribution plans, the Company has no further payment obligations once the contributions have been paid. The contributions are recognised as other staff expenses when they are due.

**(t) Foreign currency translation and functional currency**

*Functional and presentation currency*

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates (the functional currency).

The financial statements are presented in Australian dollars, which is the functional and presentation currency for the Company.

*Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit or loss.

Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Translation differences on financial instruments carried at fair value are reported as part of the fair value gain or loss.

## 14 Summary of significant accounting policies (continued)

### (t) Foreign currency translation and functional currency (continued)

*Transactions and balances (continued)*

The results and financial position of the branch of the Company that has a functional currency different from the presentation currency are translated into the presentation currency as follows:

The results and financial position of the branch of the Company that has a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities are translated at the closing rate at the reporting date
- income and expenses are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income, and accumulated in a separate component of equity.

### (u) Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount of goods and service tax (GST), except where the amount of GST incurred is not recoverable from the Australian Taxation Office (ATO). 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 tax authorities (i.e. ATO and IRD) is included as a current asset or liability in the statement of financial position.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to, the tax authorities, are classified as operating cash flows.

### (v) Rounding of amounts

The Company is of a kind referred to in Class Order 98/100, issued by the Australian Securities and Investments Commission, relating to the rounding off of amounts in the financial statements. Amounts in the financial statements have been rounded off in accordance with that Class Order to the nearest thousand dollars, or in certain cases, the nearest dollar.

### (w) New accounting standards and interpretations

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2015, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Company, except for:

- AASB 9 Financial Instruments, which becomes mandatory for the Company's 2018 financial statements and could change the classification and measurement of financial assets. The Company does not plan to adopt this standard early and the extent of the impact has not been determined.

- AASB 15 Revenue from contracts with customers, which becomes mandatory for the Company's 2018 financial statements, provides a new 5 step model for recognising revenue earned from a contract with a customer and will replace the existing AASB 118 Revenue. The Company does not plan to adopt this standard early and the extent of the impact has not been determined.

**Directors' Declaration**

In the opinion of the Directors of Hallmark General Insurance Company Ltd (the Company):

(a) the financial statements and notes set out on pages 5 to 47 are in accordance with the *Corporations Act 2001*, including:

   (i) giving a true and fair view of the Company's financial position as at 31 December 2015 and of its performance for the financial year ended on that date; and

   (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*;

(b) the financial statements also comply with International Financial Reporting Standards as disclosed in note 14; and

(c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of directors:

JoAnne Maree Stephenson (Chairman)
Director
Sydney
17 March 2016

Anna Elizabeth Gladman (Managing Director)
Director
Sydney
17 March 2016

KPMG

## Independent auditor's report to the members of Hallmark General Insurance Company Ltd

### Report on the financial report

We have audited the accompanying financial report of Hallmark General Insurance Company Ltd (the Company), which comprises the Statement of Financial Position as at 31 December 2015, and the Statement of Profit or Loss and Other Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year ended on that date, notes 1 to 14 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration.

*Directors' responsibility for the financial report*

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error. In note 14, the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements comply with International Financial Reporting Standards.

*Auditor's responsibility*

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Company's financial position and of its performance.

KPMG

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

*Independence*

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

*Auditor's opinion*

In our opinion:

(a) the financial report of Hallmark General Insurance Company Ltd is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the Company's financial position as at 31 December 2015 and of its performance for the year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in note 14.

KPMG

KPMG

AR

Andrew Reeves
*Partner*

Sydney
17 March 2016

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The Board of Directors
Hallmark General Insurance Company Ltd
Level 4, 99 Walker Street
North Sydney NSW 2060

29 March 2016

## Hallmark General Insurance Company Ltd: Appointed Actuary signoff of financial statements and financial condition as at 31 December 2015 for New Zealand reporting purposes

Dear Directors

Hallmark General Insurance Company Ltd ("HGIC") is an Australian authorised insurer regulated by the Australian Prudential Regulatory Authority ("APRA") and has a licence issued by the Reserve Bank New Zealand ("RBNZ").

On 19 September 2014, HGIC appointed me, Richard Yee of Ernst & Young to be HGIC's Appointed Actuary. The Appointed Actuary role is as described by the Insurance Act 1973, related Prudential Standards and Prudential Practice Guides current at 31 December 2015, and by the New Zealand Insurance (Prudential Supervision) Act 2010 (the Act). I have no relationship with HGIC other than being its Appointed Actuary.

It is the responsibility of the Appointed Actuary to provide advice to the Board of a general insurer on the value of its insurance liabilities and the preparation of the actuarial information contained in its financial statements. The Appointed Actuary must provide written advice to the Board of the insurer on the value of insurance liabilities in accordance with APRA's Prudential Standard GPS320, Actuarial and Related Matters.

As part of my responsibilities, I have produced a report on HGIC's insurance liabilities and financial condition, the Financial Condition Report (FCR), as at 31 December 2015, dated 9 March 2016. The scope of the FCR is to provide the Board and management with an objective assessment of the financial condition of the Australian and New Zealand business within HGIC as at 31 December 2015. The FCR identifies and assesses the material risks facing HGIC and includes discussion of relevant risk mitigants.

I have relied upon the general completeness and accuracy of this data and information supplied by HGIC without independent verification. However, I have reviewed the information for reasonableness and consistency with my knowledge of the financial services industry.

The RBNZ has exempted HGIC from compliance with their Solvency Standard for Non-life Insurance Business. This exemption has been granted subject to various conditions, including obligations of the Appointed Actuary. These obligations are addressed below. Where relevant and appropriate, I have commented on total HGIC Company level results and also separately in relation to the results of the New Zealand Branch of HGIC.

## Financial Statements – HGIC Company

Section 77 of the Act requires a review by the Appointed Actuary of the actuarial information in the financial statements of the company and in particular:

a. Unearned premium liability and liability adequacy test

b. Net outstanding claims liability

c. Reinsurance and any other recovery assets

d. Deferred acquisition cost or deferred fee revenue

e. Any other information deemed by the Appointed Actuary to warrant actuarial review for the purpose of profit or solvency reporting

Section 78 of the Act requires that the Appointed Actuary prepare a report in respect of the review required under Section 77. I confirm that this FCR and my ILVR meets the requirements of section 78 of The Act, and contains my advice regarding the net premium liabilities, liability adequacy test, net outstanding claims liabilities, reinsurance and any other recovery assets, and deferred acquisition costs.

I have previously reviewed the earning patterns adopted by HGIC and consider them to be appropriate. For the current ILVR I have also checked the unearned premium calculation performed by HGIC for certain product types and the calculations appear to be reasonable.

In my opinion and from an actuarial perspective:

a. The actuarial information contained in the HGIC financial statements has been appropriately included in those statements; and

b. The actuarial information has been used appropriately in the preparation of the HGIC financial statements.

I have obtained all information and explanations that I have required. I am not aware of any other information that warrants actuarial review for the purpose of profit or solvency reporting.

## Financial Condition Report

The Appointed Actuary must prepare a Financial Condition Report which must:

a. Identify and describe the material risks (of which it is reasonable to expect the appointed actuary to be aware) facing a licensed insurer that, in the appointed actuary's opinion, pose a threat to the licensed insurer's ability to meet its solvency requirements now and in the future, and where practicable quantify such risks

b. Comment on the steps taken or proposed by the licensed insurer to address the risks identified in (a)

c. Comment separately on the New Zealand business, these comments can be in line with Australian requirements for financial condition reports

d. Advise the licensed insurer on whether in the Appointed Actuary's opinion, the licensed insurer needs to consider reporting to the RBNZ under Section 24 of The Act, taking into account the licensed insurer's forward-looking assessment of the solvency standard and the appointed actuary's assessment of the licensed insurer's business plans, its enterprise risk management practices and the external environment.

The Appointed Actuary in the financial condition report must comment on:

a. The solvency position of the insurer if a catastrophe or extreme event, such as outlined in the Catastrophe Risk Capital Charge section of the Non-Life Standard, were to occur in New Zealand.

b. Any difference in the financial condition of the New Zealand Branch in comparison with the insurer as a whole, which might have implications if the two were separated as a result of regulatory action or litigation.

The FCR identifies and assesses the material risks facing HGIC and includes mitigating factors addressing those risks and therefore meets the requirements of Section 56(d) of the Act. The capital within HGIC is equally accessible by both the Australian and New Zealand operations.

HGIC is in a very strong financial position as at 31 December 2015, with available capital exceeding the target surplus. Capital requirements are expected to be met over the year and also in subsequent years,

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and hence no reporting under Section 24 of the Act is required. In my opinion HGIC is maintaining a solvency margin consistent with the requirements under section 21(2) (b) of the Act. HGIC is not a life insurer. As such no opinion under Section 78(h) of the Act is required.

This strong position means that HGIC would be able to withstand a catastrophe or extreme event similar to the Catastrophe Risk Capital Charge.

The Australian and New Zealand operations of HGIC are managed in conjunction and I am not aware of any differences in the financial condition of the New Zealand Branch in comparison with the insurer as a whole which might have implications if the two were separated.

Yours sincerely,

Richard Yee

Richard Yee, FIAA, FNZSA
Appointed Actuary, Hallmark General Insurance Company Ltd

# Hallmark General Insurance Company Ltd
# New Zealand Branch

# Annual financial statements
# for the year ended 31 December 2015

The directors present their report together with the financial statements of Hallmark General Insurance Company Ltd New Zealand Branch for the year ended 31 December 2015 and the auditor's report thereon.

Signed in accordance with a resolution of the board of directors.

JoAnne Maree Stephenson (Chairman)
Director
Sydney
17 March 2016

Anna Elizabeth Gladman (Managing Director)
Director
Sydney
17 March 2016

**Hallmark General Insurance Company Ltd New Zealand Branch**
**Statement of Profit or Loss and Other Comprehensive Income**
**For the year ended 31 December 2015**

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| Insurance premium revenue | | 18,976 | 18,691 |
| Net insurance premium revenue | 1(a) | 18,976 | 18,691 |
| Claims expenses | | 2,676 | 2,798 |
| Net claims incurred | 1(b) | 2,676 | 2,798 |
| Acquisition costs | | 4,111 | 4,103 |
| Administration expenses | | 6,042 | 5,865 |
| Underwriting expenses | | 10,153 | 9,968 |
| **Underwriting result** | | 6,147 | 5,925 |
| Investment income | 1(c) | 1,294 | 1,205 |
| Investment expenses | | (14) | (16) |
| Other income | | (121) | 551 |
| **Profit before income tax** | | 7,306 | 7,665 |
| Income tax expense | 1(d) | 526 | 521 |
| **Profit for the year** | | 6,780 | 7,144 |
| **Other comprehensive income for the year, net of tax** | | - | - |
| **Total comprehensive income for the year** | | 6,780 | 7,144 |
| **Profit is attributable to:** | | | |
| Owners of Hallmark General Insurance Company Ltd New Zealand Branch | | 6,780 | 7,144 |
| | | 6,780 | 7,144 |
| **Total comprehensive income for the year is attributable to:** | | | |
| Owners of Hallmark General Insurance Company Ltd New Zealand Branch | | 6,780 | 7,144 |
| | | 6,780 | 7,144 |

*The above Statement of Profit or Loss and Other Comprehensive Income should be read in conjunction with the accompanying notes.*

**Hallmark General Insurance Company Ltd New Zealand Branch**
**Statement of Financial Position**
**As at 31 December 2015**

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 2(a) | 40,493 | 40,002 |
| Trade and other receivables | 2(b) | 134 | 291 |
| Current tax assets | | 18 | - |
| Deferred acquisition costs | 2(c) | 2,311 | 3,127 |
| **Total current assets** | | 42,956 | 43,420 |
| | | | |
| **Non-current assets** | | | |
| Deferred acquisition costs | 2(c) | 1,968 | 2,886 |
| **Total non-current assets** | | 1,968 | 2,886 |
| | | | |
| **Total assets** | | 44,924 | 46,306 |
| | | | |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 2(d) | 131 | 443 |
| Current tax liabilities | | - | 676 |
| Outstanding claims liability | 2(e) | 2,234 | 2,341 |
| Unearned premium liability | 2(f) | 10,499 | 13,772 |
| **Total current liabilities** | | 12,864 | 17,232 |
| | | | |
| **Non-current liabilities** | | | |
| Outstanding claims liability | 2(e) | 768 | 792 |
| Unearned premium liability | 2(f) | 8,943 | 12,713 |
| **Total non-current liabilities** | | 9,711 | 13,505 |
| | | | |
| **Total liabilities** | | 22,575 | 30,737 |
| | | | |
| **Net assets** | | 22,349 | 15,569 |
| | | | |
| **EQUITY** | | | |
| Retained earnings | | 22,349 | 15,569 |
| **Total equity** | | 22,349 | 15,569 |

*The above Statement of Financial Position should be read in conjunction with the accompanying notes.*

**Hallmark General Insurance Company Ltd New Zealand Branch**
**Statement of Changes in Equity**
**For the year ended 31 December 2015**

| | Attributable to owners of Hallmark General Insurance Company Ltd New Zealand Branch | |
|---|---|---|
| | Retained earnings $'000 | Total equity $'000 |
| **Balance at 1 January 2014** | 8,425 | 8,425 |
| Profit for the year | 7,144 | 7,144 |
| **Total comprehensive income for the year** | 7,144 | 7,144 |
| **Balance at 31 December 2014** | 15,569 | 15,569 |
| **Balance at 1 January 2015** | 15,569 | 15,569 |
| Profit for the year | 6,780 | 6,780 |
| **Total comprehensive income for the year** | 6,780 | 6,780 |
| **Balance at 31 December 2015** | 22,349 | 22,349 |

*The above Statement of Changes in Equity should be read in conjunction with the accompanying notes.*

**Hallmark General Insurance Company Ltd New Zealand Branch**
**Statement of Cash Flows**
**For the year ended 31 December 2015**

| | Notes | 2015 $'000 | 2014 $'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net premiums received | | **11,934** | 15,233 |
| Claims paid | | **(2,807)** | (2,649) |
| Payments to suppliers and employees | | **(10,087)** | (9,789) |
| Interest received | | **1,451** | 1,045 |
| **Net cash inflow from operating activities** | 3(a) | **491** | 3,840 |
| | | | |
| **Cash flows from investing activities** | | | |
| Payment to parent company | | **-** | (5,963) |
| **Net cash inflow/(outflow) from investing activities** | | **-** | (5,963) |
| | | | |
| **Net cash inflow from financing activities** | | **-** | - |
| | | | |
| **Net increase/(decrease) in cash and cash equivalents** | | **491** | (2,123) |
| Cash and cash equivalents at 1 January | | **40,002** | 42,125 |
| **Cash and cash equivalents at 31 December** | 2(a) | **40,493** | 40,002 |

*The above statement of Cash Flows should be read in conjunction with the accompanying notes.*

## *Contents of the notes to the financial statements*

# Financial performance

This section provides additional information about those individual line items in the financial statements relating to financial peformance that management considers most relevant in the context of the operations of the entity.

## 1 Profit or loss information

### (a) Net insurance premium revenue

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Gross written premium | 11,932 | 14,091 |
| Movement in unearned premiums | 7,044 | 4,600 |
| Outwards reinsurance premium expense | - | - |
| **Net premium revenue** | **18,976** | **18,691** |

### (b) Net claims incurred

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Current Year $'000 | Prior Years $'000 | Total $'000 | Current Year $'000 | Prior Years $'000 | Total $'000 |
| Gross claims incurred and related expenses - undiscounted | 3,322 | (665) | 2,657 | 3,476 | (668) | 2,808 |
| Discount and discount movement - gross claims incurred | (37) | 56 | 19 | (53) | 43 | (10) |
| | 3,285 | (609) | 2,676 | 3,423 | (625) | 2,798 |
| **Net claims incurred** | **3,285** | **(609)** | **2,676** | **3,423** | **(625)** | **2,798** |

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

### (c) Investment income

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Interest income | 1,294 | 1,205 |
| **Total investment income** | 1,294 | 1,205 |

## 1 Profit or loss information (continued)

### (d) Income tax expense

*(i) Income tax expense*

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Current tax expense | 531 | 524 |
| (Over) provided in prior years | (5) | (3) |
| **Income tax expense** | 526 | 521 |

*(ii) Numerical reconciliation of income tax expense to prima facie tax payable*

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Profit from continuing operations before income tax expense | 7,306 | 7,665 |
| Tax at the New Zealand tax rate of 28% (2014 - 28%) | 2,046 | 2,146 |
| Tax effect of amounts which are not deductible (taxable) in calculating taxable income: | | |
| Tax effect of non-assessable income | (1,515) | (1,622) |
| | 531 | 524 |
| Adjustments for current tax of prior periods | (5) | (3) |
| Income tax expense | 526 | 521 |

# Balance sheet management

This section provides additional information about those individual line items in the statement of financial position that management considers most relevant in the context of the operations of the entity.

## 2 Financial assets and financial liabilities

### (a) Cash and cash equivalents

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Current assets** | | |
| Cash at bank | 1,367 | 1,918 |
| Short term deposits | 39,126 | 38,084 |
| **Total cash and cash equivalents** | 40,493 | 40,002 |

## 2 Financial assets and financial liabilities (continued)

### (b) Trade and other receivables

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Current assets** | | |
| Other receivables | 134 | 291 |

These balances include amounts receivable from related parties (note 12).
The carrying value disclosed above approximates fair value at end of the reporting period.

### (c) Deferred acquisition costs

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Current assets** | | |
| Deferred acquisition costs | 2,311 | 3,127 |
| **Non-current assets** | | |
| Deferred acquisition costs | 1,968 | 2,886 |
| **Total deferred acquisition costs** | 4,279 | 6,013 |

*(i) Movements in deferred acquisition costs*

Movements in deferred acquisition costs were as follows:

| **Deferred acquisition costs** | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Balance at 1 January | 6,013 | 6,927 |
| Acquisition costs incurred during the year* | 655 | 1,463 |
| Amortisation charged to income* | (2,389) | (2,377) |
| Closing balance at 31 December | 4,279 | 6,013 |

* Acquisition costs incurred during the year and Amortisation charged to income relate to the Personal loans portfolios (excludes Cards portfolios) as there were no deferred amortisation costs as at 31 December 2015 and 31 December 2014 for Cards portfolios.

### (d) Trade and other payables

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Other payables | 131 | 443 |

The carrying value disclosed above approximates fair value at end of the reporting period.
These balances include amounts payable to related parties (note 12).

## 2 Financial assets and financial liabilities (continued)

### (e) Outstanding claims liability

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Central estimate | **2,010** | 2,273 |
| Risk margin | **769** | 573 |
| Claims handling expense | **274** | 357 |
| | **3,053** | 3,203 |
| Discount to present value | **(51)** | (70) |
| Gross outstanding claims liability | **3,002** | 3,133 |
| Current | **2,234** | 2,341 |
| Non-current | **768** | 792 |
| **Total outstanding claims liability** | **3,002** | 3,133 |

*(i) The following ranges of discount rates were used in the measurement of outstanding claims and reinsurance recoveries.*

The current year discount rate is 2.65%
The subsequent years discount rate is 2.65%.

The weighted average expected term to settlement of the outstanding claims from the end of the reporting period is estimated to be 0.64 years (2014: 0.73 years).

*(ii) Risk margin*

*Process for determining risk margin*

The risk margin is an additional allowance for uncertainty in the ultimate cost of claims. The overall margin adopted is determined by the board after considering the uncertainty in the portfolio, industry trends and the branch's risk appetite.

To determine the margin adopted, the appointed actuary has reviewed the factors impacting the portfolio to establish a recommended margin at the level required by the board. Factors considered include:

- variability of claims experience of the portfolio;
- quality of historical data;
- diversification between different classes within the portfolio; and
- increase in uncertainty due to future economic environment and legislative changes.

The level of uncertainty varies between classes of business, as such the adopted risk margin varies between business classes. The risk margin is applied to the gross central estimate.

The aggregate risk margin, after diversification allowance, is intended to achieve a 90% (2014: 90%) probability of sufficiency.

The risk margins applied to the major segments of the portfolio for 90% (2014: 90%) level of adequacy are:

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Consumer credit insurance - disability | **26.7%** | 19.7% |
| Consumer credit insurance - unemployment | **60.7%** | 45.9% |

## 2 Financial assets and financial liabilities (continued)

### (e) Outstanding claims liability (continued)

*(iii) Reconciliation of movement in discounted outstanding claims liability*

Accident Year Ending 31 December

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Gross $'000** | **Reinsurance $'000** | **Net $'000** | Gross $'000 | Reinsurance $'000 | Net $'000 |
| Balance at 1 January | **3,133** | **-** | **3,133** | 2,984 | - | 2,984 |
| Current year claims incurred | **3,285** | **-** | **3,285** | 3,423 | - | 3,423 |
| Change in previous years claims | **(609)** | **-** | **(609)** | (625) | - | (625) |
| Current year claims paid / reinsurance recovered | **(1,007)** | **-** | **(1,007)** | (957) | - | (957) |
| Previous year claims paid / reinsurance recovered | **(1,800)** | **-** | **(1,800)** | (1,692) | - | (1,692) |
| Closing balance at 31 December | **3,002** | **-** | **3,002** | 3,133 | - | 3,133 |

*(iv) Claims development tables*

Claims development tables are disclosed in order to put the claims estimate included in the financial statements into context, allowing comparison of those claim estimates with the results seen in previous years. In effect, the table highlights the branch's ability to provide a reliable estimate of the total value of claims. The top part of the table provides a review of current estimates of cumulative claims and demonstrates how the estimated claims have changed at subsequent reporting or accident year-ends. The lower part of the table provides a reconciliation of the total reserve included in the Statement of Financial Position and the estimates of cumulative claims.

*Gross Ultimate Claims Cost*

| **Reporting Year** | **2011 and prior $'000** | **2012 $'000** | **2013 $'000** | **2014 $'000** | **2015 $'000** | **Total $'000** |
|---|---|---|---|---|---|---|
| **Estimate of gross ultimate claims cost** | | | | | | |
| At end of accident year | | | 3,184 | 3,328 | 3,132 | |
| One year later | | 2,217 | 2,218 | 2,946 | - | |
| Two years later | 1,129 | 2,140 | 2,217 | - | - | |
| Three years later | 1,308 | 2,182 | - | - | - | |
| Four years later | 1,416 | - | - | - | - | |
| Five years later | 396 | | | | | |
| Six years later | 184 | | | | | |
| Current estimate of cumulative claims | 1,540 | 2,182 | 2,217 | 2,946 | 3,132 | 12,017 |
| Cumulative payments to date | (1,540) | (2,124) | (2,105) | (2,448) | (1,021) | (9,238) |
| Undiscounted claims handling expenses | - | 6 | 11 | 52 | 205 | 274 |
| **Gross outstanding claims - undiscounted** | - | 64 | 123 | 550 | 2,316 | 3,053 |
| Discount impact | - | (1) | (3) | (10) | (37) | (51) |
| **Gross outstanding claims - discounted** | - | 63 | 120 | 540 | 2,279 | 3,002 |

*Net ultimate claims cost*

## 2 Financial assets and financial liabilities (continued)

### (e) Outstanding claims liability (continued)

*(iv) Claims development tables (continued)*

| Reporting Year | 2011 and prior $'000 | 2012 $'000 | 2013 $'000 | 2014 $'000 | 2015 $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Estimate of net ultimate claims cost** | | | | | | |
| At end of accident year | | | 3,184 | 3,328 | 3,132 | |
| One year later | | 2,217 | 2,218 | 2,946 | - | |
| Two years later | 1,129 | 2,140 | 2,217 | - | - | |
| Three years later | 1,308 | 2,182 | - | - | - | |
| Four years later | 1,416 | - | - | - | - | |
| Current estimate of cumulative claims | 1,540 | 2,182 | 2,217 | 2,946 | 3,132 | 12,017 |
| Cumulative payments to date | (1,540) | (2,124) | (2,105) | (2,448) | (1,021) | (9,238) |
| Undiscounted claims handling expenses | - | 6 | 11 | 52 | 205 | 274 |
| **Net outstanding claims - undiscounted** | - | 64 | 123 | 550 | 2,316 | 3,053 |
| Discount impact | - | (1) | (3) | (10) | (37) | (51) |
| **Net outstanding claims - discounted** | - | 63 | 120 | 540 | 2,279 | 3,002 |

*(v) Liability adequacy test*

The liability adequacy test (LAT) is an assessment of the carrying amount of unearned premium liabilities and is conducted at the end of each reporting period. The test is calculated separately for each portfolio of contracts that are subject to broadly similar risks and are managed together as a single portfolio.

For the purposes of the liability adequacy test, the net premium liabilities at a 75% probability of sufficiency as at 31 December 2015 is $12,475,017 (31 December 2014: $17,194,018), therefore the liability adequacy test at reporting date resulted in a surplus for the branch.

All actuarial data relating to the New Zealand Branch of the Company, prior to the 5th of March 2012, relates to the insurance portfolio of Simply Insurance New Zealand Limited, and is disclosed to reflect the historical actuarial profile of the insurance portfolio, which was transferred to the Branch on the 5th of March 2012.

### (f) Unearned premium liability

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Balance as at 1 January | 26,485 | 31,085 |
| Premiums written during the year* | 2,814 | 5,402 |
| Premiums earned during the year* | (9,857) | (10,002) |
| Closing balance as at 31 December | 19,442 | 26,485 |
| | | |
| Current | 10,499 | 13,772 |
| Non-current | 8,943 | 12,713 |
| **Total unearned premium liability** | 19,442 | 26,485 |

* Premiums written and earned during the year relate to the Personal loans portfolios (excludes Cards portfolios) as there were no unearned premium liabilities as at 31 December 2015 and 31 December 2014 for Cards portfolios.

### (g) Fair value measurement

There are no financial assets measured at fair value as at 31 December 2015. (2014: nil)

## 3 Cash flow information

**(a) Reconciliation of profit after income tax to net cash flows from operating activities**

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| Profit for the year | 6,780 | 7,144 |
| **Adjustments** | | |
| Change in operating assets and liabilities: | | |
| (Increase)/decrease in trade debtors | - | 1,143 |
| (Decrease)/increase in trade and other payables | (312) | (6,631) |
| (Increase)/ decrease in other receivables | 157 | (160) |
| Decrease/(increase) in deferred acquisition costs | 1,734 | 914 |
| Increase/ (decrease) in outstanding claim liability | (131) | 149 |
| (Decrease)/increase in unearned premium liability | (7,043) | (4,600) |
| (Decrease)/increase in current tax liability | (694) | (82) |
| Payments to/ (advances from) parent company | - | 5,963 |
| **Net cash (outflow)/ inflow from operating activities** | 491 | 3,840 |

# Risk

This section of the notes discusses the branch's exposure to various risks and shows how these could affect the branch's financial position and performance.

## 4 Critical estimates, judgements and errors

The branch makes estimates and assumptions that affect the reported amounts of assets and liabilities at year end. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The areas in which accounting estimates are applied are described below.

*Key sources of estimation uncertainty*

The key area of estimation uncertainty for the branch is in its estimation of outstanding claims and reinsurance recoveries. These are discussed in detail in note 6.

*The ultimate liability arising from claims made under insurance contracts*

Provision is made at the year-end for the estimated cost of claims incurred but not settled at the end of the reporting period, including the cost of IBNR's to the branch.

The branch takes all reasonable steps to ensure that it has appropriate information regarding its claims exposure. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the branch, where more information about the claim event is generally available. In calculating the estimated cost of unpaid claims the branch uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in the economic environment
- changes in the mix of business
- medical and technological developments

## 4 Critical estimates, judgements and errors (continued)

*The ultimate liability arising from claims made under insurance contracts (continued)*

- changes in benefit structures
- changes in claims management practice

Provisions are calculated gross of all recoveries. A separate estimate is made of the amounts that will be recoverable from decreasing adjustments and from reinsurers based upon the gross provisions. The decreasing adjustments are estimated as 1/11th of gross outstanding claims liability.

The methods used to analyse past claims experience and to project future claims experience are largely determined by the available data and the nature and maturity of the portfolio.

The determination of an appropriate outstanding claims liability and the specific assumptions used are detailed in note 5.

## 5 Actuarial assumptions and methods

**Impact of changes to valuation approach and key assumptions**

The branch writes the following lines of business:

**Consumer credit insurances**

The risks covered in this group include:

- Involuntary unemployment
- Disability
- Merchandise and price protection
- Stolen card cover

During 2007, the Company ceased writing policies categorised as hire purchase insurance and personal loan insurance ("old products") and commenced writing a new consumer credit insurance product ("new products", from August 2007). As of 31 December 2013, no liability has been projected for "old products" with all policies expired. Since May 2011, the Company has offered several credit card balance protection products which provide cover for disability, unemployment and merchandise protection, price protection and stolen cards cover.

Effective 5 March 2012, the insurance business of Simply Insurance New Zealand (SINZ), a partner company within the GE Capital Group, was transferred into Hallmark General Insurance Company Ltd. This business now operates as a branch in New Zealand.

From 25 November 2015, HGIC transitioned to new ownership under the terms of the purchase agreement between KKR, Deutsche Bank and Varde Partners, and GE Capital, trading under the name Latitude Financial Services.

**Process used to determine outstanding claims liabilities (actuarial methods)**

The general approach to actuarial estimation of insurance liabilities is to analyse available past experience, including numbers of reported and finalised claims, amount of claim payments, changes in case estimates and incurred loss ratios. This analysis allows patterns to be identified in the past experience. Based on this, development patterns associated with the run-off of outstanding claims and premium liabilities at the balance date can be estimated.

The determination of outstanding claims liabilities involves two steps:

(i) The determination of the central estimate of outstanding claims at the balance date. The central estimate of outstanding claims includes an allowance for IBNR claims and the further development of IBNER's.

The central estimate has no deliberate bias towards either over or under estimation. Generally speaking, this means that the central estimate is assessed to have a 50% chance of adequacy.

## 5 Actuarial assumptions and methods (continued)

(ii) The determination of a risk margin and claims handling expense provision to be added to the central estimates of outstanding claims.

The estimation of outstanding claims liabilities has been performed separately for each of the claim types arising under the different policies, namely: death, disability, material damage, unemployment and merchandise protection, price protection and stolen cards.

**Disability and unemployment (except credit cards)**

In determining the central estimate of the outstanding claims liabilities, separate analyses were performed on the open (including pending) claims and IBNR claims.

The individual claimant projection method was adopted for the open and pending claims. Claim payments have been projected from the valuation date until the end of the policy term, taking into account the probability of termination and limits to claim payments as stipulated in the policy. The claim payments are based on the monthly loan instalments for each individual claim. For pending claims, an acceptance rate assumption is also applied in the valuation.

For IBNR claims, the central estimate of the outstanding claims liability was based on an estimated number of IBNR claims and average claim sizes. The number of IBNR claims was based on analysis of claim numbers for lines of business in runoff and analysis of claim frequency for line of business currently underwritten. The average claim size is estimated from expected average total duration and average monthly benefits, with policy design taken into account. For example, the consumer credit Insurance has a maximum unemployment payment period of three months, which was reflected in the analysis.

**Disability, unemployment and merchandise protection, price protection and stolen cards (credit cards only)**

The standard actuarial projection technique of payment per claim finalised (PPCF) was adopted in the determination of the central estimate of the outstanding claims liability for this risk, where claims are generally finalised with the payment of a single lump sum amount. This involves estimating the number of future claim finalisations and average claim sizes. The number of future finalisations was based on analysis of claim reports, finalisations. The average claim size was based on the payments made on claims finalised.

***Actuarial assumptions***

The key actuarial assumptions for the determination of the outstanding claims are as follows:

| | **2015** Disability (excl credit cards) | **2015** Unemployment (excl credit cards) | 2014 Disability (excl credit cards) | 2014 Unemployment (excl credit cards) |
|---|---|---|---|---|
| Termination rates | **4.5 - 14.0%*** | **10.0 - 22.0%*** | 4.5 - 14.5%* | 10.0 - 15.0%* |
| Average weighted term to settlement (months) | **10.1** | **2.5 - 3.8**** | 10.9 | 2.5-3.8 ** |
| Number of IBNR claims accepted (total) | **59** | **67** | 77 | 62 |
| Average Claim Size for IBNR claims | **$5,000** | **$1,100 - $1,700** | $5,300 | $1,200-$1,800 |
| Discount rate | **2.65%pa** | | 3.54%pa | |

* Assumption varies according to the future claim duration

** Varies depending on underwriting period.

## 5 Actuarial assumptions and methods (continued)

**Actuarial assumptions (continued)**

| | 2015 Disability (credit cards) | 2015 Unemployment (credit cards) | 2015 Merchandise protection, price protection and stolen cards (credit cards) | 2014 Disability (credit cards) | 2014 Unemployment (credit cards) | 2014 Merchandise protection, Price protection and stolen cards (credit cards) |
|---|---|---|---|---|---|---|
| Average settlement size | $2,500 - $2,800 | $1,700 - $2,500 | $250 | $2,500-$2,800 | $1,700-$2,500 | $300 |
| Number of future finalisations | 56 | 90 | 19 | 61 | 115 | 31 |

**Other assumptions**

The outstanding claims provision includes a claim handling expense of 13% and an additional 1% for medical expenses, with a prudential margin calculated at a 90% probability of adequacy.

**Process used to determine actuarial assumptions**

A description of the processes used to determine the above key actuarial assumptions is provided below:

- *Termination rates*
  Termination rates by claim duration from the date of incident are adopted and these are used to derive the probability of payment on each claim for each month into the future. The projection produces the average weighted term of settlement.

- *Average weighted term to settlement from the end of the reporting period*
  The average term to settlement from reporting date is based on claim termination analysis performed on the historical claims experiences. The claim termination analysis is performed separately for unemployment and disability.

  Termination rate by duration from the date of incident are adopted and these are used to derive the probability of payment on each claim for each month into the future. The projection produces the average weighted term of settlement.

- *Average claim size for IBNR claims (new products only)*
  For disability and unemployment, the adopted average claim size was based on two types of analysis: the expected average total duration for each claim type and benefit duration (only for unemployment) multiplied by the average monthly payment amount for each claim type, and the historical average claim size. The average duration was based on the assumed termination rates.

  For death and material damage, the average claim size was based on the lump sum payments made on finalised claims.

- *Number of IBNR claims (new products only)*
  The number of IBNR claims was based on an analysis of historical claim numbers for policies in runoff and an analysis of claim frequency for lines of business currently underwritten.

- *Average claim size for settlements (credit cards only)*
  For credit cards policies, the adopted average claim size was based on historic ratios of claim payments to numbers of claims finalised.

## 5 Actuarial assumptions and methods (continued)

**Process used to determine actuarial assumptions (continued)**

- *Number of future finalisations (credit cards only)*
For credit cards policies, the number of future finalisations is based on an analysis of historical claim reports and finalisation rates. This then enables the future numbers of reports, handled claims and finalisations to be projected.

- *Expense rate*
The adopted claims handling expense rate of 13% (2014: 15%) of the projected gross claim payments, was determined based on the results of an expense investigation carried out in 2015. An additional 1% (2014: 1%) for medical expenses is applied to Disability claims.

- *Discount rate*
The central estimates of the outstanding claims liabilities for the periodic benefits were discounted to allow for future investment income attributable to the liabilities during the run off period. The discount factor was based on the annual risk free rates of return from the yield curve on New Zealand government bonds.

**Sensitivity analysis**

The outstanding claims liabilities included in the reported results are calculated based on the key actuarial assumptions as disclosed above. The movement in any of the above key actuarial assumptions will impact the performance and equity of the branch. The table below describes how a change in each of the assumptions will affect the outstanding claims liabilities. The outstanding claims liabilities are on a discounted basis and include claim handling expenses and a risk margin at the 90% probability of adequacy.

Impact of changes in assumptions for old and new products on total outstanding claims liability:

| Key actuarial assumptions | Changes | Impact on net outstanding claims liabilities ($000's) | Impact on total outstanding claims liabilities (%) |
|---|---|---|---|
| Claim termination rate* | Reduce all termination rates by 10% | +134 | 4.5% |
| IBNR | Increase IBNR ACS by 10% / increase number of IBNR claim by 10% | +116 | 3.9% |
| Claims handling expense rate | Increase the claims handling expense rate from 13% to 17% | +77 | 2.6% |

Impact of changes in assumptions for Credit Cards on total outstanding claims liability:

| Key actuarial assumptions | Changes | Impact on outstanding claims liabilities ($000's) | Impact on total outstanding claims liabilities (%) |
|---|---|---|---|
| Claim development | Increase chain ladder factors by 10% | +44 | +1.5% |
| Average settlement size | Increase average settlement size by 10% | +40 | +1.3% |
| Claims handling expense rate | Increase the claims handling expense rate from 13% to 17% | +37 | +1.2% |

## 5 Actuarial assumptions and methods (continued)

**Changes to key assumptions**

At the December 2015 valuation, risk margin assumptions were increased based on:

- APRA's new Industry Review Report as at 30 September 2013 (issued 17 February 2015);
- The current uncertainty regarding unemployment at a macro level; and
- The impact of the Green Belt claims management program.

## 6 Financial risk management

This note explains the branch's exposure to financial risks and how these risks could affect the branch's future financial performance. Current year profit or loss information has been included where relevant to add further context.

**(a) Transition Risk**

Following completion of the sale of GE's consumer business to KVD Australia Pty Ltd, operational risk exposures are higher as services provided under the Transitional Services Agreement (TSA) with GE are transferred to Latitude. This will result in significant change across the business and Hallmark General Insurance Company Ltd New Zealand Branch is actively monitoring and managing these risks.

**(b) Credit risk**

Credit risk is the risk of financial loss due to a counterparty failing to perform their contractual obligations and principally arises through the branch's investment in financial instruments, receivables from related or other parties, and claims on reinsurance contracts.

The following policies and procedures are in place to mitigate the branch's exposure to credit risk:

*(i) Financial assets*

The branch's investment mandate sets out the investment management guidelines approved by the board. The guidelines establish credit approval authorities, concentration limits, and approved investment portfolio parameters. These guidelines comply with the GE Capital Corporation Financial Institutions Credit Standards (GECC FICS) policy which sets out concentration limits and additional portfolio parameters. The Company will continue to adopt the GECC FICS policy until a new Investment Policy is approved by the Board in 2016. Management conducts a regular review of the investment holdings, compliance is monitored and exposures or breaches are reported to the board. The mandate is reviewed regularly for pertinence and for changes in the risk environment.

The branch only invests with counterparties that have a credit rating of at least A1/A from Standard & Poor's (S&P). Where a counterparty changes rating to below A1/A after acquisition, management will continue to review its holding in those counterparties and divest as deemed appropriate. The branch further limits its exposure to credit risk by setting individual exposure limits. There is no significant concentration of credit risk and management does not expect any counterparty to fail to meet its obligations.

*(ii) Reinsurance assets*

Reinsurance is placed with counterparties within the guidelines of the reinsurance management strategy (ReMS). Counterparties must have an S&P credit rating of at least A. The branch further sets its exposure to credit risk by setting individual exposure limits. At the end of each reporting period, management performs an assessment of creditworthiness of reinsurers and updates the ReMS.

## 6 Financial risk management (continued)

### (b) Credit risk (continued)

*(iii) Trade and other receivables*

The branch's maximum credit risk exposure at balance date is limited to the carrying amount of the financial assets as stated in the statement of financial position. The branch does not have a significant concentration of credit risk with any counterparty, other than related parties (see note 12).

The table below shows the branch's maximum exposure to credit risk at balance date.

| 2015 | Investment grade $'000 | Non-investment grade satisfactory $'000 | Non-investment grade unsatisfactory $'000 | Total neither past due nor impaired $'000 | Past due or impaired $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 40,493 | - | - | 40,493 | - | 40,493 |
| Trade and other receivables | - | 134 | - | 134 | - | 134 |
| **Total credit risk exposure** | **40,493** | **134** | **-** | **40,627** | **-** | **40,627** |

| 2014 | Investment grade $'000 | Non-investment grade satisfactory $'000 | Non-investment grade unsatisfactory $'000 | Total neither past due nor impaired $'000 | Past due or impaired $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | |
| Cash and cash equivalents | 40,002 | - | - | 40,002 | - | 40,002 |
| Trade and other receivables | - | 291 | - | 291 | - | 291 |
| **Total credit risk exposure** | **40,002** | **291** | **-** | **40,293** | **-** | **40,293** |

* A receivable is deemed satisfactory when management is satisfied the obligor has the capacity to meet its financial obligations.

The table below classifies the financial assets of the branch by counterparty credit rating.

| 2015 | AAA $'000 | AA $'000 | A $'000 | BBB $'000 | Not rated $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash | - | - | 40,493 | - | - | 40,493 |
| Trade and other receivables* | - | - | - | - | 134 | 134 |
| **Total credit risk exposure** | **-** | **-** | **40,493** | **-** | **134** | **40,627** |

## 6 Financial risk management (continued)

### (b) Credit risk (continued)

| 2014 | AAA $'000 | AA $'000 | A $'000 | BBB $'000 | Not rated $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash | - | - | 40,002 | - | - | 40,002 |
| Trade and other receivables* | - | - | - | - | 291 | 291 |
| **Total credit risk exposure** | - | - | 40,002 | - | 291 | 40,293 |

* No receivables are past due or impaired at balance date (2014: Nil).

### (c) Liquidity risk

Liquidity risk is the risk that the branch will not be able to meet its financial obligations as they fall due. The branch's objective and funding strategy seeks to ensure liquidity and diversity of funding sources to meet actual and contingent liabilities in both stable and adverse market conditions.

The branch's liquidity is primarily monitored through the production of the statement of cash flows for board review. Periodic review of the maturity profile of the branch's financial assets and liabilities is performed to ensure sufficient liquidity is maintained.

The following is an analysis of the maturity profile of undiscounted contractual cash flows associated with the branch's financial liabilities at balance date, excluding insurance liabilities.

| 2015 | Up to a year $'000 | 1-2 years $'000 | 2-5 years $'000 | Over 5 years $'000 | No term $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| Trade and other payables | 131 | - | - | - | - | 131 |
| Outstanding claims liabilities | 2,234 | 544 | 224 | - | - | 3,002 |
| **Net principal liabilities** | 2,365 | 544 | 224 | - | - | 3,133 |

| 2014 | Up to a year $'000 | 1-2 years $'000 | 2-5 years $'000 | Over 5 years $'000 | No term $'000 | Total $'000 |
|---|---|---|---|---|---|---|
| Trade and other payables | 443 | - | - | - | - | 443 |
| Outstanding claims liabilities | 2,341 | 581 | 211 | - | - | 3,133 |
| **Net principal liabilities** | 2,784 | 581 | 211 | - | - | 3,576 |

The branch's financial assets and liabilities are carried in the statement of financial position at amounts that approximate fair value.

## 6 Financial risk management (continued)

**(d) Market risk**

Market risk is the risk that the fair value of its financial instruments or future cash flows will decrease due to changes in external economic variables such as interest rates, currency rates and equity prices.

The board is responsible for developing and monitoring the risk management policies of the branch in relation to market risk. The branch's investment activities follow the GECC FICS policy. The GECC FICS policy document outlines the level of acceptable market risk, including counterparty ratings and exposure levels that apply to the investment activities of branch's within the GECC Group. The Company will continue to adopt the GECC FICS policy until a new Investment Policy is approved by the Board in 2016

*(i) Currency risk*

Currency risk is the risk that the value of recognised assets and liabilities or the cash flows from possible future transactions, that are denominated in a currency, other than that of the functional currency, will decrease due to changes in market exchange rates.

The branch has no foreign currency exposure at balance date that is considered material.

*(ii) Interest rate risk*

Interest rate risk is the risk that the value of financial instruments will fluctuate as a result of changes in market interest rates.

The following table analyses the impact of a reasonable possible movement in market interest rates on the branch's operating results.

| 2015 | Carrying amount $'000 | Change in variables % | Impact on profit or loss $'000 | Impact on equity: Up to a year $'000 | 1-2 years $'000 | 2-5 years $'000 | Over 5 years $'000 | Total $'000 |
|---|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | | |
| Short term deposits | 39,126 | (1)% | (391) | (282) | - | - | - | (282) |
| | 39,126 | | (391) | (282) | - | - | - | (282) |

| 2014 | Carrying amount $'000 | Change in variables % | Impact on profit or loss $'000 | Impact on equity: Up to a year $'000 | 1-2 years $'000 | 2-5 years $'000 | Over 5 years $'000 | Total $'000 |
|---|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | | |
| Short term deposits | 38,084 | (1)% | (381) | (274) | - | - | - | (274) |
| | 38,084 | | (381) | (274) | - | - | - | (274) |

## 6 Financial risk management (continued)

### (d) Market risk (continued)

*(ii) Interest rate risk (continued)*

This analysis is performed on the same basis for 2014 and assumes that all other variables remain the same.

## 7 Capital management

Capital consists of retained earnings.

The branch's capital management strategy plays a central role in managing capital risk arising from the business activities of the branch, providing an appropriate level of capital to protect policyholders' interests and satisfy regulators. The strategy seeks to ensure sufficient capital levels are maintained in both stable and adverse market conditions.

The branch has adopted a target surplus policy to assist the board and management to manage its capital position. The target surplus level has been set with reference to a range of risks and possible adverse scenarios faced by the branch.

The branch has net assets in excess of the adopted target surplus requirement, reflecting its current strong capital position.

In addition to the branch's target surplus policy, external capital requirements are set and regulated by the Australian Prudential Regulation Authority (APRA). The branch calculates its capital position according to the relevant Prudential Standards which ensures sufficient capital is maintained to meet policyholder obligations. An insurer's capital base is expected to be adequate for the size, business mix, complexity and risk profile of its business.

It is the branch's policy to hold capital levels in excess of those required by APRA according to its target surplus policy, the capital level is regularly monitored to minimise the risk of a regulatory breach.

For detailed information on the branch's capital position and the capital requirements of APRA, refer note 7(b).

### (a) Risk management

**Insurance contracts**

An insurance contract is a contract under which the insurer accepts significant insurance risk from the policyholder by agreeing to compensate the policy holder for a specified uncertain future event non-specific to the policy holder that will adversely affect them. Insurance risk is other than financial risk.

The significance of insurance risk under any one contract is determined by the uncertainty surrounding the probability and timing of the insured event occurring, and the magnitude of its effect. Insurance risk is assessed by the branch at a contract level on its inception and is periodically reassessed as the risk may vary during the period of insurance cover.

The majority of direct insurance contracts written are entered into on a standard form basis. There are no special terms and conditions in any non-standard contracts that have a material impact on the financial statements.

The policies written consists mainly of consumer credit insurance.

## 7 Capital management (continued)

**Insurance risk management**

Insurance risk management is the assessment and quantification of the likelihood and financial impact of events that may require settlement by the insurer; and the ability of the branch to mitigate the financial impact of these events on its operating results.

In accordance with Prudential Standards CPS 220 Risk Management and GPS 230 Reinsurance Management for General Insurers issued by APRA, the board and senior management of the branch have developed, implemented and maintained a sound and prudent risk management strategy (RMS) and a reinsurance management strategy (ReMS).

The RMS and ReMS identify the branch's policies, procedures, processes and controls that address all known material risks, financial and non-financial, arising from the business. Annually, the board certifies to APRA that adequate strategies have been put in place to monitor those risks, that the branch has systems in place to ensure compliance with legislative and prudential requirements, and that the board has satisfied itself as to the compliance with the RMS and ReMS.

Specific key components of the RMS and ReMS are detailed further below.

*(i) Underwriting strategy*

The board has developed an underwriting strategy to ensure that the branch has the ability to meet the insurance needs of the policy holders and to ensure the ability to pay benefits and claims when due. The strategy involves the identification of risks by type, impact and likelihood and involves the application of mathematical modelling to determine that products are appropriately priced.

*(ii) Reinsurance strategy*

A conservative approach is taken in determining the level of risk appetite appropriate for the branch and where deemed appropriate will spread the risk associated with the insured events according to its ReMS. All reinsurance treaties are subject to analytical and statistical modelling to ensure that they offer a sufficient level of cover for the identified exposures whilst in alignment with the ReMS of the branch.

*(iii) Claims management*

Strict claims management procedures ensure the timely and accurate payment of claims in accordance with policy conditions. Claim outcomes are monitored to track the actual versus expected experience of the portfolio, with feedback delivered to underwriting and product development.

*(iv) Concentration of insurance risk*

The branch's portfolio of products and policy holders is sufficiently diversified such that there is no material concentration of insurance risk.

**(b) Capital adequacy**

The branch is required to hold prudential reserves, over and above the general insurance contract liabilities, as a buffer against adverse future experience and poor investment returns. Life and General Insurers are required to follow the relevant Prudential Standards as prescribed by APRA. The required level of capital for regulatory purposes (the prudential capital amount, or PCA) is intended to take account of the full range of risks to which a general insurer is exposed and a general company must ensure that the general company has, at all times, a capital base in excess of its PCA (plus any additional amount as required by APRA).

The excess of the branch's capital base over the PCA as at 31 December 2015 was $84.9 million (2014:$63.7 million).

## 7 Capital management (continued)

### (b) Capital adequacy (continued)

In addition to the regulatory capital requirements, the branch maintains a target surplus providing an additional capital buffer against adverse events.

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| (a) Capital base | 117,525 | 101,282 |
| (b) Prescribed capital amount | 32,585 | 37,603 |
| Capital in excess of prescribed capital amount = (a) - (b) | 84,940 | 63,679 |
| Capital adequacy multiple = (a)/(b) | 3.61 | 2.69 |

| | 2015 $'000 | 2014 $'000 |
|---|---|---|
| **Capital Base:** | | |
| Net Assets | 110,926 | 94,968 |
| Regulatory adjustment applied in the calculation of Tier 1 capital | 6,599 | 6,314 |
| Common Equity Tier 1 Capital | 117,525 | 101,282 |
| **Prescribed capital amount:** | | |
| Insurance Risk Charge | 9,643 | 11,533 |
| Insurance Concentration Risk Charge | 19,088 | 21,944 |
| Asset Risk Charge | 5,340 | 4,340 |
| Asset Concentration Risk Charge | - | - |
| Operational Risk Charge | 2,330 | 2,996 |
| Aggregation benefit | (3,816) | (3,210) |
| Prescribed capital amount | 32,585 | 37,603 |

**Excess technical provisions**

The liability required by GPS 110 for prudential reporting purposes differs from accounting purposes. As described in note 13(p) the branch applies risk margins to the central estimate of net outstanding claims to achieve a 90% confidence level. GPS 110 requires a prudential margin with a sufficiency of 75%.

# Unrecognised items

This section of the notes provides information about items that are not recognised in the financial statements as they do not (yet) satisfy the recognition criteria.

## 8 Commitments and contingencies

As at 31 December 2015, the branch had no contingencies ( 2014: nil).

## 9 Matters subsequent to the end of the financial year

No matter or circumstance has arisen since 31 December 2015 that has significantly affected or may significantly affect:

- the branch's operations; or
- the results of those operations; or
- the branch's state of affairs.

# Other information

This section of the notes includes other information that must be disclosed to comply with the accounting standards and other pronouncements, but that is not immediately related to individual line items in the financial statements.

## 10 Remuneration of auditors

No remuneration to auditors has been recognised; this expense was incurred by the head office of the branch.

## 11 Key management personnel disclosures

Any remuneration received by directors was received in their capacity as directors of Hallmark General Insurance Company Ltd.

## 12 Related party transactions

### (a) Transactions with related parties

The following transactions occurred with related parties:

| | 2015<br>$ | 2014<br>$ |
|---|---|---|
| *Management fees paid to/(received from):* | | |
| Hallmark General Insurance Company Ltd | **6,047,374** | 5,817,486 |
| *Advances from parent company* | | |
| Payments to Hallmark General Insurance Company Ltd | **-** | (5,963,500) |
| *Commission paid to:* | | |
| GE Finance and Insurance NZ | **2,210,361** | 3,189,973 |
| Latitude Financial Services Ltd - NZ | **238,820** | - |

## 12 Related party transactions (continued)

### (b) Outstanding balances with related parties

| | 2015<br>$ | 2014<br>$ |
|---|---|---|
| *Receivables/(payables)* | | |
| Hallmark General Insurance Company Ltd | **(1,331,143)** | (842,076) |
| GE Finance and Insurance NZ | **-** | 413,082 |
| Latitude Financial Services Ltd - NZ | **1,262,851** | - |

No provisions for doubtful debts have been raised in relation to any outstanding balances, and no expense has been recognised in respect of bad or doubtful debts due from related parties.

## 13 Summary of significant accounting policies

### General information

Hallmark General Insurance Company Ltd New Zealand Branch (the branch) was registered in New Zealand on the 5th April 2011, under the Companies Act 1993. These are the financial statements of the New Zealand branch of Hallmark General Insurance Company Ltd (the Company).

The parent entity of Hallmark General Insurance Company Ltd is Latitude Personal Finance Pty Ltd. The ultimate parent entity of Hallmark General Insurance Company Ltd is KVD Australia Holdco Pty Ltd.

The branch is a for-profit entity and is primarily involved in the underwriting of general insurance risks.

The financial statements were authorised for issue by the directors on 17 March 2016.

### (a) Basis of preparation

*Statement of compliance*

This general purpose financial report covers the branch as a single entity and has been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS).

This financial report complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). The branch is a reporting entity for the purpose of the Financial Reporting Act 1993 and its financial statements comply with that Act.

*Basis of measurement*

The financial statements have been prepared on a fair value basis with certain exceptions as described in the accounting policies below.

*Changes in accounting policies and disclosures*

There has been no change in accounting policies for the current financial year.

### (b) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. The branch recognises revenue from non-insurance activities when it is probable that the economic benefits will flow to the branch and the revenue amount can be reliably measured. The branch bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement. In addition, the following specific recognition criteria apply to revenue streams:

## 13 Summary of significant accounting policies (continued)

### (b) Revenue recognition (continued)

*(i) Premium revenue*

Premium revenue comprises amounts charged to policyholders (direct premium) for insurance contracts, excluding stamp duties and taxes collected on behalf of third parties.

Premium revenue is recognised in the profit or loss when it has been earned. It is recognised as earned from the date of attachment of risk (generally the date a contract is agreed to but may be earlier if persuasive evidence of an arrangement exists) over the period of the related insurance contracts in accordance with the pattern of the incidence of risk expected under the contracts. The pattern of the risks underwritten is generally matched by the passing of time but where time does not approximate the pattern of risk, previous claims experience is used to derive the incidence of risk.

Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought to account based on previous experience with due allowance for any changes in the pattern of new business and renewals.

The unearned portion of premium is recognised within unearned premium liabilities in the statement of financial position.

*(ii) Investment income*

All investment income is recognised as revenue on an accruals basis. Interest income is recognised on a time proportion basis using the simple interest method. Assets are designated at fair value through profit and loss and the related net realised and unrealised gains and losses are included in the profit or loss as investment revenue.

### (c) Claims expenses

The branch's claims liability is measured as the present value of expected future payments relating to claims incurred at the reporting date. The expected future payments include those estimates in relation to claims incurred but not enough reported (IBNER's) and claims incurred but not reported (IBNR's) based on past experience.

Claims incurred all relate to providing services, including the bearing of risk, and are accordingly treated as expenses in the profit or loss. Claims expenses represent total claim payments made during the year adjusted for the movement in the outstanding claims liability.

The claims liability is measured based on the advice of valuations performed by the appointed actuary whose key assumptions are outlined in note 5.

### (d) Other expenses

Other expenses are recognised in the profit or loss on an accruals basis.

### (e) Outwards reinsurance premium

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of outwards reinsurance premium is treated at the reporting date as deferred reinsurance expense. Reinsurance recoveries on claims incurred are recognised as revenue.

### (f) Deferred acquisition costs

Costs, which vary with and are primarily related to the production of new business, have been deferred to the extent that such costs are deemed recoverable from future profits. Such costs primarily include commissions. These costs are amortised in proportion to premiums over the estimated lives of the policies. A write down to recoverable amount is recognised where the present value of expected future claims (including settlement costs) in relation to business written to the end of the reporting period exceeds related unearned premiums less the deferred acquisition costs.

## 13 Summary of significant accounting policies (continued)

### (g) Income tax

The income tax expense for the period is the tax payable on the current period's taxable income based on the notional income tax rate.

*Taxation basis*

As the branch is a non-resident, for tax purposes, general insurer in New Zealand it is taxed at 10% of its New Zealand sourced gross premium income. Deductions for expenditure are not allowed. A non-resident withholding tax of 10% or approved issuer levy of 2% applies to any New Zealand sourced interest income on investments.

### (h) Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents include cash on hand, deposits held at call with financial institutions and other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash.

### (i) Loans and other receivables

All premium and other receivables are recognised at the amounts receivable as these amounts are generally due for settlement within 30 days and less, where applicable, any provision for doubtful debts. Collectability of premium and other receivables is reviewed on an ongoing basis. Debts which are known to be uncollectible are written off in the period in which they are identified.

### (j) Reinsurance and other recoveries receivable

Reinsurance and other recoveries receivable on paid claims, reported claims not yet paid and IBNR's are recognised as revenue. Recoveries receivable are assessed in a manner similar to the assessment of the liability for outstanding claims and policy liabilities.

### (k) Classification of insurance contracts

Contracts under which the branch accepts significant insurance risk from the policyholder or another party by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event adversely affects the policyholder or other beneficiary, are classified as insurance contracts. The risks associated with insurance contracts are detailed further in note 5.

### (l) Assets backing general insurance liabilities

Hallmark General Insurance Company Ltd has established a target capital surplus policy to ensure assets are available to meet insurance liabilities.

### (m) Financial assets

The branch has elected to designate all its financial assets backing insurance policies at fair value through profit and loss consistent with the provisions of NZ IAS 39 Financial Instruments; Recognition and Measurement.

Financial assets designated at fair value through profit or loss and are initially recognised at fair value, excluding transaction costs, which are expensed in the profit or loss in the period in which they arise. Financial assets are subsequently measured at fair value at each reporting date with realised and unrealised gains and losses arising from changes in the fair value recognised in the profit or loss in the period in which they arise.

*Classification*

*(i) Short term deposits*

Short term deposits are carried at the face value of the amounts deposited as their carrying amounts approximate to their fair value.

## 13 Summary of significant accounting policies (continued)

### (m) Financial assets (continued)

*(ii) Unlisted fixed interest securities*

Unlisted fixed interest securities are recorded at amounts based on valuations using rates of interest equivalent to the yields obtainable on comparable investments at the end of the reporting period.

All financial instruments are required to be further categorised under NZ IFRS 7 Financial Instruments; Disclosures, according to the availability of observable market inputs used in the measurement of their fair values, which is detailed further in note 2(g).

### (n) *Impairment of assets*

The carrying amount of the branch's assets which are in the scope of NZ IAS 36 Impairment of Assets are assessed annually for indicators of impairment. If any such indicator exists, then the asset's recoverable amount is estimated.

An impairment loss is recognised when the carrying amount of an asset exceeds its recoverable amount. Recoverable amount is the higher of an asset's fair value less costs of disposal. Impairment losses are recognised in the profit or loss, unless an asset has previously been re-valued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the profit or loss.

Where an impairment loss subsequently reverses, the carrying amount is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment been recognised for the asset in prior years. A reversal of an impairment is recognised immediately in the profit or loss.

### (o) Trade and other payables

Trade and other payables represent liabilities for goods and services provided to the branch prior to the end of the financial year, which are unpaid. The amounts are unsecured and are usually paid within 90 days of recognition.

### (p) Outstanding claims liability

The liability for outstanding claims covers the expected future payments in relation to claims reported but not yet paid, IBNR's, IBNER's and the anticipated direct and indirect costs of settling these claims.

The liability for outstanding claims is subject to yearly actuarial review. The general approach to the actuarial estimation of outstanding claims is to analyse all available past experience. Based on this, the expected future payments are determined and discounted to present value using a risk free rate.

The provision for the outstanding claims liability also contains a risk margin to reflect the inherent uncertainty in the central estimate. The risk margin increases the probability that the net liability is adequately provided for to a 90% (2014: 90%) confidence level.

### (q) Liability adequacy test

The adequacy of the insurance contract liabilities are evaluated each year. The insurance contract test considers current estimates of all contractual and related cash flows. If it is determined using best estimate assumptions that a shortfall exists, it is immediately recognised in the profit or loss. Refer to note 2(e)(v).

## 13 Summary of significant accounting policies (continued)

### (r) Unexpired risk liability

Provision is made for unexpired risks arising from general insurance business where the expected value of claims and expenses attributed to the unexpired periods of policies in force at the end of the reporting period exceeds the unearned premiums provision in relation to such policies after the deduction of any deferred acquisition costs. The provision for unexpired risk is calculated separately by reference to separate classes of business, which are managed together, after taking into account the relevant investment return.

Unexpired risk liability, if any, remaining after writing off deferred acquisition costs is recognised immediately in the profit or loss. Refer to note 2(e)(v).

### (s) Foreign currency translation and functional currency

*Functional and presentation currency*

Items included in the financial statements of the branch are measured using the currency of the primary economic environment in which the branch operates (the functional currency).

The financial statements are presented in New Zealand dollars, which is the functional and presentation currency for the branch.

*Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the profit or loss.

Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Translation differences on financial instruments carried at fair value are reported as part of the fair value gain or loss.

### (t) New accounting standards and interpretations

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2015, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the branch, except for:

- NZ IFRS 9 Financial Instruments, which becomes mandatory for the branch's 2018 financial statements and could change the classification and measurement of financial assets. The branch does not plan to adopt this standard early and the extent of the impact has not been determined.
- NZ IFRS 15 Revenue from contracts with customers, which becomes mandatory for the Company's 2018 financial statements, provides a new 5 step model for recognising revenue earned from a contract with a customer and will replace the existing NZ IAS 18 Revenue. The Company does not plan to adopt this standard early and the extent of the impact has not been determined.

### (u) Rounding of amounts

Amounts in the financial statements have been rounded off to the nearest thousand dollars, or in certain cases, the nearest dollar.

**Directors' Declaration**

In the opinion of the directors of Hallmark General Insurance Company Ltd New Zealand Branch ("the branch"):

(a) the financial statements and notes set out on pages 2 to 30 are in accordance with the *Financial Reporting Act 1993*, including:

   (i) giving a true and fair view of the branch's financial position as at 31 December 2015 and of its performance for the financial year ended on that date; and

(b) the financial statements also comply with International Financial Reporting Standards as disclosed in note 13; and

(c) there are reasonable grounds to believe that the branch will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of directors:

JoAnne Maree Stephenson (Chairman)
Director
Sydney
17 March 2016

Anna Elizabeth Gladman (Managing Director)
Director
Sydney
17 March 2016

KPMG

# Independent auditor's report

## To the Shareholders of Hallmark General Insurance Company Ltd New Zealand Branch

### Report on the financial statements

We have audited the accompanying financial statements of Hallmark General Insurance Company Ltd New Zealand Branch ("the Branch") on pages 2 to 30. The financial statements comprise the Statement of Financial Position as at 31 December 2015, the Statement of Profit or Loss and Other Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended, and a summary of significant accounting policies and other explanatory information, for the Branch.

This report is made solely to the Shareholders of the Branch as a body. Our audit work has been undertaken so that we might state to the Branch's Shareholders those matters we are required to state to them in the 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 Branch's Shareholders as a body, for our audit work, this report or any of the opinions we have formed.

*Directors' responsibility for the Branch financial statements*

The Directors are responsible on behalf of the Branch for the preparation of the Branch financial statements in accordance with generally accepted accounting practice in New Zealand and International Financial Reporting Standards that give a true and fair view of the matters to which they relate, and for such internal control as the Directors determine is necessary to enable the preparation of Branch financial statements that are free from material misstatement whether due to fraud or error.

*Auditor's responsibility*

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

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

KPMG

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

Other than in our capacity as auditor the firm has no other relationship with, or interest in, the Branch.

*Opinion*

In our opinion the financial statements on pages 2 to 30:

- comply with generally accepted accounting practice in New Zealand;
- comply with International Financial Reporting Standards;
- give a true and fair view of the financial position of the Branch as at 31 December 2015 and of the financial performance and cash flows of the Branch for the year then ended.

**Report on other legal and regulatory requirements**

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

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

KPMG

KPMG

Sydney
17 March 2016

EY
Building a better working world

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The Board of Directors
Hallmark General Insurance Company Ltd
Level 4, 99 Walker Street
North Sydney NSW 2060

29 March 2016

**Hallmark General Insurance Company Ltd:**
**Appointed Actuary signoff of financial statements and financial condition as at 31 December 2015 for New Zealand reporting purposes**

Dear Directors

Hallmark General Insurance Company Ltd ("HGIC") is an Australian authorised insurer regulated by the Australian Prudential Regulatory Authority ("APRA") and has a licence issued by the Reserve Bank New Zealand ("RBNZ").

On 19 September 2014, HGIC appointed me, Richard Yee of Ernst & Young to be HGIC's Appointed Actuary. The Appointed Actuary role is as described by the Insurance Act 1973, related Prudential Standards and Prudential Practice Guides current at 31 December 2015, and by the New Zealand Insurance (Prudential Supervision) Act 2010 (the Act). I have no relationship with HGIC other than being its Appointed Actuary.

It is the responsibility of the Appointed Actuary to provide advice to the Board of a general insurer on the value of its insurance liabilities and the preparation of the actuarial information contained in its financial statements. The Appointed Actuary must provide written advice to the Board of the insurer on the value of insurance liabilities in accordance with APRA's Prudential Standard GPS320, Actuarial and Related Matters.

As part of my responsibilities, I have produced a report on HGIC's insurance liabilities and financial condition, the Financial Condition Report (FCR), as at 31 December 2015, dated 9 March 2016. The scope of the FCR is to provide the Board and management with an objective assessment of the financial condition of the Australian and New Zealand business within HGIC as at 31 December 2015. The FCR identifies and assesses the material risks facing HGIC and includes discussion of relevant risk mitigants.

I have relied upon the general completeness and accuracy of this data and information supplied by HGIC without independent verification. However, I have reviewed the information for reasonableness and consistency with my knowledge of the financial services industry.

The RBNZ has exempted HGIC from compliance with their Solvency Standard for Non-life Insurance Business. This exemption has been granted subject to various conditions, including obligations of the Appointed Actuary. These obligations are addressed below. Where relevant and appropriate, I have commented on total HGIC Company level results and also separately in relation to the results of the New Zealand Branch of HGIC.

## Financial Statements – HGIC Company

Section 77 of the Act requires a review by the Appointed Actuary of the actuarial information in the financial statements of the company and in particular:

a. Unearned premium liability and liability adequacy test

b. Net outstanding claims liability

c. Reinsurance and any other recovery assets

d. Deferred acquisition cost or deferred fee revenue

e. Any other information deemed by the Appointed Actuary to warrant actuarial review for the purpose of profit or solvency reporting

Section 78 of the Act requires that the Appointed Actuary prepare a report in respect of the review required under Section 77. I confirm that this FCR and my ILVR meets the requirements of section 78 of The Act, and contains my advice regarding the net premium liabilities, liability adequacy test, net outstanding claims liabilities, reinsurance and any other recovery assets, and deferred acquisition costs.

I have previously reviewed the earning patterns adopted by HGIC and consider them to be appropriate. For the current ILVR I have also checked the unearned premium calculation performed by HGIC for certain product types and the calculations appear to be reasonable.

In my opinion and from an actuarial perspective:

a. The actuarial information contained in the HGIC financial statements has been appropriately included in those statements; and

b. The actuarial information has been used appropriately in the preparation of the HGIC financial statements.

I have obtained all information and explanations that I have required. I am not aware of any other information that warrants actuarial review for the purpose of profit or solvency reporting.

## Financial Condition Report

The Appointed Actuary must prepare a Financial Condition Report which must:

a. Identify and describe the material risks (of which it is reasonable to expect the appointed actuary to be aware) facing a licensed insurer that, in the appointed actuary's opinion, pose a threat to the licensed insurer's ability to meet its solvency requirements now and in the future, and where practicable quantify such risks

b. Comment on the steps taken or proposed by the licensed insurer to address the risks identified in (a)

c. Comment separately on the New Zealand business, these comments can be in line with Australian requirements for financial condition reports

d. Advise the licensed insurer on whether in the Appointed Actuary's opinion, the licensed insurer needs to consider reporting to the RBNZ under Section 24 of The Act, taking into account the licensed insurer's forward-looking assessment of the solvency standard and the appointed actuary's assessment of the licensed insurer's business plans, its enterprise risk management practices and the external environment.

The Appointed Actuary in the financial condition report must comment on:

a. The solvency position of the insurer if a catastrophe or extreme event, such as outlined in the Catastrophe Risk Capital Charge section of the Non-Life Standard, were to occur in New Zealand.

b. Any difference in the financial condition of the New Zealand Branch in comparison with the insurer as a whole, which might have implications if the two were separated as a result of regulatory action or litigation.

The FCR identifies and assesses the material risks facing HGIC and includes mitigating factors addressing those risks and therefore meets the requirements of Section 56(d) of the Act. The capital within HGIC is equally accessible by both the Australian and New Zealand operations.

HGIC is in a very strong financial position as at 31 December 2015, with available capital exceeding the target surplus. Capital requirements are expected to be met over the year and also in subsequent years, and hence no reporting under Section 24 of the Act is required. In my opinion HGIC is maintaining a solvency margin consistent with the requirements under section 21(2) (b) of the Act. HGIC is not a life insurer. As such no opinion under Section 78(h) of the Act is required.

This strong position means that HGIC would be able to withstand a catastrophe or extreme event similar to the Catastrophe Risk Capital Charge.

The Australian and New Zealand operations of HGIC are managed in conjunction and I am not aware of any differences in the financial condition of the New Zealand Branch in comparison with the insurer as a whole which might have implications if the two were separated.

Yours sincerely,

Richard Yee, FIAA, FNZSA
Appointed Actuary, Hallmark General Insurance Company Ltd