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Munich Reinsurance Company of Australasia Limited - New Zealand Branch

Annual Financial Report
31 December 2018

Munich Reinsurance Company of Australasia Limited – New Zealand Branch

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Munich Reinsurance Company of Australasia Limited – New Zealand Branch

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2018

Munich Reinsurance Company of Australasia Limited (MRA) is an Australian company which operates in New Zealand through a branch. MRA is authorised by the Australian Prudential Regulation Authority to conduct life insurance business in Australia. The Company is also authorised by the Reserve Bank of New Zealand to conduct life reinsurance business in New Zealand. The Branch is a reporting entity in terms of the Financial Markets Conduct Act 2013 and the financial statements have been prepared in accordance with the requirements of that Act and the Financial Reporting Act 2013.

The Directors present their report together with the financial report of Munich Reinsurance Company of Australasia Limited – New Zealand Branch (the "Branch") for the year ended 31 December 2018 and the auditor's report thereon.

Directors

The names and details of the Branch's Directors in office at any time during or since the end of the year are as follows:

Director	Date of appointment / resignation	Special responsibilities
E G Tollifson	27 October 2006/	Chairman (resigned 30 September 2018)
	30 September 2018	Member of Audit Committee (resigned 30 September 2018)
		Member of Risk & Compliance Committee (resigned 30 September 2018)
B Edwards	16 May 2012	Chairman of Audit Committee
		Chairman of Risk & Compliance Committee
J B Shewan	1 January 2012	Chairman (appointed 1 October 2018)
		Member of Audit Committee
		Member of Risk & Compliance Committee
J Boddington	1 October 2018	Member of Audit Committee
		Member of Risk & Compliance Committee
A Linfoot	10 June 2016	Member of Risk & Compliance Committee (resigned 28 February 2019)
D Cossette	11 May 2016	

Quite a few changes occurred during the year, as shown in the table above. As at the date of this report, the Branch has an Audit Committee and a Risk & Compliance Committee. The members of these committees are listed above.

In accordance with the prudential standard CPS 510 Governance, the Branch is required to have a Remuneration Committee. With the approval of APRA, the Branch relies on the Remuneration Committee established by Munich Holdings of Australasia Pty Ltd (the "Parent") to discharge its obligations under CPS 510.

The Branch has outsourced certain functions to a related entity, Munichre New Zealand Service Limited (NZS). NZS is incorporated in New Zealand and provides administrative services to the Group including MRA's New Zealand branch (NZL). NZS is a 100% owned subsidiary of Munich Holdings of Australasia Pty Limited (MHA).

Insurance of officers

During the financial year, the Parent paid a premium of $48,333 (2017: $44,471) to insure the Directors and Officers of the Branch and some of its Australasian based related entities.

The liabilities insured include costs and expenses incurred in defending any civil or criminal proceedings that may be brought against Directors and Officers of the Branch.

Directors' benefits

Since the end of the period covered by the last report no Director of the Branch has received or become entitled to receive a benefit by reason of a contract made by the Branch or a related entity with the Director or with a firm of which the Director is a member, or with a company in which the Director has a substantial financial interest.

Principal activities

The Branch's principal activity is life reinsurance.

Review of operations

The result for the year was a loss after tax of $7,054,000 compared with a profit after tax of $6,510,000 in 2017.

The Branch is rated AA- by Standard & Poor's.

The Branch continues to monitor its exposure to financial and non-financial risks and apply policies and procedures to mitigate these where possible. Details are set out in section 4.

Capital transactions

There was a transfer of $10,563,000 to the New Zealand statutory fund from the Australian statutory fund (2017: $10,770,059). See note 6.5 for further details in relation to capital management subsequent to 31 December 2018.

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2018 *(continued)*

Likely developments

In the opinion of the Directors it would prejudice the interests of the Branch to comment on any likely developments in the operations of the Branch and the effect these developments would have on the results of the Branch in subsequent financial years.

Significant changes in the state of affairs

No significant events occurred during the year, which have changed the Branch's state of affairs.

Environmental regulations

The operations of the Branch are not subject to any particular or significant environmental regulations under Australian and New Zealand law.

Matters subsequent to the end of the financial year

Other than matters noted in note 6.5, the Directors are not aware, at the date of this report, of any matter or circumstance which has arisen since 31 December 2018 that has significantly affected or may significantly affect:

(i) the operations of the Branch;

(ii) the results of those operations; or

(iii) the state of affairs of the Branch in the financial years subsequent to 31 December 2018.

Signed in Sydney on 26 March 2019 in accordance with a resolution of the Directors.

J B Shewan
Director

A Linfoot
Director

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2018

CONTINUING OPERATIONS	Note	2018 $'000	2017 $'000
Reinsurance premium revenue	2.1	**50,352**	48,265
Retrocession premium expense	2.2	**(20,716)**	(19,552)
Net life reinsurance premiums		**29,636**	28,713
Net life reinsurance commissions	2.2	**(1,174)**	(1,914)
Reinsurance claims expense	2.2	**(45,025)**	(35,967)
Retrocession claims recoveries	2.1	**16,204**	13,595
Net life reinsurance claims		**(28,821)**	(22,372)
Movement in reinsurance policy liabilities	2.2	**(21,896)**	(3,898)
Movement in retrocession policy liabilities	2.2	**10,332**	1,808
Net movement in reinsurance policy liabilities		**(11,564)**	(2,090)
Underwriting profit/(loss)		**(11,923)**	2,337
Other revenue	2.1	**-**	-
Other expenses from operating activities	2.2	**(1,738)**	(1,495)
Investment gains and (losses)	2.3	**6,973**	8,087
Investment management expense	2.3	**(162)**	(152)
Profit/(Loss) before tax		**(6,850)**	8,777
Income tax expense	2.4	**(204)**	(2,267)
Profit/(Loss) after tax		**(7,054)**	6,510
Total comprehensive profit/(loss) for the year		**(7,054)**	6,510

The Statement of Comprehensive Income is to be read in conjunction with the notes to the financial statements set out on pages 7 to 25.

Munich Reinsurance Company of Australasia Limited – New Zealand Branch

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2018

	Note	Dec 31 2018 $'000	Dec 31 2017 $'000
Current assets			
Cash and cash equivalents	3.1	**14,957**	3,785
Reinsurance and other assets	3.3	**11,956**	11,143
Retrocessionaires' share of life reinsurance contract liabilities	5.2	**756**	(612)
Total current assets		**27,669**	14,316
Non-current assets			
Investment in financial assets	3.2	**184,219**	173,992
Retrocessionaires' share of life reinsurance contract liabilities	5.2	**47,993**	39,029
Deferred tax assets	2.4	**7,139**	6,558
Total non-current assets		**239,351**	219,579
Total assets		**267,020**	233,895
Current liabilities			
Income tax payable	2.4	**4,779**	3,994
Reinsurance and other liabilities	3.4	**21,350**	25,078
Provisions	3.5	**15,965**	14,458
Reinsurance contract liabilities	5.2	**3,672**	668
Total current liabilities		**45,766**	44,198
Non-current liabilities			
Reinsurance and other liabilities	3.4	**46,741**	37,585
Reinsurance contract liabilities	5.2	**120,088**	101,196
Total non-current liabilities		**166,829**	138,781
Total liabilities		**212,595**	182,979
Net assets		**54,425**	50,916
Shareholder's interests			
Retained earnings	4.3	**(84)**	6,970
Head office account	4.3	**54,509**	43,946
Total shareholder's interest		**54,425**	50,916

The Statement of Financial Position is to be read in conjunction with the notes to the financial statements set out on pages 7 to 25.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2018

2018	Note	Head office account $'000	Retained earnings $'000	Total $'000
Balance at 1 January		43,946	6,970	50,916
TOTAL COMPREHENSIVE INCOME				
Profit/(Loss) for the year	4.3	-	(7,054)	(7,054)
Total comprehensive income for the year		-	(7,054)	(7,054)
TRANSACTIONS WITH OWNERS OF THE COMPANY				
Transfer of capital		10,563	-	10,563
Total transactions with owners of the company		10,563	-	10,563
Balance at 31 December		54,509	(84)	54,425

2017	Note	Head office account $'000	Retained earnings $'000	Total $'000
Balance at 1 January		33,176	460	33,636
TOTAL COMPREHENSIVE INCOME				
Profit/(Loss) for the year	4.3	-	6,510	6,510
Total comprehensive income for the year		-	6,510	6,510
TRANSACTIONS WITH OWNERS OF THE COMPANY				
Transfer of capital		10,770	-	10,770
Total transactions with owners of the company		10,770	-	10,770
Balance at 31 December		43,946	6,970	50,916

The Statement of Changes in Equity is to be read in conjunction with the notes to the financial statements set out on pages 7 to 25.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2018

	Note	2018 $'000	2017 $'000
Cash flows from operating activities			
Treaty reinsurance		**13,400**	9,095
Retrocession received/(paid)		**(10,576)**	(3,735)
Income tax transferred/(paid)		**3**	(5,073)
Management and administrative expenses		**(2,642)**	(1,945)
Net cash from operating activities	3.1	**185**	(1,658)
Cash flows from investing activities			
Interest received		**10,812**	12,051
Payments for investments		**(54,122)**	(36,431)
Proceeds from sale of investments		**43,896**	16,211
Investment expenses		**(162)**	(152)
Net cash from investing activities		**424**	(8,321)
Cash flows from financing activities			
Transfer from the shareholder's fund		**10,563**	10,770
Net cash from financing activities		**10,563**	10,770
Net increase in cash and cash equivalents		**11,172**	791
Cash and cash equivalents at the beginning of the financial year		**3,785**	2,994
Cash and cash equivalents at the end of the financial year	3.1	**14,957**	3,785

The Statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 7 to 25.

Section 1. Basis of Preparation

1.1. Reporting entity

The Branch is the New Zealand branch of Munich Reinsurance Company of Australasia Limited (MRA) which is domiciled and incorporated in Australia, and is registered in New Zealand to carry on business as a foreign company. MRA is a subsidiary and its results are included in the group financial statements of Munich Holdings of Australasia Pty Ltd (the "Parent"). The ultimate parent undertaking of the group is Münchener Rückversicherungs-Gesellschaft ("MR-AG").

1.2. Basis of presentation

(a) Statement of compliance

This financial report is a general purpose financial report which has been prepared in accordance with the New Zealand Accounting Standards adopted by the Accounting Standards Review Board ("ASRB") and the Companies Act 1993. International Financial Reporting Standards ("IFRS") form the basis of New Zealand Accounting Standards adopted by the ASRB, being New Zealand equivalents to IFRS ("NZ IFRS"). The financial report of the Branch also complies with IFRS and interpretations adopted by the International Accounting Standards Board. The Branch is a reporting entity in terms of the Financial Markets Conduct Act 2013 and the financial statements have been prepared in accordance with the requirements of that Act and the Financial Reporting Act 2013 and Insurance (Prudential Supervision) Act 2010.

The life reinsurance operations of the Branch are conducted within a separate statutory fund as required by the Australian Life Insurance Act (1995). The life insurance operations of the Branch comprise the reinsurance of life insurance contracts.

The financial report was authorised for issue by the Directors on 26 March 2019.

(b) Basis of measurement

The financial report is prepared on a historical cost basis except for the following items, which are measured on an alternative basis at each reporting date. All financial assets are recognised at fair value to the extent permitted under the accounting standards.

Items	Note	Measurement basis
Financial instruments	4.1	Fair Value
Life reinsurance contract liabilities	5.1	Best estimate

(c) Functional and presentation currency

The financial report is presented in New Zealand Dollars, which is the Branch's functional and presentation currency.

(d) Rounding

Amounts in the financial report have been rounded off to the nearest thousand dollars.

1.3. Use of judgements and estimates

In preparing this financial report, management has made judgements, estimates and assumptions that affect the application of the Branch's accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively.

(a) Areas of significance

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in the following notes:

- Life reinsurance contract liabilities – Note 5.1
- Premium, claims and experience refund provisions – Note 2.1 & Note 2.2, Note 3.3 & Note 3.4

(b) Measurement of fair value

A number of the Branch's accounting policies and disclosures require the measurement of fair values, for both financial and non-financial assets and liabilities.

When measuring the fair value of an asset or liability, the Branch uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows:

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

Level 2: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3: Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs).

Where the determination of fair value for an instrument involves inputs from more than one category, the level within which the instrument is categorised in its entirety is determined on the basis of the lowest level input.

The Branch's policy is to recognise transfers into and transfers out of fair value hierarchy levels as at the end of the reporting period. Details of the Branch's exposure to various risks arising and the risk management policies and procedures in place to manage these are set out in note 4.2.

Section 2. Financial performance

2.1. Revenue

Life reinsurance revenue	2018 $'000	2017 $'000
Reinsurance premium revenue	**50,352**	48,265
Retrocession claims recoveries	**16,204**	13,595
Total life reinsurance premium and related revenue	**66,556**	61,860
Total revenue	**66,556**	61,860

Summary of significant accounting policies

Reinsurance premium revenue and recognition
Reinsurance premiums comprise amounts charged to insurers for business ceded under various insurance treaties.

Premium excludes stamp duties and taxes collected on behalf of third parties, including Goods and Services Tax ("GST").

Reinsurance premiums are recognised as revenue when due. The methodology used in the calculation of premium accruals takes into account the annual premium in force at the date of last premium receipt for each in force treaty and the number of premium installments outstanding for that treaty.

Premiums 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.

Retrocession claim recoveries
Retrocession claims recoveries received or receivable on paid claims and on outstanding claims are recognised as revenue.

Retrocession claims recoveries excludes stamp duties and taxes collected on behalf of third parties, including GST.

2.2. Expenses

Life reinsurance expenses	2018 $'000	2017 $'000
Life reinsurance commission - acquisition costs	**(96)**	6
Life reinsurance commission - maintenance costs	**1,270**	1,908
Net life reinsurance commission	**1,174**	1,914
Reinsurance claims expense	**45,025**	35,967
Retrocession premium expense	**20,716**	19,552
Total life reinsurance claims and related expenses	**65,741**	55,519
Movement in reinsurance policy liabilities	**21,896**	3,898
Movement in retrocession policy liabilities	**(10,332)**	(1,808)
Net movement in reinsurance policy liabilities	**11,564**	2,090
Other policy acquisition costs	**330**	284
Other policy maintenance costs	**1,408**	1,211
Other expenses from operating activities	**1,738**	1,495
Total expenses	**80,217**	61,018

Summary of significant accounting policies

Reinsurance claims expense
Claims expense represents claims payments adjusted for the movement in the outstanding claims liability. The expense takes into account all claims reported up to balance date, including outstanding bordereaux for each treaty.

Allowance for Incurred But Not Reported (IBNR) claims is incorporated into the calculation of the life reinsurance policy liability.

Retrocession premium expense
Premium ceded to retrocessionaires is recognised as an expense when due. Retrocession premium excludes stamp duties and taxes collected on behalf of third parties, including GST and Withholding tax.

Expense apportionment
Expenses are incurred in relation to the acquisition and maintenance of life reinsurance contracts and administrative activities. Acquisition costs are the fixed and variable cost of acquiring new business, including life reinsurance commissions, underwriting costs and other sundry costs. All other expenses are considered to be maintenance costs incurred to administer existing life reinsurance contracts.

Apportionments under Part 6 Division 2 of the Life Insurance Act (1995) have been made as follows:

i. Direct expenses, e.g. life reinsurance commissions are allocated to the products to which they relate.

ii. Indirect expenses are allocated on the basis of net revenue received taking into account that the expenses per product line are not of equal weighting.

2.3. Investment return

Investment gains and (losses)	2018 $'000	2017 $'000
Interest	**7,198**	7,312
Realised and Unrealised gains and (losses)	**2,555**	3,515
Foreign exchange gains and (losses)	**(7)**	(5)
Interest payable on deposit retained from related retrocessionaire	**(2,773)**	(2,735)
Total investment gains and (losses)	**6,973**	8,087
Investment management expense	**(162)**	(152)
Total Investment management expense	**(162)**	(152)

Summary of significant accounting policies

Investment gains and losses
Realised and unrealised gains and losses arising from changes in the fair value of financial assets are recognised in the Statement of Comprehensive income, to the extent permitted under New Zealand Accounting Standards.

Investment management expense
Investment management expense represents the costs involved in the ongoing management of the investment portfolio.

2.4. Income taxes

(a) Amounts recognised in profit or loss

	2018 $'000	2017 $'000
Current tax expense		
Current year	785	3,554
Adjustment for prior years	-	(939)
Current tax expense	785	2,615
Deferred tax expense		
Origination and reversal of temporary differences	(581)	(348)
Change in recognised deductible temporary differences	-	-
Deferred tax expense	(581)	(348)
Income tax expense	204	2,267

(b) Reconciliation of effective tax rate

	2018 %	2018 $'000	2017 %	2017 $'000
Profit before tax from continuing operations		(6,850)		8,777
Tax using the Branch's domestic tax rate	28	(1,918)	28	2,457
Non-deductible expenses		2,236		749
Tax-exempt income		(114)		-
Change in estimates related to prior years		-		(939)
Income tax expense	0.0	204	25.8	2,267

(c) Movement in deferred tax balances

2018	Net balance at 1 January	Movement	Net balance at 31 December
Accrued expenses	595	301	896
Components of life reinsurance contract liabilities	5,963	280	6,243
Net deferred tax asset	6,558	581	7,139

2017	Net balance at 1 January	Movement	Net balance at 31 December
Accrued expenses	232	363	595
Components of life reinsurance contract liabilities	5,979	(16)	5,963
Net deferred tax asset	6,211	347	6,558

(d) Income tax (payable)/receivable

	2018 $'000	2017 $'000
Opening balance at 1 January	(3,994)	(453)
Additional provisions recognised – current year	(785)	(3,554)
Under provisioned in prior years	-	13
Utilisation of tax losses/transfer of tax losses	-	-
Closing balance at 31 December	(4,779)	(3,994)

Summary of significant accounting policies

Income tax

The income tax expense for the period is the tax payable on the current period's taxable income based on the national income tax rate for each jurisdiction, adjusted by prior year adjustments and changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction.

The relevant tax rates are applied to the cumulative amounts of deductible and assessable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

Section 3. Financial position

3.1. Cash and cash equivalents

(a) Cash and cash equivalents balances

	2018 $'000	2017 $'000
Cash at bank	**14,957**	3,785
Total cash and cash equivalents	**14,957**	3,785

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

	2018 $'000	2017 $'000
Profit/(loss) from operating activities after income tax	**(7,054)**	6,510
Movements in:		
Reinsurance and other assets	**(815)**	(1,079)
Reinsurance and other liabilities	**5,429**	5,394
Provisions	**1,507**	(5,868)
Income tax	**785**	3,540
Adjustments for:		
Deferred tax	**(581)**	(347)
Net movement in reinsurance policy liabilities	**11,564**	2,090
Loss/(gain) on revaluation of investments	**(3,588)**	(4,595)
Retrocession portion of loss/(gain) on revaluation of investments		
Investment revenue	**(7,224)**	(7,455)
Investment expense	**162**	152
Net cash flows from operating activities	**185**	(1,658)

Summary of significant accounting policies

There are no cash balances held that are not available for use in normal operations.

3.2. Investment in financial assets

	2018 $'000	2017 $'000
Debt securities at fair value	**184,219**	173,992
Total investment in financial assets	**184,219**	173,992
Current	**-**	-
Non-current	**184,219**	173,992
Total	**184,219**	173,992

Financial assets held in the life statutory funds can only be used within the restrictions imposed under the Life Insurance Act (1995). The main restrictions are that the assets in a fund can only be used to meet liabilities and expenses of that fund, to acquire financial assets to further the business of the fund, or as distributions to the shareholder when capital adequacy requirements are met.

Summary of significant accounting policies

The Branch has elected to designate all of its financial assets at fair value through profit or loss. The Branch is an Appendix C Life Insurer as prescribed by NZ IFRS 4 'Insurance Contract', therefore, the application of temporary exemption from NZ IFRS 9 'Financial Instruments' is not permitted. The adoption of NZ IFRS 9 'Financial Instruments' effective from 1 January 2018 has no material impact on the Branch's financial statements.

Information about the Branch's exposure to credit and market risks, and fair value measurement, is included in section 4.

3.3. Reinsurance and other assets

	2018 $'000	2017 $'000
Amounts due from ceding companies	**2,679**	4,080
Recoveries due from non-related retrocessionaires	**424**	-
Recoveries due from retrocessionaires	**1,834**	328
Outstanding claims recoveries from retrocessionaires	**5,642**	5,371
Sundry debtors and prepayments	**-**	-
Accrued income	**1,377**	1,364
Total reinsurance and other assets	**11,956**	11,143
Current	**11,956**	11,143
Non-current	**-**	-
Total reinsurance and other assets	**11,956**	11,143

Summary of significant accounting policies

Receivables are initially recognised and subsequently measured at book value less provision for doubtful debts, which is the best estimate of fair value. The collectability of receivables is reviewed on an ongoing basis. Debts that are known to be uncollectible are written off. A provision for doubtful receivables is established when there is objective evidence that the Branch will not be able to collect all amounts that are due in accordance with the original terms of the receivable. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated cash flows, discounted at the effective interest rate.

There are no bad debt provisions as at year-ended 31 December 2018 (2017: nil).

3.4. Reinsurance and other liabilities

	2018 $'000	2017 $'000
Amount due to ceding companies	**13,324**	9,773
Amount due to retrocessionaires	**-**	9,816
Sundry and other payables	**82**	233
Amounts due on deposit retained from related retrocessionaires	**54,685**	42,841
Total reinsurance and other liabilities	**68,091**	62,663
Current	**21,350**	25,078
Non-current	**46,741**	37,585
Total reinsurance and other liabilities	**68,091**	62,663

Summary of significant accounting policies

The above amounts are carried at book value, which approximates fair value, and represent liabilities for goods and services provided to the Branch prior to the end of the financial year that were unpaid. The amounts are unsecured.

Sundry and other payables includes any amount due to related entities for transfer of tax losses within the tax group.

Amounts due on deposit retained from related retrocessionaires includes deposit retained from related retrocessionaire and an accrual of related retrocessionaire's share of unrealised gains on investments.

3.5. Provisions

2018	Balance at 1 January	Provisions made during the year	Liabilities paid	Balance at 31 December
Outstanding claims	**13,898**	**43,024**	**(41,520)**	**15,402**
Non-resident Withholding tax	**560**	**563**	**(560)**	**563**
Total provisions	**14,458**	**43,587**	**(42,080)**	**15,965**
2017				
Outstanding claims	19,845	34,580	(40,527)	13,898
Non-resident Withholding tax	481	560	(481)	560
Total provisions	20,326	35,140	(41,008)	14,458

Summary of significant accounting policies

Outstanding claims include Claims provisions for claims reported but not yet paid. Allowance for incurred but not reported claims is included in the life reinsurance contract liabilities.

Non-resident withholding tax represents a provision for the withholding tax payable on the interest due to Retrocessionaires on the deposit retained balance. All amounts shown above are current and payable within 12 months of balance date (2017: all current).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

FOR THE YEAR ENDED 31 DECEMBER 2018

Section 4. Financial instruments, Risk & Capital Management

4.1. Financial instruments

(a) Accounting classifications and fair values

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

31 December 2018	Carrying amount $'000				Fair Value $'000			
	Loans and receivables	Designated at fair value	Other financial liabilities	Total	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value								
Debt Securities	-	184,219	-	184,219	-	184,219	-	184,219
	-	184,219	-	184,219	-	184,219	-	184,219
Financial assets not measured at fair value								
Cash and cash equivalents	14,957	-	-	14,957				
Reinsurance and other assets	11,956	-	-	11,956				
	26,913	-	-	26,913	-	-	-	-
Financial liabilities not measured at fair value								
Reinsurance and other liabilities	-	-	68,091	68,091				
	-	-	68,091	68,091	-	-	-	-

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

FOR THE YEAR ENDED 31 DECEMBER 2018

4.1. Financial instruments (continued)

31 December 2017	Carrying amount $'000				Fair Value $'000			
	Loans and receivables	Designated at fair value	Other financial liabilities	Total	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value								
Debt Securities	-	173,992	-	173,992	-	173,992	-	173,992
	-	173,992	-	173,992	-	173,992	-	173,992
Financial assets not measured at fair value								
Cash and cash equivalents	3,785	-	-	3,785				
Reinsurance and other assets	11,143	-	-	11,143				
	14,928	-	-	14,928	-	-	-	-
Financial liabilities not measured at fair value								
Reinsurance and other liabilities	-	-	62,663	62,663				
	-	-	62,663	62,663	-	-	-	-

Life reinsurance contract assets and liabilities are considered in section 5.

Fair values are categorised into different levels in a fair value hierarchy, details of which are set out in note 1.3.

4.1. Financial instruments (continued)

(a) Measurement of fair values

i. Valuation techniques and significant unobservable inputs

The Branch has no assets with significant unobservable inputs.

ii. Transfers between levels 1, 2 and 3

There were no transfers between levels 1, 2 and 3 for recurring fair value measurements during 2018 (2017: none).

Summary of significant accounting policies

Financial assets at fair value
The Branch has determined that all assets held within its statutory fund are assets backing life reinsurance contract liabilities.

Financial assets backing life reinsurance contract liabilities are classified as fair value through profit or loss. Initial recognition and subsequent measurement is at fair value. Unrealised profits and losses on subsequent measurement to fair value are recognised as profit or loss.

Fair value by asset category is measured as follows:

- Cash assets are carried at face value of the amounts deposited. The carrying amounts of cash assets approximate their fair value. For the purposes of the statement of cash flows, cash includes cash on hand, deposits held at call with banks and investments in money market instruments, such as bills of exchange.
- Shares, fixed interest securities and units listed on stock exchanges are carried at the bid price of the instrument.
- Receivables are carried at book value, which is the best estimate of fair value, as they are settled within a short period.

Fair value excludes transaction costs for listed securities. Interest income is brought to account as it is earned. Dividend income is brought to account when it becomes receivable.

Purchases and sales of financial assets are recognised on trade date, being the date on which the Branch commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Branch has transferred substantially all the risks and rewards of ownership.

4.2. Risk management policies and procedures

The financial condition and operating results of the Branch are affected by a number of key financial and non-financial risks. Financial risks include credit risk, market risk and liquidity risk. The non-financial risks are insurance risk, compliance risk and operational risk. Risk management is the process of identifying, monitoring, controlling and reporting risks that could have a material impact on the operations and results of the Branch. The Branch's disclosed objectives and policies in respect of managing these risks are set out in the remainder of this note.

(a) Risk management framework

The Branch's risk management strategy involves the identification of risks by type, impact and likelihood of occurrence, the implementation of processes and controls to mitigate those risks and continuous monitoring and improvement of the procedures.

In an effort to protect and enhance shareholder value, the Branch actively manages its exposure to risks so that it can react in a timely manner to changes in insurance market conditions, economic and political environments and financial markets. Risk exposures are managed using various analysis and valuation techniques, pricing business to meet profitability targets, applying underwriting controls to new business, managing claims in line with assumptions and monitoring emerging results to detect and correct adverse variances.

The Branch reports financial and operational results quarterly and undertakes regular experience analyses to monitor emerging trends.

(b) Financial risks

i. Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation.

The following policies and procedures are in place to mitigate the Branch's exposure to credit risks and concentration:

- An Investment Mandate is in place which restricts the purchase of an investment by the Branch to those securities with a minimum Standard & Poor's rating of A-. If the rating of a security within the portfolio falls below A- it must be sold. In some instances approved by the Board of Directors the security will be maintained within the portfolio and its performance closely monitored.

4.2. Risk management policies and procedures (continued)

(b) Financial risks (continued)

i. Credit risk (continued)

- The Mandate also limits investments held by the Branch to New Zealand dollar fixed interest investments in New Zealand government bonds, bonds issued by the Local Government Funding Agency, treasury bills or bank bills. In addition the Mandate allows cash investments in New Zealand dollar term deposits.
- The credit risk in respect of client balances: premium paid by cedants are paid net of rebate so that no rebate liability exists until a premium is paid. Additionally claim payments may be deferred where there are outstanding client balances.

The carrying amounts of financial assets represent the maximum credit exposure. The table below provides information regarding the maximum exposure to credit risk for the components of the Branch's balance sheet.

	2018 $'000	2017 $'000
Cash and cash equivalents	**14,957**	3,785
Investment in financial assets	**184,219**	173,992
Reinsurance and other assets	**11,956**	11,143
Retrocessionaires' share of life reinsurance contract liabilities	**48,749**	38,417
Total	**259,881**	227,337
Grade 1-3 (Standard & Poor's A- to AAA)	**259,805**	227,271
Grade 4-5 (Unrated or Standard & Poor's BB+ to BBB+)	**76**	66
Total	**259,881**	227,337

No financial assets are either past due or impaired. Other than to the New Zealand government, the Branch has no significant concentration of credit risk.

ii. Liquidity risk

Liquidity risk is the risk of there being insufficient cash resources to meet payment obligations without affecting the daily operations or the financial condition of the Branch.

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

- Whilst it can arise during reporting periods that current liabilities exceed current assets, the Branch has a policy of maintaining a sufficient portfolio of liquid financial assets that are readily converted to cash to meet the needs of the business, without incurring unacceptable losses or risking damage to the Branch's reputation.
- The Branch aims to maintain financial assets with similar duration as the underlying reinsurance liabilities of the business in order to ensure sufficient funding is available to meet reinsurance contract obligations.

The table below summarises the maturity profile of the financial liabilities of the Branch based on remaining undiscounted contractual obligations.

2018	Up to 1 year $'000	1-5 years $'000	Over 5 years $'000	Total $'000
Amount due to ceding companies	13,324	-	-	13,324
Amount due to retrocessionaires	-	-	-	-
Sundry and other payables	82	-	-	82
Amounts due on deposit retained from related retrocessionaires	7,944	8,128	38,613	54,685
Reinsurance and other liabilities	21,350	8,128	38,613	68,091
Outstanding claims	15,402	-	-	15,402
Non-resident withholding tax	563	-	-	563
Provisions	15,965	-	-	15,965
Life reinsurance contract liabilities	3,672	25,999	94,089	123,760
Income tax payable	4,779	-	-	4,779
Total liabilities	45,766	34,127	132,702	212,595

4.2. Risk management policies and procedures (continued)

(b) Financial risks (continued)

ii. Liquidity risk (continued)

2017	Up to 1 year $'000	1-5 years $'000	Over 5 years $'000	Total $'000
Amount due to ceding companies	9,773	-	-	9,773
Amount due to retrocessionaires	9,816	-	-	9,816
Sundry and other payables	233	-	-	233
Amounts due on deposit retained from related retrocessionaires	5,256	7,767	29,818	42,841
Reinsurance and other liabilities	25,078	7,767	29,818	62,663
Outstanding claims	13,898	-	-	13,898
Non-resident withholding tax	560	-	-	560
Provisions	14,458	-	-	14,458
Life reinsurance contract liabilities	668	24,936	76,260	101,864
	3,994	-	-	3,994
Total liabilities	44,198	32,703	106,078	182,979

iii. Market risk

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

The following policies are in place to mitigate the Branch's exposure to market risk:

- the Branch manages its market risk within an Asset Liability Management (ALM) framework. The ALM framework forms an integral part of the reinsurance risk management policy setting the principles for the asset investments in terms of target durations, asset qualities, currencies etc. This framework aims to manage the effects of interest rate movements on the net assets of the Branch. At the balance sheet date the assets are invested with somewhat shorter duration than the liabilities, hence there is an impact on profits and equity from interest rate movements.
- An integral part of the Asset and Liability Management (ALM) framework is the investment mandate of the Branch. On an annual basis the investment mandate is reassessed and updated. This review incorporates changes which have occurred within the liabilities with the aim of modifying the asset allocation to realign the assets to the latest liability profile.

Interest rate risk

The Branch has determined that all assets held within its statutory funds are assets backing life reinsurance contract liabilities. The investment income of the Branch will decrease as interest rates decrease. This is offset to an extent by corresponding changes in the market value of fixed interest investments. The impact on profit and equity will be minimal for investment assets backing most life reinsurance contract liabilities, when the asset and liability profile is closely matched.

However in respect of investment assets in excess of life reinsurance contract liabilities and annuity and other long term life reinsurance contract liabilities where close asset/liability matching is not possible, there will be an impact on profit and equity when interest rates change.

Ignoring taxation impacts, at 31 December 2018, an increase in interest rates of 100 basis points would decrease profit and equity by $445,000 (2017: decrease $2,164,000). A corresponding decrease of 100 basis points would decrease profit and equity by $134,000 (2017: increase $1,917,000).

4.2. Risk management policies and procedures (continued)

(b) Financial risks (continued)

iii. Market risk (continued)

Interest rate risk (continued)

The Branch's exposure to interest rate risk and the effective weighted average interest rate for each significant class of interest bearing financial asset are set out below:

	Weighted average interest rate	Floating interest rate $'000	Fixed interest maturing in: Up to 1 year $'000	1 to 5 years $'000	Over 5 years $'000	Total $'000
2018						
Cash at bank	**1.85%**	**14,957**	**-**	**-**	**-**	**14,957**
Cash and cash equivalents		**14,957**	**-**	**-**	**-**	**14,957**
Debt securities						
Government bonds	**4.25%**	**-**	**-**	**85,693**	**98,526**	**184,219**
Investment in financial assets		**-**	**-**			
Total		**14,957**	**-**	**85,693**	**98,526**	**199,176**
2017						
Cash at bank	2.25%	3,785	-	-	-	3,785
Cash and cash equivalents		3,785	-	-	-	3,785
Debt securities						
Government bonds	4.71%	-	-	46,027	127,965	173,992
Investment in financial assets		-	-	46,027	127,965	173,992
Total		3,785	-	46,027	127,965	177,777

Currency risk

The Branch operates in New Zealand. Assets are maintained in local currency to match the expected reinsurance contract liabilities in local currency.

Pricing and modelling risk

The Branch is exposed to the risk that the models used for pricing and valuing liabilities give misleading results upon which it bases its economic decisions. The Branch reviews the output of its models for reasonableness and ensures that the processes used are adequate and in line with current industry standards.

Other price risk

The Branch does not trade derivatives or hold equity securities in any entity, therefore there is no material exposure to other price risk.

(c) Non-financial risks - insurance

i. Risk management objectives and policies for risk mitigation

Insurance risks are controlled through the use of underwriting procedures, adequate premium rates and policy charges and sufficient reinsurance arrangements, all of which are managed through a Board approved governance structure. Controls are also maintained over claims management practices to assure the correct and timely payment of insurance claims.

i. Strategy for managing insurance risk

Portfolio of risks

The Branch issues reinsurance contracts covering term life, accident and disability (income and lump sum) on an individual or group basis. In addition the Branch has some catastrophe business written on an annual, non-guaranteed renewable basis. The Branch does not write investment linked business.

Prudential capital requirements

Prudential capital requirements established by the Australian Prudential Regulation Authority ("APRA") are in place to safeguard policyholders' interests, which are primarily the ability to meet future claim payments to policyholders. These require the Branch's Capital Base to exceed the Prudential Capital Requirement throughout the year, not just at year end. The level of capital requirements also take into account specific risks faced by the Branch.

4.2. Risk management policies and procedures (continued)

(c) Non-financial risks – insurance (continued)

ii. Methods to limit or transfer insurance risk exposures

Underwriting and claims management procedures

Underwriting procedures are set out in the underwriting process documentation and include limits to delegated authorities and signing powers. Internal auditors and other central departments from MR-AG review from time to time the underwriting and claims management processes to ensure adequate controls are in place and that they are effective. Strict claims management procedures ensure the timely and correct payment of claims in accordance with treaty conditions. Active claims management is particularly necessary for disability income business. All large losses are reported to the Board.

Retrocession

The Branch maintains retrocession agreements with local unrelated retrocessionaires and MR-AG. The latter programme consists of a surplus and a quota share arrangement.

iii. Terms and conditions of reinsurance contracts

The nature of the terms of the reinsurance contracts written is such that certain external variables can be identified upon which related cash flows for claim payments depend. The table below provides an overview of the key variables upon which the amount of related cash flows are dependent.

Type of contract	Detail of contract workings	Nature of compensation for claims	Key variables that affect the timing and uncertainty of future cash flows
Non-participating life reinsurance contracts with fixed and guaranteed terms • Term Life • Disability (income and lump sum) • Catastrophe • Medical expenses	Guaranteed benefits paid on death, survival or disability that are fixed and guaranteed and not at the discretion of the issuer.	Benefits, defined by the reinsurance contract, are determined by the contract and are not directly affected by the performance of underlying assets or the performance of the contracts as a whole.	• Mortality • Morbidity • Market earning rates • Interest rates • Discontinuance rates • Expenses

iv. Concentrations of insurance risk

The Branch's life risk segment offers death and disablement protection to employers of large workforces. The concentration of such workforces in single locations is a factor that exposes the Branch to a higher risk of loss in the event of an accident affecting the location where the reinsured employees work. The Branch conducts analysis of single-event exposures on an ongoing basis and continues to be well within the limits mandated by MR-AG.

v. Claims development

Information about actual claims compared to previous estimates is provided below for the business for which uncertainty about the amount and timing of claim payments is not typically resolved within one year. For the Branch, such claims comprise disability income claims.

	2018 $'000	2017 $'000
Net claims incurred		
Expected	**40,390**	38,730
Actual	**44,309**	36,246

4.3. Reserves and retained profits

(a) Summary of shareholder's interests

	2018 $'000	2017 $'000
Retained profit/(loss) at 1 January	**6,970**	460
Net profit/(loss) for the year	**(7,054)**	6,510
Retained profit/(loss) at 31 December	**(84)**	6,970
Head office account	**54,509**	43,946
Shareholder's equity	**54,425**	50,916

The amount transferred to/from the New Zealand statutory fund from/to the Head Office account is determined after receiving written advice from the Appointed Actuary, including confirmation that the transfer will not breach the solvency and capital adequacy requirements in accordance with the requirements in Section 62 of the Australian Life Insurance Act (1995); and that the transfer is surplus to the solvency reserve specified in Professional Standard 5 issued by the New Zealand Society of Actuaries.

There was a transfer of $10,563,000 to the New Zealand statutory fund from the Australian statutory fund (2017: $10,770,059). See note 6.5 for further details in relation to capital management subsequent to 31 December 2018.

4.4. Capital management

(a) Types of capital

i. Regulatory capital

Under the Life (Prudential Supervision) Act 2010, MRA was issued with a full licence by the Reserve Bank of New Zealand. In accordance with the Act, it is the licensed entity, MRA, and not the Branch that must comply with the solvency requirements.

Minimum capital requirements for the Branch are set and regulated by the Australian Prudential Regulation Authority (APRA) and the Reserve Bank of New Zealand. These requirements are put in place to ensure sufficient solvency margins within the statutory funds.

The amount of capital required to be held by the Branch is based primarily upon the regulatory prescribed capital amount (PCA) and buffer capital requirements. In order to minimise the risk of breaching the regulatory capital requirements, the level of capital held by the Branch is regularly monitored relative to a Board approved Internal Capital Adequacy Assessment Policy ("ICAAP"). It also takes into account the longer term strategic objectives of the Branch's ultimate parent company MR-AG in order to maximise shareholder's value.

The Branch manages its capital requirements by assessing economic conditions and risk characteristics of the business activities on a regular basis to ensure that the above regulatory requirements and business objectives are met. The capital structure is maintained or adjusted by the amount of dividends paid or capital repatriations/(injections) to/(by) MR-AG.

ii. Ratings capital

The Branch is classified as a core entity of MR-AG and therefore obtains the same credit rating as MR-AG based on ratings published by Standard & Poor's Ratings services at 31 December 2018. The ratings help to reflect the financial strength of the Branch and demonstrate to stakeholders the ability to pay claims for the long term.

iii. Economic capital

In conjunction with the considerations set out above, which are important to the functioning business, consideration is given to the operational capital needs of the business. The capital objectives are achieved through the use of a risk based capital adequacy framework for capital needs that relies on explicit quantification of uncertainty of risk, and the use of modelling techniques to provide valuable input to the capital management process and provide the capacity to quantify and understand this risk/return trade-off.

(b) Solvency and capital requirements of the life reinsurance statutory funds

Under the Life Insurance Act 1995, life insurers are required to hold reserves in excess of the amount of policy liabilities in order to support the life insurer's capital requirements and to provide a buffer against adverse experience. MRA including the New Zealand Statutory Fund determines it's capital requirements in accordance with APRA's Life and General Insurance Capital (LAGIC) Standards effective 1 January 2013. Specifically, APRA's LPS110 prescribes the minimum capital requirement for each fund and the minimum level of assets required to be held in each fund. The figures in the table below show the Capital base as a multiple of the total prescribed capital amount.

	2018 $'000	2017 $'000
Capital Base	**47,287**	46,841
Common Equity tier 1 (Net assets)	**54,426**	50,914
Total regulatory adjustments to common equity tier 1	**(7,139)**	(4,073)
Additional tier 1 capital	-	-
Total regulatory adjustments to additional tier 1 capital	-	-
Tier 2 capital	-	-
Total regulatory adjustments to Tier 2 capital	-	-
Total capital base (A)	**47,287**	46,841
Prescribed capital		
Insurance risk capital; charge	**30,422**	22,721
Asset risk capital charge	**5,840**	6,615
Asset concentration risk charge	-	-
Operational risk charge	**1,500**	1,220
Less aggregation benefit	**(4,159)**	(4,434)
Combined stress scenario adjustment	**8,696**	5,164
Total prescribed capital amount (PCA) (B)	**42,299**	31,286
Capital adequacy multiple (A/B)	**1.12**	1.50

See note 6.5 for further details in relation to capital management subsequent to 31 December 2018.

Section 5. Life reinsurance contracts

5.1. Life reinsurance contract liabilities: Actuarial process & disclosures

(a) Basis of preparation for life reinsurance contracts

The effective date of the actuarial report on life reinsurance contract liabilities and solvency requirements is 31 December 2018. The actuarial report was prepared by Mr Stuart Blackhall FIAA, the Appointed Actuary. The actuarial report indicates that the Appointed Actuary is satisfied as to the accuracy of data upon which the life reinsurance contract liabilities and solvency requirements have been determined.

The amount of life reinsurance contract liabilities has been determined in accordance with applicable accounting and actuarial standards. Life reinsurance contract liabilities for life insurance contracts are valued in accordance with NZ IFRS 4 *Insurance Contracts*. In respect of the Branch's Life reinsurance business, there are no differences between the valuation requirements of the accounting standards and those of the Life Insurance Act (1995), which includes applicable APRA prudential requirements.

i. Actuarial valuation methods

All individual product groups have been valued using the projection method. The projection method includes appropriate allowance for all reserves including IBNR, disabled lives, unrecouped acquisition costs and other reserves.

The major product groups are individual lump sum and disability income business. The profit carrier is premiums.

ii. Actuarial assumptions

Assumption	Basis of assumption
Discount rates	Risk-free discount rates based on the current observable, objective rates that relate to the nature, structure and term of the future liability cash flows. 2018: 1.7% - 4.0% p.a. (2017: 1.8% - 4.6% p.a.)
Maintenance expenses	The allowance for future expenses is a percentage of in-force premiums based on the Branch's planned expenses in 2018.
Inflation	Expected long term inflation rate based on market and economic data. 2018: 2.3% - 2.8% p.a. (2017: 2.0% - 2.6%p.a.).
Voluntary discontinuance	Rates varying by benefit type, age, duration of policy, class of business, premium type and treaty: 2018: 0% to 100% (2017: 0% to 100%).
Surrender values	Ceding company values.
Mortality & morbidity including Disability termination	Biometric assumptions based on the branch's own experience, supplemented by other experience sources in areas where own experience lacks credibility. No change in approach from 2017, but parameters have changed for Morbidity.
IBNR	Allowance was made for inherent delays in reporting claims based on investigations into the branch's own recent life reinsurance experience. 2018 and 2017: IBNR determined using an adjusted chain-ladder method.

	Profit Carrier	Rate of Taxation
Lump Sum - Individual	Premium	28%
Lump Sum - Group	Premium	28%
Disability - Individual & Group	Premium	28%

iii. Effects of changes in actuarial assumptions

	31 December 2017 to 31 December 2018	
Assumption category	Effect on net profit margins $'000 increase / (decrease)	Effect on net life reinsurance contract liabilities $'000 increase / (decrease)
Discount rates & inflation	-	4,648
Model, repricing and assumption changes	(345)	387
Total	(345)	5,035

5.1. Life reinsurance contract liabilities: Actuarial process & disclosures *(continued)*

iv. Sensitivity of financial results

The valuations included in the reported results are calculated using certain assumptions about key underlying variables. The movement in any key variable will impact the performance and net assets of the Branch.

Variable	Impact of variable
Expense risk	An increase in the level or inflationary growth of expenses over assumed levels will decrease profit and equity.
Interest rate risk	The investment income of the Branch will decrease as interest rates decrease. This is offset to an extent by corresponding changes in the market value of fixed interest investments. The impact on profit and equity will be minimal for investment assets backing most life reinsurance contract liabilities, when the asset and liability profile is closely matched. At the balance sheet date the assets are invested with somewhat shorter duration than the liabilities, hence there would be an impact on profits and equity as a result of interest rate movements.
Mortality rates	Greater mortality rates would lead to higher levels of claims and therefore reduce profit and equity.
Morbidity rates	The cost of disability-related claims depends on both the incidence of policy holders becoming disabled and, in the case of income benefits, the duration for which they remain disabled. Higher than expected incidence and duration would increase claim costs, reducing profit and equity.
Discontinuance	The impact of the discontinuance rate assumption depends on a range of factors including the type of contract, the surrender value basis (if any) and the duration in force. An increase in discontinuance rates at earlier policy durations usually has a negative effect on profit and equity, as it reduces the base from which the Branch may recoup expenses and generate profits. However, due to the interplay between a range of factors, there is not always an adverse outcome from an increase in discontinuance rates.

Summary of significant accounting policies

Life reinsurance business

The life reinsurance operations of the Branch are conducted within separate statutory funds as required by the Life Insurance Act (1995) and are reported in aggregate with the shareholder's fund in the Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity and Statement of Cash Flows. The life insurance operations of the Branch comprise the reinsurance of life insurance contracts.

Life reinsurance contracts involve the acceptance of significant reinsurance risk. Reinsurance risk is defined as significant if, and only if, a reinsured event could cause a reinsurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction). Products that do not meet the definition of a life insurance contract are classified as life investment contracts. Reinsurance contracts include those where the insured benefit is payable on the occurrence of a specified event such as death, injury or disability caused by accident or illness.

All of the Branch's reinsurance contracts are classified as life insurance contracts. None are investment linked or other life investment type contracts.

Allocation and distribution of profit of the statutory funds

The Branch does not issue participating policies, thus all profits are allocated to the shareholder.

The amount transferred from the statutory funds to the shareholder's fund, if any, is determined after receiving written advice from the Appointed Actuary, including confirmation that the transfer will not breach the solvency and capital adequacy requirements in Section 62 of the Life Insurance Act (1995).

5.2. Life reinsurance contract liabilities: Composition and movements

(a) Reconciliation of movements

2018	Gross $'000	Reinsurance and other recoveries $'000	Net $'000
Reconciliation of movements in reinsurance contract liabilities			
Life reinsurance contract liabilities at the beginning of the financial year	**101,864**	**(38,417)**	**63,447**
(Decrease) / Increase in life reinsurance contract policy liabilities	**21,896**	**(10,332)**	**11,564**
Total reinsurance contract liabilities	**123,760**	**(48,749)**	**75,011**
Current (asset)/liability	**3,672**	**(756)**	**2,916**
Non-current (asset)/liability	**120,088**	**(47,993)**	**72,095**
Total reinsurance contract liabilities	**123,760**	**(48,749)**	**75,011**

2017	Gross $'000	Reinsurance and other recoveries $'000	Net $'000
Reconciliation of movements in reinsurance contract liabilities			
Life reinsurance contract liabilities at the beginning of the financial year	97,696	(36,609)	61,357
(Decrease) / Increase in life reinsurance contract policy liabilities	3,898	(1,808)	2,090
Total reinsurance contract liabilities	101,864	(38,417)	63,447
Current (asset)/liability	668	612	1,280
Non-current (asset)/liability	101,196	(39,029)	62,167
Total reinsurance contract liabilities	101,864	(38,417)	63,447

The gross cashflow in the first year is positive, as income (premium) exceeds outgoings (claims and expenses).

(b) Components of reinsurance contract liabilities

	2018 $'000	2017 $'000
Life reinsurance		
Best estimate liability for non investment-linked business		
Value of future policy benefits	**283,554**	267,355
Value of future expenses	**46,968**	42,898
Value of future premiums	**(255,511)**	(249,290)
	75,011	60,963
Value of future profits for non investment-linked business		
Shareholder profit margins	**-**	2,484
Net life reinsurance contract liabilities	**75,011**	63,447

(c) Sources of shareholder's operating profit of statutory funds

	2018 $'000	2017 $'000
Operating profit/(loss) after income tax arose from:		
- Planned margins of revenues over expenses released	**233**	1,449
- Experience profit/(loss)	**(7,802)**	3,689
- Capitalisation of expected future losses	**(2,042)**	(903)
- Investment earnings on assets in excess of life reinsurance contract liabilities	**2,557**	2,275
Operating profit/(loss) after income tax	**(7,054)**	6,510

Section 6. Other notes

6.1. Commitments

The Branch has no known capital commitments at the reporting date (2017: nil).

6.2. Contingencies

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

6.3. Related parties

(a) Parent and ultimate controlling party

The parent entity in Australia is Munich Holdings of Australasia Pty Ltd ("MHA"). The ultimate parent undertaking of the group is MR-AG a company incorporated in Germany with limited liability.

(b) Transactions with key management personnel

Key management personnel compensation comprised the following:

	2018	2017
Short term employee benefits	**77,080**	112,760
Post-employment benefits	**7,358**	10,418
Total employment benefits	**84,438**	123,178

Compensation of the branch's key management personnel includes salaries, non-cash benefits and contributions to a post-employment defined benefit plan and defined contribution plan. These payments originated from the Parent company.

(c) Transactions with related parties

	Transaction values for the year ended 31 December *Inwards/(Outwards)*		Balance outstanding as at 31 December *Receivable/(Payable)*	
	2018	2017	**2018**	2017
Retrocession of reinsurance contracts with ultimate parent:				
MR-AG	**10,763,672**	9,716,710	**1,833,741**	(9,813,311)
Recharge of expenses incurred on the branch's behalf:				
MHA	**(2,305,021)**	(1,996,024)	**-**	-
NZS	**(108,541)**	(86,661)	**-**	-
MRA	**-**	-	**-**	-
Transactions with tax group relating to tax sharing and funding agreement:				
MR-AG	**-**	925,359	**-**	-
Capital Injection received from head office account				
MHA	**10,563,000**	10,770,059	**-**	-

NZS is a company under common control of the parent MHA and recharges expenses incurred by the Company's New Zealand statutory fund.

No provision for doubtful debts has been raised by the Branch in relation to any outstanding balances and no expense has been recognised in respect of bad or doubtful debts due from related parties.

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

All other transactions were made on normal commercial terms and conditions and at market rates (including market rental rates), except that there are no fixed terms for the repayment of loans between the parties. Outstanding balances are unsecured and are repayable in cash.

The Branch continues to be party to a tax sharing and tax funding agreement with other members of the New Zealand tax consolidated group.

6.4. Remuneration of auditors

The following fees were paid or payable for services provided by the auditors of the Branch and its related practices:

(a) Audit services

KPMG:	2018	2017
Audit and review of financial reports under the Corporations Act 1993	**22,715**	22,938
Total remuneration for audit services	**22,715**	22,938

6.5. Events occurring after the balance sheet date

MRA maintains excess capital and manages this excess capital through the Capital Risk Management Policy (CRMP), which defines capital management zones and triggers together with the required management response. According to this policy, the minimum regulatory capital requirement for both Munich Reinsurance Company of Australasia and Munich Reinsurance Company of Australasia - New Zealand Branch is a solvency ratio greater than 100%, with the target capital adequacy ratio being 160% and 155% respectively.

The capital adequacy ratio of Statutory Fund 2, Munich Reinsurance Company of Australasia - New Zealand Branch, was reported as 112% at 31-December 2018.

Therefore, the Board of Directors in accordance with the CRMP subsequently approved the transfer of AUD $20m from Statutory Fund 1, Munich Reinsurance Company of Australasia, to Statutory Fund 2, Munich Reinsurance Company of Australasia - New Zealand Branch on 28 February 2019. Subsequent to this transfer, both Statutory Fund 1 and Statutory Fund 2 are expected to report a Capital Adequacy Ratio within the target range documented in the CRMP.

The Board of Directors consider the Branch to be a going concern in light of the capital transfer from Statutory Fund 1 to Statutory Fund 2.

6.6. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2018, and have not been applied in preparing these financial statements. Those which may be relevant to the Branch are set out below.

NZ IFRS 15 Revenue from Contracts with Customers
NZ IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including NZ IAS 18 Revenue, NZ IAS 11 Construction Contracts and NZ IFRIC 13 Customer Loyalty Programmes. NZ IFRS 15 is mandatory for annual reporting periods beginning on or after 1 January 2018.

Life reinsurance premium and related revenue continues to fall outside the scope of NZ IFRS 15 and will be accounted for under the other applicable standards, therefore it has not impacted the Branch's financial statements.

NZ IFRS 16 Leases
NZ IFRS 16 amends the accounting for leases. Lessees will be required to bring all leases on Statement of Financial Position as the distinction between operating and finance leases has been eliminated. Lessor accounting remains largely unchanged. The standard is effective for annual reporting periods beginning on or after 1 January 2019 for the Branch.

The branch does not have any lease agreements that would be affected by NZ IFRS 16 and there will be no impact to the Branch's financial statements upon the application of this standard.

NZ IFRS 17 Insurance Contracts
NZ IFRS 17 was released in August 2017. It introduces three new measurement approaches for accounting for insurance contracts. These include the Building Block Approach for long term contracts, the Premium Allocation Approach for short contracts and a Variable Fee Approach for direct participating contracts. In addition, the level of contract aggregation is likely to be lower than that under current practices. The standard is not mandatory until 1 January 2022 for the Branch. The financial impact has not yet been determined.

Directors' declaration

The Directors are pleased to present the financials statements of Munich Reinsurance Company of Australasia Limited – New Zealand Branch for the year ended 31 December 2018.

In the opinion of the Directors of Munich Reinsurance Company of Australasia Limited, the financial statements and notes of the New Zealand Branch (the Branch), on pages 1 to 25:

(a) comply with New Zealand generally accepted accounting practice and give a true and fair view of the financial position of the Branch as at 31 December 2018 and the results of operations for the year ended on that date;

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

The Directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Branch and facilitate compliance of the financial statements with the Financial Reporting Act 1993.

The Directors consider that they have taken adequate steps to safeguard the assets of the Branch, and to prevent and detect fraud and other irregularities. Internal control procedures are also considered to be sufficient to provide reasonable assurance as to the integrity and reliability of the financial statements. There are reasonable grounds to believe that, as at the time this statement is made, the Branch will be able to pay all debts or claims as and when they are due.

Signed in Sydney on 26 March 2019 in accordance with a resolution of the Directors:

J B Shewan
Director

A Linfoot
Director

KPMG

Independent Auditor's Report

To the shareholder of Munich Reinsurance Company of Australasia Limited - New Zealand Branch

Report on the financial statements

Opinion

In our opinion, the accompanying financial statements of Munich Reinsurance Company of Australasia Limited - New Zealand Branch (the branch) on pages 3 to 25:

i. present fairly in all material respects the branch's financial position as at 31 December 2018 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

We have audited the accompanying financial statements which comprise:

— the statement of financial position as at 31 December 2018;

— the statements of comprehensive income, changes in equity and cash flows for the year then ended; and

— notes, including a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) ('ISAs (NZ)'). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

Our responsibilities under ISAs (NZ) are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

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

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements in the current period. We summarise below those matters and our key audit procedures to address those matters in order that the shareholder as a body may better understand the process by which we arrived at our audit opinion. Our procedures were undertaken in the context of and solely for the purpose of our statutory audit opinion on the financial statements as a whole and we do not express discrete opinions on separate elements of the financial statements.

The key audit matter	How the matter was addressed in our audit
Reinsurance Contract Liabilities (NZ $123,761 thousand)	
Refer to Notes 5.1 and 5.2 to the Financial Report. Reinsurance contract liabilities is a key audit matter because of the judgement required to challenge the assessment of estimates determined by projecting expected cash flows long into the future. Specific audit and actuarial expertise is required to evaluate complex and judgemental actuarial methodologies and assumptions. The assumptions include the likelihood of policyholders discontinuing their policies, the incidence of policyholder sickness or death, the expected costs associated with future claims handling and policy maintenance and developments such as changes in legal practice and new medical treatments. These assumptions are used in conjunction with cedent data to project the expected future cash flows related to the liabilities over the expected life of the in-force policies.	Our audit procedures included: • Evaluating the key controls in the reinsurance contract liabilities measurement process. This included controls over the integrity of the cedent data used in the estimation process and setting of significant assumptions. • With assistance from our valuation specialists we: - Challenged the appropriateness of the actuarial methods and assumptions used by the Branch; - We assessed the selection of methods and assumptions against the actuarial and accounting standard requirements with a view to identifying management bias; - Compared assumptions and expected experience to actual historical experience; - Benchmarked assumptions and experience to observable market data, including industry averages and experience for certain classes of business; and - Challenged the analysis of profit from life insurance contracts by comparing movements with our understanding of the business and our expectations derived from industry experience.

Other information

The Directors, on behalf of the branch, are responsible for the other information included in the entity's Annual Financial Report. Other information includes the Directors' Report. Our opinion on the financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

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

Use of this independent auditor's report

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

Responsibilities of the Directors for the financial statements

The Directors, on behalf of the branch, are responsible for:

— the preparation and fair presentation of the financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;

— implementing necessary internal control to enable the preparation of a set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and

— assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objective is:

— to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and

— to issue an independent auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of these financial statements is located at the External Reporting Board (XRB) website at:

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

This description forms part of our independent auditor's report.

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

For and on behalf of

KPMG

KPMG Sydney
26 March 2019