SUNDERLAND MARINE INSURANCE COMPANY LIMITED (FORMERLY SUNDERLAND MARINE MUTUAL INSURANCE COMPANY LIMITED)

NEW ZEALAND BRANCH

FINANCIAL STATEMENTS

20TH FEBRUARY 2015

KPMG

Independent auditor's report

To the shareholders of Sunderland Marine Insurance Company Limited - the New Zealand branch

Report on the financial statements

We have audited the accompanying financial statements of Sunderland Marine Insurance Company Limited (formerly "Sunderland Marine Mutual Insurance Company Limited") - the New Zealand branch (the "branch") on pages 4 to 22. The financial statements comprise the statement of financial position as at 20 February 2015, the statements of comprehensive income, changes in equity and cash flows for the 14 month period then ended, and a summary of significant accounting policies and other explanatory information.

Directors' responsibility for the financial statements

The directors are responsible for the preparation of 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 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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.

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

Our firm has also provided other services to the branch in relation to general accounting services. Subject to certain restrictions, partners and employees of our firm may also deal with the branch on normal terms within the ordinary course of trading activities of the business of the branch. These matters have not impaired our independence as auditor of the branch. The firm has no other relationship with, or interest in, the branch.

KPMG

Opinion

In our opinion the financial statements on pages 4 to 22:

- 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 20 February 2015 and of its financial performance and cash flows for the 14 month period 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 Sunderland Marine Insurance Company Limited - the New Zealand branch as far as appears from our examination of those records.

KPMG

5 August 2015
Auckland

Sunderland Marine Insurance Company Limited

New Zealand Branch

Annual Report

For the period 1st January 2014 to 20th February 2015

The Board of Directors is pleased to present the financial statements of its New Zealand Branch for the period 1st January 2014 to 20th February 2015 and the auditor's report thereon.

Following the merger with North of England Protecting and Indemnity Association ("North") on 28th February 2014, the board resolved on 14th January 2015 to change the Company and thus the NZ Branch year end to 20th February. These statements therefore cover the period from 1st January 2014 to 20th February 2015.

As a result of the merger and thus the demutualisation, the company changed its name from Sunderland Marine Mutual Insurance Company Limited to Sunderland Marine Insurance Company Limited on 31st July 2014.

In the Directors' opinion, the financial statements and notes set out on pages 4-22:

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 20 February 2015 and the results of operations of the 14 month period ending 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 reports 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 and the Companies Act 1993. There are reasonable grounds to believe that, as at the time this statement is made, the Branch will be able to pay all debtors or claims as and when they are due.

Signed in Newcastle Upon Tyne on 13 July, 2015 for and on behalf of the Board of Directors:

P.A. Jennings
Director

13 July, 2015

A.A. Wilson
Director

13 July, 2015

Sunderland Marine Insurance Company Limited

New Zealand Branch

Statement of comprehensive income

For the period 1 January 2014 to 20 February 2015

	Note	14 month period ended 20 Feb 15 $NZ	Year ended 31 Dec 13 $NZ
Revenue			
Premium	3(a)	5,553,323	4,961,213
Investment income	3(b)	140,953	22,556
Total operating revenue		5,694,276	4,983,769
Expenses			
Claims	3(a)	(2,997,546)	(1,309,913)
Underwriting expenses	3(a)	(495,228)	(404,235)
Administration expenses		(1,251,738)	(1,026,107)
Operating surplus before taxation		949,764	2,243,514
Income tax	10	(268,201)	(629,245)
Profit from operating activites after tax attributable to members of Sunderland Marine Insurance Company Limited		681,563	1,614,269

The Statement of Comprehensive Income is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 22.

Sunderland Marine Insurance Company Limited

New Zealand Branch

Statement of Changes in Head Office Account

For the period 1 January 2014 to 20 February 2015

HEAD OFFICE ACCOUNT	Note	14 month period ended 20 Feb 15 $NZ	Year ended 31 Dec 13 $NZ
Head office account at the beginning of the period		1,899,504	1,227,330
Profit from operating activities after tax attributable to member of Sunderland Marine Insurance Company Limited		681,563	1,614,269
Transfer from /(to) head office on settlement of head office account		771,960	(942,095)
Head office account at the end of the period		3,353,027	1,899,504

The Statement of Changes in Head Office Account is to be read in conjunction with the notes to and forming part of the financial statements set out on pages 8 to 22.

Sunderland Marine Insurance Company Limited

New Zealand Branch

Statement of Financial Position

As at 20 February 2015

	Note	20 Feb 15	31 Dec 13
		$NZ	$NZ
Non current assets			
Land and buildings	5	780,916	786,196
Fixed assets		26,729	36,926
Total non-current assets		807,645	823,122
Current assets			
Cash on hand		148,341	212,385
Short term bank deposits		4,439,823	1,996,310
Financial assets	7	501,833	517,242
Debtors		4,749,602	5,098,969
Reinsurance receivable	8	1,040,882	1,006,348
Deferred tax asset	10	30,219	24,918
Total current assets		10,910,700	8,856,172
Total assets		11,718,345	9,679,294
Current liabilities			
Payables		352,634	524,058
Unearned premium		4,640,098	4,911,318
Provision for outstanding claims	9	3,372,586	2,344,414
Total current liabilities		8,365,318	7,779,790
Total liabilities		8,365,318	7,779,790
Head office account		3,353,027	1,899,504
Total liabilities and head office account		11,718,345	9,679,294

The Statement of Financial Position is to be read in conjunction with the notes to the financial statements set out on pages 8 to 22.

Sunderland Marine Insurance Company Limited

New Zealand Branch

Statement of Cashflows

	14 month period ended 20 Feb 15 $'000	Year ended 31 Dec 13 $'000
Cash flows provided by operating activities:		
Operating surplus before taxation	681,563	1,614,269
Tax paid	(512,624)	(373,334)
Changes in non-cash operating accounts:		
Receivables arising out of direct insurance operations	227,976	(109,624)
Deferred policy acquisition costs	(444)	(25,116)
Outstanding claims, net of reinsurers' share	802,050	138,142
Unearned premiums, net of reinsurers' share	(159,936)	(214,566)
Unearned reinsurance commissions	659,811	178,200
Unrealised (gains) / loss on investments	15,409	20,475
Fixed Assets Amortisation	10,196	2,368
Investment Property Depreciation	5,280	4,526
Other, net	(121,772)	669,946
	1,607,509	1,905,286
Cash flows provided by financing activities:		
From/(to) Head Office	771,960	(942,095)
Increase in cash and cash equivalents	2,379,469	963,191
Cash and cash equivalents, beginning of the period	2,208,695	1,245,504
Cash and cash equivalents, end of the period	4,588,164	2,208,695

The Statement of Cashflows is to be read in conjunction with the notes to the financial statements set out on pages 8 to 22.

Sunderland Marine Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the period 1 January 2014 to 20 February 2015

1 Summary of Significant Accounting Policies

Sunderland Marine Insurance Company Limited - New Zealand branch ("the Branch") is registered to carry on inward insurance business in New Zealand for a foreign company. The Branch's principal activity is general insurance.

The financial statements were authorised for issue by the directors on 13 July 2015

a) Reporting entity

The Branch is a company registered under the Companies Act 1993. These are the financial statements of the Branch. The financial statements of the Branch have been prepared in accordance with NZ IFRS.

The financial statements comprise the following: Statement of Comprehensive Income, Statement of Changes in Head Office Account, Statement of Financial Position and Statement of Cash Flows as well as the notes to the financial statements contained on pages 8 to 22 of this annual report. The financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand and on the basis of historical cost.

These statements cover the accounting period from 1 January 2014 to 20 February 2015. The prior period information is therefore not directly comparable.

Sunderland Marine Insurance Company Limited (the "Company") changed its accounting date to 20 February to align with North of England Protecting and Indemnity Association who the Company merged with on 28 February 2014. The Branch changed its reporting date to align with the Company.

b) Statement of compliance

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). They comply with the New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards as appropriate to profit generating entities. The Branch is a profit oriented entity. The Branch is a reporting entity for the purposes of the Financial Reporting Act 1993 ("the Act") and its financial statements comply with that Act.

1 Summary of Significant Accounting Policies (continued)

c) Basis of preparation

The accounts of the Branch have been prepared in accordance with applicable New Zealand accounting standards and are expressed in New Zealand Dollars.

The financial statements have been prepared under the historical cost convention unless otherwise stated below.

The accounting policies set out below have been applied consistently by the Branch to all periods presented in the financial statements.

d) Premium revenue

Premiums have been brought to account as income from the date of attachment. The earned portion of premiums received and receivable is recognised as revenue. Unearned premiums are calculated by apportioning the premium income written in the period over the periods of risk from the dates of attachment based on the pattern of risk.

e) Accounts receivable

Accounts receivable are stated at their estimated realisable value after providing against debts where collection is doubtful. Bad debts are written off in the period in which they are identified.

f) Financial assets backing insurance contract liabilities

The Branch has determined that all financial assets are deemed to back insurance contract liabilities and are measured at fair value through profit or loss at each balance date as they meet the criteria under NZ IAS 39 *Financial Instruments: Recognition and Measurement.* Financial assets are recognised on the date when they are originated. The Branch derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it ceases to have rights to receive contractual cash flows. Unrealised profits and losses on subsequent measurement to fair value are recognised in profit or loss.

g) Impairment of assets

All assets other than those which are set outside the scope of NZ IAS 36 *Impairment of Assets* are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

Any impairment losses are included within the Statement of Comprehensive Income. If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The amount of the reversal is recognised in the Statement of Comprehensive Income.

1 Summary of Significant Accounting Policies (continued)

h) Leases

Operating lease payments, where the lessor effectively retains substantially all the risks and benefits of ownership of the leased item, are included in the determination of operating surplus in equal instalments over the lease term.

i) Income tax

The income tax expense charged to the Statement of Comprehensive Income includes both the current year's provision and the income tax effects of timing differences calculated using the liability method. Tax effect accounting is applied on a comprehensive basis to all timing differences. A debit balance in the deferred tax account, arising from timing differences or income tax benefits from income tax losses, is only recognised if there is virtual certainty of realisation.

j) Goods and services tax

Revenues and expenses are stated net of goods and services tax (GST). Trade receivables and trade payables are stated inclusive of GST to the extent that GST is recoverable or payable.

k) Claims

Claims expense and liability for outstanding claims are recognised in respect of direct business. The liability covers claims reported and outstanding, incurred but not reported claims ("IBNR") and the anticipated direct and indirect costs of settling those claims. Claims outstanding are assessed by review of individual claim files and estimating the ultimate cost of settling claims which includes IBNR's and settlement costs using statistics based on past experience and trends. The outstanding claims reserve is estimated using internal management models and no actuarial valuation is explicitly performed on the Branch.

l) Acquisition costs

A portion of acquisition costs relating to unearned premium revenue is recognised as an asset in recognition that it represents a future benefit. Deferred acquisition costs are amortised over the financial years expected to benefit from the expenditure and are stated at the lower of cost and recoverable value.

1 Summary of Significant Accounting Policies (continued)

m) Reinsurance

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance service received.

2 Summary of Significant Actuarial Methods and Assumptions

Provision is made at the end of each period for the estimated cost of claims incurred but not settled at balance date. These reserves include estimates for claims that have been reported, claims that have been incurred but not reported (IBNR), and claims that have been incurred but not enough reported (IBNER), and include estimates of expenses associated with processing and settling these claims.

The process of establishing reserves is subject to considerable variability as it requires the use of informed estimates and judgements. These estimates and judgements are based on numerous factors, and may be revised as additional experience and other data become available or as regulations change.

Outstanding claims provision is estimated by class of business. Historical experience and other statistical information are used to estimate the ultimate claim costs. To determine the outstanding claims provision for a particular line of business, more than one method may be used to estimate ultimate losses and loss expenses and thus selecting a single point estimate. These methods may include, but are not necessarily limited to; extrapolations of historical reported and paid loss data, application of industry loss developments patterns to the reported or paid losses, expected loss ratios developed by management, or historical industry loss ratios. Underlying judgements and assumptions that may be incorporated into these actuarial results include, but are not necessarily limited to, adjustments to historical data used in models to exclude aberrations in claims data such as catastrophes that are typically analysed separately, adjustments to actuarial models and related data for known business changes, such as changes in claims covered under insurance contracts, and the effect of recent or pending litigation on future claims settlements.

The reserves as at 20 February 2015 were valued by Daniel Smith FIAA who was satisfied as to the nature, sufficiency and accuracy of the data provided.

Sunderland Marine Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the period 1 January 2014 to 20 February 2015

	14 month period ended 20 Feb 15	Year ended 31 Dec 13
	$NZ	$NZ
3 Operating Results		
(a) Underwriting result		
Gross premium income	9,705,275	7,587,915
Increase/(Decrease) in unearned premium	270,777	(281,695)
Reinsurance ceded	(4,422,729)	(2,345,007)
Net premium	5,553,323	4,961,213
Claims expense		
Claims paid	4,150,954	1,946,287
Claims settlement expenses	242,226	196,001
Increase in outstanding claims provision	1,021,360	95,585
Reinsurance recoveries	(2,416,994)	(927,960)
Total claims expense	2,997,546	1,309,913
Underwriting expenses		
Net commissions	456,553	386,266
Other income deductions	38,675	17,969
Total underwriting expenses	495,228	404,235
Underwriting result	2,060,549	3,247,065
(b) Investment income		
Interest	140,953	22,556
4 Auditor's Remuneration		
Audit fees	(7,000)	
Other services*	(4,550)	(3,900)

Other services relate to payroll services performed by KPMG Wellington

Sunderland Marine Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the period 1 January 2014 to 20 February 2015

5 Land and Buildings

	$NZ
Balance at 20 February 2015	
Revaluation	800,000
Accumulated depreciation	(13,804)
Carrying value, 31 December 2013	786,196
Depreciation for the period	(5,280)
Net Carrying Value, 20 February 2015	780,916
Balance at 31 December 2013	
Revaluation	800,000
Accumulated depreciation	(9,279)
Carrying value, 1 January 2013	790,721
Depreciation for the year	(4,525)
Net Carrying Value, 31 December 2013	786,196

The fair value of the land and buildings has been assessed by the directors, taking into account a valuation by Duke & Cooke Limited, Valuers and Property Specialists on 2 September 2010

6 (a) Net Claims Expense

	20 Feb 15 $NZ	31 Dec 2013 $NZ
Current		
Gross claims incurred	5,172,314	2,041,872
Reinsurance and other recoveries	(2,416,994)	(927,960)
Net claims incurred	2,755,320	1,113,912
Claims settlement expenses	242,226	196,001
Net claims expense	2,997,546	1,309,913

(b) Net Claims Expense

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

	Current year $NZ	Prior periods $NZ	20 Feb 15 Total $NZ	2013 Total $NZ
Gross claims incurred and related expenses - undiscounted	5,697,304	(282,764)	5,414,540	2,237,873
Reinsurance and other recoveries - Undiscounted	(2,637,909)	220,915	(2,416,994)	(927,960)
Net claims incurred - undiscounted	3,059,395	(61,849)	2,997,546	1,309,913
Discount and discount movement- gross claims incurred	-	-	-	-
Net discount movement	-	-	-	-
	3,059,395	(61,849)	2,997,546	1,309,913

	14 month period end 20 Feb 15	Year ended 31 Dec 13
7 Financial Assets	$NZ	$NZ
(a) Financial assets - fair value through profit or loss		
Debt securities - unsecured	501,833	517,242
Total financial assets - fair value through profit or loss	501,833	517,242

Changes in the fair value of financial assets through the income statement are recorded as revenue/expense in the income statement.

The following tables analyse assets held at fair value by level of the fair value hierarchy

Fair value hierarchy The following tables analyse assets held at fair value by level of the fair value hierarchy	Level 1	Level 2	Level 3	Total fair value
At 20 February 2015				
Debt securities	501,833	-	-	501,833
Cash and deposits	4,588,164	-	-	4,588,164
Land and buildings	-	-	780,916	780,916
	5,089,997	-	780,916	5,870,913
At 31 December 2013				
Debt securities	517,242	-	-	517,242
Cash and deposits	2,208,695	-	-	2,208,695
Land and buildings	-	-	786,196	786,196
	2,725,937	-	786,196	3,512,133

Level 1 consists of financial assets that are valued according to published quotes in an active market. A financial asset is regarded as quoted in an active market if quoted prices are readily available from a broker, dealer, exchange, pricing service, industry group or regulatory agency. Level 2 assets are similar to level 1 but the pricing of those assets has not been determined in an active market. Level 3 financial assets are assets for which a value cannot be obtained from observable data.

Land and buildings are included in level 3 in the hierarchy table. The movement in the fair value of the land and buildings is due to depreciation charged in the period. The method used to value land and buildings is explained in more detail in note 5. The directors do not consider that changing one or more of the inputs to reasonably priced alternative assumptions would change the fair value of the land and buildings significantly.

8 Reinsurance & Other Recoveries Receivable		
Reinsurance and other recoveries - current	1,040,882	1,006,348
Total reinsurance and other recoveries receivables	1,040,882	1,006,348

	14 month period end 20 Feb 15	Year end 31 Dec 13
	$NZ	$NZ
9 Outstanding Claims		
a) Outstanding claims liability		
Outstanding claims (gross)	2,794,059	1,965,235
Claims handling cost	242,227	196,001
Risk margin	336,300	183,178
Total outstanding claims liability - undiscounted	3,372,586	2,344,414
Current	3,372,586	2,344,414
Total	3,372,586	2,344,414

No discounting has been applied to claims on the basis that the majority of claims are expected to be settled within one year.

b) Risk margins

Incurred but not reported (IBNR) claims are initially calculated on a best estimate basis, and a risk margin of 23.32% for Hull, 24.6% for P&I and 19.52% for Aquaculture has been applied in order to achieve the probability of adequacy at a minimum confidence level of 75%. These risk margins are based on the previous years actuarial report. The same risk margins were applied in 2013.

c) Liability adequacy test

The liability adequacy test has been conducted using the central estimate of the present value of expected future cash flows and has identified a surplus.

	20 Feb 15 $NZ	31 Dec 13 $NZ
Central estimate of the present value of expected future cash flows	2,945,222	2,445,792
Risk margin	-	-

Liability adequacy has been reviewed at a Branch level, and failure in liability adequacy is not envisaged.

The principal risk the Branch faces under insurance contracts is that actual claims payments or the timing thereof, differ from expectations. This is influenced by the frequency and severity of claims and the subsequent development of long-tailed claims. The objective of the Branch is to ensure that sufficient technical provisions are available to cover these liabilities.

This risk exposure is mitigated by diversification across a large portfolio of insurance contracts. The variability of risks is also reduced by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements.

Sunderland Marine Insurance Company Limited

New Zealand Branch

Notes to the Financial Statements

For the period 1 January 2014 to 20 February 2015

10 Income Tax	14 month period end 20 Feb 15 NZ$	Year end 31 Dec 13 NZ$
a) Income tax expense		
Current taxes	271,224	634,733
Adjustments in respect of prior periods	2,278	(2,025)
Total current taxes	273,502	632,708
Deferred taxes		
Origination of timing differences	(5,301)	(3,463)
Income tax expense	268,201	629,245
b) Reconciliation of prima facie tax payable to income tax expense		
Profit from operating activities before income tax	949,764	2,243,514
Prima facie income tax payable (28%)	265,934	628,184
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Non taxable income	(643)	1,919
Non deductible expenses	632	1,167
Prior year adjustments	2,278	(2,025)
Income tax expense	268,201	629,245
c) Income tax payable		
Opening balance	(255,719)	(1,258)
Additional provisions recognised	(271,224)	(629,053)
Liabilities paid	512,624	373,334
Prior years recognised	(2,278)	1,258
Closing balance	(16,597)	(255,719)
d) Deferred tax asset		
Opening balance	24,918	21,455
Adjustments in respect of prior years		1,290
Adjusted opening balance	24,918	22,745
Movement during the period	5,301	2,173
Closing balance at 31st December	30,219	24,918
Excess of taxation allowances over depreciation on fixed assets	4,616	4,357
Other timing differences	25,603	20,561
	30,219	24,918

11 Contingencies

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

12 Commitments

a) Capital commitments
There have been no capital commitments contracted for at the reporting date or the prior year reporting date that have not been recognised as a liability.

b) Lease commitments
There have been no lease commitments contracted for at the reporting date or the prior year reporting date that have not been recognised as a liability.

13 Events Occurring after the Statement of Financial Position Date

Subsequent Events are events or transactions that occur after the Statement of Financial Position date but before financial statements were issued that provide additional evidence about conditions that existed at the date of the Statement of Financial Position. In preparing the financial statements, the Branch has evaluated events that occurred after 20 February, 2015, up until the financial statements were available to be issued, which occurred on 13 July 2015.

No significant events have occurred subsequent to the Statement of Financial Position date.

14 Related Party Transactions

At 20 February 2015, the ultimate controlling party of the Branch was The North of England Protecting and Indemnity Association Limited (NEPIA). On 28 February 2014 NEPIA acquired Sunderland Marine Mutual Insurance Company Limited, being the previous ultimate controlling party of the Branch, by becoming the sole member limited by guarantee.

Transactions with related parties

Transactions with related parties during the year include the Branch's participation in Sunderland Marine Insurance Company Limited's (SMI) global reinsurance program and service charges charged from SMI. The service charge is a distribution across SMI's branches for the running costs of the Head Office, which is allocated on an earned premium basis.

Transactions with related parties during the year are as follows:

	Feb 2015	**Dec 2013**
SMI		
Statement of Comprehensive Income		
Net reinsurance premium	3,860,203	1,993,961
Recoveries	1,793,126	1,135,382
Service charge	998,890	759,080
Statement of Financial Position		
Debtors	1,387,339	2,126,169
Reinsurance receivable	1,100,379	992,640

15 Credit Rating

Standard and Poor's have assigned an 'A' rating to the NEPIA group as a whole.

16. Risk Management

The Branch's management of insurance risk and financial risk is a critical aspect of the business. The Branch has exposure to the following risks from its use of financial instruments and its insurance contracts:

- Insurance risk
- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Branch's exposure to each of the above risks, the objectives and policies and processes for measuring and managing risk.

(a) Risk management framework

(i) *Governance framework*

The primary objective of the risk management framework is to protect the policyholders from events that hinder the achievement of financial performance objectives. A policy framework, put in place at the Company level, sets out the risk profiled for the Branch and the Board regularly approves the Company's risk management policies.

(ii) *Regulatory framework*

One of the objectives of the Company's primary regulator is to protect the rights of the policyholders. The regulator monitors the Company closely to ensure that it is satisfactorily managing its affairs for the policyholders' benefit. At the same time the regulator is also interested in ensuring that the Company maintains an appropriate solvency position to meet unforeseen liabilities.

The operations of the Branch are also subject to regulatory requirements. Such regulations not only prescribe approval and monitoring activities, but also impose certain requirements, such as capital adequacy, to minimize the risk of default and insolvency.

(iii) *Asset or liability management framework*

The Branch has limited exposure to risks arising from movements in interest rates and other prices which are exposed to general and specific market movements. The principal technique used by the Branch is to ensure that there is sufficient cash flow available to meet liabilities as they fall due.

Specific risks that the Branch is exposed to, and how they are managed, are explained below.

(b) **Insurance risk**

The Branch issues contracts that transfer significant insurance risk. This section outlines the specific insurance related risks the Branch is exposed to and how these are managed.

(i) *Underwriting risk*

Underwriting risk is the risk that the total cost of claims, claims adjustment expenses and premium acquisition expenses will exceed the premiums received. This can arise as a result of numerous factors, including pricing risk, reserving risk and catastrophe risk.

Pricing risk arises because actual claims experience can differ adversely from the assumptions included in pricing calculations. Reserving risk arises because actual claims can differ adversely from the assumptions included in setting reserves. Catastrophe risk is the risk that a single event or series of events, of major magnitude leads to a significant deviation in actual claims from the total expected claims.

Underwriting risk will be influenced by the frequency of claims, severity of claims, and subsequent development of long-tail claims. The objective of the Branch is to ensure that sufficient insurance contract provisions are available to cover these liabilities.

Strict claim review handling policies to assess all new and on-going claims, regular detailed review of claims handling procedures and frequent investigation of possible fraudulent claims are all policies and procedures put in place to reduce the insurance risk exposure of the Branch.

The Branch further enforces a policy of actively managing claims in order to reduce its exposure to unpredictable future developments that can adversely impact the Branch.

(ii) *Concentration risk*

This risk exposure is mitigated by diversification across a large portfolio of insurance contracts and geographical areas. The variability of risks is also reduced by careful selection and implementation of underwriting strategy guidelines, as well as the use of reinsurance arrangements. This serves to reduce the exposure to concentration risk, the risk of exposure to increased losses associated with inadequately diversified portfolios or assets and/or obligations.

(iii) *Reinsurance risk*

The Branch reinsures a portion of the risks it writes in order to control its exposure to losses (including catastrophic losses) and protect capital resources. The Branch buys a combination of proportional and non-proportional reinsurance to reduce the net exposure of the Branch on any one risk. Amounts recoverable from reinsurers are estimated in a manner consistent with the provision for unpaid claims and are in accordance with the reinsurance contracts.

Although the Branch has reinsurance arrangements, it is not relieved of its direct obligation to its policyholders and thus a credit risk exposure exists with respect to ceded insurance to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements. The Branch's placement of reinsurance is diversified such that it is not dependent on a single reinsurer.

(c) **Credit Risk**

Credit risk is the risk of financial loss to the Branch if a customer or counterparty to a financial instrument fails to meet its contractual obligations. It arises principally from reinsurance receivables, direct insurance receivables, and investments. The following policies and procedures are in place to mitigate the Branch's exposure to credit risk.

(i) *Reinsurance receivables*

Reinsurance is only placed with counterparties that have a good credit rating. The Company's security committee ensures that all the Branch's reinsurers' are rated as 'A' or above by Standard & Poor's.

(ii) *Direct insurance receivables*

The Branch's exposure to credit risk from receivables arising out of direct insurance operations is influenced by the individual characteristics of each policyholder and their payment of premiums. Each policyholder is required to pay the premiums in the period specified in their respective policy agreement.

The Branch manages the impact of credit risk by cancelling policies with balances outstanding after the relevant payment period has expired, subject to the terms of the individual policy agreement. If a policy is cancelled, the policyholder has ceased to be insured by the Branch and the Branch will no longer be liable for any claims occurring before or after the cancellation of insurance. This is in accordance with the Branch's general conditions.

(iii) *Investments*

The Branch holds Debt Securities with a fair value of $0.5 million (2013 - $0.5 million) which is a short term government bond and Cash and Short Term bank deposits of $4.6m (2013 - $ 2.2m). These are deemed to have minimal credit risk.

(d) **Liquidity Risk**

Liquidity risk is the risk that the Branch will encounter difficulty in meeting its financial obligations as they fall due.

The Branch's approach to managing liquidity risk is to ensure, as far as possible, that it will always have sufficient liquidity in meeting its liabilities when due. The Branch monitors its forecast liquidity position by estimating cash outflows from its insurance contracts and placing cash on deposit with similar durations to meet those obligations. All financial liabilities at 20 February 2015 and December 31 2013 are due on demand.

(e) **Market Risk**

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

Currency risk

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

All the Branch's transactions and all balances are held in New Zealand Dollars. The Branch participates in SMI's global reinsurance program. SMI's reinsurance program is denominated in Sterling and US Dollars and is managed by SMI's head office in the UK. The Branch pays its proportion of the costs of the reinsurance program in New Zealand Dollars and also receives any recoveries from the program in New Zealand Dollars. SMI in the UK is exposed to currency risk on the reinsurance program rather than the Branch.

The Branch is exposed to currency risk only to the extent that the calculation of the reinsurance premium charged and recoveries receivable in New Zealand Dollars vary due to exchange rates used in those calculations by SMI head office for the Branch.

Interest rate risk

This is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Branch's exposure to changes in market interest rates is concentrated in its investment portfolio, where there is only one short term government bond investment made.

The Branch manages its investment portfolio in accordance with an investment framework. The framework is used to determine both the investment policy and to establish the investment risk appetite. In this context, the overall risk is reviewed on a regular basis and the asset allocation is adjusted as necessary.

Other price risk

This is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest risk or currency risk, whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Branch is exposed to minimal other price risk as its investment portfolio is principally in debt securities guaranteed by the New Zealand Government or issued by New Zealand Provinces and has no exposure to equity investments or commodities prices.

(f) **Capital Management**

The required capital for Sunderland Marine Insurance Company Limited, as measured by the UK Prudential Regulatory Authority's (PRA's) Required Minimum Margin (RMM), is determined by the application of a formula that contains variables for premium and claims, expenses and reserves. The company also submits to its domiciliary regulator an annual Enhanced Capital Requirement (ECR) calculation and an Individual Capital Assessment (ICA) as required. There have been no reported breaches of the RMM, ECR and ICA throughout the period.