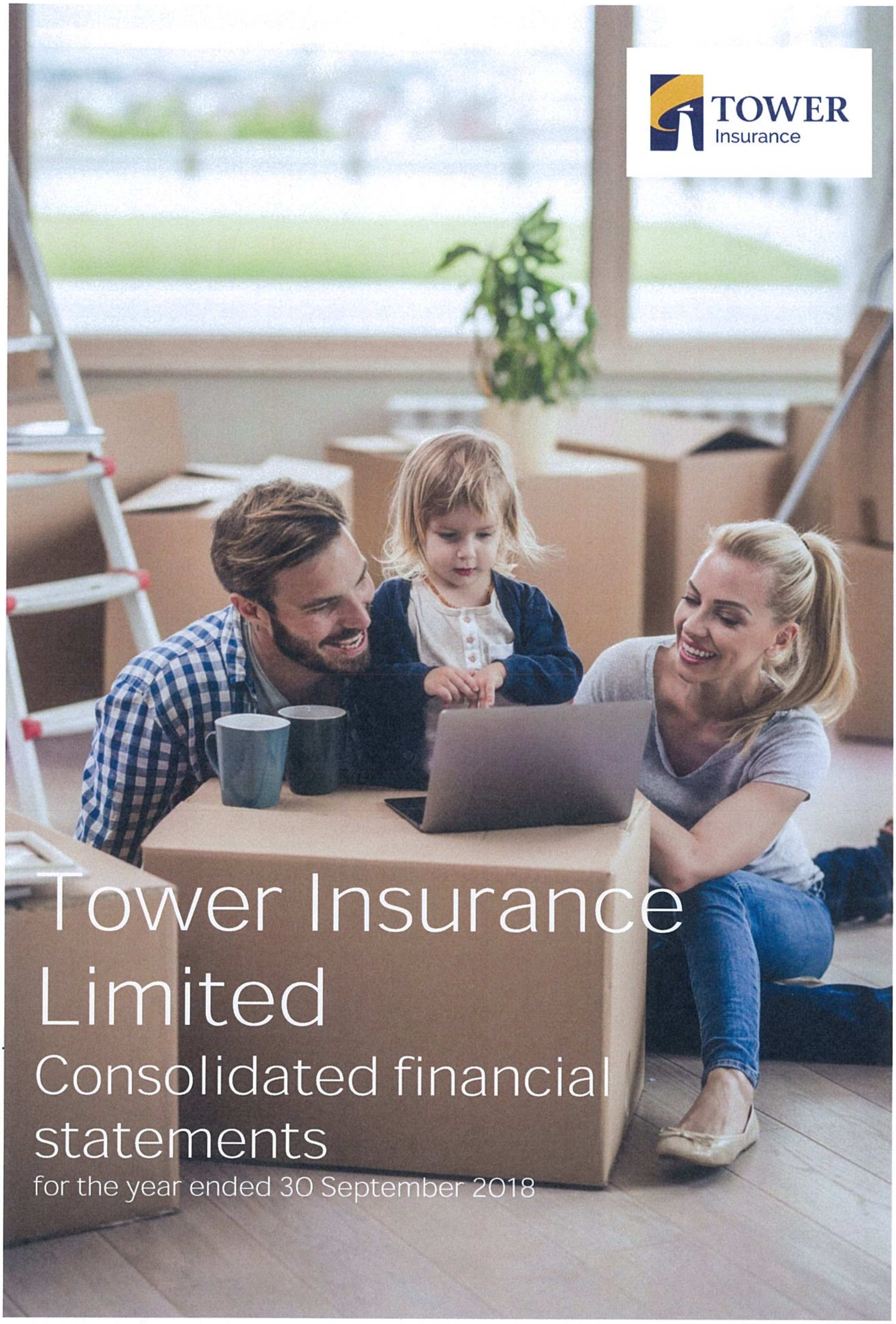

TOWER Insurance

Tower Insurance Limited

Consolidated financial statements

for the year ended 30 September 2018

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DIRECTORS' REPORT

The Directors of Tower Insurance Limited present their report and consolidated financial statements of the Group for the year ended 30 September 2018.

During the year the Group undertook its principal activity of providing general insurance and insurance related services to its customer base throughout New Zealand, Fiji, Papua New Guinea, Solomon Islands, Cook Islands, Samoa, Tonga, American Samoa and Vanuatu.

The consolidated after tax loss attributable to shareholder for the year was $7,447,000 (2017: $7,199,000 loss). Accumulated losses at the end of the year totalled $53,187,000 (2017: $45,740,000 loss). Shareholders' equity at the end of the period totalled $165,638,000 (2017: $172,786,000). The Directors consider the state of affairs of the Group to be satisfactory. No dividends were paid during the period (2017: Nil).

No disclosure has been made in respect of Section 211(1)(a) and (e) to (j) of the Companies Act 1993 following a unanimous decision by the shareholders in accordance with Section 211(3) of the Act.

The Company has arranged Directors' liability insurance for Directors and officers of the Company and its related companies which ensures that generally Directors and those officers will incur no monetary losses as a result of actions undertaken by them in the course of their duties. Such insurance arrangements exclude certain actions such as the incurring of penalties or fines that may be imposed for breaches of the law.

Directors in office during the period and at the date of this report are Michael Stiassny, Graham Stuart, Steve Smith, Warren Lee and Wendy Thorpe. David Hancock ceased his directorship on 1 March 2018.

The Board of Directors of Tower Insurance Limited authorised the financial statements for issue on 28 November 2018.

The Directors wish to thank all staff for their loyalty, application and support during the year.

For and on behalf of the Board

Graham R Stuart
Chairman

28 November 2018
Date

Stephen J Smith
Director

28 November 2018
Date

GOVERNANCE STATEMENT

The New Zealand insurance industry is regulated by the Reserve Bank of New Zealand under the Insurance (Prudential Supervision) Act 2010 ("IPSA"). All companies carrying on insurance business in New Zealand must hold a licence. Tower Insurance Limited is a licensed insurer.

Governance is a key aspect of the Reserve Bank's licensing requirements and the Reserve Bank has published Governance Guidelines setting out the governance requirements for licensed insurers. Tower Insurance Limited has adopted and developed corporate governance structures, policies and practices that are consistent with these guidelines.

Role and operation of the Board of Directors

The primary role of the Board of Tower Insurance Limited is to govern the Company, by ensuring there is a proper governance framework in place to promote and protect the Company's interests for the benefit of its stakeholders.

Under IPSA, Directors of a licensed insurer must act in the best interests of that company and cannot act in the best interests of a holding company where it is not in the best interests of the licensed insurer.

The Board is primarily governed by the Tower Insurance Limited Board Charter, and is also subject to the Tower Code of Ethics. The Board Charter records the Board's roles and responsibilities, including reserving certain functions to the Board, and the Code of Ethics ensures decision making is in accordance with Tower's values.

The Board meets a minimum of four times each calendar year and will hold additional meetings as required.

The day-to-day leadership and management of Tower Insurance Limited is undertaken by the Chief Executive Officer under a formal delegation from the Board, and by senior management. The Chief Executive Officer is solely accountable to the Board for management performance. The Chief Executive Officer has also formally delegated decision making to senior management within their areas of responsibility and subject to quantitative limits to ensure consistent and efficient decision-making within the Company.

Composition of the Board

Tower Insurance Limited's constitution provides for a minimum of two, and a maximum of nine, Directors. Tower Insurance Limited had five Directors as at 28 November 2018. Details on the Directors, including their qualifications and experience are set out below. Under the Reserve Bank Governance Guidelines for licensed insurers it is expected that at least half of the Directors will be independent. Criteria that the Reserve Bank will consider when determining whether a Director is independent include, but are not limited to:

- any financial or other obligation the Director may have to the licensed insurer or its Directors;
- whether the Director has been employed in an executive capacity by the licensed insurer or any associated person within the last three years;
- whether the Director is, or has been, a provider of material professional services to the licensed insurer or any associated person within the last three years;
- whether the Director has a material contractual relationship with the licensed insurer or any associated person;
- any remuneration received in addition to Director's fees, related directorships or shareholdings in the licensed insurer; or
- whether the Director is a related party of the licensed insurer.

All of the Tower Insurance Limited Directors are considered by the Company to be independent and those Directors are noted below. All of the Directors of Tower Insurance Limited are also Directors of Tower Limited and Tower Financial Services Group Limited.

Composition of the Board (including range of skills, knowledge and experience) and Director independence, is reviewed by the Remuneration and Appointments Committee.

GOVERNANCE STATEMENT (continued)

Graham Stuart

BCom (Hons), MS, FCA

Chairman

Independent

Appointed Director: 5 August 2013

With over 30 years of senior management experience, Graham has held senior leadership roles with several major corporates, in New Zealand and overseas, the latest being the Sealord Group of which he was Chief Executive Officer for 7 years. Prior to that he held a number of diverse leadership roles including CEO of Mainland Products, Managing Director of Lion Nathan International, and Chief Financial Officer and Director of Strategy for the Fonterra Co-operative Group. Graham has a Bachelor of Commerce (First Class Hons) from the University of Otago, a Master of Science from Massachusetts Institute of Technology and is a Fellow of Chartered Accountants Australia and New Zealand. Graham has served on a number of Government bodies including the Food & Beverage Taskforce and the Maori Economic Development Panel.

Graham resides in Auckland, New Zealand.

Michael Stiassny

LLB, BCom, FCA, CFInstD

Non Executive Director

Independent

Appointed Director: 5 August 2013

Michael is a Fellow of Chartered Accountants Australia and New Zealand. He has both a Commerce and Law degree from the University of Auckland. He is Chairman of Ngati Whatua Orakei Whai Rawa Limited, New Zealand Transport Agency and is a director of a number of other companies. Michael is the immediate past President and a Chartered Fellow of the Institute of Directors in New Zealand (Inc).

Michael resides in Auckland, New Zealand.

Steve Smith

BCom, CA, Dip Bus (Finance), CFInstD

Non Executive Director

Independent

Appointed Director: 5 August 2013

Steve has been a professional Director since 2004. He has over 35 years' business experience, including being a specialist corporate finance partner at a leading New Zealand accountancy firm. He has a Bachelor of Commerce and Diploma in Business from the University of Auckland, is a member of Chartered Accountants Australia and New Zealand and a Chartered Fellow of the Institute of Directors in New Zealand (Inc). Steve is Chairman of Pascaro Investments Ltd, and a Director of Rimu S.A. (Chile) and the National Foundation for the Deaf Inc.

Steve resides in Auckland, New Zealand.

Warren Lee

BCom, CA

Non Executive Director

Independent

Appointed Director: 26 May 2015

Warren has extensive experience and a long record of leadership in the international insurance industry, including 15 years at AXA in senior management positions within the company's Australian and Asian businesses. Warren's two most recent positions were Chief Executive Officer of the Victorian Funds Management Corporation and Chief Executive Officer, Australia and New Zealand for AXA Asia Pacific Holdings Limited. Warren is a non-executive director of MyState Limited, a listed Australian Financial Services Group. He has a Bachelor of Commerce from the University of Melbourne and is a member of Chartered Accountants Australia and New Zealand.

Warren resides in Melbourne, Australia.

Wendy Thorpe

BA (French), BBus (Accounting), Grad Dip, Applied Fin & Inv, Harvard AMP, FFin, GAICD

Non Executive Director

Independent

Appointed Director: 1 March 2018

Wendy is an experienced financial services leader and for the past 15 years her executive career has focused on leading technology and operations in insurance and wealth management. Her most recent executive role was as Group Executive, Operations for AMP Ltd, and she was previously Chief Operations Officer and Chief Information Officer for AXA Asia Pacific Holdings Ltd. Wendy is also a Director of AMP Bank Limited, Chair of Online Education Services Pty Ltd, and a Director of Very Special Kids, an Australian Not for Profit. Wendy has a Bachelor of Arts from LaTrobe University, a Bachelor of Business from Swinburne University and a Graduate Diploma in Applied Finance and Investment from the Securities Institute of Australia. She completed the Advanced Management Program at Harvard Business School, is a Fellow of the Financial Services Institute of Australasia and a Graduate member of the Australian Institute of Company Directors.

Wendy resides in Melbourne, Australia.

Board committees

The Board has two standing committees: the Audit and Risk Committee and the Remuneration and Appointments Committee. The Committees are governed by written terms of reference, which detail their specific functions and responsibilities.

The Committees make recommendations to the Board. They have no decision-making ability except where expressly provided by the Board.

Audit and Risk Committee

Members: Steve Smith (Chairman), Warren Lee, Michael Stiassny, Graham Stuart and Wendy Thorpe. David Hancock ceased his directorship on 1 March 2018.

Tower Insurance Limited has a structure to independently verify and safeguard the integrity of the Company's financial reporting. The principal components of this are the Audit and Risk Committee, the external and internal auditors, and the certifications provided to the Board by senior management.

The terms of reference of the Audit and Risk Committee include the following duties and responsibilities:

- Independently and objectively review the financial information presented by management to the Board, external auditors, regulators and the public.
- Review draft half yearly and annual Company financial statements and reports and the external audit report, and make recommendations to the Board as to their adoption.
- Oversee the performance of the external auditor and be satisfied as to its independence.
- Review draft half yearly and annual solvency returns and receive the financial condition report prepared by the Appointed Actuary.
- Advise the Board in respect of IPSA solvency issues relating to the Company.
- Review the effectiveness of management processes, risk management and internal financial controls and control systems.
- Monitor and review compliance with regulatory and statutory requirements and obligations including, but not limited to, the requirements of IPSA.
- Monitor the internal audit function and receive regular reports from the internal auditors on risks, exposures and compliance.
- Maintain open and direct lines of communication with the external and internal auditors.
- Make recommendations to the Board as to the appointment of external auditors.
- Monitor and review policies and practices established to avoid and manage conflicts of interest (pecuniary or otherwise) by the Company, Directors, management and staff.

GOVERNANCE STATEMENT (continued)

The Committee is to meet a minimum of three times per year.

The terms of reference require that the Audit and Risk Committee has a minimum of three Non-Executive Directors, the majority of whom are independent.

The Board appoints the Chairman of the Committee, who is an independent non-executive Director who cannot also be the Chairman of the Board.

The Chairman is required to provide an annual report summarising the committee's activities, findings, recommendations and results for the past year.

Remuneration and Appointments Committee

Members: Michael Stiassny (Chairman), Warren Lee, Steve Smith, Graham Stuart and Wendy Thorpe.

The Remuneration and Appointments Committee advises the Board in respect of a number of matters, including:

- the appointment, induction and succession of Board Directors, and Director remuneration;
- the composition and structure of the Board, including on-going review of Director independence;
- performance evaluations of the Board; and
- the Chief Executive Officer and senior executive appointments, termination, performance appraisal and remuneration.

The terms of reference require that the Committee has a minimum of three suitably qualified Non-Executive Directors, the majority of which are independent. The Board appoints the Chairman of the Committee, who is to be an independent, non-executive Director.

The Chairman is also required to provide an annual report summarising the Committee's activities, findings, recommendations and results for the past year.

Risk management

Tower's approach to risk management is recorded in the Tower Risk & Compliance Framework Board Policy. This policy sets out Tower's commitment to managing risk and compliance, and provides an overview of the core components of the Framework including roles and responsibilities and requirements that must be met. The Framework applies to Tower Insurance Limited. Effective management of risk and compliance is essential to ensure that Tower Insurance Limited remains a viable business and is able to achieve its objectives. This Framework is integral in providing guidance to management and staff of Tower in dealing with its risk and compliance obligations.

Tower Insurance Limited is subject to the Tower Conflicts of Interest and Related Party Transactions Policy. This Policy sets out the principles and procedures relating to the management of conflicts of interest within the Tower group and includes principles and procedures for dealings with related parties.

CONSOLIDATED INCOME STATEMENT

$ thousands For the year ended 30 September	Note	2018	2017
Revenue			
Premium revenue	B1	**323,093**	306,079
Less: Outwards reinsurance expense		**(54,251)**	(49,164)
Net premium revenue		**268,842**	256,915
Investment revenue	C1	**6,075**	7,027
Other revenue		**3,592**	3,004
Net operating revenue		**278,509**	266,946
Expenses			
Claims expense		**200,467**	225,384
Less: Reinsurance recoveries revenue		**(23,835)**	(37,833)
Net claims expense	B2	**176,632**	187,551
Management and sales expenses	D1	**87,199**	80,175
Impairment of reinsurance receivables	D2	**22,511**	-
Acquisition proposal expenses	D3	**302**	3,467
Total expenses		**286,644**	271,193
Loss before taxation		**(8,135)**	(4,247)
Tax benefit (expense) attributed to shareholders' profits	D6	**735**	(2,491)
Profit (Loss) for the year		**(7,400)**	(6,738)
Profit (Loss) attributed to:			
Shareholders		**(7,447)**	(7,199)
Non-controlling interest		**47**	461
		(7,400)	(6,738)

The above statements should be read in conjunction with the accompanying notes.

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

$ thousands For the year ended 30 September	Note	2018	2017
Loss for the year		**(7,400)**	(6,738)
Other comprehensive income (loss)			
Currency translation differences		**42**	105
Gain on asset revaluation	E2	**434**	247
Deferred income tax relating to asset revaluation	D6	**(81)**	(29)
Other comprehensive income net of taxation		**395**	323
Total comprehensive loss for the year		**(7,005)**	(6,415)
Total comprehensive income (loss) attributed to:			
Shareholders		**(7,148)**	(6,881)
Non-controlling interest		**143**	466
		(7,005)	(6,415)

The above statements should be read in conjunction with the accompanying notes.

CONSOLIDATED BALANCE SHEET

$ thousands As at	Note	2018	2017
Assets			
Cash and cash equivalents	C2	**74,906**	79,078
Receivables	E1	**259,324**	285,960
Investments	C3	**198,000**	186,702
Derivative financial assets	C4	**244**	231
Deferred acquisition costs	D4	**22,595**	20,961
Property, plant and equipment	E2	**8,510**	8,780
Intangible assets		**7**	25
Current tax assets		**1,817**	1,448
Deferred tax assets	D6	**10,333**	7,262
Total assets		**575,736**	590,447
Liabilities			
Payables	E3	**77,927**	66,254
Provisions	E4	**5,413**	5,684
Insurance liabilities	B4	**324,527**	343,498
Current tax liabilities	D6	**174**	560
Deferred tax liabilities	D6	**589**	340
Total liabilities		**408,630**	416,336
Net assets		**167,106**	174,111
Equity			
Contributed equity	F1	**209,990**	209,990
Accumulated profit (losses)		**(53,187)**	(45,740)
Reserves	F2	**8,835**	8,536
Total equity attributed to shareholders		**165,638**	172,786
Non-controlling interest		**1,468**	1,325
Total equity		**167,106**	174,111

The consolidated financial statements were approved for issue by the Board on 28 November 2018.

Graham R Stuart
Director

Stephen J Smith
Director

The above statements should be read in conjunction with the accompanying notes.

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CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

		Attributed to shareholders					
$ thousands	Note	Contributed equity	Accumulated (losses) profit	Reserves	Total	Non-controlling interest	Total Equity
Year Ended 30 September 2018							
At the beginning of year		**209,990**	**(45,740)**	**8,536**	**172,786**	**1,325**	**174,111**
Total comprehensive income (loss)		**-**	**(7,447)**	**299**	**(7,148)**	**143**	**(7,005)**
Total transactions with shareholders		**-**	**-**	**-**	**-**	**-**	**-**
At the end of the year		**209,990**	**(53,187)**	**8,835**	**165,638**	**1,468**	**167,106**
Year Ended 30 September 2017							
At the beginning of year		174,990	(38,541)	8,218	144,667	1,374	146,041
Total comprehensive income (loss)		-	(7,199)	318	(6,881)	466	(6,415)
Transactions with shareholders							
Dividends paid	F1	-	-	-	-	(515)	(515)
Share Capital issued	F1	35,000	-	-	35,000	-	35,000
Total transactions with shareholders		35,000	-	-	35,000	(515)	34,485
At the end of the year		209,990	(45,740)	8,536	172,786	1,325	174,111

The above statements should be read in conjunction with the accompanying notes.

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CONSOLIDATED STATEMENT OF CASH FLOWS

$ thousands For the year ended 30 September	Note	2018	2017
Cash flows from operating activities			
Premiums received		**319,329**	309,147
Interest received		**6,943**	7,118
Net realised investment (loss) gain		**(605)**	(1,928)
Commissions received		**3,592**	3,004
Reinsurance received		**45,780**	28,962
Reinsurance paid		**(52,327)**	(50,228)
Claims paid		**(231,843)**	(248,183)
Payments to suppliers and employees		**(84,533)**	(79,900)
Income tax paid		**(2,831)**	(4,908)
Net cash inflow (outflow) from operating activities	C5	**3,505**	(36,916)
Cash flows from investing activities			
Net proceeds from (payments for) financial assets		**(6,771)**	2,852
Purchase of property, plant and equipment and intangible assets		**(776)**	(1,114)
Disposal of property, plant and equipment and intangible assets		**22**	119
Net cash inflow (outflow) from investing activities		**(7,525)**	1,857
Cash flows from financing activities			
Proceeds from issue of share capital	F1	**-**	35,000
Payment of minority interest dividends		**-**	(515)
Net cash inflow (outflow) from financing activities		**-**	34,485
Net (decrease) increase in cash and cash equivalents		**(4,020)**	(574)
Effect of exchange rate changes		**(152)**	(392)
Cash and cash equivalents at the beginning of year		**79,078**	80,044
Cash and cash equivalents at the end of year	C2	**74,906**	79,078

Accounting policy

The consolidated statement of cash flows presents the net changes in cash flow for financial assets, property, plant and equipment, intangible assets and advances to subsidiaries. Tower Insurance Limited considers that knowledge of gross receipts and payments is not essential to understanding the activities of the Group or company based on either: the turnover of these items is quick, the amounts are large, and the maturities are short or the value of the sales are immaterial.

The above statements should be read in conjunction with the accompanying notes.

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NOTES TO THE FINANCIAL STATEMENTS

PART A - INTRODUCTION

This section provides introductory information that is helpful to an overall understanding of the financial statements, including an explanation of Tower Insurance's Group structure and the areas of critical accounting judgements and estimates included in the financial statements. It also includes a summary of Tower Insurance's financial performance by operating segment.

A1 REPORTING ENTITY AND BASIS OF PREPARATION

Entities reporting

Tower Insurance Limited (the Company) is a for-profit company incorporated in New Zealand under the Companies Act 1993. The Company is a FMC reporting entity under Part 7 of the Financial Markets Conduct Act 2013. The parent of the Company is Tower Financial Services Group Limited. The ultimate parent of the Group is Tower Limited. The Company and its subsidiaries together are referred to in this financial report as Tower Insurance, or the Group, or the consolidated entity. The address of the Company's registered office is 45 Queen Street, Auckland, New Zealand.

During the periods presented, the principal activity of the Group was provision of general insurance. The Group predominantly operates in New Zealand with some of its operations based in the Pacific Islands region.

The financial statements were authorised for issue by the Board of Directors on 28 November 2018. The entity's owners or others do not have power to amend the financial statements after issue.

Basis of preparation

The financial statements of the Group have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). They comply with International Financial Reporting Standards (IFRS) and also New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable financial reporting standards, as appropriate for Tier 1 for-profit entities.

The financial statements have been prepared on a fair value measurement basis with any exceptions noted in the accounting policies below, or in the notes to the financial statements.

Changes in comparatives

Refer to Note G5 for details of changes in comparatives. Changes relate to income statement reclassification, balance sheet reclassification and presentation of notes. There is no change to net assets or the 2017 income statement.

A2 CONSOLIDATION

Principles of consolidation

The Group financial statements incorporate the assets and liabilities of all subsidiaries of the Company at balance date and the results of all subsidiaries for the year.

Subsidiaries are those entities over which the consolidated entity has control, being power over the investee; exposure, or rights to variable returns from its involvement with the investee; and the ability to use its power over the investee to affect the amount of the investor's returns.

The results of any subsidiaries acquired during the year are consolidated from the date on which control was transferred to the consolidated entity and the results of any subsidiaries disposed of during the year are consolidated up to the date control ceased.

The acquisition of controlled entities from external parties is accounted for using the acquisition method of accounting. Non-controlling interests in the results and equity of subsidiaries are shown separately in the consolidated income statement, statement of comprehensive income, statement of changes in equity and balance sheet respectively. Acquisition related costs are expensed as incurred.

When the Group ceases to have control, any retained interest in the entity is re-measured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss.

Intercompany transactions and balances between Group entities are eliminated on consolidation.

NOTES TO THE FINANCIAL STATEMENTS

A2 CONSOLIDATION (continued)

Foreign currency

(i) Functional and presentation currencies

The financial statements of each Group entity are presented in the currency of the primary economic environment in which the entity operates. The Group financial statements are presented in New Zealand dollars and rounded to the nearest thousand dollars unless stated otherwise.

(ii) Transactions and balances

In preparing the financial statements of the individual entities, transactions denominated in foreign currencies are translated into New Zealand dollars using the exchange rates in effect at the transaction dates. Monetary items receivable or payable in a foreign currency are translated at reporting date at the closing exchange rate.

Translation differences on non-monetary items such as financial assets held at fair value through profit or loss are reported as part of their fair value gain or loss.

Exchange differences arising on the settlement or retranslation of monetary items at year end exchange rates are recognised in the income statements unless the items form part of a net investment in a foreign operation. In this case, exchange differences are taken to the Foreign Currency Translation Reserve and recognised in the statements of comprehensive income and the statements of changes in equity.

(iii) Consolidation

For the purpose of preparing consolidated financial statements the assets and liabilities of subsidiaries with a functional currency different to the Company are translated at the closing rate at the balance date. Income and expense items for each subsidiary are translated at a weighted average of exchange rates over the period, as a surrogate for the spot rates at transaction dates. Foreign currency translation differences are taken to the Foreign Currency Translation Reserve and recognised in the statements of comprehensive income and the statements of changes in equity.

On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statements.

Subsidiaries

The table below lists Tower Insurance Limited's principal subsidiary companies and controlled entities. All entities have a balance date of 30 September.

Name of company	**Country Incorporated in**	**Holdings**		**Nature of business**
		2018	2017	
Tower Insurance (Cook Islands) Limited	Cook Islands	**100%**	100%	General insurance
Tower Insurance (Fiji) Limited	Fiji	**100%**	100%	General insurance
Tower Insurance (PNG) Limited	PNG	**100%**	100%	General insurance
Tower Insurance (Vanuatu) Limited	Vanuatu	**100%**	100%	General insurance
National Pacific Insurance Limited	Samoa	**71%**	71%	General insurance

Tower Insurance Limited operates as a branch in the Solomon Islands.

NOTES TO THE FINANCIAL STATEMENTS

A3 CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The Group makes estimates and judgements in respect of certain key assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Key areas where critical accounting estimates and judgements have been applied are noted below.

Canterbury earthquake claims estimation

The valuation of net outstanding claims is an area of significant judgement and estimation. Key elements of judgement included within claims estimations are: the rate of claims closure; the quantum of closed claims reopening; the level of future increases in building and other claims costs; future claim management expenses; assessments of risk margin; apportionment of claims costs between the four main earthquake events; and the quantum of new claims being received from EQC and the average cost of these claims.

Key elements of judgement included within recoveries estimations are: the collectability of reinsurance recoveries; recoveries from EQC in respect of land damage and building costs; and the assessments of risk margin. The nature of estimation uncertainties, including from those factors listed above, mean that actual claims experience may deviate from reported results.
Refer to Note B3 for further detail on the Canterbury Earthquakes.

EQC recoveries

Valuation of additional EQC recoveries in respect of building costs and land damage is an area of significant judgement and estimation. Areas of judgement and subjectivity exist in assessments of: claim file review of earthquake event allocation; the quality of assessment information; litigation risk factors; and portfolio conservatism. Tower has filed a statement of claim against EQC in respect of land damage recoveries.

Refer to Note B3 and Note E1 for further detail on EQC recoveries for Canterbury earthquakes.

Tax Provisions

The Group is subject to income taxes in New Zealand and jurisdictions where it has foreign operations. Significant management judgement is required in determining the worldwide provision for income taxes. There are some transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The Group estimates its tax liabilities based on its understanding of tax law in each relevant jurisdiction. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

Deferred taxation

Deferred tax assets are recognised for all unused tax losses to the extent it is probable that taxable profits will be available against which the losses can be utilised. Significant management judgement is required to determine the amount of deferred tax assets that can be recognised based on the likely timing and quantum of future taxable profits.

This assessment is completed on the basis of the approved strategic plans of Tower Insurance Limited and subsidiaries. If future profits do not occur as expected, or there is a significant change in ownership, Tower may not be able to utilise all of these tax losses.

NOTES TO THE FINANCIAL STATEMENTS

A4 SEGMENTAL REPORTING

$ thousands	Note	New Zealand	Pacific Islands	Other	Total
Year Ended 30 September 2018					
Revenue					
Net operating revenue		235,335	43,174	-	278,509
Total revenue		**235,335**	**43,174**	**-**	**278,509**
Profit (loss) before interest, tax, depreciation and amortisation		(10,590)	3,964	-	(6,626)
Depreciation and amortisation		(1,027)	(482)	-	(1,509)
Profit (loss) before income tax		(11,617)	3,482	-	(8,135)
Income tax credit (expense)		2,751	(2,016)	-	735
Profit (loss) for the year		**(8,866)**	**1,466**	**-**	**(7,400)**
Year Ended 30 September 2017					
Revenue					
Net operating revenue		222,117	44,816	13	266,946
Total revenue		222,117	44,816	13	266,946
Profit (loss) before interest, tax, depreciation and amortisation		(15,648)	12,688	763	(2,197)
Depreciation and amortisation		(1,529)	(521)	-	(2,050)
Profit (loss) before income tax		(17,177)	12,167	763	(4,247)
Income tax credit (expense)		2,470	(4,958)	(3)	(2,491)
Profit (loss) for the year		(14,707)	7,209	760	(6,738)
Total assets 30 September 2018		**480,664**	**95,072**	**-**	**575,736**
Total assets 30 September 2017		502,356	88,091	-	590,447
Total liabilities 30 September 2018		**345,406**	**63,224**	**-**	**408,630**
Total liabilities 30 September 2017		356,426	59,910	-	416,336

Accounting policy

An operating segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different to those of other operating segments.

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker who reviews the operating results on a regular basis and makes decisions on resource allocation and assessing performance.

Tower Group operates predominantly in two geographical segments, New Zealand and the Pacific region.
The New Zealand segment is comprised of general insurance business written in New Zealand. The Pacific Islands segment includes general insurance business with customers in the Pacific Islands written by Tower Insurance Limited subsidiaries and branch operations. Other includes head office expenses, financing costs and eliminations.

The Group does not derive revenue from any individual or entity that represents 10% or more of the Group's total revenue.

NOTES TO THE FINANCIAL STATEMENTS

PART B - PREMIUM REVENUE AND CLAIMS

This section provides information about Tower Insurance's insurance related financial performance. Tower Insurance operates as a general insurance company and its insurance operations drive its performance and financial position.

Tower Insurance collects premiums from customers in exchange for providing insurance coverage over their assets and activities. These premiums are recognised as revenue when they are earned by Tower Insurance, with a liability for unearned premiums recognised on the balance sheet.

When customers suffer a loss that is covered by their policy, Tower Insurance will make payments to customers or suppliers, which it recognises as claims expenses. To ensure that Tower Insurance's obligations to customers are properly recorded within the financial statements, Tower Insurance recognises provisions for outstanding claims.

To manage Tower Insurance's risk and optimise its returns, Tower Insurance reinsures some of its exposure with reinsurance companies. The premiums paid to reinsurers are recognised as an expense, while recoveries from reinsurers are recognised as revenue.

B1 PREMIUM REVENUE

$ thousands	Note	2018	2017
Gross written premiums		**336,109**	312,396
Less: Gross unearned premiums		**(13,016)**	(6,317)
Premium revenue		**323,093**	306,079

Accounting policy

Premium revenue is recognised in the period in which the premiums are earned during the term of the contract.

The proportion of premiums not earned in the income statement at reporting date is recognised in the balance sheet as unearned premiums.

Premiums ceded to reinsurers under reinsurance contracts are recorded as outwards reinsurance expense and are recognised over the period of the reinsurance contract. Accordingly, a portion of outwards reinsurance premium is treated at balance date as a prepayment.

B2 NET CLAIMS EXPENSE

Net claims expense comprises:

$ thousands	Note	2018	2017
Canterbury earthquake claims (4 key events)	B3	**10,100**	15,916
Additional risk margin	B3	**(5,000)**	10,000
Kaikoura earthquake claims		**(579)**	5,739
Other claims		**172,111**	155,896
Total net claims expense		**176,632**	187,551

NOTES TO THE FINANCIAL STATEMENTS

B2 NET CLAIMS EXPENSE (continued)

Accounting policy

Claims expense is recognised when claims are notified. Provision is made at the end of the year for the estimated cost of claims incurred but not settled at balance date, including the cost of claims incurred but not yet reported to the Group.

The estimated cost of claims includes direct expenses incurred in settling claims net of any expected salvage value and other recoveries. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of claims incurred but not reported (IBNR) is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Group, where more information about the claim event is generally available. IBNR claims may often not be apparent to the insured until many years after the events giving rise to the claims have happened. In calculating the estimated cost of unpaid claims the Group uses a variety of estimation techniques, generally based on statistical analyses of historical experience, which assumes that the development pattern of current claims will be consistent with past experience. Allowance is made for changes or uncertainties which may create distortions in underlying statistics or which may cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in Group processes which might accelerate or slow down the development and (or) recording of paid or incurred claims, compared with statistics from previous periods;
- the effects of inflation; and
- the impact of large losses.

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these, the Group has regard to the claim circumstances reported, any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous periods.

Provisions are calculated net of any reinsurance recoveries. Gross provisions are estimated by adding the expected reinsurance recovery to the net provisions. Details of specific assumptions used in deriving the outstanding claims liability at year end are detailed in Note B5.

Reinsurance and other recoveries on claims expenses are recognised as revenue. Recoveries are measured as the present value of expected future receipts.

B3 CANTERBURY EARTHQUAKES

As at 30 September 2018 Tower has 163 claims remaining to settle (2017: 323 claims) out of a total number of 16,152 claims received as a result of earthquakes impacting the Canterbury region during 2010 and 2011 (2017: 16,106 claims). To date, Tower has paid out more than $869 million to customers (2017: $825 million) in respect of the four main earthquakes that occurred on 4 September 2010; 22 February 2011; 13 June 2011 and 23 December 2011.

Outstanding claims comprises case estimates, claims incurred but not reported (IBNR) and risk margins. In the year ended 30 September 2018, case estimates have reduced as claims have been settled and paid. There have been increased costs on remaining open claims; new over-cap claims being received from EQC; and litigation on claims.

As at 30 September 2018, Tower has estimated gross ultimate incurred claims of $905.8 million in respect of the four main Canterbury earthquake events (2017: $897.4 million).

The financial cost to Tower of the Canterbury earthquakes is reduced through reinsurance and is reflected within net outstanding claims. Tower continues to work closely with its catastrophe reinsurance partners as it completes its Canterbury claims settlement programme. Catastrophe reinsurance partners are required to have a financial strength rating of at least A- issued by a recognised international rating agency.

NOTES TO THE FINANCIAL STATEMENTS

B3 CANTERBURY EARTHQUAKES (continued)

The table below presents a financial representation of Tower's net outstanding claims provision at 30 September 2018 in relation to the four main earthquake events.

Canterbury earthquake provisions

$ thousands	2018	2017
Insurance liabilities		
Gross outstanding claims	**(67,900)**	(107,200)
Additional risk margin	**(5,000)**	(10,000)
	(72,900)	(117,200)
Receivables		
Reinsurance recovery receivables	**7,800**	13,600
EQC related to open claims	**4,500**	5,800
Less: EQC payable to reinsurers	**(1,000)**	(1,700)
	11,300	17,700
Net outstanding claims	**(61,600)**	(99,500)

EQC recovery receivables

Tower has one significant receivable amount related to closed Canterbury earthquake claims, being $68.4 million from EQC (2017: $65.1 million). $16.4 million of this EQC amount is payable to reinsurers which has been allowed for in payables (2017: $17.7 million). The amount payable to reinsurers may vary depending on the balance collected from EQC. A risk margin of $10.1 million has been allowed for on the receivable from EQC (2017: $10.7 million).

Tower insurance estimates the gross amount receivable due from EQC is significantly higher than the $68.4 million, but have adopted this amount, which is the actuarial valuation of the Appointed Actuary. The method by which the actuarial valuation is completed recognises the inherent risk and uncertainty with recovery of the full gross amount.

Tower acknowledges that the EQC recoveries relating to Canterbury earthquakes are an area of significant accounting estimation and judgement, including earthquake event allocation, litigation risk factors and other actuarial assumptions.

Additional risk margin

At 30 September 2017, the Board elected to create an additional risk margin of $10.0 million over and above the provision of the Appointed Actuary, which is set at the 75th percentile probability of sufficiency. This provision has been reviewed by the Board and has been reduced to $5.0 million as at 30 September 2018. The Board will continue to review this additional risk margin each half year and the remaining $5.0 million is expected to be released once the Canterbury Outstanding Claims Liability has sufficiently run off.

The following table presents the cumulative impact of the four Canterbury main earthquake events on the income statement.

$ thousands	Note	2018	2017
Cumulative expenses associated with Canterbury earthquakes:			
Earthquake claims estimate		**(905,840)**	(897,440)
Reinsurance recoveries		**723,173**	746,623
Claim expense net of reinsurance recoveries		**(182,667)**	(150,817)
Reinsurance expense		**(25,045)**	(25,045)
Additional risk margin		**(5,000)**	(10,000)
Cumulative impact of Canterbury earthquakes before tax		**(212,712)**	(185,862)
Income tax		**60,228**	52,710
Cumulative impact of Canterbury earthquakes after tax		**(152,484)**	(133,152)
Recognised in current period (net of tax)			
Net claims expense	B2	**(7,272)**	(11,460)
Additional risk margin	B2	**3,600**	(7,200)
Impairment of receivables	D2	**(15,660)**	-
		(19,332)	(18,660)

NOTES TO THE FINANCIAL STATEMENTS

B3 CANTERBURY EARTHQUAKES (continued)

The Board are actively engaged in monitoring Canterbury earthquake developments. Board process relies on the Appointed Actuary's determination of earthquake ultimate incurred claims estimates and the derivation of estimated outcomes. Recognising relative complexities which exist within remaining open claims, the Appointed Actuary has reviewed each remaining property file with Tower claims staff. This individual claim methodology included review of the latest specialist assessment reports and scope of works to repair or rebuild properties to determine the propensity for future costs to vary. In addition, further provision was made for claims re-opening; claims moving over the EQC cap of $100,000; claims in litigation and other claim categories.

The actuarial reviews performed during the year ended 30 September 2018 identified the following as key contributors to the increase in expected earthquake claims costs:

- Greater than anticipated new over-cap claims received from EQC;
- Continued growth in the number of claims subject to litigaton;
- Continued development of claim costs as they progress through the claims life cycle; and
- Increase in the level of claims handling expenses.

The key elements of judgement within the claims estimation are as follows:

Claims

- the level of future increases in building and other claims costs
- the number of new litigated claims received and the average cost of these claims
- the number of new claims expected from EQC and the average cost of these claims
- the rate of closed claims reopening
- risk margin
- future claim management expenses, and

Recoveries

- recoveries from EQC (including litigation risks) in respect of land damage and building costs
- risk margin.

Given the nature of estimation uncertainties (including those listed above) actual claims experience may still deviate, perhaps substantially, from the gross outstanding claims liabilities recorded as at 30 September 2018. Any further changes to estimates will be recorded in the accounting period when they become known.

The catastrophe reinsurance cover headroom remaining is included in the table below.

Date of event	**Catastrophe reinsurance cover remaining**	
$ thousands	**2018**	2017
June 2011	**255,700**	254,200
December 2011	**486,900**	486,500

Tower Insurance has exceeded its catastrophe reinsurance limit in relation to the September 2010 and February 2011 events.

NOTES TO THE FINANCIAL STATEMENTS

B3 CANTERBURY EARTHQUAKES (continued)

Sensitivity analysis - impact of changes in key variables

Net outstanding claims are comprised of several key elements, as described earlier in this note. Sensitivity of net outstanding claims is therefore driven by changes to the assumptions underpinning each of these elements.

The impact of changes in significant assumptions on the net outstanding claims liabilities, and hence on Tower's profit, are shown in the table below. Each change in assumption has been calculated in isolation of any other changes in assumptions.

The impact of a change to claims costs is offset by reinsurance where there is reinsurance capacity remaining. The impact will be nil where the change in claims costs is less than the remaining reinsurance capacity. However, if the change in claims costs exceeds the reinsurance capacity then Tower's profit will be impacted by the amount of claims costs in excess of the reinsurance capacity.

The changes in the table below reflect the impact on Tower's profits should that event occur.

		Split between events				**Four main earthquakes**	
$ millions	**Change variable**	**Sep 2010**	**Feb 2011**	**Jun 2011**	**Dec 2011**	**30-Sep-18**	30-Sep-17
Outstanding claims:							
(i) Change to costs and quantity of expected claim estimates including building costs and other impacts.	+ 5%	**(0.9)**	**(1.9)**	**-**	**-**	**(2.8)**	(4.3)
	- 5%	**0.9**	**1.9**	**-**	**-**	**2.8**	4.3
(ii) Change in apportionment of claim costs to / from February 2011 event.	+ 1%	**6.4**	**(8.8)**	**-**	**-**	**(2.4)**	(4.1)
	- 1%	**(6.9)**	**8.8**	**-**	**-**	**1.9**	2.0
Receivables:							
Reinsurance recovery receivables							
(iii) Recoveries from EQC in respect of land damage	+ 10%	**0.1**	**0.7**	**-**	**-**	**0.8**	0.8
	- 10%	**(0.1)**	**(0.7)**	**-**	**-**	**(0.8)**	(0.8)
(iv) Recoveries from EQC in respect of building costs	+ 10%	**3.4**	**1.0**	**-**	**-**	**4.4**	4.1
	- 10%	**(3.4)**	**(1.0)**	**-**	**-**	**(4.4)**	(4.1)

(i) Calculated as the change in case estimates (net of EQC contributions) plus IBNR/IBNER and the impact on Tower's profit quantified. Changes in case estimates include overcap claims, closed claims re-opening and risk margin.

(ii) Calculated as 1% of total reported costs (net of EQC contributions) plus IBNR/IBNER moved to/from Feb 2011 event and the impact on Tower's profit quantified.

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B4 INSURANCE LIABILITIES

$ thousands	Note	2018	2017
Unearned premiums		**175,551**	162,342
Outstanding claims		**143,976**	171,156
Additional risk margin		**5,000**	10,000
Total insurance liabilities		**324,527**	343,498
Analysed as			
Current		**291,711**	300,064
Non current		**32,816**	43,434
Total insurance liabilities		**324,527**	343,498

The table below includes the reconciliation of the unearned premiums as at the reporting date:

	2018	2017
Opening balance	**162,342**	157,620
Premiums written	**336,109**	296,855
Premiums earned	**(323,093)**	(291,472)
Foreign exchange movements	**193**	(661)
Closing balance	**175,551**	162,342

Accounting policy

Outstanding claims are measured at the central estimate of the present value of expected future payments after allowing for inflation and discounted at the risk free rate. In addition a risk margin is added to the claims provision to recognise the inherent uncertainty of the central estimate, and to ensure the provision is at least at 75% probability of sufficiency.

The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not yet reported (IBNR), claims incurred but not enough reported (IBNER) and anticipated claims handling costs. Claims handling costs include costs that can be associated directly with individual claims, such as legal and other professional fees, and costs that can only be indirectly associated with individual claims, such as claims administration costs.

Provision has been made for the estimate of claim recoveries from third parties.

Liability adequacy testing is performed in order to recognise any deficiencies in the income statement arising from the carrying amount of the unearned premium liability less any related deferred acquisition costs and intangible assets not meeting the estimated future claims under current insurance conditions. Liability adequacy testing is performed at a portfolio level of contracts that are subject to broadly similar risks and are managed together as a single portfolio.

Refer to Note B3 for further details on the additional risk margin.

NOTES TO THE FINANCIAL STATEMENTS

B5 OTHER INSURANCE DISCLOSURES

B5.1 NET CLAIMS EXPENSE

	2018			2017		
$ thousands	**Risks borne in current year**	**Risks borne in prior years**	**Total**	Risks borne in current year	Risks borne in prior years	Total
Gross claims expense						
Direct claims - undiscounted	**188,452**	**12,035**	**200,487**	175,078	50,235	225,313
Movement in discount	**(60)**	**40**	**(20)**	43	28	71
Total gross claims expense	**188,392**	**12,075**	**200,467**	175,121	50,263	225,384
Reinsurance and other recoveries						
Reinsurance and other recoveries - undiscounted	**(20,073)**	**(3,762)**	**(23,835)**	(20,559)	(17,272)	(37,831)
Movement in discount	**-**	**-**	**-**	(1)	(1)	(2)
Total reinsurance recoveries	**(20,073)**	**(3,762)**	**(23,835)**	(20,560)	(17,273)	(37,833)
Net claims expense	**168,319**	**8,313**	**176,632**	154,562	32,990	187,551

Current year amounts relate to risks borne in the current financial year. Prior period amounts relate to a reassessment of the risks borne in all previous financial years including those arising due to the Canterbury earthquakes. Refer to Note B3.

B5.2 OUTSTANDING CLAIMS

(a) Assumptions adopted in calculation of insurance liabilities

The estimation of outstanding claims as at 30 September 2018 has been carried out by the following Actuaries:

Rick Shaw, B.Sc. (Hons), FIAA, Appointed Actuary; and
John Feyter, B.Sc, FNZSA.

The New Zealand actuarial assessments are undertaken in accordance with the standards of the New Zealand Society of Actuaries, in particular Professional Standard No. 30 "Valuations of General Insurance Claims". The Actuaries were satisfied as to the nature, sufficiency and accuracy of the data used to determine the outstanding claims liability. The outstanding claims liability is set by the Actuaries at a level that is appropriate and sustainable to cover the Group's claims obligations after having regard to the prevailing market environment and prudent industry practice.

The following assumptions have been made in determining net outstanding claims liabilities:

	2018	2017
Inflation rates varied from	0.0%	0.0% - 3.8%
Inflation rates for succeeding year	0.0%	0.0% - 3.8%
Inflation rates for following years	0.0%	0.0% - 3.8%
Discount rates varied from	0.0% - 2.5%	0.0% - 6.3%
Discount rates for succeeding year	0.0% - 2.5%	0.0% - 6.3%
Discount rates for following years	0.0% - 2.5%	0.0% - 6.3%
Claims handling expense ratio	3.5% - 32.3%	3.1% - 39.1%
Risk margin	6.5% - 31.5%	4.9% - 23.1%

In addition to the risk margin range shown above, the total risk margin also includes $14,000,000, gross of reinsurance (2017: $23,900,000) associated with the Canterbury earthquakes.

NOTES TO THE FINANCIAL STATEMENTS

B5 OTHER INSURANCE DISCLOSURES (continued)

The weighted average expected term to settlement of outstanding claims (except for Canterbury earthquake claims) based on historical trends is:

	2018	2017
Short tail claims within 1 year	within 1 year	within 1 year
Long tail claims in the Pacific Islands	1.0 to 1.8 years	1.0 to 1.8 years

Inflation and Discount rate

Insurance costs are subject to inflationary pressures. The valuation implicitly assumes that future inflation will be similar to that experienced in recent years. For the Pacific countries it is assumed that additional superimposed inflation is offset by the discount effect and 0% has, therefore, been assumed for both the inflation rate and discount rate.

For New Zealand business all liabilities are short-tail. Nil additional inflation has been assumed. Outstanding claim liabilities are discounted to present value using a short-term discount rate.

EQC recoveries

For each claim to which additional EQC recoveries relate, Tower has allocated recoverable amounts according to the quality of information and evidence available. Claims with primary evidence (e.g. independent expert documentation) have been assessed as having a strong position for recovery. Claims with non-primary evidence (e.g. general documentation like post code analysis or adjacent locations) will have a lower likelihood of recovery.

Apportionment

Tower assesses claims and apportions damage between Canterbury earthquake events on an individual property basis. The allocation process uses a hierarchical approach based on the relative quality and number of claim assessments completed after each of the four main earthquakes. Results from the hierarchical approach are used as an input to the actuarial valuations which estimate the ultimate claims costs.

Claims handling expense

The estimate of outstanding claim liabilities incorporates an allowance for the future cost of administering the claims. This allowance is determined after analysing historical claim related expenses incurred by the classes of business.

Risk margin

The outstanding claim liabilities also include a risk margin that relates to the inherent uncertainty in the central estimate of the future payments.

Risk margins are determined on a basis that reflects the business. Regard is given to the robustness of the valuation models, the reliability and volume of available data, past experience of the insurer and the industry, and the characteristics of the classes of business written.

Uncertainty in claims is represented as a volatility measure in relation to the central estimate. The volatility measure is derived after consideration of statistical modelling and benchmarking to industry analysis. The measure of the volatility is referred to as the coefficient of variation (CoV), defined as the standard deviation of the distribution of future cash flows divided by the mean.

Risk margins are calculated by jurisdiction. The risk margin for all classes when aggregated is less than the sum of the individual risk margins. This reflects the benefit of diversification. The measure of the parameter used to derive the diversification benefit is referred to as correlation, which is adopted with regard to industry analysis, historical experience and actuarial judgement.

The risk margins applied to future claims payments are determined with the objective of achieving 75% probability of sufficiency for both the outstanding claims liability and the unexpired risk liability.

NOTES TO THE FINANCIAL STATEMENTS

B5 OTHER INSURANCE DISCLOSURES (continued)

The following analysis is in respect of the insurance liabilities:

$ thousands	Note	2018	2017
Central estimate of expected present value of future payments for claims incurred		**95,425**	110,398
Risk margin		**17,936**	27,885
Claims handling costs		**6,901**	9,714
		120,262	147,997
Discount		**(271)**	(270)
Net outstanding claims		**119,991**	147,727

	2018			2017		
$ thousands	**Gross**	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Reconciliation of movements in discounted outstanding claim liabilities						
Balance brought forward	**181,156**	**(33,429)**	**147,727**	210,202	(83,205)	126,997
Effect of change in foreign exchange rates	**71**	**(99)**	**(28)**	(553)	98	(455)
Incurred claims recognised in the income statement	**200,467**	**(23,835)**	**176,632**	225,384	(37,833)	187,551
Claims paid and reinsurance recoveries raised	**(232,718)**	**28,378**	**(204,340)**	(253,877)	87,511	(166,366)
Total outstanding claims	**148,976**	**(28,985)**	**119,991**	181,156	(33,429)	147,727

Reconciliation of movements in undiscounted claims to outstanding claim liabilities

	2018			2017		
$ thousands	**Gross**	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Outstanding claims undiscounted	**3,461**	**(80)**	**3,381**	1,968	(367)	1,601
Discount			**-**	60	-	60
Outstanding claims	**3,461**	**(80)**	**3,381**	2,028	(367)	1,661
Short tail outstanding claims			**116,610**			146,066
Total outstanding claims			**119,991**			147,727

(b) Sensitivity analysis

The Group's insurance business is generally short tail in nature. Key sensitivities relate to the volume of claims, in particular for significant events such as earthquakes or extreme weather.

The Group has exposure to historical inwards reinsurance business which is in run off. While this business is not material, it is sensitive to claims experience, timing of claims and changes in assumptions. Movement in these variables does not have a material impact on the performance and equity of the Group.

NOTES TO THE FINANCIAL STATEMENTS

B5 OTHER INSURANCE DISCLOSURES (continued)

(c) Future net cash out flows

The following table shows the expected run-off pattern of net outstanding claims:

$ thousands	Note	2018	2017
Expected claim payments			
Within 3 months		**50,771**	45,205
3 to 6 months		**25,762**	28,699
6 to 12 months		**17,955**	38,456
After 12 months		**25,503**	35,367
Total outstanding claim liabilities		**119,991**	147,727

B5.3 DEVELOPMENT OF CLAIMS

The following table shows the development of net outstanding claims relative to the current estimate of ultimate claims costs for the five most recent years:

	$ thousands						
Ultimate claims cost estimate	**Prior**	**2014**	**2015**	**2016**	**2017**	**2018**	**Total**
At end of incident year		116,297	125,054	133,776	138,647	149,260	
One year later		114,810	126,231	132,388	141,378		
Two years later		117,108	126,067	134,640			
Three years later		117,629	127,552				
Four years later		116,131					
Current estimate of ultimate claims cost		116,131	127,552	134,640	141,378	149,260	
Cumulative payments		(115,833)	(127,092)	(131,941)	(136,344)	(109,517)	
Undiscounted central estimate	47,192	298	460	2,699	5,034	39,743	95,426
Discount to present value							(271)
Discounted central estimate							95,155
Claims handling expense							6,901
Risk margin							17,936
Net outstanding claim liabilities							119,991
Reinsurance recoveries on outstanding claim liabilities and other recoveries							28,985
Gross outstanding claim liabilities							148,976

The development of the ultimate claims cost estimate has been restated from last year to appropriately reflect historical positions.

B5 OTHER INSURANCE DISCLOSURES (continued)

B5.4 LIABILITY ADEQUACY TEST

Liability adequacy tests are performed to determine whether the unearned premium liability is sufficient to cover the present value of the expected cash flows arising from rights and obligations under current insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate. The future cash flows are future claims, associated claims handling costs and other administration costs relating to the business.

If the unearned premium liability less related deferred acquisition costs exceeds the present value of expected future cash flows plus additional risk margin then the unearned premium liability is deemed to be adequate. The risk margins applied to future claims were determined with the objective of achieving at least 75% probability of sufficiency of the unexpired risk liability using the methodology described above. The unearned premium liabilities as at 30 September 2018 were sufficient (2017: sufficient).

	2018	2017
Central estimate claim % of premium	**44.9%**	41.2%
Risk margin	**11.3%**	12.0%

B5.5 INSURER FINANCIAL STRENGTH RATING

Tower Insurance Limited has an insurer financial strength rating of 'A-' (Excellent) issued by international rating agency AM Best Company Inc. with an effective date of 9 March 2018.

B5.6 REINSURANCE PROGRAMME

Reinsurance programmes are structured to adequately protect the solvency and capital positions of the insurance business. The adequacy of reinsurance cover is modelled by assessing Tower Insurance's exposure under a range of scenarios. The plausible scenario that has the most financial significance for Tower Insurance is a major Wellington earthquake. Each year, as part of setting the coming year's reinsurance cover, comprehensive modelling of the event probability and amount of the Group's exposure is undertaken.

B5.7 ASSETS BACKING INSURANCE BUSINESS

The Group has determined that all assets within its insurance companies are held to back insurance liabilities, with the exception of property, plant and equipment and investments in operating subsidiaries.

Assets backing insurance liabilities are managed in accordance with approved investment mandate agreements on a fair value basis and are reported to the Board on this basis.

PART C - FINANCIAL INSTRUMENTS AND LIQUIDITY

Funds provided by shareholders and collected as premiums are invested by Tower Insurance, providing a financial return and also ensuring that Tower Insurance's obligations to pay claims and expenses can be met.
This section provides information about Tower Insurance's financial instruments, including information about the cash and investments that Tower Insurance holds, its approach to managing risk for these financial instruments, and its cash flows.

C1 INVESTMENT REVENUE

$ thousands	Note	2018	2017
Fixed interest securities			
Interest income		**6,943**	7,118
Net realised gain (loss)		**146**	(631)
Net unrealised (loss) gain		**596**	913
Total fixed interest securities		**7,685**	7,400
Equity securities			
Net unrealised gain (loss)		**(745)**	(3)
Total equity securities		**(745)**	(3)
Other			
Net realised gain (loss)		**(751)**	(1,297)
Net unrealised (loss) gain		**(114)**	927
Total other		**(865)**	(370)
Total investment revenue		**6,943**	7,118
Total net realised gain (loss)		**(605)**	(1,928)
Total net unrealised (loss) gain		**(263)**	1,837
Total investment revenue		**6,075**	7,027

Accounting policy

Investment revenue is recognised as follows:

(i) *Interest income on fixed interest securities*
Interest income is recognised using the effective interest method.

(ii) *Fair value gains and losses*
Fair value gains and losses on investments are recognised through the income statement in the period in which they arise. The gains and losses from fixed interest, equity and property securities have been generated by financial assets designated on initial recognition at fair value through profit or loss.
Other investment gains and losses have been generated by derivative financial assets and financial liabilities classified as held for trading at fair value through profit or loss.

C2 CASH AND CASH EQUIVALENTS

$ thousands	Note	2018	2017
Cash at bank and in hand		**37,566**	19,283
Deposits at call		**36,886**	55,589
Restricted cash		**454**	4,206
Total cash and cash equivalents		**74,906**	79,078

Accounting policy

Cash and cash equivalents includes cash on hand and deposits held at call with financial institutions, other short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The effective interest rate at 30 September 2018 for deposits at call is 2.1% (2017: 2.6%).There was no offsetting within cash and cash equivalents (2017: nil).

Restricted cash

Tower is a party to the Canterbury Earthquake Shared Property Process – Insurer Contract (SPP) which sets out obligations for insurers and appoints a lead insurer to act on behalf of other insurers with respect to the repair and rebuild of shared properties (known as multi-units). As lead insurer on Canterbury multi-unit repairs or rebuilds, Tower receives cash from other insurance companies as settlement of their obligations under building contracts covered within the SPP. Tower separately holds this cash on behalf of other insurers in a segregated bank account.

At 30 September, Tower was holding $0.5 million (2017: $4.2 million) cash in respect of multi-unit claims as lead insurer on Canterbury claims. This is recognised within Cash and cash equivalents on the balance sheet. Related to this are corresponding amounts being $0.2 million (2017: $1.6 million) recorded within Insurance liabilities for Tower's portion of multi-unit outstanding claims; and $0.3 million (2017: $2.6 million) recorded within Payables as held on behalf of other insurers in respect of SPP claims.

C3 INVESTMENT ASSETS

$ thousands	Note	2018	2017
Fixed interest securities		**197,367**	185,256
Equity securities		**599**	1,412
Property securities		**34**	34
Total investment assets		**198,000**	186,702

C4 FINANCIAL INSTRUMENTS

C4.1 FINANCIAL INSTRUMENT CATEGORIES

Accounting policy

Financial assets and liabilities are classified in the following categories: at fair value through profit or loss; loans and receivables; and liabilities at amortised cost. The classification depends on the purpose for which the financial assets and liabilities were acquired. Management determines the classification of its financial assets and liabilities at initial recognition.

(i) Loans and receivables

Loans and receivables are measured initially at fair value plus transaction costs and subsequently at amortised cost using the effective interest method less any impairment.

(ii) Financial liabilities at amortised cost

Financial liabilities are measured initially at fair value plus transaction costs and subsequently at amortised cost less any impairment.

(iii) Financial assets and liabilities at fair value through profit or loss

Financial assets at fair value through profit or loss are stated at fair value, with any resultant gain or loss recognised in the income statements. The net gain or loss recognised in the income statements includes any dividend or interest earned on the financial assets.

(iv) Offsetting financial instruments

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

(vi) Derecognition

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

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. The Group's loans and receivables comprise trade and other receivables and cash and cash equivalents in the balance sheet.

(ii) Financial liabilities at amortised cost

Financial liabilities at amortised cost are non-derivative financial liabilities with fixed or determinable payments that are not quoted on an active market. The Group's financial liabilities comprise trade, reinsurance and other payables in the balance sheet.

(iii) Financial assets and liabilities at fair value through profit or loss

Financial assets and liabilities at fair value through profit or loss comprise of financial assets that are either held for trading or designated on initial recognition at fair value through profit or loss. A financial asset is classified in this category if acquired principally for the purpose of selling in the short-term or if so designated by management. Designation by management takes place when it is necessary to eliminate or significantly reduce measurement or recognition inconsistencies or if related financial assets or liabilities are managed and evaluated on a fair value basis.

Derivatives are categorised as held for trading unless they are designated as hedges. All derivatives entered into by the Group are classified as held for trading.

C4 FINANCIAL INSTRUMENTS (continued)

The analysis of financial assets and liabilities into their categories and classes is set out in the following tables:

			At amortised cost		At fair value through profit or loss	
$ thousands	Note	Total	Loans and receivables	Financial liabilities	Designated	Held for trading
As at 30 September 2018						
Assets						
Cash and cash equivalents		**74,906**	**74,906**	**-**	**-**	**-**
Trade and other receivables		**256,072**	**256,072**	**-**	**-**	**-**
Investments		**198,000**	**-**	**-**	**198,000**	**-**
Derivative financial assets		**244**	**-**	**-**	**-**	**244**
Total financial assets		**529,222**	**330,978**	**-**	**198,000**	**244**
Liabilities						
Trade and other payables		**47,926**	**-**	**47,926**	**-**	**-**
Derivative financial liabilities		**-**	**-**	**-**	**-**	**-**
Total financial liabilities		**47,926**	**-**	**47,926**	**-**	**-**

			At amortised cost		At fair value through profit or loss	
$ thousands	Note	Total	Loans and receivables	Financial liabilities	Designated	Held for trading
As at 30 September 2017						
Assets						
Cash and cash equivalents		79,078	79,078	-	-	-
Trade and other receivables		283,125	283,125	-	-	-
Investments		186,702	-	-	186,702	-
Derivative financial assets		231	-	-	-	231
Total financial assets		549,136	362,203	-	186,702	231
Liabilities						
Trade and other payables		41,214	-	41,214	-	-
Derivative financial liabilities		-	-	-	-	-
Total financial liabilities		41,214	-	41,214	-	-

NOTES TO THE FINANCIAL STATEMENTS

C4 FINANCIAL INSTRUMENTS (continued)

C4.2 FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Refer below for details of valuation methods and assumptions used by Tower for each category of financial assets and liabilities.

(i) Cash and cash equivalents

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

(ii) Financial assets at fair value through profit or loss and held for trading

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in Level 1.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2. The following fair value measurements are used:

- The fair value of fixed interest securities is based on the maturity profile and price/yield.

- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.

- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

(iii) Loans and receivables and other financial liabilities held at amortised cost

Carrying values of loans and receivables, adjusted for impairment values, and carrying values of other financial liabilities held at amortised cost reasonably approximate their fair values.

(iv) Derivative financial liabilities and assets

The fair value of derivative financial liabilities and assets is determined by reference to market accepted valuation techniques using observable market inputs.

C4 FINANCIAL INSTRUMENTS (continued)

The following tables present the Group's assets and liabilities categorised by fair value measurement hierarchy levels.

$ thousands	Note	Total	Level 1	Level 2	Level 3
As at 30 September 2018					
Assets					
Investment in equity securities		**599**	**-**	**-**	**599**
Investments in fixed interest securities		**197,367**	**-**	**197,367**	**-**
Investments in property securities		**34**	**-**	**34**	**-**
Investments		**198,000**	**-**	**197,401**	**599**
Derivative financial assets		**244**	**-**	**244**	**-**
Total financial assets		**198,244**	**-**	**197,645**	**599**
As at 30 September 2017					
Assets					
Investment in equity securities		1,412	-	-	1,412
Investments in fixed interest securities		185,256	-	185,256	-
Investments in property securities		34	-	34	-
Investments		186,702	-	185,290	1,412
Derivative financial assets		231	-	231	-
Total financial assets		**186,933**	**-**	**185,521**	**1,412**

The Level 3 category includes an investment in equity securities of $599,000 (2017: $1,412,000). This investment is in unlisted shares of a company which provides reinsurance to Tower. The fair value is calculated based on the net assets of the company from the most recently available financial information, adjusted for market conditions.

The following table represents the changes in Level 3 instruments:

$ thousands		Investment in equity securities	
As at	Note	**2018**	2017
Opening balance		**1,412**	1,406
Total gains and losses recognised in profit or loss		**(745)**	(3)
Foreign currency movement		**(46)**	9
Disposals		**(22)**	-
Closing balance		**599**	1,412

The following table shows the impact of increasing or decreasing the combined inputs used to determine the fair value of the investment by 10%:

$ thousands	Carrying Amount	Favourable changes of 10%	Unfavourable changes of 10%
As at 30 September 2018			
Investment in equity securities	**599**	**60**	**(60)**
As at 30 September 2017			
Investment in equity securities	1,412	141	(141)

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NOTES TO THE FINANCIAL STATEMENTS

C4 FINANCIAL INSTRUMENTS (continued)

C4.3 IMPAIRMENT OF FINANCIAL ASSETS

Accounting policy

Financial assets, with the exception of those measured at fair value through profit or loss, are assessed for indicators of impairment at each reporting date. Financial assets are impaired when there is objective evidence that the estimated future cash flows of the asset have been impacted as a result of one or more events that occurred after the initial recognition of the financial asset.

For financial assets carried at amortised cost, the amount of the impairment is the difference between the carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

For all financial assets, other than trade receivables, the carrying amount is reduced by the impairment loss directly. For trade receivables the carrying amount is reduced via an allowance account, against which an uncollectible trade receivable is written off.

A trade receivable is deemed to be uncollectible upon receipt of evidence that the Group will be unable to collect the amount. Changes in the carrying amount of the allowance account are recognised in the income statement.

A previously recognised impairment loss is reversed when, 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 loss was initially recognised.

In respect of financial assets carried at amortised cost, with the exception of trade receivables, the impairment loss is reversed through the income statement to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised. Subsequent recoveries of trade receivables previously written off are credited against the allowance for credit losses and impairment.

C5 RECONCILIATION OF LOSS FOR THE PERIOD TO NET CASH FLOWS FROM OPERATING ACTIVITIES

$ thousands	Note	**2018**	2017
Loss for the year		**(7,400)**	(6,738)
Adjusted for non-cash items			
Depreciation of property, plant and equipment	E2	**1,499**	2,032
Amortisation of software		**10**	18
Impairment of reinsurance receivables		**21,750**	-
Unrealised (gain) loss on financial assets		**263**	(1,837)
Movement on disposal of property, plant and equipment		**(50)**	(42)
Change in deferred tax		**(2,843)**	(2,534)
		20,629	(2,363)
Adjusted for movements in working capital (excluding the effects of exchange differences on consolidation)			
Change in receivables		**5,050**	(7,239)
Change in payables		**(14,052)**	(20,692)
Change in taxation		**(722)**	116
		(9,724)	(27,815)
Net cash inflows (outflows) from operating activities		**3,505**	(36,916)

NOTES TO THE FINANCIAL STATEMENTS

PART D - MANAGEMENT EXPENSES AND TAXATION

To grow and operate its business, Tower Insurance incurs management expenses, including payments to employees, suppliers and commission payments to third parties.
This section includes information about Tower Insurance's management expenses and taxation.

D1 MANAGEMENT AND SALES EXPENSES

$ thousands	Note	2018	2017
Employee benefits expense (1)		**58,292**	56,248
Net change in deferred acquisition costs		**(1,634)**	(988)
Bad debts written off		**232**	190
Change in provision for doubtful debts		**(159)**	(227)
Amortisation of software		**10**	18
Depreciation		**1,499**	2,032
Directors' fees		**20**	14
(Gain) on disposal of property, plant and equipment		**(50)**	(42)
Claims related management expenses reclassified to claims expense (2)		**(23,151)**	(28,979)
Auditors' fees		**603**	576
Commission expense		**19,488**	18,927
Lease expenses		**1,409**	1,402
Other expenses		**30,640**	31,004
Total management and sales expenses		**87,199**	80,175

(1) Personnel costs are net of capitalised labour costs in relation to internally generated software assets
(2) Claims handling expenses do not include costs in relation to Kaikoura earthquake or Canterbury earthquake related claims, as these are charged to provisions created in previous years.

D2 IMPAIRMENT OF REINSURANCE RECEIVABLE

On 28 February 2018, Tower Limited announced it had entered into a settlement agreement with Peak Re regarding an adverse development cover policy entered into in 2015. Under the settlement agreement Tower received $22.0 million of the $43.75 million claimed under the reinsurance contract and all sums claimed in the arbitration proceeding. This has resulted in a write off of the residual amount of $21.75 million. This amount along with associated professional fees of $0.76 million have been recorded in the Consolidated Income Statement as Impairment of reinsurance receivables.

D3 ACQUISITION PROPOSAL EXPENSES

The Company has worked with various legal, financial and Board advisers to assist with the acquisition proposals from Suncorp Group Limited/Vero Insurance New Zealand Limited and Fairfax Financial Holdings Limited. At 30 September 2018, Tower has provided for all costs incurred to date in respect of the acquisition activity. These have been recorded in the Consolidated Income Statement as a separate line item (Acquisition proposal expenses).

D4 DEFERRED ACQUISITION COSTS

$ thousands	Note	2018	2017
Balance at the beginning of year		**20,961**	19,973
Acquisition costs during the year		**39,555**	38,385
Current period amortisation		**(37,921)**	(37,397)
Total deferred acquisition costs		**22,595**	20,961
Analysed as:			
Current		**22,595**	20,961
Non-current		**-**	-
Total deferred acquisition costs		**22,595**	20,961

Accounting policy

Acquisition costs incurred in obtaining general insurance contracts are deferred and recognised as assets where they can be reliably measured and where it is probable that they will give rise to premium revenue that will be recognised in subsequent reporting periods.

Deferred acquisition costs are amortised systematically in accordance with the expected pattern of the incidence of risk under the general insurance contracts to which they relate. This pattern of amortisation corresponds to the earning pattern of the corresponding premium revenue.

D5 OPERATING LEASES

$ thousands	2018	2017
As lessee		
Rent payable to the end of the lease terms are:		
Not later than one year	**1,183**	1,062
Later than one year and not later than five years	**1,059**	552
Later than five years	**-**	-
	2,242	1,614

Accounting policy

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Operating lease payments are recognised as an expense in the periods the services are received over the period of the lease. Operating lease payments represent future rentals payable for office space under current leases. Initial leases were for an average of three years with rental rates reviewed every one to three years.

NOTES TO THE FINANCIAL STATEMENTS

D6 TAX

Accounting policy

Current tax

Current tax is the amount of income taxes payable or recoverable in respect of the taxable profit or loss for the period. It is calculated using tax rates and laws that have been enacted or substantively enacted by the reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred Tax

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities settled, based on the tax rates enacted or substantively enacted for each jurisdiction. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences or unused tax losses can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of the other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

Tax consolidation

Tower Insurance Limited exited the New Zealand tax consolidated group comprised of its ultimate parent company, Tower Limited, and Tower Limited's New Zealand wholly-owned subsidiaries as at 1 October 2013. Accordingly, the members of the tax consolidated group are no longer jointly and severally liable for the tax liabilities of Tower Insurance Limited. This has had no impact on the common ownership of these entities meaning tax losses of the tax consolidated group continue to remain available to offset the tax liabilities of the wider New Zealand Group including Tower Insurance Limited.

Income tax expense

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

GST

All revenues, expenses and certain assets are recognised net of goods and services taxes (GST) except where the GST is not recoverable. In these circumstances the GST is included in the related asset or expense. Receivables and payables are reported inclusive of GST. The net GST payable to or recoverable from the tax authorities as at balance date is included as a receivable or payable in the balance sheet.

Tax cash flows

Tax cash flows are included in the statements of cash flows on a net basis other than to the extent that the GST is not recoverable and has been included in the expense or asset.

NOTES TO THE FINANCIAL STATEMENTS

D6 TAX (continued)

D6.1 TAX EXPENSE

$ thousands	Note	2018	2017
Current tax		**2,715**	4,468
Deferred tax		**(2,904)**	(2,573)
Under (over) provided in prior years		**(546)**	596
Total tax (benefit)/expense		**(735)**	2,491
The tax (benefit)/expense can be reconciled to the accounting profit as follows:			
Loss before tax from continuing operations		**(8,135)**	(4,247)
Income tax at the current rate of 28%		**(2,278)**	(1,189)
Tax effect of:			
Prior period adjustments		**(546)**	597
Non-deductible expenditure/non-assessable income		**711**	966
Foreign tax credits written off		**1,372**	1,874
Other		**6**	243
Total tax (benefit)/expense		**(735)**	2,491

D6.2 CURRENT TAX LIABILITIES

Current tax liabilities of $174,000 relate to taxes payable to off shore tax authorities in the Pacific Islands (2017: $560,000).

D6.3 DEFERRED TAX ASSETS AND LIABILITIES

$ thousands	Opening balance at 1 October	(Charged) credited to income statement	(Charged) credited to comprehensive income	Closing balance at 30 September
For the Year Ended 30 September 2018				
Movement in deferred tax assets				
Provisions and accruals	**2,240**	**494**	**-**	**2,734**
Property, plant and equipment	**1,260**	**453**	**-**	**1,713**
Tax losses	**8,021**	**2,841**	**-**	**10,862**
Other	**778**	**(15)**	**-**	**763**
Total deferred tax assets	**12,299**	**3,773**	**-**	**16,072**
Set-off of deferred tax liabilities pursuant to NZ IAS 12				**(5,739)**
Net deferred tax assets				**10,333**
Movement in deferred tax liabilities				
Deferred acquisition costs	**(5,078)**	**(661)**	**-**	**(5,739)**
Other	**(299)**	**(209)**	**(81)**	**(589)**
Total deferred tax liabilities	**(5,377)**	**(870)**	**(81)**	**(6,328)**
Set-off of deferred tax liabilities pursuant to NZ IAS 12				**5,739**
Net deferred tax liabilities				**(589)**

NOTES TO THE FINANCIAL STATEMENTS

D6 TAX (continued)

D6.3 DEFERRED TAX ASSETS AND LIABILITIES (continued)

$ thousands	Opening balance at 1 October	(Charged) credited to income statement	(Charged) credited to comprehensive income	Closing balance at 30 September
For the Year Ended 30 September 2017				
Movement in deferred tax assets				
Provisions and accruals	2,745	(505)	-	2,240
Property, plant and equipment	1,033	227	-	1,260
Tax losses	6,744	1,277	-	8,021
Other	-	778	-	778
Total deferred tax assets	10,522	1,777	-	12,299
Set-off of deferred tax liabilities pursuant to NZ IAS 12				(5,037)
Net deferred tax assets				7,262
Movement in deferred tax liabilities				
Deferred acquisition costs	(4,851)	(227)	-	(5,078)
Other	(1,294)	1,024	(29)	(299)
Total deferred tax liabilities	(6,145)	797	(29)	(5,377)
Set-off of deferred tax liabilities pursuant to NZ IAS 12				5,037
Net deferred tax liabilities				(340)

Recognition of deferred tax assets is a key area of judgement. Management expects to utilise the tax losses against future profits over the next two years. Management had expected to utilise the tax losses against future profits over the following four years as at 30 September 2017.

Deferred tax liabilities of nil have not been recognised in respect of temporary differences associated with investments in subsidiaries (2017: liabilities of $946,000).

D6.4 IMPUTATION CREDITS

Tower Insurance Limited has imputation credits available for use as at 30 September 2018 of nil (2017: nil). While Tower Insurance Limited ceased to be a member of the tax consolidated group as at 1 October 2013, it elected to form a consolidated imputation group with the tax consolidated group as at the same date. Accordingly, it will generate and utilise imputation credits as part of the consolidated imputation group.

PART E - OTHER BALANCE SHEET ITEMS

This section includes information about assets and liabilities not included elsewhere, including receivables, non-current assets, payables and provisions.

E1 RECEIVABLES

$ thousands	Note	2018	2017
Premium receivables		**141,578**	124,030
Reinsurance recoveries		**32,600**	81,647
Claim recoveries and unearned reinsurance premium		**11,616**	10,783
Trade Receivables		**185,794**	216,460
EQC receivables		**69,272**	66,437
Related party receivables	G2	**470**	-
Other receivables		**3,788**	3,063
Total Receivables		**259,324**	285,960

Premium receivables represent net amounts owed to Tower (including GST) by policyholders. The majority of the amounts outstanding are not due.

Accounting policy

Receivables are recognised initially at fair value and subsequently measured at amortised cost, less provision for impairment. Premium receivables and other trade receivables are presented net of allowance for credit losses and impairment.

The table below shows the reconciliation of the allowance for credit losses and impairment at the reporting date.

$ thousands	Note	2018	2017
Opening balance		**(805)**	(1,032)
Provisions added during the year		**(208)**	(41)
Provisions released during the year		**362**	260
Foreign exchange movements		**5**	8
Closing balance		**(646)**	(805)

Trade and other receivables, including EQC reinsurance recoveries, are included in current assets except for those with maturities greater than 12 months after the reporting date, which are classified as non-current assets.

$ thousands	Note	2018	2017
Analysed as			
Current		**184,850**	198,955
Non current		**74,474**	87,005
Total receivables		**259,324**	285,960

Collectability of trade receivables

Collectability of trade receivables is reviewed on an on-going basis. The allowance for credit losses and impairment in relation to trade receivables is provided for based on estimated recoverable amounts determined by reference to current customer circumstances and past default experience. In determining the recoverability of a trade receivable the Group considers any change in the credit quality of the trade receivable from the date the credit was initially granted up to the reporting date. The Group has provided fully for receivables over 120 days past due. Trade receivables between 60 and 120 days past due are provided for based on estimated irrecoverable amounts.

E1 RECEIVABLES (continued)

Assets arising from reinsurance contracts

Assets arising from reinsurance contracts are also determined using the above methods. In addition, the recoverability of these assets is assessed on a periodic basis to ensure that the balance is reflective of the amounts that will ultimately be received, taking into consideration factors such as counterparty and credit risk. Impairment is recognised where there is objective evidence that the Group may not receive amounts due to it and these amounts can be reliably measured.

Earthquake Commission Receivables

Kaikoura Region Earthquake

At 30 September 2018, the amount due from EQC for reimbursement of claims handling expenses and claims paid in relation to the Kaikoura event is $0.9 million (2017: $1.3 million).

Canterbury Earthquakes

Other receivables include an amount of $68.4 million due from EQC for land damage and building costs relating to the Canterbury earthquake provisions as disclosed in Note B3 (2017: $65.1 million).

E2 PROPERTY, PLANT AND EQUIPMENT

$ thousands	Land and buildings	Office equipment and furniture	Motor vehicles	Computer equipment	Total
For the Year Ended 30 September 2018					
Cost					
Opening balance	2,948	8,370	1,371	14,804	27,493
Additions	-	513	65	198	776
Disposals	-	(14)	(165)	(9)	(188)
Revaluations	434	-	-	-	434
Foreign exchange movements	22	7	(3)	17	43
Closing balance	3,404	8,876	1,268	15,010	28,558
Accumulated depreciation					
Opening balance	-	(3,530)	(1,083)	(14,100)	(18,713)
Depreciation	-	(958)	(38)	(503)	(1,499)
Disposals	-	15	176	2	193
Foreign exchange movements	-	35	(84)	20	(29)
Closing balance	-	(4,438)	(1,029)	(14,581)	(20,048)
Closing balance					
Cost / revaluation	3,404	8,876	1,268	15,010	28,558
Accumulated depreciation	-	(4,438)	(1,029)	(14,581)	(20,048)
Net book value	3,404	4,438	239	429	8,510

E2 PROPERTY, PLANT AND EQUIPMENT (continued)

$ thousands	Land and buildings	Office equipment and furniture	Motor vehicles	Computer equipment	Total
For the Year Ended 30 September 2017					
Cost					
Opening balance	2,699	8,136	1,526	14,078	26,439
Additions	-	291	69	754	1,114
Disposals	(27)	(74)	(231)	(19)	(351)
Revaluations	247	-	-	-	247
Foreign exchange movements	29	17	7	(9)	44
Closing balance	**2,948**	**8,370**	**1,371**	**14,804**	**27,493**
Accumulated depreciation					
Opening balance	-	(2,654)	(1,176)	(13,098)	(16,928)
Depreciation	-	(928)	(93)	(1,011)	(2,032)
Disposals	-	57	188	16	261
Foreign exchange movements	-	(5)	(2)	(7)	(14)
Closing balance	**-**	**(3,530)**	**(1,083)**	**(14,100)**	**(18,713)**
Closing balance					
Cost / revaluation	2,948	8,370	1,371	14,804	27,493
Accumulated depreciation	-	(3,530)	(1,083)	(14,100)	(18,713)
Net book value	**2,948**	**4,840**	**288**	**704**	**8,780**

Accounting policy

Measurement of property, plant and equipment

Property, plant and equipment is initially recorded at cost including transaction costs and subsequently measured at cost less any accumulated depreciation and impairment losses.

Depreciation is calculated using the straight line method to allocate the assets' cost or revalued amounts, net of any residual amounts, over their useful lives. The assets' useful lives are reviewed and adjusted if appropriate at each balance date. An asset's carrying amount is written down immediately to its recoverable amount if it is considered that the carrying amount is greater than its recoverable amount.

Computer equipment	3-5 years
Furniture & fittings	5-9 years
Motor Vehicles	5 years
Buildings	50-100 years
Leasehold property improvements	3-12 years

Measurement of land and buildings

Land and buildings are shown at fair value, based on periodic valuations by external independent appraisers less subsequent depreciation for buildings. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.

E2 PROPERTY, PLANT AND EQUIPMENT (continued)

Land and buildings are located in Fiji and are stated at fair value. Fair value is determined using an income approach whereby future rental streams are capitalised at a rate appropriate for the type of property and lease arrangement. This value is then adjusted to take into account recent market activity. Valuation was performed as at 14 September 2018 by Rolle Associates, registered valuers in Fiji. There has been no material movement in the valuation between 14 September 2018 and 30 September 2018. Inputs to the valuation of the Fiji property are considered to be based on non-observable market data, thus classified as level 3 in the fair value hierarchy. Inputs include gross rentals per square meter of similar property in the Suva area, recent comparable property in Suva and a capitalisation rate of between 7.5% and 9.5% (2017: 6.5%).

Had land and buildings been recognised under the cost model the carrying amount would have been $1,145,000 (2017: $1,145,000). The revaluation surplus for the period is recorded in other comprehensive income and has no restrictions on the distribution of the balance to shareholders.

E3 PAYABLES

$ thousands	Note	2018	2017
Trade payables		**14,544**	15,373
Reinsurance payables		**23,388**	21,763
Payable to other insurers		**268**	2,590
Investment settlement balances		**5,099**	-
Related party payables	G2	**-**	1,057
GST payable		**16,531**	13,004
Other payables		**18,097**	12,467
Total payables		**77,927**	66,254
Analysed as:			
Current		**61,527**	48,554
Non-current		**16,400**	17,700
Total payables		**77,927**	66,254

Accounting policy

Payables represent liabilities for goods and services provided to the Group prior to the end of the financial year which are unsettled. Payables are recognised initially at fair value less transaction costs and subsequently measured at amortised cost using the effective interest method.

Payable to other insurers

At 30 September there was $0.3 million (2017: $2.6 million) recorded within Payables as funds held on behalf of other insurers in respect of SPP claims. Refer also Note C2 for further details on cash held in respect of multi-unit claims as lead insurer.

NOTES TO THE FINANCIAL STATEMENTS

E4 PROVISIONS

$ thousands	Note	2018	2017
Employee benefits		**5,413**	5,684
Total provisions		**5,413**	5,684
Analysed as:			
Current		**5,026**	5,503
Non-current		**387**	181
Total provisions		**5,413**	5,684

Accounting policy

Provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event or decision, and it is more likely than not that an outflow of resources will be required to settle the obligation. Provisions are recognised as the best estimate of future cash flows discounted to present value where the effect is material.

Provision is made for employee entitlements for services rendered up to the balance date. This includes salaries, wages, bonuses, annual leave and long service leave.

NOTES TO THE FINANCIAL STATEMENTS

PART F - CAPITAL AND RISK MANAGEMENT

This section provides information about Tower Insurance's capital structure and its approaches to managing risk.

F1 CONTRIBUTED EQUITY

$ thousands	Note	2018	2017
Ordinary share capital		**209,990**	209,990
Total contributed equity		**209,990**	209,990
Represented by:			
Number of shares			
Ordinary shares (issued and fully paid)		**211,107,758**	211,107,758
		211,107,758	211,107,758
Movement in ordinary shares			
Opening balance		**211,107,758**	176,107,758
Issue of share capital		**-**	35,000,000
Closing balance		**211,107,758**	211,107,758

No shares were issued during the 30 September 2018 year (2017: 35 million shares issued for $1 per share). All shares rank equally with one vote attached to each share. No shares are held by the entity or by its subsidiaries or are reserved for issue.

Ordinary shares issued by the Group are classified as equity and are recognised at fair value less direct issue costs.

There were no Tower Insurance Limited dividend payments during the year ended 30 September 2018 (2017: Nil).

F2 RESERVES

$ thousands	Note	2018	2017
Foreign currency translation reserve (FCTR)			
Opening balance		**(4,343)**	(4,443)
Currency translation differences arising during the year		**(54)**	100
Closing balance		**(4,397)**	(4,343)
Capital Reserve			
Opening balance		**11,990**	11,990
Closing balance		**11,990**	11,990
Asset revaluation reserve			
Opening balance		**889**	671
Gain on revaluation		**434**	247
Deferred income tax relating to asset revaluation		**(81)**	(29)
Closing balance		**1,242**	889
Total reserves		**8,835**	8,536

NOTES TO THE FINANCIAL STATEMENTS

F2 RESERVES (continued)

Accounting policy

FCTR

Exchange differences arising on translation of foreign controlled entities and net investment of a foreign entity are taken to the foreign currency translation reserve. The reserve is recognised in profit and loss when the net investment is disposed.

Asset revaluation reserve

The asset revaluation reserve is used to recognise unrealised gains on the value of land and buildings above initial cost.

F3 CAPITAL RISK MANAGEMENT & SOLVENCY

Solvency requirements

The methodology and bases for determining the solvency margin are in accordance with the requirements of the Solvency Standard for Non-life Insurance Business published by the Reserve Bank of New Zealand. The minimum solvency capital required to meet solvency requirements under the Insurance (Prudential Supervision) Act 2010 is shown below. Actual solvency capital exceeds the minimum solvency capital requirement for Tower Insurance Group by $82.4 million (2017: $96.3 million) and Tower Insurance parent by $78.2 million (2017: $87.9 million).

	Tower Insurance Limited		Tower Insurance Limited Group	
	Unaudited	Unaudited	**Audited**	Audited
$ thousands	**2018**	2017	**2018**	2017
Actual solvency capital	**136,476**	149,317	**156,765**	166,823
Minimum solvency capital	**58,298**	61,387	**74,344**	70,545
Solvency margin	**78,178**	87,930	**82,421**	96,278
Solvency ratio	**234%**	243%	**211%**	236%

The Reserve Bank of New Zealand imposed a condition of license requirement for Tower Insurance Limited to maintain a minimum solvency margin of $50.0 million. This minimum solvency requirement continues to be a requirement for Tower Insurance Limited. The actual solvency capital as determined under the solvency standards is required to exceed the minimum solvency capital level by at least this amount.

Capital risk management

The Group's objective when managing capital is to ensure that the level of capital is sufficient to meet the Group's statutory solvency obligations including on a look forward basis to enable it to continue as a going concern in order to meet the needs of its policyholders, to provide returns for shareholders, and to provide benefits for other stakeholders of the Group.

The Group's capital resources include shareholders' equity.

$ thousands	**2018**	2017
Tower Insurance shareholder equity	**167,106**	174,111
Total capital resources	**167,106**	174,111

The Group measures adequacy of capital against the Solvency Standards for Non-life Insurance Business (the solvency standards) published by the Reserve Bank of New Zealand (RBNZ) alongside additional capital held to meet RBNZ minimum requirements and any further capital as determined by the Board. During the year ended 30 September 2018 the Group complied with all externally imposed capital requirements.

The Group holds assets in excess of the levels specified by the various solvency requirements to ensure that it continues to meet the minimum requirements under a reasonable range of adverse scenarios. The Group's capital management strategy forms part of the Group's broader strategic planning process overseen by the Audit and Risk Committee of the Board.

NOTES TO THE FINANCIAL STATEMENTS

F4 RISK MANAGEMENT

The financial condition and operating results of the Group are affected by a number of key financial and non-financial risks. Financial risks include market risk, credit risk, financing and liquidity risk. The non-financial risks include insurance risk, compliance risk and operational risk. The Group's objectives and policies in respect of insurance risks are disclosed in Note F4.1 below, while the managing of financial and other non financial risks are set out in the remainder of this note.

Tower Insurance Limited's objective is to satisfactorily manage these risks in line with the Board approved Group Risk and Compliance policy. Various procedures are put in place to control and mitigate the risks faced by the Group. Business managers are responsible for understanding and managing their risks including operational and compliance risk. The consolidated entity's exposure to all high and critical risks is reported monthly to the Board and quarterly to the Audit and Risk Committee.

The Board has delegated to the Audit and Risk Committee the responsibility to review the effectiveness and efficiency of management processes, internal audit services, risk management and internal financial controls and systems as part of their duties. The Risk and Compliance team is in place in an oversight and advisory capacity and to manage the risk and compliance framework.

Financial risks are generally monitored and controlled by selecting appropriate assets to back policy liabilities. The assets are regularly monitored to ensure that there are no material asset and liability mismatching issues and other risks such as liquidity risk and credit risk are maintained within acceptable limits.

The Board has responsibility for:

- reviewing investment policies for Tower Insurance shareholder and policyholder funds;
- reviewing the Treasury Policy which includes our strategy for investment management and the use of derivatives;
- considering the establishment, adjustment or deletion of limits and counter-party approvals, and the scope of financial instruments to be used in the management of Tower Insurance's investments;
- reviewing the appointment of external investment managers;
- monitoring investment and fund manager performance; and
- monitoring compliance with investment policies and client mandates.

F4.1 INSURANCE RISK

Notes on the policies and procedures employed in managing risks in the insurance business are set out below.

(a) Objectives in managing risks arising from insurance contracts and policies for mitigating those risks

The risk management activities include prudent underwriting, pricing, and management of risk, together with claims management, reserving and investment management. The objective of these disciplines is to enhance the financial performance of the insurance operations and to ensure sound business practices are in place for underwriting risks and claims management.

The key controls in place to mitigate risks arising from writing insurance contracts include:

- comprehensive management information systems and actuarial models using historical information to calculate premiums and monitor claims;
- monitoring natural disasters such as earthquakes, floods, storms and other catastrophes using models; and
- the use of reinsurance to limit the Group's exposure to individual catastrophic risks.

(b) Concentration of insurance risk

Risk	Source of concentration	Risk management measures
An accumulation of risks arising from a natural peril	Insured property concentrations	Accumulation risk modelling, reinsurance protection
A large property loss	Fire or collapse affecting one building or a group of adjacent buildings	Maximum acceptance limits, property risk grading, reinsurance protection

pwc

F4 RISK MANAGEMENT (continued)

F4.2 MARKET RISK

Market risk is the risk of change in the fair value of financial instruments from fluctuations in foreign exchange rates (currency risk), market interest rates (interest rate risk) and market prices (price risk), whether such change in price is caused by factors specific to an individual financial instrument, or its issuer or factors affecting all financial instruments traded in a market.

(i) Currency risk

Currency risk is the risk of loss resulting from changes in exchange rates when applied to assets and liabilities or future transactions denominated in a currency that is not the Group's functional currency. The exposure is not considered to be material.

Tower Insurance's principal transactions are carried out in New Zealand dollars and its exposure to foreign exchange risk arises primarily with respect to the Pacific Island insurance business. Tower Insurance generally elects to not hedge the capital invested in overseas entities, thereby accepting the foreign currency translation risk on invested capital.

Tower also has foreign exchange risk on payments to suppliers that are denominated in other currencies. Tower may hedge future payments, where appropriate, and provided that the timing and amount of those transactions can be estimated with a reasonable degree of certainty.

The Board sets limits for the management of currency risk arising from its investments based on prudent international asset management practice. Regular reviews are conducted to ensure that these limits are adhered to. In accordance with this policy, Tower Insurance does not hedge the currency risk arising from translation of the financial statements of foreign operations other than through net investment in foreign operations.

(ii) Interest rate risk

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

Interest rate and other market risks are managed by the Group through strategic asset allocation and approved investment management guidelines that have regard to policyholder expectations and risks and to target surplus for solvency as advised by the Appointed Actuary.

Interest rate risk arises to the extent that there is a mismatch between the fixed interest portfolios used to back outstanding claim liabilities and those outstanding claims. Interest rate risk is managed by matching the duration profiles of investment assets and outstanding claim liabilities.

(iii) Price risk

Price risk is the risk of loss resulting from the decline in prices of equity securities or other assets. The exposure is not considered to be material. Refer to subsection F4.6.

F4.3 CREDIT RISK

Credit risk is the risk of loss that arises from a counterparty failing to meet their contractual commitment in full and on time, or from losses arising from the change in value of a trading financial instrument as a result in changes in credit risk of that instrument.

The Group's exposure to credit risk is limited to deposits and investments held with banks and other financial institutions, reinsurance receivables from reinsurers, as well as credit exposure to trade customers or other counterparties. Credit exposure in respect of the Group's cash deposit balances is limited to banks with minimum AA credit ratings. Investments held with banks and financial institutions that are managed by investment managers have a minimum credit rating accepted by the Group of 'A'. Independent ratings are used for customers that are rated by rating agencies. For customers with no external ratings, internally developed minimum credit quality requirements are applied, which take into account customers' financial position, past experience and other relevant factors. Overall exposure to credit risk is monitored on a Group basis in accordance with limits set by the Board. The Group has no significant exposure to credit risk.

NOTES TO THE FINANCIAL STATEMENTS

F4 RISK MANAGEMENT (continued)

(i) Credit risk concentration

Concentration of credit risk exists when the Group enters into contracts or financial instruments with a number of counterparties that are engaged in similar business activities or exposed to similar economic factors that might affect their ability to meet contractual obligations. Tower Insurance manages concentration of credit risk by credit rating, industry type and individual counterparty.

The significant concentrations of credit risk are outlined by industry type below.

	Carrying value	
$ thousands	**2018**	2017
New Zealand government	**919**	8,184
Other government agencies	**39,352**	18,412
Banks	**200,000**	224,728
Financial institutions	**32,186**	13,241
Other non-investment related receivables	**255,662**	283,124
Related party receivables	**470**	-
Total financial assets with credit exposure	**528,589**	547,689

(ii) Maximum exposure to credit risk

The Group's maximum exposure to credit risk without taking account of any collateral or any other credit enhancements, is as follows:

	Carrying value	
$ thousands	**2018**	2017
Cash and cash equivalents	**74,906**	79,078
Loans and receivables	**255,602**	283,124
Related party receivables	**470**	-
Financial assets at fair value through profit or loss	**197,367**	185,256
Derivative financial assets	**244**	231
Total credit risk	**528,589**	547,689

(iii) Credit quality of financial assets that are neither past due nor impaired

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if applicable) or to historical information about counterparty default rates:

	Carrying value	
$ thousands	**2018**	2017
Credit exposure by credit rating		
AAA	**85,321**	67,201
AA	**155,916**	179,434
A	**16,484**	527
BBB	**-**	-
Below BBB	**13,020**	15,706
Total counterparties with external credit ratings	**270,741**	262,868
Group 1	**245,581**	230,762
Group 1a	**470**	-
Group 2	**-**	-
Group 3	**1,717**	1,696
Total counterparties with no external credit rating	**247,768**	232,458
Total financial assets neither past due nor impaired with credit exposure	**518,509**	**495,326**

F4 RISK MANAGEMENT (continued)

Group 1 - trade debtors outstanding for less than 6 months

Group 1a - intercompany debtors outstanding for less than 6 months

Group 2 - trade debtors outstanding for more than 6 months with no defaults in the past

Group 3 - unrated investments

Tower Insurance invests in Pacific regional investment markets through its Pacific Island operations to comply with local statutory requirements and in accordance with Tower Insurance investment policies. These investments generally have low credit ratings representing the majority of the value included in the 'Below BBB' and unrated categories in the table above.

(iv) Financial assets that would otherwise be past due whose terms have been renegotiated

No financial assets have been renegotiated in the past year (2017: nil).

(v) Financial assets that are past due but not impaired

The Group considers that financial assets are past due if payments have not been received when contractually due. At the reporting date, the total carrying value of past due but not impaired assets held are as follows:

$ thousands	Less than 30 days	31 to 60 days	61 to 90 days	Over 90 days	Total
As at 30 September 2018					
Reinsurance recoveries receivable	**-**	**27**	**-**	**-**	**27**
Outstanding premiums and trade receivables	**5,526**	**1,422**	**2,641**	**464**	**10,053**
Total	**5,526**	**1,449**	**2,641**	**464**	**10,080**
As at 30 September 2017					
Reinsurance recoveries receivable	3,735	2,680	1,999	35,491	43,905
Outstanding premiums and trade receivables	5,026	1,754	1,268	410	8,458
Total	8,761	4,434	3,267	35,901	52,363

(vi) Financial assets that are individually impaired

	Carrying value	
$ thousands	**2018**	2017
Outstanding premiums and trade receivables	**-**	-
Total	**-**	-

F4 RISK MANAGEMENT (continued)

F4.4 FINANCING AND LIQUIDITY RISK

Financing and liquidity risk is the risk that the Group will not be able to meet its cash outflows or refinance debt obligations, as they fall due, because of lack of liquid assets or access to funding on acceptable terms. To mitigate financing and liquidity risk the Group maintains sufficient liquid assets to ensure that the Group can meet its debt obligations and other cash outflows on a timely basis.

Financial liabilities and guarantees by contractual maturity

The table below summarises the Group's financial liabilities and guarantees into relevant maturity groups based on the remaining period to the contractual maturity date at balance date. All amounts disclosed are contractual undiscounted cash flows that include interest payments and exclude the impact of netting agreements.

$ thousands	Carrying value	Total contractual cash flows	Less than one year	Greater than one year
As at 30 September 2018				
Financial liabilities				
Trade payables	**14,812**	**14,812**	**14,812**	**-**
Reinsurance payables	**23,388**	**23,388**	**6,988**	**16,400**
Other payables	**9,727**	**9,727**	**9,727**	**-**
Related party payables	**-**	**-**	**-**	**-**
Total	**47,927**	**47,927**	**31,527**	**16,400**
As at 30 September 2017				
Financial liabilities				
Trade payables	17,963	17,963	17,963	-
Reinsurance payables	21,763	21,763	4,063	17,700
Other payables	431	431	431	-
Related party payables	1,057	1,057	1,057	-
Total	41,214	41,214	23,514	17,700

F4.5 DERIVATIVE FINANCIAL INSTRUMENTS

The Group utilises derivative financial instruments to reduce investment risk. Specifically, derivatives are used to achieve cost effective short-term re-weightings of asset class, sector and security exposures and to hedge portfolios, as an economic hedge, when a market is subject to significant short-term risk.

Derivative financial instruments used by the Group include interest rate swaps and foreign exchange forward contracts. Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The fair values of interest rate swaps are calculated by discounting estimated future cash flows based on the terms and maturity of each contract using market interest rates. The average interest rate is based on the outstanding balances at the start of the financial year.

The table below details the notional principal amounts (amounts used to calculate payments made on swap contracts), fair values and remaining terms of interest rate swap contracts outstanding as at the reporting date:

	Average contracted fixed interest		Notional principal amount		Fair value	
	2018	2017	**2018**	2017	**2018**	2017
	%		$ thousands		$ thousands	
Less than 1 year	**0%**	0%	**15,863**	25,249	**244**	165
1 to 2 years	**0%**	0%	**-**	-	**-**	-
2 to 5 years	**0%**	2%	**-**	20,580	**-**	65
Over 5 years	**0%**	0%	**-**	-	**-**	-
			15,863	45,829	**244**	230

F4 RISK MANAGEMENT (continued)

F4.6 SENSITIVITY ANALYSIS

The analysis below demonstrates the impact of changes in interest rates, exchange rates and equity prices on profit after tax and equity on continuing business. The analysis is based on changes in economic conditions that are considered reasonably possible at the reporting date. The potential impact is assumed as at the reporting date.

(i) Interest rate

The impact of a 50 basis point change in New Zealand and international interest rates as at the reporting date on profit after tax and equity is included in the tables below. The sensitivity analysis assumes changes in interest rates only. All other variables are held constant.

	2018		2017	
	Impact on:		Impact on:	
$ thousands	**Profit after tax**	**Equity**	Profit after tax	Equity
Change in variables				
+ 50 basis points	**(696)**	**(696)**	(546)	(546)
- 50 basis points	**768**	**768**	474	474

This analysis assumes that the sensitivity applies to the closing market yields of fixed interest investments. A parallel shift in the yield curve is assumed.

The risks assumed and methods used for deriving sensitivity information and significant variables have been applied consistently over the reporting period included in the analysis.

(ii) Foreign currency

The following tables demonstrate the impact of a 10% movement of currency rates against the New Zealand dollar on profit after tax and equity. The analysis assumes changes in foreign currency rates only, with all other variables held constant. The potential impact on the profit and equity of the Group is due to the changes in fair value of currency sensitive monetary assets and liabilities as at the reporting date.

	2018		2017	
	Impact on:		Impact on:	
$ thousands	**Profit after tax**	**Equity**	Profit after tax	Equity
Change in variables				
10% appreciation of New Zealand dollar	**129**	**(2,641)**	292	(2,380)
10% depreciation of New Zealand dollar	**(158)**	**2,905**	(357)	2,909

The dollar impact of the change in currency movements is determined by applying the sensitivity to the value of the international assets.

The risks assumed and methods used for deriving sensitivity information and significant variables have been applied consistently over the reporting period included in the analysis.

F4 RISK MANAGEMENT (continued)

(iii) Other price

Other price sensitivity includes sensitivity to unit price fluctuations. Unit price risk is the risk that the fair value of investments in property fund units and international equities held in unit trusts will decrease as a result of changes in the value of these units.

The following tables demonstrate the impact of a 10% movement in the value of property funds and other unit trusts on the profit after tax and equity. The potential impact is assumed as at the reporting date.

	2018		2017	
	Impact on:		Impact on:	
$ thousands	**Profit after tax**	**Equity**	Profit after tax	Equity
Change in variables				
+ 10% property funds and other unit trusts	**2**	**2**	2	2
- 10% property funds and other unit trusts	**(2)**	**(2)**	(2)	(2)

The risks assumed and methods used for deriving sensitivity information and significant variables have been applied consistently over the two reporting periods included in the analysis.

NOTES TO THE FINANCIAL STATEMENTS

PART G - OTHER DISCLOSURES

This section includes additional disclosures which are required by financial reporting standards.

G1 AUDITORS' REMUNERATION

$ thousands	Note	2018	2017
Fees paid to Group's auditors:			
Audit of financial statements		**554**	495
Other assurance related services		**30**	30
Non-assurance advisory related services		**5**	6
Total fees paid to Group's auditors		**589**	531
Fees paid to subsidiaries' auditors different to Group auditors:			
Audit of financial statements		**14**	45
Total fees paid to auditors		**603**	576

Audit of financial statements includes fees for both the audit of annual financial statements and the review of interim financial statements. In 2018 the Group's auditors were further engaged to perform the audit of National Pacific Insurance Limited (2017: BDO). The audit of Tower Insurance (Vanuatu) Limited was performed by Law Partners (2017: Law Partners).

Other assurance related services includes annual solvency return assurance and Pacific Island regulatory return audits.

Non-assurance advisory related services related to Annual Shareholders' Meeting procedures.

G2 TRANSACTIONS WITH RELATED PARTIES

During the year there have been transactions between Tower Insurance Limited, its subsidiaries, its parent and entities within the parent's group. Balances outstanding are payable on demand and are interest free. None of Tower Insurance Limited's subsidiaries have related party transactions or balances with entities outside of the Tower Insurance Limited Group. All balances and transactions below relate to the parent only.

Related party receivable and payable balances of Tower Insurance Limited at the reporting date were as follows:

$ thousands	2018	2017	Nature of relationship	Type of Transaction
Tower New Zealand Limited	**470**	(1,057)	Fellow subsidiary	Management expenses

Tower Insurance Limited enters into transactions with its related parties in the normal course of business. Transactions during the year are shown below:

$ thousands	2018	2017	Nature of relationship	Type of Transaction
Tower New Zealand Limited	**5,185**	6,377	Fellow subsidiary	Management expenses

All key management personnel are employed by Tower New Zealand Limited, a fellow subsidiary of Tower Limited. As a result, Tower Insurance Limited pays no key management personnel remuneration.

There have been no loans made to Directors of the Company and other key management personnel of the Group, including their personally related parties (2017: nil).

Key management hold various policies and accounts with Tower Insurance Limited. These are operated in the normal course of business on normal customer terms.

G3 CONTINGENT LIABILITIES

The Group is occasionally subject to claims and disputes as a commercial outcome of conducting insurance business. Provisions are recorded for these claims or disputes when it is probable that an outflow of resources will be required to settle any obligations. Best estimates are included within claims reserves for any litigation that has arisen in the usual course of business.

The Group has no other contingent liabilities (2017: Nil).

G4 SUBSEQUENT EVENTS

There were no subsequent events after balance date.

G5 CHANGE IN COMPARATIVES

Comparative information has been reclassified to achieve consistency with the current year presentation. Changes relate to income statement reclassification, balance sheet reclassification and presentation of notes. There is no change to net assets or the 2017 profit.

Income Statement - Gross up of premium revenue and outwards reinsurance expense

Premium revenue and outwards reinsurance expense in the Income Statement have been changed to recognise unearned reinsurance expense as opposed to being netted off against premium revenue. The 2017 amount for premium revenue has decreased from $306.8 million to $306.1 million and outwards reinsurance expense has decreased from $49.8 million to $49.2 million. There is no change to net premium revenue.

Changes for internal consistency have also been made to Note B1 Premium revenue.

Income Statement - Gross up of claims expense and reinsurance recoveries revenue

Claims expense and reinsurance and other recoveries revenue in the Income Statement have been changed to recognise non-reinsurance recoveries revenue as opposed to being netted off against the claims expense. The 2017 amount for claims expense has increased from $217.5 million to $225.4 million and reinsurance and other recoveries revenue has increased from $30.0 million to $37.8 million. There is no change to net claims expense.

Balance Sheet - Gross up of reinsurance receivables and reinsurance payables

In 2017 amounts payable to reinsurers on receipt of the amount receivable from EQC for recoveries related to the Canterbury earthquakes were netted off reinsurance receivables. On the Balance Sheet, 2017 receivables increased $17.7 million and 2017 payables increased $17.7 million. Total assets and total liabilities have increased accordingly. There is no change to net assets.

Changes for internal consistency have also been made to Note A4 Segmental reporting, B5 Other insurance disclosures, C4 Financial instruments, E1 Receivables, E3 Payables, and F4 Risk management.

Balance Sheet - Gross up of other trade receivables and reinsurance payables

In 2017 a portion of unearned reinsurance assets were netted off against unearned premium liabilities. On the Balance Sheet, 2017 receivables increased $7.5 million and 2017 insurance liabilities increased $7.5 million. Total assets and total liabilities have increased accordingly. There is no change to net assets.

Changes for internal consistency have also been made to Note A4 Segmental reporting, B4 Insurance Liabilities, C4 Financial instruments, E1 Receivables, and F4 Risk management.

Balance Sheet - Reclassification between cash and cash equivalents and investments

Within the balance sheet $19.0 million of term deposits with maturity dates greater than 3 months but less than 12 months has been reclassified from cash and cash equivalents to investments.

Changes for internal consistency have also been made to the cash flow statement, Note C2 Cash and cash equivalents, Note C3 Investments, Note C4 Financial instruments, and F4 Risk management.

Note Disclosure - Reclassification of management expenses

Within note D1 management and sales expenses, there has been a reclassification between employee benefits expense and claims related to management expenses reclassified to claims expense. In 2017, internal assessor personnel costs had been netted off against personnel costs. To achieve consistent presentation with 2018, the employee benefits expense has increased by $3.0 million to $56.2 million and the claims related management expenses reclassified to claims expense has decreased by $3.0 million to $29.0 million.

NOTES TO THE FINANCIAL STATEMENTS

G5 CHANGE IN COMPARATIVES (continued)

Note Disclosure - Change in presentation of Deferred Acquisition Costs
Within Note D4 Deferred Acquisition Costs the movements ("acquisition costs during the year" and "current period amortisation") have been changed to reflect the gross movement during the year. The 2017 balance for acquisition costs during the year has increased from $21.0 million to $38.4 million. The 2017 balance for current period amortisation has decreased from $20.0 million to $37.4 million. The overall movement has not changed.

Note Disclosure - Change in presentation of claims handling expense and central estimate of expected present value of future payments for claims incurred
Within Note B5 other insurance business disclosures the claims handling expenses for the Canterbury earthquakes have been reclassified from IBNR into the general provision for claims handling expense. The 2017 balance for claims handling costs has therefore increased from $3.9 million to $9.7 million, offset by a movement in the 2017 balance for central estimate of expected present value of future payments for claims incurred.

G6 IMPACT OF AMENDMENTS TO NZIFRS

G6.1 Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group

The following standards, amendments and interpretations to existing standards have been published and are mandatory for the Group's accounting periods beginning after 1 October 2018 or later periods, and the Group has not adopted them early. The Group expects to adopt the following new standards on 1 October after the effective date.

- **NZ IFRS 9 Financial Instruments** is effective for periods beginning on or after 1 January 2018. Tower will apply the standard for the year ending 30 September 2019. The standard replaces the existing accounting standards that relate to the classification and measurement of financial instruments. Tower's investments are currently designated as at fair value through profit or loss on initial recognition and are subsequently re-measured to fair value at each reporting date, and Tower does not designate any financial instruments in hedging relationships. Consequently, NZ IFRS 9 is not expected to have a material impact on Tower's financial statements.

- **NZ IFRS 15 Revenue from Contracts with Customers** is effective for periods beginning on or after 1 January 2018. Tower will apply the standard for the year ending 30 September 2019. The standard will provide a single source of requirements for accounting for all contracts with customers and will replace all current accounting pronouncements on revenue. New revenue disclosures are also introduced. NZ IFRS 15 does not apply to insurance contracts and financial instruments and consequently, as the majority of Tower's revenue comes from such items, is not expected to have a material impact on Tower's financial statements.

- **NZ IFRS 16 Leases** is effective for periods beginning on or after 1 January 2019. Tower will apply the standard for the year ending 30 September 2020. The standard replaces the current guidance in NZ IAS 17 Leases. Under NZ IAS 17, a lessee was required to make a distinction between a finance lease, which is recognised on balance sheet, and an operating lease, which is not recognised on the balance sheet. NZ IFRS 16 now requires a lessee to recognise a lease liability reflecting future lease payments and a right-of-use asset for most lease contracts. Following adoption of NZ IFRS 17, the treatment of leases for Tower's office buildings, motor vehicles, and other equipment will change. The expected impact of the changes on Tower's financial statements is an increase to assets of approximately $1.5 million, an increase to liabilities of approximately $1.7 million and a decrease to retained earnings of approximately $0.2 million. There will also be some impact on the pattern of expense recognition for leases, which is not expected to be material. This is based on lease commitments and discount rates at 30 September 2018.

- **NZ IFRS 17 Insurance Contracts** is effective for periods beginning on or after 1 January 2021. Tower will apply the standard for the year ending 30 September 2022. The standard replaces the current guidance in NZ IFRS 4, and establishes the principles for recognition, measurement, presentation and disclosure of insurance contracts. Tower has commenced work to assess the impact of adopting NZ IFRS 17. Due to the complexity of the requirements within the standard the final impact may not be determined until global interpretations and regulatory responses to the new standard are developed.

Deloitte.

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Tower Insurance Limited – 30 September 2018

Appointed Actuary's Section 78 Report

This report has been prepared by Rick Shaw, the Appointed Actuary, as required by Section 78 of the *Insurance (Prudential Supervision) Act 2010* (*IPSA*), for use within the financial statements as at 30 September 2018 of Tower Insurance Limited (*TIL*).

The purpose of this Section 78 report is to provide information to the Directors and Management of TIL on the actuarial information (as defined by Section 77 of IPSA) contained in the TIL financial statements as at 30 September 2018 as well as an opinion on the appropriateness thereof.

For the purpose of this report, actuarial information means:

(a) Information relating to an insurer's calculations of premiums, claims, reserves, dividends, insurance and annuity rates, and technical provisions; and
(b) Information relating to assessments of the probability of uncertain future events occurring and the financial implications for the insurer if those events do occur; and
(c) Information specified in an applicable solvency standard as being actuarial information for the purposes of this section.

Review of the actuarial information contained in the 30 September 2018 Tower Insurance Limited Financial Statements

The Directors are responsible for the preparation of TIL's (*the company's*) financial statements. TIL's current policy is to seek the advice of the Appointed Actuary in the preparation of the actuarial information contained in its financial statements.

For this purpose, I, Rick Shaw, acting as the Appointed Actuary to the company under a contract for services have completed the following work:

(a) Provision of actuarial information to be used in the preparation of financial statements by TIL.
(b) Review that the actuarial information contained in or used in the preparation of the financial statements is appropriate and accurate.

There were no limitations placed on me in preparing and reviewing the actuarial information and all the data requested to perform the work required has been provided by TIL.

In my opinion the actuarial information contained in the financial statements has been appropriately included and used in the 30 September 2018 financial statements.

Review of the Tower Insurance Limited Solvency Position as at 30 September 2018

I have reviewed TIL's solvency position as at 30 September 2018. In my opinion TIL is maintaining a solvency margin in accordance with the RBNZ Solvency Standard for Non-life Insurance Business.

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Reliances and Limitations

In my work documented in the report *Tower Insurance Limited: Review of Canterbury Earthquake claims as at 30 September 2018*, I have relied upon:

- Information, data, and assertions made by TIL; and
- The assessment of potential additional EQC contributions, undertaken by Clyde & Co. lawyers.

I have further reviewed and relied upon the following:

- Information underlying the determination of outstanding claims provisions, both gross and net of reinsurance recoveries.
- Premium liabilities and deferred acquisition cost components.
- The report *Valuation of Insurance Liabilities as at 30 September 2018* (prepared at TIL's request by John Feyter in his capacity as the Company Actuary of TIL).
- The report *Tower Insurance: Pacific Islands Operations; Valuation of Insurance Liabilities as at 30 September 2018* (prepared at TIL's request by John Feyter in his capacity as the Company Actuary of TIL).

While I have conducted reasonableness checks regarding the accuracy of the provided information, I have not independently verified it.

I am comfortable with the actuarial information presented in TIL's 30 September 2018 financial statements.

Conclusion

I, Rick Shaw, the Appointed Actuary to TIL, am of the opinion that the actuarial information contained in the financial statements has been appropriately included and used as at 30 September 2018.

I am also of the opinion that TIL is maintaining a solvency margin in accordance with the RBNZ Solvency Standard for Non-Life Insurance Business as at 30 September 2018.

RShaw

Rick Shaw

Fellow of the Institute of Actuaries of Australia & Member of New Zealand Society of Actuaries

26 November 2018

Independent auditor's report

To the shareholder of Tower Insurance Limited

The financial statements comprise:

- the consolidated balance sheet as at 30 September 2018;
- the consolidated income statement for the year then ended;
- the consolidated statement of comprehensive income for the year then ended;
- the consolidated statement of changes in equity for the year then ended;
- the consolidated statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of general accounting policies. .

Our opinion

In our opinion, the financial statements of Tower Insurance Limited (the Company), including its subsidiaries (the Group), present fairly, in all material respects, the financial position of the Group as at 30 September 2018, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Basis for opinion

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

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

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

Our firm carries out other services for the Group in the areas of solvency return assurance and agreed upon procedures. The provision of these other services has not impaired our independence as auditor of the Group.

Information other than the financial statements and auditor's report

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

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

Responsibilities of the Directors for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-5/

This description forms part of our auditor's report.

Who we report to

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

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
28 November 2018

Auckland