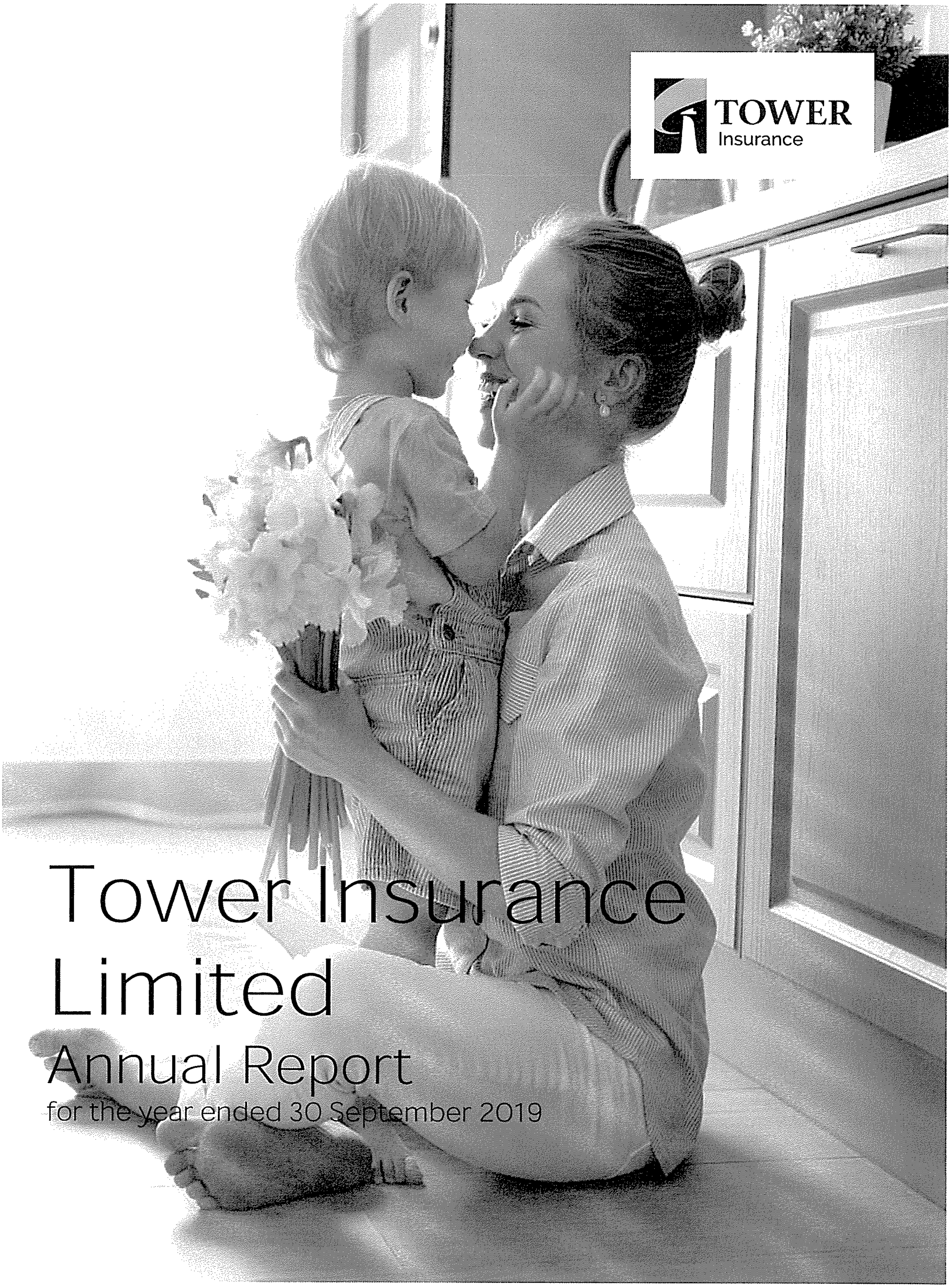

Tower Insurance Limited

Annual Report

for the year ended 30 September 2019

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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 2019.

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 profit attributable to shareholder for the year was $17,073,000 (2018: $7,447,000 loss). Accumulated losses at the end of the year totalled $36,101,000 (2018: $53,187,000 loss). Shareholders' equity at the end of the period totalled $183,697,000 (2018: $165,638,000). The Directors consider the state of affairs of the Group to be satisfactory. No dividends were paid during the period (2018: 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, Wendy Thorpe and Marcus Nagel.

The Board of Directors of Tower Insurance Limited authorised the financial statements for issue on 20 November 2019.

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	Stephen J Smith
Chairman	**Director**
20 November 2019	20 November 2019
Date	**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 six Directors as at 20 November 2019. 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.

Five of the six Tower Insurance Limited Directors are considered by the Company to be independent and one director is considered to be non-independent; 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

Graham is an experienced director, based in Auckland. His current directorships include Chair of NZX listed technology company EROAD Limited, Chair of the Audit & Risk Committee and Independent Director of NorthWest Healthcare Property Management Limited, Director of VinPro Limited and non-executive director of Tower Limited. Graham has over 30 years' experience in senior executive and governance roles in New Zealand and internationally. These include the Sealord Group of which he was Chief Executive Officer for 7 years. Prior to that Chief Financial Officer and Director of Strategy for the Fonterra Co-operative Group, Managing Director of Lion Nathan International and CEO of Mainland Products.

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, the Maori Economic Development Panel and he Chaired the Lincoln Hub Establishment Board.

Graham resides in Auckland, New Zealand.

Michael Stiassny
LLB, BCom, FCA, CFInstD
Non Executive Director
Independent
Appointed Director: 5 August 2013

Michael is a Chartered Fellow of The Institute of Directors in NZ (Inc) (CFInstD) and is also past President of the Institute of Directors. He is a Fellow of Chartered Accountants Australia and New Zealand (retired). He has both a BCom and a law degree. He is currently chairman of Ngati Whatua Orakei Whai Rawa Ltd and a director of a number of other companies.

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 40 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 Limited, and a Director of Rimu S.A. (Chile) and its subsidiaries, and the National Foundation for the Deaf Inc.

Steve resides in Auckland, New Zealand.

GOVERNANCE STATEMENT (continued)

Warren Lee
BCom, CA
Non Executive Director
Independent
Appointed Director: 26 May 2015

Warren has extensive experience in the international financial services industry. Warren's two most recent executive 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 currently a non-executive director of MetLife Australia, MyState Limited and Go Hold Limited.

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 with deep expertise in leading technology, operations and transformational change. Her executive roles included Chief Information Officer and Chief Operations Officer with AXA in Australia, and Group Executive, Operations with AMP. Wendy is Chair of Online Education Services, and a non-executive director of Ausgrid, Epworth Healthcare and Very Special Kids. 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.

Marcus Nagel
MBA (International Management), MBA (Banking and Finance)
Non Executive Director
Non Independent
Appointed Director: 14 January 2019

Marcus has significant experience in the insurance industry. For a decade he has performed senior leadership roles for Zurich in Europe and globally. In his last role at Zurich, he served as the Chief Executive Officer of Zurich Germany, managing both life insurance and general insurance businesses. He has also held the position of Vice Chairman of the joint venture with ADAC, Germany largest Automotive Club, Chairman of the direct insurer DA Direct and Chairman of the life insurer, Zurich Deutscher Herold. Prior to that he also managed the independent financial adviser/broker business for Zurich Global Life. Marcus was nominated by Bain Capital Credit LP (Bain Capital) to represent Bain Capital's stake in Tower (Bain Capital hold 19.99% of Tower's ordinary shares) and his appointment was supported by the Tower Board.

Marcus resides in Switzerland.

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.

GOVERNANCE STATEMENT (continued)

Audit and Risk Committee

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

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.

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, Wendy Thorpe and Marcus Nagel.

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.

GOVERNANCE STATEMENT (continued)

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	2019	2018
Revenue			
Premium revenue	B1	**344,995**	323,093
Less: Outwards reinsurance expense		**(54,975)**	(54,251)
Net premium revenue		**290,020**	268,842
Investment revenue	C1	**7,036**	6,075
Fee and other revenue		**3,948**	3,592
Net operating revenue		**301,004**	278,509
Expenses			
Claims expense		**190,699**	200,467
Less: Reinsurance and other recoveries revenue		**(14,985)**	(23,835)
Net claims expense	B2	**175,714**	176,632
Management expenses	D1	**77,603**	68,013
Sales commission expenses	D1	**20,252**	19,488
Impairment of reinsurance receivable	D2	**-**	22,511
Total expenses		**273,569**	286,644
Profit / (Loss) before taxation		**27,435**	(8,135)
Tax (expense) / benefit	D5	**(10,122)**	735
Profit / (Loss) for the year		**17,313**	(7,400)
Profit / (Loss) attributed to:			
Shareholders		**17,073**	(7,447)
Non-controlling interest		**240**	47
		17,313	(7,400)

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	2019	2018
Profit / (Loss) for the year		**17,313**	(7,400)
Other comprehensive profit / (loss)			
Items that may be reclassified to profit / (loss):			
Currency translation differences		**793**	42
Items that will not be reclassified to profit / (loss):			
Gain on asset revaluation	E2	**305**	434
Deferred income tax relating to asset revaluation	D5	**(32)**	(81)
Other comprehensive profit net of tax		**1,066**	395
Total comprehensive profit / (loss) for the year		**18,379**	(7,005)
Total comprehensive profit / (loss) attributed to:			
Shareholders		**18,046**	(7,148)
Non-controlling interest		**333**	143
		18,379	(7,005)

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

CONSOLIDATED BALANCE SHEET

$ thousands As at 30 September	Note	2019	2018
Assets			
Cash and cash equivalents	C2	**56,112**	74,906
Receivables	E1	**256,117**	259,324
Investments	C3	**229,172**	198,000
Derivative financial assets	C4	**-**	244
Deferred acquisition costs	D3	**23,736**	22,595
Property, plant and equipment	E2	**9,104**	8,510
Intangible assets		**-**	7
Current tax assets	D5	**1,575**	1,817
Deferred tax assets	D5	**3,333**	10,333
Total assets		**579,149**	575,736
Liabilities			
Payables	E3	**74,067**	77,927
Provisions	E4	**6,449**	5,413
Unearned premiums	B4	**187,855**	175,551
Outstanding claims & additional risk margin	B5	**124,060**	148,976
Current tax liabilities	D5	**229**	174
Deferred tax liabilities	D5	**991**	589
Total liabilities		**393,651**	408,630
Net assets		**185,498**	167,106
Equity			
Contributed equity	F1	**209,990**	209,990
Accumulated losses		**(36,101)**	(53,187)
Reserves	F2	**9,808**	8,835
Total equity attributed to shareholders		**183,697**	165,638
Non-controlling interest		**1,801**	1,468
Total equity		**185,498**	167,106

The consolidated financial statements were approved for issue by the Board on 20 November 2019.

Graham R Stuart	Stephen J Smith
Director	**Director**

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

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 2019							
At the beginning of year		**209,990**	**(53,187)**	**8,835**	**165,638**	**1,468**	**167,106**
Comprehensive profit / (loss)							
Profit for the year		-	17,073	-	17,073	240	17,313
Currency translation differences		-	-	700	700	93	793
Gain on asset revaluation	E2	-	-	305	305	-	305
Deferred income tax relating to asset revaluation		-	-	(32)	(32)	-	(32)
Total comprehensive profit / (loss)		-	17,073	973	18,046	333	18,379
Transactions with shareholders							
Other		-	13	-	13	-	13
Total transactions with shareholders		-	13	-	13	-	13
At the end of the year		**209,990**	**(36,101)**	**9,808**	**183,697**	**1,801**	**185,498**
Year Ended 30 September 2018							
At the beginning of year		209,990	(45,740)	8,536	172,786	1,325	174,111
Comprehensive profit / (loss)							
Profit / (loss) for the year		-	(7,447)	-	(7,447)	47	(7,400)
Currency translation differences		-	-	(54)	(54)	96	42
Gain on asset revaluation	E2	-	-	434	434	-	434
Deferred income tax relating to asset revaluation		-	-	(81)	(81)	-	(81)
Total comprehensive profit / (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

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

CONSOLIDATED STATEMENT OF CASH FLOWS

$ thousands For the year ended 30 September	Note	2019	2018
Cash flows from operating activities			
Premiums received		**343,411**	319,329
Interest received		**7,632**	6,943
Net realised investment gain (loss)		**69**	(605)
Fee and other income received		**3,948**	3,592
Reinsurance received		**18,421**	45,780
Reinsurance paid		**(55,968)**	(52,327)
Claims paid		**(201,663)**	(231,843)
Payments to suppliers and employees		**(93,642)**	(84,533)
Income tax paid		**(2,453)**	(2,831)
Net cash inflow from operating activities	C5	**19,755**	3,505
Cash flows from investing activities			
Net payments for financial assets		**(36,691)**	(6,771)
Purchase of property, plant and equipment and intangible assets		**(1,879)**	(776)
Disposal of property, plant and equipment and intangible assets		**-**	22
Net cash (outflow) from investing activities		**(38,570)**	(7,525)
Cash flows from financing activities			
Dividends paid		**14**	-
Net cash inflow from financing activities		**14**	-
Net (decrease) in cash and cash equivalents		**(18,801)**	(4,020)
Effect of foreign exchange rate changes		**7**	(152)
Cash and cash equivalents at the beginning of year		**74,906**	79,078
Cash and cash equivalents at the end of year	C2	**56,112**	74,906

Accounting policy

Tower Insurance Limited considers that knowledge of gross receipts and payments of financial assets 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.

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 20 November 2019. The entity's owners or others do not have power to amend the financial statements after issue.

Basis of preparation

The Company is a for profit entity and the financial statements 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 presentation of notes. There is no change to net assets or the 2018 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 statement 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 statement of comprehensive income and the statement 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 statement of comprehensive income and the statement 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 statement.

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 2019	Holdings 2018	Nature of business
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 assumptions are the expected number and cost of new overcap claims and expected costs, including expected building costs, associated with settling existing open claims. Other elements of judgement are the quantum of closed claims reopening, apportionment of claim costs between the four main earthquake events, future claim management expenses and assessment of the risk margin.

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

The valuation of the EQC receivable is an area of significant accounting estimation and judgement. The amount received could be more or less, depending on the allocation of liability for damage, the quality of assessment information, the time taken to settle and the risks involved in litigation, therefore the Directors have taken extensive advice from independent experts in confirming the appropriateness of the valuation recorded.

Refer to Note B3 for further detail.

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.

Refer to Note D5 for further detail.

NOTES TO THE FINANCIAL STATEMENTS

A4 SEGMENTAL REPORTING

$ thousands	Note	New Zealand	Pacific Islands	Total
Year Ended 30 September 2019				
Revenue				
Premium revenue		285,677	59,318	344,995
Less: Outwards reinsurance expense		(37,816)	(17,159)	(54,975)
Investment revenue		6,106	930	7,036
Fee and other revenue		2,042	1,906	3,948
Net operating revenue		**256,009**	**44,995**	**301,004**
Profit (loss) before interest, tax, depreciation and amortisation		16,431	12,602	29,033
Depreciation and amortisation		(1,125)	(473)	(1,598)
Profit before income tax		15,306	12,129	27,435
Income tax (expense)		(5,557)	(4,565)	(10,122)
Profit for the year		**9,749**	**7,564**	**17,313**
Total assets 30 September 2019		480,694	98,455	579,149
Total liabilities 30 September 2019		334,809	58,842	393,651
Year Ended 30 September 2018				
Revenue				
Premium revenue		266,111	56,982	323,093
Less: Outwards reinsurance expense		(38,804)	(15,447)	(54,251)
Investment revenue		6,061	14	6,075
Fee and other revenue		1,967	1,625	3,592
Net operating 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)**
Total assets 30 September 2018		480,664	95,072	575,736
Total liabilities 30 September 2018		345,406	63,224	408,630

The impairment of reinsurance receivable of $22.5m in 2018 was incurred in the New Zealand General Insurance segment.

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 (CEO) who reviews the operating results on a regular basis and makes decisions on resource allocation and assessing performance.

NOTES TO THE FINANCIAL STATEMENTS

A4 SEGMENTAL REPORTING (continued)

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.

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

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	2019	2018
Gross written premiums		**356,767**	336,109
Less: Gross unearned premiums		**(11,772)**	(13,016)
Premium revenue		**344,995**	323,093

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	2019	2018
Canterbury earthquake claims (4 key events)	B3	**8,400**	10,100
Additional risk margin release	B3	**-**	(5,000)
Other claims		**167,314**	171,532
Total net claims expense		**175,714**	176,632

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. 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 2019 Tower has 109 claims remaining to settle (2018: 163 claims) as a result of earthquakes impacting the Canterbury region during 2010 and 2011.

The table below presents a financial representation of Tower's net outstanding claims provision at 30 September 2019 in relation to the four main earthquake events.

Canterbury earthquake insurance liability provisions

$ thousands	**2019**	2018
Insurance liabilities		
Gross outstanding claims	**(46,600)**	(67,900)
Additional risk margin	**(5,000)**	(5,000)
	(51,600)	(72,900)

The Board is 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.

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 2019. Any further changes to estimates will be recorded in the accounting period when they become known.

Additional risk margin

As at 30 September 2019, the Board has maintained an additional risk margin of $5.0m (30 September 2018: $5.0m) over and above the provision of the Appointed Actuary, which is set at the 75th percentile probability of sufficiency. The Board will continue to review this additional risk margin each half year and the $5.0m is expected to be released once the Canterbury outstanding claims liability has sufficiently run off.

The table below presents a financial representation of Tower's outstanding reinsurance receivables at 30 September 2019 in relation to the four main earthquake events.

Canterbury earthquake receivables

$ thousands	**2019**	2018
Reinsurance recovery receivables	**3,900**	7,100
Reinsurance recoveries on risk margin	**900**	800
Receivable from reinsurers	**4,800**	7,900

EQC recovery receivable

Tower has recognised a receivable of $69.9m from the EQC (2018: $68.4m) related to the Canterbury earthquake claims. This receivable is a disputed amount, and is largely the result of differences between the Tower and EQC approaches to allocation of damage to properties across the four Canterbury events.

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.

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.

NOTES TO THE FINANCIAL STATEMENTS

B3 CANTERBURY EARTHQUAKES (continued)

EQC recovery receivable (continued)

Tower's approach to allocation is based on extensive advice from independent experts (both external legal advisers and technical experts) including the modelling of damage for properties where primary evidence is very limited or not held. Tower's position is that: (a) there is a portfolio of approximately 3,000 properties in respect of which Tower made payments and where a reallocation is required, and (b) within that portfolio, there are a significant number of properties where part of Tower's contribution ought to have been made by EQC instead.

Tower's estimate of the gross amount receivable from EQC is, based on independent expert review, higher than the reported $69.9m. The Appointed Actuary has reviewed the independent experts' allocations for reasonableness, and then applied actuarial approaches that recognise the inherent risk and uncertainty in the recovery of the gross amount receivable to determine a central estimate. The Appointed Actuary then applied a risk margin of $9.4m to arrive at a 75th percentile probability of recovery (2018: $10.1m).

The resultant valuation is that which is carried in the financial statements, and includes an allowance for anticipated future legal costs. The valuation does not include any allowance for interest and certain other costs that the EQC may be required to pay Tower, which would be additional to the final principal amount for which EQC may be liable.

$16.9m of the receivable from EQC is payable to reinsurers if the full amount is recovered. This has been allowed for in payables (2018: $16.4m).

Tower acknowledges that the EQC receivable is an area of significant accounting estimation and judgement. The amount received could be more or less, depending on the allocation of liability for damage between the four events and between EQC and Tower, the quality of assessment information available in respect of each property, the time taken to settle with EQC, and the risks involved in litigation.

While Tower has issued proceedings against the EQC in regards to land damage and is currently seeking to settle the building dispute using an alternative dispute resolution process, there remains a prospect of continued (land recoveries) and new (building recoveries) litigation against the EQC which would take time.

While the Directors have taken extensive advice from independent experts in determining the appropriateness of the valuation recorded, it should be noted that the inherent risk and uncertainty in the recovery of the receivable is such that there remains risk that any amount ultimately recovered may be less than the amount of the receivable carried in the financial statements.

EQC recovery receivable

$ thousands	2019	2018
EQC related to closed claims	**77,300**	74,000
EQC related to open claims	**2,000**	4,500
Risk margin on EQC receivable	**(9,400)**	(10,100)
Receivable from EQC	**69,900**	68,400
EQC payable to reinsurers on closed claims	**(18,700)**	(17,900)
EQC payable to reinsurers on open claims	**(500)**	(1,000)
Risk margin on EQC payable to reinsurers	**2,300**	2,500
EQC payable to reinsurers	**(16,900)**	(16,400)
Receivable from EQC net of reinsurance	**53,000**	52,000

NOTES TO THE FINANCIAL STATEMENTS

B3 CANTERBURY EARTHQUAKES (continued)

Cumulative impact of Canterbury earthquakes

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

$ thousands	Note	2019	2018
Cumulative expenses associated with Canterbury earthquakes:			
Earthquake claims estimate		**(916,890)**	(905,840)
Reinsurance recoveries		**725,823**	723,173
Claim expense net of reinsurance recoveries		**(191,067)**	(182,667)
Reinsurance expense		**(25,045)**	(25,045)
Additional risk margin		**(5,000)**	(5,000)
Cumulative impact of Canterbury earthquakes before tax		**(221,112)**	(212,712)
Income tax		**62,580**	60,228
Cumulative impact of Canterbury earthquakes after tax		**(158,532)**	(152,484)
Recognised in current period (net of tax)			
Net claims expense	B2	**(6,048)**	(7,272)
Additional risk margin release	B2	**-**	3,600
Impairment of receivables	D2	**-**	(15,660)
		(6,048)	(19,332)

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

Date of event	**Catastrophe reinsurance cover remaining**	
$ thousands	**2019**	2018
June 2011	**253,300**	255,700
December 2011	**486,600**	486,900

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

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-19**	30-Sep-18
Outstanding claims:								
(i)	Change to costs arising from new overcap claims	+ 50%	**(1.6)**	**(2.9)**	**-**	**-**	**(4.5)**	(0.9)
		- 50%	**1.6**	**2.8**	**-**	**-**	**4.4**	0.9
(ii)	Changes to expected claims costs for open claims	+ 20%	**(1.5)**	**(3.6)**	**-**	**-**	**(5.1)**	(10.0)
		- 20%	**1.5**	**3.6**	**-**	**-**	**5.1**	9.9
Receivables:								
Reinsurance recovery receivables								
(iii)	Recoveries from EQC in respect of land damage	+20%	**0.1**	**1.2**	**-**	**-**	**1.3**	1.6
		-20%	**(0.1)**	**(1.2)**	**-**	**-**	**(1.3)**	(1.6)
(iv)	Recoveries from EQC in respect of building costs	+20%	**7.1**	**2.1**	**-**	**-**	**9.2**	8.8
		-20%	**(7.2)**	**(2.1)**	**-**	**-**	**(9.3)**	(8.8)

(i) The volume of new overcap claims received from the EQC (i.e. claims above the EQC limit) is a source of uncertainty. This sensitivity is calculated as future new overcaps ultimately being +/- 50% to that currently in the Canterbury earthquake insurance liability provisions.

(ii) Unexpected development of open claims is also a source of uncertainty. This sensitivity is calculated as the outstanding cost of open claims being +/- 20% to that currently in the Canterbury earthquake insurance liability provisions.

(iii)&(iv) As outlined in note B3, the EQC Receivable is a source of significant uncertainty. A number of factors could vary the ultimate amount received from EQC including, but not limited to, (a) changes in apportionment of damage across events, and (b) differences in assessment of liability for damage across properties. This sensitivity is calculated as the ultimate amount received from EQC being +/- 20% to that currently carried in the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

B4 UNEARNED PREMIUMS

$ thousands	2019	2018
Opening balance	**175,551**	162,342
Premiums written	**356,767**	336,109
Premiums earned	**(344,995)**	(323,093)
Foreign exchange movements	**532**	193
Closing balance	**187,855**	175,551

The majority of unearned premiums is a current liability as at 30 September 2019.

Accounting policy

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.

NOTES TO THE FINANCIAL STATEMENTS

B5 OTHER INSURANCE DISCLOSURES

B5.1 NET CLAIMS EXPENSE

$ thousands	2019 Risks borne in current year	2019 Risks borne in prior years	2019 Total	2018 Risks borne in current year	2018 Risks borne in prior years	2018 Total
Gross claims expense						
Direct claims - undiscounted	**177,786**	**12,913**	**190,699**	188,452	12,035	200,487
Movement in discount	**-**	**-**	**-**	(60)	40	(20)
Total gross claims expense	**177,786**	**12,913**	**190,699**	188,392	12,075	200,467
Reinsurance and other recoveries						
Reinsurance and other recoveries - undiscounted	**(9,793)**	**(5,192)**	**(14,985)**	(20,073)	(3,762)	(23,835)
Movement in discount	**-**	**-**	**-**	-	-	-
Total reinsurance recoveries	**(9,793)**	**(5,192)**	**(14,985)**	(20,073)	(3,762)	(23,835)
Net claims expense	**167,993**	**7,721**	**175,714**	168,319	8,313	176,632

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 2019 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 (excluding Canterbury earthquakes):

	2019	2018
Inflation rates varied from	0.0%	0.0%
Inflation rates for succeeding year	0.0%	0.0%
Inflation rates for following years	0.0%	0.0%
Discount rates varied from	0.0%	0.0% - 2.5%
Discount rates for succeeding year	0.0%	0.0% - 2.5%
Discount rates for following years	0.0%	0.0% - 2.5%
Weighted average claims handling expense ratio	7.2%	5.5%
Weighted average risk margin	6.8%	8.6%

Please refer to Note B3 for details on 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:

	2019	2018
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. Nil explicit additional inflation has been assumed. Similarly a nil discount rate has been used.

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.

B5 OTHER INSURANCE DISCLOSURES (continued)

The following analysis is in respect of the insurance liabilities:

$ thousands	Note	2019	2018
Central estimate of expected present value of future payments for claims incurred		**87,017**	95,425
Risk margin		**11,562**	12,936
Additional risk margin - Canterbury		**5,000**	5,000
Claims handling costs		**7,024**	6,901
		110,603	120,262
Discount		**-**	(271)
Net outstanding claims		**110,603**	119,991

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

	2019			2018		
$ thousands	**Gross**	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Reconciliation of movements in discounted outstanding claim liabilities						
Balance brought forward	**148,976**	**(28,985)**	**119,991**	181,156	(33,429)	147,727
Effect of change in foreign exchange rates	**489**	**(368)**	**121**	71	(99)	(28)
Incurred claims recognised in the income statement	**190,699**	**(14,985)**	**175,714**	200,467	(23,835)	176,632
Claims paid and reinsurance recoveries raised	**(216,104)**	**30,881**	**(185,223)**	(232,718)	28,378	(204,340)
Total outstanding claims	**124,060**	**(13,457)**	**110,603**	148,976	(28,985)	119,991

Reconciliation of movements in undiscounted claims to outstanding claim liabilities

	2019			2018		
$ thousands	**Gross**	**Reinsurance**	**Net**	Gross	Reinsurance	Net
Long tail outstanding claims	**4,460**	**(79)**	**4,381**	3,461	(80)	3,381
Short tail outstanding claims	**119,600**	**(13,378)**	**106,222**	145,515	(28,905)	116,610
Total outstanding claims	**124,060**	**(13,457)**	**110,603**	148,976	(28,985)	119,991

Accounting policy

Outstanding claims are calculated at the central estimate of the present value of expected future payments allowing for inflation implicit in historical trends. There is no discounting applied. 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.

NOTES TO THE FINANCIAL STATEMENTS

B5 OTHER INSURANCE DISCLOSURES (continued)

(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.

(c) Future net cash out flows

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

$ thousands	Note	**2019**	2018
Expected claim payments			
Within 3 months		**46,797**	50,771
3 to 6 months		**24,430**	25,762
6 to 12 months		**16,957**	17,955
After 12 months		**22,419**	25,503
Total outstanding claim liabilities		**110,603**	119,991

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**	**2015**	**2016**	**2017**	**2018**	**2019**	**Total**
At end of incident year		125,260	130,904	139,670	144,337	147,526	
One year later		126,431	129,629	141,577	142,126		
Two years later		126,267	131,713	142,946			
Three years later		127,746	131,446				
Four years later		127,243					
Current estimate of ultimate claims cost		127,243	131,446	142,946	142,126	147,526	
Cumulative payments		(126,781)	(129,768)	(140,951)	(137,420)	(102,854)	
Central estimate outstanding	33,504	462	1,678	1,995	4,706	44,672	87,017
Claims handling expense							7,024
Risk margin							11,562
Additional risk margin - Canterbury							5,000
Net outstanding claim liabilities							110,603
Reinsurance recoveries on outstanding claim liabilities and other recoveries							13,457
Gross outstanding claim liabilities							124,060

Prior year numbers have been restated at current year exchange rates to reflect the underlying development of claims.

NOTES TO THE FINANCIAL STATEMENTS

B5 OTHER INSURANCE DISCLOSURES (continued)

B5.4 LIABILITY ADEQUACY TEST

Liability adequacy tests are performed for each country 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 2019 were sufficient for all businesses except Fiji and NPI where small deficits were recognised. The total deficit recognised as a charge against deferred acquisition cost was $331,000 (2018: sufficient).

	2019	2018
Central estimate claim % of premium	**42.9%**	44.9%
Risk margin	**10.0%**	11.3%

Refer to Note B5.3 for additional information on central estimate and risk margin.

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 8 March 2019.

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.

B5.8 UNDERWRITING PROFIT

$ thousands	2019	2018
Gross written premium	**356,767**	336,109
Gross earned premium	**344,995**	323,093
Reinsurance expense	**(54,975)**	(54,251)
Net premium revenue	**290,020**	**268,842**
Net claims expense	**(175,714)**	(176,632)
Management expenses related to underwriting	**(77,603)**	(68,013)
Sales commission expenses	**(20,252)**	(19,488)
Underwriting profit	**16,451**	**4,709**

NOTES TO THE FINANCIAL STATEMENTS

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	2019	2018
Fixed interest securities			
Interest income		**7,631**	6,943
Net realised gain (loss)		**(262)**	146
Net unrealised (loss) gain		**(333)**	596
Total fixed interest securities		**7,036**	7,685
Equity securities			
Net unrealised gain (loss)		**-**	(745)
Total equity securities		**-**	(745)
Property securities			
Net unrealised gain (loss)		**-**	-
Total property securities		**-**	-
Other			
Net realised gain (loss)		**331**	(751)
Net unrealised gain (loss)		**(331)**	(114)
Total other		**-**	(865)
Total investment revenue		**7,631**	6,943
Total net realised gain (loss)		**69**	(605)
Total net unrealised gain (loss)		**(664)**	(263)
Total investment revenue		**7,036**	6,075

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 at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS

C2 CASH AND CASH EQUIVALENTS

$ thousands	Note	2019	2018
Cash at bank and in hand		**32,332**	37,566
Deposits at call		**22,753**	36,886
Restricted cash		**1,027**	454
Total cash and cash equivalents		**56,112**	74,906

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 average interest rate at 30 September 2019 for deposits at call is 1.79% (2018: 2.10%).There was no offsetting within cash and cash equivalents (2018: 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 $1.0m (2018: $0.5m) 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 $0.3m (2018: $0.2m) recorded within Insurance liabilities for Tower's portion of multi-unit outstanding claims; and $0.7m (2018: $0.3m) recorded within Payables as held on behalf of other insurers in respect of SPP claims.

C3 INVESTMENT ASSETS

$ thousands	Note	2019	2018
Fixed interest securities		**228,527**	197,367
Equity securities		**611**	599
Property securities		**34**	34
Total investment assets		**229,172**	198,000

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; financial assets at amortised cost; and financial 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) Financial assets at amortised cost

Financial assets at amortised cost are measured initially at fair value plus transaction costs and subsequently at amortised cost using the effective interest method less any impairment. Financial assets within the scope of NZ IFRS 9 are managed to collect contractual cash flows and their contractual terms generate cash flows that are solely payments of principal (and interest, if any).

The Group's financial assets at amortised cost comprise trade and other receivables and cash and cash equivalents. They are non-derivative financial assets with fixed or determinable payments that are not quoted on an active market.

(ii) Financial liabilities at amortised cost

Financial liabilities at amortised cost are measured initially at fair value plus transaction costs and subsequently at amortised cost less any impairment. There was no change to this categorisation as a result of the transition to NZ IFRS 9.

The Group's financial liabilities at amortised cost comprise debt facilities and trade and other payables. They are non-derivative financial liabilities with fixed or determinable payments that are not quoted on an active market.

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

Financial assets at fair value through profit or loss (i.e. investments) are stated at fair value, with any resultant gain or loss recognised in the income statement. The net gain or loss recognised in the income statement includes any dividend or interest earned on the financial assets. Assets that are subsequently measured at their fair value through profit or loss are not subject to impairment considerations under the expected credit loss model of NZ IFRS 9.

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. Tower's financial instruments that are classified at fair value through profit or loss on initial recognition, and which are subsequently re-measured to fair value at each reporting date, are classified on this basis because they back general insurance liabilities and measuring them at fair value significantly reduces a potential measurement inconsistency which would arise if the assets were measured at amortised cost or fair value through other comprehensive income.

All derivatives entered into by the Group are categorised at fair value through profit or loss unless they are designated as hedges.

(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.

(v) Derecognition

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

NOTES TO THE FINANCIAL STATEMENTS

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**	**Financial Assets**	**Financial liabilities**	**Financial Assets**	**Financial liabilities**
As at 30 September 2019						
Assets						
Cash and cash equivalents		**56,112**	**-**	**-**	**56,112**	**-**
Trade and other receivables		**253,085**	**253,085**	**-**	**-**	**-**
Investments		**229,172**	**-**	**-**	**229,172**	**-**
Derivative financial assets		**-**	**-**	**-**	**-**	**-**
Total financial assets		**538,369**	**253,085**	**-**	**285,284**	**-**
Liabilities						
Trade and other payables		**40,355**	**-**	**40,355**	**-**	**-**
Total financial liabilities		**40,355**	**-**	**40,355**	**-**	-

			At amortised cost		At fair value through profit or loss	
$ thousands	Note	Total	Financial Assets	Financial liabilities	Financial Assets	Financial liabilities
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	256,072	-	272,906	244
Liabilities						
Trade and other payables		47,926	-	47,926	-	-
Total financial liabilities		47,926	-	47,926	-	-

Accounting policy

Cash and cash equivalents held by Tower are financial assets which are within the scope of NZ IFRS 9. The classification has been established based on the assessment of business model and the contractual cash flow characteristics of the cash and cash equivalents held.

Cash and cash equivalents held by Tower's corporate entities are held in order to collect contractual cash flows and give rise to cash flows that are solely payments of principal and interest therefore classified at amortised cost.

Cash and cash equivalents held by Tower's insurance companies are held in order to back general insurance liabilities and meet its obligations and therefore classified at fair value through profit or loss.

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 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

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) Financial assets and other financial liabilities held at amortised cost

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

(iv) Derivative financial assets and liabilities

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

NOTES TO THE FINANCIAL STATEMENTS

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 2019					
Assets					
Investment in equity securities		**611**	**-**	**-**	**611**
Investments in fixed interest securities		**228,527**	**-**	**228,527**	**-**
Investments in property securities		**34**	**-**	**34**	**-**
Investments		**229,172**	**-**	**228,561**	**611**
Derivative financial assets		**-**	**-**	**-**	**-**
Total financial assets		**229,172**	**-**	**228,561**	**611**
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**

The Level 3 category includes an investment in equity securities of $611,000 (2018: $599,000). 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	**2019**	2018
Opening balance		**599**	1,412
Total gains and losses recognised in profit or loss		**-**	(745)
Foreign currency movement		**12**	(46)
Disposals		**-**	(22)
Closing balance		**611**	599

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 2019			
Investment in equity securities	**611**	**61**	**(61)**
As at 30 September 2018			
Investment in equity securities	599	60	(60)

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. NZ IFRS 9 requires entities to estimate and account for expected credit losses (ECL) for all relevant financial assets not at fair value through profit and loss (FVTPL). The group has adopted and applied the simplified model for ECL on trade receivables. Premium and reinsurance receivables are accounted for in accordance with NZ IFRS 4.

For financial assets carried at amortised cost, the impairment is calculated as a provision for expected credit losses (ECLs). The provision for ECLs is based on the difference between the cash flows due in accordance with the contract and the cash flows that Tower expects to receive. Any shortfall is discounted at an approximation to the asset's original effective interest rate. The assessment of ECLs is performed based on historical credit loss experience adjusted for forward-looking factors specific to debtors and the economic environment.

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 a provision 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 provision 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 provision for credit losses and impairment.

C5 RECONCILIATION OF PROFIT / (LOSS) FOR THE PERIOD TO NET CASH FLOWS FROM OPERATING ACTIVITIES

$ thousands	Note	2019	2018
Profit / (Loss) for the year		**17,313**	(7,400)
Adjusted for non-cash items			
Depreciation of property, plant and equipment	E2	**1,597**	1,499
Amortisation of software		**-**	10
Impairment of reinsurance receivables		**-**	21,750
Unrealised loss on financial assets		**661**	263
Movement on disposal of property, plant and equipment		**-**	(50)
Change in deferred tax		**7,372**	(2,843)
		9,630	20,629
Adjusted for movements in working capital (excluding the effects of exchange differences on consolidation)			
Change in receivables		**(2,436)**	5,050
Change in payables		**(5,049)**	(14,052)
Change in taxation		**297**	(722)
		(7,188)	(9,724)
Net cash inflows from operating activities		**19,755**	3,505

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 ANALYSIS OF EXPENSES

$ thousands	Note	2019	2018
Employee benefits expense		**62,862**	58,292
Commission expense		**20,252**	19,488
Administration expense		**16,903**	12,573
Other expenses		**8,486**	8,516
Marketing expense		**8,770**	7,408
Lease expenses (1)		**4,245**	3,393
Depreciation		**1,591**	1,499
Auditors' fees		**600**	603
Acquisition proposal expenses		**-**	302
Bad debts written off		**52**	232
Directors' fees		**22**	20
Amortisation of software		**7**	10
(Gain) on disposal of property, plant and equipment		**(20)**	(50)
Net change in indirect deferred acquisition costs		**(968)**	(1,634)
Claims related management expenses reclassified to claims expense (2)		**(24,947)**	(23,151)
Total management and sales expenses		**97,855**	87,501

(1) Lease expenses include payments made to a related party under a services contract where the lessee is Tower NZ Ltd.

(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 $22.0m of the $43.75m 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 $21.75m. This amount along with associated professional fees of $0.76m have been recorded in the Consolidated Income Statement as Impairment of reinsurance receivables.

No impairment expense has been recognised in 2019.

NOTES TO THE FINANCIAL STATEMENTS

D3 DEFERRED ACQUISITION COSTS

$ thousands	Note	2019	2018
Balance at the beginning of year		**22,595**	20,961
Acquisition costs during the year		**44,977**	39,555
Current period amortisation		**(43,836)**	(37,921)
Total deferred acquisition costs		**23,736**	22,595
Analysed as:			
Current		**23,736**	22,595
Non-current		**-**	-
Total deferred acquisition costs		**23,736**	22,595

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.

D4 OPERATING LEASES

$ thousands	2019	2018
As lessee		
Rent payable to the end of the lease terms are:		
Not later than one year	**1,030**	1,183
Later than one year and not later than five years	**858**	1,059
Later than five years	**-**	-
	1,888	2,242

Operating lease commitments excludes payments made under a services contract to a related party where the Group is not a formal party to the contract.

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

D5 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

D5 TAX (continued)

D5.1 TAX EXPENSE

$ thousands	Note	2019	2018
Current tax		**2,744**	2,715
Deferred tax		**7,338**	(2,904)
Under (over) provided in prior years		**40**	(546)
Total tax expense / (benefit)		**10,122**	(735)

The tax expense / (benefit) can be reconciled to the accounting profit or loss as follows:

Profit / (Loss) before tax from continuing operations		**27,435**	(8,135)
Income tax at the current rate of 28%		**7,682**	(2,278)
Tax effect of:			
Prior period adjustments		**40**	(546)
Non-deductible expenditure/non-assessable income		**(7)**	711
Foreign tax credits written off		**2,149**	1,372
Other		**258**	6
Total tax expense / (benefit)		**10,122**	(735)

D5.2 CURRENT TAX ASSETS

$ thousands	Note	2019	2018
Current		**1,551**	1,575
Non-current		**24**	242
Total current tax assets		**1,575**	1,817

A non-current tax asset of $24,000 is recognised in the financial statements as at 30 September 2019 in relation to excess tax payments made in previous years (2018: $242,000). Non-current tax assets are expected to be recovered from 2022, as determined by the Board approved operational plan for financial years 2020 to 2023. A current tax asset of $1,551,000 is recognised in relation to excess tax payments made in the Pacific Islands over and above the estimated tax liabilities for the year (2018: $1,575,000).

D5.3 CURRENT TAX LIABILITIES

Current tax liabilities of $229,000 relate to taxes payable to offshore tax authorities in the Pacific Islands (2018: $174,000).

D5.4 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 2019				
Movement in deferred tax assets				
Provisions and accruals	**2,734**	**1,315**	**-**	**4,049**
Property, plant and equipment	**1,713**	**(583)**	**-**	**1,130**
Tax losses	**10,862**	**(6,656)**	**-**	**4,206**
Other	**763**	**(763)**	**-**	**-**
Total deferred tax assets	**16,072**	**(6,687)**	**-**	**9,385**
Set-off of deferred tax liabilities pursuant to NZ IAS 12				**(6,052)**
Net deferred tax assets				**3,333**
Movement in deferred tax liabilities				
Deferred acquisition costs	**(5,739)**	**(306)**	**-**	**(6,045)**
Other	**(589)**	**(377)**	**(32)**	**(998)**
Total deferred tax liabilities	**(6,328)**	**(683)**	**(32)**	**(7,043)**
Set-off of deferred tax liabilities pursuant to NZ IAS 12				**6,052**
Net deferred tax liabilities				**(991)**

NOTES TO THE FINANCIAL STATEMENTS

D5 TAX (continued)

D5.4 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 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)

Recognition of deferred tax assets is a key area of judgement. Management expects to utilise the tax losses against future taxable profits over the next year (2018: two years).

Deferred tax liabilities of nil have not been recognised in respect of temporary differences associated with investments in subsidiaries (2018: nil).

D5.5 IMPUTATION CREDITS

Tower Insurance Limited has imputation credits available for use as at 30 September 2019 of nil (2018: 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.

NOTES TO THE FINANCIAL STATEMENTS

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	2019	2018
Premium receivables		**153,883**	141,578
Reinsurance and other recoveries		**19,316**	35,741
Unearned reinsurance premiums		**8,794**	8,475
Trade Receivables		**181,993**	185,794
EQC receivables	B3	**70,263**	69,272
Related party receivables	G2	**168**	470
Prepayments		**2,486**	2,520
Other		**1,207**	1,268
Total Receivables		**256,117**	259,324

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

Accounting policy

All receivables (except for Prepayments and Other) reflect rights arising under insurance and reinsurance contracts as defined in NZ IFRS 4 Insurance Contracts. These are recognised initially at transaction price and subsequently at amortised cost, less provision for impairment. A provision for impairment is established when there is objective evidence that Tower will not be able to collect all amounts due according to the original terms of the receivable.

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

$ thousands	Note	2019	2018
Opening balance		**(646)**	(805)
Provisions added during the year		**(586)**	(208)
Provisions released during the year		**136**	362
Foreign exchange movements		**(4)**	5
Closing balance		**(1,100)**	(646)

Trade and other receivables 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	2019	2018
Analysed as			
Current		**183,489**	184,850
Non current		**72,628**	74,474
Total receivables		**256,117**	259,324

NOTES TO THE FINANCIAL STATEMENTS

E1 RECEIVABLES (continued)

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.

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

Earthquake Commission receivables included $69.9m relating to the Canterbury earthquake provision as disclosed in Note B3 (2018: $68.4m) and $0.4m relating to the Kaikoura region earthquake (2018: $0.9m).

E2 PROPERTY, PLANT AND EQUIPMENT

$ thousands	Land and buildings	Office equipment and furniture	Motor vehicles	Computer equipment	Total
For the Year Ended 30 September 2019					
Cost					
Opening balance	3,404	8,876	1,268	15,010	28,558
Additions	337	562	97	862	1,858
Disposals	-	(243)	(91)	(2,110)	(2,444)
Revaluations	305	-	-	-	305
Foreign exchange movements	36	62	(117)	(122)	(141)
Closing balance	4,082	9,257	1,157	13,640	28,136
Accumulated depreciation					
Opening balance	-	(4,438)	(1,029)	(14,581)	(20,048)
Depreciation	-	(1,018)	(112)	(461)	(1,591)
Disposals	-	240	87	2,109	2,436
Foreign exchange movements	-	(39)	102	108	171
Closing balance	-	(5,255)	(952)	(12,825)	(19,032)
Closing balance					
Cost / revaluation	4,082	9,257	1,157	13,640	28,136
Accumulated depreciation	-	(5,255)	(952)	(12,825)	(19,032)
Net book value	4,082	4,002	205	815	9,104

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 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**

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.

NOTES TO THE FINANCIAL STATEMENTS

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 11 September 2019 by Rolle Associates, registered valuers in Fiji. There has been no material movement in the valuation between 11 September 2019 and 30 September 2019. 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 sales of commercial property in Suva and a capitalisation rate of between 6.0% and 9.6% (2018: between 7.5% and 9.5%).

Had land and buildings been recognised under the cost model the carrying amount would have been $1,557,733 (2018: $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	2019	2018
Trade payables		**12,110**	14,544
Reinsurance payables		**22,394**	23,388
Payable to other insurers		**725**	268
Investment settlement balances		**-**	5,099
GST payable		**18,395**	16,531
Other payables		**20,443**	18,097
Total payables		**74,067**	77,927
Analysed as:			
Current		**57,167**	61,527
Non-current	B3	**16,900**	16,400
Total payables		**74,067**	77,927

The non-current portion of payables relates to payments due to reinsurers in relation to the disputed EQC receivables, refer to Note B3 for further details.

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.

NOTES TO THE FINANCIAL STATEMENTS

E4 PROVISIONS

$ thousands	Note	2019	2018
Employee benefits		**6,449**	5,413
Total provisions		**6,449**	5,413
Analysed as:			
Current		**6,053**	5,026
Non-current		**396**	387
Total provisions		**6,449**	5,413

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.

E5 CAPITAL COMMITMENTS

As at 30 September 2019, the Group has capital commitments of $0.9m relating to new IT equipment and hardware (2018: nil).

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	2019	2018
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**	211,107,758
Issue of share capital		**-**	-
Closing balance		**211,107,758**	211,107,758

No shares were issued during the 30 September 2019 year (2018: Nil). 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 2019 (2018: Nil).

F2 RESERVES

$ thousands	Note	2019	2018
Foreign currency translation reserve (FCTR)			
Opening balance		**(4,397)**	(4,343)
Currency translation differences arising during the year		**700**	(54)
Closing balance		**(3,697)**	(4,397)
Capital reserve			
Opening balance		**11,990**	11,990
Closing balance		**11,990**	11,990
Asset revaluation reserve			
Opening balance		**1,242**	889
Gain on revaluation		**305**	434
Deferred income tax relating to asset revaluation		**(32)**	(81)
Closing balance		**1,515**	1,242
Total reserves		**9,808**	8,835

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 or 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
For the year ending 30 September 2019, and through the comparative period, the Reserve Bank of New Zealand had imposed a license condition that Tower Insurance Limited was required to maintain a minimum solvency margin of at least $50.0m.

	Tower Insurance Limited		Tower Insurance Limited Group	
	Unaudited	Unaudited	**Audited**	Audited
$ thousands	**2019**	2018	**2019**	2018
Actual solvency capital	**155,894**	136,476	**182,197**	156,765
Minimum solvency capital	**56,598**	58,298	**73,276**	74,344
Solvency margin	**99,296**	78,178	**108,921**	82,421
Solvency ratio	**275%**	234%	**249%**	211%

Effective from 31 October 2019, the license condition was amended so that Tower Insurance Limited is required to maintain a minimum solvency margin of at least $50.0m in respect of all assets and liabilities except for Specified Excluded Assets. Specified Excluded Assets are the assets net of reinsurance in respect of the disputed EQC recoveries, referred to in note B3. Also during October 2019, Tower Insurance Limited issued $45.0m of ordinary share capital. If the change to the license condition and the share issue had both applied at 30 September 2019, the net impact would have been a reduction in Tower Insurance Limited's solvency margin by $7.6m.

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	**2019**	2018
Tower Insurance shareholder equity	**185,498**	167,106
Total capital resources	**185,498**	167,106

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 2019 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.

These requirements and associated processes are articulated in the Board approved Treasury Policy applicable to Tower Insurance Limited which is itself reviewed every two years, with the next review due in May 2020.

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

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 customers or other counterparties. Credit exposure in respect of the Group's New Zealand 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-'. Overall exposure to credit risk is monitored on a Group basis in accordance with limits set by the Board.

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 F4.3*(iii)*.

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	**2019**	2018
New Zealand government	**9,513**	919
Other government agencies	**109,834**	107,752
Banks	**187,925**	200,000
Financial institutions	**47,266**	32,186
Other non-investment related receivables	**183,017**	187,262
Related party receivables	**168**	470
Total financial assets with credit exposure	**537,723**	528,589

(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	**2019**	2018
Cash and cash equivalents	**56,112**	74,906
Receivables	**252,916**	255,602
Related party receivables	**168**	470
Investments	**228,527**	197,367
Derivative financial assets	**-**	244
Total credit risk	**537,723**	528,589

(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	**2019**	2018
Credit exposure by credit rating		
AAA	**111,950**	85,321
AA	**126,528**	153,215
A	**25,063**	16,484
BBB	**-**	-
Below BBB	**15,102**	13,020
Total counterparties with external credit ratings	**278,643**	268,040
Group 1	**172,385**	177,181
Group 1a	**168**	470
Group 2	**-**	-
Group 3	**5,997**	1,717
Total counterparties with no external credit rating	**178,550**	179,368
EQC Recovery Receivable	**69,900**	68,400
Total financial assets neither past due nor impaired with credit exposure	**527,093**	**518,509**

NOTES TO THE FINANCIAL STATEMENTS

F4 RISK MANAGEMENT (continued)

Group 1 - Receivables outstanding for less than 6 months
Group 1a - Intercompany receivables outstanding for less than 6 months
Group 2 - Receivables outstanding for more than 6 months with no defaults in the past
Group 3 - Unrated investments

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

No financial assets have been renegotiated in the past year (2018: 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 2019					
Reinsurance recoveries receivable	**-**	**-**	**78**	**-**	**78**
Outstanding premiums	**5,552**	**3,371**	**991**	**638**	**10,552**
Total	**5,552**	**3,371**	**1,069**	**638**	**10,630**
As at 30 September 2018					
Reinsurance recoveries receivable	-	27	-	-	27
Outstanding premiums	5,526	1,422	2,641	464	10,053
Total	5,526	1,449	2,641	464	10,080

(vi) Financial assets that are individually impaired

	Carrying value	
$ thousands	**2019**	2018
Outstanding premiums	**-**	-
Total	**-**	-

NOTES TO THE FINANCIAL STATEMENTS

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 2019				
Financial liabilities				
Trade payables	**12,835**	**12,835**	**12,835**	**-**
Reinsurance payables	**22,394**	**22,394**	**5,494**	**16,900**
Other payables	**5,127**	**5,127**	**5,127**	**-**
Total	**40,356**	**40,356**	**23,456**	**16,900**
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	-
Total	47,927	47,927	31,527	16,400

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**	
	2019	2018	**2019**	2018	**2019**	2018
	%		$ thousands		$ thousands	
Less than 1 year	**0%**	0%	**-**	15,863	**-**	244
1 to 2 years	**0%**	0%	**-**	-	**-**	-
2 to 5 years	**0%**	0%	**-**	-	**-**	-
Over 5 years	**0%**	0%	**-**	-	**-**	-
			-	15,863	**-**	244

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/(loss) after tax and equity. 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/(loss) 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.

	2019		2018	
	Impact on:		Impact on:	
$ thousands	**Profit after tax**	**Equity**	Profit after tax	Equity
Change in variables				
+ 50 basis points	**(688)**	**(688)**	(696)	(696)
- 50 basis points	**761**	**761**	768	768

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.

	2019		2018	
	Impact on:		Impact on:	
$ thousands	**Profit after tax**	**Equity**	Profit after tax	Equity
Change in variables				
10% appreciation of New Zealand dollar	**438**	**(3,332)**	129	(2,641)
10% depreciation of New Zealand dollar	**(535)**	**3,666**	(158)	2,905

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

NOTES TO THE FINANCIAL STATEMENTS

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.

	2019		2018	
	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	2019	2018
Fees paid to Group's auditors:			
Audit of financial statements (1)		**528**	531
Other assurance related services (2)		**46**	47
Agreed upon procedures (3)		**12**	11
Total fees paid to Group's auditors		**586**	589
Fees paid to subsidiaries' auditors different to Group auditors:			
Audit of financial statements (1)		**14**	14
Total fees paid to auditors		**600**	603

(1) Audit of financial statements includes fees for both the audit of annual financial statements and the review of interim financial statements. In 2019 the Group's auditors were further engaged to perform the audit of National Pacific Insurance Limited (2018: PwC). The audit of Tower Insurance (Vanuatu) Limited was performed by Law Partners (2018: Law Partners).

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

(3) Agreed upon procedures 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	2019	2018	Nature of relationship	Type of Transaction
Tower New Zealand Limited	**294**	470	Fellow subsidiary	Management fees
Tower New Zealand Limited	**(126)**	-	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	2019	2018	Nature of relationship	Type of Transaction
Tower New Zealand Limited	**6,573**	5,185	Fellow subsidiary	Management expenses

Management expenses include payments for assets that are owned by Tower New Zealand Limited but used by Tower Insurance Limited.

In addition, Tower Insurance Limited reimburses Tower New Zealand Limited for services carried out on its behalf including employee, administration, marketing and other 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 (2018: 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.

NOTES TO THE FINANCIAL STATEMENTS

G3 CONTINGENT ASSETS AND LIABILITIES

The Group may, from time to time, pursue claims through legal processes against other parties during the course of business that give rise to the possibility of an inflow of economic benefits where the outcome is uncertain. These items are judged to be contingent assets. All contingent assets are continually assessed to ensure that when the realisation of income is virtually certain, an appropriate related asset is recognised.

The Group is also 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.

No contingent assets or liabilities are judged to be sufficiently material to require individual disclosure.

G4 SUBSEQUENT EVENTS

Purchase of Youi NZ Pty Ltd's Portfolio
Tower Insurance Limited has entered into an agreement for the purchase of Youi NZ Pty Ltd's insurance portfolio, subject to regulatory approval. Under this agreement, Tower Insurance Limited will acquire Youi NZ's approximately 34,000 inforce policies for a total purchase price of NZ$13m, plus transaction and migration costs, with Tower policy renewals to be offered as current Youi NZ policies expire. This is subject to regulatory approvals and the acquisition is expected to settle prior to the end of the 2019 calendar year.
Tower Insurance Limited is purchasing the customer relationships (and associated assets and liabilities) and not the systems or processes that Youi NZ uses to run its business. Therefore, the transaction is being treated as the purchase of an intangible asset rather than a business combination. After initial recognition, the cost model will be adopted to measure the asset.

Change in Licence Condition
The Reserve Bank of New Zealand has modified Tower Insurance's licence conditions to remove the disputed EQC receivable from Tower Insurance's solvency calculation to reflect the increased likelihood of litigation and associated delay in receiving the funds. This took effect from 31 October 2019. While the EQC receivable is excluded from the solvency calculations, it remains on the balance sheet at a net $53.1m (2018: $52.0m).

Issuing of Additional Share Capital
To accommodate the purchase of the Youi NZ portfolio and the change to its licence condition, Tower Insurance Limited issued $45m of additional share capital to its immediate parent – Tower Financial Services Group Limited – on 31 October 2019 at $1 par value.

Corporate Structure
Tower Limited is giving active consideration to simplifying its corporate structure to make Tower Insurance Limited the listed parent. If this is not feasible Tower Limited has agreed with RBNZ that Tower Insurance Limited will have a majority of directors independent of the listed parent company by 30 September 2020.

G5 CHANGE IN COMPARATIVES

Comparative information has been reclassified to achieve consistency with the current year presentation. Changes relate to the presentation of certain notes only. There is no change to net assets or the 2018 profit.

Note Disclosure - Financial Instruments

Within note C4, there has been a reclassification of cash and cash equivalents from financial assets at amortised cost to financial assets at fair value through profit or loss in line with the requirement of NZ IFRS 4 *Insurance Contracts*. Cash and cash equivalents measured at amortised cost have reduced by $74.9m, and cash and cash equivalents measured at fair value through profit or loss has increased by $74.9m. This reclassification has no impact on the cash and cash equivalent balance disclosed in the Consolidated Balance Sheet.

Note Disclosure - Financial Instruments

Within note F6.3 (iii), total counterparties with external credit ratings of AA has been adjusted down by $2.7m and total counterparties with no external credit rating (Group 3) has been adjusted up by $2.7m. This is to correct a misclassification in the 2018 amounts.

NOTES TO THE FINANCIAL STATEMENTS

G6 IMPACT OF AMENDMENTS TO NZ IFRS

G6.1 New and amended standards adopted

The following new Accounting Standards, the adoption of which had no material financial impact on the Group, are applicable for the current reporting period.

NZ IFRS 9 Financial Instruments

For Tower, NZ IFRS 9 *Financial Instruments* became effective for the period beginning on 1 October 2018, replacing the existing accounting requirements for financial instruments under IAS 39 *Financial Instruments: Recognition and Measurement.* NZ IFRS 9 introduces changes to the classification and measurement of financial instruments, replaces the 'incurred loss' impairment model with a new 'expected loss' model when recognising expected credit losses on financial assets, and imposes new general hedge accounting requirements. NZ IFRS 9 specifically excludes from its scope the rights and obligations arising from insurance contracts, as defined under NZ IFRS 4 *Insurance Contracts*.

Tower has applied NZ IFRS 9 retrospectively, with no material change to the carrying amount of its financial instruments when measured under the requirements of NZ IFRS 9.

Tower's financial instruments that are classified at fair value through profit or loss on initial recognition, and which are subsequently re-measured to fair value at each reporting date, are classified on this basis because they back general insurance liabilities and measuring them at fair value significantly reduces a potential measurement inconsistency which would arise if the assets were measured at amortised cost or fair value through other comprehensive income.

Financial assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Tower assesses the expected credit losses on a forward looking basis, and have amended the impairment methodology for subsequent measurement depending on whether there has been a significant increase in credit risk.

The measurement bases of Tower's financial assets and liabilities under NZ IAS 39 and NZ IFRS 9, showing changes in classification of Tower's financial instruments, are as follows:

Asset/Liability	Measurement basis under NZ IAS 39	Measurement basis under NZ IFRS 9	Carrying amount under NZ IAS 39 and NZ IFRS9*
Cash and cash equivalents held by insurance companies**	Fair value through profit or loss	Fair value through profit or loss	56,112
Investments	Fair value through profit or loss	Fair value through profit or loss	229,172
Claim recoveries	Amortised cost	Amortised cost	5,097
Derivative financial assets	Fair value through profit or loss	Fair value through profit or loss	0
Trade and other payables	Amortised cost	Amortised cost	32,553

* The reclassifications of the financial instruments on adoption of NZ IFRS 9 did not result in any material changes to carrying amounts.

** Refer to Note G5 for changes in comparatives.

NOTES TO THE FINANCIAL STATEMENTS

G6 IMPACT OF AMENDMENTS TO NZ IFRS

G6.1 New and amended standards adopted (continued)

NZ IFRS 15 Revenue from Contracts with Customers

NZ IFRS 15 *Revenue from Contracts with Customers* was adopted by the Group from 1 October 2018 and replaces NZ IAS 18 Revenue and related interpretations. NZ IFRS 15 introduces a single model for the recognition of revenue based on when an entity satisfies the contractual performance obligations by transferring a promised good and service to a customer. It does not apply to insurance contracts and financial instruments. Hence the majority of Tower's revenue is not impacted by this change.

The revenue stream that is within the scope of NZ IFRS 15 is disclosed as part of "Fee and other revenue" and relates to the provision of insurance administration activities of $0.9m (2018: $0.8m). There has been no material change in the measurement of this revenue stream as the existing recognition and measurement of revenue under the applicable contracts meets the requirements under the new standard. The remaining balance within "Fee and other revenue" relates to reinsurance commission income, which is within the scope of NZ IFRS 4 *Insurance Contracts*.

G6.2 New and amended standards issued but not yet effective

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 2019 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 16 Leases

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 using the modified retrospective approach. Therefore, the cumulative effect of adopting NZ IFRS 16 will be recognised as an adjustment to the opening balance of retained earnings on 1 October 2019, with no restatement of comparative information. 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 16, 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 $4.2m, an increase to liabilities of approximately $4.4m and a decrease to retained earnings of approximately $0.2 m. 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 2019.

NZ IFRS 17 Insurance Contracts

NZ IFRS 17 *Insurance Contracts* is effective for periods beginning on or after 1 January 2022 (subject to approval of proposed one year delay). Tower will apply the standard for the year ending 30 September 2023. The standard replaces the current guidance in NZ IFRS 4, and establishes the principles for recognition, measurement, presentation and disclosure of insurance contracts. Tower assessment of the impact of adopting NZ IFRS 17 is ongoing, however it is expected that the majority of Tower's insurance contracts will meet the requirements of the simplified approach. However, there are expected to be significant changes in the presentation of the financial standards and disclosures. 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.

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Tower Insurance Limited – 30 September 2019

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 2019 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 2019 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 2019 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 2019 financial statements.

Review of the Tower Insurance Limited Solvency Position as at 30 September 2019

I have reviewed TIL's solvency position as at 30 September 2019. In my opinion TIL is maintaining a solvency margin in accordance with the RBNZ Solvency Standard for Non-life Insurance Business.

Deloitte.

Reliances and Limitations

In my work documented in the report *Tower Insurance Limited: Review of Canterbury Earthquake claims as at 30 September 2019*, 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 2019* (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 2019* (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 2019 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 2019.

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 2019.

R Shaw

Rick Shaw

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

19 November 2019

Independent auditor's report

To the shareholder of Tower Insurance Limited

We have audited the consolidated financial statements which comprise:

- the consolidated balance sheet as at 30 September 2019;
- 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 consolidated financial statements, which include a summary of accounting policies.

Our opinion

In our opinion, the accompanying consolidated 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 2019, 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 consolidated 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. These services are assurance services in respect of solvency and regulatory insurance returns and agreed upon procedures in respect of a regulatory insurance return. In addition, certain partners and employees of our firm may deal with the Group on normal terms within the ordinary course of trading activities of the Group. These matters have not impaired our independence as auditor of the Group.

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Our audit approach

Overview

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

Overall Group materiality: $3.4 million, which represents approximately 1% of premium revenue.

We chose premium revenue as the benchmark because, in our view, it is a key financial statement metric used in assessing the performance of the Group and is a generally accepted benchmark for insurance companies. The 1% is based on our professional judgement, noting that it is also within the range of commonly accepted revenue related thresholds.

We have determined that there are two key audit matters:

- Valuation of outstanding claims
- Valuation of Earthquake Commission (EQC) receivable in respect of Canterbury earthquake claims

Materiality

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

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

Audit scope

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

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

Our Group audit focused on the Company, which contributes approximately 83% of the Group's premium revenue. The subsidiaries of the Company are not significant for the Group. We performed audit procedures over material balances and transactions of the subsidiaries and the consolidation of the Group's subsidiaries.

Key audit matters

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

Key audit matter	How our audit addressed the key audit matter
(1) Valuation of outstanding claims (2019 $124,060,000, 2018 $148,976,000)	
We considered the valuation of outstanding claims a key audit matter because this involves a complex estimation process and significant judgements and assumptions that management make in estimating future claims payments. These include the estimate of claims that have been reported but there is uncertainty over the amount which will be settled and those incurred at the reporting date but not yet reported to the Group. There is generally less information available in relation to these claims and such claims require the use of informed estimates of the quantum of loss. Small changes in assumptions can lead to significant movements in claim reserves. Key actuarial assumptions for non Canterbury claims are inflation rate, discount rate and claims handling expense ratio. Outstanding claims in relation to Canterbury earthquakes have a greater degree of uncertainty and judgement. This mainly arises due to Earthquake Commission (EQC) reporting new claims to the Group which have gone over the $100,000 statutory liability cap (over cap claims), how damages are allocated between the four major earthquake events, expected claims costs for open claims and estimates of future claims handling cost. Outstanding claims include a risk margin that allows for the inherent uncertainty in the central estimate of the future claim payments. In determining the risk margin, the Group makes judgements about the volatility of each class of business written and the correlation between each division and between different geographical locations.	Historical claims data is a key input to the actuarial estimates. Accordingly, we: ○ evaluated the design effectiveness and tested controls over claims processing; ○ assessed a sample of claim case estimates at the year end to check that they were supported by appropriate management assessment and documentation; ○ assessed on a sample basis the accuracy of the previous claim case estimates by comparing with actual amount settled during the year and analysed escalation in the claim case estimate to determine whether it is based on new information available during the year; ○ inspected a sample of claims paid during the year to confirm that they were supported by appropriate documentation and approved within delegated authority limits; and ○ tested the integrity of data used in the actuarial models by agreeing the relevant model inputs to source. Together with our actuarial experts, we: ○ considered the work and findings of the actuaries engaged by the Group; ○ evaluated the actuarial models and methodologies used by comparing with generally accepted models and methodologies applied in the sector and with the prior year; ○ assessed key actuarial judgements and assumptions and challenged them by comparing with our expectations based on the Group's experience, our own sector knowledge and independently observable industry trends; and

Key audit matter	How our audit addressed the key audit matter
Relevant references in the consolidated financial statements. Refer to notes B2, B3 and B5 to the consolidated financial statements, which also describes the elements that make up this balance.	o assessed the risk margin, by comparing to known industry practices. In particular we focused on the assessed level of uncertainty in the central estimate.
(2) Valuation of Earthquake Commission (EQC) receivable in respect of Canterbury earthquake claims (2019 $69,900,000, 2018 $68,400,000) We considered the valuation of EQC receivable a key audit matter because significant management judgement is required to estimate expected recoveries from EQC in respect of land and building damage. Management use independent technical and actuarial experts to calculate the amount receivable. This receivable is dependent on the ultimate contribution by the EQC to the land and building damage arising from the Canterbury earthquake events in terms of its statutory liability under the Earthquake Commission Act 1993. The quantum is highly dependent on the agreement with EQC on allocation of liability for damage between these events, in particular the September 2010 and February 2011 events, the quality of information available in respect of the damage to each property, the time taken to settle with EQC and risk associated with litigation. *Relevant references in the consolidated financial statements* Refer to notes B3 and E1 to the consolidated financial statements.	Together with our actuarial expert, we: o assessed management's approach to estimate the EQC receivable; o reviewed external legal counsel advice and independent technical experts' conclusions; o evaluated the work performed by Tower's actuary and understood the assumptions applied in allocation of cost between the four major Canterbury earthquake events and the risk margin setting process. We compared these assumptions with sector peers and obtained evidence for any significant variances; and o considered the range of expected recoveries from which the amount recognised as due from EQC has been determined and assessed whether in the current circumstances a different receivable amount would be appropriate.

Information other than the consolidated financial statements and auditor’s report

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated 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 consolidated financial statements

The Directors are responsible, on behalf of the Company, for the preparation and fair presentation of the consolidated 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 consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated 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 consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated 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 consolidated 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-1/

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 Karen Shires.

For and on behalf of:

Chartered Accountants | Auckland
20 November 2019