

**ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH**

ANNUAL FINANCIAL REPORT

For the year ended 31 December 2012

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This annual financial report covers Zurich Australian Insurance Limited New Zealand Branch as an individual entity only.

Zurich Australian Insurance Limited New Zealand Branch is a branch domiciled in New Zealand. Its registered office is:

21 Queen Street
Auckland 1010

**ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH**

**Statement of Comprehensive Income
For the year ended 31 December 2012**

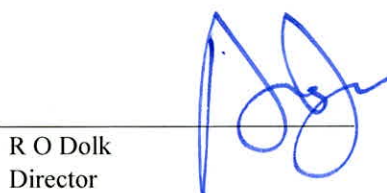
	Notes	2012 \$'000	2011 \$'000
Premium revenue			
Direct premium revenue		78,967	90,748
Outwards reinsurance expense		(14,842)	(22,528)
Net premium revenue		64,125	68,220
Claims expense	8	8,009	(946,067)
Reinsurance and other recoveries revenue		(23,382)	843,904
Net claims incurred		(15,373)	(102,163)
Gross movement in unexpired risk liability		2,245	1,588
Reinsurance recoveries on unexpired risk liability		(2,245)	(1,588)
Net movement in unexpired risk liability		-	-
Acquisition costs		(8,457)	(6,354)
Other underwriting expenses		(18,053)	(18,273)
Total Underwriting expenses		(26,510)	(24,627)
Underwriting result		22,242	(58,570)
Investment income		4,376	2,471
Other income		133	70
Net foreign exchange (gains)/losses		(15)	16
Profit/(Loss) before income tax		26,736	(56,013)
Income tax expense	7(a)	-	(2,051)
Total comprehensive income/(expense) for the year		26,736	(58,064)

The above Statement of Comprehensive Income should be read in conjunction with the accompanying notes.

The Board of Directors of Zurich Australian Insurance Limited authorised this Annual Financial Report for issue on 26 March 2013.



T J Paradine
Director



R O Dolk
Director

**ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH**

**Balance Sheet
As at 31 December 2012**

	Notes	2012 \$'000	2011 \$'000
Head Office Account		<u>4,539</u>	<u>(510)</u>
Represented by:			
Assets			
Cash and equivalents	9	267,406	96,767
Receivables	10	32,091	32,220
Other financial assets at fair value through profit or loss		504	526
Reinsurance and other recoveries	11	541,214	849,802
Deferred acquisition costs	12	585	1,757
Other assets	14	4,114	10,150
Total Assets		<u>845,914</u>	<u>991,222</u>
Liabilities			
Payables	15	211,231	8,521
Provisions	16	478	894
Unearned premium liability	17	32,801	46,755
Unexpired risk liability	18	4,406	6,651
Outstanding claims	19	592,459	928,911
Total Liabilities		<u>841,375</u>	<u>991,732</u>
Net Assets/(Liabilities)		<u>4,539</u>	<u>(510)</u>

The above Balance Sheet should be read in conjunction with the accompanying notes

**ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH**

**Statement of Changes in Head Office Account
For the year ended 31 December 2012**

	Head Office Current account \$'000	Accumulated Losses \$'000	Total \$'000
Balance at 1 January 2011	59,966	(78,186)	(18,220)
Total comprehensive expense for the year	-	(58,064)	(58,064)
Transactions with head office:			
Contributions from head office, net of transaction costs	75,774	-	75,774
Balance as at 31 December 2011	<u>135,740</u>	<u>(136,250)</u>	<u>(510)</u>
Total comprehensive expense for the year	-	26,736	26,736
Transactions with head office:			
Contributions to head office, net of transaction costs	(21,687)	-	(21,687)
Balance as at 31 December 2012	<u>114,053</u>	<u>(109,514)</u>	<u>4,539</u>

The above Statement of Changes in Head Office Account should be read in conjunction with the accompanying notes.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements For the year ended 31 December 2012

1. General information

This financial report includes the financial statements of Zurich Australian Insurance Limited New Zealand Branch ("the Branch"), as at 31 December 2012. The Branch results represent the general insurance activities in New Zealand that are underwritten by Zurich Australian Insurance Limited (ZAIL).

The Branch is domiciled in New Zealand. The financial statements of the Branch are presented in New Zealand dollars, which is the functional and presentation currency.

This financial report has been approved for issue by the Board of Directors on 26 March 2013. The Board has the power to amend and reissue the report.

2. Summary of significant accounting policies

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), and other applicable New Zealand Financial Reporting Standards, as appropriate for profit-oriented entities.

(a) Basis of preparation

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

Statutory base

Zurich Australian Insurance Limited New Zealand Branch is a branch which is domiciled in New Zealand. It is registered under the New Zealand Companies Act 1993.

The financial statements have been prepared in accordance with the requirements of the New Zealand Financial Reporting Act 1993 and the New Zealand Companies Act 1993.

Critical accounting estimates

The preparation of financial statements in conformity with NZ IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Branch's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 3.

It is prepared in accordance with the historical cost convention.

Early adoption of standards

The Company has elected to apply the following pronouncements to the annual reporting period beginning 1 January 2012:

- NZ IAS 1 *Presentation of Financial Statements* which requires entities to separate items presented in other comprehensive income into two groups, based on whether they may be recycled to profit or loss in the future. This will not affect the measurement of any of the items recognised in the balance sheet or the profit or loss in the current period. This standard is applicable for periods beginning on or after 1 July 2012.

New Accounting Standards and Interpretations

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2012 reporting periods. The Company's assessment of the impact of these new standards and interpretations is set out below.

NZ IFRS 9 *Financial Instruments* addresses the classification, measurement and derecognition of financial assets and financial liabilities. The standard is not applicable until 1 January 2015 but is available for early adoption. There will be no impact on the Company upon adoption.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*) For the year ended 31 December 2012

2. Summary of significant accounting policies (*continued*)

Differential reporting

The Branch is qualified within the Framework for Differential Reporting. The Branch qualifies on the basis that it is not publicly accountable and there is no separation between the owners and governing body of Zurich Australian Insurance Limited (ZAIL). The Branch has taken advantage of all differential reporting exemptions available to it except for NZ IAS 12 Income Taxes with which it has complied fully.

(b) Principles of general insurance contracts

The general insurance operations of the Branch comprise the underwriting of various classes of direct insurance contracts. These contracts transfer significant insurance risk by agreeing to compensate the insured on the occurrence of a specified insured event, such as damage to property or the crystallisation of a third party liability within a given timeframe.

These contracts are defined as general insurance contracts.

(c) Insurance premium and related revenue

Direct premium comprises amounts charged to the policyholders or other insurers, excluding fire service levies and earthquake levies, and other amounts collected on behalf of third parties. The earned portion of premiums received and receivable, including bound but not incepted and unclosed business, is recognised as revenue. Premium is treated as earned from the date of attachment of risk. Premiums on unclosed business are brought to account by reference to the previous year's premium processing delays, with due allowance for any changes in the pattern of new business and renewals.

The pattern of recognition of income over the policy or indemnity periods is based on time, which closely approximates the pattern of risks underwritten. The proportion of premiums received and receivable but not earned in the Statement of Comprehensive Income at the reporting date is recognised in the Balance Sheet as an unearned premium liability. The unearned portion of commissions and other acquisition costs are also deferred and shown as deferred acquisition costs in the Balance Sheet.

(d) Insurance claims and related expenses

Claims expense represents payment for claims (and claims related expenses) and the movement in outstanding claims liabilities.

(e) Outwards reinsurance expense

Amounts paid to reinsurers under insurance contracts held by the Branch are recorded as outwards reinsurance expense and are recognised in the Statement of Comprehensive Income from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of the incidence of the risk ceded. Accordingly, a portion of outwards reinsurance expense is treated as a prepayment and presented as Deferred Outward Reinsurance Expense on the balance sheet as at reporting date.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements For the year ended 31 December 2012

2. Summary of significant accounting policies (*continued*)

(f) Income tax

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements, and unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the company's subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax assets and liabilities are recognised using the liability method for temporary differences at the tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Current and deferred tax balances attributable to amounts recognised directly in reserves are also recognised directly in reserves.

(g) Goods and Services Tax (GST)

Revenues, expenses and assets, liabilities are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the New Zealand Inland Revenue. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense.

Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from or payable to, the New Zealand Inland Revenue is included as an asset or liability in the Balance Sheet.

(h) Foreign currency translation

Foreign currency transactions are initially translated into New Zealand currency at the rate of exchange at the date of the transaction. At balance date, amounts payable and receivable in foreign currencies are translated into New Zealand currency at rates of exchange current at that date. Resulting exchange differences are brought to account in determining the profit or loss for the year.

(i) Cash and cash equivalents

Cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash which are subject to an insignificant risk of change in value, and bank overdrafts. Bank overdrafts are shown within interest bearing liabilities in liabilities on the balance sheet.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*) For the year ended 31 December 2012

2. Summary of significant accounting policies (*continued*)

(j) Assets backing insurance liabilities

The assets of the Branch have been determined as being assets backing policy liabilities and are therefore valued at fair value through profit or loss.

It is considered that the use of fair value through profit or loss results in more relevant information because it eliminates or significantly reduces a measurement or recognition inconsistency.

(k) Reinsurance and other recoveries receivable

The benefits to which the Branch is entitled under its reinsurance contracts held are recognised as reinsurance receivable. Reinsurance and other recoveries receivable on paid claims, reported claims not yet paid, claims incurred but not reported (IBNR), claims incurred but not enough reported and unexpired risk liabilities are recognised as reinsurance and other recoveries revenue. Insurance recoveries receivable are assessed in a manner similar to the assessment of insurance outstanding claims. Recoveries receivable in relation to long-tail classes are measured as the present value of the expected future receipts, calculated on the same basis as the liability for insurance outstanding claims to which they relate.

(l) Deferred acquisition costs

The fixed and variable costs of acquiring new business, "the acquisition costs", include commission, advertising, policy issue and underwriting costs, agency expenses and other sales costs.

A portion of acquisition costs relating to unearned premium revenue is deferred and recognised as an asset, where it can be reliably measured and where it is probable that it will give rise to premium revenue that will be recognised in the Statement of Comprehensive Income in future periods. Deferred acquisition costs are measured at the lower of cost and recoverable amount and are amortised in accordance with the earning pattern of the corresponding premium revenue.

(m) Receivables

Receivables are recognised initially at fair value and subsequently subject to impairment testing. Impairment testing is based on collectability of receivables and is reviewed on an ongoing basis. An impairment charge is recognised when there is objective evidence that the entity will not be able to collect all amounts due according to the original terms of the contracts. The impairment charge is recognised in the Statement of Comprehensive Income.

(n) Payables

These amounts represent liabilities for goods and services provided to the Branch prior to the end of the financial year and which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition.

(o) Provisions

Provisions are recognised when the Branch has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are not recognised for future operating losses.

(p) Outstanding claims

The liability for outstanding claims is measured as the central estimate of the present value of expected future payments against claims incurred at the reporting date under general insurance contracts issued by the Branch, with an additional risk margin to allow for the inherent uncertainty in the central estimate.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*) For the year ended 31 December 2012

2. Summary of significant accounting policies (*continued*)

(p) Outstanding claims (*continued*)

The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not 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.

The expected future payments are discounted to present value using a risk free rate.

(q) Unexpired risk liabilities

At each reporting date the Branch assesses whether the unearned premium liability is sufficient to cover all expected future cash flows relating to future claims against current insurance contracts. This assessment is referred to as the liability adequacy test and is performed separately for each group of contracts subject to broadly similar risks and managed together as a single portfolio.

If the present value of the expected future cash flows relating to future claims plus the additional risk margin to reflect the inherent uncertainty in the central estimate exceeds the unearned premium liability less related intangible assets and related deferred acquisition costs then the unearned premium liability is deemed to be deficient. The Branch applies a risk margin to achieve the same probability of sufficiency for future claims as is achieved by the estimate of the outstanding claims liability, see Note 4.

A write down to recoverable amount is recognised when the present value of expected future claims (including settlement costs) in relation to business written to the reporting date exceeds related unearned premium revenue. The entire deficiency, net of reinsurance, is recognised immediately in the Statement of Comprehensive Income. The deficiency is recognised first by writing down any related intangible assets and then related deferred acquisition costs, with any excess being recorded in the Balance Sheet as an unexpired risk liability.

(r) Equity

The Branch does not have any share capital; however, the Total Head Office Account represents the value of any funding provided by Zurich Australian Insurance Limited (ZAIL) in support of the Branch operations and accumulated profits / (losses).

(s) Financial assets

The investment assets of the Branch have been determined as being assets backing policy liabilities and are therefore valued at fair value through profit or loss.

It is considered that the use of fair value through profit or loss results in more relevant information because it eliminates or significantly reduces a measurement or recognition inconsistency.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Branch establishes fair value by using valuation techniques. These include reference to the fair values of recent arm's length transactions, involving the same instruments or other instruments that are substantially the same, discounted cash flow analysis, and option pricing models refined to reflect the issuer's specific circumstances.

ZURICH AUSTRALIAN INSURANCE LIMITED

NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*)
For the year ended 31 December 2012

2. Summary of significant accounting policies (*continued*)

(s) Financial assets (*continued*)

Purchases and sales of investments are recognised on trade-date – the date on which the Branch commits to purchase or sell the asset. Financial assets are initially recognised at cost. These assets are subsequently measured at fair value. Realised, unrealised gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the Statement of Comprehensive Income in the period in which they arise.

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

(t) Impairment of assets

Financial assets measured at fair value, where changes in value are reflected in the Statement of Comprehensive Income, are not subject to impairment testing. Other assets such as receivables are subject to impairment testing.

Assets that have an indefinite useful life, such as identifiable intangible assets, are not subject to amortisation and are tested at least annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value (including realisation costs) and its value in use.

(u) Rounding of amounts

The financial statements are presented in New Zealand dollars and all values are rounded to the nearest thousand dollars (\$000) unless otherwise indicated.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*) For the year ended 31 December 2012

3. Critical accounting judgements and estimates

The Branch makes estimates and assumptions 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. The key areas in which critical estimates are applied are described below.

It has been determined that no critical accounting judgements have been made in the year.

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

Provision is made at the year end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Branch.

The estimated cost of claims includes direct expenses to be incurred in settling claims gross of the expected value of salvage and other recoveries. The Branch 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 Branch, where information about the claim event is generally available. IBNR claims may not be apparent to the insured until many years after the events giving rise to the claims has happened. The long-tailed classes of business will typically display greater variations between initial estimates and final outcomes because there is a greater degree of difficulty in estimating IBNR reserves. For the short-tailed classes, claims are typically reported soon after the claim event, and hence tend to display lower levels of volatility. In calculating the estimated cost of unpaid claims the Branch uses a variety of estimation techniques, generally based upon statistical analysis of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in the Branch's processes which might accelerate or slow down the development and/or recording of paid or incurred claims, compared with the statistics from previous periods
- changes in the legal environment
- the effects of inflation (both economic/wage and superimposed)
- changes in the mix of business
- the impact of large losses
- movements in industry benchmarks
- medical and technological developments
- changes in policyholder behaviour

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 Branch has regard to the claim circumstance as reported, any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous periods.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of these large claims.

Where possible the Branch adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections given by the various methodologies also assist in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions.

**ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH**

**Notes to the Financial Statements (*continued*)
For the year ended 31 December 2012**

3. Critical accounting judgements and estimates (*continued*)

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

Details of specific assumptions used in deriving the outstanding claims liability at year end are detailed in Note 4.

(b) Assets arising from reinsurance contracts

Assets arising from reinsurance contracts are also computed 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 Branch may not receive amounts due to it and these amounts can be reliably measured.

ZURICH AUSTRALIAN INSURANCE LIMITED

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Notes to the Financial Statements (*continued*)

For the year ended 31 December 2012

4. Actuarial assumptions and methods

The Branch writes both short-tailed and long-tailed business. The process for determining the value of outstanding claims liabilities is described below.

Case estimates are established by individual claims officers. The provision for large losses is reviewed by senior claims managers. The ultimate undiscounted cost of claims by year of accident and line of business is then established by actuaries using a variety of actuarial models at a line of business level. IBNR is then derived by subtracting from the ultimate cost, the amount of paid claims and case reserves. The estimation of IBNR is subject to a greater degree of uncertainty than the estimate of the cost of settling claims already notified and the estimate of the ultimate cost of long-tail lines is generally more uncertain than the estimate for short-tail lines where claims are often reported and settled within 1 year of occurrence.

The methods used to establish the ultimate cost of claims include the following:

- Projecting ultimate numbers of claims and multiplying by projected ultimate average cost
- Projecting ultimate claim payments
- Projecting ultimate incurred claim amounts
- Applying plan or expected loss ratios to earned premiums

Claims inflation is incorporated into the resulting projected payments, to allow for both general economic/wage inflation as well as any superimposed inflation detected in the modelling of payments experience. Superimposed inflation arises from non-economic factors such as legal developments. Future wage inflation is based on current levels and economic indicators. Future superimposed inflation is assessed based on current trends and industry information.

Projected reinsurance assets are derived using similar methods or applying net to gross ratios.

Projected payments are discounted to allow for the time value of money, based on current Government interest rates.

These methods assume that historical development is a reasonable basis on which to set assumptions about the future, and are thus subject to uncertainty surrounding changes to these patterns from whatever cause. In addition, there is uncertainty arising from the underlying assumptions for future wage inflation and superimposed inflation and of discount rates. Significant events, such as catastrophes, close to the balance sheet date also increase the level of uncertainty. The presence of asbestos claims in the portfolio and the potential emergence of new types of latent claim also increase the potential variability of the outcome.

For these reasons a risk margin is added to the central estimate established above. The establishment of the risk margin takes into account the variability of the outcome of each line of business and the diversification benefit of writing a number of lines of business. The Board and Management have decided that the level of risk margin shall be established to provide a probability of adequacy of 85% (2011: 85%).

(a) Selected key variables

The following indicators reflect the key variables that have been used in determining the outstanding claims liabilities.

	2012	2012	2011	2011
	Long-tail	Short-tail	Long-tail	Short-tail
Average weighted term to settlement	1.7 years	0.5 years	1.9 years	0.7 years
Discount rate	2.66%	2.71%	2.71%	N/A
Wage inflation	3.50%	N/A	4.00%	N/A
Superimposed inflation	0 to 4.5%	N/A	0 to 4.5%	N/A

ZURICH AUSTRALIAN INSURANCE LIMITED

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Notes to the Financial Statements *(continued)*
For the year ended 31 December 2012

4. Actuarial assumptions and methods *(continued)*

(b) Sensitivity analysis – insurance contracts

The Branch conducts sensitivity analysis to quantify the exposure to risk of changes in the key underlying variables. The valuations included in the reported results are calculated using certain assumptions about these variables as disclosed above. The movement in any key variable will impact the performance and equity of the Branch. The tables below give an analysis of the sensitivity of the profit/(loss) and net assets/(liabilities), to changes in these assumptions both gross and net of reinsurance.

Impact of changes in key variables

December 2012		Profit/(Loss)		Net Assets/ (Liabilities)
		Gross of reinsurance	Net of reinsurance	
		\$'000	\$'000	\$'000
Recognised amounts per the financial statements		55,873	26,736	4,539
Variable	Movement in variable	Adjusted amounts		
Long-tail	0.5	55,941	26,776	4,578
Average weighted term to settlement - years	-0.5	55,810	26,699	4,501
Discount rate	1%	55,951	26,784	4,586
	-1%	55,792	26,686	4,488
Wage inflation and superimposed inflation rates	1%	55,791	26,685	4,487
	-1%	55,954	26,786	4,588
Financial assets				
Shift in Yield Curve	1%	56,013	26,803	4,550
	-1%	55,733	26,669	4,528

December 2011		Profit/(Loss)		Net Assets/ (Liabilities)
		Gross of reinsurance	Net of reinsurance	
		\$'000	\$'000	\$'000
Recognised amounts per the financial statements		(648,312)	(58,064)	(510)
Variable	Movement in variable	Adjusted amounts		
Long-tail	0.5	(648,180)	(58,004)	(450)
Average weighted term to settlement - years	-0.5	(648,430)	(58,119)	(565)
Discount rate	1%	(648,167)	(57,996)	(442)
	-1%	(648,460)	(58,135)	(581)
Wage inflation and superimposed inflation rates	1%	(648,464)	(58,136)	(582)
	-1%	(648,162)	(57,994)	(440)
Financial assets				
Shift in Yield Curve	1%	(650,463)	(60,216)	(2,662)
	-1%	(646,160)	(55,913)	1,641

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*) For the year ended 31 December 2012

5. Financial risk management policies and procedures

The Branch's activities expose it to a variety of financial risks; market risk (including currency risk), credit risk and liquidity risk. The Branch's overall risk management focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the financial performance of the Branch.

Risk management controls are outlined in the Risk Management Strategy (RMS). The objective of the RMS is to provide a summary of the policies and controls in place to address enterprise risks including certain operational and financial risks and the procedures for assessing compliance with these policies and controls. In addition, the Ultimate Controlling Entity, Zurich Insurance Group Limited's Zurich Risk Policy (ZRP) provides constraints on the mix of investment assets.

The risks within the business are subject to at least an annual review by the Internal Audit Department, resulting in an annual audit plan which is approved by the Board Risk Compliance and Audit Committee. The Internal Audit Department is independent of the day to day operational management of the Company. The Internal Audit Department executes a review of components of the internal control systems in accordance with the annual audit plan to assess the effectiveness of the internal controls, risk management within Zurich Financial Services Australia Limited (ZFSA) and compliance with the RMS.

The following list of factors are considered and addressed as part of the financial risk management policies and procedures.

a) Market risk

Market risk is the risk of diminution in value of the Branch's investment portfolio arising from adverse movements in the levels and volatility of interest rates, foreign exchange rates and equity prices. The Branch is not exposed to significant market risk. The exposure to changes in interest rate on cash holding is disclosed in Note 9.

b) Net fair value of financial assets and liabilities

On-Balance Sheet

The aggregate carrying values of financial assets and financial liabilities approximate their net fair values. The methods used to determine the carrying values of financial assets and liabilities are included in the Summary of significant accounting policies at Note 2.

Off-Balance Sheet

The Branch does not have potential financial liabilities which may arise from certain contingencies.

c) Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. Where entities have a right of set-off and intend to settle on a net basis, this set-off has been reflected in the financial statements in accordance with accounting standards.

Cash and cash equivalents

The table below shows the Branch's major concentrations of credit risk in cash and cash equivalents disclosed in Note 9:

	2012	2011
Counterparty	\$'000	\$'000
Auckland Saving Bank NZ (ASB)	99,569	76,015
Westpac Bank NZ	37,837	10,752
Australia and New Zealand Banking Group NZ (ANZ)	130,000	10,000
Total	267,406	96,767

Standard and Poors (S&P) rating for Cash at bank disclosed in Note 9 is AA- (2011: AA-).

The Branch does not hold listed equity or debt securities and has limited exposure to government bonds.

ZURICH AUSTRALIAN INSURANCE LIMITED

NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*)
For the year ended 31 December 2012

5. Financial risk management policies and procedures (*continued*)

c) Credit risk (*continued*)

Premium receivable

The premiums receivable disclosed in Note 10 include amounts past due and not impaired which are analysed below.

	2012 \$'000	2011 \$'000
< 30 days	1,652	2,305
31 – 90 days	529	1,918
> 91 days	131	849
Total premiums receivable past due but not impaired	2,312	5,072

Other receivable

All other receivables do not include material amounts that are either past due or impaired.

Reinsurance receivable

Reinsurance security is monitored continuously taking advantage of the, the Ultimate Controlling Entity, Zurich Insurance Group Limited's Security Committee analysis and there are strict controls around the use of individual reinsurers. Reinsurance accumulations are also monitored closely and used in deciding the appropriate placement programme at renewal.

Refer to Note 6(f) for information on credit quality of reinsurance assets.

d) Liquidity risk

Liquidity risk is the risk that the Branch will encounter difficulty in meeting obligations associated with financial liabilities.

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close-out market positions.

The risk is controlled by carefully monitoring cash flow, and maintaining suitable floats of readily realisable assets.

The table shows expected undiscounted cash flows from outstanding claims (notified claims, IBNR and claims handling costs) and premium liability (expected future claims). Both are net of reinsurance and non-insurance recoveries and before risk margin.

	Carrying amount (Undiscounted)	Expected cash flows (undiscounted)				
2012		0-1 yrs	1-5 yrs	5-10 yrs	10-15 yrs	>15yrs
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Insurance contracts						
Outstanding Claims (Note 11, 19)	48,587	40,353	8,223	11	-	-
Premium Liability	21,574	15,319	6,241	14	-	-
Total	70,161	55,672	14,464	25	-	-

ZURICH AUSTRALIAN INSURANCE LIMITED
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Notes to the Financial Statements (continued)
For the year ended 31 December 2012

5. Financial risk management policies and procedures (continued)

d) Liquidity risk (continued)

2011	Carrying amount (Undiscounted)	Expected cash flows (undiscounted)				
	\$'000	0-1 yrs \$'000	1-5 yrs \$'000	5-10 yrs \$'000	10-15 yrs \$'000	>15yrs \$'000
Insurance contracts						
Outstanding Claims (Note 11, 19)	73,031	61,362	11,577	92	-	-
Premium Liability	27,310	17,895	9,255	160	-	-
Total	100,341	79,257	20,832	252	-	-

A contractual maturity analysis is not provided in respect of other financial liabilities as typically the credit terms for other financial liabilities are up to 31 days.

e) Derivative holdings

A derivative transaction is a contract whose value is derived from the value of an underlying asset or index. The Branch does not hold any derivative contracts.

f) Fair value measurements

The Branch adopted the amendment to NZ IFRS 7 *Financial Instruments: Disclosures* which requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1);
- inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (level 2); and
- inputs for the asset or liability that are not based on observable market data (unobservable inputs) (level 3).

The following tables present the Branch's assets measured and recognised at fair value at 31 December 2012 and 31 December 2011.

As at 31 December 2012	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets at fair value through profit and loss	-	504	-	504
Total	-	504	-	504
As at 31 December 2011	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
Financial assets at fair value through profit and loss	-	526	-	526
Total	-	526	-	526

The fair value of financial instruments traded in active markets (such as trading and available-for-sale securities) is based on quoted market prices at the end of the reporting period. The quoted market price used for financial assets held by the Branch 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 is determined using valuation techniques. The Branch uses a variety of methods and makes assumptions that are based on market conditions existing at the end of each reporting period. Estimated discounted cash flows, are used to determine fair value for the New Zealand government bond.

The Branch did not have any transfers between levels during the year.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*)
For the year ended 31 December 2012

6. Insurance contracts - risk management policies and procedures

The financial condition and operation of the Branch are affected by a number of key risks including insurance risk, investment market risk (including interest rate risk and currency risk), credit risk, liquidity risk, financial risk, compliance risk and operational risk. Notes on the policies and procedures in respect of managing these risks are set out in this note.

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

The Branch has an objective to manage insurance risk thus reducing the volatility of operating profits. In addition to the inherent uncertainty of insurance risk, which can lead to significant variability in the loss experience, profits from insurance business are affected by market factors, particularly competition and movements in asset values. Short-term variability is, to some extent, a feature of insurance business.

The Risk Management Strategy (RMS) and Reinsurance Management Strategy (REMS) identify the policies and procedures, processes and controls that comprise the risk management and control systems. These systems address all material risks, financial and non-financial, likely to be faced.

Key aspects of the processes established in the RMS to mitigate risks arising from insurance contracts include:

- A formal annual high-level hazard assessment that focuses on key risks that impact the achievement of strategic and business objectives, including the development of action plans for the treatment and continuous monitoring of identified risks. This is bolstered by formal quarterly reviews of risk issues and progress against action plans.
- The maintenance and use of appropriate management information systems, which provide up to date, reliable data on the risks to which the business is exposed at any point in time.
- Actuarial models, using information from the management information systems, are used in calculating premiums and monitoring claims patterns. Past experience and statistical methods are used as part of the process.
- Formally delegated authorities and documented guidelines are followed for underwriting and accepting insurance risks.
- Natural disasters exposure is monitored through use of models involving the collation of our own exposure and wider environmental data, which support decisions on limiting exposure.
- Reinsurance is used to limit the exposure to large single claims and catastrophes. When selecting a reinsurer we only consider those companies on a list approved by Zurich Group head office, which assesses reinsurer security using rating information from the public domain or gathered through internal investigations. If the Branch selects a reinsurer not on the list approved by Zurich Group head office, a separate approval by Zurich Group head office is required before placing the risk.
- In order to limit concentrations of credit risk in purchasing reinsurance, the Branch has regard to existing reinsurance assets including the level of exposure to any single reinsurer or group of related reinsurers. Placing reinsurance with other companies in the Zurich Group is used as an initial step on much of the reinsurance program to enable group-wide reinsurance purchasing efficiencies.
- The mix of investment assets is driven by the nature and term of the insurance liabilities. The management of assets and liabilities is closely monitored to broadly align the sensitivity of asset values to changes in interest rates with the equivalent sensitivity of the expected pattern of claim payments.
- The diversification of business over various classes of insurance and large numbers of uncorrelated individual risks reduces variability in loss experience.

(b) Terms and conditions of insurance business

The terms and conditions attaching to insurance contracts affect the level of insurance risk accepted by the Branch. The majority of direct insurance contracts written are entered into on a standard form basis. Any non standard terms and conditions are signed off by appropriately experienced underwriters within a framework, which includes delegated authorities, in line with the RMS.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*) For the year ended 31 December 2012

6. Insurance contracts - risk management policies and procedures (*continued*)

(c) Concentration of insurance risk

The Branch's exposure to concentration of insurance risk is mitigated by a portfolio of diversified individual risks. Specific processes for monitoring identified key concentrations are set out below.

Risk	Source of concentration	Risk management measures
Natural catastrophes	Properties and motor vehicles concentrated in regions that are subject to: <ul style="list-style-type: none"> • Earthquakes • Cyclones • Hail storms • Other significant natural events 	<p>The Branch's underwriting strategy requires individual risk premiums to be differentiated in order to reflect the higher loss frequency in particular geographical segments.</p> <p>The Branch has modelled aggregated risk using commercially available catastrophe models.</p> <p>Based on the probable maximum loss per the models, the Branch purchases catastrophe reinsurance cover to limit exposure to any single event.</p>

(d) Development of claims

There is a possibility that changes may occur in the estimate of the Branch's obligations at the end of a contract period. The tables in Note 19 show the Branch's estimates of total claims outstanding for each accident year at successive year ends for classes of businesses that are typically resolved in more than one year.

(e) Interest rate risk

None of the financial assets or liabilities arising from insurance or reinsurance contracts entered into by the Branch is directly exposed to interest rate risk.

Insurance and reinsurance contracts are generally entered into annually. At the time of entering into the contract all terms and conditions are negotiable or, in the case of renewals, renegotiable.

(f) Credit risk

Financial assets and liabilities arising from insurance and reinsurance contracts are stated in the Balance Sheet at the amount that best represents the maximum credit risk exposure at balance date.

At balance date:

- 0.20% (2011: 0.16%) of the reinsurance and other recoveries receivable in Note 11 had a single third party reinsurer as a counter party; and
- 97.17% (2011: 98.69%) of the reinsurance and other recoveries receivable in Note 11 had other companies in the Zurich Group as a counter party.

There are no other significant concentrations of credit risk.

During 2012, irrevocable standby letters of credit were issued by Australian banks on behalf of other entities in the Zurich Group in favour of the Company. These letters of credit relate to all reinsurance contracts entered into between ZAIL and other entities in the Zurich Group on or after 31 December 2008. Two of these letters of credit are due to expire on 31 December 2012. One is due to expire on 31 December 2014. As at 31 December 2012, \$10.0m (2011: \$12.0m) of reinsurance recoverables due from other entities in the Zurich group were secured under these letters of credit.

Reinsurance receivable on incurred claims disclosed in Note 11 are analysed in the table below using Standard and Poors (S&P) rating.

	2012 \$'000	2011 \$'000
AAA or AA	345,621	657,935
A	25,033	46,096
BBB or unrated	10,572	4,841
Total reinsurance receivable on incurred claims (excluding Risk Margin and other recoveries)	381,226	708,872

ZURICH AUSTRALIAN INSURANCE LIMITED
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Notes to the Financial Statements (continued)
For the year ended 31 December 2012

7. Income tax

	2012 \$'000	2011 \$'000
(a) Income tax expense		
Deferred tax (Note 13, 20)	-	2,051
Total income tax expense	-	2,051

Deferred income tax expense included in income tax expense comprises:

Decrease in deferred tax assets (Note 13)	(6)	1,722
Increase in deferred tax liabilities (Note 20)	6	329
	-	2,051

8. Net claims incurred

	2012 \$'000	2011 \$'000
Gross claims incurred and related expenses:		
- Direct	(4,347)	948,489
- Inwards Reinsurance	3,537	(2,666)
- Discount	(7,199)	244
	(8,009)	946,067
Reinsurance and other recoveries:		
- Direct	(30,793)	847,374
- Inwards Reinsurance	13,679	(3,670)
- Discount	(6,268)	200
	(23,382)	843,904
Net incurred claims	15,373	102,163

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (continued) For the year ended 31 December 2012

8. Net claims incurred (continued)

Claims Development

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

	2012			2011		
	Current Year	Prior Years	Total	Current Year	Prior Years	Total
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Gross claims expense						
Undiscounted	73,238	(74,048)	(810)	993,376	(47,553)	945,823
Discount	(608)	(6,591)	(7,199)	(281)	525	244
	<u>72,630</u>	<u>(80,639)</u>	<u>(8,009)</u>	<u>993,095</u>	<u>(47,028)</u>	<u>946,067</u>
Reinsurance and other recoveries:						
Undiscounted	24,524	(41,638)	(17,114)	867,133	(23,429)	843,704
Discount	(248)	(6,020)	(6,268)	(121)	321	200
	<u>24,276</u>	<u>(47,658)</u>	<u>(23,382)</u>	<u>867,012</u>	<u>(23,108)</u>	<u>843,904</u>
Net claims incurred – discounted	<u>48,354</u>	<u>(32,981)</u>	<u>15,373</u>	<u>126,083</u>	<u>(23,920)</u>	<u>102,163</u>

9. Cash and cash equivalents

	2012	2011
	\$'000	\$'000
Cash at bank and on hand	7,706	9,936
Term deposit and cash equivalents	<u>259,700</u>	<u>86,831</u>
	<u>267,406</u>	<u>96,767</u>

Cash and cash equivalents were invested at floating interest rate of 2.50% to 3.84% (2011: 2% to 3.72%).

10. Receivables

	2012	2011
	\$'000	\$'000
Premiums receivable	21,420	24,351
Unclosed premiums	<u>1,375</u>	<u>5,112</u>
	<u>22,795</u>	<u>29,463</u>
Provision for impairment	<u>(200)</u>	<u>(126)</u>
	<u>22,595</u>	<u>29,337</u>
Due from related entities (Note 22)	141	1,078
Other debtors	8,612	1,645
Interest receivable	<u>743</u>	<u>160</u>
Total current receivables	<u>32,091</u>	<u>32,220</u>

**ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH**

**Notes to the Financial Statements (continued)
For the year ended 31 December 2012**

11. Reinsurance and other recoveries

	2012 \$'000	2011 \$'000
Analysis of Reinsurance and other recoveries		
Expected future reinsurance recoveries undiscounted		
- on claims paid	118	34
- on outstanding claims	386,202	709,024
Discount to present value	(5,094)	(186)
Reinsurance receivable on incurred claims	381,226	708,872
Other recoveries undiscounted	73,985	122,029
Discount to present value	(971)	(54)
	73,014	121,975
Risk Margin	83,056	12,347
Discount to present value	(488)	(43)
	82,568	12,304
Reinsurance and other recoveries receivables on incurred claims	536,808	843,151
Expected future reinsurance recoveries on unexpired risk liability	4,406	6,651
Reinsurance and other recoveries receivable	541,214	849,802
Current	442,793	817,084
Non-current	98,421	32,718
	541,214	849,802

12. Deferred acquisition costs

	2012 \$'000	2011 \$'000
Deferred acquisitions costs as at 1 January	1,757	750
Acquisition costs deferred	8,914	10,654
Amortisation charged to Statement of Comprehensive Income	(5,522)	(5,064)
Write down for premium deficiency	(4,564)	(4,583)
Deferred acquisitions costs as at 31 December	585	1,757
Current	585	1,757
	585	1,757

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements *(continued)* For the year ended 31 December 2012

13. Deferred tax asset

	2012 \$'000	2011 \$'000
The balance comprises temporary differences attributable to:		
Amounts recognised in profit or loss		
Provision for DAC write off and Unexpired Risk Liability	-	-
Provision for doubtful debt	56	35
Tax Loss	860	875
Set-off of deferred tax liabilities pursuant to set-off provisions (Note 20)	(916)	(910)
Net deferred tax asset	-	-

Deferred tax assets movements:

Opening balance at 1 January	-	2,051
Charged to Statement of Comprehensive Income (Note 7)	6	(1,722)
Set-off of deferred tax liabilities pursuant to set-off provisions (Note 20)	(6)	(329)
Closing balance at 31 December	-	-

The Branch only recognises deferred tax assets in respect of unused tax losses incurred by the New Zealand branch to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised. The Branch has undertaken a prima-facie analysis of future taxable profits to determine the likelihood of being able to recover the unused tax losses over the short term. The Branch has concluded that, based on profit history and the uncertainty of future profits, no deferred tax asset should be recognised for the unused tax losses. The deferred tax asset that has not been recognised in respect of unused tax losses at 31 December 2012 is \$31,825,290 (2011: \$39,125,381)

14. Other assets

	2012 \$'000	2011 \$'000
Current		
Deferred outward reinsurance expense	3,738	10,150
Other Assets	376	-
	4,114	10,150

15. Payables

	2012 \$'000	2011 \$'000
Current		
Reinsurance Creditors	1,863	5,657
Due to related entities (Note 22)	208,667	1,854
Commission payable	599	879
Other payables	102	131
	211,231	8,521

ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH

Notes to the Financial Statements (continued)
For the year ended 31 December 2012

16. Provisions

	2012	2011
	\$'000	\$'000
<i>Current</i>		
Fire Service Levy	260	877
Earthquake Levy	218	16
Others	-	1
	<u>478</u>	<u>894</u>

Movements in provisions

	Fire Service	Earthquake	Others	Total
	\$'000	\$'000	\$'000	\$'000
2011				
Carrying amount at 1 January	1,141	85	-	1,226
Additional provision recognised	4,840	239	1	5,080
Payments / other sacrifices of economic benefits	(5,104)	(308)	-	(5,412)
Carrying amount at 31 December	<u>877</u>	<u>16</u>	<u>1</u>	<u>894</u>
2012				
Carrying amount at 1 January	877	16	1	894
Additional provision recognised	3,903	615	-	4,518
Payments / other sacrifices of economic benefits	(4,520)	(413)	(1)	(4,934)
Carrying amount at 31 December	<u>260</u>	<u>218</u>	<u>-</u>	<u>478</u>

17. Unearned premium liability

	2012	2011
	\$'000	\$'000
Unearned premium liability as at 1 January	46,755	44,647
Premiums deferred during the period	65,013	92,856
Premiums earned during the period	<u>(78,967)</u>	<u>(90,748)</u>
Unearned premium liability as at 31 December	<u>32,801</u>	<u>46,755</u>
Current	32,798	46,492
Non-current	3	263
	<u>32,801</u>	<u>46,755</u>

ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH

Notes to the Financial Statements *(continued)*
For the year ended 31 December 2012

18. Unexpired risk liability

	2012	2011
	\$'000	\$'000
(a) Unexpired risk liability		
Unexpired risk liability as at 1 January	6,651	8,240
Release of unexpired risk liability recorded in previous periods	(2,245)	(1,589)
Unexpired risk liability as at 31 December	<u>4,406</u>	<u>6,651</u>
Unexpired risk liability - Current	<u>4,406</u>	<u>6,651</u>
(b) Deficiency recognised in the Statement of Comprehensive Income		
Gross movement in unexpired risk liability	(2,245)	(1,588)
Recoveries on unexpired risk liability	2,245	1,588
Net movement in unexpired risk liability	<u>-</u>	<u>-</u>
Write down of deferred acquisition cost (Note 12)	4,564	4,583
Total deficiency recognised in the Statement of Comprehensive Income	<u>4,564</u>	<u>4,583</u>
(c) Calculation of deficiency		
Unearned premium liability	32,800	46,755
Related reinsurance asset	(3,738)	(10,150)
Related deferred acquisition costs	(4,762)	(4,604)
Total net unearned premium liability	<u>24,300</u>	<u>32,001</u>
Total net for business that have deficiency only (A)	21,869	23,387
Central estimate of present value of gross expected future cashflows arising from future claims on inwards insurance contracts issued	30,341	42,687
Risk margin: 18.68% (2011: 19.46%)	3,950	5,315
Present Value of expected future cash inflows arising from reinsurance recoveries	(1,512)	(6,204)
Present Value of expected future cash inflows arising from non-reinsurance recoveries	(7,688)	(9,172)
Total net premium liability	<u>25,091</u>	<u>32,626</u>
Total net for business that have deficiency only (B)	23,393	24,878
Net Deficiency (A) – (B)	<u>(1,524)</u>	<u>(1,491)</u>
Add back recoveries element of present value of expected future cash flows for future	(7,446)	(9,743)
Gross deficiency	<u>(8,970)</u>	<u>(11,234)</u>

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*)
For the year ended 31 December 2012

19. Outstanding claims

(a) Outstanding claims liability

	2012 \$'000	2011 \$'000
Central Estimate	504,331	902,404
Discount to present value	(6,760)	(424) ¹
	<u>497,571</u>	<u>901,980</u>
Claims Handling Costs	4,443	2,044
Discount to present value	(62)	(17) ¹
	<u>4,381</u>	<u>2,027</u>
Risk Margin	91,404	24,982
Discount to present value	(897)	(78)
	<u>90,507</u>	<u>24,904</u>
Gross outstanding claims liability	<u>592,459</u>	<u>928,911</u>
Undiscounted expected future claims payments	600,178	929,430
Discount to present value	(7,719)	(519)
Liability for outstanding claims	<u>592,459</u>	<u>928,911</u>
Current	481,394	878,361
Non-current	111,065	50,550
	<u>592,459</u>	<u>928,911</u>

¹ The 2011 numbers have been restated to reflect the correct classification for discounting of central estimate and discounting of claims handling costs

(b) Risk margin

Process for determining risk margin

The overall risk margin was determined allowing for diversification between the different portfolios and the relative uncertainty of the outstanding claims estimate for each portfolio. Uncertainty was analysed for each portfolio taking into account potential uncertainties relating to the actuarial models and assumptions, the quality of the underlying data used in the models, the general insurance environment, and the impact of legislative reform.

The estimate of uncertainty is greater for long tailed classes when compared to short tail classes due to the longer time until settlement of outstanding claims.

The assumptions regarding uncertainty for each class were applied to the net central estimates, and the results were aggregated, allowing for diversification. These margins are consistent with those applied to Zurich Australian Insurance Limited as a whole in order to arrive at an overall provision which is intended to have an 85% (2011: 85%) probability of sufficiency.

**ZURICH AUSTRALIAN INSURANCE LIMITED
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Notes to the Financial Statements *(continued)*
For the year ended 31 December 2012

19. Outstanding claims *(continued)*

(b) Risk margin *(continued)*

Risk Margins Applied

Class

Short Tail

Commercial Motor Vehicle
Fire and Industrial Specialised Risk (Including Inwards Treaty)
Marine & Aviation
Other Accident

Average Short Tail

Long Tail

Public & Product Liability (Including Inwards Treaty)
Professional Indemnity

Average Long Tail

Overall

	2012 Net Outstanding Claims Margin	2011 Net Outstanding Claims Margin
Commercial Motor Vehicle	15.4%	16.1%
Fire and Industrial Specialised Risk (Including Inwards Treaty)	17.1%	17.9%
Marine & Aviation	15.3%	11.7%
Other Accident	14.1%	37.8%
Average Short Tail	16.6%	17.1%
Long Tail		
Public & Product Liability (Including Inwards Treaty)	14.1%	16.5%
Professional Indemnity	18.4%	20.1%
Average Long Tail	17.7%	18.6%
Overall	16.7%	17.2%

(c) Reconciliation of movement in discounted outstanding claims liability

	2012 Gross \$'000	2012 Reinsurance \$'000	2012 Net \$'000	2011 Gross \$'000	2011 Reinsurance \$'000	2011 Net \$'000
Brought Forward	928,911	(843,117)	85,794	131,047	(66,965)	64,081
Effect of changes in assumptions	(80,639)	47,658	(32,981)	(47,028)	23,054	(23,974)
Increase in claims incurred/recoveries anticipated over the year	72,630	(24,276)	48,354	993,095	(866,958)	126,137
Incurring claims recognised in the Statement of Comprehensive Income	(8,009)	23,382	15,373	946,067	(843,904)	102,163
Claim payments / recoveries during the year	(328,443)	283,044	(45,399)	(148,203)	67,752	(80,450)
Carried Forward	592,459	(536,691)	55,768	928,911	(843,117)	85,794

ZURICH AUSTRALIAN INSURANCE LIMITED
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Notes to the Financial Statements *(continued)*
For the year ended 31 December 2012

19. Outstanding claims *(continued)*

(d) Claims development tables

The following tables show the development of gross and net undiscounted outstanding claims relative to the ultimate expected claims for the five most recent accident years for classes of business that are typically resolved in more than one year, plus the provision for short tail claims.

(i) Gross Incurred

Accident Year	2008 \$'000	2009 \$'000	2010 \$'000	2011 \$'000	2012 \$'000	Total \$'000
End of Accident Year	274	5,034	5,810	6,090	4,092	
One Year Later	635	5,295	6,462	3,772		
Two years later	367	3,650	3,742			
Three years later	294	1,602				
Four years later	194					
Current Estimate of Incurred	194	1,602	3,742	3,772	4,092	13,402
Cumulative Payments	168	1,305	3,048	908	394	5,823
Outstanding claims - Undiscounted	26	297	694	2,864	3,698	7,579
Discount						(307)
Claim Handling Expense						221
2007 and prior years						18
Outstanding claims - Discounted						7,511
Short Tail Outstanding Claims						584,948
Total Gross						592,459

(ii) Net Incurred

Accident Year	2008 \$'000	2009 \$'000	2010 \$'000	2011 \$'000	2012 \$'000	Total \$'000
End of Accident Year	274	5,034	5,810	6,090	3,107	
One Year Later	635	5,294	6,462	1,497		
Two years later	367	3,650	1,698			
Three years later	294	833				
Four years later	164					
Current Estimate of Incurred	164	833	1,698	1,497	3,107	7,299
Cumulative Payments	140	646	1,435	302	453	2,976
Outstanding claims - Undiscounted	24	187	263	1,195	2,654	4,323
Discount						(187)
Claim Handling Expense						221
2007 and prior years						16
Outstanding claims - Discounted						4,373
Short Tail Outstanding Claims						51,395
Total Net						55,768

**ZURICH AUSTRALIAN INSURANCE LIMITED
NEW ZEALAND BRANCH**

**Notes to the Financial Statements (*continued*)
For the year ended 31 December 2012**

20. Deferred tax liabilities

	2012 \$'000	2011 \$'000
The balance comprises temporary differences attributable to:		
Amounts recognised in profit or loss		
Provision for DAC write off & Unexpired Risk Liability	916	910
Set-off of deferred tax liabilities pursuant to set-off provisions (Note 13)	(916)	(910)
Net deferred tax liability	-	-
Deferred tax liability movements:		
Opening balance at 1 January	-	-
Charged to Statement of Comprehensive Income (Note 7)	6	329
Set-off of deferred tax liabilities pursuant to set-off provisions (Note 13)	(6)	(329)
Closing balance at 31 December	-	-

21. Remuneration of auditors

	2012 \$	2011 \$
Remuneration for audit or review of the financial reports of the Branch:		
Statutory audit fees	73,549	57,274
	<u>73,549</u>	<u>57,274</u>

22. Related parties

	2012 \$	2011 \$
(a) Aggregate amounts receivable from related entities at balance date		
<i>Current</i>		
Immediate controlling entity	-	455,382
Other related entities	141,097	622,293
	<u>141,097</u>	<u>1,077,675</u>
(b) Aggregate amounts payable to related entities at balance date		
<i>Current</i>		
Immediate controlling entity	116,491	1,069,799
Other related entities	208,551,001	783,970
	<u>208,667,492</u>	<u>1,853,769</u>

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*)
For the year ended 31 December 2012

22. Related parties (*continued*)

(c) Aggregate amounts recognised in respect of the following types of transactions and each class of related party involved were:

	2012	2011
	\$	\$
<i>Payment of reinsurance premium expenses</i>		
Other related entities	8,790,216	17,186,251
<i>Payment of reinsurance commission expense</i>		
Other related entities	1,576,048	2,113,239
<i>Reinsurance claims recoveries</i>		
Other related entities	12,903,997	728,518,030

The above transactions were made on commercial terms and conditions at market rates.

(d) Aggregate amount of receivable from and payable to head office

	2012	2011
	\$	\$
Head office account	21,761,527	72,812

(e) Related parties of Zurich Australian Insurance Limited New Zealand Branch fall into the following categories:

(i) Head Office

This branch is the New Zealand branch of an Australian operation, Zurich Australian Insurance Limited, which is an Australian registered insurance company.

(ii) Controlling Entities

The immediate controlling entity is Zurich Financial Services Australia Limited and is incorporated in Australia.

The ultimate controlling entity is Zurich Insurance Group Limited, an entity incorporated in Switzerland.

(iii) Other related entities

Included in the reinsurance and other recoveries amounts in Note 11 is \$525,897,403 (2011: \$846,644,353) owing by related entities.

23. Credit rating of insurer

During 2012, Standard & Poors has affirmed the credit rating of the head office company, Zurich Australian Insurance Limited with an A+ credit rating. This rating was assigned on 17 December 2012.

ZURICH AUSTRALIAN INSURANCE LIMITED NEW ZEALAND BRANCH

Notes to the Financial Statements (*continued*) For the year ended 31 December 2012

24. Reinsurance programme

The reinsurance strategy chosen to protect Zurich Australian Insurance Limited's liabilities in New Zealand matches the Australian reinsurance strategy in 2012. It has the following characteristics:

- A maximum per risk net retention of NZD 5 million, except for Liability and Motor TPPD (Third Party Property Damage) which is NZD 8 million, and Engineering which is NZD equivalent to AUD 1million.
- A maximum per event retention of NZD equivalent to AUD20 million.

Reinsurance is purchased through a series of treaty and facultative contracts with external reinsures and with members of the Zurich Insurance Group Limited group.

25. Capital management

While the Branch does not have any Capital of its own it does manage funds from the Head Office. When managing capital, management's objective is to ensure the Branch continues as a going concern as well as maintaining optimal returns to the holding company and benefits for other stakeholders. The investment strategy is conservative whereby investments are held in cash and fixed interest securities.

26. Capital adequacy for Zurich Australian Insurance Limited

The capital adequacy multiple for Zurich Australian Insurance Limited for 2012 is 1.339 (2011: 1.527).

27. Events occurring after reporting date

The directors have not become aware of any matter or circumstance not otherwise dealt with in the financial statements that has significantly affected or may significantly affect the operations of the Branch, the results of those operations or the state of affairs of the Branch in subsequent financial years.



Independent Auditors' Report to the Directors of Zurich Australian Insurance Limited

Report on the Financial Statements

We have audited the financial statements of Zurich Australian Insurance Limited New Zealand Branch (the Branch) on pages 1 to 30, which comprise the balance sheet as at 31 December 2012, the statement of comprehensive income and statement of changes in head office account for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The Directors of Zurich Australian Insurance Limited (the Company) are responsible for the preparation of these financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate and for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

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

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

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

PricewaterhouseCoopers, ABN 52 780 433 757

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Independent Auditors' Report to the Directors of Zurich Australian Insurance Limited (continued)

Opinion

In our opinion, the financial statements on pages 1 to 30:

- (i) comply with generally accepted accounting practice in New Zealand;
- (ii) give a true and fair view of the financial position of the Branch as at 31 December 2012, and its financial performance for the year then ended.

Restriction on Distribution or Use

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

A handwritten signature in cursive script that reads 'PricewaterhouseCoopers'.

Chartered Accountants
26 March 2013

Sydney

I, Voula Papageorgiou, am currently a member of the Institute of Chartered Accountants in Australia and my membership number is 96318.

PricewaterhouseCoopers was the audit firm appointed to undertake the audit of Zurich Australian Insurance Limited New Zealand Branch for the year ended 31 December 2012. I was responsible for the execution of the audit and delivery of our firm's auditors' report. The audit work was completed on 26 March 2013 and an unqualified opinion was issued.

A handwritten signature in cursive script that reads 'V. Papageorgiou'.

Voula Papageorgiou