



Tower Limited Annual Report 2018



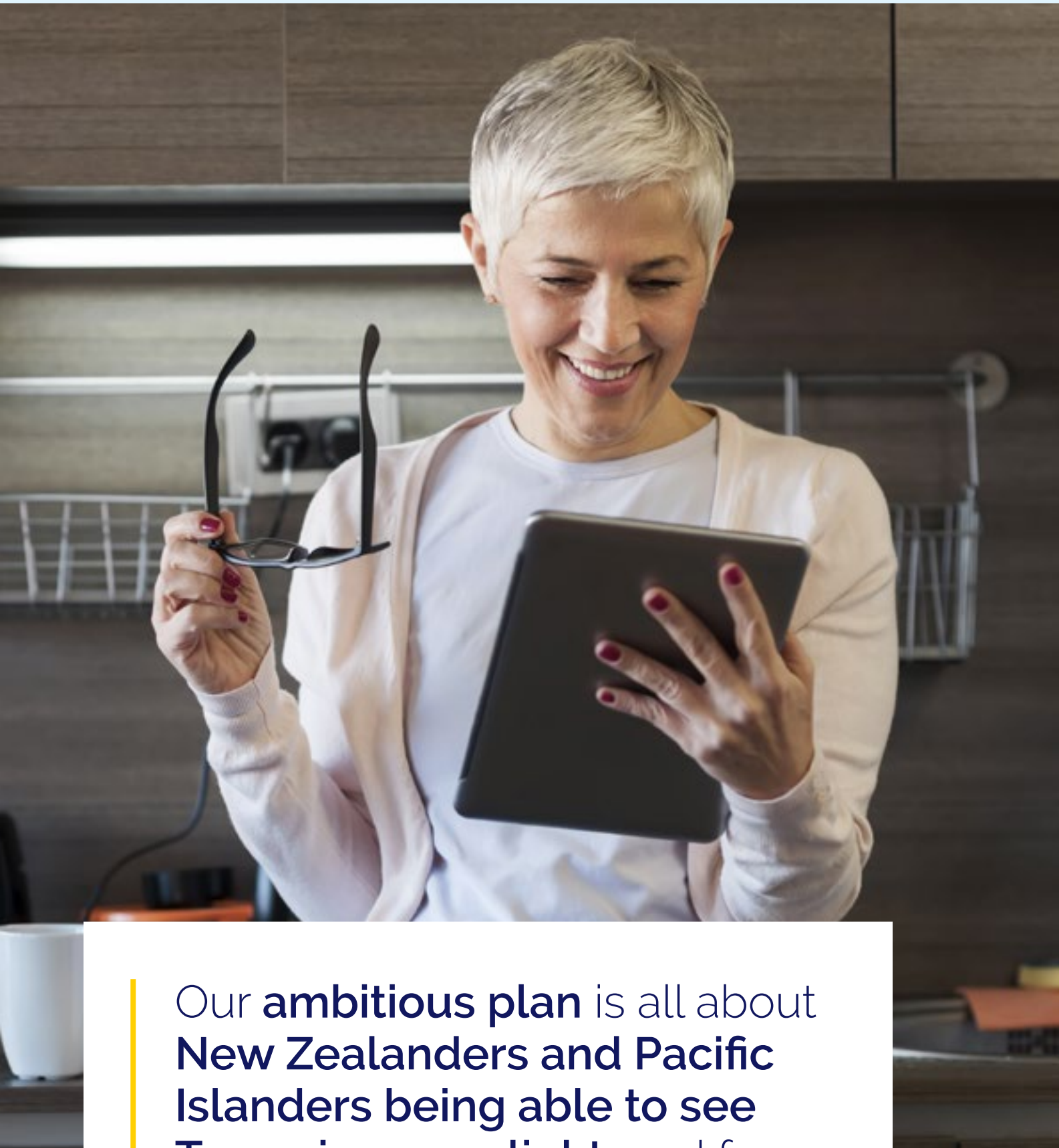
Looking back on a year of transformation, **strong growth** and **customer confidence**.

Tower has a history spanning nearly 150 years. What started as a conversation to provide fairer, local insurance to those who called New Zealand home is now the Tower Insurance of today.

As we transform into a challenger brand, we once again find ourselves in a position where we're challenging the market and offering Kiwis a genuinely different choice for insurance.

Over the past year...

- Added over 18,000 risks to our core New Zealand portfolio
- Grew GWP in our core New Zealand portfolio by 11.9%
- Launched risk based pricing, resulting in 4% growth in larger, low risk areas like Auckland and Taranaki, while reducing our exposure in extreme risk areas by an annualised figure of 17%
- Increased sales through digital channels to 45% of new business in September 2018, up from less than 10% in FY16
- Hit the half way point of our major technology upgrade with new business to be on sale on the new platform midway through the 2019 calendar year



Our **ambitious plan** is all about **New Zealanders and Pacific Islanders** being able to see **Tower in a new light**, and for Tower to set the bar for how insurance 'should' be.

Update from the Chair and CEO on behalf of the directors

For almost 150 years Tower has been insuring New Zealanders, and over the course of those years, has transformed and changed considerably.

A little over two years ago, we embarked on our latest – and arguably most difficult – transformation to date, to reposition the business as a contemporary, challenger brand, underpinned by a customer-focused, digital-first strategy to successfully compete in the 21st century.

We recognised that we hold a unique position in the New Zealand insurance market. We have a solid existing customer base, yet plenty of room to continue growing and acquiring market share from the two large incumbents.

Over the past 18 months, research has shown us that customers are unhappy with insurers. Our goal is to challenge industry norms to change this because we believe this customer dissatisfaction provides us with opportunity.

Our ambitious plan is all about New Zealanders and Pacific Islanders being able to see Tower in a new light, and for Tower to set the bar for how insurance "should" be. We believe that delivering unique customer value through amazing claims experiences will be our key differentiator and will build strength and long-term value in our business.

Our focus on customers and the creation of new products and processes will enable amazing claims experiences and allow us to reach our challenger brand aspiration faster. This will be supported with continued refinement of our underwriting, enhanced operational efficiency and the replacement of our core IT platform.

Over the past year we have delivered a number of proof points that demonstrate our transformation is well underway.

New technology is accelerating growth with work already completed resulting in a significant uplift in customers. In the past year we added over 18,000 risks to our core New Zealand portfolio, grew GWP in the core New Zealand portfolio by 11.9% and saw total GWP reach \$336 million across New Zealand and the Pacific. Online sales comprised 45% of new business in September 2018, up from less than 10% in 2016.

This uptake from our customers is proof that our confidence in user-friendly technology is well placed.

Throughout the year we continued investing in our business, building capability to enable growth and we achieved this while reducing our expense ratio almost 1%, to 39%.

We are also well progressed on our technology upgrade, recently moving through the half way point, where costs are within tolerances, however like all projects of this nature there remains risk and complexity in the delivery. We are managing this with robust governance controls at all levels.

It is unfortunate that this growth and good progress has been offset by increased claims costs and the settlement of the Peak Re dispute earlier in the year. Weather in the Pacific was the most significant impact on claims costs along with some prior year development in New Zealand and other costs. Each of these is well understood with pricing and underwriting responses either already implemented or in train to improve performance through the coming year.

Achieving settlement with Peak Re marked an important step towards finalising this legacy issue and resulted in a \$16.2 million after-tax impact on profit.

These results show that we are removing legacy risks and at the same time, realising the potential in the underlying Tower business.

We are proud of the vision for Tower and the commitment and passion of the team that is working to see our transformation come to life. It is gratifying to see Tower's approach really resonating with our customers and as a result, delivering the substantial growth seen in 2018.

Shareholders can be confident that the work we are doing will deliver significant long-term value.



Michael Stiassny
Chairman

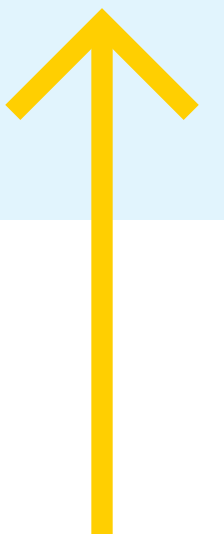


Richard Harding
Chief Executive Officer

Features of full year 2018.

- Transformation of core business well underway and driving strong GWP growth in the core New Zealand book of 11.9% on the prior year, and strong volume growth, with 18,192 risks added to the core New Zealand book¹
- Claims costs increased due to severe weather in the Pacific along with some prior year development in New Zealand and other cost impacts. Each of these is well understood and pricing and underwriting responses either already implemented or in train to improve performance through the coming year
- Major technology upgrade progressing well, with replacement of core platform with leading technology tracking well
- Reported full year loss of \$6.7 million impacted by
 - \$16.2 million after-tax impact from Peak Re settlement
 - \$11 million before-tax impact from weather and large events
 - Minor adjustment to Canterbury provisions, resulting in a \$3.6 million after-tax impact
- Continued positive progress closing Canterbury earthquake claims, with open claims almost halved, down to 163, from 323 on October 1 2017

11.9%
GWP Growth in core
NZ book on prior year



Tower has strong underlying New Zealand and Pacific businesses and the 2018 Financial Year has seen the continued delivery against its strategy to transform.

With a focus clearly on simplifying and improving all aspects of our business to differentiate the company, strong growth in GWP and customer numbers, contained expenses and a major technology upgrade progressing well, all demonstrate that transformation is well underway.

The implementation of risk-based pricing and continued improvements in digital channels added 18,192 new risks² to Tower's core New Zealand portfolio, seeing core NZ GWP for the year grow 11.9% contributing to total GWP of \$336 million.

Tower reported a loss after tax of \$6.7 million for the year ended 30 September 2018 (FY18), narrowing from a loss of \$8 million for the year ended 30 September 2017 (FY17).

The strong growth of \$23.7m in gross written premium and \$13.1m in net earned premium has been offset by storm activity, higher claims costs, the resolution of the Peak Re dispute as well as an increase in ultimate incurred claims for Canterbury.

Severe storm activity in New Zealand and the Pacific resulted in an \$11 million before-tax impact to underlying profit, seeing it decline to \$13.6 million, from \$18 million in the year prior.

Claims costs increased over the 2018 financial year, with weather in the Pacific the most significant impact along with some prior year development in New Zealand and other cost impacts. Each of these is well understood and pricing and underwriting responses either already implemented or in train to improve performance through the coming year.

Severe weather across the Pacific increased claims costs significantly in FY18. Cyclone Gita impacted Tonga heavily, while Cyclones Keni and Josie impacted Fiji, resulting in a 10.4 percentage point uplift on the Pacific FY17 claims ratio. Reinsurance is being utilised to minimise impacts of weather along with ongoing refinement of products and underwriting criteria.

New Zealand claims expenses also increased over the 2018 financial year due to a number of claims challenges, however, these are being countered with pricing and underwriting responses to improve performance.

A continued focus on non-personnel costs saw the management expense ratio decrease almost 1% to 39%, while still allowing further investment in the business.

Tower's Pacific premium remains stable and in line with the same period in the prior year, however, underlying profit of \$2.2 million has been impacted by Cyclones Gita, Josie and Keni and a small number of commercial fires.

Group Profit Summary (NZ\$m)¹

\$ MILLION	FY18	FY17	Change
Gross written premium	336.1	312.4	23.7
Gross earned premium	323.1	306.1	17.0
Reinsurance expense	(53.1)	(49.2)	(3.9)
Net earned premium	270.0	256.9	13.1
Net claims expense	(141.2)	(124.2)	(17.1)
Large events claims expense	(11.0)	(7.4)	(3.6)
Management and sales expenses	(105.4)	(102.4)	(3.0)
Underwriting profit	12.4	22.9	10.5
Investment revenue and other revenue	7.2	6.1	1.1
Financing costs	(0.6)	(0.8)	0.3
Underlying profit before tax	19.1	28.2	(9.2)
Income tax expense	(5.5)	(10.2)	4.7
Underlying profit after tax	13.6	18.0	(4.5)
Peak Re settlement	(16.2)	0.0	(16.2)
Christchurch impact	(3.6)	(18.6)	15.1
Kaikoura impact	0.3	(4.1)	4.5
Corporate transaction costs	(0.2)	(3.1)	2.9
Foreign tax credit write-offs	(1.2)	(1.9)	0.7
Business in runoff	(0.0)	1.7	(1.7)
Other non-underlying items	0.6	0.0	0.6
Reported loss after tax	(6.7)	(8.0)	(1.3)

Tower continues to make solid progress settling claims in Canterbury, reducing open claims by 160. On October 1 2017, Tower had 323 open claims remaining. In the intervening 12 months, the number of open Canterbury Earthquake claims was reduced to 163, with 318 claims closed, however, 115 new claims from the EQC were received and 43 claims were reopened.

1. Following the end to Tower's distribution relationship with Kiwibank on 4 April 2018, the 'core' portfolio now refers to the NZ business excluding the ANZ Bank and Kiwibank portfolios. The FY17 comparative has been restated to be consistent with this approach.

2. In prior years Tower has reported volumes using policy numbers as the relevant metric. Tower has changed to using risk numbers as the key metric in FY18 to align with internal management reporting and to better illustrate risk exposures, e.g., where one policy might cover several risks.

Tower holds a
unique position in the
New Zealand insurance
market, with a solid
existing customer base,
yet plenty of room
to grow.

A clear strategic plan to continue transforming and growing the business by delivering a compelling, challenger proposition to the market will see Tower turn industry norms upside down and revolutionise the way customers interact with us.

The achievements seen to date show that there is a powerful platform for future growth with progress in crucial areas:

- Focus on customers has delivered strong growth
- Management expenses ratio has reduced, while continuing to invest
- Major technology upgrade progressing well
- Increases to claim costs well understood with action taken to offset inflation



Focus on customers driving growth

Overview

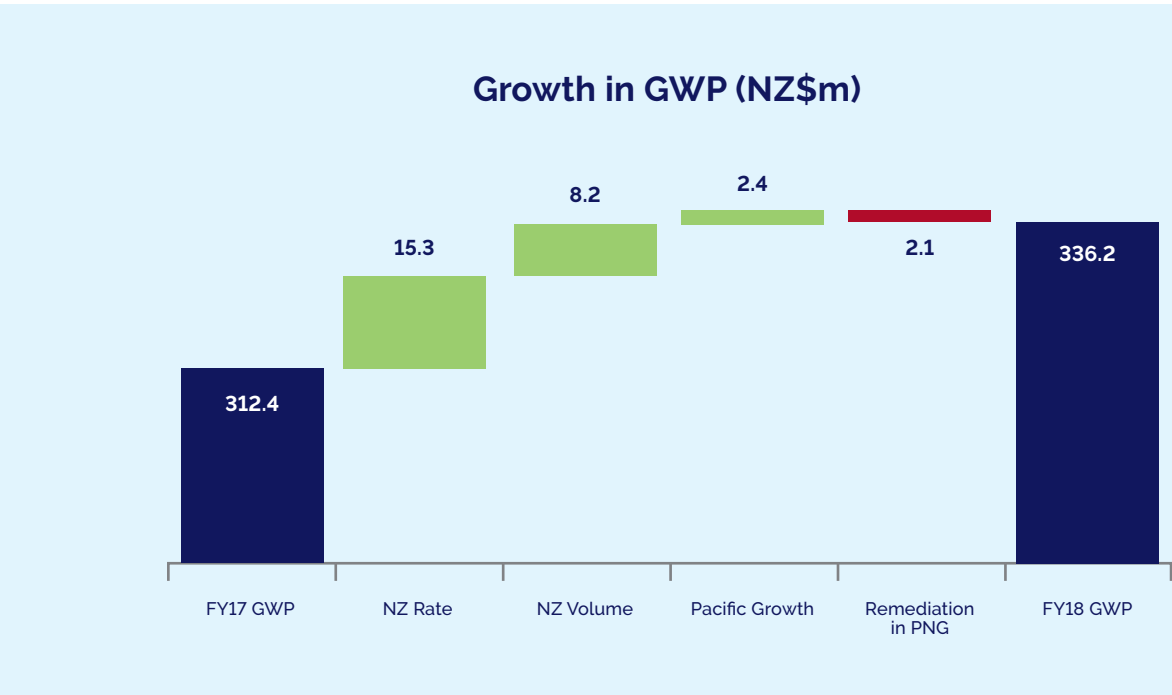
- Strong GWP growth of 11.9% in core book with total GWP growing strongly at 7.6%
- Growth in risks in core New Zealand book increased significantly by 18,192
- 45% of new business sales online in September 2018, up from less than 10% during FY16
- New approach to pricing combined with simple and easy products driving impressive customer growth and improved mix

Tower's focus on customers has seen continued growth in its core New Zealand portfolio in FY18, with 18,192 risks added to the core book and GWP increasing 11.9%.

With Tower's new product suite fully available online, and continued refinement and optimisation of the digital sales channels, more customers are choosing Tower, delivering a significant uplift in new business sales, with 45% of new business sales online in September 2018, up from less than 10% in FY16.

In the Pacific, Samoa, American Samoa and the Solomon and Cook Islands have returned to growth thanks to additional underwriting, pricing and marketing support for local teams. However, this growth has been offset by the continued remediation of the Papua New Guinea portfolio to reduce risk and exposure which will lead to improved profitability.

- This positive result across Tower's businesses is being achieved through a combination of:
- Ongoing pricing improvements in New Zealand motor, house and contents portfolios to offset increased claims costs
 - Constant refinement of underwriting criteria enabling more granular assessment to improve profitability of portfolio
 - Attracting new, profitable customers with improved and targeted offerings;
 - Building and refining Tower's digital offering and online sales process
 - The creation of the Pacific operations centre, centralising back office functions, ensuring that the pricing and underwriting approach is consistent and minimises claims leakage



New Zealand and Pacific claims expenses

Overview

- Claims costs increased across New Zealand and Pacific
- Inflation is well understood and has been addressed through pricing and underwriting responses already implemented or in train to improve performance through the coming year
- Strengthened underwriting and risk selection in the Pacific to improve profitability

New Zealand claims expenses increased in FY18 due to a number of claims challenges, however, these challenges are well understood and swift action has been taken to address each of them.

Throughout the year an increase in the development of open FY17 claims was experienced. The reserving model used didn't respond well during the claims backlog experienced due to storms, understating expected development of claims in FY17. This resulted in a 1.2 percentage point increase in the claims ratio and the reserving methodology has now been updated accordingly.

Tower's new, simpler products have resulted in a decrease in NZ House claim frequency, however, this positive result has been offset by an increase in severity, driven by a number of large house fires and the increased costs relating to increasing Health & Safety costs and asbestos testing requirements which are both industry-wide issues driven by regulatory change. In response to these issues Tower has strengthened pricing and improved its underwriting criteria and expects to see improved outcomes in the coming year.

Supply chain constraints and inflation continues to impact the industry with increasingly advanced technology in cars seeing the cost of repair rise. Tower is addressing motor claims inflation through pricing and more granular underwriting.

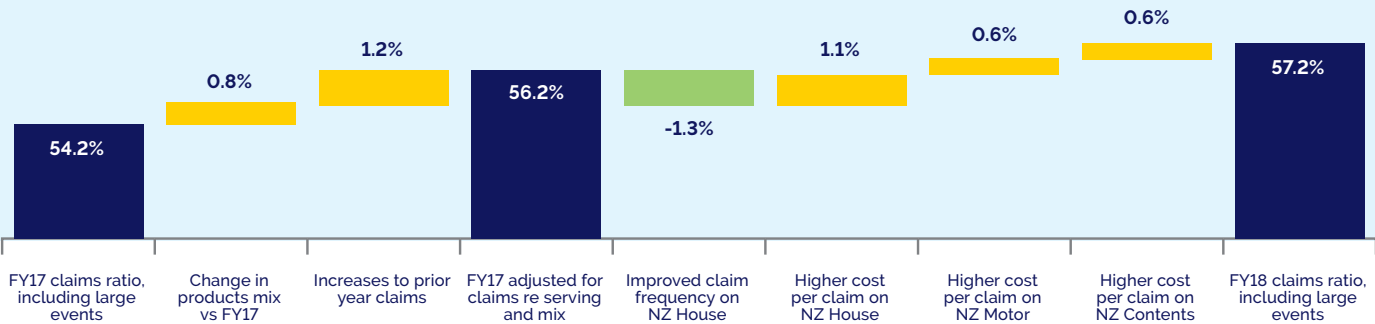
A higher cost per claim in Tower's NZ Contents book is also linked to the increase in house fires and work has been completed to actively address this through improved pricing and underwriting.

In the Pacific, severe weather increased claims costs significantly in FY18. Cyclone Gita impacted Tonga heavily, while Cyclones Keni and Josie impacted Fiji, resulting in a 10.4 percentage point uplift on Tower's FY17 Pacific claims ratio.

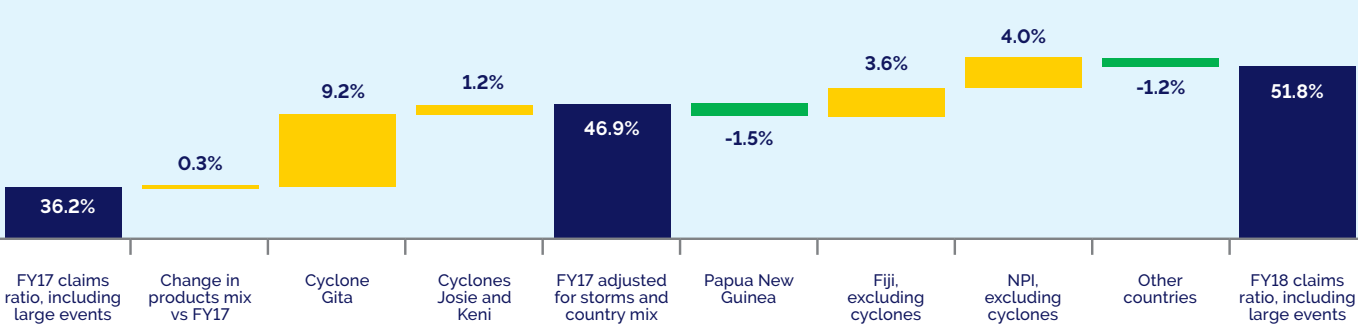
In Fiji, an increase in claims expenses mostly relates to motor claims inflation and in Tower's National Pacific Insurance business, a small number of large commercial fires have driven the claims ratio higher.

Reinsurance is being utilised to minimise impacts of weather and constant refinement of Tower's pricing, product offering and underwriting criteria in response to weather events and claims inflation means that Tower expects to see its claims ratio excluding large events revert to prior year levels.

Year on year change in the claims ratio – New Zealand



Year on year change in the claims ratio – Pacific



Severe weather events and reducing volatility

Overview

- Severe and unprecedented weather drove increased claims expenses in both FY17 and FY18
- Losses for these two years are significantly above long-term trends
- Gross impact of weather events in FY18, before reinsurance \$20.1 million
- Reinsurance structure will reduce volatility from exposure to large events with FY19 reinsurance secured on favourable terms

The past two years have seen a number of unprecedented and severe weather events that have impacted communities and the business beyond expectations. Impacts to Tower in FY17 totalled \$15.5 million before reinsurance, and this year reached a gross amount of \$20.1 million, well above both Tower's 10 year average of \$7.6 million, and its five year average of \$11.3 million.

This is not unique to Tower, with industry wide losses in New Zealand from weather in the 2018 calendar year totalling over \$200 million so far.

In response to these increased impacts Tower has adjusted pricing and strengthened its reinsurance programme to increase cover and reduce volatility from large events in FY19

Tower has:

- Doubled its aggregate cover from \$10 million to \$20 million and increased the excess from \$7 million to \$10 million
- Increased cover for single large events from \$5 million to \$7.5 million, once its excess of \$10 million is used
- Purchased drop-down cover to bridge the gap between aggregate and catastrophe cover
- Secured FY19 reinsurance on favourable terms

Tower is putting in considerable effort and taking all appropriate steps to preserve capital and reduce any volatility from these short-term weather abnormalities.



Building capability while controlling costs

Achievements

- Management expense ratio continues to improve
- Investment made to build capability and deliver growth

Tower has maintained its focus on non-personnel related costs, reducing the management expense ratio to 39% in FY18, compared to 39.9% FY17.

Tower has achieved a significant capability lift with a lower expense ratio thanks to close management of costs. Tower has increased capability in the pricing and underwriting, technology and digital, data lake, data science, claims management, procurement and customer insights areas.

In addition, the management expense ratio of 39.0%, includes incremental investment of:

- \$1.0m to reduce cyber security risks
- \$1.2m on acquisition, including partnerships and marketing
- \$0.7m on ancillary IT system refresh

Tower expects expenses will continue to stabilise as simplification programme initiatives are embedded, with a step change in productivity gains to be realised after the implementation of its new IT platform.



Major technology upgrade underway

Overview

The key to accelerating Tower’s transformation is a new IT platform that enables the simplification of products and processes. This will remove complexity for frontline teams and enable the delivery of a unique and revolutionary customer experience.

Combined with Tower’s push to move 50 - 70% of all transactions online, removing complexity from the business will deliver significant cost savings and productivity gains.

Tower is now approaching the half way mark of this programme and progress to date is in line with expectations. This programme is complex and includes legacy replacement, digital enhancement and product rationalisation. The programme remains on track to deliver in the first half of the 2019 calendar year.

At the half way point costs are within tolerances, however like all projects of this nature there remains risk and complexity in the delivery. Tower’s robust governance controls include a focus on managing delivery risk and cost trade-off.

- Key benefits to be seen from Tower’s new IT platform include the ability to:
- Create and deliver a unique customer experience
 - Quickly deliver simple, customer focussed products
 - Target specific, profitable customer segments through granular, and automated pricing and underwriting
 - Charge fairer and more accurate premiums through improved access to, and use of, internal and external data
 - Easily trial new products and pricing
 - Rationalise products and reduce claims costs by improving the customer claims journey and overall claims management
 - Significantly reduce our cost base and realise large productivity gains by moving low value transactions online
 - Add value through improved employee engagement
- Tower’s approach to implementing this new IT platform is designed to deliver on a dual purpose – accelerate transformation and protect and realise shareholder value. Tower’s robust governance approach and clear roadmap forward will enable Tower to commence selling new business on the new platform in the first half of the 2019 calendar year. Once new business is live, migration of the existing book can start.



Canterbury update

Tower continues to make solid progress settling claims in Canterbury, reducing open claims by 160. On October 1 2017, Tower had 323 open claims remaining. In the intervening 12 months, the number of open Canterbury Earthquake claims was reduced by 318. However, 115 new claims from the EQC were received and 43 claims were reopened.

Tower’s gross outstanding claims have more than halved since September 2016. This demonstrates that solid progress is being made. In addition, the amount of IBNR / IBNER and risk margin has increased from 60% to 95% of case estimates.

Tower also welcomes the recent government announcement of an enquiry into EQC as an important step toward ensuring that mistakes of the past are learnt from and not repeated in future.

EQC Act reform will assist in ensuring past experience is not repeated and that the pitfalls and problems associated with the EQC set up and the 2010 model can be avoided. Tower strongly believes that the Kaikoura model is successful and that any reform of the EQC must include these changes.

\$ MILLION	Sep 18	Mar 18	Sep 17	Mar 17	Sep 16
Case estimates	37.5	48.0	58.9	73.9	93.2
IBNR/IBNER ¹	21.4	22.0	34.4	47.4	44.0
Risk margin	9.0	10.8	13.9	18.2	11.9
Additional risk margin	5.0	10.0	10.0	-	-
Actuarial provisions	35.4	42.8	58.3	65.6	55.9
Gross outstanding claims	72.9	90.8	117.2	139.5	149.1
Ratio of provisions to case estimates ²	95%	89%	99%	89%	60%

1. IBNR / IBNER includes claims handling expenses

2. Ratio of IBNR / IBNER plus risk margin to case estimates

Solvency position

Overview

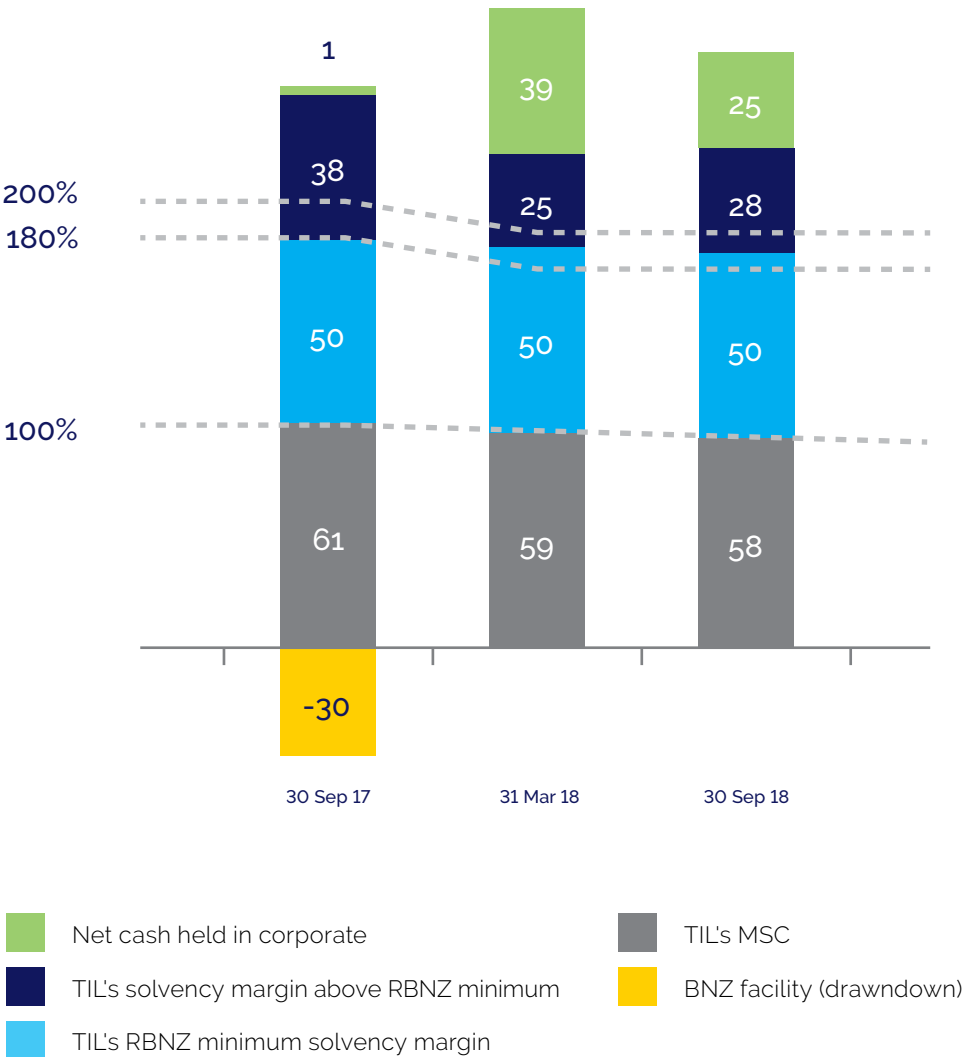
Tower holds significant capital over and above the minimum regulatory requirement.

As at 30 September 2018, following the Peak re settlement and the weather events earlier this year, Tower Insurance Limited held approximately \$78 million of solvency margin, \$28 million above RBNZ requirements and equivalent to 234% of minimum solvency capital.

An additional \$25 million in corporate cash is also held by Tower Limited.

Tower retains access to undrawn debt facilities and has a preference to fund remaining IT investment from debt.

Tower Insurance Limited solvency position plus corporate cash (\$m)



Outlook

Overview

Tower is transforming, and is focussed on progressing initiatives that will continue accelerating momentum and deliver long-term shareholder value.

Tower has provided a one-off guidance for FY19 to demonstrate its confidence in the strategy and performance of its underlying business. Tower's guidance for underlying NPAT in FY19 is in excess of \$22m.

This includes the following assumptions:

- Continued momentum in revenue growth and sales through improved digital channels
- Underwriting and pricing changes will be implemented, continuing to drive improvement in mix of risk, as well as addressing inflation
- Pacific contribution will return to normal levels
- The management expenses ratio will be maintained at a steady level
- The Aggregate excess will be fully utilised for weather events

Accordingly, Tower's Board has determined that in FY19, Tower will pay a dividend of 50% to 70% of reported NPAT where prudent to do so.

Tower is being transformed and the work underway will deliver significant long-term value



Over the past two years we've spoken about the significant opportunity that exists in the Tower business. Our clear strategic plan is seeing us realise this potential with our transformation into a digital challenger brand well underway.

Our desire to step outside the confines of a traditional insurer to challenge industry norms, along with our dynamic size means that we can make decisions faster and capitalise on opportunities quicker and more efficiently than our competitors.

There are many similarities between the New Zealand and Australian insurance industries where two large multi-nationals hold a high percentage of the market. In Australia, challenger brands entered and achieved significant growth thanks to their ability to quickly deliver something unique and targeted to customers.

Over the past 18 months, research has shown us that customers are unhappy with insurers. Our goal is to challenge industry norms to change this because we believe this customer dissatisfaction provides us with opportunity.

We believe that delivering unique customer value through amazing claims experiences will be our key differentiator and will build strength and long-term value in our business.

Our focus on customers and the creation of new products and processes will enable amazing claims experiences and allow us to reach our challenger brand aspiration faster. This will be supported with continued refinement of our underwriting, enhanced operational efficiency and the replacement of our core IT platform.

With this work already delivering benefits and we are now accelerating our progress to deliver a step change in results and long-term shareholder value.

Delivering against our challenger strategy will enable us to achieve our uplifted, medium-term operating targets of:

- GWP growth of 8-10%
- Combined Operating Ratio < 85%
- Return on equity of 14-16%

Our transformation is driven by our purpose to set things right for our customers and communities.

Over the past 18 months we've spent time working with our customers to understand their frustrations and what they think a Tower of the future could look like.

As a result of this work, we've come to a firm belief that customers deserve better and we have refined our customer proposition to start offering customers a truly different choice for insurance.

We are removing jargon filled policies and making our award winning policies even simpler. Not only does this benefit our customers, it reduces the complexity and leakage that comes from having over 400 different products.

We will continue with our push for fairer pricing which will allow us to grow in the large low risk areas, like Auckland and Taranaki, that had previously been subsidising those in high-risk areas. We have communicated this change openly and honestly, receiving positive feedback about our approach and we will continue operating and educating the community in this way – transparently.

Our key differentiator will see us deliver amazing claims experiences. Our new platform, combined with a number of other ancillary systems, will increase automation. This will improve the customer experience, reduce claim turn-around-times and reduce leakage, resulting in improved efficiency and profitability.

In September we launched our first community partnership and Tower became staunch supporters of the New Zealand Paralympic Team. This partnership signals a change for our brand and a shift to closer connections with the communities within which we operate. We will continue increasing our presence and engagement with the community to improve these connections and build a brand that is known for being a part of local communities.

In the Pacific, our new operations centre will support local teams through improved product, pricing and underwriting capability to ensure we grow within our risk appetite. Complex claims management will improve customer experience and reduce leakage.

What we're building will be unique and will continue to attract more customers to Tower and drive strong growth.



The positive results we've delivered in the underlying business are being driven by our people and a noticeable change in our culture.

We actively encourage our people to do things differently and challenge the traditions and norms of the industry in which we operate. Pleasingly, we are seeing positive shifts in our culture measures as well as steady increases in employee engagement measures over the past two years.

This passion to do things differently has seen our people initiate and drive a number of projects that have improved our performance thanks to improving customer experience. We have reduced the amount of duplication occurring in our back offices and implemented a number of diversity and inclusion initiatives.

In 2018 we held our first annual Buddy Up day, where employees from across the business buddied up with our frontline teams to understand our current customer experience and the steps we're taking to improve this. Activities like this signal a shift in our culture toward one that is more customer centric and focussed on delivering on our strategy.

Throughout 2018 our employees also helped us celebrate International Women's Day, Diwali, the Paralympics New Zealand Spirit of Gold Day, Chinese New Year, Christmas, Matariki, Eid Mubarak, Te Wiki O Te Reo Maori, Tongan Language Week, the Auckland Pride Parade and launched a women's networking and development initiative, Lean-In.

In the coming year, our focus on diversity and inclusion and improving culture and engagement will increase with a continued drive to make Tower recognised as an employer of choice.

Being an employer of choice is an important strategic decision for us as it enables us to attract and retain employees who continuously improve and reinvigorate the business and what we do for our customers.



Board of Directors



Michael Stiasny

LLB, BCom, FCA, CFInstD
Chairman
Non-Executive Director
Independent
Appointed Director: 12 October 2012

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

Michael resides in Auckland, New Zealand.



Graham Stuart

BCom (Hons), MS, FCA
Non-Executive Director
Independent
Appointed Director: 24 May 2012

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

Graham resides in Auckland, New Zealand.



Steve Smith

BCom, CA, Dip Bus (Finance),
CFInstD
Non-Executive Director
Independent
Appointed Director: 24 May 2012

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

Steve resides in Auckland, New Zealand.



Warren Lee

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

Warren has extensive experience and a long record of leadership in the international insurance industry, including 15 years at AXA in senior management positions within the company's Australian and Asian businesses. Warren's two most recent 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 a non executive director of MyState Limited, a listed Australian Financial Services Group and the Go Hold Limited Group. He has a Bachelor of Commerce from the University of Melbourne and is a member of Chartered Accountants Australia and New Zealand.

Warren resides in Melbourne, Australia.



Wendy Thorpe

BA (French), BBus (Accounting),
Grad Dip, Applied Fin & Inv,
Harvard AMP, FFin, GAICD
Non-Executive Director
Independent
Appointed Director: 1 March 2018

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

Wendy resides in Melbourne, Australia.

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Independent auditor's report

To the shareholders of Tower Limited

The financial statements comprise:

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

Our opinion

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

Basis for opinion

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

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

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

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

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Our audit approach

Overview



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

Overall group materiality: \$3,241,000, 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 not as volatile as other profit and loss measures, and is a generally accepted benchmark. The 1% is based on our professional judgement, noting that it is also within the range of commonly accepted revenue related thresholds.

The following have been determined as key audit matters:

- Valuation of outstanding claims
- Valuation of EQC recovery receivables
- Recoverability of the deferred tax asset

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 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 financial statements as a whole.

Audit scope

We designed our audit by assessing the risks of material misstatement in the 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 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 scope focused on the most financially significant subsidiary, which contributes approximately 83% of the Group's premium revenue. We performed further audit procedures over the balances and transactions of the non-significant 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 financial statements of the current year. These matters were addressed in the context of our audit of the 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 (2018 \$148,976,000, 2017 \$181,156,000) We considered the valuation of outstanding claims a key audit matter because of the complexity involved in the estimation process and the significant judgements that management make in determining the balance. The valuation of outstanding claims relies on the quality of underlying data and involves significant judgements and assumptions given the inherent uncertainty in estimating the expected present value of future payments for claims incurred. In particular, judgement arises over the estimation of payments for claims that have been incurred at the reporting date but have not yet been reported to the Group, as there is generally less information available in relation to these claims, and claims that have been reported but there is uncertainty over the amount which will be settled. 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. <i>Relevant references in the financial statements</i> Refer to notes B2, B3, B4 and B5 to the financial statements, which also describes the elements that make up the balance.	Our audit procedures included obtaining an understanding of key controls, including key data reconciliations and management review of the estimates. Historical claims data is a key input to the actuarial estimates. Accordingly, we: - Evaluated the design effectiveness and tested controls over claims processing; - Re-performed claims data reconciliations; - Assessed a sample of claim case estimates at the year end to check that they were supported by appropriate documentation; and - Inspected a sample of claims paid during the year to confirm that they were supported by appropriate documentation and approved within delegated authority limits. Together with PwC actuarial experts we: - 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; - Considered the work and findings of the external independent actuaries engaged by the Group; and - Assessed the risk margin, by comparing to known industry practices and the Actuaries Institute recommended framework. In particular we focused on the assessed level of uncertainty in the central estimate. We have no matters to report from the procedures performed.



(2) Valuation of Earthquake Commission (EQC) recovery receivables (2018 \$68,400,000, 2017 \$65,100,000)

We considered EQC recovery receivables a key audit matter because significant management judgement is required to value expected recoveries from EQC in respect of land damage and building costs, as these recoveries are subject to agreement with EQC. The expected recoveries from EQC are related to the Canterbury earthquakes which requires judgement and actuarial expertise to evaluate the attribution of claims cost between the major earthquake events, in particular the September 2010 and February 2011 events.

Relevant references in the financial statements

Refer to notes B3 and E1 to the financial statements.

We assessed management's approach to estimate the EQC recovery receivables. We reviewed correspondence with EQC and held discussions with management, lawyers, external advisors and external independent actuaries to understand assumptions, including the attribution of losses to the different Canterbury earthquake events, used to establish the right to recovery. We compared these assumptions with sector peers and obtained evidence for any significant variances.

We considered the range from which the amount recognised has been determined and assessed whether the current circumstances could support a different recovery receivable amount.

We have no matters to report from the procedures performed.

(3) Recoverability of the deferred tax asset on tax losses (2018 \$36,376,000, 2017 \$37,782,000)

The Group has a deferred tax asset balance of \$36,376,000, of which \$30,685,000 relates to deferred tax assets arising from past tax losses.

We considered recoverability of the deferred tax asset a key audit matter because it is sensitive to the Group's expected future profitability and its entitlement to offset these losses against future profits. Significant management judgement is involved in forecasting future taxable profits which are inherently uncertain.

Relevant reference in the financial statements

Refer to note D6 to the financial statements.

We evaluated management's assessment of the recoverability of the deferred tax asset, including understanding the progress made by management in improving the profitability of the business in recent periods, which includes the remediation of the causes of past losses through, amongst other things, assessment of the Canterbury earthquakes claims and related reinsurance and other recoveries (assessment of the recoverability of the receivables from EQC) and other expense reduction and income initiatives.

We assessed the operational plan used in the deferred tax asset recoverability assessment by comparing previous operational plans with actual results and assessed the appropriateness of the assumptions used in the operational plan. We used our tax specialist to assess whether the Group is entitled to offset the tax losses against future profits.

We have no matters to report from the procedures performed.



Information other than the financial statements and auditor's report

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard, except that not all other information was available to us at the date of our signing.

Responsibilities of the Directors for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

<https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/>

This description forms part of our auditor's report.

Who we report to

This report is made solely to the Company's shareholders, as a body. 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 shareholders, as a body, for our audit work, for this report or for the opinions we have formed.

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
28 November 2018

Auckland



TOWER Limited

Consolidated **Income Statement**

For the **year** ended 30 September 2018

	NOTE	2018 \$'000	2017 \$'000
Revenue			
Premium revenue	B1	323,093	306,079
Less: Outwards reinsurance expense		(54,251)	(49,164)
Net premium revenue		268,842	256,915
Investment revenue	C1	7,125	7,643
Fee and other revenue		5,755	3,040
Net operating revenue		281,722	267,598
Expenses			
Claims expense		200,467	225,384
Less: Reinsurance and other recoveries revenue		(23,835)	(37,833)
Net claims expense	B2	176,632	187,551
Management and sales expenses	D1	89,728	81,744
Impairment of reinsurance receivables	D2	22,511	-
Acquisition proposal expenses	D3	302	3,467
Financing expenses		570	835
Total expenses		289,743	273,597
Profit (Loss) attributed to shareholders before tax		(8,021)	(5,999)
Tax (expense) benefit attributed to shareholders' profits	D6	1,295	(2,001)
Profit (Loss) for the year		(6,726)	(8,000)
Profit (Loss) attributed to:			
Shareholders		(6,773)	(8,461)
Non-controlling interest		47	461
		(6,726)	(8,000)
		CENTS	CENTS
Basic and diluted profit (loss) per share	F5	(2.20)	(4.12)

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

Consolidated Statement of Comprehensive Income

For the **year** ended 30 September 2018

	NOTE	2018 \$000	2017 \$000
Loss for the year		(6,726)	(8,000)
Other comprehensive income			
Currency translation differences		42	105
Gain on asset revaluation	E3	434	247
Deferred income tax relating to asset revaluation	D6	(81)	(29)
Other comprehensive income net of tax		395	323
Total comprehensive loss for the year		(6,331)	(7,677)
Total comprehensive (loss) income attributed to:			
Shareholders		(6,474)	(8,143)
Non-controlling interest		143	466
		(6,331)	(7,677)

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

Consolidated Balance Sheet

As at 30 September 2018

	NOTE	2018 \$000	2017 \$000
Assets			
Cash and cash equivalents	C2	102,001	83,876
Receivables	E1	259,607	286,569
Investments	C3	198,000	186,702
Derivative financial assets	C5	271	231
Deferred acquisition costs	D4	22,595	20,961
Property, plant and equipment	E3	8,510	8,780
Intangible assets	E2	45,042	31,334
Current tax assets	D6	13,831	13,462
Deferred tax assets	D6	36,376	32,745
Total assets		686,233	664,660
Liabilities			
Payables	E5	80,375	68,824
Provisions	E6	5,789	5,773
Insurance liabilities	B4	324,527	343,498
Borrowings	C4	–	29,921
Current tax liabilities	D6	174	560
Deferred tax liabilities	D6	589	340
Total liabilities		411,454	448,916
Net assets		274,779	215,744
Equity			
Contributed equity	F1	447,543	382,172
Accumulated (losses) profit		(58,077)	(51,299)
Reserves	F2	(116,155)	(116,454)
Total equity attributed to shareholders		273,311	214,419
Non-controlling interest		1,468	1,325
Total equity		274,779	215,744

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

Michael P Stiasny
Chairman

Graham R Stuart
Director

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

Consolidated Statement of **Changes in Equity**

For the **year** ended 30 September 2018

		ATTRIBUTED TO SHAREHOLDERS				NON-CONTROLLING INTEREST \$000	TOTAL EQUITY \$000
	NOTE	CONTRIBUTED EQUITY \$000	ACCUMULATED (LOSSES) PROFIT \$000	RESERVES \$000	TOTAL \$000		
Year Ended 30 September 2018							
At the beginning of the year		382,172	(51,299)	(116,454)	214,419	1,325	215,744
Total comprehensive income (loss)		–	(6,773)	299	(6,474)	143	(6,331)
Transactions with shareholders							
Net proceeds of capital raise	F1	65,371	–	–	65,371	–	65,371
Other		–	(5)	–	(5)	–	(5)
Total transactions with shareholders		65,371	(5)	–	65,366	–	65,366
At the end of the year		447,543	(58,077)	(116,155)	273,311	1,468	274,779
Year Ended 30 September 2017							
At the beginning of the year		382,172	(42,822)	(116,772)	222,578	1,374	223,952
Total comprehensive income (loss)		–	(8,461)	318	(8,143)	466	(7,677)
Transactions with shareholders							
Dividends paid	F1	–	–	–	–	(515)	(515)
Other		–	(16)	–	(16)	–	(16)
Total transactions with shareholders		–	(16)	–	(16)	(515)	(531)
At the end of the year		382,172	(51,299)	(116,454)	214,419	1,325	215,744

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

Consolidated Statement of **Cash Flows**

For the **year** ended 30 September 2018

NOTE	2018 \$000	2017 \$000
Cash flows from operating activities		
Premiums received	319,329	309,147
Interest received	8,010	7,734
Net realised investment gain (loss)	(605)	(1,928)
Fee and other income received	5,285	3,040
Reinsurance received	45,780	28,962
Reinsurance paid	(52,327)	(50,228)
Claims paid	(231,843)	(248,183)
Payments to suppliers and employees	(80,614)	(76,408)
Income tax paid	(2,831)	(4,908)
Net cash inflow (outflow) from operating activities C6	10,184	(32,772)
Cash flows from investing activities		
Net proceeds from financial assets	(6,815)	2,852
Purchase of property, plant and equipment and intangible assets	(19,802)	(6,883)
Disposal of property, plant and equipment and intangible assets	73	136
Net cash inflow (outflow) from investing activities	(26,544)	(3,895)
Cash flows from financing activities		
Net proceeds of share issue	65,371	–
Facility fees and interest paid	(734)	(778)
Repayment of borrowings	(30,000)	–
Proceeds of borrowings	–	30,000
Payment of non-controlling interest dividends	–	(515)
Net cash inflow (outflow) from financing activities	34,637	28,707
Net increase (decrease) in cash and cash equivalents	18,277	(7,960)
Foreign exchange movement in cash	(152)	(392)
Cash and cash equivalents at the beginning of year	83,876	92,228
Cash and cash equivalents at the end of year C2	102,001	83,876

Accounting policy

The consolidated statement of cash flows presents the net changes in cash flow for financial assets. Tower considers that knowledge of gross receipts and payments is not essential to understanding certain activities of Tower 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 statement should be read in conjunction with the accompanying notes.

Notes to the Financial Statements

For the **year** ended 30 September 2018

Part A – Introduction

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

A1 Reporting Entity and Basis of Preparation

Entities reporting

The financial statements presented are those of Tower Limited (the Company) and its subsidiaries. The Company and its subsidiaries together are referred to in this financial report as Tower or the Group. The address of the Company's registered office is 45 Queen Street, Auckland, New Zealand.

Statutory base

Tower Limited is a company incorporated in New Zealand under the Companies Act 1993 and listed on the NZX Main Board and the Australian Securities Exchange. The Company is a reporting entity under Part 7 of the Financial Markets Conduct Act 2013.

Basis of preparation

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

The financial statements of the Group have been prepared in accordance with the requirements of Part 7 of the Financial Markets Conduct Act 2013 and the NZX Main Board Listing Rules.

The Group financial statements are presented in New Zealand dollars and rounded to the nearest thousand dollars. They 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 change in comparatives. Changes relate to income statement reclassification, balance sheet reclassification and presentation of notes. There is no change to net assets or the 2017 income statement.

A2 Consolidation

Principles of consolidation

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

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

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

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

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

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

Foreign currency

(i) Functional and presentation currencies

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

(ii) Transactions and balances

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

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

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

(iii) Consolidation

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

Goodwill and fair value adjustments arising on the acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and are translated at the closing rate with movements recorded through the Foreign Currency Translation Reserve in the statements of changes in equity.

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

Subsidiaries

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

NAME OF COMPANY	COUNTRY INCORPORATED IN	HOLDINGS		NATURE OF BUSINESS
		2018	2017	
Incorporated in New Zealand				
Tower Financial Services Group Limited	NZ	100%	100%	Holding company
Tower Insurance Limited	NZ	100%	100%	General insurance
Tower New Zealand Limited	NZ	100%	100%	Management services
Incorporated Overseas				
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
National Pacific Insurance Limited	Samoa	71%	71%	General insurance
Tower Insurance (Vanuatu) Limited	Vanuatu	100%	100%	General insurance

Notes to the Financial Statements

For the **year** ended 30 September 2018

A3 Critical Accounting Judgements and Estimates

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

Canterbury earthquake claims estimation

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

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

Refer to Note B3 for further detail on the Canterbury Earthquakes.

EQC recoveries

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

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

Tax provisions

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

Deferred taxation

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

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

Capitalised IT development costs

Capitalisation of IT development costs is an area of judgement and estimation. The application of NZ IAS 38 Intangible Assets includes accounting considerations required for capitalisation of IT projects. When applying NZ IAS 38, areas of judgement include consideration of impairment indicators, economic useful life, and previous Board impairment decisions.

Goodwill

Goodwill is an area of significant judgement and estimation. Areas of judgement and subjectivity exist in the assessment of cash generating units and assumptions underlying goodwill impairment testing. Refer to Note E2 for further details of key assumptions used.

A4 Segmental Reporting

	NEW ZEALAND GENERAL INSURANCE \$000	PACIFIC ISLANDS GENERAL INSURANCE \$000	OTHER (HOLDING COMPANIES & ELIMINATIONS) \$000	TOTAL \$000
Year Ended 30 September 2018				
Revenue				
Net operating revenue	235,335	43,174	3,213	281,722
Total revenue	235,335	43,174	3,213	281,722
Earnings before interest, tax, depreciation and amortisation				
Interest expense	–	–	(570)	(570)
Depreciation and amortisation	(1,027)	(482)	(5,186)	(6,695)
Profit (Loss) before income tax	(11,617)	3,482	114	(8,021)
Income tax credit (expense)	2,751	(2,016)	560	1,295
Profit (Loss) for the year	(8,866)	1,466	674	(6,726)
Total assets 30 September 2018				
	480,664	95,072	110,497	686,233
Total liabilities 30 September 2018				
	345,406	63,224	2,824	411,454
Acquisition of property, plant and equipment and intangibles				
	173	603	19,026	19,802

Year Ended 30 September 2017

Revenue				
Net operating revenue	222,117	44,816	665	267,598
Total revenue	222,117	44,816	665	267,598

Earnings before interest, tax, depreciation and amortisation	(15,648)	12,688	6,223	3,263
Interest expense	–	–	(835)	(835)
Depreciation and amortisation	(1,529)	(521)	(6,377)	(8,427)
Profit (Loss) before income tax	(17,177)	12,167	(989)	(5,999)
Income tax credit (expense)	2,470	(4,958)	487	(2,001)
Profit (Loss) for the year	(14,707)	7,209	(502)	(8,000)

Total assets 30 September 2017	501,299	88,091	75,270	664,660
Total liabilities 30 September 2017	355,369	59,910	33,637	448,916
Acquisition of property plant and equipment and intangibles	819	295	12,059	13,173

Accounting policy

An operating segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different to those of other operating segments. Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker who reviews the operating results on a regular basis and makes decisions on resource allocation and assessing performance.

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

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

Notes to the Financial Statements

For the **year** ended 30 September 2018

Part B – Revenue and Claims

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

Tower 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, with a liability for unearned premiums recognised on the balance sheet.

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

To manage Tower’s risk and optimise its returns, Tower 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

	2018 \$000	2017 \$000
Gross written premiums	336,109	312,396
Less: Gross unearned premiums	(13,016)	(6,317)
Premium revenue	323,093	306,079

Accounting policy

Premium revenue is recognised in the period in which the premiums are earned during the term of the contract. The proportion of premiums not earned in the income statement at reporting date is recognised in the balance sheet as unearned premiums. Premiums ceded to reinsurers under reinsurance contracts are recorded as outwards reinsurance expense and are recognised over the period of the reinsurance contract. Accordingly, a portion of outwards reinsurance premium is treated at balance date as a prepayment.

B2 Net Claims Expense

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

Accounting policy

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

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

The estimation of claims 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 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 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 expense are recognised as revenue. Recoveries are measured as the present value of expected future receipts.

B3 Canterbury Earthquakes

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

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

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

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

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

Canterbury earthquake provisions

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

Notes to the Financial Statements

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B3 Canterbury Earthquakes (continued)

EQC recovery receivables

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

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

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

Additional risk margin

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

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

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

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

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

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

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

Claims

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

Recoveries

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

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

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

DATE OF EVENT	CATASTROPHE REINSURANCE COVER REMAINING	
	2018 \$000	2017 \$000
June 2011	255,700	254,200
December 2011	486,900	486,500

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

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.

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For the **year** ended 30 September 2018

B3 Canterbury Earthquakes (continued)

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

		SPLIT BETWEEN EVENTS				FOUR MAIN EARTHQUAKES		
		CHANGE VARIABLE	SEP 2010 \$M	FEB 2011 \$M	JUN 2011 \$M	DEC 2011 \$M	30-SEP-18 \$M	30-SEP-17 \$M
Outstanding claims:								
(i)	Change to costs and quantity of expected claim estimates including building costs and other impacts.	+ 5%	(0.9)	(1.9)	–	–	(2.8)	(4.3)
		- 5%	0.9	1.9	–	–	2.8	4.3
(ii)	Change in apportionment of claim costs to / from February 2011 event.	+ 1%	6.4	(8.8)	–	–	(2.4)	(4.1)
		- 1%	(6.9)	8.8	–	–	1.9	2.0
Receivables:								
Reinsurance recovery receivables								
(iii)	Recoveries from EQC in respect of land damage	+ 10%	0.1	0.7	–	–	0.8	0.8
		- 10%	(0.1)	(0.7)	–	–	(0.8)	(0.8)
(iv)	Recoveries from EQC in respect of building costs	+ 10%	3.4	1.0	–	–	4.4	4.1
		- 10%	(3.4)	(1.0)	–	–	(4.4)	(4.1)

- (i) Calculated as the change in case estimates (net of EQC contributions) plus IBNR/IBNER and the impact on Tower's profit quantified. Changes in case estimates include over-cap claims, closed claims re-opening and risk margin.
- (ii) Calculated as 1% of total reported costs (net of EQC contributions) plus IBNR/IBNER moved to/from Feb 2011 event and the impact on Tower's profit quantified.

B4 Insurance Liabilities

	2018 \$000	2017 \$000
Unearned premiums	175,551	162,342
Outstanding claims	143,976	171,156
Additional risk margin	5,000	10,000
Total insurance liabilities	324,527	343,498
Analysed as		
Current	291,711	300,064
Non current	32,816	43,434
Total insurance liabilities	324,527	343,498
The table below includes the reconciliation of the unearned premiums as at the reporting date:		
Opening balance	162,342	157,620
Premiums written	336,109	296,855
Premiums earned	(323,093)	(291,472)
Foreign exchange movements	193	(661)
Closing balance	175,551	162,342

Accounting policy

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

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

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

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

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

B5 Other Insurance Disclosures

B5.1 Net claims expense

	2018			2017		
	RISKS BORNE IN CURRENT YEAR \$000	RISKS BORNE IN PRIOR YEARS \$000	TOTAL \$000	RISKS BORNE IN CURRENT YEAR \$000	RISKS BORNE IN PRIOR YEARS \$000	TOTAL \$000
Gross claims expense						
Direct claims – undiscounted	188,452	12,035	200,487	175,078	50,235	225,313
Movement in discount	(60)	40	(20)	43	28	71
Total gross claims expense	188,392	12,075	200,467	175,121	50,263	225,384
Reinsurance and other recoveries						
Reinsurance and other recoveries – undiscounted	(20,073)	(3,762)	(23,835)	(20,559)	(17,272)	(37,831)
Movement in discount	–	–	–	(1)	(1)	(2)
Total reinsurance recoveries	(20,073)	(3,762)	(23,835)	(20,560)	(17,273)	(37,833)
Net claims expense	168,319	8,313	176,632	154,561	32,990	187,551

Current year amounts relate to risks borne in the current financial year. Prior period amounts relate to a reassessment of the risks borne in all previous financial years including those arising due to the Canterbury earthquakes. Refer to Notes B2 and B3.

B5.2 Outstanding claims

(a) Assumptions adopted in calculation of insurance liabilities

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

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

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

Notes to the **Financial Statements**For the **year** ended 30 September 2018

B5 Other Insurance Disclosures (continued)

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

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

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

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

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

Inflation and discount rate

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

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

EQC recoveries

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

Apportionment

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

Claims handling expense

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

Risk margin

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

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

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

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

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

The following analysis is in respect of the insurance liabilities:

	2018 \$000	2017 \$000
Central estimate of expected present value of future payments for claims incurred	95,425	110,398
Risk margin	17,936	27,885
Claims handling costs	6,901	9,714
	120,262	147,997
Discount	(271)	(270)
Net outstanding claims	119,991	147,727

Reconciliation of movements in discounted outstanding claim liabilities

	2018			2017		
	GROSS \$000	REINSURANCE \$000	NET \$000	GROSS \$000	REINSURANCE \$000	NET \$000
Balance brought forward	181,156	(33,429)	147,727	210,202	(83,205)	126,997
Effect of change in foreign exchange rates	71	(99)	(28)	(553)	98	(455)
Incurred claims recognised in the income statement	200,467	(23,835)	176,632	225,384	(37,833)	187,551
Claims paid and reinsurance recoveries raised	(232,718)	28,378	(204,340)	(253,877)	87,511	(166,366)
Total outstanding claims	148,976	(28,985)	119,991	181,156	(33,429)	147,727

Reconciliation of movements in undiscounted claims to outstanding claim liabilities

	2018			2017		
	GROSS \$000	REINSURANCE \$000	NET \$000	GROSS \$000	REINSURANCE \$000	NET \$000
Outstanding claims undiscounted	3,461	(80)	3,381	1,968	(367)	1,601
Discount	–	–	–	60	–	60
Outstanding claims	3,461	(80)	3,381	2,028	(367)	1,661
Short tail outstanding claims			116,610			146,066
Total outstanding claims			119,991			147,727

(b) Sensitivity analysis

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

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

(c) Future net cash out flows

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

	2018 \$000	2017 \$000
Expected claim payments		
Within 3 months	50,771	45,205
3 to 6 months	25,762	28,699
6 to 12 months	17,955	38,456
After 12 months	25,503	35,367
Total outstanding claim liabilities	119,991	147,727

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B5 Other Insurance Disclosures (continued)

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:

ULTIMATE CLAIMS COST ESTIMATE	PRIOR \$000	2014 \$000	2015 \$000	2016 \$000	2017 \$000	2018 \$000	TOTAL \$000
At end of incident year		116,297	125,054	133,776	138,647	149,260	
One year later		114,810	126,231	132,388	141,378		
Two years later		117,108	126,067	134,640			
Three years later		117,629	127,552				
Four years later		116,131					
Current estimate of ultimate claims cost		116,131	127,552	134,640	141,378	149,260	
Cumulative payments		(115,833)	(127,092)	(131,941)	(136,344)	(109,517)	
Undiscounted central estimate	47,192	298	460	2,699	5,034	39,743	95,426
Discount to present value							(271)
Discounted central estimate							95,155
Claims handling expense							6,901
Risk margin							17,936
Net outstanding claim liabilities							119,991
Reinsurance recoveries on outstanding claim liabilities and other recoveries							28,985
Gross outstanding claim liabilities							148,976

B5.4 Liability adequacy test

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

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

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

B5.5 Insurer financial strength rating

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

B5.6 Reinsurance programme

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

B5.7 Assets backing insurance business

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

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

Part C – Financial Instruments and Liquidity

Funds provided by shareholders and collected as premiums are invested by Tower, providing a financial return and also ensuring that Tower's obligations to pay claims and expenses can be met.

This section provides information about Tower's financial instruments, including information about the cash and investments that Tower holds, its approach to managing risk for these financial instruments, and its cash flows.

C1 Investment Revenue

	2018 \$000	2017 \$000
Fixed interest securities		
Interest income	8,010	7,734
Net realised gain (loss)	146	(631)
Net unrealised gain (loss)	596	913
Total fixed interest securities	8,752	8,016
Equity securities		
Net unrealised gain (loss)	(745)	(3)
Total equity securities	(745)	(3)
Other		
Net realised gain (loss)	(751)	(1,297)
Net unrealised gain (loss)	(131)	927
Total other	(882)	(370)
Total investment revenue	8,010	7,734
Total net realised gain (loss)	(605)	(1,928)
Total net unrealised gain (loss)	(280)	1,837
Total investment revenue	7,125	7,643

Accounting policy

Investment revenue is recognised as follows:

(i) Interest income on fixed interest securities

Interest income is recognised using the effective interest method.

(ii) Fair value gains and losses

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

Notes to the Financial Statements

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C2 Cash and Cash Equivalents

	2018 \$000	2017 \$000
Cash at bank and in hand	45,986	21,981
Deposits at call	55,561	57,689
Restricted cash	454	4,206
Total cash and cash equivalents	102,001	83,876

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, and bank overdrafts.

The effective interest rate at 30 September 2018 for deposits at call is 2.25% (2017: 2.60%). There was no offsetting within cash and cash equivalents (2017: nil).

Restricted cash

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

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

C3 Investment Assets

	2018 \$000	2017 \$000
Fixed interest securities	197,367	185,256
Equity securities	599	1,412
Property securities	34	34
Total Investments	198,000	186,702

C4 Borrowings

	CURRENCY	INTEREST RATE	ROLLOVER DATE (DRAWN) / MATURITY DATE (UNDRAWN)	FACE VALUE \$000	UNAMORTISED COSTS \$000	CARRYING VALUE \$000	FAIR VALUE \$000
As at 30 September 2018							
Bank facilities (undrawn)	NZD	Variable	9-Sep-19	50,000	–	–	–
Total borrowings					–	–	–

As at 30 September 2017

Bank facilities (drawn)	NZD	4.505%	13-Nov-17	30,000	(79)	29,921	29,921
Bank facilities (undrawn)	NZD	Variable	9-Sep-19	20,000	–	–	–
Total borrowings					(79)	29,921	29,921

	2018 \$000	2017 \$000
Analysed as		
Current	–	29,921
Non current	–	–
Total borrowings	–	29,921

Accounting policy

Borrowings are recognised initially at fair value, net of transaction costs incurred. Subsequent to initial recognition, borrowings are measured at amortised cost with any difference between the initial recognised amount and the redemption value being recognised in the income statement over the period of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. The fee is capitalised as a pre-payment for liquidity services and amortised over the period of the facility to which it relates.

The following table represents the change in borrowings:

	2018 \$000	2017 \$000
Opening balance	30,000	–
Drawdown of credit facility	–	30,000
Repayment of credit facility	(30,000)	–
Closing balance	–	30,000

Standby credit facility

The Company entered into a cash advance facility with Bank of New Zealand on 7 September 2016. The facility provides for an amount of up to \$50.0 million that can be drawn for general corporate purposes over a three year term and is subject to normal terms and conditions for a facility of this nature, including financial covenants.

In May 2017, the Company utilised the cash advance facility agreement. An amount of \$30.0 million was drawn (from the available \$50.0 million). Funds were used for new share capital within Tower Insurance Limited.

In December 2017, the Company repaid the drawn cash advance facility using funds obtained from the capital raise.

All borrowings are unsecured and are subject to various financial covenants. The Company has fully complied with all covenants during the year ended 30 September 2018.

Notes to the Financial Statements

For the **year** ended 30 September 2018

C5 Financial Instruments

C5.1 Financial instrument categories

Accounting policy

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

(i) Loans and receivables

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

(ii) Financial liabilities at amortised cost

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

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

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

(iv) Offsetting financial instruments

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

(v) Derecognition

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

(i) Loans and receivables

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

(ii) Financial liabilities at amortised cost

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

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

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

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

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	
	TOTAL \$000	LOANS AND RECEIVABLES \$000	FINANCIAL LIABILITIES \$000	DESIGNATED \$000	HELD FOR TRADING \$000
As at 30 September 2018					
Assets					
Cash and cash equivalents	102,001	102,001	–	–	–
Trade and other receivables	255,779	255,779	–	–	–
Investments	198,000	–	–	198,000	–
Derivative financial assets	271	–	–	–	271
Total financial assets	556,051	357,780	–	198,000	271
Liabilities					
Trade and other payables	50,590	–	50,590	–	–
Total financial liabilities	50,590	–	50,590	–	–

	TOTAL \$000	AT AMORTISED COST		AT FAIR VALUE THROUGH PROFIT OR LOSS	
		LOANS AND RECEIVABLES \$000	FINANCIAL LIABILITIES \$000	DESIGNATED \$000	HELD FOR TRADING \$000
As at 30 September 2017					
Assets					
Cash and cash equivalents	83,876	83,876	–	–	–
Trade and other receivables	283,158	283,158	–	–	–
Investments	186,702	–	–	186,702	–
Derivative financial assets	231	–	–	–	231
Total financial assets	553,967	367,034	–	186,702	231
Liabilities					
Trade and other payables	43,514	–	43,514	–	–
Borrowings	29,921	–	29,921	–	–
Total financial liabilities	73,435	–	73,435	–	–

C5.2 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 and held for trading

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

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

- The fair value of fixed interest securities is based on the maturity profile and price/yield.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

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

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

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

(iv) Derivative financial liabilities and assets

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

Notes to the Financial Statements

For the **year** ended 30 September 2018

C5 Financial Instruments (continued)

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

	TOTAL \$'000	LEVEL 1 \$'000	LEVEL 2 \$'000	LEVEL 3 \$'000
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	271	–	271	–
Total financial assets	198,271	–	197,672	599
As at 30 September 2017				
Assets				
Investment in equity securities	1,412	–	–	1,412
Investments in fixed interest securities	185,256	–	185,256	–
Investments in property securities	34	–	34	–
Investments	186,702	–	185,290	1,412
Derivative financial assets	231	–	231	–
Total financial assets	186,933	–	185,521	1,412
Liabilities				
Borrowings	29,921	–	29,921	–
Total financial liabilities	29,921	–	29,921	–

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

	INVESTMENT IN EQUITY SECURITIES	
	2018 \$'000	2017 \$'000
Opening balance	1,412	1,406
Total gains and losses recognised in profit or loss	(745)	(3)
Foreign currency movement	(46)	9
Disposals	(22)	–
Closing balance	599	1,412

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

	CARRYING AMOUNT \$'000	FAVOURABLE CHANGES OF 10%	UNFAVOURABLE CHANGES OF 10%
As at 30 September 2018			
Investment in equity securities	599	60	(60)
As at 30 September 2017			
Investment in equity securities	1,412	141	(141)

C5.3 Impairment of financial assets

Accounting policy

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

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

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

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

A previously recognised impairment loss is reversed when, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss was initially recognised.

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

C6 Reconciliation of Loss for the Period to Net Cash Flows From Operating Activities

	2018 \$'000	2017 \$'000
Loss for the year	(6,726)	(8,000)
Adjusted for non-cash items		
Depreciation of property, plant and equipment	1,499	2,032
Amortisation of software	5,195	6,395
Impairment of reinsurance receivables	21,750	–
Unrealised (gain) loss on financial assets	280	(1,837)
Movement on disposal of property, plant and equipment	(50)	(42)
Change in deferred tax	(3,404)	(3,024)
	25,270	3,524
Adjusted for movements in working capital (excluding the effects of exchange differences on consolidation)		
Change in receivables	4,907	(7,653)
Change in payables	(13,279)	(21,537)
Change in taxation	(722)	116
	(9,094)	(29,074)
Adjusted for other items classified as investing / financing activities		
Facility fees and interest paid	734	778
	734	778
Net cash inflows (outflows) from operating activities	10,184	(32,772)

Notes to the Financial Statements

For the **year** ended 30 September 2018

Part D – Management Expenses and Taxation

To grow and operate its business, Tower incurs management expenses, including payments to employees, suppliers and commission payments to third parties.

This section includes information about Tower's management expenses and taxation.

D1 Management and Sales Expenses

	2018 \$000	2017 \$000
Employee benefits expense (1)	59,610	56,581
Net change in deferred acquisition costs	(1,634)	(988)
Bad debts written off	232	176
Change in provision for doubtful debts	(159)	(945)
Amortisation of software	5,195	6,395
Depreciation	1,499	2,032
Directors' fees	515	509
(Gain) on disposal of property, plant and equipment	(50)	(42)
Claims related management expenses reclassified to claims expense (2)	(23,151)	(28,979)
Auditors fees	603	576
Commission expense	19,488	18,927
Lease expenses	3,393	3,256
Other expenses	24,187	24,246
Total management and sales expenses	89,728	81,744

(1) Personnel costs are net of capitalised labour costs in relation to internally generated software assets.

(2) Claims handling expenses do not include costs in relation to Kaikoura earthquake or Canterbury earthquake related claims, as these are charged to provisions created in previous years.

D2 Impairment of Reinsurance Receivable

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

D3 Acquisition Proposal Expenses

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

D4 Deferred Acquisition Costs

	2018 \$000	2017 \$000
Balance at the beginning of year	20,961	19,973
Acquisition costs during the year	39,555	38,385
Current period amortisation	(37,921)	(37,397)
Total deferred acquisition costs	22,595	20,961
Analysed as:		
Current	22,595	20,961
Non-current	–	–
Total deferred acquisition costs	22,595	20,961

Accounting Policy

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

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

D5 Operating Leases

	2018 \$000	2017 \$000
As lessee		
Rent payable to the end of the lease terms are:		
Not later than one year	3,286	2,806
Later than one year and not later than five years	7,701	7,444
Later than five years	–	2,010
	10,987	12,260

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 four years with rental rates reviewed every one to three years.

Notes to the Financial Statements

For the **year** ended 30 September 2018

D6 Tax

Accounting Policy

Current tax

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

Deferred tax

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

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

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

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 consolidation

Tower Limited and its subsidiaries are part of a single consolidated group for New Zealand tax purposes, with the exception of Tower Insurance Limited.

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.

Imputation credit account

The balance of the imputation account at the end of the year is determined having adjusted for imputation credits that will arise from the payment of income tax provided; dividends recognised as a liability; and the receipt of dividends recognised as receivables at the reporting date.

D6.1 Tax expense

	2018 \$000	2017 \$000
Current tax	2,714	4,468
Deferred tax	(3,463)	(3,064)
Under (over) provided in prior years	(546)	597
Total tax (benefit) expense	(1,295)	2,001
The tax (benefit) expense can be reconciled to the accounting profit as follows:		
Loss before tax from continuing operations	(8,021)	(5,999)
Income tax at the current rate of 28%	(2,246)	(1,680)
Tax effect of:		
Prior period adjustments	(546)	597
Non-deductible expenditure/non-assessable income	120	967
Foreign tax credits written off	1,372	1,874
Other	5	243
Total tax (benefit) expense	(1,295)	2,001

D6.2 Current tax assets

	2018 \$000	2017 \$000
Current	1,575	1,206
Non-current	12,256	12,256
Total current tax assets	13,831	13,462

A non-current tax asset of \$12,256,000 is recognised in the financial statements of the Group as at 30 September 2018 in relation to excess tax payments made in previous years (2017: \$12,256,000). Non-current tax assets are expected to be recovered from 2022, as determined by the Board approved operational plan for financial years 2019 to 2022. A current tax asset of \$1,575,000 is recognised in relation to excess tax payments made in the Pacific Islands over and above the estimated tax liabilities for the year (2017: \$1,206,000).

D6.3 Current tax liabilities

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

D6.4 Imputation credits

The Group imputation credit account reflects the imputation credits held by the Company as the representative member of the Group.

	2018 \$000	2017 \$000
Imputation credits available for use in subsequent reporting periods	489	489

Notes to the **Financial Statements**For the **year** ended 30 September 2018

D6 Tax (continued)

D6.5 Deferred tax assets and liabilities

	OPENING BALANCE AT 1 OCTOBER \$000	(CHARGED) CREDITED TO INCOME STATEMENT \$000	(CHARGED) CREDITED TO COMPREHENSIVE INCOME \$000	CLOSING BALANCE AT 30 SEPTEMBER \$000
For the Year Ended 30 September 2018				
Movement in deferred tax assets				
Provisions and accruals	2,265	576	–	2,841
Property, plant and equipment	7,781	45	–	7,826
Tax losses	26,958	3,727	–	30,685
Other	778	(15)	–	763
Total deferred tax assets	37,782	4,333	–	42,115
Set-off of deferred tax liabilities pursuant to NZ IAS 12				(5,739)
Net deferred tax assets				36,376
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)
For the Year Ended 30 September 2017				
Movement in deferred tax assets				
Provisions and accruals	3,141	(876)	–	2,265
Property, plant and equipment	3,288	4,493	–	7,781
Tax losses	29,086	(2,128)	–	26,958
Other	–	778	–	778
Total deferred tax assets	35,515	2,267	–	37,782
Set-off of deferred tax liabilities pursuant to NZ IAS 12				(5,037)
Net deferred tax assets				32,745
Movement in deferred tax liabilities				
Deferred acquisition costs	(4,851)	(227)	–	(5,078)
Other	(1,294)	1,024	(29)	(299)
Total deferred tax liabilities	(6,145)	797	(29)	(5,377)
Set-off of deferred tax liabilities pursuant to NZ IAS 12				5,037
Net deferred tax liabilities				(340)

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

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

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

	2018 \$000	2017 \$000
Premium receivables	141,578	124,030
Reinsurance recovery receivables	32,600	81,647
Claim recoveries and unearned reinsurance premiums	11,616	10,783
Trade receivables	185,794	216,460
EQC receivables	69,272	66,437
Other	4,541	3,672
Total receivables	259,607	286,569

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

Accounting policy

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

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

	2018 \$000	2017 \$000
Opening balance	(805)	(1,750)
Provisions added during the year	(208)	(41)
Provisions released during the year	362	978
Foreign exchange movements	5	8
Closing balance	(646)	(805)

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

	2018 \$000	2017 \$000
Analysed as		
Current	185,133	199,960
Non current	74,474	87,005
Total receivables	259,607	286,569

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.

Notes to the Financial Statements

For the **year** ended 30 September 2018

E1 Receivables (continued)

[Earthquake Commission receivables](#)

[Kaikoura Region earthquake](#)

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

[Canterbury earthquakes](#)

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

E2 Intangible Assets

		SOFTWARE			
	GOODWILL	ACQUIRED	INTERNALLY DEVELOPED	UNDER DEVELOPMENT	TOTAL
Year Ended 30 September 2018					
Cost:					
Opening balance	17,744	5,097	37,045	4,484	64,370
Additions	-	-	-	19,026	19,026
Disposals	-	-	-	(74)	(74)
Transfers	-	285	600	(885)	-
Transfers to Property, plant and equipment	-	-	-	(49)	(49)
Closing balance	17,744	5,382	37,645	22,502	83,273
Accumulated amortisation:					
Opening balance	-	(4,501)	(28,535)	-	(33,036)
Amortisation charge	-	(197)	(4,998)	-	(5,195)
Closing balance	-	(4,698)	(33,533)	-	(38,231)
Net book value					
At cost	17,744	5,382	37,645	22,502	83,273
Accumulated amortisation	-	(4,698)	(33,533)	-	(38,231)
Closing net book value	17,744	684	4,112	22,502	45,042

Year Ended 30 September 2017

Cost:					
Opening balance	17,744	5,020	31,305	4,554	58,623
Additions	-	-	-	6,237	6,237
Disposals	-	(6)	-	(17)	(23)
Transfers	-	82	5,740	(5,822)	-
Transfers to Property, plant and equipment	-	-	-	(468)	(468)
Foreign exchange movements	-	1	-	-	1
Closing balance	17,744	5,097	37,045	4,484	64,370
Accumulated amortisation:					
Opening balance	-	(4,265)	(22,376)	-	(26,641)
Amortisation charge	-	(235)	(6,160)	-	(6,395)
Foreign exchange movements	-	(1)	1	-	-
Closing balance	-	(4,501)	(28,535)	-	(33,036)
Net book value					
At cost	17,744	5,097	37,045	4,484	64,370
Accumulated amortisation	-	(4,501)	(28,535)	-	(33,036)
Closing net book value	17,744	596	8,510	4,484	31,334

Software

Accounting policy

Application software is recorded at cost less accumulated amortisation and impairment. Amortisation is charged on a straight line basis over the estimated useful life of the software.

Internally generated intangible assets are recorded at cost which includes all the directly attributable costs necessary to create, produce and prepare the asset capable of operating in the manner intended by management. Amortisation of internally generated intangible assets begins when the asset is available for use and is amortised on a straight line basis over the estimated useful life.

General use computer software	3 – 5 years
Core operating system software	3 – 10 years

Impairment testing for software under development

Software under development includes expenditure relating to the development of a new core IT platform, digital enhancements, communications technology and work to extend the useful life of other IT assets. Software under development is subject to impairment testing and no impairment loss has been recognised in 2018 (2017: Nil). In assessing the recoverable amount for software under development, Management has based its assumptions on the five year projections covered by Tower's 2019-2023 operating plans, including an assessment of additional revenue and expense savings expected to be generated by each asset. These assumptions are determined from a variety of sources, including Management's past experience, comparison of key metrics to industry baselines, sensitivity of revenues to changes in drivers and analysis of current expenditure that can be reduced. Management has not put any value on projected cash flows beyond a five year period. A discount rate of 12% has been used in the valuation (2017: 12%).

Goodwill

Accounting policy

Goodwill acquired in a business combination is initially measured at cost being the excess of the cost of the business combination over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of the entity acquired, at the date of acquisition. Following initial recognition, goodwill on acquisition of a business combination is not amortised but is tested for impairment bi-annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash generating units, or groups of cash generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units.

Any impairment is recognised immediately in the income statement.

Impairment testing for goodwill

Goodwill is allocated to the New Zealand general insurance cash generating unit. The carrying amount of goodwill allocated to the cash generating unit is shown below:

	2018 \$000	2017 \$000
Carrying amount of goodwill	17,744	17,744

Goodwill is subject to impairment testing at the cash-generating unit level and no impairment loss has been recognised in 2018 as a result of the impairment review (2017: Nil). The recoverable amount of the general insurance business has been assessed with reference to its appraisal value to determine its value in use. A base discount rate of 13% was used in the calculation (2017: 14%). Other assumptions used are consistent with the actuarial assumptions in Note B5 in respect of Tower Insurance. The cash flows were projected over the expected life of the policies. The projected cash flows are determined based on past performance and management's expectations for market developments with a terminal growth rate of 2% (2017: 2%). Management considers that the recoverable amount from the general insurance business, as determined by the appraisal value, will exceed the carrying value under a reasonable range of adverse scenarios.

Notes to the Financial Statements

For the **year** ended 30 September 2018

E3 Property, Plant and Equipment

	LAND AND BUILDINGS \$'000	OFFICE EQUIPMENT AND FURNITURE \$'000	MOTOR VEHICLES \$'000	COMPUTER EQUIPMENT \$'000	TOTAL \$'000
For the Year Ended 30 September 2018					
Cost					
Opening balance	2,959	7,715	1,122	14,764	26,560
Additions	–	513	65	198	776
Revaluations	434	–	–	–	434
Disposals	–	(14)	(165)	(9)	(188)
Foreign exchange movements	22	7	(3)	17	43
Closing balance	3,415	8,221	1,019	14,970	27,625
Accumulated depreciation					
Opening balance	–	(2,880)	(837)	(14,063)	(17,780)
Depreciation	–	(958)	(38)	(503)	(1,499)
Disposals	–	15	176	2	193
Foreign exchange movements	–	35	(84)	20	(29)
Closing balance	–	(3,788)	(783)	(14,544)	(19,115)
Closing balance					
Cost / revaluation	3,415	8,221	1,019	14,970	27,625
Accumulated depreciation	–	(3,788)	(783)	(14,544)	(19,115)
Net book value	3,415	4,433	236	426	8,510
For the Year Ended 30 September 2017					
Cost					
Opening balance	2,710	7,481	1,277	14,038	25,506
Additions	–	291	69	754	1,114
Revaluations	247	–	–	–	247
Disposals	(27)	(74)	(231)	(19)	(351)
Foreign exchange movements	29	17	7	(9)	44
Closing balance	2,959	7,715	1,122	14,764	26,560
Accumulated depreciation					
Opening balance	–	(2,004)	(930)	(13,061)	(15,995)
Depreciation	–	(928)	(93)	(1,011)	(2,032)
Disposals	–	57	188	16	261
Foreign exchange movements	–	(5)	(2)	(7)	(14)
Closing balance	–	(2,880)	(837)	(14,063)	(17,780)
Closing balance					
Cost / revaluation	2,959	7,715	1,122	14,764	26,560
Accumulated depreciation	–	(2,880)	(837)	(14,063)	(17,780)
Net book value	2,959	4,835	285	701	8,780

Accounting policy

Measurement of property, plant and equipment

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

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

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

Measurement of land and buildings

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

Land and buildings are located in Fiji and are stated at fair value. Fair value is determined using an income approach whereby future rental streams are capitalised at a rate appropriate for the type of property and lease arrangement. This value is then adjusted to take into account recent market activity. Valuation was performed as at 14 September 2018 by Rolle Associates, registered valuers in Fiji. There has been no material movement in the valuation between 14 September 2018 and 30 September 2018. Inputs to the valuation of the Fiji property are considered to be based on non-observable market data, thus classified as level 3 in the fair value hierarchy. Inputs include gross rentals per square meter of similar property in the Suva area, recent comparable sales of commercial property in Suva and a capitalisation rate of between 7.5% and 9.5% (2017: 7.0%).

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

E4 Capital Commitments

As at the 30 September 2018, the Group has capital commitments of \$13.9 million dollars in relation to the implementation and delivery of a new insurance policy management system (2017: nil).

E5 Payables

	2018 \$'000	2017 \$'000
Trade payables	16,028	16,479
Reinsurance payables	23,388	21,763
Payable to other insurers	268	2,590
Investment settlement balances	5,099	–
GST payable	16,272	12,991
Other payables	19,320	15,001
Total payables	80,375	68,824
Analysed as:		
Current	63,975	51,124
Non current	16,400	17,700
Total payables	80,375	68,824

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

For the **year** ended 30 September 2018

Payable to other insurers

At 30 September 2018 there was \$0.3 million (2017: \$2.6 million) recorded within Payables as funds held on behalf of other insurers in respect of SPP claims. Refer to Note C2 for further details on cash held in respect of multi-unit claims as lead insurer.

E6 Provisions

	2018 \$000	2017 \$000
Employee benefits	5,789	5,773
Total provisions	5,789	5,773
Analysed as:		
Current	5,402	5,592
Non current	387	181
Total provisions	5,789	5,773

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.

Part F – Capital and Risk Management

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

F1 Contributed Equity

	2018 \$000	2017 \$000
Opening balance	382,172	382,172
Issue of share capital	70,838	–
Costs of capital raise	(5,467)	–
Total contributed equity	447,543	382,172

On 14 November 2017 the Company invited its eligible shareholders to subscribe to a rights issue of 1 new share for every 1 existing share held at the record date on 22 November 2017 at a price of NZD0.42 (or AUD0.39) for each new share. The issue was fully subscribed on 20 December 2017.

Represented by:	2018 NUMBER OF SHARES	2017 NUMBER OF SHARES
Opening balance	168,662,150	168,662,150
Issued shares	168,662,150	–
Total shares on issue	337,324,300	168,662,150

Ordinary shares issued by the Group are classified as equity and are recognised at fair value less direct issue costs. All shares rank equally with one vote attached to each share. There is no par value for each share.

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

F2 Reserves

	2018 \$000	2017 \$000
Foreign currency translation reserve (FCTR)		
Opening balance	(4,343)	(4,443)
Currency translation differences arising during the year	(54)	100
Closing balance	(4,397)	(4,343)
Separation Reserve		
Opening balance	(113,000)	(113,000)
Closing balance	(113,000)	(113,000)
Asset revaluation reserve		
Opening balance	889	671
Gain on revaluation, net of deferred tax	353	218
Closing balance	1,242	889
Total reserves	(116,155)	(116,454)

Accounting policy

FCTR

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

Separation reserve

The separation reserve was created in 2007 at the time of the demerger of the New Zealand and Australian businesses in accordance with a ruling provided by the Australian Tax Office (ATO). It will be carried forward indefinitely as a non-equity reserve to meet the requirements of the ATO.

Asset revaluation reserve

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

F3 Capital Risk Management & Solvency

Solvency requirements

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

	TOWER INSURANCE LIMITED		TOWER INSURANCE LIMITED GROUP	
	UNAUDITED 2018 \$000	UNAUDITED 2017 \$000	AUDITED 2018 \$000	AUDITED 2017 \$000
Actual solvency capital	136,476	149,317	156,765	166,823
Minimum solvency capital	58,298	61,387	74,344	70,545
Solvency margin	78,178	87,930	82,421	96,278
Solvency ratio	234%	243%	211%	236%

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

Notes to the Financial Statements

For the **year** ended 30 September 2018

F3 Capital Risk Management & Solvency (continued)

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.

	NOTE	2018 \$000	2017 \$000
Tower shareholder equity		273,311	214,419
Standby credit facility (undrawn)	C4	50,000	20,000
Total capital and liquidity resources		323,311	234,419

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

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

F4 Net Assets per Share

	2018 \$	2017 \$
Net assets per share	0.81	1.28
Net tangible assets per share	0.57	0.90

Accounting Policy

Net assets per share represent the value of the Group's total net assets divided by the number of ordinary shares on issue at the period end. Net tangible assets per share represent the net assets per share adjusted for the effect of intangible assets and deferred tax balances. Net assets per share and net tangible assets per share for 30 September 2017 have not been restated to reflect the bonus element of the rights issue.

Reconciliation to net tangible assets is provided below:

	2018 \$000	2017 \$000
Net assets	274,779	215,744
Less: deferred tax	(35,787)	(32,405)
Less: intangible assets	(45,042)	(31,334)
Net tangible assets	193,950	152,005

F5 Earnings per Share

	2018 \$000	2017 \$000
Loss attributable to shareholders	(6,773)	(8,461)
	2018 NUMBER OF SHARES	2017 NUMBER OF SHARES
Weighted average number of ordinary shares for basic and diluted earnings per share	308,077,348	205,532,480
	2018 CENTS	2017 CENTS
Basic and diluted (loss) earnings per share	(2.20)	(4.12)

Accounting Policy

Basic earnings per share is calculated by dividing the net profit attributed to shareholders of the Company, excluding any costs of servicing equity other than ordinary shares, by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share is calculated by dividing the net profit attributed to shareholders of the Company by the weighted average number of ordinary shares on issue during the year adjusted for the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

As a result of the rights issue, the weighted average number of ordinary shares have been adjusted retrospectively for the bonus element of the rights issue. The basic and diluted (loss) per share for 30 September 2017 has been restated to reflect the change.

There was no dilutive impact on basic earnings per share for 2018 (2017: nil).

F6 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.

Tower 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 Limited 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 Limited's investments;
- reviewing the appointment of external investment managers;
- monitoring investment and fund manager performance; and
- monitoring compliance with investment policies and client mandates.

Notes to the Financial Statements

For the **year** ended 30 September 2018

F6 Risk Management (continued)

F6.1 Insurance risk

The financial condition and operations of the insurance business are affected by a number of key risks including insurance risk, interest rate risk, currency risk, market risk, financial risk, compliance risk, fiscal risk and operational risk. Notes on the policies and procedures employed in managing these risks 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

F6.2 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.

The Group'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. The Group generally elects to not hedge the capital invested in overseas entities, thereby accepting the foreign currency translation risk on invested capital.

The Group 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.

F6.3 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 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. The Group has no significant exposure to credit risk.

(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 Limited 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	
	2018 \$'000	2017 \$'000
New Zealand government	919	8,184
Other government agencies	39,352	18,412
Banks	227,180	229,526
Financial institutions	32,186	13,241
Other non-investment related receivables	255,782	283,158
Total financial assets with credit exposure	555,419	552,521

(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	
	2018 \$'000	2017 \$'000
Cash and cash equivalents	102,001	83,876
Loans and receivables	255,780	283,158
Financial assets at fair value through profit or loss	197,367	185,256
Derivative financial assets	271	231
Total credit risk	555,419	552,521

(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	
	2018 \$'000	2017 \$'000
Credit exposure by credit rating		
AAA	85,321	67,201
AA	183,095	184,233
A	16,484	527
BBB	–	–
Below BBB	13,020	15,706
Total counterparties with external credit ratings	297,920	267,667
Group 1	245,702	230,795
Group 2	–	–
Group 3	1,717	1,696
Total counterparties with no external credit rating	247,419	232,491
Total financial assets neither past due nor impaired with credit exposure	545,339	500,158

Group 1 – trade debtors outstanding for less than 6 months

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

Group 3 – unrated investments

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

Notes to the Financial Statements

For the **year** ended 30 September 2018

F6 Risk Management (continued)

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

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

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

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

	LESS THAN 30 DAYS \$000	31 TO 60 DAYS \$000	61 TO 90 DAYS \$000	OVER 90 DAYS \$000	TOTAL \$000
As at 30 September 2018					
Reinsurance recoveries receivable	–	27	–	–	27
Outstanding premiums and trade receivables	5,526	1,422	2,641	464	10,053
Total	5,526	1,449	2,641	464	10,080
As at 30 September 2017					
Reinsurance recoveries receivable	3,735	2,680	1,999	35,491	43,905
Outstanding premiums and trade receivables	5,026	1,754	1,268	410	8,458
Total	8,761	4,434	3,267	35,901	52,363

(vi) Financial assets that are individually impaired

	CARRYING VALUE	
	2018 \$000	2017 \$000
Outstanding premiums and trade receivables	–	–
Total	–	–

F6.4 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.

	CARRYING VALUE \$000	TOTAL CONTRACTUAL CASH FLOWS \$000	LESS THAN ONE YEAR \$000	GREATER THAN ONE YEAR \$000
As at 30 September 2018				
Financial liabilities				
Trade payables	16,296	16,296	16,296	–
Reinsurance payables	23,388	23,388	6,988	16,400
Other payables	10,906	10,906	10,906	–
Total	50,590	50,590	34,190	16,400
As at 30 September 2017				
Financial liabilities				
Trade payables	19,069	19,069	19,069	–
Reinsurance payables	21,763	21,763	4,063	17,700
Other payables	2,682	2,682	2,682	–
Borrowings	29,921	29,921	29,921	–
Total	73,435	73,435	55,735	17,700

F6.5 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, foreign exchange forward contracts and foreign exchange options. 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, fair values and remaining terms of derivatives outstanding as at the reporting date:

	AVERAGE CONTRACTED FIXED INTEREST		NOTIONAL PRINCIPAL AMOUNT		FAIR VALUE	
	2018 %	2017 %	2018 \$000	2017 \$000	2018 \$000	2017 \$000
Less than 1 year	0%	0%	23,555	25,249	271	166
1 to 2 years	0%	0%	–	–	–	–
2 to 5 years	0%	2%	–	20,580	–	65
Over 5 years	0%	0%	–	–	–	–
			23,555	45,829	271	231

F6.6 Sensitivity analysis

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

(i) Interest rate

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

	2018 IMPACT ON:		2017 IMPACT ON:	
	PROFIT AFTER TAX \$000	EQUITY \$000	PROFIT AFTER TAX \$000	EQUITY \$000
Change in variables				
+ 50 basis points	(696)	(696)	(546)	(546)
- 50 basis points	768	768	474	474

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

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

(ii) Foreign currency

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

	2018 IMPACT ON:		2017 IMPACT ON:	
	PROFIT AFTER TAX \$000	EQUITY \$000	PROFIT AFTER TAX \$000	EQUITY \$000
Change in variables				
10% appreciation of New Zealand dollar	129	(2,641)	292	(2,380)
10% depreciation of New Zealand dollar	(158)	2,905	(357)	2,909

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

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

Notes to the Financial Statements

For the **year** ended 30 September 2018

F6 Risk Management (continued)

(iii) **Other price**

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

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

	2018 IMPACT ON:		2017 IMPACT ON:	
	PROFIT AFTER TAX \$000	EQUITY \$000	PROFIT AFTER TAX \$000	EQUITY \$000
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.

Part G – Other Disclosures

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

G1 Auditors' Remuneration

	2018 \$000	2017 \$000
Fees paid to Group's auditors:		
Audit of financial statements ⁽¹⁾	554	495
Other assurance related services ⁽²⁾	30	30
Non-assurance advisory related services ⁽³⁾	5	6
Total fees paid to Group's auditors	589	531
Fees paid to subsidiaries' auditors different to Group auditors:		
Audit of financial statements ⁽¹⁾	14	45
Total fees paid to auditors	603	576

- (1) Audit of financial statements includes fees for both the audit of annual financial statements and the review of interim financial statements. In 2018 the Group's auditors were further engaged to perform the audit of National Pacific Insurance Limited (2017: BDO). The audit of Tower Insurance (Vanuatu) Limited was performed by Law Partners (2017: Law Partners).
- (2) Other assurance related services includes annual solvency return assurance and Pacific Island regulatory return audits.
- (3) Non-assurance advisory related services related to Annual Shareholders' Meeting procedures.

G2 Transactions With Related Parties

The remuneration of key management personnel during the year was as follows:

	2018 \$000	2017 \$000
Salaries and other short term employee benefits paid	3,981	4,244
Independent director fees	515	509
	4,496	4,753

Accounting policy

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

Tower considers key management personnel to consist of the Board of Directors, Chief Executive Officer and executive leadership team. Information regarding individual director and executive compensation is provided in the Corporate Governance section of the annual report.

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

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

G3 Contingent Liabilities

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

The Group has no other contingent liabilities.

G4 Subsequent Events

There were no subsequent events after balance date.

G5 Change in Comparatives

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

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

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

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

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

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

Balance Sheet – Gross up of reinsurance receivables and reinsurance payables

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

Changes for internal consistency have also been made to Note A4 Segment reporting, B4 Other insurance business disclosures, C5 Financial instruments, E1 Receivables, E5 Payables, and F6 Risk management.

Balance Sheet – Gross up of other trade receivables and unearned premium liabilities

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

Changes for internal consistency have also been made to Note A4 Segment reporting, B4 Insurance liabilities, C5 Financial instruments, E1 Receivables, and F6 Risk management.

Balance Sheet – Reclassification between cash and cash equivalents and investments

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

Changes for internal consistency have also been made to the cash flow statement, Note C2 Cash and cash equivalents, Note C3 Investments, Note C5 Financial Instruments, and F6 Risk management.

Note Disclosure – Reclassification of management expenses

Within Note D1 management and sales expenses, there has been a reclassification between employee benefits expense and claims related to management expenses reclassified to claims expense. In 2017, internal assessor personnel costs had been netted off against personnel costs. To achieve consistent presentation with 2018, the employee benefits expense has increased by \$3.0 million to \$56.6 million and the claims related management expenses reclassified to claims expense has decreased by \$3.0 million to \$29.0 million.

Notes to the Financial Statements

For the year ended 30 September 2018

G5 Change in Comparatives (continued)

[Note Disclosure – Change in presentation of deferred acquisition costs](#)

Within Note D4 deferred acquisition costs the movements ("acquisition costs during the year" and "current period amortisation") have been changed to reflect the gross movement during the year. The 2017 balance for acquisition costs during the year has increased from \$21.0 million to \$38.4 million. The 2017 balance for current period amortisation has decreased from \$20.0 million to \$37.4 million. The overall movement has not changed.

[Note Disclosure – Change in presentation of claims handling expense and central estimate of expected present value of future payments for claims incurred](#)

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

G6 Impact of Amendments to NZ IFRS

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

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

- NZ IFRS 9 Financial instruments is effective for periods beginning on or after 1 January 2018. Tower will apply the standard for the year ending 30 September 2019. The standard replaces the existing accounting standards that relate to the classification and measurement of financial instruments. Tower's investments are currently designated as at fair value through profit or loss on initial recognition and are subsequently re-measured to fair value at each reporting date, and Tower does not designate any financial instruments in hedging relationships. Consequently, NZ IFRS 9 is not expected to have a material impact on Tower's financial statements.
- NZ IFRS 15 Revenue from Contracts with Customers is effective for periods beginning on or after 1 January 2018. Tower will apply the standard for the year ending 30 September 2019. The standard will provide a single source of requirements for accounting for all contracts with customers and will replace all current accounting pronouncements on revenue. New revenue disclosures are also introduced. NZ IFRS 15 does not apply to insurance contracts and financial instruments and consequently, as the majority of Tower's revenue comes from such items, is not expected to have a material impact on Tower's financial statements.
- NZ IFRS 16 Leases is effective for periods beginning on or after 1 January 2019. Tower will apply the standard for the year ending 30 September 2020. The standard replaces the current guidance in NZ IAS 17 Leases. Under NZ IAS 17, a lessee was required to make a distinction between a finance lease, which is recognised on balance sheet, and an operating lease, which is not recognised on the balance sheet. NZ IFRS 16 now requires a lessee to recognise a lease liability reflecting future lease payments and a right-of-use asset for most lease contracts. Following adoption of NZ IFRS 17, the treatment of leases for Tower's office buildings, motor vehicles, and other equipment will change. The expected impact of the changes on Tower's financial statements is an increase to assets of approximately \$11.0 m, an increase to liabilities of approximately \$9.1 m and a decrease to retained earnings of approximately \$1.9 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 2018.
- NZ IFRS 17 Insurance Contracts is effective for periods beginning on or after 1 January 2021. Tower will apply the standard for the year ending 30 September 2022. The standard replaces the current guidance in NZ IFRS 4, and establishes the principles for recognition, measurement, presentation and disclosure of insurance contracts. Tower has commenced work to assess the impact of adopting NZ IFRS 17. Due to the complexity of the requirements within the standard the final impact may not be determined until global interpretations and regulatory responses to the new standard are developed.



Corporate Governance
at Tower Limited (Tower)



This section of the Annual Report provides an overview of the corporate governance principles, policies and processes adopted and followed by Tower's Board.

The Board is committed to achieving the highest standards of corporate governance, ethical behaviour, and accountability, and has implemented corporate governance practices that are consistent with best practice. Where developments arise in corporate governance, the Board reviews Tower's practices and incorporates changes where appropriate.

Governance Framework

Tower Limited is a company incorporated in New Zealand under the Companies Act 1993 (NZ) ('Companies Act'), whose fully paid ordinary shares ('Shares') are listed on the NZX Main Board and Australian stock exchange ('NZX' and 'ASX'). As an ASX Foreign Exempt Listing, Tower is primarily regulated by the listing rules of its home exchange (being the NZX Main Board (NZX)) and is exempt from complying with most of ASX's Listing Rules.

Compliance

In addition to compliance with the NZX listing rules, Tower's corporate governance framework also requires compliance with the NZX Corporate Governance Code (NZX Code) and the Financial Markets Authority's 'Corporate Governance in New Zealand: Principles and Guidelines' handbook (FMA Handbook).

Tower Insurance Limited, a subsidiary of Tower Limited, is licensed to undertake general insurance business in New Zealand under the Insurance (Prudential Supervision) Act 2010 (IPSA). Tower Insurance Limited must comply with the requirements of IPSA, and is regulated by the Reserve Bank of New Zealand.

For the reporting period to 30 September 2018, the Board considers that Tower's corporate governance practices have materially adhered to the NZX Code and the FMA Handbook, other than as outlined in this corporate governance section.

In May 2017, NZX published a new Corporate Governance Code (new Code), which replaced the existing NZX Code from 31 December 2017.

Tower fully supports the new Code and is undertaking a review of its governance practices to ensure alignment with the new Code. From 2017, Tower amended the structure of its Corporate Governance section to better align with the new Code, and the content of reporting will comply with the new Code upon release of the FY19 annual report.

This statement is current as at 14 November 2018 and has been approved by Tower's Board.

More information

Tower's principal governance policies and practices can be found on Tower's website at <https://www.tower.co.nz/investor-centre/corporate-governance>.

Ethical behaviour

Code of Ethics

Tower is committed to acting responsibly and ethically, and meeting its legal and other obligations to shareholders, customers, employees and the wider community. Maintaining Tower's reputation for honesty and fairness is crucial to its success as a financial services business. To help achieve these goals, Tower has a Code of Ethics which sets out minimum standards of ethical behaviour. The Code of Ethics applies to Tower's directors, executives, employees and contractors.

The Code of Ethics is available to Tower's people on its staff intranet and website, and training is provided on the Code through the orientation process. The behavioural expectations set out in the Code of Ethics include:

- Acting honestly, with personal integrity, and in the best interests of Tower, its shareholders and stakeholders
- Avoiding situations in which personal interests interfere or appear to interfere with the interests of Tower, and advising of any such conflicts
- Proper receipt and use of Tower's corporate information, assets and property
- Taking appropriate action when giving and receiving gifts
- Adhering to whistleblowing procedures

The Code of Ethics requires any person who becomes aware of a breach or suspected breach of the Code to report it immediately to the Head of Risk and Controls or the People and Culture Team. Failure to comply with the Code of Ethics may lead to disciplinary action and, in serious cases, dismissal. All persons who disclose a breach will be protected in accordance with Tower's Whistleblower Policy.

Insider Trading and Market Manipulation Policy

Tower has an Insider Trading and Market Manipulation Policy which governs dealing in financial products. The policy applies to directors, employees, consultants and contractors and helps provide transparency around Tower's requirements in relation to financial dealing, in particular protecting Tower's people from the risk of breaching Insider Trading laws. The policy prohibits these people from trading and dealing in

Tower shares while they are in possession of information that has not been released to the public and that is likely to have a material effect on the price of Tower securities. The policy also requires directors and designated employees to obtain prior consent to trade, and specifies blackout periods where all trading is prohibited.

The policy is available on Tower's staff intranet and website, and is circulated to all staff at the beginning of each blackout period.

Board composition and performance

Board charter

Tower's Board operates in accordance with a written charter which sets out the roles and responsibilities of the Board.

It provides that the primary role of the Board is to effectively represent and promote the interests of shareholders with a view to enhancing growth and returns across Tower and its subsidiaries, adding long-term value to Tower shares. The Board, when fulfilling its roles and responsibilities, is required to have appropriate regard to Tower's values, the concerns of its shareholders, policy holders, its relationships with significant stakeholders and the communities and environment in which it operates.

The Board reserves certain functions to itself. These include:

- approving and overseeing the implementation of the company's strategic objectives, annual operating plans, financial targets and capital expenditure plans
- ongoing assessment and monitoring of performance, including management's performance against the strategic objectives, operating plans and financial targets
- approving all changes to the company's corporate structure, including tax and financial, where these are of strategic importance
- determining company financial and treasury strategies and policies, including approving all dividend policies and distributions to shareholders, lending and borrowing, charging of assets, tax, and investment and foreign exchange policies in respect of shareholders' funds
- approving capital expenditure, operating expenditure, asset acquisitions and divestments, and settlement of legal proceedings, in all cases where this is outside the normal course of business and/or above delegated limits
- approving all transactions relating to major business and company acquisitions, mergers and divestments

The Charter provides that the day-to-day leadership and management of the company is undertaken by the Chief Executive Officer and 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 across the company. Senior management has no power to do anything which the Chief Executive Officer cannot do pursuant to his delegations. Within this formal delegation framework those executives who report directly to the Chief Executive Officer have authority to sub-delegate certain authorities to their direct reports.

The Board meets regularly with management to provide strategic guidance for Tower and effective oversight of management.

Nomination and Appointment of Directors to the Board

Tower's procedure for the nomination and appointment of directors to the Board is set out in Tower's Remuneration and Appointments Committee Terms of Reference. The Remuneration and Appointments Committee will identify and recommend to the Board suitable candidates for appointment as directors. The Committee will consider, among other matters, a candidate's:

- experience as a director
- skills, expertise and competencies (the Board aims to have a mix of skilled directors with particular competencies in the insurance and financial services sector)
- the extent to which those skills complement the skills of existing directors
- the candidate's ability to devote sufficient time to the directorship, and
- the candidate's reputation and integrity.

To ensure that the Board appoints directors and officers who have appropriate skills, knowledge, experience and integrity to perform their duties and to fulfil their roles, Tower has developed a Fit and Proper Policy benchmarked to the requirements of the Insurance (Prudential Supervision) Act 2010 and the Fit and Proper Standard for Licensed Insurers, along with the Fit and Proper Policy Guidelines for Licensed Insurers issued by the Reserve Bank of New Zealand. All newly appointed directors and relevant officers are subject to Fit and Proper assessments prior to appointment. The Fit and Proper assessment considers a candidate's character, experience, education, criminal record, and credit history.

In the case of a candidate standing for election as a director for the first time, Tower will provide information to shareholders about the candidate to enable them to make an informed decision on whether or not to elect the candidate, including:

- Material adverse information revealed by any Fit and Proper checks
- Details of any interest, position, association or relationship that might influence, or reasonably be perceived to influence in a material respect the candidate's capacity to exercise judgement on board matters or to act in the best interests of Tower and its shareholders
- The Board's view on whether the candidate will be considered to be an independent director; and
- A recommendation by the Board in respect of the candidate's election.

Written agreements with directors

All Tower directors have entered into written agreements establishing the terms of their appointment. These written agreements include information relating to:

- Tower's expectations of the director in his or her role
- The director's expected time commitment to Tower (including other duties)
- Remuneration entitlements (including any superannuation included); and
- Indemnity and insurance arrangements.

Director profiles and independence

Profiles of Tower's directors are available at pages 24 and 25 of this report. Directors' independence is assessed in accordance with the requirements for independence set out in Tower's Board and Director Protocols. Those independence requirements are benchmarked against the Reserve Bank of New Zealand and NZX independence requirements.

At 30 September 2018, the Board comprised of five non-executive directors, all of whom are independent. Tower's constitution currently requires a minimum of five directors and provides for a maximum of eight.

Diversity policy

Tower has a written diversity policy which embodies Tower's commitment to pursuing an inclusive and flexible workplace. The Board is responsible for overseeing the implementation of Tower's Diversity Policy. The Remuneration and Appointments Committee are delegated responsibility to annually review and report on policy effectiveness and diversity within Tower.

Tower's business operations are spread across 11 sites in 9 different countries and Tower recognises the value of its diverse employee population as an essential driver of performance culture, brand and shareholder returns. An inclusive environment improves the quality of decision making, incentivises productivity, and creates innovation through collaboration. Tower's Board is committed to further developing an inclusive culture that encourages Tower's people to perform to their highest potential.

During FY18, Tower celebrated the diversity of its people through a number of initiatives, including International Women's Day, Pride March, Women in Leadership Lean In Circles, Diwali, Harmony Day, Matariki, Eid Mubarak, Te Wiki O Te Reo Maori and Tongan Language Week.

Tower is also committed to attracting and retaining quality, passionate people who are dedicated to helping transform Tower's business. Throughout FY18, Tower's Executive Leadership Team, Senior Leadership Team and People Leaders continued participation in a leadership development programme focussed on developing key leadership skills and enhancing engagement.

While the Board considers that Tower has addressed the requirements of its Diversity Policy, the Policy does not currently require the Board to set measurable objectives for achieving diversity. Tower's diversity programme remains under review and will be finalised in FY19.

The table below shows gender representation across Tower as at 30 September 2018.

GROUP	2017-2018		2016-2017	
	% BY GROUP	NUMBER	% BY GROUP	NUMBER
Board of Directors				
Male	80%	4	100%	5
Female	20%	1	0%	0
Executive leadership team ¹				
Male	75%	6	63%	5
Female	25%	2	37%	3
Senior leadership team ²				
Male	58%	21	66%	21
Female	42%	15	34%	11
Employees				
Male	41%	241	42%	256
Female	59%	349	58%	352
Total company ³				
Male	42%	268	44%	283
Female	58%	366	56%	304

- 1 'Executive Leadership Team' includes the Chief Executive Officer, and those employees who report directly to the Chief Executive Officer.
- 2 'Senior Leadership Team' is the second level of employees below the Chief Executive Officer, who report directly to the Executive Leadership Team.
3. 'Total Company' figures do not include the Board of Directors. Both the 2016-2017 and 2017-2018 figures include Tower's Pacific Island subsidiaries.

Director training

Directors are expected to develop their skills, competencies and industry knowledge by taking responsibility for their continuing education. To ensure ongoing education, directors are regularly informed of developments that affect Tower's industry and business environment, as well as company and legal issues that impact the directors themselves. Directors receive comprehensive board papers and briefing information before Board meetings, including reports from the Chief Executive Officer and senior management.

Directors have unrestricted access to management and any additional information they consider necessary for informed decision making. Senior management also attend Board meetings in order to provide presentations to the Board and answer any queries directors may have.

Director, Board and Committee performance

The Board recognises that the performance of its directors and Board Committees is crucial to Tower's success and to the interests of its shareholders. The Board regularly reviews its own composition and performance and that of the Board Committees in accordance with the terms of the Board Charter.

Independence of Chair and CEO

Tower's Chair is responsible for leading the board, facilitating the effective contribution of all directors and promoting constructive and respectful relations between the board and management. The Chair of the Board is elected by the directors.

The Board supports the separation of the roles of Chair and Chief Executive Officer, and these roles are separate at Tower. Michael Stiassny was appointed Chair of Tower on 21 March 2013 and is independent.

Board committees

The Board currently has two standing committees: the Audit and Risk Committee and the Remuneration and Appointments Committee. Other committees are established from time to time to examine specific issues as required by the Board.

The Committees are governed by written terms of reference, which detail their specific functions and responsibilities. The terms of reference for each Committee are reviewed periodically.

The Committees make recommendations to the Board. They have no decision making ability except where expressly provided by the Board. The Board is required to annually confirm the membership and Chair of each of the Committees. The experience and skills of individual Committee members are set out in the directors' profiles on pages 24 and 25. Member attendance at each Committee meeting is set out on page 85.

Audit and Risk Committee

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

- The written Terms of Reference of the Audit and Risk Committee include the following duties and responsibilities:
- Ensure processes are in place so that the Board is regularly informed about significant financial matters relating to Tower
 - Review Tower's draft half yearly and annual financial statements and reports
 - Obtain reports from management, external audit, legal counsel or internal audit on any regulatory, accounting or financial reporting issues of significance.
 - Review adequacy of accounting policies and actuarial methodologies
 - Recommend the appointment and removal of, and oversee the performance of, the external auditor and be satisfied as to the auditor's independence
 - Review the effectiveness and efficiency of management processes, risk management and internal financial controls and control systems
 - Monitor and review compliance with regulatory and statutory requirements and obligations
 - Monitor the internal audit function and receive regular reports from the internal auditors on risks, exposures and compliance; and
 - Maintain unrestricted and direct lines of communication with the external and internal auditors

The Committee meets with the external auditors at least twice per year and has regular contact with the internal audit function.

The Terms of Reference require that the Committee has a minimum of three non-executive directors, the majority of whom are independent. At least one must have a financial or accounting background. The Board appoints the Chair of the Committee, who cannot also be Chair of the Board, and who is an independent director.

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

Employee attendance at Committee meetings

Tower's employees may attend Audit and Risk Committee meetings only at the invitation of Chair of the Committee.

Remuneration and Appointments Committee

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

- The Remuneration and Appointments Committee advises the Board in respect of a number of matters, including:
- performance management and appraisals for individual Directors' performance and any training requirements
 - performance evaluations of the Board Committees and the Board as a whole
 - review of Directorships in terms of ongoing compliance with relevant NZX Listing Rule and NZX Corporate Governance Code requirements
 - the Board's composition, structure and succession planning; and
 - the Chief Executive Officer and senior executive appointments, termination, performance appraisal and remuneration.

The written Terms of Reference for the Remuneration and Appointments Committee require that the Committee comprises suitably qualified non-executive directors, the majority of whom are independent. The Board appoints the Chair of the Committee, who will be an independent, non-executive director.

Following each meeting the Chair of the Committee provides a report to the Board. The Chair is also required to provide an annual report summarising Committee activities, findings, recommendations and results for the past year.

Management may attend Remuneration and Appointments Committee meetings only at the invitation of Chair of the Committee.

The Company's remuneration policies for directors and senior executives are set out on page 86 and 87.

Nominations Committee

Tower's Remuneration and Appointments Committee carries out the functions of a nominations committee. The Committee's authority, duties, responsibilities and relationship with the Board are set out in the Remuneration and Appointments Committee's Terms of Reference. Tower's Board considers that due to its size and the nature of Tower's business, it is appropriate for its remuneration and nomination committees to be combined.

Other Committees

Tower's Board has the ability to establish additional subcommittees from time to time. During FY17, the Board established a Due Diligence Committee to consider the merits of undertaking a Capital Raise and to ensure the Capital Raise adhered to appropriate laws and regulations.

Acquisition proposals

Tower was not subject to any acquisition proposals in FY18.

Board and Committee meeting attendance

- The following numbers of Board and Committee meetings were held during the year from 1 October 2017 to 30 September 2018:
- Board meetings – 15
 - Audit and Risk Committee meetings – 6
 - Remuneration and Appointments Committee – 3
 - Capital Raise Due Diligence Committee – 3

The Chief Executive Officer and Chief Financial Officer attend all Board and Committee meetings. The Chief Executive Officer, Chief Financial Officer and Chief Risk Officer attend all Audit and Risk Committee meetings. All meetings are attended by an appropriately qualified person who is responsible for taking accurate minutes of each meeting and ensuring that Board procedures are observed.

Director attendance at these meetings is set out below.

2017/2018 Tower Limited directors' attendance record

	TOWER LIMITED BOARD	AUDIT AND RISK COMMITTEE	REMUNERATION AND APPOINTMENTS COMMITTEE	CAPITAL RAISE DUE DILIGENCE COMMITTEE
Meetings held (to 30 September 2018)	15	6	3	3
Michael Stiassny	15	6	3	3
Steve Smith	14	5	3	3*
Graham Stuart	14	4	2	3
Warren Lee	13	6	3	3
David Hancock**	2	1	1	1*
Wendy Thorpe**	9	3	2	N/A

*Attended as an observer.

** David Hancock resigned as director from 1 March 2018, having signalled his intention to retire on 31 August 2017, and was not eligible to attend meetings after the 1 March 2018 date.

***Wendy Thorpe was appointed on 1 March 2018. She attended one meeting of the Audit and Risk Committee meeting and one meeting of the Remuneration and Appointments Committee as a guest, pending Board approval of her membership to the respective committees.

Reporting and disclosure

Continuous disclosure policy

- Tower recognises that public confidence in the integrity of Tower is based on continuous, full and open disclosure of information about its activities to the market and relevant stakeholders. Tower's Corporate Disclosure Policy provides for a planned, proactive communication programme with shareholders and the wider investment community to encourage their participation and interaction with Tower. Tower believes this communication programme assists in creating a fully informed market and enhances shareholder value. The Policy explains the respective roles of directors, officers and employees in relation to:
- Complying with Tower's continuous disclosure obligations
 - Safeguarding the confidentiality of corporate information to avoid premature disclosure
 - External communications, including analyst briefings
 - Responding to or avoiding the emergence of a false market

The policy provides that only authorised spokespersons can communicate on behalf of Tower with the investment community, shareholders and the media.

Announcements

- Tower makes the following regular announcements to the market and shareholders:
- Annual results are announced in November
 - Annual reports are released in December
 - Tower's Notice of Annual Shareholders' Meeting is generally sent to shareholders in December or January
 - Tower's Annual Shareholders' Meeting is generally held in February or March
 - Half year results are announced in May
 - Half year reports are released in June.

Key governance documents

Tower's website provides information to shareholders and investors about Tower. The website includes copies of past annual reports, results announcements, media releases (including NZX and ASX announcements) and general Tower information.

The following key governance documents are also available on Tower's Investor Centre website, <https://www.tower.co.nz/investor-centre/corporate-governance/policies>.

- Tower Limited constitution
- Board Charter
- Board Protocols
- Audit and Risk Committee Terms of Reference
- Remuneration and Appointments Committee Terms of Reference
- Insider Trading and Market Manipulation Policy
- Corporate Disclosure Policy
- External Audit Independence Policy
- Director and Executive Remuneration Policy
- Code of Ethics
- Diversity Policy
- Health and Safety Policy

Financial reporting

The Financial information contained in this annual report has been audited by Tower's external auditors, PwC, and complies with relevant financial reporting requirements under the Companies Act 1993, Financial Markets Conduct Act 2013, and the NZX Listing Rules.

Tower has a structure to independently verify and safeguard the integrity of its 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. These certifications include a representation letter from the CEO and CFO provided to the Board prior to the Board's approval of Tower's financial statements, which states that, to the best of the CEO and CFO's knowledge and belief, Tower's financial records have been properly maintained, that Tower's accounting policies and financial statements comply with the appropriate accounting standards, and that the financial statements fairly represent the financial position of Tower as at the balance date. This letter is provided on the basis that Tower has maintained an internal control structure which is sufficient to produce reliable accounting records.

Non-financial reporting

Tower recognises the importance of environmental, social and governance (ESG) practices for the long-term sustainability of its business. While Tower has not chosen to report against a formal ESG reporting framework, a number of initiatives have been undertaken in FY18 to promote sustainable processes and minimise waste.

Tower is passionate about setting things right for our customers and their communities. All of Tower's people have the ability to take one volunteer day per year to give back to the community. Tower teams have volunteered their time and resources to clearing scrub and planting trees in Auckland, holding a family day at a home for orphaned children in Fiji, and donating water tanks for fresh, clean water to schools in the Solomon Islands.

Tower intends to develop an ESG framework in FY19, and continues to work on improving recording and reporting of sustainability measures.

Remuneration

Director remuneration

The Board's approach is to remunerate directors at a similar level to comparable Australasian companies, with a small premium to reflect the complexity of the insurance and financial services sector. At the Annual Shareholders' Meeting in February 2004 shareholders approved an increase in non-executive director annual remuneration to the current maximum of NZ\$900,000 per annum.

Tower seeks external advice when reviewing Board remuneration. The Remuneration and Appointments Committee is responsible for reviewing directors' fees. Non-executive directors are also paid additional annual fees for sitting on certain Board Committees.

BOARD/COMMITTEE	CHAIR	MEMBER
Base fee – Board of directors	\$130,000	\$78,570
Audit and Risk Committee	\$15,000	\$9,000
Remuneration and Appointments Committee ¹	-	-

1 The Board determined that from 1 December 2012 no fees would be payable for sitting on the Remuneration and Appointments Committee

Additional fees may be paid to non-executive directors for one-off tasks and/or additional appointments where required.

2017/2018 directors' remuneration and benefits of Tower and its subsidiaries

Amounts in the table below reflect fees paid and accrued for the year ended 30 September 2018.

Fees include base fees and additional fees in the financial year for one-off tasks and additional appointments.

DIRECTORS' REMUNERATION AND BENEFITS OF TOWER LIMITED	
FOR THE YEAR TO 30 SEPTEMBER 2018	FEES (NZ\$)
Michael Stiasny	139,000
Graham Stuart	93,570
Steve Smith	87,570
Warren Lee	87,570
Wendy Thorpe	51,083
David Hancock	36,488

DIRECTORS' REMUNERATION AND BENEFITS OF TOWER LIMITED SUBSIDIARIES	
FOR THE YEAR TO 30 SEPTEMBER 2018	FEES
Alden Godinet ¹	\$7,250
Rodney Reid ¹	\$7,250
Isikeli Tikoduadua ²	\$18,000

1. Fees earned in capacity as director of National Pacific Insurance Limited. NPI fees are paid in Western Samoan Tala.
2. Fees earned in capacity as director of Tower Insurance (Fiji) Limited. Tower Insurance (Fiji) Limited fees are paid in Fijian Dollars.

Remuneration policy

Tower aims to attract and retain talented and motivated directors and employees by offering remuneration that is competitive, equitable and related to the achievement of individual, team and business unit objectives. Tower rewards high performing staff for providing superior performance.

Tower's Remuneration Policy will be updated in FY19, in accordance with the new Code and as appropriate for Tower's business.

CEO and senior executive remuneration

The Board's approach to remunerating the Chief Executive Officer and other key executives is to provide market based remuneration packages comprising a blend of fixed and incentive based remuneration with clear links between individual and company performance, and reward. Remuneration packages currently comprise a mixture of fixed and performance-based remuneration in the form of short and long term incentives. The Remuneration and Appointments Committee reviews the remuneration packages of the Chief Executive Officer and other senior executives at least annually. This approach is intended to encourage Tower's executives to meet Tower's short and long term objectives.

Employee remuneration

Set out in the following table are the number of employees or former employees of Tower, not being directors or former directors, who received remuneration and other benefits valued at or exceeding \$100,000 for the year ended 30 September 2017. Remuneration includes redundancy payments and termination payments made during the year to employees whose remuneration would not otherwise have been included in the table. The remuneration bands are expressed in New Zealand Dollars.

FROM	TO	2017-2018	2016-2017
100,000	109,999	21	13
110,000	119,999	11	19
120,000	129,999	15	13
130,000	139,999	9	10
140,000	149,999	9	9
150,000	159,999	9	6
160,000	169,999	0	6
170,000	179,999	4	3
180,000	189,999	1	4
190,000	199,999	3	1
200,000	209,999	2	3
210,000	219,999	3	2
220,000	229,999	5	2
230,000	239,999	5	1
240,000	249,999	1	2
250,000	259,999	0	5
260,000	269,999	0	1
270,000	279,999	2	2
280,000	289,999	0	0
290,000	299,999	1	0
300,000	309,999	2	1
310,000	319,999	1	2
320,000	329,999	1	2
330,000	339,999	0	0
340,000	349,999	0	0
350,000	359,999	1	1
360,000	369,999	0	1
370,000	379,999	1	0
380,000	389,999	1	1
390,000	399,999	0	0
400,000	409,999	0	0
430,000	499,999	3	1
500,000	599,999	2	0
700,000	759,999	0	0
760000+		1	1
		114	112

The table includes base salaries, short-term incentives (if applicable) and vested or exercised long-term incentives. If the individual is a KiwiSaver member the table does not include contributions of 3% of gross earnings towards that individual's KiwiSaver scheme.

| Risk management

Risk Management Framework

Tower has established a framework to identify, assess, monitor and manage exposure to risk. The Framework applies to Tower and all of its subsidiaries and related companies, and all staff and contractors employed by Tower and any of its subsidiaries. At the forefront of this are the internal audit and compliance processes, and the risk management process for each operating company. Tower faces a range of risks that are inherent to the business activities undertaken. Executive and senior management and staff must be able to demonstrate that reasonable steps have been taken to effectively manage Tower's risks.

Tower maintains a risk register which records the likelihood and impact of relevant risks on Tower's business. Tower's Risk and Compliance team actively monitors the risk register, identifies key risks and notes steps taken to mitigate the risks. A Risk and Compliance report is provided to each Audit and Risk Committee meeting so that the Committee is aware of relevant risks and how they are being managed.

The Audit and Risk Committee regularly reviews its risk management procedures and framework to ensure that it complies with its legal obligations. Tower's Board has adopted a Risk Appetite Statement, which articulates the amount and type of risk that Tower is willing to take in order to meet its strategic objectives and provides direction to management on how to manage risks.

The Audit and Risk Committee is responsible for reviewing whether Tower has any material exposure to any economic, environmental and social sustainability risks, and if so, to develop strategies to manage such risks, and present such strategies to the Board. For the reporting period to 30 September 2018, no material exposure to these risks was identified.

Health and Safety risks

Health, safety and wellbeing of Tower's people is a key Board priority. Tower employs a Health and Safety consultant to assist with the implementation and socialisation of policies and processes relating to health and safety. In addition, Tower has designated health and safety representatives at each of its sites in New Zealand and the Pacific. All of Tower's people are required to complete a health and safety e-learning module when they begin with Tower, and extensive information about health, safety and wellbeing is available on Tower's staff intranet. Additional health and safety training is undertaken by all Tower people in the field, including site assessors. Tower has robust health and safety standards in place for contractors and third party providers.

Tower employees, in New Zealand and across the Pacific, have participated in a wide array of health, safety and wellbeing activities that include operational health and safety meetings, training, process reviews, wellness events, audits and site visits. Tower's Board receives regular Health and Safety reports which are considered and discussed at Board meetings.

| Auditors

External audit framework

The Tower Board is fully committed to ensuring the quality and independence of the external audit process. As part of this process Tower encourages full and frank disclosure and discussions between the Board, Tower's internal auditors, management and the external auditor, PricewaterhouseCoopers (PwC).

PwC was re-appointed as auditor by shareholders at the Annual Shareholders' Meeting in March 2018 to audit the financial statements for Tower and its subsidiaries.

A formal engagement letter with PwC sets out the respective obligations and responsibilities of PwC and Tower in relation to the preparation and audit of financial statements.

The Board also has a formal External Audit Independence Policy that covers the provision of non-audit services by the external auditor.

The Policy describes the Board's approach to the approval of Tower's external audit firm; what services the external auditor may and may not provide to Tower; auditor rotation; and hiring of staff from the audit firm. The Board reviews external auditor quality and effectiveness by reference to obligations described in the Policy. Tenure and reappointment of the external auditor is managed through compliance with relevant legislation and NZX and FMA guidance.

The Board mitigates any threats to auditor independence by prohibiting Tower's external audit firm from providing any non-audit services. Allowable services are limited to statutory financial statement audit engagements and directly related assurance engagements (including assurance opinions on solvency returns; regulatory return audits; and opinions required by legislation such as shareholder meeting votes

or proxy counts). Should a situation arise which may require Tower's external audit firm to provide services beyond these, any such engagement must first be pre-approved by Tower's Audit and Risk Committee.

Under the Policy, PwC is required to provide the Audit and Risk Committee with an annual certification of its continued independence, and in particular confirm that it has not carried out any engagements during the year which would impair its professional independence. Non-audit services provided by PwC to Tower and its subsidiaries during the financial year did not, in Tower's opinion, affect auditor objectivity and independence.

The Policy is overseen by the Audit and Risk Committee. The external auditor generally attends all Audit and Risk Committee meetings.

Details of PwC fees for audit and other services provided to Tower are set out in the Tower Limited financial statements.

Attendance at annual meeting

Tower's Annual Shareholders' meeting is an opportunity for shareholders to receive updates from the Chief Executive Officer and Chair on Tower's performance, ask questions of the Board and vote on the various resolutions affecting Tower's business. Shareholders are also given an opportunity at the Annual Shareholders' Meetings to ask questions of Tower's auditors regarding the conduct of the audit and preparation and content of the auditor's report.

Internal audit functions

Tower has an Internal Audit Function. The structure of that function, and the roles it performs, are set out in Tower's Internal Audit Policy.

The purpose of the internal audit function is to provide independent and objective assurance of the adequacy and effectiveness of the controls set up by management. It helps the organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. The scope of work of the internal audit function includes determining whether the organisation's network of risk management, compliance, control and governance processes, as designed and represented by management, is adequate. The internal audit function will complete reviews identified and agreed in the annual Internal Audit Plan.

The internal audit function is managed within the Risk and Controls function under the Chief Risk Officer and receives strategic support from the Audit and Risk Committee. The internal audit function has direct access to the Chief Executive Officer and the Chair of the Committee whenever required.

Tower regularly evaluates the effectiveness of its risk management framework, including the internal audit function, to ensure that its internal control systems and processes are monitored and updated on an on-going basis.

| Shareholder rights and relations

Investor Centre website

Tower's website, www.tower.co.nz, provides information to shareholders and investors about Tower. The website includes copies of past annual reports, results announcements, media releases (including NZX and ASX announcements) and general Tower information.

Investor Communication

Tower encourages shareholders to receive communications from, and send communications to, Tower and the share registry electronically, for reasons of speed, convenience, cost and environmental considerations. Tower shareholders can receive company information electronically by registering their email addresses online with Tower's share registry www.investorcentre.com/nz.

Tower shareholders can also contact Tower at investor.relations@tower.co.nz

Shareholder voting

Tower confirms its compliance with Listing Rule specifications in respect of obtaining shareholder approval. Where appropriate, Tower will conduct voting by polls at shareholder meetings.

Annual shareholder meeting

Tower is aware of the new Code requirements to provide notice of annual shareholder meetings 28 days prior to the meeting. Tower's next shareholder meeting will be held in February 2018 and a notice of meeting will be provided to shareholders in due course.

Statutory disclosures

Some information in this section is provided as at 14 November 2018, being not less than 2 months before the date of publication of this report.

Substantial product holders (as at 14 November 2018)

The names and holdings of Tower’s substantial product holders based on notices filed with Tower under the Financial Markets Conduct Act 2013 as at 14 November 2018 were:

NAME	TOTAL ORDINARY SHARES ¹
Bain Capital Credit LP	67,464,858
Salt Funds Management Limited	41,634,524
Accident Compensation Corporation	28,785,340

1. Total ordinary shares held by the substantial product holder is the number of shares disclosed in the latest Substantial Product Holder notice filed with Tower, which may differ from the stated holdings below

Principal shareholders (as at 14 November 2018)

The names and holdings of the 20 largest registered Tower shareholders as at 14 November 2018 were:

NAME	TOTAL ORDINARY SHARES	%
Dent Issuer Designated Activity Company	67,464,808	19.99
Accident Compensation Corporation	31,054,313	9.2
HSBC Nominees (New Zealand) Limited	28,635,612	8.48
Citibank Nominees (New Zealand) Limited	21,712,084	6.43
National Nominees New Zealand Limited	16,073,949	4.76
HSBC Nominees (New Zealand) Limited A/C State Street	13,003,606	3.85
BNP Paribas Nominees (Nz) Limited	12,733,575	3.77
JBWere (NZ) Nominees Limited <NZ Resident A/C>	11,843,574	3.51
JP Morgan Chase Bank NZ Branch - Segregated Clients Acct	10,537,096	3.12
FNZ Custodians Limited	8,563,608	2.53
Citicorp Nominees Pty Limited	4,318,156	1.28
FNZ Custodians Limited <DTA Non Resident A/C>	3,018,982	0.89
Philip George Lennon	3,000,000	0.88
National Nominees Limited	2,080,574	0.61
One Managed Inv't Funds Ltd <1 A/C>	2,000,000	0.59
UBS Nominees Pty Ltd	1,514,143	0.44
JBWere (NZ) Nominees Limited <53329 A/C>	1,458,376	0.43
Ronald James Woodrow	1,159,727	0.34
Leveraged Equities Finance Limited	1,020,000	0.3
UBS Nominees Pty Limited	1,008,115	0.29

Directors' shareholdings

At 30 September 2018, Tower Limited directors held the following interests in Tower Limited shares:

ORDINARY SHARES	
DIRECTOR	BENEFICIAL
Michael Stiasny	395,464
Graham Stuart	100,000
Steve Smith	18,460
Wendy Thorpe	5,000
Warren Lee	36,400

Directors' trading in Tower securities

No directors disclosed acquisitions or disposals of relevant interests in Tower securities during the financial year pursuant to section 148 of the Companies Act 1993.

DIRECTOR	DATE OF DISCLOSURE	INTEREST	NUMBER ACQUIRED (DISPOSED)	CONSIDERATION ¹
Wendy Thorpe	1 Mar 2018	Beneficial	5,000	Acquired pre-directorship
Michael Stiasny	14 Dec 2017	Beneficial	230,000	\$152,439.22
	22 Dec 2017	Beneficial	82,732	\$34,747.44
Graham Stuart	12 Dec 2017	Beneficial	87,692	\$54,629.58
	14 Dec 2017	Beneficial	6,154	\$2,584.68
Steve Smith	22 Dec 2017	Beneficial	9,230	\$3,876.60
Warren Lee	8 Dec 2017	Beneficial	32,400	\$19,764 (AUD)
	22 Dec 2017	Beneficial	2,000	\$780.00

1. Consideration is in New Zealand dollars, unless otherwise specified.

Shareholder analysis

Tower’s shares are quoted on both the NZSX and ASX. As at 14 November 2018, 16,115 Tower shareholders held less than A\$500 of Tower shares (i.e. less than a marketable parcel as defined in the ASX Listing Rules), holding a total of 5,783,418 Tower shares.

Total voting securities

In December 2017, Tower raised additional capital through a pro rata renounceable entitlement offer. As at 14 November 2018, Tower had 337,324,300 ordinary shares held by 26,066 holders. By comparison, on 14 November 2017, Tower had 168,662,150 ordinary shares held by 26,901 holders. Tower’s ordinary shares each carry a right to vote on any resolution on a poll at a meeting of shareholders. Holders of ordinary shares may vote at a meeting in person, or by proxy, representative or attorney.

The address and telephone number of each office at which a register of Tower securities is kept is set out in the directory at the back of this Annual Report.

Tower Limited Shareholder Statistics (as at 14 November 2018)

HOLDING RANGE	HOLDER COUNT	HOLDER COUNT %	HOLDING QUANTITY (ORDINARY SHARES)	HOLDING QUANTITY %
1 to 1,000	18524	71.07	7808354	2.31
1,001 to 5,000	5235	20.08	10867347	3.22
5,001 to 10,000	905	3.47	6591531	1.95
10,001 to 100,000	1249	4.79	36861960	10.93
100,001 and over	153	0.59	275195108	81.58
Total	26066	100	337324300	100

Credit rating

Global rating organisation A.M. Best Company issued the following ratings of companies:

Tower Insurance Limited
Financial Strength Rating A- (Excellent)
Issuer Credit Rating a-
Effective 9 March 2018

Tower Limited
Issuer Credit Rating bbb- (Good)
Effective 9 March 2018

Waivers

There were no applications to NZX or ASX for any waivers in the financial year ending 30 September 2018.

Interests register

Tower and its subsidiaries are required to maintain an interests register in which the particulars of certain transactions and matters involving the directors must be recorded. The interests register for Tower Limited is available for inspection on request by shareholders. Tower’s constitution provides that an ‘interested’ director may not vote on a matter in which he or she is interested unless the director is required to sign a certificate in relation to that vote pursuant to the Companies Act 1993, or the matter relates to a grant of an indemnity pursuant to section 162 of the Companies Act 1993.

General disclosures of interest

During the financial year, Tower’s directors disclosed interests, or a cessation of interests (indicated by an asterisk (*)), in the following entities pursuant to section 140 of the Companies Act 1993. No disclosures were made by directors of any other Tower subsidiary.

Any cessation of interest that occurred after 30 September 2018 is indicated by two asterisks (**). Any disclosure of new interests that occurred after 30 September 2018 is indicated by three asterisks (***).

Warren Lee	
MyState Limited and subsidiary companies	Director
Tasmanian Perpetual Trustees Limited	Director
Go Hold Limited***	Director
Go Blank Limited***	Director
David Hancock ¹	
Afterpay Pty Limited	Director
Finarch Pty Limited	Director
Finclear Pty Limited	Director
Freedom Insurance Pty Limited	Chair
ELMO Talent Management Software Pty Limited	Director
Fix X Pty Limited	Chair
Steve Smith	
Kinrich Trust	Trustee
Kinrich Holdings Limited	Director
Summerlee Investments Limited	Director
Unison Securities Limited	Director
Unison Capital Advisors Limited	Director
Pascaro Investments Limited	Chair
Trebol Investments Limited and subsidiary companies	Director
Rimu SA (Chile) and subsidiary companies	Director
The National Foundation for the Deaf Incorporated	Board Member
Good Soundz Limited	Board Member
Michael Stiasny	
Atapo Corporation Limited	Director
Bengadol Corporation Limited	Director
Frequency Media Group Limited	Director
Emerald Group Limited	Director
Gadol Corporation Limited	Director
Geffen Holdings Limited	Director
Glenogle Trust Limited	Director
Knotser Properties Limited	Director
Michael Spencer Limited	Director
Ngati Whatua Orakei Housing Trustee Limited	Director
Ngati Whatua Orakei Whai Rawa Limited	Chair
Plan B Limited	Director
Poukawa Estate Limited	Director
Queenstown Airport Corporation Limited	Director
Sasha Properties Limited	Director
SB Entertainment Holdings and subsidiary companies	Director
Ted Kingsway Limited	Director
WEST24 Limited	Director
Whai Rawa GP Limited	Director
Whai Rawa Kainga Development Limited	Director
LPF Group	Director
New Zealand Transport Agency	Chair

Graham Stuart	
Leroy Holdings Limited	Director
EROAD Limited	Chair
VinPro Limited	Director
NorthWest Healthcare Properties Management Limited**	Director
Wendy Thorpe ²	
AMP Bank Limited	Director
Online Education Services Pty Ltd	Chair
Very Special Kids	Director
Epworth Foundation***	Director

1. David Hancock resigned as director on 1 March 2018.
2. Wendy Thorpe was appointed as director on 1 March 2018.

Specific disclosures of interest

During the financial year, no subsidiary of Tower entered into any transaction in which directors were interested. Accordingly, no disclosures of interest were made.

Donations

During the financial year ended 30 September 2018, Tower Limited and its subsidiaries did not make any donations

Tower subsidiary company director disclosures

The following persons held office as directors of subsidiary companies at 30 September 2018. Those who were appointed during the financial year are footnoted.

TOWER SUBSIDIARY COMPANY DIRECTOR DISCLOSURES	
Tower Insurance Limited	Warren Lee, Steve Smith, Michael Stiasny, Graham Stuart, Wendy Thorpe ¹
Tower Financial Services Group Limited	Warren Lee, Steve Smith, Michael Stiasny, Graham Stuart, Wendy Thorpe ¹
The National Insurance Company of New Zealand Limited	Richard Harding, David Callanan
Tower New Zealand Limited	Richard Harding, David Callanan
National Insurance Company (Holdings) Limited	Richard Harding, Sarah-Jane Wild, Christopher Sutherland, Isikeli Tikoduadua, Jeffrey Wright ² , Michelle James ²
Southern Pacific Insurance Company (Fiji) Limited	Richard Harding, Sarah-Jane Wild, Christopher Sutherland, Jeffrey Wright ² , Michelle James ²
Tower Insurance (Fiji) Limited	Richard Harding, Sarah-Jane Wild, Christopher Sutherland, Isikeli Tikoduadua, Jeffrey Wright ² , Michelle James ²
Tower Insurance (Cook Islands) Limited	Richard Harding, Christopher Sutherland, Jeffrey Wright ² , Michelle James ²
Tower Insurance (PNG) Limited	Richard Harding, Christopher Sutherland, Stefan Hansen, Jeffrey Wright ² , Michelle James ²
National Pacific Insurance Limited	Alden Godinet, Richard Harding, Rodney Reid, Christopher Sutherland, Jeffrey Wright ² , Michelle James ²
National Pacific Insurance (Tonga) Limited	Alden Godinet, Richard Harding, Rodney Reid, Christopher Sutherland, Jeffrey Wright ² , Michelle James ²

Tower Insurance (Vanuatu) Limited	Richard Harding, Christopher Sutherland, Jeffrey Wright ² , Michelle James ²
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1. Wendy Thorpe was appointed as a director on 1 March 2018.
2. Jeffrey Wright and Michelle James were appointed as directors on 26 February 2018.

No employee appointed as a director of a subsidiary receives any remuneration in their role as a director. The number of employees who receive remuneration of more than \$100,000 is included in the remuneration table on page 87. Auditor fees paid on behalf of Tower and its subsidiaries are disclosed in the financial statements.

Other matters

Indemnity and insurance

In accordance with section 162 of the Companies Act 1993 and Tower's constitution, Tower has provided insurance for and indemnities to, directors and employees of Tower for losses from actions undertaken in the course of their duties. The insurance includes indemnity costs and expenses incurred to defend an action that falls outside the scope of the indemnity. Particulars have been entered in the Interests Register pursuant to section 162 of the Companies Act 1993. .

Limits on acquisition of securities under New Zealand law

Tower undertook to the ASX, at the time it granted Tower a full listing (July 2002), to include the following information in its annual report. Except for the limitations detailed below, Tower securities are freely transferable under New Zealand law.

The New Zealand Takeovers' Code imposes a general rule by which an acquisition of more than 20% of the voting rights in Tower or an increase of an existing holding to 20% or more can only occur in certain permitted ways. These include a full or partial takeover offer in accordance with the Takeovers Code, an acquisition or an allotment approved by an ordinary resolution of shareholders, a creeping acquisition (in defined circumstances) and a compulsory acquisition once a shareholder owns or controls 90% or more of the voting rights in Tower.

The New Zealand Overseas Investment Act and related regulations determine certain investments in New Zealand by overseas persons. Generally the Overseas Investment Office's consent is required if an 'overseas person' acquires Tower shares or an interest in Tower shares of 25% or more of the shares on issue or, if the overseas person already holds 25% or more, the acquisition increases that holding.

The New Zealand Commerce Act is likely to prevent a person from acquiring Tower shares if the acquisition would, or would be likely to, substantially lessen competition in a market.

Corporations Act 2001 (Australia)

Tower is not subject to Chapters 6, 6A, 6B or 6C of the Corporations Act 2001 (Australia) dealing with the acquisition of shares (such as substantial holdings and takeovers).

The Annual Report is signed on behalf of the Board by

Michael Stiasny
Chair

Graham Stuart
Director



Notes

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Tower Directory

Enquiries

For customer enquiries, call
Tower on 0800 808 808 or visit
www.tower.co.nz

For investor enquiries:
Telephone: +64 9 369 2000
Email: investor.relations@tower.co.nz
Website: www.tower.co.nz

Board of Directors

Michael Stiasny (Chair)
Warren Lee
Steve Smith
Graham Stuart
Wendy Thorpe

Chief Executive Officer

Richard Harding

Company Secretary

David Callanan

Executive Leadership Team

Richard Harding
Tony Antonucci
David Callanan
Michelle James
Chris Sutherland
Glenys Talivai
Jeff Wright
Michelle McBride
Peter Muggleston

Registered Office

New Zealand

Level 14
Tower Centre
45 Queen Street
PO Box 90347
Auckland

Telephone: +64 9 369 2000
Facsimile: +64 9 369 2245

Australia

C/ – PricewaterhouseCoopers
Nominees (N.S.W) Pty Ltd
PricewaterhouseCoopers
Darling Park Tower 2
Level 1
201 Sussex Street
Sydney NSW 2000
Australia

Auditor

PricewaterhouseCoopers

Banker

Westpac New Zealand Limited

Company numbers

Tower Limited
(Incorporated in New Zealand)
NZ Incorporation 979635
NZBN 9429 0374 84576
ARBN 088 481 234

Stock exchanges

The Company's ordinary shares are listed on the NZSX and the ASX. On Wednesday 18 May 2016, Tower's ASX admission category changed to "ASX Foreign Exempt Listing".

Registrar

New Zealand

Computershare Investor Services Limited
Level 2, 159 Hurstmere Road,
Takapuna, Auckland
Private Bag 92119
Auckland 1142

Freephone within New Zealand: 0800 222 065
Telephone New Zealand: +64 9 488 8777
Facsimile New Zealand: +64 9 488 8787

Australia

Computershare Investor Services Pty Limited
Yarra Falls, 452 Johnston Street
Abbotsford VIC 3067
GPO Box 3329
Melbourne Vic 3000

Freephone within Australia: 1800 501 366
Telephone Australia: +61 3 9415 4083
Facsimile Australia: +61 3 9473 2500
Email: enquiry@computershare.co.nz
Website: www.computershare.com/nz

You can also manage your holdings electronically by using Computershare's secure website www.investorcentre.com/nz

This website enables holders to view balances, change addresses, view payment and tax information and update payment instructions and report options.

Tower recommends shareholders elect to have any payments direct credited to their nominated bank account in New Zealand or Australia to minimise the risk of fraud and misplacement of cheques.

We also encourage shareholders to receive investor communications electronically as it keeps costs down, delivery of our communications to you is faster and it is better for the environment. All you need to do is log in to www.investorcentre.com/nz and update your 'Communication Preference' to enable us to send all your investor correspondence electronically where possible.

Please quote your CSN number or shareholder number when contacting Computershare.



Tower Limited Investor Relations

Telephone: +64 9 369 2000

Email: investor.relations@tower.co.nz

Website: www.tower.co.nz

Registrar

Computershare Investor Services Limited

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Telephone New Zealand: +64 9 488 8777

Freephone within Australia: 1800 501 366

Telephone Australia: +61 3 9415 4083

Email: enquiry@computershare.co.nz

Website: www.investorcentre.com/nz