SOUTHERN RESPONSE

Urupare ki te Tonga

Southern Response Earthquake Services Ltd

Interim Report for the period to 31 December 2012 Te Pūroko Taupua

Southern Response's Purpose:

To manage covered claims, to manage the company's recoveries from reinsurers, to manage its investment portfolio and to conduct any activities that are associated with those purposes.

Contents

Opposite image: BeckerFraserPhotos
This interim report was produced and printed in Christchurch.

Chairman and Chief Executive's Report

Background

This report covers the six month period to 31 December 2012.

Southern Response is the government-owned company responsible for managing and settling claims by AMI policyholders for Canterbury earthquake damage which occurred before 5 April 2012 (the date AMI was sold to IAG Holdings Limited). Southern Response also has responsibility for recovering reinsurance proceeds and managing the remaining investments of the company.

Achievements by 31 December 2012

Payment of Claims

In the period from 5 April to 31 December 2012, the company has settled claims for $256,010,000 in response to claims covering houses, cars, contents, out of scope claims such as fences, driveways and pools, temporary accommodation, and loss of rent.

Over Cap Claims

(Where Southern Response has responsibility for managing and settling house claims in excess of EQC limits).

Southern Response has completed 6,630 (or 99%) assessments for AMI policyholders' damaged or destroyed homes.

- 90% of over cap customers have received a settlement offer
- 71% have made a settlement election decision based on their offer (the objective is to have 90% of these over cap customers with settlement decisions based on their offer by 30 June 2013)
- 22% have bought another house or are doing a self-managed rebuild
- 34% are building with Southern Response
- 11% are in design, construction, or completed.

All over cap assessments for new claims are being processed within two weeks.

Out of Scope Claims

(Claims not covered under the Earthquake Commission Act, typically fences, driveways and pools).

Assessments have been done for 25% of out of scope claims and 20% of repairs are complete. A cash settlement regime has been initiated to satisfy customers whose needs are not addressed by the repair programme and timing.

Reinsurance

The company is effectively managing the reinsurance recovery process. It addressed and implemented recommendations from external reviews by reinsurers who together make up 21% of the company's reinsurance programme.

Dispute Resolution

As expected, and as with other insurers, there has been an increase in the level of disputes. Three per cent of the level of settled claims are in dispute, but this level is expected to increase.

The company's approach is to settle customers' claims in accordance with the company's obligations under their AMI policy in force at the time of the claim, in a fair and consistent manner.

Reporting

Key progress statistics are updated each month on the company's website.

During December 2012:

- The first annual report of the company was tabled in Parliament
- The company conducted its first annual public meeting
- The company held its annual general meeting of shareholders.

Company Structure and Resourcing

The focus of the company's operations is progressively shifting from the insurance phase (completing comprehensive house assessments and insurance policy settlements) to the building phase (repairing or rebuilding the homes of customers who have chosen this settlement option).

Southern Response is well equipped to move into the build phase and expects to repair or rebuild around 3,600 homes between now and the middle of 2016, based on the number of people who have elected to build with Southern Response to date. The company structure and resourcing has, and will continue to evolve, to reflect this emphasis.

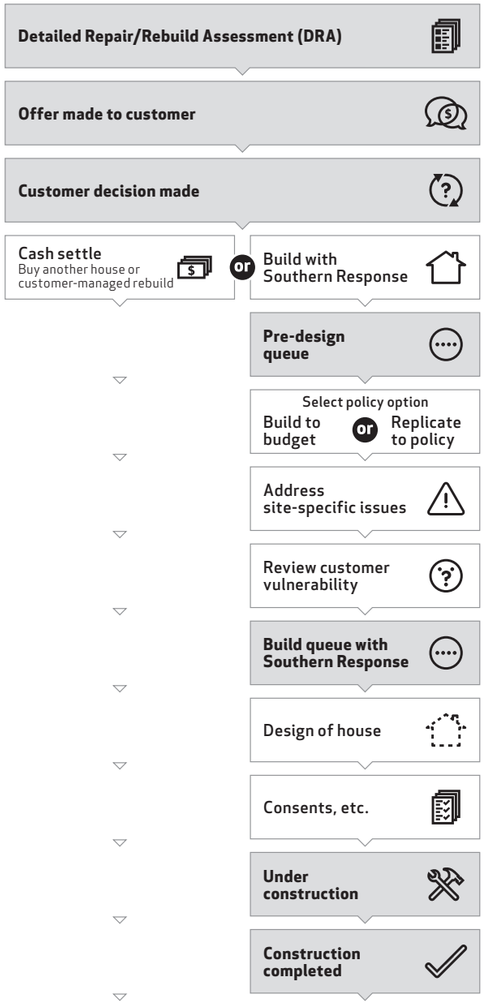
Financial Summary

Key aspects of Southern Response's consolidated financial results are:

Comprehensive Income	Unaudited 6 months ended 31 December 2012 $000	Audited 12 months ended 30 June 2012 $000
Continuing operations -		
Net earthquake claims incurred	(5,548)	(450,121)
Other costs	(9)	(3,486)
Investment income	11,853	18,112
Unrealised gain/(loss) on fair value of Crown receivable	8,722	(32,018)
Profit/(loss) for the year from continuing operations	**15,018**	**(467,513)**
Discontinued operations -		
Gain on disposal of operations	-	244,526
Profit from discontinued operations	-	34,902
Profit for the year from discontinued operations	**-**	**279,428**
Other comprehensive income	-	1,432
Total comprehensive income/(loss) for the year	**15,018**	**(186,653)**

Claims liability	Unaudited 31 December 2012 $000	Audited 30 June 2012 $000
Discounted central estimate (including claims handling expenses)	1,668,708	1,814,575
Risk margin	221,200	244,425
Gross outstanding claims liabilities	**1,889,908**	**2,059,000**
Reinsurance receivables	**(657,726)**	**(936,876)**
Net outstanding claims liability	**1,232,182**	**1,122,124**

Repair or Rebuild Journey



Financial Support

In addition to collecting reinsurance recoverables from its panel of international reinsurers, Southern Response is realising its investment portfolio to fund its settlement of customers' claims. To give it the financial surety to meet all customers' valid claims, the company has the benefit of:

- The $500 million of financial support from the Crown under the Crown Support Deed entered into between the Crown and AMI in April 2011, now amended to reflect Southern Response's Crown ownership. On 5 April 2012 the new shareholders (the Minister of Finance and the Minister for Canterbury Earthquake Recovery) paid $100 million to the company to convert 100 million of the 500 million convertible preference shares to ordinary shares
- Additional support provided by the Crown under a $500 million uncalled capital facility entered into after 30 June 2012, to be drawn on only if the company fully utilises the proceeds of its reinsurance, investments and Crown Support Deed.

Outlook

The company's key challenges for the remainder of this year are:

- A shift in focus from insurance and assessment issues to a focus on repairing and rebuilding customers' homes
- Resourcing the company to deliver on that focus
- Keeping customers informed of progress with their claims, and enabling all stakeholders to monitor the company's overall progress via regular updates on the website www.southernresponse.co.nz
- Continued active participation in the insurance industry's initiatives to rebuild Canterbury.

Ross Butler
Chairman

Peter Rose
Chief Executive Officer

8 February 2013

Statement of Responsibility

In accordance with the Public Finance Act 1989, the board is responsible for the preparation of Southern Response Earthquake Services Limited and Group's financial statements and the judgements made in them.

The board of directors of Southern Response Earthquake Services Limited has the responsibility for establishing and maintaining a system of internal control designed to provide reasonable assurance as to the integrity and reliability of financial reporting for the Company and Group.

In the board's opinion, these interim financial statements fairly reflect the financial position and operations of Southern Response Earthquake Services Limited and Group for the six months ended 31 December 2012.

Signed on behalf of the Board.

Ross Butler
Chairman

Anne Urlwin
Director

8 February 2013

Review Report

Deloitte.

Review report of the Auditor-General to the readers of the condensed consolidated interim financial statements of Southern Response Earthquake Services Limited

We have reviewed the condensed consolidated interim financial statements on pages 10 to 25. The condensed consolidated interim financial statements provide information about the past financial performance of Southern Response Earthquake Services Limited and its subsidiaries (the 'Group') and its financial position as at 31 December 2012. This information is stated in accordance with the Group's accounting policies referred to on page 14.

Board of Directors' Responsibilities

The Board of Directors is responsible for the preparation, in accordance with New Zealand law and generally accepted accounting practice, of condensed consolidated interim financial statements which present fairly the financial position of the Group as at 31 December 2012 and the results of its operations and cash flows for the six months ended on that date.

Reviewer's Responsibilities

The Auditor-General is the auditor of the Group pursuant to section 5(1) (f) of the Public Audit Act 2001. Pursuant to section 32 of the Public Audit Act 2001, the Auditor-General has appointed me, Michael Wilkes, using the staff and resources of Deloitte to undertake the annual audit of the Group.

We are responsible for reviewing the condensed consolidated interim financial statements presented by the Board of Directors in order to report to you whether, in our opinion and on the basis of the procedures performed by us, anything has come to our attention that would indicate that the condensed consolidated interim financial statements do not present fairly the matters to which they relate.

Basis of Opinion

A review is limited primarily to enquiries of company personnel and analytical review procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

We have reviewed the condensed consolidated interim financial statements of the Group for the six months ended 31 December 2012 in accordance with the Review Engagement Standards issued by the External Reporting Board.

Other than in our capacity as auditors as appointed by the Auditor-General and some principal and employees of Deloitte holdings insurance contracts with the Group we have no relationship or interests in Southern Response Earthquake Services Limited or its' subsidiaries.

Basis for Qualified Conclusion

We draw your attention to Note 1 of the condensed consolidated interim financial statements which describes the basis of preparation. The interim financial statements comply with NZ IAS 34 except for the comparative information presented in the Condensed Consolidated Statement of Comprehensive Income, Condensed Consolidated Statement of Changes in Equity and Condensed Consolidated Statement of Cash Flows which is required to be presented for the immediately preceding comparative period (31 December 2011). The comparative information presented in the above mentioned statements is for the year ended 30 June 2012.

Qualified Conclusion

Based on our review, which is not an audit, except for the non-provision of the comparative information referred to above nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial statements on pages 10 to 25 do not present fairly the financial position of the Group as at 31 December 2012 and the results of its operations and cash flows for the six month period ended on that date in accordance with both IAS-34: Interim Financial Reporting and NZ IAS-34: Interim Financial Reporting.

Emphasis of Matters – Uncertainties associated with the outstanding claims liability and reinsurance receivables

Without modifying our review opinion, we draw your attention to notes 2, 7 and 9 of the condensed consolidated interim financial statements. Those notes describe how the Canterbury earthquakes have affected the outstanding claims liability and related reinsurance receivables of the Group. Those notes also describe the significance of the amounts of the earthquake related outstanding claims liability and reinsurance receivables, and the inherent uncertainties involved in estimating those amounts using actuarial assumptions. The valuation of the reinsurance receivables is subject to similar uncertainties as the valuation of the outstanding claims liability.

Our review was completed on 8 February 2013 and our review opinion is expressed as at that date.

Michael Wilkes
DELOITTE

On behalf of the Auditor-General
Christchurch, New Zealand

Matters relating to the electronic presentation of the condensed consolidated interim financial statements

This review report relates to the condensed consolidated interim financial statements of Southern Response Earthquake Services Limited Group for the six month period ended 31 December 2012 included on the Company's website. The Board of Directors is responsible for the maintenance and integrity of the Company's website. We have not been engaged to report on the integrity of the Company's website. We accept no responsibility for any changes that may have occurred to the condensed consolidated interim financial statements since they were initially presented on the website.

The review report refers only to the condensed consolidated interim financial statements named above. It does not provide an opinion on any other information which may have been hyperlinked to or from the condensed consolidated interim financial statements. If readers of this report are concerned with the inherent risks arising from electronic data communication they should refer to the published hard copy of the condensed consolidated interim financial statements as well as the related review report dated 8 February 2013 to confirm the information included in the condensed consolidated interim financial statements presented on this website.

Legislation in New Zealand governing the preparation and dissemination of financial information may differ from legislation in other jurisdictions.

Condensed consolidated statement of comprehensive income

For the six months ended 31 December 2012

	Note	Unaudited 6 months ended 31 Dec 2012 $000	Audited 12 months ended 30 Jun 2012 $000
Continuing operations:			
Net claims incurred – non earthquake	3	-	(3,087)
Net claims incurred – earthquake	3	(5,548)	(450,121)
Less operating costs		(9)	(399)
Net underwriting (loss)		**(5,557)**	**(453,607)**
Investment income		11,853	18,112
Unrealised gain/(loss) on fair value of crown receivable	8	8,722	(32,018)
Profit/(loss) for the period from continuing operations before tax		**15,018**	**(467,513)**
Tax expense/(benefit)		-	-
Profit/(loss) for the period from continuing operations after tax		**15,018**	**(467,513)**
Discontinued operations:			
Profit for the period from discontinued operations	4	-	279,428
Profit /(loss) for the period		**15,018**	**(188,085)**
Other comprehensive income:			
Revaluation of land and buildings		-	(1,965)
Movement in actuarial value of defined benefit superannuation scheme		-	3,701
Tax effect of other comprehensive income		-	(304)
Other comprehensive income for the period after tax		**-**	**1,432**
Total comprehensive profit/(loss) for the period		**15,018**	**(186,653)**

The notes to the condensed consolidated financial statements on pages 14 to 25 form part of and should be read in conjunction with these condensed consolidated financial statements.

Condensed consolidated statement of changes in equity

For the six months ended 31 December 2012

	Ordinary Shares $000	Convertible Preference Shares $000	Accumulated Profit/ (Losses) $000	Property Reval'n Reserve $000	Total Equity $000
2013 (unaudited)					
Opening balance 1 July 2012	95,580	382,359	(535,470)	10,272	(47,259)
Profit for the period	-	-	15,018	-	15,018
Total comprehensive profit/(loss) for the period	-	-	15,018	-	15,018
Transfer property revaluation to retained earnings	-	-	207	(207)	-
Closing balance 31 December 2012	**95,580**	**382,359**	**(520,245)**	**10,065**	**(32,241)**

	Ordinary Shares $000	Convertible Preference Shares $000	Accumulated Profit/ (Losses) $000	Property Reval'n Reserve $000	Total Equity $000
2012 (audited)					
Opening balance 1 July 2011	-	477,939	(353,108)	14,563	139,394
Loss for the year	-	-	(188,085)	-	(188,085)
Revaluation of land and buildings	-	-	-	(1,965)	(1,965)
Actuarial movement in defined benefit superannuation scheme	-	-	3,701	-	3,701
Tax effect of items recognised in other comprehensive income	-	-	(1,036)	732	(304)
Other comprehensive income/(loss) for the year	**-**	**-**	**2,665**	**(1,233)**	**1,432**
Total comprehensive (loss) for the year	-	-	(185,420)	(1,233)	(186,653)
Transfer property revaluation to retained earnings	-	-	3,058	(3,058)	-
Conversion of preference shares into ordinary shares	95,580	(95,580)	-	-	-
Closing balance 30 June 2012	**95,580**	**382,359**	**(535,470)**	**10,272**	**(47,259)**

The notes to the condensed consolidated financial statements on pages 14 to 25 form part of and should be read in conjunction with these condensed consolidated financial statements.

Condensed consolidated statement of financial position

As at 31 December 2012

	Note	Unaudited 31 Dec 2012 $000	Audited 30 Jun 2012 $000
Shareholders' equity			
Total shareholders' (deficit)		**(32,241)**	**(47,259)**
Represented by:			
Assets			
Financial assets			
Cash and cash equivalents		213,215	82,394
Receivables		33,804	29,944
Reinsurance receivables	7	658,272	937,422
Investments		561,381	582,555
Crown receivable	8	372,882	364,160
Property held for sale		26,171	27,670
Current taxation		79	266
Property, plant and equipment		997	899
Intangible assets		39	31
Total assets		**1,866,840**	**2,025,341**
Less:			
Liabilities			
Trade and other payables		6,231	10,001
Employee entitlements		341	547
Outstanding claims – non earthquake		2,601	3,052
Outstanding claims – earthquake	9	1,889,908	2,059,000
Total liabilities		**1,899,081**	**2,072,600**
Net (liabilities)		**(32,241)**	**(47,259)**

On behalf of the board

Ross Butler, Chairman

Anne Urlwin, Director

Authorised for issue on 8 February 2013

The notes to the condensed consolidated financial statements on pages 14 to 25 form part of and should be read in conjunction with these condensed consolidated financial statements.

Condensed consolidated statement of cash flows

For the six months ended 31 December 2012

	Note	Unaudited 6 months ended 31 Dec 2012 $000	Audited 12 months ended 30 Jun 2012 $000
Cash flows from operating activities			
Premiums received from customers		-	281,434
Interest received		12,511	20,507
Dividends received		-	973
Other investment income		1,852	2,550
Claim costs – non earthquake		(451)	(142,874)
Claim costs – earthquake		(174,062)	(359,533)
Claim costs – recoveries		283,442	246,454
Payments to suppliers and employees		(12,958)	(56,832)
Payments for reinsurance		-	(39,934)
Income tax received/(paid)		187	(13)
Net cash inflow/(outflow) from operating activities	5	**110,521**	**(47,268)**
Cash flows from financing activities			
Proceeds from Crown receivable		-	100,000
Net cash inflow from financing activities		**-**	**100,000**
Cash flows from investing activities			
Proceeds from sale of property, plant and equipment		325	9,449
Payments for property, plant and equipment		(252)	(5,279)
Payments for intangible assets		(35)	(5,757)
Payments for financial assets		-	(529,943)
Sales and maturities of financial assets		20,262	326,923
Proceeds from sale of business net of cash and cash equivalents disposed		-	125,397
Net cash inflow/(outflow) from investing activities		**20,300**	**(79,210)**
Net increase/(decrease) in cash and cash equivalents		**130,821**	**(26,478)**
Add opening cash and cash equivalents		82,394	108,872
Ending cash and cash equivalents		**213,215**	**82,394**

The notes to the condensed consolidated financial statements on pages 14 to 25 form part of and should be read in conjunction with these condensed consolidated financial statements.

Notes to the interim financial statements

1. Interim financial statements - basis of preparation

Southern Response Earthquake Services Limited (the Company) is a limited liability company incorporated and domiciled in New Zealand and registered under the Companies Act 1993.

The Company is a Crown-owned company listed in schedule 4 of the Public Finance Act 1989, effective 18 April 2012.

The registered office for the Company is located at 6 Show Place, Addington, Christchurch.

The condensed consolidated interim financial statements are those of Southern Response Earthquake Services Limited and its subsidiaries and companies in which the Company has a beneficial interest and are reported in New Zealand dollars.

These unaudited condensed consolidated interim financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP) as appropriate for profit-orientated entities and NZ IAS 34- Interim Financial Reporting, except in respect of comparatives. IAS 34 and NZ IAS 34 require comparative information to be presented in the interim statement of comprehensive income, statement of changes in equity and statement of cash flows for the comparable interim period. The comparatives disclosed are from the audited financial statements for the year ended 30 June 2012 as there was no actuarial valuation performed at 31 December 2011 due to interim financial statements having not previously been prepared.

The same accounting policies, presentation and methods of computation are followed in these interim condensed consolidated financial statements as were applied in the preparation of the Group's financial statements for the year ended 30 June 2012.

The condensed consolidated interim financial statements were authorised for issue by the directors on 8 February 2013.

2. Critical accounting judgements and estimates

The Group make estimates and assumptions in respect of certain key assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The key areas in which critical estimates and judgements are applied are described below.

The ultimate liability arising from claims made under insurance contracts
Provision is made at the period-end for the estimated cost of claims incurred but not settled at the reporting date, including the cost of claims incurred but not yet reported to the Company and Group.

The estimated ultimate cost of claims includes direct expenses to be incurred in settling claims, gross of the expected value of salvage 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.

Notes to the interim financial statements

The estimation of claims incurred but not reported (IBNR) is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified, where more information about the claim event is generally available.

In calculating the estimated ultimate cost of unpaid claims the Group uses an actuarial valuation carried out by an independent actuary. Refer Note 9.

Assets arising from reinsurance contracts
Assets arising from reinsurance contracts are computed using actuarial valuations. 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. Refer note 7.

Valuation of the Crown receivable
The Crown receivable is recorded at the fair value of projected cash flows based on forecast payments of claims settlements and operating costs.

Going concern
As at 30 June 2012 the Group had a net asset deficit of $47.259 million caused by increases in the estimated level of claim liabilities. Furthermore, as a consequence of the increased claim liability, the estimated cash flow forecasts prepared by the Group also indicated that the assets of the Group may not be sufficient to meet the claim payment obligations particularly if the full risk margin was required to settle claims.

As a result, the Crown agreed to subscribe for an additional $500 million of uncalled capital to ensure the Group had sufficient cash and capital to meet the payment of claim obligations as they fall due. Cabinet approved the funding request on 24 October 2012 and the subscription agreement and an amended Crown support deed were executed on 30 January 2013. This funding arrangement is in addition to the Crown support deed and subscription agreement entered into on 7 April 2011 (refer Notes 6 and 8).

The Group has a net asset deficit of $32.241 million as at 31 December 2012. However, due to the additional $500m of capital subscribed for on 30 January 2013, the Group has sufficient cash and capital to meet the claim obligations as they fall due. For this reason the directors have concluded that the financial statements are appropriately presented on a going concern basis.

Notes to the interim financial statements

3. Net claims incurred

Claims have been separated between non earthquake related claims and claims that relate to the Canterbury earthquakes.

	Group Unaudited 6 months ended 31 Dec 2012 $000	Group Audited 12 months ended 30 Jun 2012 $000
Non earthquake:		
Gross claims expense	-	2,433
Reinsurance recovery revenue	-	654
Total net non earthquake claims incurred	**-**	**3,087**
Earthquake:		
Gross claims expense	9,840	428,207
Reinsurance recovery revenue	(4,292)	21,914
Total net earthquake claims incurred	**5,548**	**450,121**
Total net claims incurred	**5,548**	**453,208**

Notes to the interim financial statements

4. Discontinued operations

On 16 December 2011, the board of directors entered into a sale agreement to dispose of the Group's fire and general insurance operations. The disposal was completed on 5 April 2012, on which date control of the fire and general insurance operations passed to the acquirer. The Group retained responsibility for certain fire and general claims which are subject to catastrophe reinsurance cover.

The results and cash flows of the discontinued operations are set out below:

	Unaudited 6 months ended 31 Dec 2012 $000	Audited 12 months ended 30 Jun 2012 $000
Profit from discontinued operations:		
Premium revenue	-	287,461
Less reinsurance expense	-	(39,934)
	-	**247,527**
Less net claims incurred	-	(141,226)
Less operating costs	-	(71,595)
Profit before tax	**-**	**34,706**
Attributable income tax benefit	-	196
Profit for the period after tax	**-**	**34,902**
Gain on disposal of operations	-	244,526
Profit from discontinued operations	**-**	**279,428**
Other comprehensive income:		
Movement in actuarial value of defined benefit superannuation scheme	-	3,701
Tax effect of other comprehensive income	-	(1,036)
	-	**2,665**
Total comprehensive income from discontinued activities	**-**	**282,093**

Notes to the interim financial statements

	Unaudited 6 months ended 31 Dec 2012 $000	Audited 12 months ended 30 Jun 2012 $000
Cash flows from discontinued operations:		
Net cash flows from operating activities	-	40,924
Net cash flows from investing activities	-	125,397
Net cash flows from financing activities	-	-
Net cash flows	**-**	**166,321**
The disposal of the fire and general insurance operations affected the statement of financial position as follows:		
Cash and cash equivalents	-	(237,024)
Receivables and prepayments	-	(6,589)
Insurance receivables	-	(22,758)
Deferred acquisition costs	-	(1,864)
Deferred taxation	-	(2,105)
Property, plant and equipment	-	(7,280)
Intangible assets	-	(19,502)
Trade and other payables	-	33,562
Employee entitlements	-	8,654
Unearned premiums	-	90,638
Outstanding claims	-	43,607
Defined benefit superannuation scheme	-	661
Net assets disposed	**-**	**(120,000)**
Net sale value	**-**	**364,526**
Gain on disposal of operations	**-**	**244,526**

Notes to the interim financial statements

5. Cash inflows from operating activities

Reconciliation of profit/(loss) for the period to cash inflows from operating activities	Group Unaudited 6 months ended 31 Dec 2012 $000	Group Audited 12 months ended 30 Jun 2012 $000
Profit/(loss) for the period	15,018	(188,085)
Add/(less) non-cash items:		
Depreciation and amortisation	172	5,762
Unrealised (gains)/losses	(660)	1,648
Unrealised movement in discounting Crown receivable to fair value	(8,722)	32,018
Decrease in deferred acquisition costs	-	260
Net movement in deferred tax asset/liability	-	75
Deferred tax on movements via reserves	-	(304)
Sub-total "A"	**5,808**	**(148,626)**
Movement in working capital items:		
(Increase) in receivables and tax	(3,673)	(24,505)
Decrease in reinsurance and insurance receivables	279,150	269,212
(Decrease) in payables	(3,770)	(25,652)
(Decrease) in employee entitlements	(206)	(7,775)
(Decrease) in insurance liabilities	(169,543)	(19,540)
Sub-total "B"	**101,958**	**191,740**
Items classified as investing activities:		
(Gain) on sale of operations net of working capital items	-	(95,003)
Decrease in interest receivable capitalised	2,266	4,158
Net loss/(gain) on sale of property, plant and equipment	9	(476)
Net loss on sale of investments	480	939
Sub-total "C"	**2,755**	**(90,382)**
Cash inflow/(outflow) from operating activities (A+B+C)	**110,521**	**(47,268)**

Notes to the interim financial statements

6. Share capital

At 31 December 2012, there were 1,000,102 (30 June 2012: 1,000,102) paid ordinary shares and 400,000,000 (30 June 2012: 400,000,000) unpaid convertible preference shares.

In addition there were 500,000,000 uncalled ordinary shares issued on 30 January 2013. The issue price (yet to be called) is $1 per share.

Under the terms of the deed of amendment and restatement to the Crown support deed, the Company may issue a payment notice for a number of unpaid convertible preference shares. On payment the shares will be designated as paid-up convertible preference shares. Such shares are convertible into ordinary shares at the option of the convertible preference shareholder. Following the payment or redemption of all convertible preference shares, calls can be made on the uncalled ordinary shares.

Each paid-up convertible preference share will rank equally in respect of dividends and other distributions with all ordinary shares.

7. Reinsurance receivables

	Group Unaudited 31 Dec 2012 $000	Group Audited 30 Jun 2012 $000
Gross reinsurance receivable	671,677	952,671
Discount to present value	(13,405)	(15,249)
Net reinsurance receivable	**658,272**	**937,422**
Being:		
Non-earthquake	546	546
Earthquake (Note 9)	657,726	936,876
	658,272	**937,422**

Changes in gross reinsurance receivable

	Group Unaudited 6 months ended 31 Dec 2012 $000	Group Audited 12 months ended 30 Jun 2012 $000
Opening balance	**952,671**	**1,249,938**
Change in gross estimated recovery	2,447	(22,567)
Reinsurance collections	(283,441)	(274,700)
Closing balance	**671,677**	**952,671**

Notes to the interim financial statements

At 31 December 2012, the Group conducted an impairment review of the reinsurance receivables. No loss was recognised (30 June 2012: $Nil). The carrying amounts disclosed above approximate fair value at each reporting date.

Actuarial assumptions
The measurement of reinsurance and other recoveries on outstanding claims is an inherently uncertain process involving estimates. The amounts are generally calculated using actuarial assumptions and methods similar to those used for the outstanding claims liability.

Where possible, the valuation of reinsurance recoveries is linked directly to the valuation of the gross outstanding claims liability. Accordingly, the valuation of outstanding reinsurance recoveries is subject to similar risks and uncertainties as the valuation of the outstanding claims liability. Significant individual losses are analysed on a case by case basis for reinsurance purposes.

The effect of changes in assumptions
The effect of changes in assumptions on the net outstanding claims liability, which incorporates the reinsurance recoveries on outstanding claims and other recoveries receivable, is disclosed in Note 9.

8. Crown receivable

	Group Unaudited 31 Dec 2012 $000	Group Audited 30 Jun 2012 $000
Opening balance	**364,160**	**496,178**
Capital called	-	(100,000)
Fair value adjustment	8,722	(32,018)
Closing balance	**372,882**	**364,160**

On 7 April 2011, the Company entered into a Crown support deed and subscription agreement with the New Zealand Government (the Crown) under which the Crown was issued 500 million convertible preference shares (CPS), a special share and one ordinary share for $1 per share. These shares were called but not paid up.

On 5 April 2012 a deed of amendment and restatement to the Crown support deed was signed with the Crown. At this time the Crown paid up 100 million convertible preference shares and converted these to 1 million ordinary shares.

On 30 January 2013 a further deed of amendment and restatement to the Crown support deed was signed with the Crown. At this time the Crown subscribed for 500,000,000 uncalled ordinary shares.

The Company may draw down the Crown receivable by issuing a payment notice for a number of unpaid convertible preference shares equal to the shortfall amount in any quarter, being the shortfall between the cumulative balance of the Company's reinsurance receivables and financial investments less $25 million and less any payments expected to be made in the ordinary course of its business.

Notes to the interim financial statements

The Crown receivable as at 31 December 2012 is recorded at its fair value taking into account all relevant circumstances including the timing of the potential cash flows and the terms of the Crown support deed. The risk free discount rates used are in the range of 2.53% to 2.68% (30 June 2012: 2.53% to 2.84%). Cash flows of $400 million within four years have been assumed (30 June 2012 $400 million within 5 years).

9. Outstanding claims liability: earthquake

Outstanding earthquake claims	Group Unaudited 31 Dec 2012 $000	Group Audited 30 Jun 2012 $000
Discounted central estimate	1,582,978	1,726,281
Risk margin	221,200	244,425
Claims handling costs	85,730	88,294
Gross outstanding claims liability	**1,889,908**	**2,059,000**
Expected reinsurance recoveries	(671,131)	(952,125)
Impact of discounting on reinsurance recoveries	13,405	15,249
Reinsurance receivables (Note 7)	(657,726)	(936,876)
Net outstanding claims liability	**1,232,182**	**1,122,124**

Changes in gross claims liability	Group Unaudited 6 months 31 Dec 2012 $000	Group Audited 12 months 30 Jun 2012 $000
Outstanding claims beginning of period	**2,059,000**	**1,936,620**
Change in central estimate	19,667	338,296
Change in claims handling expense	(2,564)	56,394
Change in discounting to present value	4,084	38,532
Change in risk margin	(23,225)	15,425
Claim payments	(167,054)	(326,267)
Outstanding claims end of period	**1,889,908**	**2,059,000**

Notes to the interim financial statements

Claims development

Below is a reconciliation of the central estimate to the net outstanding claims liability reflected in the financial statements.

	Group Unaudited 31 Dec 2012 $000	Group Audited 30 Jun 2012 $000
Central estimate	2,177,083	2,157,416
Claims handling expense	85,730	88,294
Cumulative payments	(541,721)	(374,667)
Discount to present value	(52,384)	(56,468)
Discounted central estimate	1,668,708	1,814,575
Risk margin	221,200	244,425
Gross outstanding claims liabilities	1,889,908	2,059,000
Reinsurance receivables (Note 7)	(657,726)	(936,876)
Net outstanding claims liabilities	**1,232,182**	**1,122,124**

Actuarial calculation, assumptions and methods

The effective date of the actuarial report on the earthquake insurance liabilities is 31 December 2012. The actuarial report was prepared by the appointed actuary. Finity Consulting are satisfied with the quality of data provided for the purpose of estimating insurance liabilities.

In the Actuary's opinion the insurance liabilities have been prepared in accordance with the New Zealand equivalents to International Financial Reporting Standard (NZ IFRS 4 Insurance Contracts) and the NZ Society of Actuaries Professional Standard 4 governing technical liability valuations for general insurance business.

Key actuarial assumptions – earthquake

The valuation of the net outstanding claims liabilities for the current financial period is based on detailed assumptions about the number of properties damaged, the mix and cost of rebuilds/repairs/cash settlements, with adjustments for the amounts of damage which will be covered by the Earthquake Commission. In addition, assumptions are made regarding future economic conditions and claims handling expenses, as set out in the table on the following page.

Notes to the interim financial statements

	Group Unaudited 31 Dec 2012	Group Audited 30 Jun 2012
Building cost	8.00%	8.00%
Temporary accommodation	0.00%	0.00%
Other cover types	3.00%	3.00%
Discount rate	2.57%	2.57%
Claims handling expenses	5.54%	5.15%
Risk margin – outstanding claims liabilities	14.20%	14.20%
Average weighted term to settlement from reporting date	1.76 years	1.83 years

Process to determine assumptions

Inflation

The actuarial models allowed for the following inflationary impacts on expected future payments:

- 8% per annum for building costs, based on advice from New Zealand Treasury
- 0% per annum on temporary accommodation (as the allowance in the valuation is already set at the maximum payable under the Company's cover), and
- 3% per annum for the other cover types.

Overall this equates to 6.8% per annum.

Discount rate

Discounting has been applied to the outstanding claims by reference to the risk free zero coupon yields published by the New Zealand Treasury at 31 December 2012.

Claims handling expenses

The estimate of outstanding claims liabilities includes allowance for the future cost of administrating claims. It is based on the Company's projected costs.

Risk margin

The risk margin is intended to achieve a 75% probability of adequacy for the outstanding claims. The unique and unprecedented nature of the earthquake events precludes application of a formal statistical process to determining the 75% risk margin. Instead the Actuary has set the risk margin with reference to:

- the risk margins applying to the Company's business–as–usual claim liabilities
- the risk margins generally adopted for a range of other insurance classes, and
- the results of sensitivity tests on the Actuary's valuation results taking into account factors such as building cost inflation; the number of property claims; the mix of rebuilds/repairs/cash settlements, the claim payment pattern; and the allocation of the Earthquake Commission related event costs.

Notes to the interim financial statements

There is considerable uncertainty attaching to many elements of the likely ultimate cost of the Company's earthquake related outstanding claims liabilities. The higher than normal level of uncertainty is due to a number of factors including:

- the relatively early stage of claims development
- that not all of the over cap claims have been formally assessed
- issues relating to application of multiple Earthquake Commission caps and to the Government's land remediation package that are still developing, and
- the potential impact of demand surge on building costs.

As a result of these uncertainties, the risk margin applied is materially higher than would be applied to a more normal level of uncertainty. The selected risk margin is 14.2% of the gross central estimate.

Average weighted term to settlement

Expected payment patterns have been used to determine the outstanding claims liability. The payment patterns adopted have been set based on the Actuary's best estimate of when the payments are likely to be made.

Sensitivity analysis – impact of changes in key variables

The impact of change in key assumptions on the net outstanding claims liabilities are shown in the table below for the Group. Each change has been calculated in isolation to other changes.

Variable	Change in variable	Group Unaudited 31 Dec 2012	Group Audited 30 June 2012
		$000	**$000**
Inflation rate	+1% p.a.	32,455	22,720
	-1% p.a.	(24,208)	(22,536)
Discount rate	+1% p.a.	(18,742)	(19,300)
	-1% p.a.	19,333	20,009
Claims handling expense	+10%	9,733	10,027
	-10%	(9,733)	(10,027)
Risk margin	+1%	15,577	17,274
	-1%	(15,577)	(17,153)

Directory

Shareholders

Minister of Finance
Minister for Canterbury Earthquake Recovery

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Offices

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Web: www.southernresponse.co.nz

Board of Directors

Ross Butler	Chair
Anne Urlwin	Deputy Chair
Jenn Bestwick	Director
Susan Thodey	Director
Bevan Killick	Director
David Whyte	Director

Executive Management

Peter Rose	Chief Executive Officer
Keith Land	Chief Corporate Officer
Tony Feaver	Chief Financial Officer

Project Management Office

Arrow International (NZ) Limited

Actuary

Finity Consulting Pty Limited

Auditor

The Auditor-General pursuant to section 15 of the Public Audit Act 2001

Michael Wilkes of Deloitte was appointed to perform the audit on behalf of the Auditor-General

Banker

ANZ Bank New Zealand Limited

Legal Advisors

Wynn Williams

Bell Gully

DLA Phillips Fox

Affiliations

Insurance Council of New Zealand, associate member

Insurance and Savings Ombudsman (ISO) scheme participant

Notes

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Southern Response is the government-owned company responsible for settling claims by AMI policyholders for Canterbury earthquake damage which occurred before 5 April 2012 (the date AMI was sold to IAG).