



ACE Insurance Limited

A scenic landscape photograph of Lake Dunstan in Central Otago, New Zealand. The lake is in the foreground, reflecting the sky and the surrounding hills. The middle ground is filled with trees in vibrant autumn colors, including yellows, oranges, and reds. In the background, large, rugged mountains rise under a clear blue sky. A small boat is visible on the water. The bottom of the image features a blue and yellow graphic overlay with text.

Annual Report 2005

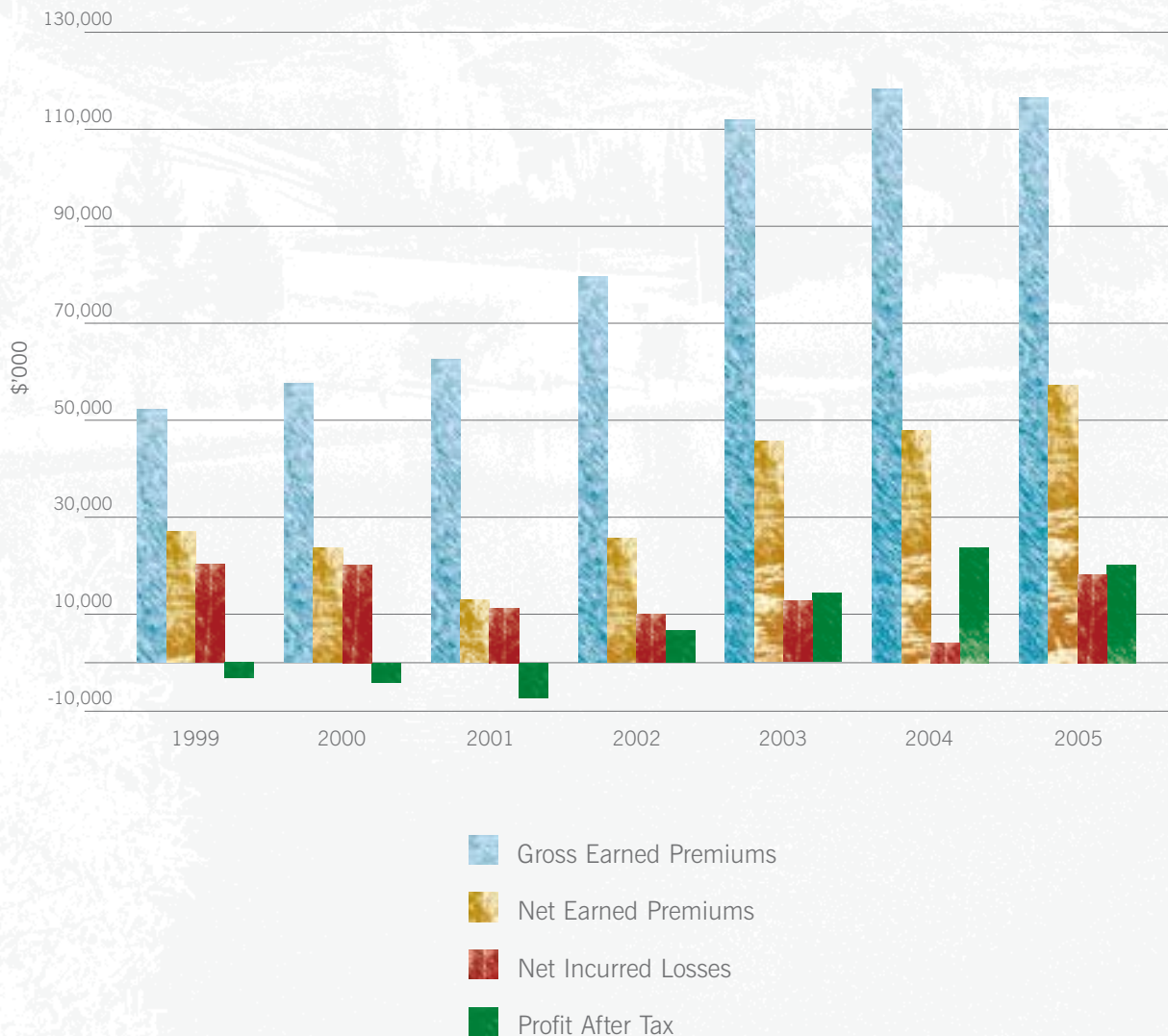
Lake Dunstan - Central Otago

New Zealand

## ACE Insurance Limited

ACE Insurance Limited is one of the ACE Group of Companies, a major global provider of insurance and reinsurance protection, with US\$62 billion in assets and gross premiums of US\$16.8 billion. In a wide range of traditional and speciality lines, ACE uses its strong analytical skills, breadth of resources and global reach to deliver quality products and exceptional service.

### ACE Insurance Limited Financial Highlights



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## Directors' Responsibility Statement

For The Year Ended 31 December 2005

The Directors are responsible for ensuring that the financial statements give a true and fair view of the financial position of the Company as at 31 December 2005, and its financial performance and Cash Flows for the year ended on that date.

The Directors consider that the financial statements of the Company have been prepared using appropriate accounting policies, consistently applied and supported by reasonable judgments and estimates, and that all relevant financial reporting and accounting standards have been followed.

The Directors believe that proper accounting records have been kept which enable, with reasonable accuracy, the determination of the financial position of the Company and facilitate compliance of the financial statements with the Financial Reporting Act 1993.

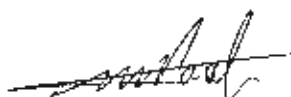
The Directors have taken adequate steps to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors have pleasure in presenting the financial statements of ACE Insurance Limited for the year ended 31 December 2005.

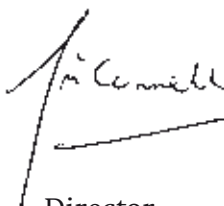
### Shareholders' Resolution

In accordance with section 211(3) of the Companies Act 1993, the shareholders have passed a unanimous resolution that the annual report of the Company include only the signed financial statements for the accounting period completed alongside an Auditors' report.

For and on behalf of the Board of Directors



Director  
Mike Poole  
5 April 2006



Director  
Stephen McConnell  
5 April 2006

## Managing Director's Report

For The Year Ended 31 December 2005

I am pleased to be able to present our annual report to shareholders and other interested parties.

2005 was another strong year for ACE Insurance Limited New Zealand with a net profit after tax of \$20.7m recorded. We have achieved an average Combined Operating Ratio of 61.6% and a Return on Equity of 62.25% over the last 4 years. Investment income at \$5.7m produced good returns in excess of 7%. The New Zealand portfolio is predominantly in the Government Bonds and Corporate Securities market with an average duration of 4 years. The Reserve Bank of New Zealand imposed further interest rate tightening during 2005 and this helped to strengthen short to medium term interest rates.

We have provided consistent returns to our shareholders and this year we were able to pay a dividend to shareholders of \$15m at 31 December 2005, whilst maintaining an increased level of equity of \$6m over 2004. We also maintained capital adequacy of \$21.5m in excess of the preferred capital requirement established by the Public Trustee in the Company's Trust Deed.

Our largest market segment, Corporate, was impacted by rate reductions across most lines of business as the year progressed. Nonetheless, we were able to maintain a leading position in this segment by adherence to selective and disciplined underwriting coupled with a service oriented approach and continued utilisation of our internal risk management capabilities.

We continue to have a strong focus on our Commercial segment, developing our middle market business sector, which is now into its fourth year and continues to show positive growth. We will continue to dedicate resources and investment to this segment as we see it as a key contributor to future growth. It also provides us with even greater balance to our overall business portfolio.

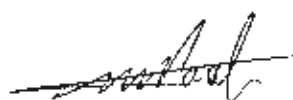
March 2005 saw the opening of our Christchurch office. We listened to what our customers and potential customers were saying and we did not believe the industry, as a whole, were meeting their needs. By opening this office we have been able to make quick decisions on brokers underwriting and risk submissions in both the Corporate and Commercial markets, enabling them to better manage their client's expectations.

In October 2005, Standard & Poors reaffirmed our A rating. A.M. Best also reaffirmed their A (Excellent) rating in November 2005.

The Company is firmly committed to maintaining the highest levels of corporate governance and risk management processes, with the Board Audit Committee directing and monitoring our Business Risk Management Steering Committee in this area. During the course of the year a number of operational audits and peer reviews took place and the Company will continue to act promptly and proactively on any areas identified for improvement.

The Company will be adopting International Financial Reporting Standards (IFRS) for the year beginning 1 January 2007. Preparation for this change in reporting is currently being undertaken.

On behalf of the entire Board I would like to extend my thanks to our loyal and dedicated staff for their efforts in contributing to the overall success of the Company in 2005.



Michael Poole  
Managing Director  
5 April 2006

## Auditors' Report to the Shareholders of ACE Insurance Limited

For The Year Ended 31 December 2005

We have audited the financial statements on pages 5 to 25. The financial statements provide information about the past financial performance and cash flows of the Company for the year ended 31 December 2005 and its financial position as at that date. This information is stated in accordance with the accounting policies set out on pages 9 to 11.

### DIRECTORS' RESPONSIBILITIES

The Company's Directors are responsible for the preparation and presentation of the financial statements which give a true and fair view of the financial position of the Company as at 31 December 2005 and its financial performance and cash flows for the year ended on that date.

### AUDITORS' RESPONSIBILITIES

We are responsible for expressing an independent opinion on the financial statements presented by the Directors and reporting our opinion to you.

### BASIS OF OPINION

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- (a) the significant estimates and judgements made by the Directors in the preparation of the financial statements; and
- (b) whether the accounting policies are appropriate to the circumstances of the Company, consistently applied and adequately disclosed.

We conducted our audit in accordance with generally accepted auditing standards in New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

We have no relationship with or interests in the Company other than in our capacity as auditors and tax advisers.

## Auditors' Report to the Shareholders of ACE Insurance Limited

For The Year Ended 31 December 2005

### UNQUALIFIED OPINION

We have obtained all the information and explanations we have required.

In our opinion:

- (a) proper accounting records have been kept by the Company as far as appears from our examination of those records; and
- (b) the financial statements on pages 5 to 25:
  - (i) comply with generally accepted accounting practice in New Zealand; and
  - (ii) give a true and fair view of the financial position of the Company as at 31 December 2005 and its financial performance and cash flows for the year ended on that date.

Our audit was completed on 5 April 2006 and our unqualified opinion is expressed as at that date.

*PriceWaterhouseCoopers*

Chartered Accountants  
Auckland

## Statement of Financial Performance

For The Year Ended 31 December 2005

	NOTE	2005 \$'000	2004 \$'000
Premium revenue		116,037	116,685
Outwards reinsurance expense		57,392	69,988
Net premium income		58,645	46,697
Claims incurred	22	47,527	27,631
Reinsurance and other recoveries revenue	23	28,889	23,869
Net claims incurred	22	18,638	3,762
Net acquisition expenses		4,217	3,867
Other expenses		10,369	10,808
Total expenses		14,586	14,675
Other income		217	382
<b>UNDERWRITING RESULT</b>		<b>25,638</b>	<b>28,642</b>
Investment revenue	2	5,736	4,564
<b>OPERATING SURPLUS BEFORE TAX</b>	2	<b>31,374</b>	<b>33,206</b>
Income tax expense	3	10,667	11,016
<b>OPERATING SURPLUS AFTER TAX</b>		<b>20,707</b>	<b>22,190</b>
<b>NET SURPLUS ATTRIBUTABLE TO MEMBERS OF THE HOLDING COMPANY</b>		<b>20,707</b>	<b>22,190</b>

The attached notes form an integral part of these financial statements.

## Statement of Movements in Equity

For The Year Ended 31 December 2005

	<b>2005</b> <b>\$'000</b>	<b>2004</b> <b>\$'000</b>
Equity at beginning of the year	33,026	33,363
	<b>33,026</b>	<b>33,363</b>
Net surplus for the year	20,707	22,190
Revaluation of land and building	284	121
<b>TOTAL RECOGNISED REVENUES AND EXPENSES FOR THE YEAR</b>	<b>20,991</b>	<b>22,311</b>
Dividends paid	(15,000)	(22,648)
<b>EQUITY AT END OF THE YEAR</b>	<b>39,017</b>	<b>33,026</b>

The attached notes form an integral part of these financial statements.



# Statement of Financial Position

As At 31 December 2005

	NOTE	2005 \$'000	2004 \$'000
<b>EQUITY</b>			
Share capital	4	16,900	16,900
Reserves	5	748	464
Retained earnings	5	21,369	15,662
<b>Total equity</b>		<b>39,017</b>	<b>33,026</b>
Represented by:			
<b>CURRENT ASSETS</b>			
Cash and bank deposits	14	3,076	11,984
Premiums receivable		34,203	35,198
Reinsurance and other recoveries	8a	20,686	17,206
Prepayments and other receivables		1,498	1,244
Deferred acquisition costs		6,004	5,047
		65,467	70,679
<b>NON CURRENT ASSETS</b>			
Investments	6	83,719	69,132
Fixed assets	7	3,979	3,588
Reinsurance and other recoveries	8a	15,913	11,606
		103,611	84,326
<b>Total assets</b>		<b>169,078</b>	<b>155,005</b>
<b>CURRENT LIABILITIES</b>			
Accounts payable	21	9,820	11,718
Intercompany payables	10	3,659	7,850
Income tax payable		1,539	585
Unearned premiums	8b	45,179	45,449
Outstanding claims	8a	34,215	30,171
		94,412	95,773
<b>NON CURRENT LIABILITIES</b>			
Accounts payable		1,584	1,844
Deferred income tax liability	3	641	753
Outstanding claims	8a	33,424	23,609
		35,649	26,206
<b>Total liabilities</b>		<b>130,061</b>	<b>121,979</b>
<b>NET ASSETS</b>		<b>39,017</b>	<b>33,026</b>

The attached notes form an integral part of these financial statements.

## Statement of Cash Flows

For The Year Ended 31 December 2005

	NOTE	2005 \$'000	2004 \$'000
<b>OPERATING ACTIVITIES</b>			
<b>Cash was provided from</b>			
Receipts of premium revenue		115,751	113,548
Receipts from reinsurance recoveries		21,094	22,087
Interest received		5,209	5,395
		142,054	141,030
<b>Cash was applied to</b>			
Payment of claims and claims expenses		(33,660)	(31,990)
Payment of outward reinsurance		(60,582)	(67,793)
Commission paid		(4,895)	(4,089)
Payment to suppliers and employees		(12,198)	(8,470)
Income tax paid		(9,826)	(11,924)
		(121,161)	(124,266)
<b>Net cash inflow from operating activities</b>	13	<b>20,893</b>	<b>16,764</b>
<b>INVESTMENT ACTIVITIES</b>			
<b>Cash was provided from</b>			
Proceeds from sale of investments		92,620	110,640
Proceeds from sale of fixed assets		57	24
		92,677	110,664
<b>Cash was applied to</b>			
Purchase of investments		(107,028)	(114,278)
Purchase of fixed assets		(450)	(380)
		(107,478)	(114,658)
<b>Net cash outflows from investing activities</b>		<b>(14,801)</b>	<b>(3,994)</b>
<b>FINANCING ACTIVITIES</b>			
<b>Cash was applied to</b>			
Dividends paid to parent company		(15,000)	(22,648)
<b>Net cash outflows from financing activities</b>		<b>(15,000)</b>	<b>(22,648)</b>
<b>Net decrease in cash held</b>		<b>(8,908)</b>	<b>(9,878)</b>
<b>Cash at beginning of year</b>	14	11,984	21,862
<b>Cash at end of year</b>	14	<b>3,076</b>	<b>11,984</b>

# Notes to Financial Statements

For The Year Ended 31 December 2005

## 1. STATEMENT OF ACCOUNTING POLICIES

### (i) Reporting entity and basis of reporting

The financial statements are for the reporting entity ACE Insurance Limited. The Company is registered under the Companies Act 1993.

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

The financial statements have been prepared on the basis of historical cost with the exception of certain items for which specific accounting policies are identified.

### (ii) Income recognition

#### General insurance

Premiums comprise of amounts charged to policyholders and brought into account from the date of attachment of risk. The earned portion of premiums received/receivable, including unclosed business, is recognised as revenue.

Unearned premiums have been determined from the date of attachment of risk based on the number of days of unexpired cover for each policy.

Outward reinsurance premiums are expensed in accordance with the pattern of benefits received. Accordingly, proportional reinsurance is expensed on a daily pro-rata basis over the period of the underlying risk and, excess of loss treaty reinsurance charges are expensed over the treaty period.

#### Investment income

Investment income is recognised on an accrual basis. Unrealised gains or losses on revaluation of investments are included in or charged against investment income in the Statement of Financial Performance.

### (iii) Claims

Claims expense represents claims paid, cost of handling the claims and changes in amounts for provision for outstanding claims. Reinsurance and other recoveries are recognised in deriving the net claims expense.

Claims outstanding represent estimates of payments to be made on individual claims which have been incurred and reported, estimates of losses which have occurred but have not yet been reported, and the anticipated direct and indirect costs of settling these claims. Reinsurance recoveries are included in these estimates, other recoveries are recognised when the amount to be recovered can be reliably measured. The provision for outstanding claims, reinsurance and other recoveries are discounted to their net present value.

### (iv) Deferred acquisition costs

Costs directly associated with obtaining policies of general insurance business, and which can be reliably measured, are deferred and recorded as assets where they give rise to premium revenue in subsequent periods. Deferred acquisition costs are measured at the lower of cost and recoverable amount and are amortised over the period expected to benefit from the expenditure.

# Notes to Financial Statements

For The Year Ended 31 December 2005

## 1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

### (v) Taxation

Income tax expense/(credit) recognises the current obligations and amounts arising from timing differences between the accounting results and assessable income for the year. This is the liability method applied on a comprehensive basis.

A deferred tax asset or the effect of losses carried forward that exceed the deferred tax liability, is recognised in the financial statements only where there is virtual certainty that the benefit of timing differences, or losses, will be utilised.

### (vi) Fixed assets

All fixed assets are initially recorded at cost. Freehold land and buildings are subsequently revalued to net market value by an independent valuer on an annual basis.

Depreciation of fixed assets, other than freehold land, is calculated using straight line basis, so as to allocate the cost of the assets or the revalued amounts, less their residual value over their useful lives. The rates are as follows:

Computer equipment	13.5% to 36.0%
Furniture and fittings	6.5% to 48.0%
Motor vehicles	18.0% to 21.6%

Gains and losses on disposal of fixed assets are taken into account in determining the operating surplus for the year.

### (vii) Goods and services tax (GST)

The Statement of Financial Performance and Statement of Cash Flows have been prepared so that all components are stated exclusive of GST. All items in the Statement of Financial Position are stated net of GST, with the exception of receivables and payables invoiced, which include GST.

### (viii) Investments

Investments are recorded on the following basis:

- a) debentures, local authority and government stock and offshore fixed interest securities are valued at market or yield to maturity.
- b) a statutory deposit, comprising of government stock, is held in accordance with the Insurance Companies Deposit Act 1953 and is recorded at market value.

# Notes to Financial Statements

For The Year Ended 31 December 2005

## 1. STATEMENT OF ACCOUNTING POLICIES (CONTINUED)

### (ix) Operating leases

Leases under which all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Operating lease payments are recognised as an expense in the periods the amounts are payable.

### (x) Statement of Cash Flows

The following are the definitions of the terms used in the Statement of Cash Flows:

- (a) Operating activities include all transactions and other events that are not investing or financing activities.
- (b) Investing activities are those activities relating to the acquisition, holding and disposal of property, plant and equipment, and of investments. Investments include securities not falling within the definition of cash.
- (c) Financing activities are those activities that result in changes in size and composition of the capital structure. This includes both equity and debt not falling within the definition of cash. Dividends paid in relation to capital structure are included in financing activities.
- (d) Cash is considered to be cash on hand, current accounts in banks, and deposits on call, net of bank overdrafts.

### (xi) Financial instruments

#### Recognised

Financial instruments carried on the Statement of Financial Position include cash and bank balances, investments, receivables, trade creditors and borrowings. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

#### Unrecognised

There were no unrecognised financial instruments at the balance date.

### (xii) Foreign currency transactions

Transactions denominated in a foreign currency are converted to New Zealand dollars at the exchange rates in effect at the date of the transaction. Monetary assets and liabilities arising from trading transactions or overseas borrowings are translated at closing rates. Gains and losses due to currency fluctuations on these items are included in the Statement of Financial Performance.

### (xiii) Employee Entitlements

#### Long Service Leave

A liability for long service leave is recognised, and is measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date.

#### Restricted Stock Grants

The Company operates a long term incentive plan. The market value of shares on the grant date is expensed over the period that shares vest. Shares granted are shares in the Ultimate Holding Company, ACE Limited.

### (xiv) Changes in Accounting Policy

There have been no changes in accounting policy during the current year.

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 2. OPERATING SURPLUS

	2005 \$'000	2004 \$'000
The operating surplus for the year is after charging/(crediting):		
Interest received	(5,464)	(5,415)
(Increase)/decrease in valuation of investments	(139)	646
(Gain)/loss on sale of investments	(133)	205
Investment Revenue	(5,736)	(4,564)
(Gain)/loss on foreign exchange translation	(91)	346
Depreciation		
– Furniture and equipment	207	177
– Motor vehicles	65	61
Audit fees	95	89
Other fees paid to auditors	37	47
Rent and lease expenses	75	64
Doubtful debts provision	88	-
Loss/(gain) on sale of fixed assets	20	(9)

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 3. TAXATION

<b>INCOME TAX EXPENSE</b>	<b>2005</b>	<b>2004</b>
	<b>\$'000</b>	<b>\$'000</b>
Operating surplus before income tax	31,374	33,206
<b>Permanent differences:</b>		
Prior year adjustment	-	39
Expenditure not deductible for tax	152	137
Surplus subject to tax	31,526	33,382
Tax at 33%	10,403	11,016
Recognition of prior year tax losses	264	-
<b>Income tax recognised in Statement of Financial Performance</b>	<b>10,667</b>	<b>11,016</b>
<b>Comprising:</b>		
Estimated current year tax assessment	10,515	11,111
Recognition of prior year tax losses	264	-
Deferred tax liability	(112)	(95)
	<b>10,667</b>	<b>11,016</b>
<b>DEFERRED TAX BALANCES</b>	<b>2005</b>	<b>2004</b>
	<b>\$'000</b>	<b>\$'000</b>
Opening Balance	753	848
Surplus for year	(112)	(95)
	<b>641</b>	<b>753</b>

# Notes to Financial Statements

For The Year Ended 31 December 2005

## 3. TAXATION (CONTINUED)

<b>IMPUTATION BALANCES</b>	<b>2005</b>	<b>2004</b>
	<b>\$'000</b>	<b>\$'000</b>
Balance at the beginning of the year	778	-
Tax Payment	9,538	7,936
Imputation credits attached to dividends paid	(4,741)	(7,158)
<b>Balance at the end of the year</b>	<b>5,575</b>	<b>778</b>

## 4. SHARE CAPITAL

	<b>2005</b>	<b>2004</b>
	<b>\$'000</b>	<b>\$'000</b>
Balance at beginning of year	16,900	16,900
<b>Balance at end of year – 16,899,558 ordinary fully paid</b>	<b>16,900</b>	<b>16,900</b>

All ordinary shares rank equally with one vote attached to each fully paid ordinary share.

## 5. RESERVES

	<b>2005</b>	<b>2004</b>
	<b>\$'000</b>	<b>\$'000</b>
<b>Revaluation reserve:</b>		
Balance at beginning of year	464	343
Revaluation of land and building	284	121
<b>Balance at end of year</b>	<b>748</b>	<b>464</b>
<b>Retained earnings:</b>		
Balance at beginning of year	15,662	16,120
Net surplus for the year	20,707	22,190
Dividends paid	(15,000)	(22,648)
<b>Balance at end of year</b>	<b>21,369</b>	<b>15,662</b>

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 6. INVESTMENTS

	2005 \$'000	2004 \$'000
Statutory deposit	506	516
Government and local authority securities	83,213	65,338
Offshore fixed interest securities	-	3,278
	<b>83,719</b>	<b>69,132</b>

### 7. FIXED ASSETS

	Cost/ valuation \$'000	Accumulated depreciation \$'000	Net book value \$'000
<b>2005</b>			
Land – valuation	882	-	882
Buildings – valuation	2,088	-	2,088
Furniture & equipment – cost	1,647	879	768
Motor vehicles – cost	371	130	241
	<b>4,988</b>	<b>1,009</b>	<b>3,979</b>
<b>2004</b>			
Land – valuation	1,200	-	1,200
Buildings – valuation	1,486	-	1,486
Furniture & equipment – cost	1,528	852	676
Motor vehicles – cost	375	149	226
	<b>4,589</b>	<b>1,001</b>	<b>3,588</b>

An independent valuation of freehold land and buildings was made at 20 December 2005 by an independent registered valuer, Colliers International New Zealand Limited. The total net market valuation is \$2,970,000 (2004: \$2,686,000). The valuation reflects the building being fully leased.

### 8. INSURANCE PROVISIONS

	2005 \$'000	2004 \$'000
Net claims outstanding	31,040	24,968
Unearned premiums	45,179	45,449
	<b>76,219</b>	<b>70,417</b>

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 8a. OUTSTANDING CLAIMS

	2005 \$'000	2004 \$'000
Gross outstanding claims reserve	74,889	58,297
Discount to present value	(7,250)	(4,517)
	67,639	53,780
Reinsurance and other recoveries on outstanding claims	(40,033)	(30,982)
Discount to present value	3,434	2,170
	(36,599)	(28,812)
<b>Net outstanding claims</b>	<b>31,040</b>	<b>24,968</b>
<b>Comprising:</b>		
Current liabilities	34,215	30,171
Non current liabilities	33,424	23,609
	67,639	53,780
Current assets	20,686	17,206
Non current assets	15,913	11,606
	36,599	28,812

#### NET OUTSTANDING CLAIMS RESERVE

The following discount rates were used in the measurement of outstanding claims, reinsurance and other recoveries:

	2005	2004
<b>The discount rates are determined from the government bond yield curve. Rates used are:</b>		
2004	N/A	6.40%
2005	6.50%	6.20%
2006	6.15%	6.10%
2007	6.00%	6.10%
Thereafter	5.95%	6.00%

The weighted average term to settlement is 1.90 years (2004: 1.50 years).

### 8b. UNEARNED PREMIUMS

	2005 \$'000	2004 \$'000
Gross unearned premium reserve	59,657	60,938
Reinsurance on unearned premium reserve	(14,478)	(15,489)
<b>Total unearned premium reserve</b>	<b>45,179</b>	<b>45,449</b>

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 9. ULTIMATE HOLDING COMPANY

ACE Insurance Limited is a wholly owned subsidiary of ACE INA International Holdings, Ltd, registered in Delaware, United States of America. The ultimate holding company is ACE Limited, whose principal office is located in Hamilton, Bermuda.

### 10. RELATED PARTY TRANSACTIONS

The Company has transactions in the normal course of business with fellow subsidiaries. These comprise of insurance and reinsurance transactions, management and support services. The significant transactions are as follows:

Related party	Relationship	Type of transaction	2005 Transaction \$'000	2005 Balances \$'000	2004 Transaction \$'000	2004 Balances \$'000
Tempest Reinsurance Company Limited, Bermuda	Fellow Subsidiary	Reinsurance placements/ claims	37,709	(2,826)	51,683	(7,376)
Other ACE entities	Fellow Subsidiary	Reinsurance placements/ claims	6,554	(789)	9,206	(841)
Other ACE entities	Fellow Subsidiary	Premiums & other recharges	147	(45)	186	18
Safire Pte Ltd, Singapore	Fellow Subsidiary	Management charges	707	-	842	-
Cover Direct Ltd, USA	Fellow Subsidiary	Management charges	440	-	1,028	-
ACE UK Services Ltd, UK	Fellow Subsidiary	EDP support service charges	538	-	458	-
ACE Insurance Limited, Australia	Fellow Subsidiary	Management/ IT service charges	788	1	880	349
			46,883	(3,659)	64,283	(7,850)

Other ACE entities comprise transactions with fellow subsidiary entities which are not individually material to disclose separately.

No related party balances have been written off or forgiven during the year. (2004: Nil)

# Notes to Financial Statements

For The Year Ended 31 December 2005

## 11. SEGMENT INFORMATION

Throughout the year the Company operated predominantly in general insurance business in New Zealand. The Company was registered as an insurer under Section 201 of the Accident Insurance Act 1998 on 2 June 1999.

### Re-nationalisation of accident insurance

In accordance with the Accident Insurance (Transitional Provisions) Act 2000 and Accident Insurance Amendment Act 2000, the Company ceased to underwrite new accident insurance business effective 1 April 2000 and all policies in existence as at 1 July 2000 were not renewed.

	General Insurance		Accident Insurance (Run off)		Total	
	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000	2005 \$'000	2004 \$'000
Net premium income	58,645	46,697	-	-	58,645	46,697
Net claims incurred	18,621	3,824	17	(62)	18,638	3,762
Net acquisition expenses	4,217	3,867	-	-	4,217	3,867
Other expenses	10,369	10,792	-	16	10,369	10,808
Other income	217	382	-	-	217	382
<b>Underwriting result</b>	<b>25,655</b>	<b>28,596</b>	<b>(17)</b>	<b>46</b>	<b>25,638</b>	<b>28,642</b>
Investment revenue	5,709	4,529	27	35	5,736	4,564
<b>Operating surplus before tax</b>	<b>31,364</b>	<b>33,125</b>	<b>10</b>	<b>81</b>	<b>31,374</b>	<b>33,206</b>
Income tax expense	10,667	11,016	-	-	10,667	11,016
<b>Operating surplus after tax</b>	<b>20,697</b>	<b>22,109</b>	<b>10</b>	<b>81</b>	<b>20,707</b>	<b>22,190</b>
<b>Total assets</b>	<b>160,744</b>	<b>146,086</b>	<b>8,334</b>	<b>8,919</b>	<b>169,078</b>	<b>155,005</b>

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 12. FINANCIAL INSTRUMENTS

The Company has financial instruments comprising cash at bank and on hand, cash on deposit, premiums receivable, intercompany receivables, other receivables, fixed interest securities, trade and other payables and lease liabilities.

#### a) Interest Rate Risk

The following table identifies the years in which interest rates are subject to review on interest bearing assets and provides the current weighted average interest rate of each item.

	Weighted Average Interest rate	Current \$'000	1 year or less \$'000	Over 1 to 5 years \$'000	More than 5 years \$'000	Total \$'000
<b>2005 FINANCIAL ASSETS</b>						
Cash & Deposits	6.53%	3,076	-	-	-	3,076
Fixed Interest Securities	6.61%	-	15,832	40,359	27,528	83,719
		<b>3,076</b>	<b>15,832</b>	<b>40,359</b>	<b>27,528</b>	<b>86,795</b>
<b>2004 FINANCIAL ASSETS</b>						
Cash & Deposits	5.17%	11,984	-	-	-	11,984
Fixed Interest Securities	6.59%	-	7,109	27,958	34,065	69,132
		<b>11,984</b>	<b>7,109</b>	<b>27,958</b>	<b>34,065</b>	<b>81,116</b>

#### b) Credit risk

The Company incurs credit risk from transactions with reinsurers, trade receivables and financial institutions in the normal course of its business. The Company has a credit policy, which restricts the exposure to individual trade receivables, which are reviewed on a regular basis. The Company places a majority of its reinsurance placements with ACE group entities. The credit risk on financial assets, which have been recognised in the financial statements, is generally the carrying amount of the assets net of any provision for doubtful debts. The Company does not have any significant concentrations of credit risk, except for reinsurance placements with ACE group entities.

#### c) Fair values

The carrying value of financial assets and liabilities of the Company are representative of their fair values as at balance date. The carrying amounts of all financial assets and liabilities are reviewed to ensure they equal or approximate their fair market values.

#### d) Currency risk

During the normal course of business the Company transacts insurance and other business with amounts denominated in foreign currencies, primarily certain reinsurance transactions are arranged in United States Dollars. As a result of these transactions exposures to fluctuations in foreign currency exchange rates arise. These foreign exchange transactions are settled on a quarterly basis to minimise foreign exchange risk exposure.

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 13. RECONCILIATION OF NET OPERATING CASH FLOWS

	2005 \$'000	2004 \$'000
Operating surplus after income tax	20,707	22,190
<b>Items not involving cash flows</b>		
Decrease in unearned premium reserve	(270)	(1,849)
Increase/(decrease) in outstanding claims	6,072	(6,141)
Increase in deferred acquisition costs	(957)	(661)
Changes in net market value of investments	(139)	646
Increase in doubtful debts	88	-
Depreciation expense	272	238
	5,066	(7,767)
<b>Impact of changes in working capital items</b>		
Increase in other receivables	(254)	(20)
Decrease/(increase) in policyholder debtors	995	(3,137)
(Decrease)/increase in accounts payable	(2,158)	1,376
(Decrease)/increase in intercompany payables	(4,191)	4,834
Increase/(decrease) in tax payable	841	(908)
	(4,767)	2,145
<b>Items classified as investing activities</b>		
(Gain)/loss on disposal of investments	(133)	205
Loss/(gain) on disposal of assets	20	(9)
	(113)	196
<b>Net cash flows from operating activities</b>	<b>20,893</b>	<b>16,764</b>

### 14. RECONCILIATION OF CASH

	2005 \$'000	2004 \$'000
Cash on hand and at bank	726	274
Deposits at call	2,350	11,710
	<b>3,076</b>	<b>11,984</b>

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 15. CHARGE

Under the Trust Deed, which governs the operation and management of the accident insurance business, the Public Trustee maintains a floating first charge over the assets of the Company.

### 16. CREDIT RATING

On 11 November 2005, the Company's financial strength rating of A (Excellent) was reaffirmed by rating agency A.M. Best in accordance with the Insurance Companies Rating and Inspections Act 1994. A.M. Best's A rating is assigned to companies which in their opinion have demonstrated excellence in overall performance, and have a strong ability to meet their obligation to policyholders over a long period of time. During 2004, the NZ operation obtained a Standard and Poors rating of "A" and this was reaffirmed as "A" on 4 October 2005.

### 17. ACTUARIAL INFORMATION

The actuary who carried out the valuation of the Outstanding Claims Liability is Andrew Bendall BSc. FIAA of ACE's regional office in Singapore. The Outstanding Claims Liability has been determined in accordance with the standards of the New Zealand Society of Actuaries and the actuary is satisfied as to the nature, sufficiency and accuracy of the data used in the determination. The determination of the outstanding claims liabilities is documented in the actuary's report dated 8 March 2006. Key assumptions used in the valuation are:

	2005	2004
Discount rate	6.50%	6.40%
Volatility adjustment	25.0%	25.0%
Inflation rate	4.00%	4.00%

### 18. CAPITAL COMMITMENTS

As at 31 December 2005 there were no capital commitments (2004: Nil).

### 19. CONTINGENT LIABILITIES

As at 31 December 2005 there were no contingent liabilities outstanding (2004: Nil).

### 20. LEASE COMMITMENTS

The Company has future rental commitments on property leases as follows:

	2005 \$'000	2004 \$'000
<b>Operating lease commitments:</b>		
Within one year	77	88
One to two years	79	52
Two to five years	114	2
Beyond five years	-	-
	<b>270</b>	<b>142</b>

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 21. ACCOUNTS PAYABLE

Included in the accounts payable are the following employee entitlements:

	2005 \$'000	2004 \$'000
<b>Employee entitlements:</b>		
Holiday pay provisions	279	266
Bonus provisions	320	286
Restricted stock grants in the ultimate parent company	265	55
Long service leave provisions	19	19
	<b>883</b>	<b>626</b>

#### Restricted Stock Grants

The Company operates an incentive scheme for individuals who, by virtue of their position, can influence the achievement of business results. This plan is completely discretionary and individuals have no entitlement to continued participation.

Under the plan the individuals have no entitlements. However, subject to achievement of annual performance standards, and the company's achievement of global business plans, they may be awarded shares.

The Restricted Stock Grants (shares) have a three year vesting period. The maximum potential value of shares will vary in accordance with the ACE share price.

For Restricted Stock Grants the market value of shares on the grant date is expensed over the period that the shares vest.

### 22. CLAIMS INCURRED

	2005			2004		
	Current \$'000	Previous years \$'000	Total \$'000	Current \$'000	Previous years \$'000	Total \$'000
Gross claims incurred	29,141	15,653	44,794	24,245	5,686	29,931
Discounted movement	1,528	1,205	2,733	(96)	(2,204)	(2,300)
Discounted gross claims incurred	30,669	16,858	47,527	24,149	3,482	27,631
Reinsurance and other recoveries	(17,745)	(12,409)	(30,154)	(16,075)	(7,048)	(23,123)
Discounted movement	723	542	1,265	131	(877)	(746)
Discounted reinsurance and other recoveries	(17,022)	(11,867)	(28,889)	(15,944)	(7,925)	(23,869)
<b>Net claims incurred</b>	<b>13,647</b>	<b>4,991</b>	<b>18,638</b>	<b>8,205</b>	<b>(4,443)</b>	<b>3,762</b>

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 23. REINSURANCE AND OTHER RECOVERIES

	2005 \$'000	2004 \$'000
Reinsurance recoveries	28,275	22,673
Other recoveries	614	1,196
	28,889	23,869

### 24. REINSURANCE PROGRAMME PRINCIPLES

Reinsurance is purchased to make the Company's results more predictable by reducing the effect that individual large claims, and catastrophic events that lead to multiple claims, have on results. The majority of reinsurance will be arranged on a non proportional excess of loss treaty basis.

Reinsurance is purchased by the ACE Group on a centralised basis to ensure tight control over reinsurer security, underwriting discipline and maximising economies of scale. The majority of ACE's reinsurance is on a treaty basis via Quota Share and Excess of Loss contracts. Facultative reinsurance is used on a limited basis to protect net exposures.

### 25. CAPITAL ADEQUACY

The basis that has been used for capital adequacy is the Preferred Capital Requirement established by the Public Trustee in the Trust Deed entered into with the Company on 1 June 1999. The Preferred Capital Requirement is the greatest of \$2,000,000, 30% of Net Written Premiums or 25% of Net Outstanding Claims.

The amount of equity retained for the purpose of capital adequacy as at 31 December 2005 is \$17,512,309 (2004: \$13,454,476) based on the Net Written Premiums requirement. The Company has more than met the Preferred Capital Requirements as at 31 December 2005. The total amount of equity retained in the Company as at 31 December 2005 is \$39,017,000 (2004: \$33,026,000).

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 26. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Institute of Chartered Accountants of New Zealand has announced that New Zealand entities will adopt International Financial Reporting Standards (“NZ IFRS”) for financial years commencing after 1 January 2007. Entities may however, choose to adopt NZ IFRS from 1 January 2005. The Company has chosen to adopt NZ IFRS for the financial year commencing on 1 January 2007.

The first set of financial statements that the Company will release under NZ IFRS will be for the year ended 31 December 2007. The requirement for comparative figures means that an NZ IFRS opening balance sheet will be prepared as at 1 January 2006.

The Board is considering the implication of NZ IFRS on the Company and is currently working on quantifying the impact on the financial statements and preparing the Company for transition. As the Company progresses towards adoption of NZ IFRS the Board will update shareholders and users of the financial statements with the specific impacts of transition to NZ IFRS.

In accordance with FRS 41 the key areas where accounting policies may change and have an impact on the financial statements are:

#### **NZIAS 39 – Financial Instruments: Recognition and Measurement**

Under NZ IFRS the Company will continue to classify and measure financial assets at “fair value through profit or loss” in the Income Statement. However the “fair value” under NZ IFRS requires the use of the bid price rather than the last sale price and for transaction costs previously capitalised to be recognised in the Income Statement. The impact of this change in valuation methodology is not expected to be material.

#### **NZIAS 12 – Income Taxes**

Under NZ IFRS deferred tax will be calculated using a “balance sheet” approach which recognises deferred tax assets and liabilities by reference to differences between the accounting and tax values of balance sheet items, rather than the accounting and tax values recognised in the Statement of Financial Performance. It is expected that on adoption of NZ IFRS the Company will be required to recognise additional deferred tax assets and liabilities. These amounts have not been quantified to date but are not expected to be material.

## Notes to Financial Statements

For The Year Ended 31 December 2005

### 26. ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

(CONTINUED)

#### Investment Properties

Currently the Company classifies land and building owned as owner-occupied and treats these as depreciable fixed assets. Under NZ IFRS there is a requirement to recognise portions of buildings that could be sold separately as investment property. The investment property will continue to be carried at fair value, however, any gains or losses arising on revaluation are required to be recognised in the Statement of Financial Performance.

#### Liability Adequacy

Under NZ IFRS there will be a requirement to undertake a liability adequacy test by line of business. At this stage we have not undertaken this test but we consider that the adjustment required will be immaterial.

#### Disclosure requirements

NZ IFRS will require additional disclosure and will result in a number of changes to the way that the financial information is presented. Prior to adoption the Company will be preparing pro-forma financial statements to assist in the identification of all additional disclosure requirements and to ensure that processes and systems are put in place to ensure that all relevant information is captured.

The information disclosed above represents the best estimate of the impacts of NZ IFRS adoption as at the date of preparing the financial statements. This information could change due to further work undertaken by the Company and any further amendments to NZ IFRS or interpretations.

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## Ultimate Parent

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## Legal Advisors

### Bell Gully Barristers and Solicitors

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### Andrew Bendall

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