

ANNUAL REPORT - JUNE 2007



**FIDELITY CAPITAL GUARANTEED BOND LIMITED**

## DIRECTORS' RESPONSIBILITY STATEMENT

The Directors are required by the Financial Reporting Act 1993 to prepare financial statements for the accounting period which comply with Generally Accepted Accounting Practice (GAAP) and provide information as required to present a true and fair view of the financial affairs of the Company.

The Directors are required by Companies Act 1993 to ensure that proper accounting records have been kept in order to determine with reasonable accuracy the financial position of the Company.

The Directors have a responsibility for taking necessary steps that are reasonably available to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The shareholder unanimously agreed to take advantage of the reporting concessions available to it under Section 211(3) of the Companies Act 1993, and agreed to limit the annual report to the following:

- Completed and signed financial statements including Chairman's report
- Auditors' report

Signed on behalf of the Board 13 September 2007.



**IAN BRADDOCK**  
Chairman



**JEFFREY MELTZER**  
Director

# CONTENTS

*Annual Report*

1. Directors' responsibility statement	INSIDE COVER
2. Chairman's report	PAGE 1
3. Income statement	PAGE 2
4. Balance sheet	PAGE 3
5. Statement of changes in equity	PAGE 4
6. Cash flow statement	PAGE 4
7. Accounting policies	PAGE 5-10
8. Notes to the financial statements	PAGE 11-31
9. Independent auditor's report	PAGE 32



## CHAIRMAN'S REPORT

Fidelity Capital Guaranteed Bond Limited raised \$80 million on 3 April 2007 comprising \$75 million Capital Guaranteed Bonds and \$5 million Subordinated Bonds. The Capital Guaranteed Bonds are listed on the NZDX Market.

After paying issue costs and pre-funding ongoing expenses, \$77.15 million was transferred to Tyndall Investment Management in accordance with the Trust Deed and Investment Statement.

The investment fund is invested in bank deposits. These deposits earn interest and are used as collateral for writing bond options.

The investment fund pays out when options are struck or when the investment manager closes out open positions. Options are struck when interest rate movements in the option period exceed the defined margin. Typically, options are written on Australian and US 10 year bonds, twice a week for 30 days with strikes set at 25 basis points either side of the current yield. The larger the interest rate movement the greater the strike payout.

The performance has largely tracked expectations save for a volatile period mid June, when global rates saw some exceptional movements that resulted in a \$2.8m loss booked at balance date, 30 June 2007.

Under the terms of the Trust Deed, the investment fund should exceed the face value of the Capital Guaranteed Bonds after payment of the coupon. The Subordinated Bondholder (Fidelity Life), Trustee (Guardian Trust) and Capital Guarantor (Westpac) agreed to waive the provision in the Trust Deed for suspension of coupon and paid the first coupon on 15 July 2007.

Investors will know that markets have remained quite erratic and to date the fund has not recovered the shortfall. Despite this, our investment manager, Tyndall Investment Management New Zealand Limited remains confident of the future prospects for the fund.

The next interest payment is scheduled for 15 January 2008 and performance will require close monitoring between now and that date before deciding whether this payment can be met from the surplus funds generated. The Capital Guarantee is of course unaffected by this trading activity.

In the event that the coupon is suspended in January the arrears plus interest will be paid at the next coupon date when the fund has accrued sufficient income to cover the arrears after paying the current coupon and fees.

A handwritten signature in cursive script that reads "Ian Braddock".

IAN BRADDOCK  
Chairman

13 September 2007

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

## Income statement

For the year ended 30 June 2007

	Note	2007 \$	2006 \$
<b>Income</b>			
Derivative income from options		(25,050)	–
Bank deposit interest		241,687	–
Interest		521,487	–
Foreign exchange		3,931	–
Net change in financial assets and liabilities at fair value through profit or loss	3	(2,023,694)	–
<b>Total net (loss)</b>		<b>(1,281,639)</b>	–
<b>Expenses</b>			
Fund management fee	4	77,390	–
Guarantee fee	5	125,334	–
Administration fee	6	56,404	–
Other operating Expenses	7	27,448	–
<b>Total operating expenses</b>		<b>286,576</b>	–
<b>Finance costs</b>			
Interest expense	8	2,123,886	–
<b>(Loss) before tax</b>		<b>(3,692,101)</b>	–
Taxation	9	865,911	–
<b>(Loss) after taxation</b>		<b>(2,826,190)</b>	–
<b>(Loss) for the year attributable to equity shareholder of Fidelity Capital Guaranteed Bond Limited</b>		<b>(2,826,190)</b>	–

The accounting policies (identified alphabetically) on pages 5 to 10 and notes (identified numerically) on pages 11 to 31 are an integral part of these financial statements.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

## Balance sheet

As at 30 June 2007

	Note	2007 \$	2006 \$
<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents		1,143,826	–
Financial assets at fair value through profit or loss			
Debt securities	10	75,912,057	–
Derivative financial instruments	11	359	–
Receivables and other financial assets	12	55,261,729	100
<b>Total current assets</b>		<b>132,317,971</b>	<b>100</b>
<b>Non current assets</b>			
Deferred tax asset	13	867,919	–
<b>Total non current assets</b>		<b>867,919</b>	<b>–</b>
<b>Total assets</b>		<b>133,185,890</b>	<b>100</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Derivative financial instruments	11	555,775	–
Payables	14	57,734,777	–
<b>Total current liabilities</b>		<b>58,290,552</b>	<b>–</b>
<b>Non current liabilities</b>			
Borrowings			
Capital Guaranteed Bonds	15	75,000,000	–
Subordinated Bonds	15	2,721,428	–
<b>Total non current liabilities</b>		<b>77,721,428</b>	<b>–</b>
<b>Total Liabilities</b>		<b>136,011,980</b>	<b>–</b>
<b>Net Assets</b>		<b>(2,826,090)</b>	<b>100</b>
<b>Equity</b>			
Capital			
Contributed equity	16	100	100
Retained earnings	17	(2,826,190)	–
<b>Total Equity attributable to shareholder of Fidelity Capital Guaranteed Bond Limited</b>		<b>(2,826,090)</b>	<b>100</b>

Approved by the Board on 13 September 2007 and signed on its behalf by:

  
IAN BRADDOCK  
Chairman

  
JEFFREY MELTZER  
Director

The accounting policies (identified alphabetically) on pages 5 to 10 and notes (identified numerically) on pages 11 to 31 are an integral part of these financial statements.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

## Statement of Changes in Equity

For the year ended 30 June 2007

Note	2007 \$	2006 \$
<b>Balance at 1 July</b>	<b>100</b>	100
Loss for the year	(2,826,190)	–
<b>Total recognised income and expense for the year</b>	<b>(2,826,190)</b>	–
<b>Balance at 30 June</b>	<b>(2,826,090)</b>	<b>100</b>

## Cash flow statement

For the year ended 30 June 2007

Note	2007 \$	2006 \$
<b>Cash flows from operating activities</b>		
Purchase of financial assets	(584,611,335)	–
Proceeds from sale of investments	506,832,551	–
Proceeds from derivative financial instruments	529,230	–
Interest received	762,914	–
<b>Net cash from operating activities</b>	<b>(76,486,640)</b>	–
<b>Cash flows from financing activities</b>		
Proceeds from issue of Capital Guaranteed Bonds	75,000,000	–
Proceeds from issue of Subordinated Bonds, net of transaction costs	2,630,466	–
<b>Net cash from financing activities</b>	<b>77,630,466</b>	–
Net increase in cash and cash equivalents	1,143,826	–
Cash and cash equivalents at 1 July	–	–
Effect of exchange rate changes on cash and cash equivalents	–	–
<b>Cash and cash equivalents at 30 June</b>	<b>1,143,826</b>	–

The accounting policies (identified alphabetically) on pages 5 to 10 and notes (identified numerically) on pages 11 to 31 are an integral part of these financial statements.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

## *Accounting policies*

### **General Information**

Fidelity Capital Guaranteed Bond Limited (the “Company”), is a limited liability investment company incorporated and domiciled in New Zealand (NZ), trading within NZ and listed on the New Zealand Debt Exchange (NZDX), offering Capital Guaranteed Bonds and Subordinated Bonds. The Company was incorporated on the 12 February 1998 under the name of Corporate Life Limited. The Company changed its name to Fidelity Capital Guaranteed Bond Limited on the 5 October 2006. The Company was a dormant company prior to February 2007. The Company received its first subscription proceeds for Capital Guaranteed Bonds in February 2007, and issued the fully subscribed Capital Guaranteed Bonds of \$75m on 3 April 2007. The ultimate holding company is Fidelity Life Assurance Company Limited, the registered office of the ultimate holding company and Company is Level 1, 81 Carlton Gore Road, Newmarket, Auckland, New Zealand.

The board approved the accounts on the 12 September 2007.

### **(A) Basis of presentation**

The Company is registered under the Companies Act 1993 (company number: 890726). The financial statements have been prepared in accordance with the requirements of the Financial Reporting Act 1993 and the Companies Act 1993.

### **(i) Application of NZ IFRS 1 First time Adoption of New Zealand Equivalents to International Financial Reporting Standards**

The New Zealand Accounting Standards Review Board adopted International Financial Reporting Standards (‘IFRS’) by issuing them as New Zealand equivalents (‘NZ IFRS’). New Zealand entities are required to prepare their financial statements in accordance with NZ IFRS for financial periods commencing on or after 1 January 2007. These financial statements are the first Fidelity Capital Guaranteed Bond Limited financial statements to be prepared in accordance with NZ IFRS. NZ IFRS 1 First time Adoption of New Zealand Equivalents to International Financial Reporting Standards has been applied in preparing these financial statements. Financial statements of Fidelity Capital Guaranteed Bond Limited until 30 June 2006 had been prepared in accordance with previous New Zealand Financial Reporting Standards (NZ FRS). NZ FRS differs in certain respects from NZ IFRS. When preparing Fidelity Capital Guaranteed Bond Limited 2007 financial statements, management has amended certain accounting and valuation methods applied in the NZ FRS financial statements to comply with NZ IFRS. No restatement of the comparatives was required as the company had not traded prior to 1 July 2006.

### **(B) Statement of Compliance**

Compliance with NZ IFRS ensures that the financial statements and notes of the Company comply with International Financial Reporting Standards (IFRS).

**(C) Functional and presentation currency**

The functional currency is the currency in the primary economic environment in which the individual reporting entity operates. Transactions in currencies other than the functional currency are transactions denominated in foreign currencies. The presentation currency of the Company's financial statements is New Zealand dollars (NZD), which is the functional and presentation currency of the Company.

**(D) Foreign currency translation**

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the relevant rates of exchange ruling at the balance sheet date. Gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement. Translation differences on other monetary financial assets measured at fair value and designated as held at fair value through profit or loss (FV) (see policy H) are included in foreign exchange gains and losses in the income statement.

**(E) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risk and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and rewards that are different from those segments operating in other economic environments. The Company comprises one business segment; that of investment. This is consistent with internal reporting. The geographical split is based on where the financial assets are located, being either NZ, Australia, or United States of America. This geographical split is in line with fund managers investment guidelines.

**(F) Interest income and expense**

Interest income and expense are recognised in the income statement for all interest-bearing financial instruments, except for those classified at fair value through profit or loss, using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Company that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

### **(G) Derivative income**

The realised gain or loss on disposal of a derivative asset or liability is the difference between the proceeds received or paid, net of transaction costs, and its original cost or purchase. Unrealised gains and losses represent the difference between the carrying value at the year end and the carrying value at the previous year end after recognising unrealised gains and losses in respect of disposals made during the year.

### **(H) Financial assets**

The Company's financial assets are classified into one of the following categories; financial assets at fair value through profit or loss and, loans and receivables.

#### **(i) Financial assets at fair value through profit or loss**

Financial assets at fair value through profit or loss has two subcategories, including financial assets held for trading and those designated at fair value through profit or loss on initial recognition.

Debt securities acquired principally for the purpose of selling in the short term or which are part of a portfolio which is managed for short-term gains are classified as trading securities and recognised in the balance sheet at their fair value. Gains and losses arising from changes in their fair value are recognised in the income statement within net income in the period in which they occur. Derivative financial instruments fall into this category. Other financial assets and liabilities at fair value through profit or loss are designated as such by management upon initial recognition. Such assets and liabilities are carried in the balance sheet at their fair value and gains and losses arising from changes in fair value together with interest coupons are recognised in the income statement within net income in the period in which they occur.

Financial assets and liabilities are designated as at fair value through profit or loss, when doing so results in more relevant information because either:

- it eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets and liabilities or recognising gains or losses on them on a different basis; or
- the assets and liabilities are part of a group which is managed, and its performance evaluated, on a fair value basis in accordance with an investment strategy

The fair values of assets and liabilities traded in active markets are based on current bid and offer prices respectively. If the market is not active the Company establishes a fair value by using valuation techniques. These include the use of recent arm's-length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. Purchases and sales of securities and other financial assets and liabilities are recognised on trade date, being the date that the Company is committed to purchase or sell an asset. Other financial assets and liabilities at fair value through profit or loss are initially recognised at fair value. These financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Company has transferred substantially all risks and rewards of ownership.

**(ii) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, loans and receivables (including trade and other receivables) are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

**(I) Derivative financial instruments**

All derivatives are classified as trading securities and are recognised at their fair value. Derivatives are carried in the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative. Derivatives may only be designated as hedges provided certain strict criteria are met. At the inception of a hedge its terms must be clearly documented and there must be an expectation that the derivative will be highly effective in offsetting changes in the fair value or cash flow of the hedged risk. The effectiveness of the hedging relationship must be tested throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its objective the hedge relationship is terminated. Derivatives that do not qualify for hedge accounting are classified as financial assets or liabilities held for trading. Changes in fair values of such derivatives are recognised directly in the income statement

**(J) Cash and cash equivalents**

Cash and cash equivalents consist of cash at banks and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments with less than 90 days' maturity from the date of acquisition. For the purposes of the cash flow statement, cash and cash equivalents also include bank overdrafts, which are included in payables and other financial liabilities on the balance sheet.

**(K) Provisions and contingent liabilities**

Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events, it is virtually certain that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Where the Company expects a provision to be reimbursed, for example under a guarantee contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The Company recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract. Contingent liabilities are disclosed if the future obligation is certain and the amount cannot be reasonably estimated.

#### **(L) Taxation**

Current income tax which is payable on taxable profits is recognised as an expense in the period in which the profits arise. Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised. The utilisation of deferred tax assets will depend on whether it is possible to generate sufficient taxable income. Various factors are used to assess the probability of the future utilisation of deferred tax assets, including, projections, and tax planning strategies. If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that the assessment of future utilisation of deferred tax assets changes, the recognised deferred tax assets must be reduced and this reduction be recognised in profit or loss. Deferred and current tax assets and liabilities are offset where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

#### **(M) Financial liabilities**

Financial liabilities issued by the Company are classified according to the substance of the contractual arrangements entered into. Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

#### **(N) Derecognition and offset of financial assets and financial liabilities**

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- The rights to receive cash flows from the asset have expired;
- The Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third-party under a “pass-through” arrangement; or
- The Company has transferred its rights to receive cash flows from the asset and has either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

**(O) Share capital**

Ordinary shares and contributed capital are classified as equity.

**(P) Use of Estimates**

The preparation of the financial statements in conformity with NZ IFRS requires management to make estimates and assumptions that affect the amounts that are reported in the Financial Statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates.

Key estimates are:

- (i)** Yield performance of the funds under management which is estimated at a net 13.4% over the term of the bonds.
- (ii)** 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. The Company uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at each balance sheet date.
- (iii)** Significant judgement is required in determining the Company's income tax liabilities and tax assets. In arriving at the deferred tax asset of \$867,919 at 30 June 2007 (2006: current tax liability nil and deferred tax asset of nil), the Company has taken an assessment of legal and professional advice, case law and other relevant guidance. In these situations, the various risks are categorised and approximate weightings applied in arriving at the assessment of the expected asset. The recoverability of the deferred tax asset has been derived based on the performance yield as covered in (i) above. Any reduction in this yield from actual trading activities will result in a reduction of the tax recoverable. Where the expected tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the reported profit or loss and current and deferred tax amounts in the period in which such determination is made.

**(Q) Goods and Services Tax (GST)**

The Company is an exempt company for GST. Exempt supplies include financial services and interest charges. All purchases are therefore connected with an exempt supply. The full amount of the purchase is recognised as part of the related asset or, where the expenditure relates to an expense item, the GST is incorporated in the expensed item. Receivables and payables are stated with the amount of GST included. Cash flows are included in the cash flow statement on a gross basis.

**(R) New standards and interpretations not yet adopted**

At the date of authorisation of these financial statements, NZ IFRS 7 Financial Instruments: Disclosures is in issue but not effective for this reporting period. NZ IFRS 7 will have minimal impact on the reported results going forward. There are no other Standards or Interpretations in issue but not yet effective that would impact on these financial statements in future periods.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

## Notes to the financial statements

### 1 – First time adoption of International Financial Reporting Standards

The Company has adopted New Zealand International Financial Reporting Standards (NZ IFRS) for these financial statements for the year ended 30 June 2007.

The Company did not trade prior to February 2007, accordingly there were no measurement or recognition differences on transition between previous NZ GAAP and NZ IFRS. As such, there is no disclosure of the transitional arrangements applicable under New Zealand International Financial Reporting Standard 1, First time adoption of International Financial Reporting Standards, (NZ IFRS 1).

### 2 – Segment information

#### (a) Primary reporting format – business segments

The Company operates in a single business segment, being investment of funds obtained via the issue of Capital Guaranteed Bonds and Subordinated Bonds.

#### (b) Secondary reporting format – geographical segments

The secondary reporting format is geographical segments based on the location/currency of investments.

	2007 Total \$	2006 Total \$
<b>Income/(Loss)</b>		
New Zealand	1,432,131	–
Australia	(1,363,775)	–
United States of America	(1,349,995)	–
	<b>(1,281,639)</b>	<b>–</b>

	2007 Total \$	2006 Total \$
<b>Assets</b>		
New Zealand	77,426,959	100
Australia	55,472,242	–
United States of America	286,689	–
	<b>133,185,890</b>	<b>100</b>

## FIDELITY CAPITAL GUARANTEED BOND LIMITED

*Notes to the financial statements – continued*

### 3 – Net change in financial assets and liabilities at fair value through profit or loss

For the year ended 30 June	2007 \$	2006 \$
Realised losses based on carrying value/ fair value	(2,690,906)	–
Unrealised profits at year end	667,212	–
	<b>(2,023,694)</b>	<b>–</b>

### 4 – Fund management fee

For the year ended 30 June	2007 \$	2006 \$
Active Portfolio Assets	77,390	–
Fixed Portfolio Net Asset value	–	–
	<b>77,390</b>	<b>–</b>

The fee is calculated at 0.6% of the Active Portfolio Assets on a daily basis throughout the period, and 0.2% of the non-active portfolio on a daily basis.

The Active Portfolio Assets are those investments as defined in the Supplemental Trust Deed dated 7 February 2007. The investments include:

- a. New Zealand, Australian or United States of America denominated registered certificates of deposits or other marketable debt securities not greater than a maturity of 365 days.
- b. New Zealand, Australian or United States Government bonds issued with an original maturity less than or equal to 15 years.
- c. New Zealand, Australian or United States futures contracts traded on the Sydney Futures Exchange, Chicago Board of Trade and the Chicago Mercantile Exchange.
- d. Exchange traded options on the futures contracts as defined under c. above and which are traded on those exchanges.
- e. Over the Counter (OTC) European Call and Put Options with the underlying asset as defined under b. above.
- f. Forward foreign exchange contracts (FEC) either being NZD/USD or AUD/NZD paired with a maturity not exceeding 3 months.

The Fixed Portfolio Net Asset value (non-active portfolio) is defined as zero coupon bonds or zero coupon deposits issued by the Guarantor with a maturity equal to the maturity date, or deposits.

During the period all investments fell under the Active Portfolio Assets category.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

*Notes to the financial statements – continued*

## 5 – Guarantee fee

The Company entered in to a Reimbursement Agreement dated 7 February 2007 in accordance with the Master Trust Deed dated 7 February 2007 with Westpac Banking Corporation, New Zealand branch (the ‘Capital Guarantor’) who have guaranteed the Capital value of the Capital Guaranteed Bonds. The fee is calculated at 1% on either the lower of: the Principal Amount outstanding on the Capital Guaranteed Bonds on a daily basis throughout the period or the Active Portfolio Net Asset Value (see note 4) on a daily basis throughout the period.

## 6 – Administration fee

The Company entered in to a Administration fee contract dated 7 February 2007 with Fidelity Life Assurance Company Limited (“Fidelity Life”), the ultimate holding company, whereby Fidelity Life manage the day-to-day operations of the Company excluding the investment management activities. The administration fee is calculated at 0.4% per annum of the Principal Amount outstanding under the Capital Guaranteed Bonds.

### Employee information

The Company has no employees. Management of the Company is covered by the Administration contract dated 7 February 2007, whereby Fidelity Life undertakes the administration of the Company on a day-to-day basis.

### Directors

The directors received no emoluments or had any interests including transactions in the Company. See related party note 18 for parent company emoluments paid to the directors.

## 7 –Other operating expenses

Other expenses relate to the on going expenses fund as covered by Supplemental Trust Deed (No.1) in respect of Capital Guaranteed Bonds and Subordinated Bonds dated the 7 February 2007. Including those expenses covered in notes 5 and 6 and reported separately.

	2007	2006
	\$	\$
Auditors’ fees	12,500	–
Trustee fees	3,616	–
Registrar fees	10,849	–
Custody fees	37	–
Bank fees	446	–
	<b>27,448</b>	<b>–</b>

### Trustees fees

Fees payable to the Trustee (The New Zealand Guardian Trust Company Limited), are governed by the Master Trust Deed dated 7 February 2007.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

## Registrar fees

Fees payable to the Registrar (Computershare Investor Services Limited) for services provided, are governed by the Master Trust Deed dated 7 February 2007, and the Registrar and Paying Agency Agreement dated 7 February 2007.

## Auditors' remuneration

The total remuneration payable by the Company, including GST, to its auditors', PricewaterhouseCoopers, in respect of the audit of these financial statements is shown below, together with fees payable in respect of other work.

	2007 \$	2006 \$
Fees payable to PricewaterhouseCoopers for the statutory audit of the Fidelity Capital Guaranteed Bond Limited	12,500	–
Fees payable to PricewaterhouseCoopers for other services:		
Other services pursuant to Prospectus	7,678	–
	<b>20,178</b>	<b>–</b>

## 8 – Finance costs

	2007 \$	2006 \$
Finance costs		
Interest expense on:		
Capital Guaranteed Bonds (senior bond)	1,672,603	–
Subordinated Bonds	148,877	–
Amortised transaction costs	90,962	–
Early bird interest	211,444	–
<b>Total finance costs</b>	<b>2,123,886</b>	<b>–</b>

The Fidelity Capital Guaranteed Bond issuer, Sub-debt holder, Trustee and Capital Guarantor signed a waiver in respect of the senior bond interest payment on 9 July 2007, giving consent for payment of senior bond interest of \$1,957,707 (at 9.25% for 103 days) and early bird interest of \$211,444 (7% to 3 April 2007), both of which were paid on 16 July 2007 being the first business day after the coupon date as provided for in the Trust Deed.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

## 9 – Taxation

### (a) Tax charged to the income statement

(i) The total tax charge comprises:

	2007 \$	2006 \$
Current tax		
For this year	–	–
<b>Total current tax</b>	<b>–</b>	<b>–</b>
Deferred tax		
Origination of timing differences	865,911	–
<b>Total deferred tax</b>	<b>865,911</b>	<b>–</b>
<b>Total tax charged to income statement (note 9d)</b>	<b>865,911</b>	<b>–</b>

All tax is attributable to New Zealand.

(ii) The Company, as a proxy for bondholders under New Zealand tax legislation, is required to deduct withholding taxes on interest income paid in each period and remit to the New Zealand Inland Revenue. There was no withholding tax expense attributable to bondholders' returns for the year ended 30 June 2007 (2006 nil).

(iii) Deferred tax charged to the income statement represents movements on the following items:

	2007 \$	2006 \$
Temporary difference on deferred transaction costs	(551,152)	–
Other temporary differences on recoverable tax losses	(314,759)	–
<b>Total deferred tax charged to income statement</b>	<b>(865,911)</b>	<b>–</b>

### (b) Tax charged/(credited)

(i) The total tax charge/(credit) comprises:

	2007 \$	2006 \$
Resident withholding tax deducted	2,008	–
Deferred tax	865,911	–
<b>Total tax charged/(credited)</b>	<b>867,919</b>	<b>–</b>

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements - continued

## (c) Imputation credit reconciliation

	2007	2006
	\$	\$
Balance at 1 July	-	-
Tax payments made net of refunds	-	-
Tax credits attached to distributions	-	-
<b>Balance at 30 June</b>	<b>-</b>	<b>-</b>

## (d) Reconciliation of operating loss to (loss) before tax

	2007	2006
	\$	\$
(Loss) before tax attributable to shareholder		
Operating loss before adjusting items and tax attributable to shareholder	(3,692,101)	-
<b>Tax at 30%</b>	<b>1,107,630</b>	<b>-</b>
<b>Adjusted for the following tax effects:</b>		
Transaction costs offset against borrowings	578,440	-
Amortisation of transaction costs	(27,288)	-
Current year losses not tax effected	(792,871)	-
<b>Loss after tax attributable to shareholder losses</b>	<b>865,911</b>	<b>-</b>

The company tax rate for 2007 is 33% and from 1 April 2008 reduces to 30%. The company expects to recover its expected tax losses in periods after 1 April 2008 (see note 9 e) and accordingly has applied a tax effective rate on its tax recoverability at 30%.

## (e) Unrecognised deferred tax assets

The company has not recognised deferred tax assets that relate to unused tax losses amounting to \$2,642,902 (2006: \$nil) in the current period, as projections indicated that it is not probable that future taxable profit will be available against which the company can utilise the benefits. Any shortfall in profit is first offset against payment on interest on Subordinated Bonds and secondly against the capital value of the Subordinated Bonds.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

## 10 – Financial assets at fair value through profit or loss

### (a) Financial investments comprise:

	2007				2006			
	At fair value through profit or loss				At fair value through profit or loss			
	Face Value \$	Trading \$	Other than trading \$	Total \$	Face Value \$	Trading \$	Other than trading \$	Total \$
<b>Debt securities</b>								
Securities issued by New Zealand registered banks	81,500,000	-	75,912,057	75,912,057	-	-	-	-
	<b>81,500,000</b>	<b>-</b>	<b>75,912,057</b>	<b>75,912,057</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Other investments</b>								
Derivative financial instruments	-	-	-	-	-	-	-	-
Deposits with credit institutions	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-
	-	-	-	-	-	-	-	-
<b>Total financial investments</b>	<b>81,500,000</b>	<b>-</b>	<b>75,912,057</b>	<b>75,912,057</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

Of the above total, \$nil is expected to be recovered more than one year after the balance sheet date.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

## 11 – Derivative financial instruments

The Company uses options to generate investment income. No derivatives are used for hedging purposes.

### Non-hedge derivatives

The Company's non-hedge derivative activity at 30 June was as follows:

	2007					2006				
	Contract/ notional amount AUD\$m	Contract/ notional amount US\$m	Contract/ notional amount NZ \$m	Fair value asset NZ\$	Fair value liability NZ\$	Contract/ notional amount AUD\$m	Contract/ notional amount US\$m	Contract/ notional amount NZ \$m	Fair value asset NZ NZ\$	Fair value liability NZ\$
<b>Put Options</b>										
<b>OTC</b>										
Australian	294	–	323	–	399,641	–	–	–	–	–
USA	–	144	186	–	35,318	–	–	–	–	–
<b>Total</b>	<b>294</b>	<b>144</b>	<b>509</b>	<b>–</b>	<b>434,959</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Call Options</b>										
<b>OTC</b>										
Australian	59	–	65	–	31,718	–	–	–	–	–
USA	–	144	186	–	88,434	–	–	–	–	–
<b>Total</b>	<b>59</b>	<b>144</b>	<b>251</b>	<b>–</b>	<b>120,152</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Totals at 30 June</b>	<b>353</b>	<b>288</b>	<b>760</b>	<b>–</b>	<b>555,111</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>

### Non-hedge derivatives – Forward Currency Contracts

The Company's non-hedge derivative activity at 30 June was as follows:

	2007			2006		
	Contract/ notional amount \$	Fair value asset \$	Fair value liability \$	Contract/ notional amount \$	Fair value asset \$	Fair value liability \$
<b>Forward Currency Purchases</b>						
Australian dollars	238,500	–	664	–	–	–
<b>Total</b>	<b>238,500</b>	<b>–</b>	<b>664</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Forward Currency Selling</b>						
Australian dollars	133,000	359	–	–	–	–
<b>Total</b>	<b>133,000</b>	<b>359</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Totals at 30 June</b>	<b>371,500</b>	<b>359</b>	<b>664</b>	<b>–</b>	<b>–</b>	<b>–</b>

The Company's derivative risk management policies are outlined in Note 20.

## FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

### (b) Derivative financial instruments

The following is a summary of the cost/amortised cost, gross unrealised gains and losses and fair value of financial investments:

	2007				2006			
	Cost \$	Unrealised gains \$	Unrealised losses \$	Fair value \$	Cost \$	Unrealised gains \$	Unrealised losses \$	Fair value \$
Debt securities	75,244,845	667,212	–	75,912,057	–	–	–	–
Represented as:								
Assets	75,244,845	667,212	–	75,912,057	–	–	–	–
	<b>75,244,845</b>	<b>667,212</b>	<b>–</b>	<b>75,912,057</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>

The contractual undiscounted cash flows in relation to non-hedge derivative liabilities have the following maturities:

	2007 \$	2006 \$
Within one year	555,775	–
	<b>555,775</b>	<b>–</b>

### 12 – Receivables and other financial assets

	2007 \$	2006 \$
Amounts owed from parent company	100	100
Other financial assets:		
Proceeds due from sale of investments	55,114,657	–
Proceeds from sale of derivatives	146,712	–
Interest receivable	260	–
Total	55,261,729	100
Expected to be recovered in less than one year	55,261,629	–
Expected to be recovered in more than one year	100	100
	<b>55,261,729</b>	<b>100</b>

## 13 – Tax assets and liabilities

**(a) General**

Deferred tax assets recoverable within one year \$136,817 (2006 \$nil) and in more than one year are \$731,102 (2006 \$nil). An analysis of the movements in deferred tax assets and liabilities is shown below. Deferred tax assets and liabilities are only offset where the Company has a legally enforceable right to set off current tax assets against current tax liabilities.

**(b) Deferred tax**

(i) The balances at 30 June comprise:

	2007 \$	2006 \$
Deferred tax asset	867,919	–
Deferred tax liabilities	–	–
<b>Net deferred tax asset</b>	<b>867,919</b>	<b>–</b>

(ii) The net deferred tax asset arises on the following items:

	2007 \$	2006 \$
Temporary difference on subordinate transaction costs of issue	551,152	–
Timing difference on recoverable tax losses	316,767	–
<b>Net deferred tax asset</b>	<b>867,919</b>	<b>–</b>

The net deferred tax asset includes resident withholding tax of \$2,008.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

## 14 – Payables and other financial liabilities

	2007 \$	2006 \$
<b>Interest Accrued:</b>		
Early bird interest	211,444	–
Capital Guaranteed Bonds	1,672,603	–
Subordinated Bonds	148,877	–
	<b>2,032,924</b>	<b>–</b>
<b>Accrued Expenses:</b>		
Guarantee fee	125,334	–
Administration fee	56,404	–
Fund management fee	77,390	–
Trustee fee	3,616	–
Registrar fee	10,849	–
Audit fees	12,500	–
	<b>286,093</b>	<b>–</b>
<b>Other:</b>		
Purchase of investments outstanding	55,377,718	–
Transaction costs refundable to Fidelity Life	38,042	–
	<b>55,415,760</b>	<b>–</b>
<b>Total</b>	<b>57,734,777</b>	<b>–</b>
Expected to be settled within one year	57,734,777	–
Expected to be settled in more than one year	–	–
	<b>57,734,777</b>	<b>–</b>

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

## 15 – Borrowings

	Note	Nominal interest rate	Effective interest rate	Cost \$	Transaction costs \$	Interest accrued \$	Effective interest rate	2007 \$
Capital Guaranteed Bonds		9.25%	9.25%	75,000,000	–	(1,672,603)	1,672,603	75,000,000
Subordinated Bonds		12.35%	37.82%	5,000,000	(2,369,534)	(148,877)	239,839	2,721,428
<b>Total</b>				<b>80,000,000</b>	<b>(2,369,534)</b>	<b>(1,821,480)</b>	<b>1,912,442</b>	<b>77,721,428</b>
Expected to be settled within one year (see payables)	14	–	–	–	–	(1,821,480)	–	(1,821,480)
Expected to be settled in more than one year		–	–	–	–	–	–	–
		–	–	–	–	(1,821,480)	–	(1,821,480)

The final settlement date to repay the principal borrowings for both the Capital Guaranteed Bonds and Subordinated Bonds is the 15 July 2013.

Interest was paid up to 15 July 2007 on the Guaranteed Capital Bonds under the terms of the Trust Deed dated 7 February 2007 and a waiver of senior bond interest payment threshold and consent to payment dated the 9 July 2007. Payment of this interest occurred on the 16 July 2007 amounting to \$1,957,704.

	Note	Nominal interest rate	Effective interest rate	Cost \$	Transaction costs \$	Interest accrued \$	Effective interest rate	2006 \$
Capital Guaranteed Bonds		–	–	–	–	–	–	–
Subordinated Bonds		–	–	–	–	–	–	–
<b>Total</b>		<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
Expected to be settled within one year (see payables)	14	–	–	–	–	–	–	–
Expected to be settled in more than one year –		–	–	–	–	–	–	–
		–	–	–	–	–	–	–

The fair value of the Capital Guaranteed Bonds at the 29 June 2007 as reported on the NZDX was \$78,470,681(2006: nil).

## FIDELITY CAPITAL GUARANTEED BOND LIMITED

*Notes to the financial statements – continued*

### 16 – Ordinary share capital

Details of the Company's ordinary share capital are as follows:

	2007 \$	2006 \$
-----		
The share capital of the Company at 30 June was: 100 paid up ordinary shares (2006:100)	100	100
-----		
The allotted, called up and fully paid share capital of the Company at 30 June was:		
<b>100 (2006: 100) ordinary shares</b>	<b>100</b>	<b>100</b>
-----		

Ordinary shares in issue in the Company rank pari passu. All the ordinary shares in issue carry the same right to receive all dividends and other distributions declared, made or paid by the Company.

### 17 – Retained earnings

	2007 \$	2006 \$
-----		
Balance at 1 July	–	–
(Loss) for the year attributable to shareholder	(2,826,190)	–
<b>Balance at 30 June</b>	<b>(2,826,190)</b>	<b>–</b>
-----		

### Dividends and appropriations

There were no dividends declared or paid.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements – continued

## 18 – Related party transactions

The Company paid expenses to Fidelity Life Assurance Company Limited the ultimate parent company from transactions made in the normal course of business. The parent company acquired all of the 12.35% Subordinated Bonds debt – amounting to \$5m.

### Interest to Parent

	2007		2006	
	Income expense in year \$	Payable at year end \$	Income expense in year \$	Payable at year end \$
Interest accrued on Subordinated Bonds payable				
15 January 2008	239,839	148,877	–	–
	<b>239,839</b>	<b>148,877</b>	<b>–</b>	<b>–</b>

### Services payable to Parent

	2007		2006	
	Expenses in year \$	Payable at year end \$	Expenses in year \$	Payable at year end \$
Administration fee accrued payable 15 January 2008	56,404	56,404	–	–
Transaction costs of Prospectus	38,041	38,041	–	–
	<b>94,445</b>	<b>94,445</b>	<b>–</b>	<b>–</b>

### Receivable from Parent

	2007		2006	
	Income in year \$	Receivable at year end \$	Income in year \$	Receivable at year end \$
Contributed capital	–	100	–	100
	<b>–</b>	<b>100</b>	<b>–</b>	<b>100</b>

## FIDELITY CAPITAL GUARANTEED BOND LIMITED

### *Notes to the financial statements – continued*

The related parties' receivables are not secured and no guarantees were received in respect thereof. The receivables will be settled in accordance with the Trust Deed.

There were no services provided by related parties in 2006.

The administration fee payable to the parent for the administration of the Company is an amount equal to 0.40% per annum of the Principal Amount of the Capital Guaranteed Bonds and is payable on the 15th January 2008.

The total outstanding to the parent at 30 June was \$5,243,222 comprised of interest, administration fees and Subordinated Bonds (2006 receivable \$100).

### **Total compensation paid by the parent to the directors (key management) of the Company**

#### **Details of Directors' Compensation**

Key management personnel include directors who have the strategic responsibility in the areas of planning, directing and controlling the activities of the Company, directly or indirectly.

Directors fees are paid by the parent company on behalf of the Group.

FIDELITY CAPITAL GUARANTEED BOND LIMITED

Notes to the financial statements - continued

19 – Reconciliation of operating loss after tax to net cash from operating activities

	2007 \$	2006 \$
<hr/>		
Operating loss before tax attributable to shareholder losses		
Operating loss after tax attributable to shareholder (losses)	(2,826,190)	–
<b>Adjusted for the following non cash items:</b>		
Amortisation of transaction costs	90,962	–
Operating expenses	209,186	–
Interest payable on Capital Guaranteed Bonds	1,672,603	–
Interest payable on Subordinated Bonds	148,877	–
Early bird interest	211,444	–
Unrealised gains and losses	50,134	–
Management fees	77,390	–
<b>Adjusted for the following cash items not included in operating loss:</b>		
Transaction costs paid	(2,369,534)	–
	<hr/> (2,735,128) <hr/>	<hr/> – <hr/>
Add/(less) movements in working capital related to operating activities		
(Increase) in financial assets	(55,261,729)	–
(Increase) in receivables	(75,912,057)	–
(Increase) in deferred tax assets	(867,919)	–
Increase in payables	57,734,777	–
Increase in derivatives	555,416	–
<b>Net cash inflows from Operating activities</b>	<b>(76,486,640)</b>	<b>–</b>

## 20 – Risk management

### **(a) Risk management framework**

The Company uses Fidelity Life Assurance Company Limited (Fidelity Life) the ultimate parent company as its business administrator, and accordingly the Company's risk management framework is based on that of Fidelity Life. The Company's risk management frameworks primary objective is to protect Fidelity Capital Guaranteed Bond Limited from events that hinder the sustainable achievement of the Company's performance objectives, including failing to exploit opportunities. Risk is categorised as follows:

- Market
- Credit
- Operational
- Liquidity

The Company recognises the critical importance of having efficient and effective risk management systems in place. To this end, Fidelity Life has an established governance framework, which has three key elements:

- Defined terms of reference for the Board, its committees, and the associated executive management committees;
- A clear organisational structure with documented delegated authorities and responsibilities from the Board to executive management committees and senior management; and
- A Company policy framework that sets out risk appetite, risk management, control and business conduct standards for the Company's operations.

Each policy has a member of senior management who is charged with overseeing compliance with the policy throughout the Company.

### **Risk assessments**

The adoption of Fidelity Life's policies on risk management enables a consistent approach to management of risk at operational unit level. Fidelity Life operates a number of oversight committees that monitor aggregate risk data and take overall risk management decisions.

The Company also monitors a set of specific risks on a regular basis through the Company's risk monitoring framework. A review of all material risks, along with information on likelihood and severity of risks, and the mitigating actions taken or planned is undertaken on a regular basis. This enables the Company to assess its overall risk exposure and to develop a risk map, identifying any concentrations of risk that may exist, and to define which risks and what level of risk the Company is prepared to accept.

The risk map is refreshed regularly, and escalation is required if material changes occur.

**(a) Market risk**

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity prices, property prices, and foreign currency exchange rates. Market risk arises in the business due to fluctuations in both the value of liabilities and the value of investments held.

Fidelity Life has established a policy on market risk which sets out the principles that are adopted in respect of management of the key market risks to which the Company is exposed. Fidelity Life monitors adherence to this market risk policy and regularly reviews how the fund manager is managing these risks, through the Fidelity Life Investment Committee.

For each of the major components of market risk, described in more detail below, Fidelity Life has put in place additional policies and procedures to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite. The management of market risk is undertaken by the Fidelity Life Investment Committee who is responsible for managing market risk, and a number of investment related risks, in particular those faced by the Capital Guaranteed Bondholders.

The financial impact from changes in market risk (such as interest rates, equity prices and property values) is managed by the fund managers.

The sensitivity of Company earnings to changes in economic markets is regularly monitored through the fund managers who provide daily reports to the Company.

The Company market risk policy provided to the fund manager sets out the minimum principles and framework for matching liabilities with appropriate assets, the approaches to be taken when liabilities cannot be matched and the monitoring processes that are required. The Company has criteria for matching assets and liabilities in order to manage the financial risk from the mismatching of assets and liabilities when investment markets change.

**Price risk**

The Company is subject to securities price risk due to daily changes in the market values of its bank securities portfolio and derivatives portfolio. The Fidelity Life Investment Committee delegates active monitoring of its financial assets owned directly by the Company, which may include some material deposits and zero rate coupon bonds with the Company's bankers. Concentrations of specific holdings are also managed and monitored by the Company's fund manager.

At 30 June 2007, the Company had entered into a number of put and call options to mitigate the effects of potential adverse price rate movements, and to enable close matching of assets and liabilities.

## FIDELITY CAPITAL GUARANTEED BOND LIMITED

### *Notes to the financial statements – continued*

#### **Interest rate risk**

Interest rate risk arises primarily from the Company's investments in fixed income securities, which are exposed to fluctuations in interest rates. Exposure to interest rate risk is monitored through several measures that include, position limits, and asset and liability matching using measures such as duration.

Further information on borrowings is included in note 15.

#### **Currency risk**

The Company through its funds manager invests in Australia and the USA, as a result the Company is exposed to foreign currency exchange risk arising from fluctuations in exchange rates of these currencies. Approximately 74% of the Company's income arises in currencies other than New Zealand dollars and the Company's net assets are denominated in Australian dollars, US dollars as well as New Zealand dollars. The Company does not hedge foreign currency revenues.

The Company's foreign exchange policy requires that the fund manager maintains sufficient assets to meet currency liabilities. Therefore, the Company limits its exposures regardless of foreign currency movements. For this reason, no sensitivity analysis is given for these holdings.

#### **Derivatives risk**

Derivatives are used, within policy guidelines agreed by the board of directors and overseen by the Fidelity Life Investment Committee, which monitors implementation of the policy, exposure levels and performance of fund manager. Derivatives are primarily used for investment income generation within a defined framework.

Over the counter derivative contracts are entered into only with approved counterparties, in accordance with Company policies, thereby reducing the risk of credit loss. The Company applies strict requirements to the administration and valuation processes it uses, and has a control framework that is consistent with market and industry practice for the activity that is undertaken.

#### **(b) Credit risk**

Credit risk is the risk of loss in the value of financial assets due to counterparties failing to meet all or part of their obligations. The Company's management of credit risk includes monitoring exposures entered into by the funds manager. Credit risk policies involve the establishment and operation of specific risk management committees and the detailed reporting and monitoring of the financial asset portfolio against pre-established risk criteria. The Company deals only with approved counterparty's reflecting the credit ratings by Standard & Poor's and Moody's.

Financial assets are graded according to current credit ratings issued. AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to A2 ratings. Financial assets are not to fall outside this range. Credit limits for each counterparty are set based on the value at risk within the Active Portfolio.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

## Notes to the financial statements – continued

The following table provides information regarding the aggregated credit risk exposure, for financial assets with external credit ratings, of the Company at 30 June 2007.

	Credit rating				Carrying value in the balance sheet \$'000
	AAA	AA	A	A2	
Debt securities		75,912			75,912
Derivative contracts		–			–

The carrying amount of assets included on the balance sheet represents the maximum credit exposure.

### (c) Operational risk

Operational risk arises as a result of inadequately controlled internal processes or systems, human error, or from external events.

This definition is intended to include all risks to which the Company is exposed, other than the financial risks described previously, and strategic risks that are considered elsewhere. Hence, operational risks include for example, information technology, information security, human resources, project management, outsourcing, tax, legal, fraud and compliance risks.

In accordance with Company policies, senior management has primary responsibility for the effective identification, management, monitoring and reporting of risks to the executive management team and to the Board as part of the regular risk reporting process. Each operational risk is assessed by considering the potential impact and the probability of the event occurring.

Impact assessments are made against financial, operational and reputational criteria.

The executive committee are responsible for implementing the Company risk management methodologies and frameworks to assist line management in this work. They also provide support and independent challenge on the completeness, accuracy and consistency of risk assessments, and the adequacy of mitigating action plans. As a result, the executive management team satisfies itself that all material risks falling outside our risk appetite are being mitigated, monitored and reported at an appropriate level. Any risks with a high impact level are continually monitored centrally.

The Board and senior management of Fidelity Life Assurance Company Limited determines the risk appetite that the group can work within for these types of risk, assesses and monitors overall operational risk exposures, identifying any concentrations of operational risk across the company, and in particular verifies that mitigating action plans are implemented.

## FIDELITY CAPITAL GUARANTEED BOND LIMITED

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*Notes to the financial statements – continued*

### **(d) Liquidity risk**

The Company has a strong liquidity position and through the application of a Liquidity Management policy seeks to maintain sufficient financial resources to meet its obligations as they fall due.

Note 15 provides a maturity analysis of borrowings.

# FIDELITY CAPITAL GUARANTEED BOND LIMITED

*Independent auditor's report*



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## **Auditors' Report**

To the shareholders of Fidelity Capital Guaranteed Bond Limited

We have audited the financial statements on pages 2 to 31. The financial statements provide information about the past financial performance and cash flows of the Company for the year ended 30 June 2007 and its financial position as at that date. This information is stated in accordance with the accounting policies set out on pages 5 to 10.

### **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 30 June 2007 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 advisors.

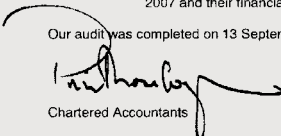
### **Unqualified Opinion**

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 2 to 31:
  - (i) comply with generally accepted accounting practice in New Zealand;
  - (ii) comply with International Financial Reporting Standards; and
  - (iii) give a true and fair view of the financial position of the Company and Group as at 30 June 2007 and their financial performance and cash flows for the year ended on that date.

Our audit was completed on 13 September 2007 and our unqualified opinion is expressed as at that date.

  
Chartered Accountants

Auckland

