QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

ANNUAL REPORT – 31 December 2017

CONTENTS

This financial report includes separate financial statements for QBE Lenders' Mortgage Insurance Limited, New Zealand Branch (the "branch") as an individual entity. The financial report is presented in New Zealand dollars.

The branch is a branch of QBE Lenders' Mortgage Insurance Limited (the "company") and is a reporting entity for the purposes of the Financial Reporting Act 2013 and the Financial Markets Conduct Act 2013. Its principal place of business is:

Level 6, AMP Centre, 29 Customs Street West,
Auckland 1010 New Zealand

STATEMENT BY DIRECTORS

For the year ended 31 December 2017

We, being two directors of QBE Lenders' Mortgage Insurance Limited, certify that the Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Balances Due To Head Office, Statement of Cash Flows and notes set out on pages 8 to 35 are true copies of the Financial Statements of the New Zealand Branch of the Company for the year ended 31 December 2017.

The Board of Directors of QBE Lenders' Mortgage Insurance Limited authorised these statements for issue on 15 February 2018.

Director..

Director..

Independent auditor's report

To the Directors of QBE Lenders' Mortgage Insurance Limited – New Zealand Branch

The financial statements comprise:

- the balance sheet as at 31 December 2017;
- the statement of comprehensive income for the year then ended;
- the statement of changes in balances due to Head Office for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the financial statements of QBE Lenders' Mortgage Insurance Limited, New Zealand Branch (the Branch), present fairly, in all material respects, the financial position of the Branch as at 31 December 2017, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Basis for opinion

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

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

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

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

Information other than the financial statements and auditor's report

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

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

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

https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-8/

This description forms part of our auditor's report.

Who we report to

This report is made solely to the Branch's directors, as a body. Our audit work has been undertaken so that we might state those matters which we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Branch and the Branch's directors, as a body, for our audit work, for this report or for the opinions we have formed.

The engagement partner on the audit resulting in this independent auditor's report is S J Hadfield.

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
15 February 2018

Sydney

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2017

	Note	2017 $	2016 $
Gross written premium		-	-
Unearned premium movement		**740,747**	1,293,381
Gross earned premium revenue	5(A)	**740,747**	1,293,381
Outward reinsurance premium		-	(1,782,637)
Deferred reinsurance premium movement		**(333,336)**	670,128
Outward reinsurance premium expense	5(B)	**(333,336)**	(1,112,509)
Net earned premium		**407,411**	180,872
Gross claims releases	5(B)	**220,131**	452,845
Reinsurance and other recoveries	5(A)	**(60,645)**	385,254
Net claims releases	6(A)	**159,486**	838,099
Reinsurance commission revenue	5(A)	**75,334**	131,537
Other acquisition costs	5(B)	**(77,338)**	(189,489)
Underwriting and other expenses	5(B)	**(88,404)**	(188,540)
Underwriting result		**476,489**	772,479
Investment income on policyholder's funds	5(A)	**19,032**	27,218
Insurance profit		**495,521**	799,697
Profit before income tax		**495,521**	799,697
Income tax expense	7(A)	**(138,741)**	(223,960)
Profit after income tax		**356,780**	575,737
Other comprehensive income			
Other comprehensive income after income tax		-	-
Total comprehensive income after income tax		**356,780**	575,737
Profit after income tax attributable to Head Office Account		**356,780**	575,737
		356,780	575,737
Total comprehensive income after income tax attributable to:			
Head Office Account		**356,780**	575,737
		356,780	575,737

The statement of comprehensive income should be read in conjunction with the accompanying notes.

BALANCE SHEET
As at 31 December 2017

	Note	2017 $	2016 $
Assets			
Cash and cash equivalents	8	**1,295,753**	1,571,358
Trade and other receivables	9	**7,479**	120,855
Current tax receivable		**56,733**	-
Reinsurance and other recoveries on outstanding claims	13(A)	**164,221**	300,487
Deferred insurance costs	10	**426,145**	836,819
Total assets		**1,950,331**	2,829,519
Liabilities			
Trade and other payables	12	**65,118**	78,858
Current tax liabilities		**-**	76,752
Deferred tax liabilities	11(B)	**25,019**	46,674
Outstanding claims	13(A)	**358,968**	666,707
Unearned premium	14(A)	**748,426**	1,489,173
Unearned reinsurance commission	14(B)	**76,115**	151,449
Total liabilities		**1,273,646**	2,509,613
Net Assets		**676,685**	319,906
Due to Head Office - Australia		**676,685**	319,906

The balance sheet should be read in conjunction with the accompanying notes.

STATEMENT OF CHANGES IN BALANCES DUE TO HEAD OFFICE
For the year ended 31 December 2017

2017	Head office account $
As at 1 January	**319,906**
Profit after income tax	**356,780**
Other comprehensive income	**-**
Total comprehensive income	**356,780**
Net funding movements	**(1)**
As at 31 December	**676,685**

2016	
As at 1 January	(3,559,416)
Profit after income tax	575,737
Other comprehensive income	-
Total comprehensive income	575,737
Net funding movements	3,303,585
As at 31 December	319,906

The statement of changes in balances due to Head Office should be read in conjunction with the accompanying notes.

STATEMENT OF CASH FLOWS
For the year ended 31 December 2017

	Note	2017 $	2016 $
Operating activities			
Non-reinsurance recoveries received		**75,621**	109,694
Reinsurance commissions received		-	282,986
Outward reinsurance paid		-	(1,782,637)
Claims paid		**(87,608)**	(113,708)
Other underwriting costs paid		**11,231**	(250,801)
Interest received		**19,032**	27,218
Income taxes paid		**(293,881)**	(450,000)
Net cash flows from operating activities	8(A)	**(275,605)**	(2,177,248)
Investing activities			
Net cash flows from investing activities		-	-
Financing activities			
Net funding received		-	3,303,585
Net cash flows from financing activities		-	3,303,585
Net movement in cash and cash equivalents		**(275,605)**	1,126,337
Cash and cash equivalents at the beginning of the financial year		**1,571,358**	445,021
Cash and cash equivalents at the end of the financial year	8	**1,295,753**	1,571,358

The statement of cash flows should be read in conjunction with the accompanying notes.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2017

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The financial report includes financial statements for QBE Lenders' Mortgage Insurance Limited, New Zealand Branch (the "branch") as an individual entity. The branch is a branch of QBE Lenders' Mortgage Insurance Limited ("QBE LMI" or the "company") and is a reporting entity for the purposes of the *Financial Reporting Act 2013*.

For a complete understanding of the financial position of the company refer to the company's full financial statements as lodged with the Australian Securities and Investments Commission.

(A) Basis of preparation

The financial statements have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS"), other applicable Financial Reporting Standards, as appropriate for profit-oriented entities, the requirements of the *Financial Reporting Act 2013* and the *Financial Markets Conduct Act 2013*.

The sole shareholder of the company has exercised its right under section 211(3) of the *Companies Act 1993* and determined that these financial statements need not comply with paragraphs (a), and (e) to (j) of section 211(1) of the Act.

The company has applied for and has been granted an exemption from preparing consolidated financial statements by the Financial Markets Authority under the *Financial Reporting Act 2013* and the *Financial Markets Conduct Act 2013*. The company's ultimate parent, QBE Insurance Group Limited (QBE Group), prepares and will lodge consolidated financial statements with the Financial Markets Authority.

The financial statements have been prepared in accordance with the *Financial Reporting Act 2013*, the *Companies Act 1993* and the *Financial Markets Conduct Act 2013*.

The company is a for-profit entity for the purpose of preparing the financial statements.

(i) Compliance with IFRS
The financial report complies with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

(ii) Historical cost convention
These financial statements have been prepared under the historical cost convention, as modified by certain exceptions noted in the financial report, with the principal exceptions being the measurement of financial assets at fair value and the measurement of the outstanding claims liability and related recoveries at present value. Refer to note 3.

(iii) Critical accounting estimates and judgements
The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions or estimates are significant, are disclosed in note 3.

(iv) Going concern
With effect from September 2013, the branch ceased to write new insurance policies. The directors of the company believe that the branch has access to sufficient resources to meet its future liabilities and commitments. For this reason the directors continue to adopt the going concern assumption in the preparation of the branch's financial statements.

(B) Premium revenue

Premium comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. The earned portion of premium received and receivable is recognised as revenue. Premium is treated as earned from the date of attachment of risk.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(C) Insurance contracts

All of the insurance products offered or utilised by the branch meet the definition of insurance contracts under New Zealand IFRS, and are accounted for and reported in accordance with these standards. These products do not contain embedded derivatives or deposits that are required to be unbundled.

(D) Unearned premium

Unearned premium is calculated based on the term of the policies written and the likely pattern in which risk will emerge over that term.

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the business segment level, being a portfolio of contracts that are broadly similar and managed together as a single portfolio. If the present value of expected future cash flows relating to future claims plus the additional risk margin exceeds the unearned premium liability less deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The resulting deficiency is recognised immediately through profit or loss.

(E) Outward reinsurance

Premium ceded to reinsurers is recognised as an expense from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of incidence of risk. Where applicable, a portion of outward reinsurance premium is treated as a prepayment at the balance date.

(F) Claims

The provision for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not reported ("IBNR"), and estimated claims handling costs. Claims expense represents claims payments adjusted for movements in the outstanding claims liability.

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

A risk margin is applied to the central estimate, net of non-reinsurance recoveries, to reflect the inherent uncertainty in the central estimate.

(G) Non-reinsurance recoveries

Non-reinsurance recoveries receivable on paid claims, reported claims not yet paid and IBNR are recognised as revenue.

Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

(H) Acquisition costs

Acquisition costs are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised when they relate to the acquisition of new business and are amortised on the same basis as the earning pattern of the premium, in accordance with the premium income earning pattern adjusted for policy terminations. At the reporting date, deferred acquisition costs represent the capitalised costs that relate to the unearned premium. Acquisition costs are deferred in recognition of their future benefit and are measured at the lower of cost and recoverable amount.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(I) Investment income

Interest income is recognised on an accruals basis.

(J) Taxation

The income tax expense for the period is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted for changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authority.

Deferred income 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. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also 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 income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Current and deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, as appropriate.

(K) Insurance profit

Insurance profit is derived by adding investment income on assets backing policyholders' funds to the underwriting result.

(L) Cash and cash equivalents

Cash and cash equivalents include cash at bank and on hand and deposits at call which are readily convertible to cash on hand and which are used for operational cash requirements.

(M) Trade and other receivables

Trade receivables are recognised at amounts receivable less a provision for impairment. A provision for impairment is established when there is objective evidence that the branch will not be able to collect all amounts due according to the original term of the receivable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. Any increase or decrease in the provision for impairment is recognised in the profit or loss within underwriting expenses. When a receivable is uncollectible, it is written off against the provision for impairment account. Subsequent recoveries of amounts previously written off are credited against underwriting expenses in the profit or loss.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(N) Impairment of assets

Assets that have an indefinite useful life are tested annually for impairment or more frequently when changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised as the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use. For the purposes of assessing impairment, assets are grouped in cash generating units which are the lowest levels for which there are separately identifiable cash flows.

(O) Trade and other payables

Trade and other payables are measured at cost and are settled under standard terms and conditions. Intercompany payables are measured at amortised cost and are repayable on demand.

(P) Functional and presentation currency

The branch's financial statements are presented in New Zealand dollars, being the functional and presentation currency of the branch.

(Q) Goods and services tax ("GST")

GST incurred is not recoverable from the Inland Revenue Department. GST is recognised as part of the cost of acquisition of an asset or as part of an item of expense. Payables in the balance sheet and commitments are shown inclusive of GST.

(R) Comparative figures

Where appropriate, prior period comparatives have been reclassified in this financial report to ensure comparability in the current reporting period. The reclassification was necessary to provide the readers of the financial report with a greater understanding of the branch's financial statements.

2. NEW ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET EFFECTIVE

(i) New and amended standards adopted by the company

The company adopted the following new or revised accounting standards which became effective for the annual reporting period commencing on 1 January 2017.

TITLE	
NZ IFRS 2016–1	Recognition of Deferred Tax Assets for Unrealised Losses
NZ IFRS 2016–2	Disclosure Initiative: Amendments to NZ IFRS 107
NZ IFRS 2017–2	Further Annual Improvements 2014-2016 Cycle

The adoption of these new or revised standards did not materially affect the company's accounting policies or financial statements.

2. NEW ACCOUNTING STANDARDS AND AMENDMENTS ISSUED BUT NOT YET EFFECTIVE (CONTINUED)

(ii) New accounting standards and amendments issued but not yet effective

TITLE		OPERATIVE DATE
NZ IFRS 9	Financial Instruments	1 January 2018 [1]
NZ IFRS 15	Revenue from Contracts with Customers	1 January 2018
NZ IFRS 2016-6	Applying NZ IFRS 9 Financial Instruments with NZ IFRS 4 Insurance Contracts	1 January 2018
IFRIC Interpretation 22	Foreign Currency Transactions and Advance Consideration	1 January 2018
IFRIC Interpretation 23	Uncertainty over Income Tax Treatments	1 January 2019
NZ IFRS 17	Insurance Contracts	1 January 2021

1 The Company intends to defer the application of NZ IFRS 9 as discussed below

The New Zealand Accounting Standards and amendments detailed in the table above are not mandatory for the company until the operative dates stated; however, early adoption is permitted.

Other than NZ IFRS 9, the company currently plans to apply the standards and amendments detailed above for the reporting periods beginning on the operative dates set out above. An initial assessment of the financial impact of the standards and amendments has been undertaken and they are not expected to have a material impact on the company's financial statements.

NZ IFRS 9 was issued during 2014 and will replace existing accounting requirements for financial instruments. Having met the relevant criteria, the company expects to defer adoption of NZ IFRS 9 to 1 January 2021 at the latest. The new requirements primarily relate to the company's accounting for investments. Investments are currently designated as at fair value through profit or loss on initial recognition and are subsequently remeasured to fair value at each reporting date, reflecting the business model applied by the company to manage and evaluate its investment portfolio. Under this business model, adoption of NZ IFRS 9 is not expected to result in significant changes to accounting for investments, with the potential exception of equity investments held by the company for strategic purposes where changes in fair value may be presented in other comprehensive income.

On 18 May 2017, after around 20 years of development, the International Accounting Standards Board issued IFRS 17, a new accounting standard for insurance contracts. The New Zealand equivalent, NZ IFRS 17, was adopted by the New Zealand Accounting Standards Board on 10 August 2017. NZ IFRS 17 will be effective for reporting periods beginning on or after 1 January 2021 and will be applicable to general, life and health insurance business. Given the broad scope, complexity and lack of general consensus on the interpretation of some key areas of the standard, the impact of NZ IFRS 17 on the company's financial statements is still being determined; however, significant disclosure changes and some impact on profit or loss are expected. In particular, NZ IFRS 17 introduces a new general model for measuring and accounting for insurance contracts but permits application of a simplified measurement model (which is similar to the current basis on which general insurance is brought to account under NZ IFRS 4) if the liability measurement under the simplified model would not materially differ from the general model. The company has initiated a project to assess the impact of this change on both the financial statements and the broader business, with a view to achieving full compliance for the first applicable reporting date, for the year ending 31 December 2021. An initial impact assessment has identified a number of key areas of uncertainty of interpretation of NZ IFRS 17 as well as the potential for changes in interpretation during 2018 as the International Accounting Standards Board progresses its education support for the new standard.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The company is a lenders' mortgage insurance company underwriting business in Australia and New Zealand. The branch underwrites all business in New Zealand and none in Australia.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

The company has developed a strong, centralised risk management and policy framework, designed to ensure consistency of approach across a number of operational activities, subject to the specific requirements of the local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of claims provisions and investment management. In addition, assessment of the net outstanding claims provision set at a company and subsidiary level is subject to detailed head office review. The probability of adequacy of the company's insurance liabilities is measured by the company's senior actuaries.

The company makes estimates and judgements in respect of the reported amounts of certain assets and liabilities. These estimates and judgements are determined by qualified and experienced employees with reference to historical data and reasoned expectations of future events, and are continually updated. The key areas in which critical estimates and judgements are applied are described on the following pages.

(A) Outstanding claims provision

The branch's net outstanding claims provision comprises:

- the gross central estimate of expected future claims payments;
- amounts recoverable from reinsurers, borrowers and third parties based on the gross central estimate;
- a reduction to reflect the discount to present value using risk-free rates of return to reflect the time value of money; and
- a risk margin that reflects the inherent uncertainty in the net discounted central estimate.

A net discounted central estimate is intended to represent the mean of the distribution of the expected future cash flows. As the branch requires a higher probability that estimates will be adequate over time, a risk margin is added to the net discounted central estimate to determine the outstanding claims provision.

(i) Central estimate

The provision for expected future payments includes those in relation to claims reported but not yet paid; IBNR; and estimated claims handling costs, being the direct and indirect expenses incurred in the settlement of claims.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the branch, where more information about the claims is generally available. The longer the delay between the event giving rise to the claim and final claim settlement, the greater the variability between initial estimates of the loss to be incurred and the final settlement amount, as a result of additional financing and settlement costs incurred by the lender and changes in property valuations.

The branch's process for establishing the central estimate involves extensive consultation with internal and external actuaries, claims managers, underwriters and other senior management. This process includes regular internal claims review meetings attended by senior management and detailed review by an external actuary at least annually. The risk management procedures related to the actuarial function are explained further in note 4.

The determination of the amounts that the branch will ultimately pay for claims arising under insurance contracts involves a number of critical assumptions. Some of the uncertainties impacting these assumptions are as follows:

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs during the time that elapses before a definitive determination of the ultimate claims cost can be made;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example house price inflation, unemployment and interest rates.

The potential impact of changes in key assumptions used in the determination of the central estimate and the probability of adequacy of the central estimate on the branch's profit or loss are summarised in note 3(A)(iv).

Central estimates are determined by reference to a variety of estimation techniques, generally based on a statistical analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimate is based on a judgemental consideration of the results of each method and qualitative information, for example:

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

- historical trends in the development and incidence of the numbers of defaults reported, numbers of defaults cured, numbers of properties taken into possession, numbers of such properties sold, numbers of claims arising from these sales, and the costs of those claims;
- exposure details, including policy counts, sums insured and various other characteristics of the borrowers and loans; and
- historical and likely future trends of expenses associated with managing claims to finalisation.

Central estimates are calculated gross of any non-reinsurance recoveries. Separate estimates are made of the amounts recoverable from borrowers and third parties based on the gross central estimate.

The net central estimate is discounted at risk-free rates of return to reflect the time value of money. Details of the key assumptions applied in the discounting process are summarised in note 3(A)(iii).

(ii) Risk margin

Risk margins are determined by management and are held to mitigate the potential for uncertainty in the central estimate. The determination of the appropriate level of risk margin takes into account similar factors to those used to determine the central estimate, such as:

- prior accident year claims development; and
- the level of uncertainty in the net discounted central estimate due to actuarial estimation, data quality issues, variability of key discount assumptions and legislative uncertainty.

The measurement of variability uses techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. These techniques use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation. The potential impact of changes in the coefficient of variation assumptions on the branch's profit or loss is summarised in note 3(A)(iv).

Both the Reserve Bank of New Zealand ("RBNZ") and the Australian Prudential Regulation Authority ("APRA") require a probability of adequacy of 75% for the determination of minimum capital. For the actual probability of adequacy applied at the end of the financial year to the branch, refer to note 13(C).

The probability of adequacy is a statistical measure of the relative adequacy of the outstanding claims provision and is derived from the comparison of the risk margin with the net discounted central estimate. Using a range of outcomes, it allows a determination of the probability of adequacy represented by a risk margin. For example, a 90% probability of adequacy indicates that the outstanding claims provision is expected to be adequate nine times in ten. The appropriate level of risk margin is not determined by reference to a fixed probability of adequacy.

(iii) Financial assumptions used to determine the outstanding claims provision

Key variables

	2017	**2016**
Severity ('000)	**$25.0**	$25.0
Claim rates	**11.2%**	21.8%
Coefficient of variation	**53.0%**	53.0%

- Severity is a measure of the anticipated claims cost;
- Claim rate is the percentage of current defaults that are expected to become claims; and
- The percentages adopted in the actuarial model are determined based on an analysis of historical experience combined with actuarial and management judgement of future trends.

Discount rates

The company generally uses risk-free rates to discount the outstanding claims provision.

The weighted average risk-free rates used to discount the outstanding claims provision are summarised below.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

	2017 %	2016 %
Discount factor	**1.9**	1.8

Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the central estimate, including related recoveries, determined by the reference to a combination of historical analysis and current expectations of when claims and recoveries will be settled.

The weighted average term to settlement of the branch's net outstanding claims provision at the balance date is 1.3 years (2016: 1.4 years).

(iv) Impact of changes in key variables on the outstanding claims provision

The impact of changes in key variables used in the calculation of the outstanding claims provision is summarised in the table below. Each change has been calculated in isolation from the other changes and each change shows the after tax impact on profit assuming that there is no change to any of the other variables.

The sensitivities below assume that all changes directly impact profit after tax. In practice, however, it is likely that if the central estimate was to increase by 5%, at least part of the increase may result in a decrease in the appropriate level of risk margins rather than in profit after tax, depending on the nature of the change in central estimate. Likewise, if the coefficient of variation were to increase by 1%, it is possible that the probability of adequacy would reduce from its current level rather than result in a change to net profit after income tax or to equity.

The impact of a change in interest rates on profit after tax due to market value movements on fixed interest securities is shown in note 4(D)(ii).

	Sensitivity	Profit (Loss)[1]	
		2017	2016
	%	$	$
Severity	+20	**(28,534)**	(53,217)
	-20	**28,533**	53,217
Claim rates	+20	**(28,486)**	(50,153)
	-20	**28,448**	53,272
Discount factors	+5	**186**	338
	-5	**(187)**	(339)
Coefficient of variation	+20	**(5,875)**	(11,047)
	-20	**5,875**	11,047

[1] Net of tax at the prima facie rate of 28%.

(B) Liability adequacy test

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims, plus a risk margin to reflect the inherent uncertainty of the central estimate (note 14(C)). Future claims are those claims expected to arise from claims events occurring after the balance sheet . The assessment is carried out using the same methods described in note 3(A).

NZ IFRS 4: Insurance Contracts requires that this test be carried out at the level of a "portfolio of contracts that are subject to broadly similar risks and are managed together in a single portfolio". As NZ IFRS 4 does not explicitly define "broadly similar risks" or "managed together as a single portfolio", and the branch is a monoline insurer, the branch has interpreted these terms to represent the entire portfolio.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (CONTINUED)

(C) Unearned premium liabilities and deferred insurance costs

As highlighted in note 1, premium is earned and insurance costs recognised based on the term of the policies written and the likely pattern in which risk will emerge over that term. An actuarial analysis of the emergence of risk over the life of a policy is performed annually and is used to derive an earning pattern for each underwriting year. Premium is earned and insurance costs recognised in accordance with these patterns, adjusted for policy terminations.

During the year, in accordance with accounting standards, the company reassessed the expected pattern of risk emergence over the life of its portfolio to reflect updated claims experience. An actuarial analysis concluded there were no changes to the earning pattern for 2017, as such a release to the unearned premium liability was not recognised (2016: nil).

4. RISK MANAGEMENT

QBE Group's risk management policy, strategy and framework are embedded in the head office function and in each of the divisional operations, ensuring a consistent approach to managing risk across the organisation. The board annually approves a comprehensive risk management strategy, and a reinsurance management strategy ("REMS"), both of which are lodged with APRA.

Risk management for the branch is managed by the company.

As a member of the QBE Group, the company has adopted the risk management policy of QBE Group where applicable. The company's risk management objectives are to:

- achieve competitive advantage through better understanding the risk environment in which the company operates;
- optimise risk and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises by reducing uncertainty and volatility.

It is QBE Group's policy to adopt a rigorous approach to managing risk throughout the QBE Group of entities. Risk management is a continuous process and an integral part of quality business management. QBE Group's approach is to integrate risk management into the broader management processes of the organisation. It is QBE Group's philosophy to ensure that risk management is embedded in the business and that the risk makers or risk takers are themselves the risk managers. Specifically, the management of risk must occur at each point in the business management cycle.

Risk management is a key part of the company's governance structure and strategic and business planning. It underpins the setting of limits and authorities and it is embedded in the monitoring and evaluation of performance. This holistic approach to risk management allows all of the QBE Group's risks to be managed in an integrated manner.

QBE Group's global risk management framework sets out the approach to managing key risks and meeting strategic objectives whilst taking into account the creation of value for our shareholders. The framework is made up of complementary elements that are embedded throughout the business management cycle and culture. Key aspects include: governance, risk appetite and tolerance, delegated authorities, risk policies, measurement and modelling, risk and control self-assessment, risk treatment, optimisation and ongoing improvement through management action plans and risk and performance monitoring.

A fundamental part of the QBE Group's overall risk management strategy is the effective governance and management of the risks that impact the amount, timing and uncertainty of cash flows from insurance contracts. The operating activities of the company expose it to risks such as market risk, credit risk and liquidity risk. The QBE Group's risk management framework recognises the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance. The company has established internal controls to manage risk in the key areas of exposure relevant to its business.

4. RISK MANAGEMENT (CONTINUED)

The company's risk profile is described under the following broad risk categories:
- Strategic risk
- Insurance risk
- Credit risk
- Market risk
- Liquidity risk
- Operational risk
- Group risk

Each of these is described more fully in sections (A) to (G) below.

(A) Strategic risk

Strategic risk refers to the current and prospective impact on earnings and/or capital arising from strategic business decisions, implementation of decisions and responsiveness to external change. This includes risks associated with business strategy and change, investment strategy and corporate governance. Of particular relevance is capital management risk.

(i) Capital management risk

The company is subject to extensive prudential and other forms of regulation in the jurisdictions in which it conducts business. Prudential regulation is generally designed to protect the policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations.

The regulatory environments in Australia and New Zealand continue to evolve in response to economic, political and industry developments. QBE Group works closely with regulators and monitors regulatory developments across its global operations to assess their potential impact on its ability to meet solvency and other requirements.

In New Zealand, the Insurance (Prudential Supervision) Act 2010 provides the RBNZ regulatory authority over insurance companies. The branch has been given an exemption from compliance with the New Zealand solvency requirements on the basis of the company's compliance with the APRA solvency standards.

(B) Insurance risk

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to expectations. This includes underwriting, insurance concentrations and reserving and reinsurance. The risks inherent in any single insurance contract are the possibility of the insured event occurring and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, these risks are random and unpredictable for a single contract. In relation to the pricing of individual insurance contracts and the determination of the level of the outstanding claims provision in relation to a portfolio of insurance contracts, the principal risk is that the ultimate claims payments will exceed the carrying amount of the provision established.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability around the expected outcome will be. In addition, a more diversified insurance and reinsurance group is less likely to be affected by a change in any one specific portfolio. The company has developed its underwriting strategy to diversify the type of insurance risks accepted and, within each of these categories, to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

QBE Group has established the following protocols to manage its insurance risk across the underwriting, claims and actuarial disciplines.

(i) Underwriting risks

Selection and pricing of risks

The branch provides lenders' mortgage insurance ("LMI") in New Zealand. In 2013, the branch ceased underwriting new policies.

LMI insures the lender should the borrower default on repayment of the loan, and covers the remaining loan balance, plus selling costs and expenses, following the application of the proceeds from the sale of the security property.

4. RISK MANAGEMENT (CONTINUED)

LMI is characterised by coverage of 100% of the loan amount however, insurance coverage may also be "top cover", where the total loss (including expenses) is paid up to a prescribed percentage of the original loan amount. Typical top cover in New Zealand ranges from 20% to 30% of the original loan amount.

Key risk mitigation policies and procedures comprise:

- the pricing model measures return on capital and reflects risks on a long term cyclical performance basis for both standard and new products. Pricing tables are set according to appropriate risk characteristics, such as type of product, loan amounts and loan to valuation ratio;
- standard insurance agreements and documented underwriting policies and procedures are in place with allocation of delegated authority levels to approve applications; and
- quality assurance reviews of underwriting and claims management are conducted on a regular basis.

(ii) Concentration risk

Concentration risk is the risk of exposure due to concentration of activity in certain geographical locations, industries or counterparties. The company operates throughout all regions in Australia and New Zealand and therefore has limited geographic concentration risk on insurance contracts; exposures are monitored but not limited by region. The branch only insures risks in New Zealand. Limits, such as those placed on maximum aggregate exposures to individual borrowers and per property, are contained in underwriting policies and are embedded in systems and processes.

The company is exposed to the possibility of very large losses from economic events such as a significant increase in regional or nationwide unemployment levels, weakening in house prices, or a significant increase in interest rates over a short period of time. The company calculates its insurance concentration risk charge ("ICRC"), which is the estimated maximum net loss from significant economic events with an approximate return period of 200 years (2016: 200 years). The ICRC must be less than the company's concentration risk tolerance; otherwise, steps such as the purchase of additional reinsurance are taken to limit the exposure. As at 31 December 2017, the ICRC was AUD 459.2 million (2016: AUD 480.6 million) before tax benefit, which was less than the risk tolerance.

(iii) Claims management and claims estimation risks

The company's approach to determining the outstanding claims provision and the related sensitivities are set out in note 3. The company seeks to ensure the adequacy of its outstanding claims provision through the implementation of the following controls:

- experienced claims managers operate within policy and within the levels of authority delegated to them in respect of the settlement of claims;
- processes to ensure that all defaults are captured and updated on a timely basis and with a realistic assessment of the ultimate claims cost;
- initial IBNR estimates are set by experienced internal actuaries in conjunction with the product managers and underwriters for each class of business in each business unit. The valuation of the central estimate is primarily performed by actuaries who are not involved in the pricing function and who therefore provide an independent assessment;
- the determination of the risk margin is performed by senior management and the board with input from senior actuaries; and
- the outstanding claims provision is assessed regularly by senior management and is reviewed by the external Appointed Actuary at least annually.

Despite the rigour involved in the establishment and review of the outstanding claims provision, the provision is subject to significant uncertainty for the reasons set out in note 3(A).

(C) Credit risk

Credit risk is the risk of default by transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Exposure to credit risk results from financial transactions with securities issuers, customers, mortgagees and reinsurers.

The company's credit risk arises mainly from investment, insurance and reinsurance protection activities. The following policies and procedures are in place to mitigate the company's exposure to credit risk:

4. RISK MANAGEMENT (CONTINUED)

- A QBE Group-wide investment credit risk policy is in place which defines what constitutes credit risk for QBE Group and establishes tolerance levels. Compliance with the policy is monitored and exposures and breaches are reported to the QBE Group investment committee;
- Net exposure limits are set for each counterparty or group of counterparties in relation to investments, cash deposits and forward foreign exchange exposures. The policy also sets out minimum credit ratings for investments. The branch did not enter into any forward foreign exchange contracts during the year; and
- QBE Group has strict guidelines covering the limits and terms of net open derivative positions and the counterparties with which the company may transact. The branch did not invest in derivatives during the year.

(i) Credit risk arising from insurance contracts

Credit risk arising from insurance contracts principally relates to the risk of default by the underlying borrowers.

As insurer, the company does not receive access to the current credit quality of performing insured loans but is provided with data on loans in default by insured lenders. The relevant LMI master policy defines "default" as the borrower's failure to pay when due an amount equal to the scheduled monthly mortgage payment under the terms of the mortgage. Generally, however, the master policies require an insured to notify the insurer of a default within fourteen days of the end of the month when the total amount due is unpaid and in arrears by more than ninety days. For reporting and internal tracking purposes, the company does not consider a loan to be in default until it has been delinquent for three consecutive monthly payments.

Credit risk on LMI contracts is therefore principally managed up-front through the underwriting process, prior to the acceptance of risk. The company has a centralised credit risk function that incorporates pricing, claims liability modelling, credit policy, portfolio performance reporting and analysis, and underwriting quality assurance.

Acceptance of credit risk is managed primarily using two scorecards, built on credit bureau data and company portfolio history. Credit rules are used to support these two scorecards. The centralised credit risk unit manages and maintains the scorecards and a centralised underwriting policy and procedure.

Lenders usually collect the single premium from a prospective borrower and remit the amount to the company; generally, under a standard LMI policy, premium payment is required before policy cover is incepted, which eliminates credit risk on premiums receivable.

The company does not hold any collateral as security against its exposures; however, in the event of a claim by the lender, the lender's rights as mortgagee are assigned to the company.

(ii) Investment counterparty credit risk

The company's principal exposure to credit risk from financial instruments arises from the company's holdings of fixed and floating interest rate securities and short term money market securities. Additional credit risk arises in respect of cash holdings and trade and other receivables. The branch's principal exposures related to cash.

The following table provides information regarding the aggregate credit risk exposure at the balance date in respect of the major classes of financial assets. Trade and other receivables are excluded from this analysis on the basis that they comprise of smaller credit risk items which generally cannot be rated and are not individually material. The analysis classifies the assets according to Standard and Poor's counterparty credit ratings. AAA (2016: AAA) is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

	Credit Rating						
	AAA	AA	A	BBB	Speculative	Not Rated	Total
	$	$	$	$	$	$	$
As at 31 December 2017							
Cash and cash equivalents	-	**1,295,753**	-	-	-	-	**1,295,753**
As at 31 December 2016							
Cash and cash equivalents	-	1,571,358	-	-	-	-	1,571,358

4. RISK MANAGEMENT (CONTINUED)

The carrying amount of the relevant asset classes in the balance sheet represents the maximum amount of credit exposure.

None of the branch's financial assets are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2016: nil).

(iii) Reinsurance counterparty credit risk
Reinsurance risk management is the process of transferring insurance risk to another insurer for a price. The company reinsures a portion of risks underwritten to control exposure to insurance losses, reduce volatility and protect capital.

The company's strategy in respect of the selection, approval and monitoring of reinsurance arrangements is addressed by the following protocols:
- reinsurance is placed in accordance with the requirements of the company's REMS and security committee guidelines;
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical and potential future losses and the company's ICRC; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

The branch has no reinsurance recoveries receivable on paid or outstanding claims at 31 December 2017 (2016: nil).

(D) Market risk

Market risk is the risk of variability in the value of, and returns on, investments and the risk associated with variability of interest rates, credit spreads, foreign exchange rates and economy-wide inflation on both assets and liabilities, excluding insurance liabilities.

Market risk comprises three types of risk: currency risk (due to fluctuations in foreign exchange rates); interest rate risk (due to fluctuations in market interest rates); and price risk (due to fluctuations in market prices). Within each of these categories, risks are evaluated before considering the effect of mitigating controls. The existence and effectiveness of such mitigating controls are then measured to ensure that residual risks are maintained within the company's risk appetite.

(i) Currency risk
The company's exposure to currency risk generally arises as a result of the translation of foreign currency amounts back to the functional currency. The branch's exposure to currency risk generally arises in respect of amounts due from or payable to related parties denominated in Australian dollars. Foreign currency balances are actively monitored and exposures kept to acceptable levels.

(ii) Interest rate risk
Financial instruments with a floating rate interest rate expose the company to cash flow interest rate risk, whereas fixed interest rate instruments expose the company to fair value interest rate risk.

QBE Group's risk management approach is to minimise interest rate risk by actively managing investment portfolios to achieve a balance between cash flow interest rate risk and fair value interest rate risk. The company predominately invests in high quality, liquid interest-bearing securities and cash and may use derivative financial instruments to manage the interest rate risk of the fixed interest portfolio. The risk management processes over these derivative financial instruments include close senior management scrutiny, including appropriate board and other management reporting. Derivatives are used only for approved purposes and are subject to delegated authority levels provided to management. The level of derivative exposure is reviewed on an ongoing basis. Appropriate segregation of duties exists with respect to derivative use and compliance with policy, limits and other requirements is closely monitored.

The claims provision is discounted to present value by reference to risk-free interest rates. The company is therefore exposed to potential underwriting result volatility as a result of interest rate movements. The company has a policy of maintaining a relatively short duration for assets backing policyholders' funds in order to minimise any potential volatility affecting insurance profit.

4. RISK MANAGEMENT (CONTINUED)

The contractual maturity profile of the branch's interest-bearing financial assets, and hence its exposure to interest rate risk, and the effective weighted average interest rate for interest-bearing financial assets is analysed in the table below. The table includes investments at the maturity date of the security.

	Interest bearing financial assets maturing in						
	1 year or less	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	over 5 years	Total
As at 31 December 2017							
Floating rate ($)	**1,295,753**	-	-	-	-	-	**1,295,753**
Weighted average interest rate (%)	**0.04%**	-	-	-	-	-	**0.04%**
As at 31 December 2016							
Floating rate ($)	1,571,358	-	-	-	-	-	1,571,358
Weighted average interest rate (%)	1.37%	-	-	-	-	-	1.37%

Movements in interest rates impact the interest income on interest-bearing financial assets and therefore impact reported profit after tax. The impact of a 0.5% increase or decrease in interest rates on interest-bearing financial assets owned by the branch at the balance date is shown in the table below.

	Sensitivity	Profit (Loss)[1]	
		2017	2016
	%	$	$
Interest rate movement	+0.5	-	(350)
Interest-bearing financial assets	-0.5	-	350

[1] Net of tax at the branch's prima facie rate of 28%.

(iii) Price risk

Price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded on the market.

The branch had no price risk at the end of either the current or prior financial year.

(E) Liquidity risk

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due to policyholders and other creditors. This includes the risk associated with asset and liability management. The key objective of the company's asset and liability management strategy is to ensure sufficient liquidity is maintained at all times to meet the company's obligations including its settlement of insurance liabilities and, within these parameters, to optimise investment returns for policyholders and shareholders.

Liquidity must be sufficient to meet both planned and unplanned cash requirements. The nature of the business is that cash is received by way of single premiums at the inception of insurance contracts and is invested to fund future claims. The company is exposed to liquidity risk mainly through its obligations to make payments in relation to its insurance activities.

In addition to treasury cash held for working capital requirements, and in accordance with the company's liquidity policy, a minimum percentage of investments and cash is held in liquid, short-term money market securities to ensure that there are sufficient liquid funds available to meet insurance and investment obligations. The company has a strong liquidity position. The maturity of the branch's interest-bearing financial assets is included in note 4(D)(ii).

Surplus cash flows are transferred to the company in Australia, and conversely cash flow deficits, if any, are supported by the company.

4. RISK MANAGEMENT (CONTINUED)

The following tables summarise the contractual maturity profile of certain financial liabilities based on the remaining contractual obligations.

	1 year or less $	1 to 3 years $	1 to 3 years $	Over 5 years $	Total $
As at 31 December 2017					
Trade and other payables	**65,118**	-	-	-	**65,118**
As at 31 December 2016					
Trade and other payables	78,858	-	-	-	78,858

The branch has no significant concentration of liquidity risk.

The maturity profile of the branch's net outstanding claims provision is analysed in note 13(B).

(F) Operational risk

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk). The company manages operational risk within the same risk management framework as its other risks. The risk assessment and monitoring framework involves on-going:

- identification and review of the key risks to the company;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks throughout the company in terms of the acceptable level of risk (risk tolerance) and the residual risk remaining after having considered risk treatment;
- assessment of whether each risk is within the acceptable level of risk, or requires appropriate action be taken to mitigate any excess risk;
- transparent monitoring and reporting of risk management related matters on a timely basis; and
- setting the audit universe and resulting internal audit plan on a risk basis.

One of the cornerstones of the QBE Group's risk management framework is the recruitment and retention of high quality people who are entrusted with appropriate levels of autonomy within the parameters of disciplined risk management practices.

The company operates a system of delegated authorities based on expertise and proven performance, and compliance is closely monitored. Other controls include effective segregation of duties, access controls and authorisation and reconciliation procedures.

(G) Group risk

Group risk is the risk to a division arising specifically from being part of the wider QBE Group, including the financial impact and loss of support from the parent company.

5. INCOME AND EXPENSES

(A) Income summary

	2017 $	2016 $
Gross earned premium revenue		
Direct	**740,747**	1,293,381
	740,747	1,293,381
Other underwriting revenue		
Reinsurance and other recoveries	**(60,645)**	385,254
Reinsurance commission revenue	**75,334**	131,537
	14,689	516,791
Other income		
Interest income	**19,032**	27,218
	19,032	27,218
Income	**774,468**	1,837,390

(B) Expenses summary

	2017 $	2016 $
Outward reinsurance premium expense	**333,336**	1,112,509
Gross claims	**(220,131)**	(452,845)
Other acquisition costs	**77,338**	189,489
Underwriting expenses	**88,404**	188,540
Expenses	**278,947**	1,037,693
Profit before income tax	**495,521**	799,697

6. CLAIMS INCURRED

(A) Claims Analysis

	2017 $	2016 $
Gross claims and related expenses		
Direct	**(220,131)**	(452,845)
Reinsurance and other recoveries		
Direct	**60,645**	(102,471)
Inward reinsurance	-	(282,783)
Net claims	**(159,486)**	(838,099)

6. CLAIMS INCURRED (CONTINUED)

(B) Claims development

Current year's claims relate to risks borne in the current reporting year. Prior year claims relate to a reassessment of the risks borne in all the previous reporting periods and include release of risk margins as claims are paid. Refer to note 6(C).

	2017			2016		
	Current Year $	Prior Years $	Total $	Current Year $	Prior Years $	Total $
Gross claims released and related expenses						
Undiscounted	**259,894**	**(486,100)**	**(226,206)**	521,797	(986,633)	(464,836)
Discount	**(5,460)**	**11,535**	**6,075**	(10,003)	21,994	11,991
	254,434	**(474,565)**	**(220,131)**	511,794	(964,639)	(452,845)
Reinsurance and other recoveries reversal (revenue)						
Undiscounted	**(106,450)**	**169,852**	**63,402**	(210,261)	(180,747)	(391,008)
Discount	**2,523**	**(5,280)**	**(2,757)**	4,538	1,216	5,754
	(103,927)	**164,572**	**60,645**	(205,723)	(179,531)	(385,254)
Net claims released						
Undiscounted	**153,444**	**(316,248)**	**(162,804)**	311,536	(1,167,380)	(855,844)
Discount	**(2,937)**	**6,255**	**3,318**	(5,465)	23,210	17,745
	150,507	**(309,993)**	**(159,486)**	306,071	(1,144,170)	(838,099)

(C) Reconciliation of net claims to claims development table

The development of the net outstanding claims provision for the four most recent accident years is shown in note 13(E). This note is a reconciliation of the amounts included in the table in note 6(B) and the current financial year movements in the claims development table.

	2017			2016		
	Current Year $	Prior Years $	Total $	Current Year $	Prior Years $	Total $
Net undiscounted claims development – central estimate (note 13(E))	**119,903**	**(212,780)**	**(92,877)**	244,688	(973,450)	(728,762)
Movement in claims settlement costs	**5,483**	**(11,376)**	**(5,893)**	12,665	(23,376)	(10,711)
Movement in discount	**(2,937)**	**6,255**	**3,318**	(5,465)	23,210	17,745
Movement in risk margin	**28,058**	**(92,092)**	**(64,034)**	54,183	(170,554)	(116,371)
Net claims incurred - discounted	**150,507**	**(309,993)**	**(159,486)**	306,071	(1,144,170)	(838,099)

7. INCOME TAX EXPENSE

(A) Reconciliation of prima facie tax to income tax expense

	2017 $	2016 $
Profit before income tax	**495,521**	799,697
Prima facie tax payable at 28%	**138,746**	223,915
Tax effect of non-temporary differences:		
Non allowable expenses and non-taxable income	**-**	-
Prima facie tax adjusted for non-temporary differences	**138,746**	223,915
(Overprovision)/underprovision in prior year	**(5)**	45
Income tax expense	**138,741**	223,960
Analysed as follows:		
Current tax	**160,401**	276,977
Deferred tax	**(21,655)**	(53,062)
(Overprovision)/underprovision in prior year	**(5)**	45
	138,741	223,960
Deferred tax credit comprises:		
Deferred tax liabilities recognised in profit or loss	**(21,655)**	(53,062)
	(21,655)	(53,062)

8. CASH AND CASH EQUIVALENTS

	2017 $	2016 $
Cash at bank and on hand	**343,352**	437,294
Overnight money	**952,401**	1,134,064
Cash and cash equivalents	**1,295,753**	1,571,358

Amounts in cash and cash equivalents are the same as those included in the cash flow statement.

Cash and cash equivalents include balances readily convertible to cash. All balances are held to service normal operational requirements.

(A) Reconciliation of cash flows from operating activities to profit after income tax

	2017 $	2016 $
Cash flows from operating activities	**(275,605)**	(2,177,248)
Decrease in net outstanding claims	**307,739**	566,553
Decrease in unearned premiums	**740,747**	1,293,381
Decrease (increase) in unearned reinsurance commission	**75,334**	(151,449)
(Decrease) increase in deferred insurance costs	**(410,674)**	480,639
(Decrease) increase in reinsurance recoveries	**(136,266)**	275,560
(Decrease) increase in trade and other receivables	**(113,376)**	113,853
Decrease (increase) in trade and other payables	**13,741**	(51,592)
Decrease in deferred tax liabilities	**21,655**	53,062
Decrease in amounts due tax authorities for current tax	**133,485**	172,978
Profit after income tax	**356,780**	575,737

9. TRADE AND OTHER RECEIVABLES

	2017 $	2016 $
Amounts due from related parties	**7,479**	120,855
Trade and other receivables	**7,479**	120,855
Amounts maturing within 12 months	**7,479**	120,855
Amounts maturing in greater than 12 months	-	-
Trade and other receivables	**7,479**	120,855

(A) Fair value

Due to the short term nature of these receivables, their carrying value is assumed to approximate their fair value.

(B) Risk

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables have been pledged by the branch as collateral for liabilities or contingent liabilities. No receivables are past due or impaired (2016: nil).

10. DEFERRED INSURANCE COSTS

	2017 $	2016 $
Deferred reinsurance premium	**336,792**	670,128
Deferred acquisition costs	**89,353**	166,691
Deferred insurance costs	**426,145**	836,819
To be expensed within 12 months	**228,944**	399,198
To be expensed in greater than 12 months	**197,201**	437,621
Deferred insurance costs	**426,145**	836,819

	DEFERRED REINSURANCE PREMIUM		DEFERRED ACQUISITION COSTS	
	2017 $	2016 $	2017 $	2016 $
At 1 January	**670,128**	-	**166,691**	356,180
Costs deferred in financial year	-	1,252,149		-
Amortisation of costs deferred in current and previous financial years	**(333,336)**	(582,021)	**(72,857)**	(185,008)
Additional release	-	-	**(4,481)**	(4,481)
At 31 December	**336,792**	670,128	**89,353**	166,691

11. DEFERRED INCOME TAX

	2017 $	2016 $
Deferred tax liabilities	**25,019**	46,674

(A) Tax jurisdiction

The branch qualifies as a permanent establishment for New Zealand tax purposes, and consequently lodges income tax returns and pays income tax in New Zealand as though it were a separate entity.

(B) Deferred tax liabilities

(i) The balance comprises temporary differences attributable to:

	2017 $	2016 $
Amounts recognised in profit or loss		
Insurance assets	**25,019**	46,674
	25,019	46,674
Deferred tax liabilities as follows:		
Payable within 12 months	**13,441**	22,226
Payable in greater than 12 months	**11,578**	24,448
	25,019	46,674

(ii) Movements:

	2017 $	2016 $
At 1 January	**46,674**	99,736
Amounts recognised in profit or loss	**(21,655)**	(53,062)
At 31 December	**25,019**	46,674

12. TRADE AND OTHER PAYABLES

	2017 $	2016 $
Amounts due to related entities	**63,377**	15,892
Other payables	**1,741**	62,966
Trade and other payables	**65,118**	78,858
Amounts payable within 12 months	**65,118**	78,858
Amounts payable in greater than 12 months	**-**	-
Trade and other payables	**65,118**	78,858

13. OUTSTANDING CLAIMS

(A) Net outstanding claims

	2017 $	2016 $
Gross outstanding claims provision	**286,244**	529,949
Risk margin	**72,724**	136,758
Outstanding claims	**358,968**	666,707
Reinsurance and other recoveries on outstanding claims	**(164,221)**	(300,487)
Net outstanding claims provision	**194,747**	366,220
Analysed as follows:		
Net undiscounted central estimate	**158,035**	296,904
Discount	**(4,084)**	(7,402)
Net discounted central estimate	**153,951**	289,502
Risk margin	**40,796**	76,718
Net outstanding claims provision	**194,747**	366,220
Gross undiscounted central estimate	**287,303**	531,190
Claims settlement costs	**6,694**	12,587
	293,997	543,777
Discount to present value	**(7,753)**	(13,828)
Gross discounted central estimate	**286,244**	529,949
Payable within 12 months	**145,101**	259,929
Payable in greater than 12 months	**141,143**	270,020
Gross discounted central estimate	**286,244**	529,949
Reinsurance and other recoveries on outstanding claims	**167,890**	306,913
Discount to present value	**(3,669)**	(6,426)
Reinsurance and other recoveries on outstanding claims	**164,221**	300,487
Receivable within 12 months	**83,247**	117,934
Receivable in greater than 12 months	**80,974**	182,553
Reinsurance and other recoveries on outstanding claims	**164,221**	300,487

(B) Maturity profile of net outstanding claims

The expected maturity of the branch's net outstanding claims provision is analysed below:

	1 year or less $	1 to 2 years $	2 to 3 years $	3 to 4 years $	4 to 5 years $	Over 5 years $	Total $
At 31 December 2017	**98,720**	**57,091**	**22,338**	**8,031**	**3,695**	**4,872**	**194,747**
At 31 December 2016	179,626	111,909	43,502	15,353	6,668	9,162	366,220

(C) Risk margins

The process used to determine risk margins is explained in note 3(A)(ii) and details of the risk-free discount rates adopted are set out in note 3(A)(iii).

The probability of adequacy at 31 December 2017 is 75.0% (2016: 75.0%) - 75.0% is a recognised industry benchmark in New Zealand and Australia, being the minimum probability of adequacy required for licensed insurers by RBNZ and APRA. The risk margin included in net outstanding claims is 26.5% (2016: 26.5%) of the central estimate.

13. OUTSTANDING CLAIMS (CONTINUED)

(D) Reconciliation of movement in outstanding claims provision

	2017			2016		
	Gross	Recoveries	Net	Gross	Recoveries	Net
	$	$	$	$	$	$
At 1 January	**666,707**	**300,487**	**366,220**	1,233,260	24,927	1,208,333
Increase in net claims incurred in current accident year	**254,434**	**103,927**	**150,507**	511,794	205,723	306,071
Movement in prior year claims provision	**(474,565)**	**(164,572)**	**(309,993)**	(964,639)	179,531	(1,144,170)
Incurred claims recognised in profit or loss	**(220,131)**	**(60,645)**	**159,486**	(452,845)	385,254	(838,099)
Claims payments	**(87,608)**	**(75,621)**	**(11,987)**	(113,708)	(109,694)	(4,014)
At 31 December	**358,968**	**164,221**	**194,747**	666,707	300,487	366,220

(E) Claims development – undiscounted net central estimate

Net undiscounted central estimate of outstanding claims for the branch for the four most recent accident years.

	2013 & prior years	2014	2015	2016	2017	Total
	$	$	$	$	$	$
Estimate of net ultimate claims cost:						
At end of accident year	-	1,509,846	1,053,019	244,687	119,903	2,927,455
One year later	-	1,064,384	284,758	103,860	-	1,453,002
Two years later	-	966,495	220,890	-	-	1,187,385
Three years later	-	966,495	-	-	-	966,495
Current central estimate cost for the four most recent accident years	-	966,495	220,890	103,860	119,903	1,411,148
Cumulative net claims payments to date	-	966,495	218,652	58,841	15,819	1,259,807
Net undiscounted central estimate	-	-	2,238	45,019	104,084	151,341
Discount to present value	-	-	-	-	-	(4,084)
Net risk margin	-	-	-	-	-	40,796
Claims settlement costs	-	-	-	-	-	6,694
Net outstanding claims	-	-	-	-	-	194,747
Net central estimate development Increase (decrease) in the year	(8,084)	-	(63,868)	(140,828)	119,903	(92,877)

A reconciliation of the net claims development in the table above to net incurred claims in the income statement is included in note 6(C).

The development of claims from prior accident years was better than expected at 31 December 2017, leading to an overall release of the central estimate for prior years of $212,780. The release is mainly due to favourable overall claim experiences and runoff of the portfolio..

Uncertainty surrounding claims development for the company is materially resolved within four years, and for the branch the accident years 2015 and prior are fully developed.

Conditions and trends that have affected the development of the liabilities in the past may, or may not, occur in the future, and accordingly, conclusions about future results may not necessarily be derived from the information presented in the tables.

14. UNEARNED PREMIUM

(A) Unearned premium

	2017 $	2016 $
At 1 January	**1,489,173**	2,782,554
Earning of premium written in previous periods	**(740,747)**	(1,293,381)
Release deferral (note 3(C))	**-**	-
At 31 December	**748,426**	1,489,173
Amounts to be earned within 12 months	**402,087**	710,399
Amounts to be earned in greater than 12 months	**346,339**	778,774
Unearned premium	**748,426**	1,489,173

(B) Net premium liabilities

	2017 $	2016 $
Unearned premium	**748,426**	1,489,173
Unearned reinsurance commission (note 14(C))	**76,115**	151,449
Deferred insurance costs (note 10)	**(426,145)**	(836,819)
Net premium liabilities	**398,396**	803,803

(C) Unearned reinsurance commission movements

	2017 $	2016 $
At 1 January	**151,449**	-
Deferral of commission on contracts written in the financial year	**-**	282,986
Expensing of commission written in previous periods and current period	**(75,334)**	(131,537)
Net premium liabilities	**76,115**	151,449

(D) Expected present value of future cash flows for future claims including risk margin

	2017 $	2016 $
Undiscounted central estimate	**42,748**	74,461
Discount to present value	**(13,870)**	(24,117)
	28,878	50,344
Risk margin	**11,551**	20,137
Expected present value of net future cash flows for future claims including risk margin	**40,429**	70,481

(E) Liability adequacy test

The probability of adequacy of the unearned premium liability may differ from the probability of adequacy of the outstanding claims provision. The reason for the difference is that the former is a benchmark used only to test the sufficiency of net unearned premium liability whereas the latter is a measure of the adequacy of the outstanding claims provision actually carried by the branch.

The application of the liability adequacy test in respect of the net unearned premium liabilities identified a surplus at 31 December 2017 and 2016.

(F) Risk margin

The process used to determine the risk margins is explained in note 3(A)(ii).

The risk margin in expected net future cash flows for future claims as a percentage of the discounted central estimate is 40% (2016: 40%).

15. CAPITAL RISK MANAGEMENT

Capital is managed at a company level.

As a member of the wholly owned group, the company has adopted the risk management policies and framework of the QBE Group. QBE Group's objective when managing capital is to maintain an optimal balance of debt and equity in the capital structure to reduce the cost of capital whilst meeting capital adequacy requirements, providing security for policyholders and continuing to provide sufficient returns to shareholders.

Where appropriate, adjustments are made to capital levels in light of changes in economic conditions and risk characteristics of the company's activities. In order to maintain or adjust the capital structure, the company has the option to adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or vary the level of outward reinsurance.

The company is subject to, and complies with, various externally imposed regulatory capital requirements. These requirements are designed to ensure a sufficient solvency margin is maintained in order to provide adequate protection for policyholders. In addition, the company aims to maintain a strong credit rating and insurer financial strength rating, along with robust capital ratios in order to support its business objectives and maximise shareholder wealth.

The company reviews its capital structure on an ongoing basis to optimise the allocation of capital whilst minimising the cost of capital. Active management of the business and its capital has enabled the company to maintain its insurer financial strength and credit rating, and has supported QBE Group's good access to capital markets when needed.

Management monitors the company's capital levels on an ongoing basis, with particular focus on the following performance indicators which were updated during 2017:

- The company is subject to regulatory requirements that a minimum level of capital is maintained to meet obligations to policyholders. It is the company's policy to maintain a capital base appropriate to its size, business mix, complexity and risk profile which fully complies with and meets or exceeds regulatory requirements; and
- Insurer financial strength ratings provided by the major rating agencies which demonstrate the company's financial strength and claims paying ability.

In addition to the management reporting and planning processes, the company has dedicated staff through QBE Group across its business units responsible for understanding the regulatory capital requirements of its operations. The quality of assets (particularly investments) held by the company is continuously monitored to ensure any potential issues are identified and remedial action, where necessary, is taken to restore effective capital performance and levels.

16. SOLVENCY

The table below discloses the solvency coverage for the company which includes the branch as calculated under the Australian APRA requirements.

	2017 A$000's	2016 A$000's
APRA capital base	**898,667**	894,884
APRA prescribed capital amount	**606,873**	609,819
Capital surplus	**291,794**	285,065
Solvency coverage	**1.48**	1.47

16.1 A licensed insurer must disclose the information set out in paragraph 16.3 in its financial statements. This disclosure need only be made within the financial statements prepared for the New Zealand branch. This disclosure must be as at the balance date to which the financial statements relate along with a comparative for the immediately preceding financial year.

16.2 A licensed insurer must disclose the information set out in paragraph 16.3 within 10 working days following the required date for submission of solvency information to the Reserve Bank.

16.3 The information is the home jurisdiction equivalent of the :

(a) Actual solvency capital
(b) Minimum solvency capital
(c) Solvency margin; and
(d) Solvency ratio

17. REMUNERATION OF AUDITORS

Audit fees for the company incorporate the New Zealand branch and are paid by the company. Amounts received by the company's auditors are as follows:

	2017 $	2016 $
PricewaterhouseCoopers (PwC) – Australian firm		
Audit or review of financial reports of the entity	**588,307**	575,362
Special audits required by regulators	**169,590**	152,026
	757,897	727,388

The board believes some non-audit services are appropriate given the external auditor's knowledge of the QBE Group. The company may engage the external auditor for non-audit services other than the excluded services subject to the general principle that fees for non-audit services should not exceed 50% of all fees paid to the external auditor in any one financial year. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, PwC cannot provide the excluded services of preparing accounting records or financial reports, asset or liability valuations, acting in a management capacity, acting as a custodian of assets or acting as share registrar.

18. CONTINGENT LIABILITIES

The branch had no contingent liabilities as at 31 December 2017 (2016: nil)

19. CAPITAL EXPENDITURE COMMITMENTS

The branch had no capital commitments as at 31 December 2017 (2016: nil).

20. RELATED PARTY DISCLOSURES

(A) Parent and ultimate parent

The branch forms part of QBE LMI, a company incorporated and domiciled in Australia.

The company's ultimate parent is QBE Group, incorporated in Australia.

(B) Transactions with related parties

The following material transactions occurred with related parties:

	2017 $	2016 $
Revenues		
Management fee received or receivable from controlled entities	**88,293**	71,132

	2017 $	2016 $
Expenses		
Payments made for management fees and cost allocations to related entities	**159,228**	159,436
Outwards reinsurance premium (net of no claims bonus)	**333,336**	1,112,509
Reinsurance claims paid to a controlled entity	**94,774**	(333,952)

(C) Outstanding balances arising from transactions with related parties

The following balances are outstanding at the reporting date in relation to transactions with related parties:

	2017 $	2016 $
Assets		
Trade and other receivables	**7,479**	120,855
Deferred reinsurance premium	**336,792**	670,128
Reinsurance and other recoveries receivable	**152,411**	286,609
Liabilities		
Trade and other payables	**63,377**	15,892
Unearned reinsurance commission	**76,115**	151,449

(D) Terms and conditions

All transactions were made on normal commercial terms and conditions and at market rates.

Outstanding balances are unsecured and repayable in cash.

(E) Other related party disclosures

All other material information required to be disclosed under the NZIAS 124: Related Party Disclosures has been included in the financial statements as follows:

	Reference
Trade and other receivables	Note 9
Trade and other payables	Note 12

21. EVENTS OCCURRING AFTER REPORTING DATE

There is, at the date of these statements, no other matter or circumstance that has arisen since 31 December 2017 that has significantly affected, or may significantly affect:

(i) the branch's operations in future financial years;
(ii) the results of those operations in future financial years; or
(iii) the branch's state of affairs in future financial years.

22. CORPORATE GOVERNANCE

Information regarding the corporate governance policies, practices and processes of QBE Group is available from www.group.qbe.com/investor-centre/corporate-governance.