QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

ANNUAL REPORT – 31 DECEMBER 2018

CONTENTS

This financial report includes separate 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 (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 21 QBE Centre
125 Queen Street
Auckland Central 1010
New Zealand

The financial report was authorised for issue by the directors on 15 February 2019. The directors have the power to amend and reissue the financial report.

STATEMENT BY DIRECTORS

For the year ended 31 December 2018

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 9 to 36 are true copies of the Financial Statements of the New Zealand branch of the company for the year ended 31 December 2018.

The Board of Directors of QBE Lenders' Mortgage Insurance Limited authorised these statements for issue on 15 February 2019.

Director

Director

Independent auditor's report

To the members of QBE Lenders' Mortgage Insurance Limited

The financial statements comprise:

- the balance sheet as at 31 December 2018;
- the statement of comprehensive income for the year then ended;
- the statement of changes in balances due to head office;
- 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 Company), present fairly, in all material respects, the financial position of the Company as at 31 December 2018, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Basis for opinion

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

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

We are independent of the Company 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 Company.

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Our audit approach

Overview

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

Overall materiality: $21,000, which represents approximately 5% of the Company's profit before tax from continuing operations, averaged over the current and previous two years.

We chose profit before tax from continuing operations because, in our view, it is the benchmark against which the performance of the Company is most commonly measured, and is a generally accepted benchmark. We used a three year average because the recognition of premium and acquisition costs is as per the adopted earning pattern over a number of years and not on a straight line basis. . We used a 5% threshold based on our professional judgement, noting it is within the range of commonly acceptable thresholds.

We have determined that there are two key audit matters and we have communicated this to the audit committee:

- Earning patterns adopted by the directors
- Valuation of the outstanding claims liability

Materiality

The scope of our audit was influenced by our application of materiality.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole as set out above. These, together with qualitative considerations, helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Audit scope

We designed our audit by assessing the risks of material misstatement in the financial statements and our application of materiality. As in all of our audits, we also addressed the risk of management override of internal controls including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the Company, the accounting processes and controls, and the industry in which the Company operates.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current year. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. Further, any commentary on the outcomes of a particular audit procedure is made in that context.

Key audit matter	How our audit addressed the key audit matter
Net earned premiums (NEP) and valuation of the unearned premium liability (note 2.5) *Net earned premium: $317 thousand* *Unearned premium liability: $172 thousand* The Company sold Lenders Mortgage Insurance products and received payments for all insurance policies upfront, however this premium revenue has been recognised over time. The timing pattern for recognition of premiums and the resulting valuation of the unearned premium liability (the proportion of the premium revenue not yet recognised), has been determined by applying actuarial modelling techniques to develop an earnings curve. In this way, the timing of revenue recognition is dependent on the way in which claims are expected to emerge. Net earned premiums (NEP) and the unearned premium liability were a key audit matter due to the complexity of the actuarial methodology used to model the earnings curve and the significant level of judgment applied in assessing the assumptions adopted, including risk profile of the portfolio and expected housing market growth. The earnings curve and the timing of revenue recognition is dependent on an assessment of future claim emergence. As a result, the complexities discussed in the key audit matter 'Outstanding claims liabilities' were also relevant to our work over net earned premiums and the valuation of the unearned premium liability. During the year, the Company performed a detailed review of the earning patterns adopted, which management believe is a more forward-looking approach. This change looks to reflect current claims experiences and the expected future economic impacts such as future property prices. Other Financial Statement Line Items impacted by this change are: • Deferred insurance costs ($100 thousand) • Unearned reinsurance commission ($17 thousand) • Deferred reinsurance premium movement ($259 thousand) and • Reinsurance commission revenue ($59 thousand).	Working alongside PwC actuarial experts, we have assessed the appropriateness of the assumptions and methodologies used by comparing them with our expectations based on experience, current trends and benchmarks. This included an assessment of the sensitivity of the adopted earnings curve to key model assumptions and an analysis of key changes from previous periods. To assess the calculation of the NEP along with other impacted balances we have: • Tested the underlying policy in force reports and data used in the calculation by agreeing a sample of the information back to source systems • Obtained a listing of acquisition costs taken into consideration in the model, testing a sample to verify their nature through comparison with source records that these are recognised in line with applicable accounting standards • Recalculated the unearned premium liability using the underlying policy in force reports and updated earning patterns, including recalculation of the movement recognised in the income statement • Recalculated the deferred insurance costs recognised as at 31 December 2018, primarily the deferred reinsurance premiums • Assessed the overall earning pattern accounting estimate and its application in deriving the unearned premium liability, in light of the requirements of the applicable accounting standard.

Key audit matter	How our audit addressed the key audit matter
Valuation of the outstanding claims liability (Note 2.3) $327 thousand The estimation of outstanding claims involves significant judgement given the size of the liability and the inherent uncertainty in estimating the expected future payments for claims incurred. The two key elements to this are the gross discounted central estimate and risk margin, both considered below. The valuation of the outstanding claims liability was a key audit matter due to the higher level of estimation and judgement required in determining the appropriateness of the assumptions used in valuing the liability. *Gross discounted central estimate* Valuation of the liability involves complex and subjective judgements on a number of areas, including: • Future events, internal and external to the business, for which small changes in assumptions can result in material impacts on the estimate • Estimation of payments for claims incurred but not reported at the reporting date given there is generally less clarity on this information • Estimation of the period over which claims are expected to settle, impacting the estimation of expected future payments. *Risk margins* A risk margin, relating to the inherent uncertainty in the estimation of the present value of expected future payments, is determined by making judgements on the variability of the book of business. Management will consider the Probability of Adequacy in determining the appropriate risk margin. Probability of Adequacy (PoA) is a measure of the estimated overall sufficiency of reserves including a risk margin in light of that variability.	Our audit procedures included evaluating the design effectiveness and implementation of relevant key actuarial controls, including the Appointed Actuary review of the estimate adopted. Historical claims data was a key input to the actuarial estimates. Accordingly, we tested the underlying reports used in the valuation of the outstanding claim liability by agreeing a sample of items back to supporting documentation, including arrears reporting and policy application data. To evaluate the methodologies and assumptions utilised, we, together with PwC actuarial experts, we developed an understanding of and evaluated the actuarial practices, gross discounted central estimate and risk margin: • Evaluated whether actuarial methodologies were consistent with those in the industry and in prior years. • Assessed key actuarial assumptions, including claims ratios and relevant economic factors by comparing them with our expectations based on experience, current trends and benchmarks. • Assessed the approach to setting the risk margin in light of the requirements of New Zealand Accounting Standards. • Considered the findings of external actuarial experts engaged by the Company.

Information other than the financial statements and auditor's report

Management 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, and will not express any form of assurance conclusion on the other information. At the time of our audit, the directors have advised that no other information will be included in the annual report.

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.

Responsibilities of Management for the financial statements

Management is responsible, on behalf of the Company, for the preparation and fair presentation of the financial statements in accordance with NZ IFRS and IFRS, and for such internal control as Management determines 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, Management is responsible for assessing the Company'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 Management either intends to liquidate the Company or to cease operations, or has 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-2/

This description forms part of our auditor's report.

pwc

Who we report to

This report is made solely to the Company'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 Company and the Company'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 CP Verhaeghe. CP Verhaeghe is a registered Auditor with the Australian Securities and Investments Commission.

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
20 February 2019

Sydney

FINANCIAL REPORT CONTENTS

FINANCIAL STATEMENTS

QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2018

	NOTE	2018 $	2017 $
Gross written premium		-	-
Unearned premium movement	2.5	**576,511**	740,747
Gross earned premium revenue	2.1	**576,511**	740,747
Outward reinsurance premium		-	-
Deferred reinsurance premium movement	2.5	**(259,430)**	(333,336)
Outward reinsurance premium expense		**(259,430)**	(333,336)
Net earned premium (a)		**317,081**	407,411
Gross claims releases	2.2	**174,849**	192,019
Reinsurance and other recoveries	2.2	**12,513**	(32,533)
Net claims releases (b)		**187,362**	159,486
Reinsurance commission revenue (c)	2.1	**58,631**	75,334
Underwriting and other expenses (d)		**(137,114)**	(165,742)
Underwriting result (a)+(b)+(c)+(d)		**425,960**	476,489
Investment income - policyholders' funds	2.1	**17,137**	19,032
Insurance profit		**443,097**	495,521
Profit before income tax		**443,097**	495,521
Income tax expense	5.1	**(124,067)**	(138,741)
Profit after income tax		**319,030**	356,780
Other comprehensive income			
Other comprehensive income after income tax		-	-
Total comprehensive income after income tax		**319,030**	356,780
Profit after income tax attributable to:			
Profit after income tax attributable to Head Office Account		**319,030**	356,780
		319,030	356,780
Total comprehensive income after income tax attributable to:			
Head Office Account		**319,030**	356,780
		319,030	356,780

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

QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

BALANCE SHEET
As at 31 December 2018

	NOTE	2018 $	2017 $
Assets			
Cash and cash equivalents	4.1	**1,205,203**	1,295,753
Trade and other receivables	2.6	**9,392**	7,479
Current tax receivable		**26,364**	56,733
Reinsurance and other recoveries on outstanding claims	2.3	**61,148**	132,293
Deferred insurance costs	2.5	**100,351**	426,145
Total assets		**1,402,458**	1,918,403
Liabilities			
Payables	2.7	**58,716**	65,118
Deferred tax liabilities	5.2	**6,437**	25,019
Outstanding claims	2.3	**152,191**	327,040
Unearned premium	2.5	**171,915**	748,426
Unearned reinsurance commission	2.5	**17,484**	76,115
Total liabilities		**406,743**	1,241,718
Net assets		**995,715**	676,685
Due to Head Office – Australia		**995,715**	676,685

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 2018

2018	**HEAD OFFICE ACCOUNT $**
At 1 January	**676,685**
Profit after income tax	**319,030**
Total comprehensive income	**319,030**
Net funding movements	**-**
At 31 December	**995,715**

2017	**HEAD OFFICE ACCOUNT $**
At 1 January	319,906
Profit after income tax	356,780
Total comprehensive income	356,780
Net funding movements	(1)
At 31 December	676,685

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

QBE LENDERS' MORTGAGE INSURANCE LIMITED
New Zealand Branch

STATEMENT OF CASH FLOWS
For the year ended 31 December 2018

	NOTE	2018 $	2017 $
Operating activities			
Reinsurance and other recoveries received		**83,658**	75,621
Claims paid		-	(87,608)
Other underwriting costs (paid) received		**(79,065)**	11,231
Interest received		**17,137**	19,032
Income taxes paid		**(112,280)**	(293,881)
Net cash flows from operating activities	6.3	**(90,550)**	(275,605)
Investing activities			
Net cash flows from investing activities		-	-
Financing activities			
Net cash flows from financing activities		-	-
Net movement in cash and cash equivalents		**(90,550)**	(275,605)
Cash and cash equivalents at the beginning of the year		**1,295,753**	1,571,358
Cash and cash equivalents at the end of the year	4.1	**1,205,203**	1,295,753

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 2018

1. OVERVIEW

1.1 About the company

About QBE Lenders' Mortgage Insurance Limited, New Zealand Branch

QBE Lenders' Mortgage Insurance Limited (the company) is a residential lenders' mortgage insurance company incorporated in Australia and operating in New Zealand as a branch (the Branch).

About insurance

In simple terms, insurance and reinsurance companies help their customers (consumers, businesses and other insurance companies) to manage risk. More broadly put, insurance companies create value by pooling and redistributing risk. This is done by collecting premium from those that it insures (that is policyholders) and then paying the claims of those that call upon their insurance protection. The company may also choose to reduce some of its own accumulated risk through the use of outward reinsurance, which is insurance for insurance companies. As not all policyholders will actually experience a claims event, the effective pooling and redistribution of risk lowers the total cost of risk management, thereby making insurance protection more cost effective for all.

The operating model of insurance companies relies on profits being generated:

- by appropriately pricing risk and charging adequate premium to cover the expected payouts that will be incurred over the life of the insurance policy (both claims and operating expenses); and
- by earning a return on the collected premium and funds withheld to pay future claims through the adoption of an appropriate investment strategy.

Insurance therefore serves a critical function of providing customers with the confidence to achieve their business and personal goals through cost effective risk management. This is achieved within a highly regulated environment, designed to ensure that insurance companies maintain adequate capital to protect the interests of policyholders.

1.2 About this report

This financial report includes the financial statements of QBE Lenders' Mortgage Insurance Limited, New Zealand Branch as an individual entity.

The financial report includes the four primary statements, namely the statement of comprehensive income (which comprises profit or loss and other comprehensive income), balance sheet, statement of changes in balances due to head office and statement of cash flows, as well as associated notes. Refer to Note 1.2.1 for more details.

Disclosures have been grouped into the following categories in order to assist users in their understanding of our financial statements:

1. **Overview** contains information that impacts the financial report as a whole.
2. **Underwriting activities** brings together all results and balance sheet disclosures relevant to the branch's insurance activities.
3. **Risk management** provides commentary on the branch's exposure to various financial and capital risks, explaining the potential impact on the results and balance sheet and how the branch manages these risks.
4. **Capital structure** provides information about the branch's cash and the company's capital.
5. **Tax** includes disclosures in relation to the branch's tax balances.
6. **Other** includes other required disclosures.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2018

Where applicable within each note, disclosures are further analysed as follows:

- **Overview** provides some context to assist users in understanding the disclosures.
- **Disclosures** (both numbers and commentary) provides required analysis of balances.
- **How we account for the numbers** summarises the accounting policies relevant to an understanding of the numbers.
- **Critical accounting judgements and estimates** explains the key estimates and judgements applied by management in determining the numbers.

The notes include information which the directors believe is required to understand the financial statements and is material and relevant to the operations, balance sheet and results of the branch. Information is considered material and relevant if:

- the amount in question is significant because of its size or nature;
- it is important to assist in understanding the results of the branch;
- it helps to explain the impact of significant changes in the branch's business; or
- it relates to an aspect of the branch's operations that is important to its future performance.

1.2.1 Basis of preparation

This financial report:

- has been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). It complies with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable financial reporting standards, as appropriate for for-profit entities. The Branch is a for-profit entity registered under the *Companies Act 1993*. The financial statements are prepared in accordance with the requirements of Part 7 of the *Financial Markets Conduct Act 2013*, *Financial Reporting Act 2013* and the *Companies Act 1993*;
- 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;
- has been prepared on a historical cost basis as modified by certain exceptions, the most significant of which is the measurement of the net outstanding claims liability at present value;
- 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;
- is presented in New Zealand dollars; and
- is presented with values rounded to the nearest dollar.

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

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 company's notes to the financial statements.

New and amended Accounting Standards and Interpretations issued by the New Zealand Accounting Standards Board (NZASB) that are now effective are detailed in note 6.1.

The branch has not adopted any Accounting Standards and Interpretations that have been issued or amended but are not yet effective.

The branch's ultimate parent company, the QBE Group (incorporated in Australia) produces consolidated financial statements in accordance with AASB and IFRS for public use, which can be obtained at www.qbe.com or Level 27, 8-12 Chifley Square, Sydney, NSW 2000, Australia.

1.2.2 Critical accounting judgements and estimates

The preparation of the branch's financial statements requires management to make judgements and estimates that affect reported amounts.

QBE Group has developed a centralised risk management and policy framework, designed to ensure consistency of approach across a number of operational activities. The company adopts these subject to the specific requirements of local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of the outstanding claims liability and investment management.

Given the centralised approach to many of its activities, sensitivity analyses in respect of critical accounting estimates and judgements are presented in order to provide information and analysis which is meaningful, relevant, reliable and comparable year on year.

The key areas in which critical estimates and judgements are applied are as follows:

- net outstanding claims liability (note 2.3);
- unearned premium and deferred insurance costs (note 2.5);
- liability adequacy test (note 2.5.1); and
- deferred income tax (note 5.2).

1.2.3 Foreign currency

Translation of foreign currency transactions and balances

Transactions included in the financial statements are measured using the currency of the primary economic environment in which the branch operates (the functional currency). Foreign currency transactions are translated into functional currencies at the spot rates of exchange applicable at the dates of the transactions. At the balance date, monetary assets and liabilities denominated in foreign currencies are retranslated at the rates of exchange prevailing at that date. Resulting exchange gains and losses are included in profit or loss.

Exchange rates

The principal exchange rates used in the preparation of the financial statements were:

	2018		2017	
	PROFIT OR LOSS	BALANCE SHEET	PROFIT OR LOSS	BALANCE SHEET
A$/NZ$	**1.080**	**1.049**	1.079	1.101

2. UNDERWRITING ACTIVITIES

Overview

This section provides analysis and commentary on the branch's underwriting activities. Underwriting, in simple terms, is the agreement by the insurer to assume insurance risk in return for a premium paid by the insured. The underwriter assesses the quality of the risk and prices it accordingly.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2018

2.1 Revenue

Overview

Revenue mainly comprises premiums charged for providing insurance coverage. Premiums are classified as direct, being those paid by the policyholder to the insurer.

Other sources of revenue principally comprise amounts recovered from reinsurers under the terms of reinsurance contracts and commission income from reinsurers.

	NOTE	2018 $	2017 $
Gross earned premium revenue			
Direct		**576,511**	740,747
		576,511	740,747
Other revenue			
Reinsurance and other recoveries revenue	2.2	**12,513**	(32,533)
Reinsurance commission revenue		**58,631**	75,334
Interest Income		**17,137**	19,032
		88,281	61,833
Total revenue		**664,792**	802,580

How we account for the numbers

Premium revenue
Premium written comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. Premium is recognised as revenue in profit or loss based on the incidence of the pattern of risk. Premium is treated as earned from the date of attachment of risk associated with the insurance policy.

With effect from 2013, the branch ceased to write new insurance policies.

Reinsurance and other recoveries
Reinsurance and other recoveries on paid claims, reported claims not yet paid, and claims incurred but not reported (IBNR) are recognised as revenue. Receivables are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

2.2 Net claims expense

Overview

The largest expense for an insurance company is net claims expense, which is the difference between the net outstanding claims liability (as described in note 2.3 below) at the beginning and the end of the financial year plus any claims payments made, net of reinsurance and other recoveries received during the financial year.

	NOTE	2018 $	2017 $
Gross claims incurred and related expenses			
Direct		**(174,849)**	(192,019)
Reinsurance and other recoveries revenue			
Direct	2.1	**(12,513)**	32,533
Net claims recoveries revenue		**(187,362)**	(159,486)
Analysed as follows:			
Movement in net discounted central estimate	2.4.1	**(165,638)**	(123,564)
Movement in risk margin	2.3.3	**(21,724)**	(35,922)
Net claims recoveries revenue		**(187,362)**	(159,486)

2.3 Net outstanding claims liability

Overview

The net outstanding claims liability comprises the elements described below.

- The gross central estimate (note 2.3.1). This is the provision for expected future claims payments and includes claims reported but not yet paid, claims incurred but which have not yet been reported (IBNR) and estimated claims handling costs.
- Less reinsurance and other recoveries (note 2.3.2). Insurance companies may elect to purchase reinsurance to manage their exposure to any one claim or series of claims. When an insurance company incurs a claim as a result of an insured loss, it may be able to recover some of that claim from the reinsurers or other parties associated with the claim.
- Less an amount to reflect the discount to present value using risk-free rates of return. The net central estimate is discounted to present value recognising that the claim and/or recovery may not be settled for some time. The weighted average risk-free rate used to discount the outstanding claims liability is summarised in note 2.3.4.
- Plus a risk margin (note 2.3.3). A risk margin is added to reflect the inherent uncertainty in the net discounted central estimate of outstanding claims.

	NOTE	2018 $	2017 $
Gross discounted central estimate	2.3.1	**133,119**	286,244
Risk margin	2.3.3	**19,072**	40,796
Gross outstanding claims liability		**152,191**	327,040
Reinsurance and other recoveries on outstanding claims	2.3.2	**(61,148)**	(132,293)
Net outstanding claims liability		**91,043**	194,747

The table below analyses the movement in the outstanding claims liability, showing separately the movement in gross claims liability and the impact of reinsurance:

	2018			2017		
	GROSS $	REINSURANCE $	NET $	GROSS $	REINSURANCE $	NET $
At 1 January	**327,040**	**(132,293)**	**194,747**	606,667	(240,447)	366,220
Current accident year development in net discounted outstanding claims (note 2.4.2)	**104,670**	**(48,080)**	**56,590**	226,377	(103,928)	122,449
Prior accident year development in net discounted outstanding claims (note 2.4.2)	**(257,795)**	**35,567**	**(222,228)**	(382,474)	136,461	(246,013)
Movement in risk margin (note 2.2)	**(21,724)**	**-**	**(21,724)**	(35,922)	-	(35,922)
Incurred claims recognised in profit or loss	**(174,849)**	**(12,513)**	**(187,362)**	(192,019)	32,533	(159,486)
Claims payments	**-**	**83,658**	**83,658**	(87,608)	75,621	(11,987)
At 31 December	**152,191**	**(61,148)**	**91,043**	327,040	(132,293)	194,747

2.3.1 Gross discounted central estimate

	NOTE	2018 $	2017 $
Gross undiscounted central estimate excluding claims settlement costs		**133,379**	287,303
Claims settlement costs		**3,129**	6,694
Gross undiscounted central estimate		**136,508**	293,997
Discount to present value		**(3,389)**	(7,753)
Gross discounted central estimate	2.3	**133,119**	286,244
Payable within 12 months		**64,023**	145,101
Payable in greater than 12 months		**69,096**	141,143
Gross discounted central estimate	2.3	**133,119**	286,244

How we account for the numbers

The gross discounted central estimate is the present value of the expected future payments for claims incurred and includes reported but unpaid claims, IBNR and claims settlement costs. The gross discounted central estimate is determined by the Appointed Actuary, supported by a team of actuaries. The valuation process includes extensive consultation with claims and underwriting staff as well as senior management. The net discounted central estimate of outstanding claims is subject to a comprehensive independent review at least annually. The risk management procedures related to the actuarial function are explained further in note 3.2.

Critical accounting judgements and estimates

The determination of the amounts that the branch will ultimately pay for claims arising under insurance and reinsurance 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 due to 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
- changing social, political and economic trends, for example, house price inflation, unemployment and interest rates.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims that have been reported to the company but not yet paid, for which some 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 incurred and the final settlement amount, as a result of additional financing and settlement costs incurred by the lender and changes in property valuations.

Central estimates are determined using a variety of estimation techniques, generally based on an 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:

- 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.

The gross central estimate is discounted to present value using the appropriate risk-free rate.

Central estimates are calculated gross of any reinsurance and other recoveries. A separate estimate is made of the amounts recoverable based on the gross central estimate (note 2.3.2).

2.3.2 Reinsurance and other recoveries on outstanding claims

	NOTE	2018 $	2017 $
Reinsurance and other recoveries on outstanding claims - undiscounted		**62,742**	135,962
Discount to present value		**(1,594)**	(3,669)
Reinsurance and other recoveries on outstanding claims	2.3	**61,148**	132,293
Receivable within 12 months		**29,409**	67,062
Receivable in greater than 12 months		**31,739**	65,231
Reinsurance and other recoveries on outstanding claims	2.3	**61,148**	132,293

How we account for the numbers

The recoverability of amounts due from reinsurers and others is assessed at each balance date to ensure that the balances properly reflect the amounts that are ultimately expected to be received, taking into account counterparty credit risk and the contractual terms of the reinsurance contract. Counterparty credit risk in relation to reinsurance assets is considered in note 3.3. Recoveries are discounted to present value using the appropriate risk-free rate.

2.3.3 Risk Margin

Overview

A risk margin is determined by the company Board to reflect the inherent uncertainty in the net discounted central estimate.

The risk margin and the net discounted central estimate are key inputs in the determination of the probability of adequacy, which is a statistical measure of the relative adequacy of the net outstanding claims liability to ultimately be able to pay claims. For example, a 90% probability of adequacy indicates that the net discounted central estimate is expected to be adequate nine years in ten.

	2018 $	2017 $
Risk margin ($)	**19,072**	40,796
Risk margin as a percentage of the net discounted central estimate (%)	**26.5%**	26.5%
Probability of adequacy (%)	**75.0%**	75.0%

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.

How we account for the numbers

NZ IFRS 4 *General Insurance Contracts* requires an entity to adopt an appropriate risk margin. The resulting probability of adequacy is not of itself an accounting policy as defined by NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* The appropriate level of risk margin is not determined by reference to a fixed probability of adequacy.

Critical accounting judgements and estimates

The determination of the appropriate level of risk margin takes into account the level of uncertainty in the central estimate due to estimation error, data quality, variability of key discount assumptions and possible economic and legislative changes.

The key drivers of uncertainty unique to the company's insurance liability are as follows:

- Reliance on consistent arrears management practices and this may change in the future
- Uncertainties surrounding the global economy, with potential flow-on impacts to the Australian economy through future property prices, unemployment and interest rates
- Legislation changes affecting the company's underwriting practices
- Concentration of property losses in a particular region.

2.3.4 Discount rate used to determine the outstanding claims liability

Overview

Claims typically may not settle for some time. As such, the liability is discounted to reflect the time value of money. The table below summarises the weighted average discount rate used to discount the outstanding claims liability.

	2018 YEARS	2017 YEARS
Discount rate	**1.9**	1.9

How we account for the numbers

NZ IFRS 4 *Insurance Contracts* requires that the net central estimate is discounted to reflect the time value of money using risk-free rates that are based on current observable, objective rates that relate to the nature, structure and terms of the future obligations.

2.3.5 Weighted average term to settlement

Overview

The weighted average term to settlement refers to the period from the balance date to the expected date of claims settlement. All other factors being equal, a longer weighted average term to settlement generally results in a larger impact on the central estimate from discounting. Details of the weighted average term to settlement of the branch's outstanding claims liability is summarised below.

	2018 YEARS	2017 YEARS
Weighted average term to settlement	**1.3**	1.3

2.3.6 Net discounted central estimate maturity profile

Overview

The maturity profile is the branch's expectation of the period over which the net central estimate will be settled. The branch uses this information to ensure that it has adequate liquidity to pay claims as they are due to be settled and to inform the branch's investment strategy. The expected maturity profile of the branch's net discounted central estimate 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
2018	**$**	**34,614**	**22,765**	**8,836**	**2,947**	**1,263**	**1,546**	**71,971**
2017	$	78,040	45,131	17,659	6,348	2,921	3,852	153,951

2.3.7 Impact of changes in key variables on the net outstanding claims liability

Overview

The impact of changes in key variables used in the calculation of the outstanding claims liability is summarised in the table below. Each change has been calculated in isolation from the other changes and shows the after tax impact on profit assuming that there is no change to any of the other even if in practice, this may be considered unlikely to occur.

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

	SENSITIVITY	PROFIT (LOSS)[1,2]	
		2018	2017
	%	$	$
Severity	+20	**(13,287)**	(28,534)
	-20	**13,287**	28,533
Claim rates	+20	**(13,274)**	(28,486)
	-20	**13,259**	28,448
Discount rate	+5	**82**	186
	-5	**(83)**	(187)
Coefficient of variation	+20	**(2,746)**	(5,875)
	-20	**2,746**	5,875

[1] Net of tax at the prima facie rate of 28%.
[2] The impact of a change in interest rates on profit after income tax due to market value movements on fixed interest securities is shown in note 3.4.

2.4 Claims development - net undiscounted central estimate

Overview

The claims development table demonstrates the extent to which the original estimated ultimate claims payments in any one accident year (item (a) in the table below) has subsequently developed favourably (that is, claims cost estimates have reduced) or unfavourably (i.e. further claims expense has been recognised in subsequent years). This table therefore illustrates the variability and inherent uncertainty in estimating the central estimate each year. The ultimate claims cost for any particular accident year is not known until all claims payments have been made, which could be some time into the future. The estimated ultimate claims payments at the end of each subsequent accident year demonstrates how the original estimate has been revised over time (b).

Cumulative actual net claims payments (d) are deducted from the expected ultimate claims payments in each accident year (c) at the current balance date, resulting in the net undiscounted central estimate (e), which is reconciled to the discounted central estimate (f).

The accident year movement (g) reflects the ultimate undiscounted net claims estimate at the end of the current financial year (c) less the equivalent at the end of the previous financial year (b). This is further summarised in note 2.4.1.

The claims development table is presented net of reinsurance. With reinsurance arrangements and with the branch's risk tolerance managed on a net basis, it is considered neither meaningful nor practicable to provide this information other than on a net accident year basis.

	2014 & PRIOR YEARS $	2015 $	2016 $	2017 $	2018 $	TOTAL $
Net ultimate claims payments:						
(a) Original estimate of net ultimate claims payments	-	1,053,019	244,687	119,902	55,540	
(b) One year later	-	284,758	103,859	30,915	-	
Two years later	-	220,889	58,841	-	-	
Three years later	-	218,651	-	-	-	
(c) Current estimate of net ultimate claims payments	-	218,651	58,841	30,915	55,540	363,947
(d) Cumulative net payments to date	-	(218,651)	(58,841)	(15,818)	-	(293,310)
(e) Net undiscounted central estimate at 31 Dec 2018	-	-	-	15,097	55,540	70,637
Discount to present value	-	-	-	-	-	(1,795)
Claims settlement costs	-	-	-	-	-	3,129
Risk margin	-	-	-	-	-	19,072
(f) Net outstanding claims liability at 31 Dec 2018 (note 2.3)	-	-	-	-	-	91,043
(g) Movement in accident year net undiscounted central estimate (note 2.4.1)	(83,659)	(2,238)	(45,018)	(88,987)	55,540	(164,362)

Uncertainty surrounding claims development is materially resolved within four years.

The development of claims from prior accident years was better than expected at 31 December 2018, leading to an overall release of the central estimate for prior years of $219,902. The release is mainly due to favourable overall claim experiences and run-off of the portfolio.

2.4.1 Reconciliation of claims development table to profit or loss

Overview

The table below reconciles the net increase or decrease in estimated ultimate claims payments in the current financial year from the claims development table (item (g) in note 2.4) to the analysis of current and prior accident year central estimate development recognised in profit or loss (note 2.4.2).

	2018			2017		
	CURRENT ACCIDENT YEAR $	PRIOR ACCIDENT YEARS $	TOTAL $	CURRENT ACCIDENT YEAR $	PRIOR ACCIDENT YEARS $	TOTAL $
Net undiscounted central estimate movement (note 2.4)	55,540	(219,902)	(164,362)	119,903	(240,892)	(120,989)
Movement in claims settlement costs	2,525	(6,090)	(3,565)	5,483	(11,376)	(5,893)
Movement in discount	(1,475)	3,764	2,289	(2,937)	6,255	3,318
Movement in net discounted central estimate (note 2.4.2)	56,590	(222,228)	(165,638)	122,449	(246,013)	(123,564)

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2018

2.4.2 Net central estimate development

Overview

The table further analyses the current and prior accident year movement in the net discounted central estimate separately identifying the gross and reinsurance components. Prior accident year claims are those claims that occurred in a previous year but for which a reassessment of the claims cost has impacted the result in the current period.

	2018			2017		
	CURRENT ACCIDENT YEAR $	PRIOR ACCIDENT YEARS $	TOTAL $	CURRENT ACCIDENT YEAR $	PRIOR ACCIDENT YEARS $	TOTAL $
Gross central estimate development						
Undiscounted	**107,399**	**(264,888)**	**(157,489)**	231,837	(394,009)	(162,172)
Discount	**(2,729)**	**7,093**	**4,364**	(5,460)	11,535	6,075
	104,670	**(257,795)**	**(153,125)**	226,377	(382,474)	(156,097)
Reinsurance and other recoveries						
Undiscounted	**(49,334)**	**38,896**	**(10,438)**	(106,451)	141,741	35,290
Discount	**1,254**	**(3,329)**	**(2,075)**	2,523	(5,280)	(2,757)
	(48,080)	**35,567**	**(12,513)**	(103,928)	136,461	32,533
Net central estimate development						
Undiscounted	**58,065**	**(225,992)**	**(167,927)**	125,386	(252,268)	(126,882)
Discount	**(1,475)**	**3,764**	**2,289**	(2,937)	6,255	3,318
Net discounted central estimate development (note 2.4.1)	**56,590**	**(222,228)**	**(165,638)**	122,449	(246,013)	(123,564)

2.5 Unearned premium and deferred insurance costs

Overview

Unearned premium

Gross written premium is earned in profit or loss in accordance with the pattern of incidence of risk. The unearned premium liability is that portion of gross written premium that the branch has not yet earned in profit or loss as it represents insurance coverage to be provided by the company after the balance date.

Deferred insurance costs

Premium ceded to reinsurers by the branch in exchange for reinsurance protection is expensed in profit or loss in accordance with the reinsurance contract's expected pattern of incidence of risks. The deferred reinsurance premium asset is that portion of the reinsurance premium that the branch has not yet expensed in profit or loss as it represents reinsurance coverage to be received by the branch after the balance date.

Acquisition costs are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised and amortised on the same basis as the related premium. Commissions are a type of acquisition cost but are disclosed separately. At the balance date, deferred acquisition costs represent the capitalised costs incurred to acquire the related unearned premium and are carried forward to a subsequent accounting period in recognition of their future benefit.

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2018

Summary of unearned premium and deferred insurance costs balances

	2018 $	2017 $
Unearned premium (a)	**171,915**	748,426
To be earned within 12 months	**127,089**	402,087
To be earned in greater than 12 months	**44,826**	346,339
Unearned premium	**171,915**	748,426
Unearned reinsurance commission (b)	**17,484**	76,115
To be earned within 12 months	**12,925**	40,892
To be earned in greater than 12 months	**4,559**	35,223
Unearned reinsurance commission	**17,484**	76,115
Deferred reinsurance premium	**77,362**	336,792
Deferred acquisition costs	**22,989**	89,353
Deferred insurance costs (c)	**100,351**	426,145
To be expensed within 12 months	**74,185**	228,944
To be expensed in greater than 12 months	**26,166**	197,201
Deferred insurance costs	**100,351**	426,145
Net premium liabilities (a)+(b)-(c)	**89,048**	398,396

Unearned premium movements

	2018 $	2017 $
At 1 January	**748,426**	1,489,173
Earning of premium written in previous financial years	**(576,511)**	(740,747)
At 31 December	**171,915**	748,426

Unearned reinsurance commission income movements

	2018 $	2017 $
At 1 January	**76,115**	151,449
Earning of commission written in previous financial years	**(58,631)**	(75,334)
At 31 December	**17,484**	76,115

Deferred insurance costs movements

	DEFERRED REINSURANCE PREMIUM		DEFERRED ACQUISITION COSTS	
	2018 $	2017 $	2018 $	2017 $
At 1 January	**336,792**	670,128	**89,353**	166,691
Amortisation of costs deferred in previous financial years	**(259,430)**	(333,336)	**(66,364)**	(77,338)
At 31 December	**77,362**	336,792	**22,989**	89,353

How we account for the numbers

Insurance revenues are earned, and insurance costs are expensed, based on the term of the policies written and the likely pattern in which risk will emerge over that term. This pattern is applied to insurance revenues and costs that relate to the active portfolio at the reporting date to determine the amounts to be deferred until future years, when the underlying insurance risks are expected to emerge.

During the year, as required by accounting standards and highlighted below, the branch reviewed the expected pattern of risk emergence for the current portfolio. Consequently, the branch revised the earning patterns previously adopted across all underwriting years for the determination of unearned and deferred balances at 31 December 2018.

Unearned premium

Unearned premium on insurance or reinsurance contracts at balance date is calculated by applying the premium earning pattern to premium written on active policies. The review of this pattern during the year increased the unearned premium liability at 31 December 2018 by $145,194 compared to the balance if the previous earning pattern had been applied.

Unearned commission income

Unearned commission income is calculated by applying the premium income earning pattern to commission received or receivable on active reinsurance polices. The review of this pattern during the year increased the unearned commission liability at 31 December 2018 by $14,766 compared to the balance if the previous earning pattern had been applied.

Deferred insurance costs

Deferred reinsurance premium is calculated by applying the premium income earning pattern, adjusted where necessary for varying indemnity periods, to reinsurance premiums paid or payable on active reinsurance policies. The review of the earning pattern during the year increased the deferred reinsurance premium asset at 31 December 2018 by $65,337 compared to the balance if the previous earning pattern had been applied.

Deferred acquisition costs are calculated by applying the premium income earning pattern to acquisition costs incurred on acquiring and recording insurance policies that are still active. The carrying value of deferred acquisition costs is subject to impairment testing in the form of the liability adequacy test (note 2.5.1). The review of the earning pattern during the year increased the deferred acquisition cost asset at 31 December 2018 by $17,854 compared to the balance if the previous earning pattern had been applied.

Critical accounting judgements and estimates

An actuarial analysis of the expected pattern of the incidence of risk over the policy coverage period is used to derive a recognition (earning) pattern for each underwriting year. This review requires estimating both the total amount of claims expense expected under the contract and when those claims are expected to arise. These estimations involve the use of significant judgement and are reassessed at the end of each reporting period.

With respect to the review performed at the current reporting date, actuarial analysis of claims experience and market conditions indicated a slightly slower pattern of risk emergence than previously expected. This resulted in a revision to the applicable earning patterns.

2.5.1 Liability adequacy test

Overview

At each balance date, the branch is required to assess net premium liabilities (being unearned premium less deferred insurance costs) to determine whether the amount provided is sufficient to pay future claims.

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

	2018 $	2017 $
Undiscounted net central estimate	**30,829**	42,748
Discount to present value	**(5,081)**	(13,870)
	25,748	28,878
Risk margin at the 75th percentile of insurance liabilities	**10,299**	11,551
Expected present value of future cash flows for future claims including risk margin	**36,047**	40,429

How we account for the numbers

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 claims cash flows, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the portfolio level, being a portfolio of contracts subject to broadly similar risks and which are managed together as a single portfolio.

If the present value of expected future claims exceeds the net premium liabilities, the net premium liability is deemed deficient. This deficiency is immediately recognised in profit or loss. In recognising the deficiency, an insurer must first write down any related intangible assets and then deferred acquisition costs before recognising an unexpired risk liability.

The application of the liability adequacy test did not identify a deficiency at either 31 December 2018 or 2017.

Critical accounting judgements and estimates

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.

The branch has adopted a risk margin of 26.5% (2017: 26.5%) for the purpose of the liability adequacy test to produce a 75% probability of adequacy in respect of total insurance liabilities. The 75% basis is a recognised industry benchmark in New Zealand, as required by RBNZ, and in Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA.

2.6 Trade and other receivables

Overview

Trade and other receivables are principally amounts owed to the branch by Head Office.

	2018 $	2017 $
Trade receivables		
Amounts due from Head Office	**9,392**	7,479
Trade and other receivables	**9,392**	7,479
Receivable within 12 months	**9,392**	7,479
Trade and other receivables	**9,392**	7,479

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

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables are pledged by the branch as collateral for liabilities or contingent liabilities. Information on the ageing and credit rating of these balances is included in note 3.3.

How we account for the numbers

Receivables are initially recognised at fair value and are subsequently measured at amortised cost less an allowance for expected credit losses (ECL's).

Any increase or decrease in the loss allowance is recognised in profit or loss within operating expenses. When a receivable is uncollectible, it is written off against the loss allowance account. Subsequent recoveries of amounts previously written off are credited against underwriting expenses in profit or loss.

Critical accounting judgements and estimates

The allowance for ECLs is based on the difference between the cash flows due in accordance with the contract and the cash flows that the company expects to receive. Any shortfall is discounted at an approximation to the asset's original effective interest rate.

The allowance is based on the portion of lifetime ECLs that result from possible default events within 12 months from reporting date, unless there has been a significant increase in credit risk since initial recognition, in which case the allowance is based on the lifetime ECL.

The credit risk in relation to amounts due from Head Office is assessed with regard to the credit standing of the company and policies and practices surrounding the periodic settlements of intragroup balances. The branch has determined that the credit risk on receivables has not increased significantly since initial recognition.

The allowance for ECL's reflects judgements and assumptions that take into account prior credit risk and loss history, current and expected future market conditions and individual debtor circumstances. The transition to the expected credit loss model contained within NZ IFRS 9 *Financial Instruments* had no impact on the branch. The branch has determined that no allowance for ECLs is required at the reporting date (2017: nil).

2.7 Payables

Overview

Payables are principally amounts owed to related entities.

	2018 $	2017 $
Amounts due to related entities	**56,975**	63,377
Other payables	**1,741**	1,741
Payables	**58,716**	65,118
Payable within 12 months	**58,716**	65,118
Payables	**58,716**	65,118

How we account for the numbers

Other payables are measured at cost and are settled under standard terms and conditions.

Amounts due to related entities are measured at amortised cost and are repayable on demand.

3. RISK MANAGEMENT

Overview

QBE Group is in the business of managing risk. The company's and the branch's ability to satisfy customers' risk management needs is central to the business model. QBE Group aims to generate wealth and maximise returns for its shareholders by pursuing opportunities that involve risk. Management are responsible for ensuring that QBE Group's risks are managed and controlled on a day-to-day basis. QBE Group aims to use its ability to properly manage risk to provide more certainty and improved outcomes for all stakeholders. As a member of the QBE Group, the company has adopted the risk management policies of QBE Group where applicable.

QBE Group applies a consistent and integrated approach to enterprise risk management (ERM); this is referred to as ONE ERM. 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. QBE Group's risk management framework is articulated in the Risk Management Strategy (RMS) and Reinsurance Management Strategy (REMS), both of which are accepted by the company and, with minor change made for statutory and regulatory purposes, are approved annually by the company Board and lodged with APRA.

The framework consists of complementary elements that are embedded throughout the business management cycle and culture of the organisation. Key aspects include: risk appetite, governance, reporting, risk assessments, modelling and stress testing, management, and monitoring and risk culture.

Risk management is a continuous process and an integral part of robust business management. The company's approach, as adopted from QBE Group, is to integrate risk management into the broader management processes of the organisation. It is the company's philosophy to ensure that risk management remains 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.

The company's strategy for managing risk is to:

- achieve competitive advantage by better understanding the risk environments in which the branch operates;
- operate within the stated risk appetite and more effectively allocate capital and resources by assessing the balance of risk and reward; and
- avoid unwelcome surprises to the achievement of business objectives by reducing uncertainty and volatility through the identification and management of risks.

The global framework is supported by a suite of policies that detail QBE Group's approach to the key risk categories used by QBE Group to classify risk. These policies are adopted by the company as follows:

- Strategic risk (note 3.1)
- Insurance risk (note 3.2)
- Credit risk (note 3.3)
- Liquidity risk (note 3.4)
- Operational risk (note 3.5)

3.1 Strategic risk

Overview

Strategic risk is the potential impact on earnings and/or capital as a result of strategic business decisions or lack of responsiveness to external change. QBE Group classifies strategic risk into four sub-categories, that have been adopted by the company, as follows:

- business, product and market distribution;
- capital structure and management;
- acquisition, decision and negotiation; and
- tax risk management.

The company's approach to managing strategic risk is underpinned by the company's strategic risk appetite statement as set by the company Board and is summarised below.

Business, product and market distribution

Business: The company is a residential lenders' mortgage insurance company underwriting business in Australia and New Zealand. The company Board meets at least quarterly to review performance against business plans. Actual results are monitored and analysed regularly at various levels in the company to identify adverse trends so that remedial action can be taken at an early stage. One of the key tools used to ensure achievement of business plans is to identify the 'manage to' likely scenarios impacting the plan year, based on events that have occurred or risks identified since plans were set. The company assesses how these scenarios would impact return on equity (ROE) forecasts and develop and implement bridging actions to drive plan achievability.

Products: The company reviews the structuring of its insurance products on an ongoing basis in line with developments in market expectations, legislation and claims trends.

Market distribution approach: The company makes use of banks and other financial institutions to market its insurance products.

Capital structure and management

The Capital Management Plan (CMP) outlines the company's approach for ensuring adequate capital is maintained over time and for monitoring compliance with regulatory capital requirements and targets. The CMP is a key component of the Internal Capital Adequacy Assessment Process (ICAAP) and includes:

- specific capital targets set in the context of the company's risk profile, the Board's risk appetite and regulatory capital requirements;
- plans for how target levels of capital are to be met; and
- potential sources of additional capital, if required.

Management has a particular focus on the following performance indicators.

- The company actively manages the components of capital in order to maintain a level of eligible regulatory capital that exceeds APRA requirements. The Board set the target level of regulatory capital for 2018 at 1.32-1.44 times (2017: 1.32-1.44 times) the Prescribed Capital Amount (PCA).
- The company is subject to regulatory requirements to maintain a minimum level of capital 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 local regulatory requirements.
- Insurer financial strength ratings provided by the major rating agencies demonstrate the company's financial strength and claims paying ability.

In addition to the management reporting and planning processes, the company has dedicated staff responsible for understanding the regulatory capital requirements of its operations. The quality of assets (particularly investments and reinsurance recoveries) 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 levels.

Tax risk management

The company's approach to managing taxation risk is underpinned by the QBE Group Tax Risk Management Framework, which is approved by the Group Board and aligns with QBE Group's business strategy.

3.2 Insurance risk

Overview

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to expectations. Key drivers of insurance risk include natural or man-made catastrophic events, pricing of individual insurance contracts, reserving and insurance claims.

QBE Group classifies insurance risk into four subcategories which are adopted by the company, as follows:

- underwriting;
- insurance concentration;
- reserving; and
- reinsurance.

The branch's approach to managing insurance risk is underpinned by the company insurance risk appetite statement as set by the Board and is summarised below.

Underwriting risk

The company manages underwriting risk by appropriately setting and adjusting underwriting strategy, risk selection and pricing practices throughout the underwriting cycle.

The branch is a monoline insurer providing residential lenders' mortgage insurance (LMI) in New Zealand. With effect from 2013, the branch ceased to write new insurance 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.

Insurance 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. 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 (2017: 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 2018, the ICRC was $501.1 million (2017: $459.2 million) before tax benefit, which was less than the risk tolerance.

Reserving risk

Reserving risk is managed through the actuarial valuation of insurance liabilities. The valuation of the net central estimate is performed by qualified and experienced actuaries, with reference to historical data and reasoned expectations of future events. The net central estimate is subject to a comprehensive independent review at least annually.

Reinsurance risk

The company limits its exposure to an accumulation of claims by reinsuring a portion of risks underwritten. This allows the company to control exposure to insurance losses, reduce volatility of reported results and protect capital. Risks associated with reinsurance counterparty credit risk are discussed in note 3.3.

3.3 Credit risk

Overview

Credit risk is the risk of not recovering money owed by third parties as well as the loss of value of assets due to deterioration in credit quality. The branch's exposure to credit risk principally arises from cash and cash equivalents and/or a reduction or delay in repayments or interest payments from the default of counterparties such as mortgagees and reinsurers. QBE Group categorises credit risk into three sub-categories, as follows:

- reinsurance counterparty credit;
- investment counterparty credit; and
- premium and other counterparty credit.

The branch's approach to managing credit risk is underpinned by the company credit risk appetite as set by the company Board and summarised below.

Reinsurance counterparty credit risk

The company's objective is to maximise placement of reinsurance with highly rated counterparties. Concentration of risk with reinsurance counterparties is monitored strictly and regularly by QBE Group's security committee and is controlled by reference to the following protocols:

- treaty or facultative 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 claims and potential future losses based on the company's insurance concentrations; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

Credit risk exposures are calculated regularly and compared with authorised credit limits. In certain cases, the company requires letters of credit or other collateral arrangements to be provided to guarantee the recoverability of the amount involved. The company holds $190.5 million (2017: $150.0 million) in collateral to support reinsurance recoveries on outstanding claims.

The following table provides information about the quality of the branch's credit risk exposure in respect of reinsurance recoveries on outstanding claims at the balance date. The analysis classifies the assets according to Standard & Poor's (S&P) counterparty credit ratings. 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 GRADE $	NOT RATED $	TOTAL $
As at 31 December 2018							
Reinsurance recoveries on outstanding claims[1,2]	-	-	**56,324**	-	-	-	**56,324**
As at 31 December 2017							
Reinsurance recoveries on outstanding claims[1,2]	-	-	120,483	-	-	-	120,483

[1] The branch has no reinsurance recoveries receivable on paid claims at 31 December 2018 (2017: nil).
[2] Excludes other non-reinsurance recoveries of $4,824 (2017: $11,810).

None of the branch's reinsurance recoveries are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2017: nil).

Investment counterparty credit risk

The branch only transacts with investment counterparties within the limits outlined in the delegated authorities. Investment counterparty exposure limits are applied to individual counterparty exposures and to multiple exposures within the one group of related companies in relation to cash deposits. Counterparty exposure limit compliance is monitored daily. The branch's principal exposures relate to cash.

The following table provides information regarding the company's aggregate credit risk exposure at the balance date in respect of the major classes of financial assets. The analysis classifies the assets according to S&P counterparty credit ratings. 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 GRADE $	NOT RATED $	TOTAL $
As at 31 December 2018							
Cash and cash equivalents	-	**1,205,203**	-	-	-	-	**1,205,203**
As at 31 December 2017							
Cash and cash equivalents	-	1,295,753	-	-	-	-	1,295,753

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

Premium and other counterparty credit risk

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

As an insurer, the branch 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 branch. Under a standard LMI policy, premium payment is required before policy cover is incepted, which eliminates credit risk on premiums receivable.

The branch 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 branch.

3.4 Liquidity risk

Overview

Liquidity risk is the risk of insufficient liquid assets to meet liabilities as they fall due or only being able to achieve the required level of liquidity at excessive cost. The company's liquidity risk arises due to the nature of insurance activities where the timing and amount of cash outflows are uncertain.

The branch's approach to managing liquidity risk is underpinned by the company's risk appetite as set by the company Board and is summarised below.

The company manages liquidity risk using a number of tools, as follows:

- cash flow targeting;
- maintaining a proportion of liabilities in liquid assets;
- cash flow forecasting; and
- stress testing and contingency planning.

Liquidity is managed across the company using a number of cash flow forecasting and targeting tools and techniques. Cash flow forecasting and targeting is conducted at operational level and involves actively managing operational cash flow requirements.

To supplement the cash flow targeting and to ensure that there are sufficient liquid funds available to meet insurance and investment obligations, a minimum percentage of the company's liabilities is held, at all times, in cash and liquid securities. The company also maintains a defined proportion of the funds under management in liquid assets.

The company actively forecasts cash flow requirements to identify future cash surpluses and shortages to optimise invested cash balances and limit unexpected calls from the investment pool. The company limits the risk of liquidity shortfalls resulting from mismatches in the timing of claims payments and receipts of claims recoveries by negotiating cash call clauses in reinsurance contracts and seeking accelerated settlements for large reinsurance recoveries.

The following table summarises the maturity profile of the branch's financial liabilities based on the remaining contractual obligations.

	1 YEAR OR LESS $	1 TO 3 YEARS $	3 TO 5 YEARS $	OVER 5 YEARS $	TOTAL $
As at 31 December 2018					
Payables	**58,716**	**-**	**-**	**-**	**58,716**
As at 31 December 2017					
Payables	65,118	-	-	-	65,118

The maturity profile of the branch's net discounted central estimate is analysed in note 2.3.6.

The maturity of the branch's directly held interest-bearing financial assets is shown in the table below.

		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 2018								
Floating rate	$	**1,205,203**	**-**	**-**	**-**	**-**	**-**	**1,205,203**
Weighted average interest rate	%	**0.15%**						**0.15%**
As at 31 December 2017								
Floating rate	$	1,295,753	-	-	-	-	-	1,295,753
Weighted average interest rate	%	0.04%						0.04%

3.5 Operational risk

Overview

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk).

Operational risk can materialise in a number of forms including fraud perpetrated by employees or by external parties (for example claims fraud or cyber attacks), employment practices (losses arising from breaches of employment, health or safety laws, breach of employment contracts, fraudulent payment of personal injury claims or diversity and discrimination events), improper business practices (failure to meet professional obligations or issues with the nature or design of an insurance product), disasters and other events, technology and infrastructure failures, or business and transaction processing failures.

QBE Group identifies and assesses operational risk through Risk and Control Assessment (RCA), Divisional Risk Assessment (DRA), top risks and emerging risks processes, and scenario analysis. The company has adopted these QBE Group risk processes. The RCA process identifies and assesses the key risks to achieving business objectives and is conducted at the business unit level. The DRA process creates a single, divisional-level view of risk across all of the company's risk categories. The top risks process involves the identification and assessment of the key risks relating to the company and of QBE's Australia and New Zealand operations (the division). The emerging risks process identifies and assesses new risks, which are characterised by incomplete but developing knowledge or existing risks that develop in new or surprising ways. The scenario analysis process assesses the impact of potentially extreme scenarios and the appropriateness of our contingency planning.

The company manages operational risk through various systems, controls and processes, including effective segregation of duties, access controls, authorisations and reconciliation procedures, business continuity management, fraud management, information security and physical security. The company monitors operational risk through risk & control assessments, control assurance, key risk indicators and internal loss events and issues and actions.

4. CAPITAL STRUCTURE

Overview

QBE Group's objective in managing capital is to maintain an optimal balance between debt and equity in order to reduce the overall cost of capital whilst satisfying the capital adequacy requirements of regulators and rating agencies, providing financial security for our policyholders and continuing to provide an adequate return to shareholders. As a wholly owned member of the group, the company and therefore the branch has adopted the capital management policies and framework of the QBE Group.

Details of the company's approach to capital risk management are disclosed in note 3.1.

4.1 Cash and cash equivalents

	2018 $	2017 $
Cash at bank on hand	**236,606**	343,352
Overnight money	**968,597**	952,401
	1,205,203	1,295,753

Analysed as follows:		
Floating interest rate	**1,205,203**	1,295,753
	1,205,203	1,295,753

How we account for the numbers

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

The reconciliation of profit after income tax to cash flows from operating activities is included in note 6.3.

4.2 APRA capital adequacy

Overview

APRA Prudential Standard GPS 110 Capital Adequacy for General Insurers requires that the company maintain a capital base in excess of its prudential capital requirement as defined under the prudential standard.

The following table discloses the capital adequacy calculated in accordance with the APRA prudential framework for the company which includes the branch. The 2017 and 2018 position reflects the December quarter APRA return (unaudited).

	2018 A$M	2017 A$M
Eligible Tier 1 capital as defined by APRA		
Contributed equity	**364.3**	364.3
General reserves	**0.5**	0.4
Retained profits [1]	**568.8**	584.5
Insurance liability surplus	**51.3**	26.1
Total equity	**984.9**	975.3
Less: APRA deductions	**76.1**	76.6
Total APRA capital base	**908.8**	898.7
APRA prudential capital requirement	**639.3**	606.8
APRA Capital adequacy multiple	**1.42**	1.48

[1]Retained profits are in accordance with APRA prudential standards

5. TAX

Overview

Income tax expense is the accounting tax charge for the period and is calculated as the tax payable on the current period taxable income based on the applicable income tax rate, adjusted for changes in deferred tax assets and liabilities attributable to temporary differences and unused tax losses. The relationship between accounting profit and income tax expense is provided in the reconciliation of prima facie tax to income tax expense (note 5.1). Income tax expense does not equate to the amount of tax actually paid to tax authorities as it is based upon the accrual accounting concept.

Accounting income and expenses do not always have the same recognition pattern as taxable income and expenses, creating a timing difference as to when a tax expense or benefit can be recognised. These differences usually reverse over time but until they do, a deferred tax asset or liability is recognised on the balance sheet. Note 5.2 details the composition and movements in deferred tax balances and the key management assumptions applied in recognising tax losses.

The company's approach to managing tax risk is disclosed in note 3.1.

5.1 Income tax

Reconciliation of prima facie tax to income tax expense

	NOTE	2018 $	2017 $
Profit before income tax		**443,097**	495,521
Prima facie tax payable at 28%		**124,067**	138,746
Prima facie tax adjusted for non-temporary differences		**124,067**	138,746
Overprovision in prior year		**-**	(5)
Income tax expense		**124,067**	138,741
Analysed as follows:			
Current tax		**142,649**	160,401
Deferred tax		**(18,582)**	(21,655)
Overprovision in prior year		**-**	(5)
		124,067	138,741
Deferred tax expense comprises:			
Deferred tax liabilities recognised in profit or loss	5.2.1	**(18,582)**	(21,655)
		(18,582)	(21,655)

How we account for the numbers

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 and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends to either 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.

5.2 Deferred income tax

	NOTE	2018 $	2017 $
Deferred tax liabilities	5.2.1	**6,437**	25,019

5.2.1 Deferred tax liabilities

The balance comprises temporary differences attributable to:

	NOTE	2018 $	2017 $
Amounts recognised in profit or loss			
Insurance assets		**6,437**	25,019
Deferred tax liabilities	5.2	**6,437**	25,019

Deferred tax liabilities analysed as follows:		
Payable within 12 months	**4,759**	13,441
Payable greater than 12 months	**1,678**	11,578
	6,437	25,019

Movements:

	NOTE	2018 $	2017 $
At 1 January		**25,019**	46,674
Amounts recognised in profit or loss	5.1	**(18,582)**	(21,655)
At 31 December		**6,437**	25,019

How we account for the numbers

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 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 substantively 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 not recognised for temporary differences between the carrying amount and tax bases of investments in foreign operations where the company is able to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset in the financial statements 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.

5.2.2 Tax losses

The branch has brought to account nil tax losses (2017: nil).

6. OTHER

Overview

This section includes other information that must be disclosed to comply with the New Zealand Accounting Standards or the *Corporations Act 1993.*

6.1 Other accounting policies

6.1.1 New and amended standards adopted by the branch

The branch adopted the following new or revised accounting standards which became effective for the annual reporting period commencing on 1 January 2018.

TITLE	
NZ IFRS 9	Financial Instruments
NZ IFRS 15	Revenue from Contracts with Customers
NZ IFRS 2016-6	Applying *NZ IFRS 9 Financial Instruments* with *NZ IFRS 4 Insurance Contracts*
IFRIC Interpretation 22	Foreign Currency Transaction and Advance Consideration

NZ IFRS 15 introduced a single model for the recognition of revenue based on when control of goods and services transfers to a customer. It does not apply to insurance contracts and financial instruments, hence the branch's revenue is excluded from the scope of the standard and there was no impact on the amounts recognised in the financial statements in the current year and no retrospective changes were required in respect of the prior year.

NZ IFRS 9 introduced changes in the classification and measurement of financial assets and financial liabilities. The branch's insurance assets and liabilities are excluded from the scope of NZ IFRS 9. Given the nature of the branch's other financial assets and liabilities, there was no impact on the amounts recognised in the financial statements in the current year and no retrospective changes were required in respect of the prior year

6.1.2 New accounting standards and amendments issued but not yet effective

TITLE		OPERATIVE DATE
IFRIC Interpretation 23	Uncertainty over Income Tax Treatments	1 January 2019
NZ IFRS 17	Insurance Contracts	1 January 2021

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

The branch 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 branch's financial statements, except where noted below.

NZ IFRS 17 *Insurance Contracts*

NZ IFRS 17, a new accounting standard for insurance contracts, was adopted by the New Zealand Accounting Standards Board on 10 August 2017. It is currently effective for reporting periods beginning on or after 1 January 2021, but this is expected to be deferred to 1 January 2022 following a tentative decision of the International Accounting Standards Board (IASB) to delay the mandatory implementation date by one year.

The standard will be applicable to general, life and health insurance business and introduces a new 'general model' for recognition and measurement of insurance contracts. It also permits application of a simplified model (which is similar to the current basis on which general insurance is brought to account under NZ IFRS 4) if the liability for remaining coverage under the simplified model would not materially differ from the general model.

The company has completed an initial impact assessment and additional analysis on key areas of interpretation. The company has not yet determined whether the general model or the simplified model is the most appropriate reflection of the company's business model. Further analysis and industry input is required in respect of this product type.

This analysis also identified key requirements of NZ IFRS 17 where the technical interpretation remains unclear. The IASB is in the process of considering potential changes to the wording of NZ IFRS 17 to remedy implementation issues identified and it is expected these changes would then be adopted into NZ IFRS 17.

Given the potential for changes in NZ IFRS 17 and 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 reported profit or loss are expected. We continue to monitor market developments in order to assess the impact of changes and evolving interpretations on the company.

6.2 Contingent liabilities

Overview

Contingent liabilities are disclosed when the possibility of a future settlement of economic benefits is considered to be less than probable but more likely than remote. If the expected settlement of the liability becomes probable, a provision is recognised.

In the normal course of business, the branch is exposed to contingent liabilities in relation to claims litigation arising out of its insurance and reinsurance transactions and may be exposed to the possibility of contingent liabilities in relation to non-insurance litigation. Provisions are made for obligations that are probable and quantifiable.

The branch had no contingent liabilities as at 31 December 2018 (2017: nil).

6.3 Reconciliation of profit after income tax to cash flows from operating activities

	2018 $	2017 $
Profit after income tax	**319,030**	356,780
(Decrease) in net outstanding claims	**(174,849)**	(279,627)
(Decrease) in unearned premiums	**(576,511)**	(740,747)
(Decrease) in unearned reinsurance commission	**(58,631)**	(75,334)
Decrease in deferred insurance costs	**325,794**	410,674
Decrease in reinsurance and other recoveries	**71,145**	108,153
(Increase) Decrease in trade and other receivables	**(1,913)**	113,376
Decrease in trade and other payables	**(6,402)**	(13,740)
(Decrease) in deferred tax liabilities	**(18,582)**	(21,655)
Decrease (increase) in amounts due from tax authorities for current tax	**30,369**	(133,485)
Cash flows from operating activities	**(90,550)**	(275,605)

6.4 Remuneration of auditors

Overview

The company may engage the external auditor for non-audit services other than 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. The Board believes some non-audit services are appropriate given the external auditor's knowledge of the company. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, the external auditor cannot provide the excluded services of preparing accounting records or financial reports or acting in a management capacity.

	2018 $	2017 $
PricewaterhouseCoopers (PwC) – Australian firm		
Audit of financial reports of the company	**600,406**	588,307
Audit of statutory returns and other assurance services	**174,841**	169,590
	775,247	757,897

6.5 Related parties

6.5.1 Parent entity

The branch forms part of QBE Lenders' Mortgage Insurance Limited, a company incorporated and domiciled in Australia.

The company's parent entity is QBE Holdings (AAP) Pty Limited and the ultimate parent entity is QBE Insurance Group Limited.

6.5.2 Transactions with related parties

The following material transactions occurred with related parties:

	2018 $	2017 $
Expenses		
Management fees paid to related parties	**64,866**	87,867

6.5.3 Outstanding balances arising from transactions with related parties

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

	2018 $	2017 $
Current assets		
Amounts due from related entities	**9,392**	7,479
Reinsurance recoveries from related entity on outstanding claims	**56,324**	120,483
Current liabilities		
Amounts due to related entities	**56,975**	63,377

How we account for the numbers

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

Outstanding balances are unsecured and repayable in cash.

6.6 Events occurring after reporting date

There is, at the date of this report, no other matter or circumstance that has arisen since 31 December 2018 that, in the opinion of the directors, has significantly affected or may significantly affect the branch's operations, the results of those operations, or the branch's state of affairs in future financial periods.