VIRGINIA SURETY COMPANY INC – NEW ZEALAND BRANCH

Annual financial report

For the year ended
For the year ended 31 December 2019

Contents

VIRGINIA SURETY COMPANY INC – NEW ZEALAND BRANCH

Director's report

The Director presents the annual report together with the audited Financial Statements for the year ended 31 December 2019.

No disclosure has been made pursuant to Section 211(1) (a) and (e) to (j) of the Companies Act 1993 following a unanimous decision by the shareholders in accordance with Section 211 (3) of the Act.

Results

The proft for the year after income tax was $2,127,815 (2018: loss $386,751).

Dividend

The Director recommends that no dividend be paid (2018: $Nil).

Activities

The principal activities during the year were those of insurance underwriting and investment.

Directors interests in transactions

The Directors have no interests to declare in the transactions of the year ended 31 December 2019.

Review of operations

The profit for the financial year after tax $2,127,815 (2018 loss: $386,751) reflects the maturity of its existing earnings profile and claim experience. The full impact of Protecta Insurance New Zealand Pty Ltd and the Noel Leeming Group is reflective in the 2019 after tax profit.

Subsequent events

The COVID-19 pandemic announced by the World Health Organisation subsequent to 31 December 2019 is having a negative impact on global markets and business activity, which may have a flow-on effect to the operations of VSC New Zealand and its financial performance.

In the current market environment it is challenging to predict with certainty the expected impact in future periods. There is a continuing risk of disruption to the VSC New Zealand's customers, which is anticipated to increase the credit risk associated with financial assets such as loans and advances resulting in impact on the expected credit loss estimated and recorded in future period financial statements. A possible outcome of increased credit risk is an increase in customer default events during future periods, and an increase in the repossession of equipment held as collateral. As a result, there may be increased residual risk associated with the valuation of the repossessed equipment which is recorded as inventory.

The timing and extent of the impact of the pandemic and the associated recovery process is unknown. The VSC New Zealand continues to monitor the situation and no estimate of its financial effect can be made at this stage. The directors have concluded that there is no impact from COVID-19 on the VSC New Zealand's financial statements for the year ended 31 December 2019.

No other matter or circumstance has occurred subsequent to year end that has significantly affected, or may significantly affect, the operations of the VSC New Zealand, the results of those operations or the state of affairs of the VSC New Zealand or economic entity in subsequent financial years.

On behalf of the board

11th May 2020 Director

pwc

Independent auditor's report

To the shareholders of Virginia Surety Company Inc. - New Zealand Branch

The financial statements comprise:

- the statement of financial position as at 31 December 201;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the financial statements of Virginia Surety Company Inc. - New Zealand Branch (the Company) present fairly, in all material respects, the financial position of the Company as at 31 December 2019, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards Reduced Disclosure Regime (NZ IFRS RDR).

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.

Information other than the financial statements and auditor's report

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

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

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T: +64 9 355 8000, F: +64 9 355 8001, pwc.co.nz

Responsibilities of the Directors for the financial statements

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

In preparing the financial statements, the Directors are responsible for assessing the 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 the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at:
https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-8/

This description forms part of our auditor's report.

Who we report to

This report is made solely to the Company's shareholders, 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 shareholders, 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 Andrew Barlow

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
11 May 2020

Melbourne

I, Andrew Barlow, am currently a member of Chartered Accountants Australia New Zealand and my membership number is 301279

PricewaterhouseCoopers was the audit firm appointed to undertake the audit of Virginia Surety Company Inc – New Zealand Branch for the year ended 31 December 2019. I was responsible for the execution of the audit and delivery of our firm's auditor's report. The audit work was completed on 11 May 2020 and an unqualified opinion was issued.

Barlow

Andrew Barlow

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Comprehensive Income

For the year ended 31 December 2019

	Notes	2019 $	2018 $
Revenue			
Premium revenue		48,119,437	13,228,846
Change in unearned premium reserve related to reinsurance contract		(22,238,459)	(10,214,889)
Total Revenue		**25,880,978**	**3,013,957**
Reinsurance premium ceded		(20,517,187)	(5,837,148)
Change in unearned premium revenue		5,684,838	5,245,792
Net insurance premum revenue		**11,048,629**	**2,422,601**
Expenses			
Claims incurred	5	14,632,373	1,831,935
Insurance claims recovered from reinsurer		(9,773,431)	(680,658)
Expenses for acquisition of insurance contracts	19a	5,148,687	1,435,036
		10,007,629	**2,586,313**
Investment income	8	4,514,851	2,654,815
Unrealised loss on investments	9	(86,374)	(43,385)
		4,428,477	**2,611,430**
Other operating and administration expenses	7	(3,483,250)	(2,257,523)
Profit before income tax		**1,986,227**	**190,195**
Income tax benefit/(expense)	10	141,588	(576,946)
Profit/(Loss) after income tax		**2,127,815**	**(386,751)**
Total comprehensive income/(loss)		**2,127,815**	**(386,751)**
Operating profit for the year attributable to:			
Non-controlling interest		-	-
Owners of the parent		2,127,815	(386,751)
Operating Profit after tax		**2,127,815**	**(386,751)**
Total comprehensive income is attributable to:			
Non-controlling interest		-	-
Owners of the parent		2,127,815	(386,751)
Operating Profit after tax		**2,127,815**	**(386,751)**

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

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Financial Position

As at 31 December 2019

	Notes	2019 $	2018 $
Assets			
Non-current assets			
Investments at fair value through profit or loss	15	66,122,642	56,138,850
Deferred tax assets	11a	1,387	83,726
Fixed Asset		-	3,274
Total non-current assets		**66,124,029**	**56,225,850**
Current assets			
Cash and cash equivalents	12	11,201,549	3,938,116
Trade and other receivables	13	15,612,193	7,510,843
Deferred acquisition costs	19b	9,044,245	3,507,602
Current tax asset	11b(ii)	402,550	158,110
Reinsurance assets	17	11,253,857	2,426,169
Total current assets		47,514,394	17,540,840
Total assets		**113,638,423**	**73,766,690**
Liabilities			
Current liabilities			
Trade and other payables	14	14,283,848	3,893,034
Outstanding claims	18	6,468,224	1,237,777
Unearned premiums	21	36,911,220	14,707,340
Total current liabilities		57,663,292	19,838,151
Total liabilities		**57,663,292**	**19,838,151**
Net assets		**55,975,131**	**53,928,539**
Total equity	23	**55,975,131**	**53,928,539**

The statement of financial position should be read in conjunction with the accompanying notes.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Changes in Equity

For the year ended 31 December 2019

	2019 $	2018 $
Total Equity as at 1 January 2019	53,928,539	45,348,163
Capital contribution	-	8,967,127
Profit/(Loss) for the year	2,127,815	(386,751)
Unrealised loss on foreign exchange	(81,223)	-
Total Equity as at 31 December 2019	**55,975,131**	**53,928,539**

The statement of changes in equity should be read in conjunction with the accompanying notes.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Cash Flows

For the year ended 31 December 2019

	Notes	2019 $	2018 $
Cash flows from operating activities			
Receipts from customers		40,767,150	5,903,019
Payments to suppliers and employees		(34,790,531)	(4,012,342)
Interest received		4,428,477	2,585,125
Net cash flows generated from operating activities	11	**10,405,096**	**4,475,802**
Cash flows from investing activities			
Purchase of investment assets		(15,334,557)	(9,632,981)
Proceeds from sale of investments		5,354,039	-
Net cash flows used in investing activities		**(9,980,518)**	**(9,632,981)**
Cash flows from financing activities			
Capital contribution		-	5,961,142
Repayments from related parties		6,838,855	2,296,637
Net cash flows from financing activities		**6,838,855**	**8,257,779**
Net decrease in cash and cash equivalents		7,263,433	3,100,600
Cash and cash equivalents at beginning of period		3,938,116	837,516
Cash and cash equivalents at end of period		**11,201,549**	**3,938,116**

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

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2019

1 Corporate information

These financial statements have been prepared for the New Zealand branch of the Virginia Surety Company Inc., which is incorporated in the United States of America.

Corporate Information
Virginia Surety Company Inc for the year ended 31 December 2019, incorporated in the United States of America, is the Branch's immediate parent company.

The registered office of Virginia Surety Company Inc New Zealand branch (the Branch) for the year ended 31 December 2019 is

73 Manchester Street,
Christchurch,
New Zealand, 8011

TPG Capital, incorporated in U.S, is the Branch's ultimate holding company.

2 Summary of significant accounting policies

Insurance Contract
All of the insurance products offered or utilised by the Branch meet the definition of insurance contracts under the New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), and are accounted for and reported in accordance with these standards.

These products do not contain embedded derivatives or deposits that are required to be unbundled.

Reinsurance contracts

Contracts are entered into by VSC NZ branch with reinsurers under which it is compensated for losses on one or more contracts that meet the classification requirements for reinsurance contracts held. The benefits to which the Company is entitled under its reinsurance contracts held are recognised as reinsurance assets.

VSC New Zealand has a reinsurance agreement with The Hollard Insurance Company Ltd to reinsure 100% of the risk associated with certain classes of business as described below; -

- Prestige Motor Vehicle Insurance
- Motorcycle Insurance
- Motor Vehicle Insurance
- Classic Motor Vehicle Insurance

The reinsurance period is from 1st September 2018 to 31st August 2021 with a further extension upon mutual agreement.

Basis of preparation

Act 1993 and the FMC Act 2013 on a historical cost basis. For the purposes of complying with NZ GAAP the entity is a for-profit entity.

The financial report has been prepared on an accrual basis of accounting including the historical cost convention and the going concern assumption.

The financial statements are presented in New Zealand dollars.

The following particular accounting policies have been applied:

2 Summary of significant accounting policies (continued)

a) Revenue

Premium revenue for insurance comprises amounts charged to policyholders. The earned portion of premium received and receivable is recognised as revenue. The pattern of recognition of income over the policy or indemnity periods is based on time, which closely approximates the pattern of risks underwritten. Interest on investment income is accounted for on an accrual basis.

b) Unearned premium

Provisions in respect of the proportion of premiums relating to risk in future periods of account are calculated on both the straight-line and rule of 78 basis over the period of risk.

c) Deferred acquisition expenses

Acquisition expenses, principally comprising commissions and fees incurred on insurance contracts, are deferred and expensed over the period in which the related premiums are earned. Deferred acquisition costs are measured at the lower of cost and recoverable amount.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period and are treated as a change in an accounting estimate.

An impairment review is performed at each reporting date or more frequently when an indication of impairment arises. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the statement of comprehensive income. Deferred acquisition expenses are also considered in the liability adequacy test for each reporting period.

d) Outstanding claims

The Outstanding Claims provision comprises the estimated costs of claims incurred including indirect claims settlement costs, whether reported or not, and claims not settled at balance date. Reported claims have been assessed in the light of the information available at balance date and after taking account of present value of the expected future payments. The provision for claims incurred but not reported has been assessed having regard for the Branch's claim performance. The expected future payments include claims handling costs which are to be incurred in settling the insured claims.

e) Taxation

Current tax is calculated by reference to the amount of income taxes payable or recoverable in respect of the taxable profit or tax loss for the period. It is calculated using tax rates and tax laws that have been enacted or substantively enacted by reporting date. Current tax for current and prior periods is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax is accounted for using the comprehensive balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax base of those items.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period(s) when the asset and liability giving rise to them are realised or settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Branch expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax is recognised as an expense or income in the statement of comprehensive income, except when it relates to items credited or debited directly to equity, in which case the deferred tax is also recognised directly in equity.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2019

2 Summary of significant accounting policies (continued)

f) Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except:

• Where the amount of GST incurred is not recoverable from the taxation authority, it is recognised as part of the cost of acquisition of
an asset or as part of an item of expense; or
• For receivables and payables which are recognised inclusive of GST.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables.

f) Investments

Financial assets at fair value through profit and loss:

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as investment loss (negative net changes in fair value) or investment income (positive net changes in fair value) in the statement of profit or loss.

g) Foreign currency translation

(i) Functional and presentation currency

Both the functional and presentation currency of Virginia Surety Company Inc – New Zealand Branch is New Zealand dollars ($).

(ii) Transactions & balances
Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the reporting date.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

i) Claims

Reported claims have been assessed in the light of the information available at balance date and after taking account of expected trends in future settlements. The outstanding claims liability is measured as the central estimate of the present value of expected future payments relating to claims incurred at the reporting date with an additional risk margin to allow for the inherent uncertainty in the central estimate. The liability is measured based on valuations performed by the Appointed Actuary. The liability is discounted to present value using a risk free rate. Refer to Note (q).

2 Summary of significant accounting policies (continued)

i) Claims (continued)

The liability adequacy test is an assessment of the carrying value of the unearned premium liability and is conducted at each reporting date. If current estimates of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate, exceed the unearned premium liability (net of reinsurance) less relevant deferred acquisition costs (if any), then the unearned premium liability is deemed to be deficient. The test is performed at the level of a portfolio of contracts that are subject to broadly similar risks and that are managed together as a portfolio. In these accounts, this represents the overall New Zealand portfolio of contracts. Any deficiency arising from the test is recognised in the profit or loss with the corresponding impact on the Statement of Financial Position recognised first through the write down of deferred acquisition costs (if any) for the relevant portfolio of contracts, with any remaining balance being recognised on the Statement of Financial Position as an unexpired risk liability.

j) Trade and other receivables

Trade receivables, which generally have 30 day terms, are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less an allowance for impairment.

Collectability of trade receivables is reviewed on an ongoing basis at an operating unit level. Individual debts that are known to be uncollectible are written off when identified. An impairment provision is recognised when there is objective evidence that the VSC New Zealand will not be able to collect the receivable. Financial difficulties of the debtor, default payments or debts more than 30 days overdue are considered objective evidence of impairment. The amount of the impairment loss is the receivable carrying amount compared to the present value of estimated future cash flows discounted at the original effective interest rate.

k) Trade and other payables

Trade and other payables are carried at amortised cost and due to their short-term nature are not discounted. They represent liabilities for goods and services provided to the Branch prior to the end of the financial year that are unpaid and arise when the Branch becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are usually paid within 30 days of recognition.

Trade and other payables are carried at amortised cost and due to their short-term nature are not discounted. They represent liabilities for goods and services provided to the Branch prior to the end of the financial year that are unpaid and arise when the Branch becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are usually paid within 30 days of recognition.

l) Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash at bank and in hand and short term deposits with an original maturity of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

m) Plant and equipment

Plant and equipment is stated at historical cost less accumulated depreciation and any accumulated impairment losses.

(i) Depreciation

Depreciation is calculated on a straight-line basis over the estimated useful life of the assets as follows:

	2019	2018
Plant and equipment:	3 to 10 years	3 to 10 years
Leasehold improvements:	7 years	7 years

2 Summary of significant accounting policies (continued)

m) Plant and equipment (continued)

(ii) Impairment

The carrying values of plant and equipment are reviewed for impairment at each reporting date with recoverable amount being estimated when events or changes in circumstances indicate the carrying value may be impaired.

The recoverable amount of plant and equipment is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using pre-tax discount rate that reflects current assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate largely independent cash inflows, recoverable amount is determined for the cash-generating unit to which the asset belongs, unless the asset's value in use can be estimated to be close to its fair value.

An impairment exists when the carrying value of an asset or cash-generating units exceeds its estimated recoverable amount. The asset or cash-generating unit is then written down to its recoverable amount.

For plant and equipment impairment losses are recognised in the income statement in the administration and other costs line item.

(iii) Derecognition and disposals

An item of plant and equipment is derecognised upon disposal or when no further future economic benefits are expected from its use or disposal.

Any gain or loss arising from the derecognition of the asset (calculated as the difference between the net disposal proceeds and any carrying amount of the asset) is included in the profit or loss in the year the asset is derecognised.

n) Impairment of assets

At each reporting date, the Branch reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Branch estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised in profit or loss immediately, unless the relevant asset is carried at fair value, in which case the reversal of the impairment loss is treated as a revaluation increase.

2 Summary of significant accounting policies (continued)

o) New Accounting Standards and Interpretations

New Zealand Accounting standards and interpretations that have been recently issued or amended but are not yet effective have not been adopted by the VSC New Zealand for the annual reporting period ending 31 December 2019.

NZ IFRS 17 Insurance Contracts

The branch has not elected to early adopt any new standards or interpretations that are issued but not yet effective, as it continues to determine the impact on the financial statements.

p) Significant Accounting Judgements, Estimates & Assumption

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts in the financial statements. Management continually evaluates its judgements and estimates in relation to assets, liabilities, contingent liabilities, revenue and expenses. Management bases its judgements and estimates on historical experience and on other various factors it believes to be reasonable under the circumstances, the result of which form the basis of the carrying values of assets and liabilities that are not readily apparent from other sources.

(q) Valuation of outstanding claims provision

For insurance contracts, estimates have to be made both for the expected ultimate cost of claims reported at the reporting date and for the expected ultimate cost of claims incurred but not yet reported at the reporting date (IBNR). It can take a significant period of time before the ultimate claims form the majority of the liability in the statement of financial position. The IBNR included assumptions such as claims frequency, cancellations and average claim size.

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques, including Paid Chain Ladder, Inflation-Adjusted Payments Per Claims Incurred and Bornheutter-Ferguson method.

The main assumption underlying these techniques is that a VSC New Zealand's past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analysed by accident years, but can also be further analysed by geographical area, as well as by significant business lines and claim types. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development.

In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based. Additional qualitative judgement is used to assess the extent to which past trends may not apply in future, (e.g., to reflect one-off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy features and claims handling procedures) in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

Similar judgements, estimates and assumptions are employed in the assessment of adequacy of provisions for unearned premium. Judgement is also required in determining whether the pattern of insurance service provided by a contract requires amortisation of unearned premium on a basis other than time apportionment.

The carrying value at the reporting date of expected claims liabilities is $6,468,224 (2018: $1,237,777).

Claims provisions are expected to be settled within one year. The amount of expected future payments does not differ materially from the present value; therefore the claims provision has not been discounted.

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2019

3. RISK MANAGEMENT

(a) Risk management framework

The financial condition and operation of the branch is affected by a number of key risks including insurance risk, credit risk, market risk and liquidity risk.

The branch has developed, implemented and maintained a Risk Management Strategy (RMS) and Reinsurance Risk Management Strategy (ReMS). The RMS and ReMS identify the branch's policies and procedures, processes and controls that comprise its risk management and control systems.

(b) Insurance risk

Insurance Risk is defined as the risk of loss due to the actual experience being different than that assumed when an insurance product was designed and priced.

VSC's local underwriter is responsible for pricing the risk. When the value is above the underwriter's delegated authority it is referred to the US Underwriting Group for review and approval.

These files provide guidance on the willingness to accept risk and such issues as geographic and monetary limits.

The following processes are undertaken:

- Continuous assessment of product characteristics to ensure that pricing and outcomes remain consistent with t
- Systems of claims categorisation and loss measurement by risk category.
- Effective correction strategies for under-pricing of risk.
- Anticipation of factors leading to changes in claims incidence and claims costs.

Unless approved by the local Underwriter or confirmation is received from the US Underwriting Group, no business will be accepted nor new classes of business introduced. In accordance with the Reinsurance Policy no liability which exceeds the maximum retention levels shall be approved by the Executive Management Committee.

The Underwriting Committee meets on a monthly basis to review and monitor portfolio performance.

On a monthly basis all product programs are reviewed by the underwriter and presented to the Underwriting Committee who review them, in particular the loss ratio.

(c) Credit risk

Credit risk refers to the risk that a customer or counterparty to a financial instrument fails to meet its contractual obligations resulting in financial loss to the branch and arises principally from the branch's premium receivables and investments.

VSC's exposure to credit risk is concentrated in the following key activities:

Investments: These activities involve the investment of a significant proportion of assets in fixed interest and bonds. VSC's New Zealand investment policy ensures that it only invests in assets that are of investment grade BBB- or above and that no more than 5% is invested in the one asset. The Branch does hold a US dollar denominated corporate bond fund of which no single issuer is greater than 10%.

Business partner risk: Intermediaries and business partners, act on behalf of VSC in insurance sales, premium collection and remittance to VSC. To counteract counterparty risk, VSC receives monthly remittance from their business partners. If this is not received on time, investigative action is undertaken.

3. RISK MANAGEMENT (continued)

(c) Credit risk (continued)

Intermediaries and business partners are subject to a variety of statutory regulatory controls in addition to controls within VSC management framework. Financial Institutions in general are subject to a range of regulatory control processes. Agents tend to be less subject to statutory regulatory control with greater emphasis on monitoring and supervision on the part of VSC.

The Branch does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The maximum exposure to credit risk is the amounts shown in the statement of financial condition and notes. The maximum credit risk to the Branch is the carrying value of the assets. The Branch does not have any concentration of credit exposure.

(d) Market risk

Market risk is the risk that changes in market prices, such as changes in interest rates and foreign exchange, will affect the branch's interest income, claims expense or the value of its holdings in financial instruments.

Foreign currency risk:

The Branch has minimal exposure to foreign currency risk as core investments are undertaken in New Zealand dollars. The Branch does hold a US dollar denominated corporate bond fund of which the future liabilities are also denominated in US dollars thus mitigating any foreign currency risk.

(e) Liquidity risk

Liquidity risk can be defined as the risk that the branch will not be able to meet its payment obligations as they fall due without excessive cost.

Ultimate responsibility for liquidity risk management rests with the board of directors, who have built an appropriate liquidity risk management framework for the management of the Branch's short, medium and long term funding and liquidity management requirements.

The Branch manages liquidity risk by maintaining adequate reserves and banking facilities by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

4. RELATED PARTY TRANSACTIONS

The following table provides the total amount of transactions that were entered into with related parties for the relevant financial year (for information regarding outstanding balances for trade and other receivables, refer to Note 11):

		Sales to Related Parties	Purchases from Related Parties	Expenses Charged by Related Parties
Fellow subsidiaries :		$	$	$
The Warranty Group Australasia Pty Ltd	**2019**	-	-	**(5,064,361)**
Expenses paid for on behalf of the Branch	2018	-	-	(1,484,488)
The Warranty Group Australasia Pty Ltd	**2019**	-	-	**(2,125,180)**
Marketing & administration fees	2018	-	-	(1,060,493)

Notes to the financial statements for the year ended 31 December 2019

4. RELATED PARTY TRANSACTIONS (continued)

During the year, The Warranty Group Australasia Pty Ltd, paid expenses of $5,064,361 (2018: $1,484,488) on behalf of the New Zealand Branch of Virginia Surety Company Inc. These expenses were recharged to the Branch at year end.

Year-end receivable/(payable) balances arising from sales/purchases of products/services

	2019 $	2018 $
VSC Australia	493,416	(203,393)
TWG Australasia	(8,611,198)	(3,583,588)
Total	**(8,117,782)**	**(3,786,981)**

Unless otherwise stated, related parties are fellow subsidiaries of the ultimate parent company.

Terms and conditions of transactions with related parties

Sales to and purchases from related parties are made in arm's length transactions both at normal market prices and on normal commercial terms.

Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

5. CLAIMS INCURRED

Current year claims relate to risks borne in the current financial year. Prior year claims relate to a reassessment of the risks borne in all previous financial periods

	2019 $	2018 $
Current year	14,480,857	1,644,796
Prior years	151,516	151,516
Reinsurance recovery	(9,773,431)	(680,658)
Total incurred claims	**4,858,942**	**1,115,654**
Movement in claims provision	1,636,703	351,283
Net claims expense – discounted	14,302,998	1,502,560
Net risk margin	329,375	329,375
Total incurred claims	**14,632,373**	**1,831,935**

6. AUDITORS' REMUNERATION

The auditor of the Branch is PricewaterhouseCoopers.

Auditors' fees payable for the audit of the financial report of the company as at 31st December 2019 amounted to $69,654 (2018: $67,625).

Auditors' fees charged for the year comprises

	2019 $	2018 $
Auditor Remuneration		
Audit fee	69,654	67,625
Tax compliance	12,000	12,000
	81,654	**79,625**

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2019

7. OTHER OPERATING AND ADMINISTRATION EXPENSES

Other Operating and administration expenses comprises:

	2019 $	2018 $
Salaries & benefits	12,523	15,389
Other operating and administrative expenses	6,599,643	1,660,075
Office & communication	(100,344)	159,471
Travel & entertainment	81,058	78,474
Bank charges	1,196	1,377
Bad debts	(507)	(5,560)
Legal fees	29,423	12,505
Auditors & consultants fees	249,628	265,034
Loss on foreign exchange	(3,583,297)	63,561
Other expenses	193,927	7,197
	3,483,250	**2,257,523**

8. INVESTMENT INCOME

	2019 $	2018 $
Investment income comprises:		
Interest on government stock	3,424,307	94,885
Dividend income	-	2,525,010
Other interest	1,090,544	34,920
	4,514,851	**2,654,815**

9. GAIN ON INVESTMENTS

	2019 $	2018 $
Unrealised (gain) on Corporate fund	(84,201)	(41,212)
(Gain) on other investments	(2,173)	(2,173)
	(86,374)	**(43,385)**

10. INCOME TAX EXPENSE

(a) The components of tax expenses comprise:

	2019 $	2018 $
Current Tax Expense	556,144	53,255
Deferred tax	(82,339)	597,881
Adjustments to current tax relation to prior years	(615,393)	(74,190)
Total income tax benefit/(expense)	**141,588**	**(576,946)**

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2019

10. INCOME TAX EXPENSE (CONTINUED)

(b) the prima facie tax on profit from ordinary activities before income tax is reconciled to the income tax as follows:

	2019	2018
	$	$
Profit/ (Loss) before Taxation	**1,986,227**	**190,195**
Current Tax expense @28%	556,144	53,255
Foreign income	(621,222)	(1,705,752)
Entertainment expenses	6,481	1,142
Derecognition of deferred tax asset on losses carried forward	-	589,349
Losses not recognised on balance sheet	58,597	1,641,430
PPA - deferred tax	(141,588)	(2,478)
Total income tax benefit/(expense)	**141,588**	**(576,946)**

11. DEFERRED TAX ASSETS

(a) Asset

	2019	2018
	$	$
Deferred tax assets comprise:		
Provisions and accruals	1,226	185
Pension Plan	161	-
2016 restatement due to accounting policy change	-	83,541
	(1,387)	**(83,726)**

(b) Reconciliation

(i) Deferred tax asset

The movement in deferred tax assets for each temporary difference during the year is as follows:

	2019	2018
	$	$
Opening balance	83,726	681,607
Movement in provision and accruals	1,202	(8,532)
2016 restatement due to accounting policy change	(83,541)	-
Derecognition of losses to be carried forward	-	(589,349)
Deferred Tax Asset	**(1,387)**	**(83,726)**

(ii) Current tax asset

	2019	2018
	$	$
Tax installment	402,550	158,110
Current Tax Asset	**(402,550)**	**(158,110)**

12. CASH AND CASH EQUIVALENTS

	2019	2018
	$	$
Cash at bank and in hand	**11,201,549**	**3,938,116**

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2019

12. CASH AND CASH EQUIVALENTS (continued)

Reconciliation to Cash Flow Statement

For the purpose of the Cash Flow statement, cash and cash equivalents comprise the following at 31 December 2019:

Reconciliation of net profit after tax to net cash flows from operations

	2019 $	2018 $
Net profit	2,127,815	(386,751)
Adjustments for:		
Unrealised gain on foreign exchange	(81,223)	-
Changes in Assets and Liabilities:		
(Increase) in trade receivables	(8,101,350)	(6,801,555)
(Increase) in reinsurance asset	(8,827,688)	-
(Increase) in Investment Assets	-	(26,305)
(Increase) in Deferred Acquisition Cost	(5,536,643)	-
Increase in outstanding claims	5,230,447	260,751
Increase in trade and other payables	3,551,959	2,582,327
(Increase)/decrease in deferred tax asset	(162,101)	681,607
(Increase) in current taxes	-	(73,324)
Increase in gross unearned premium	22,203,880	8,239,051
Net cash flows generated from operating activities	**10,405,096**	**4,475,801**

13. TRADE AND OTHER RECEIVABLES

	2019 $	2018 $
Investment Income Receivable	1,568,805	52,798
Premium Debtors	14,022,935	6,960,910
Provision for Doubtful Debts	-	(662)
Prepayment	-	4,982
Other Receivables	8,330	492,815
Deferred income	12,123	-
	15,612,193	**7,510,843**

14. TRADE AND OTHER PAYABLES

	2019 $	2018 $
Trade payables and accruals	6,166,066	2,614,107
Related party payable	8,117,782	1,278,927
	14,283,848	**3,893,034**

15. INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2019 $	2018 $
Government Stock	7,197,972	1,919,517
Corporate bond fund	58,924,670	54,219,333
Total Investment at fair value through profit or loss	**66,122,642**	**56,138,850**

The investments included in the Statement of financial position are carried at fair value. The major methods used in determining fair value of investments are disclosed below.

15. INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

The table below analyses financial instruments carried at fair value according to the inputs used in their valuation. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

31 December 2018	**Level 1**	**Level 2**	**Total**
Government stock	1,919,517	-	**1,919,517**
Corporate bond fund	-	54,219,333	**54,219,333**
There are no level 3 investment that VSC NZ holds			

31 December 2019	**Level 1**	**Level 2**	**Total**
Government stock	7,197,972	-	**7,197,972**
Corporate bond fund	-	58,924,670	**58,924,670**
There are no level 3 investment that VSC NZ holds			

16. FINANCIAL ASSETS AND LIABILITIES

Categories of financial assets and liabilities

	2019	**2018**
Financial Assets	**$**	**$**
Cash and cash equivalents	11,201,549	10,606,081
Investments	77,376,499	56,138,850
Loans and receivables	15,612,193	5,593,390
	104,190,241	72,338,321
Financial Liabilities		
Trade and other payable	(14,283,848)	(5,658,661)

Financial assets carried at fair value through profit or loss have been designated as such upon initial recognition.

The carrying value of all financial assets and liabilities approximate to their fair value.

17. REINSURANCE ASSET BREAKDOWN

	2019	**2018**
	$	**$**
Reinsurance premium payable	(4,087,538)	(533,192)
Reinsurance debtor receivable	15,341,395	2,957,343
Net receivable	**11,253,857**	**2,424,151**

Above is the recoveries expected from our reinsurance program

18. CLAIMS PROVISIONS

Composition of claims provision

	2019	**2018**
	$	**$**
Undiscounted central estimate	3,537,261	751,952
Net discount to present value	2,081,919	(6,550)
Discounted central estimate	5,619,180	745,402
Discounted claims administration expenses	249,712	163,000
Net claims expense – discounted	5,868,892	908,402
Net risk margin	599,332	329,375
Net outstanding claims – discounted including risk margin	**6,468,224**	**1,237,777**

18. CLAIMS PROVISIONS (continued)

Claims provisions are expected to be settled within one year. The amount of expected future payments does not differ materially from the present value; therefore, the claims provision has not been discounted.

a) Process for determining net outstanding claims provision

Discounting:

A projection of future claims payments both gross and net of reinsurance and other recoveries is undertaken. Projected future claims payments and associated claims handling costs are discounted to a present value as required, using appropriate risk free discount rates.

Risk margin:

The central estimate of the outstanding claims liability is an estimate which is intended to contain no deliberate or conscious over or under estimation and is commonly described as providing the mean of the distribution. It is considered appropriate for the measurement of the claims liability to represent a higher degree of certainty regarding the sufficiency of the liability over time, and so a risk margin is added to the central estimate. The risk margin refers to the amount by which the liability recognised in the financial statements is greater that the actuarial central estimate of the liability. The risk margin added to the central estimate increases the probability that the net outstanding claims provision will ultimately prove to be adequate to 75%.

Risk margins are held to allow for uncertainty surrounding the outstanding claims provision estimation process. Potential uncertainties include those relating to the actuarial model and assumptions, the quality of the underlying data used in the model, general statistical uncertainty, and the general insurance environment.

b) Description for Assumptions made

Discount rate

Because the outstanding claims provision represents payments that will be made in the future, they are discounted to reflect the time value of money, effectively recognising that the assets held to back insurance liabilities will earn a return during that period. Discount rates represent a risk free rate derived from market yields on Australian government securities.

Risk Margin Rate

Due to the short term nature of the provisions, and the level of reinsurance cover, the approach adopted for determining the risk inherent in the provision, involved review of statistical variation in the incremental cost movement of gross incurred costs net of facultative reinsurance recoveries, allowing for additional variation in the Excess of Loss (XoL) reinsurance recoveries, loss adjustment expenses and claims handling costs.

CLAIMS RESERVE	**2019**	**2018**
	$	**$**
At beginning of year	1,237,777	977,026
Gross claims incurred	14,632,373	1,796,312
Reinsurance recovery	(9,773,431)	(680,658)
Claims settled	371,505	(854,903)
At end of year	**6,468,224**	**1,237,777**

19. DEFERRED ACQUISITION COSTS (continued)

19a. Expenses for acquisition of insurance contracts

	2019	2018
	$	$
LAT write down	(2,484,604)	(516,511)
Recognised in Statement of comprehensive income	(2,664,083)	(918,525)
Expenses for acquisition of insurance contracts	**(5,148,687)**	**(1,435,036)**

19b. Deferred acquisition cost

	2019	2018
	$	$
At beginning of year	3,507,602	1,535,342
Costs incurred	10,685,330	3,407,296
LAT write down	(2,484,604)	(516,511)
Recognised in statement of comprehensive income	(2,664,083)	(918,525)
At end of year	**9,044,245**	**3,507,602**

20. ASSETS BACKING GENERAL INSURANCE LIABILITES

In determining which assets back general insurance liabilities, a comparison between the asset values and the amount needed to meet claims liabilities and solvency requirements was carried out.

21. LIABILITY ADEQUACY TEST

The liability adequacy test carried out on the insurance portfolio in the current year in accordance with NZ IFRS 4 identified a deficiency of $2,484,604 (2018: $516,511).

	2019	2018
	$	$
Insurance Portfolio		
Gross unearned premium reserve	36,911,220	14,707,340
Unearned Premium related to Reinsurance contracts	(2,849,772)	(2,424,151)
Net unearned premium	**34,061,448**	**12,283,189**
Ultimate net loss ratio	71.4%	71.4%
Future claims provision - discounted	(24,168,159)	(8,283,212)
Claims handling costs	(249,712)	(163,000)
Risk margin	(599,332)	(329,375)
Expected future claims	**(25,017,203)**	**(8,775,587)**
Deferred acquisition costs		
Commission expense	(11,095,245)	(3,489,242)
Administration	(433,604)	(534,871)
LAT deficiency	2,484,604	516,511
Total deferred acquisition costs	**(9,044,245)**	**(3,507,602)**
Level of (deficiency)	**(2,484,604)**	**(516,511)**

The liability adequacy test carried out on the insurance portfolio in the current year identified a deficiency resulting in a write down.

22. INSURER FINANCIAL STRENGTH RATING AND SOLVENCY DISCLOSURE

Virginia Surety Company Inc has a financial strength rating of A- issued by AM Best (2018: A-) and the following solvency information:

	2019	2018
	$	$
Actual solvency capital	587,017,405	586,308,189
Minimum solvency capital	112,929,046	95,310,303
Solvency margin	474,088,359	490,997,886
Solvency ratio	**5.20**	**6.15**

23. EQUITY

	2019	2018
	$	$
Paid in Capital		
At start of year	650,000	650,000
Capital contribution	55,325,131	53,278,539
At end of year	**55,975,131**	**53,928,539**

24. EQUITY RETAINED FOR THE PURPOSES OF FINANCIAL SOUNDNESS

The branch retains a level of equity and retained reserves which enable it to maintain an adequate solvency margin for ongoing ability to pay clients. These financial statements relate to a branch of an overseas company. Its assets are available to support the liabilities of the company outside of New Zealand.