Company Registration number: 581 7931

Factory Mutual Insurance Company

New Zealand Branch

Financial Statements

For the year ended 31 December 2020

CONTENTS

DIRECTORS' REPORT

The Directors present their report, together with financial statements of Factory Mutual Insurance Company (New Zealand Branch) for the year ended 31 December 2020.

Corporate Information

Factory Mutual Insurance Company, New Zealand Branch (the "Branch") is licensed by the Reserve Bank New Zealand (RBNZ) under the Insurance (Prudential Supervision) Act 2010.

The principal activity of the Branch is the underwriting of property insurance risks to large and medium sized clients.

The Branch is a part of Factory Mutual Insurance Company (the "Company"). The Company is incorporated in the United States of America. The registered office of the Company is 270 Central Avenue, Johnston, RI, 02919-4923 USA.

Results

The results of the Branch's operations for the year are set out on page 7 and the financial position of the Branch at the end of the year is set out on page 8.

Review of the business

Revenue was $35,515,409 (2019: $29,838,492) during the year. The Branch made a post-tax profit of $186,580 (2019: $10,556,693).

Events subsequent to reporting date

No transactions or events occurred after the reporting date which significantly affected, or may significantly affect, the results of the Branch, the operations of the Branch, or the state of affairs of the Branch.

Going concern

The Directors have a reasonable expectation that the Company has adequate resources to continue in existence for the foreseeable future. As such, they continue to adopt the going concern basis in preparing the annual financial statements.

Directors

The names of the Company's Directors in office during the year is as follows:

Director	Title	Date changed
Francis Thomas Connor	Non-Executive Director	
Colin Day	Non-Executive Director	Appointed 10 December 2020
Michel Serge Giannuzzi	Non-Executive Director	
Daniel Lee Knotts	Non-Executive Director	
Glenn Rodney Landau	Non-Executive Director	
Thomas Alan Lawson	Executive Director	
John Anderson Luke Jnr	Non-Executive Director	
Gracia Catherine Martore	Non-Executive Director	
Christine Mary McCarthy	Non-Executive Director	
Stuart Blain Parker	Non-Executive Director	
Israel Ruiz	Non-Executive Director	
David Thomas Walton	Non-Executive Director	

No Directors had any interest in the shares of the Company during the year.

Insurance of Directors

Insurance is maintained for the Directors in respect of their duties as Directors of the Company.

Disclosure of information to the auditors

So far as each person who was a Director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware.

Non-audit services

During the year, EY were not engaged to perform any services with respect to the Branch, other than their statutory duties.

On behalf of the board

T Lawson

Thomas Alan Lawson
Director Dated 8 April 2021

Gracia C. Martore

Gracia Catherine Martore
Director Dated 8 April 2021

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Independent auditor's report to the Shareholder of Factory Mutual Insurance Company

Report on the audit of the financial statements

Opinion

We have audited the financial statements of the New Zealand Branch of Factory Mutual Insurance Company ("the company") on pages 7 to 57, which comprise the statement of financial position of the New Zealand Branch of Factory Mutual Insurance Company as at 31 December 2020, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended of the New Zealand Branch of Factory Mutual Insurance Company, and the notes to the financial statements including a summary of significant accounting policies.

In our opinion, the financial statements on pages 7 to 57 present fairly, in all material respects, the financial position of the New Zealand Branch of Factory Mutual Insurance Company as at 31 December 2020 and its financial performance and cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

This report is made solely to the company's shareholder. Our audit has been undertaken so that we might state to the company's shareholders those matters 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 shareholder, for our audit work, for this report, or for the opinions we have formed.

Basis for opinion

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

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

Other than in our capacity as auditor we have no relationship with, or interest in, the New Zealand Branch of the company.

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, but we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of the audit report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.

Valuation of outstanding claims liability

Why significant	How our audit addressed the key audit matter
The estimation of the value of outstanding claims involves significant judgement and is based on an actuarial model of the expected cost of claims incurred on, or prior to, balance date. An external actuary was appointed by the New Zealand Branch of the Company to assist in assessing the outstanding claims liability. Assumptions included in the model can generally be categorised as either economic assumptions such as inflation and discount rates or non-economic assumptions relating to claims development and cost. Non-economic assumptions are often based on historical data relating to the volume, amount and pattern of claims settlement. Disclosures regarding the outstanding claims liability and the assumptions used in its calculation are included in Note 19 to the financial statements.	Our audit procedures over the valuation of the outstanding claims liability included: ► Evaluating and testing key controls relating to the claims processes; ► On a sample basis validating the costs recorded for claims closed in the year; ► On a sample basis checking the claims data used by the appointed actuary to the underlying claims system; ► Using our actuarial specialists to review the outstanding claims liability valuation report prepared by the appointed actuary and evaluate the appropriateness of the methodologies and assumptions used in the valuation. Economic assumptions were considered in the context of relevant market rates and non-economic assumptions within the context of historical claims experience; ► Evaluating the objectivity and expertise of the appointed actuary; ► Tested the accuracy and integrity of the processed data which forms the basis for the insurance liability valuation; and ► Considering the adequacy of disclosures for the outstanding claims liability.

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Directors' responsibilities for the financial statements

The directors are responsible, on behalf of the entity, for the preparation and fair presentation of the financial statements in accordance with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards, 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 on behalf of the entity the New Zealand Branch of 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 New Zealand Branch of the company or 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 International Standards on Auditing (New Zealand) 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 website: https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-2/. This description forms part of our auditor's report.

The engagement partner on the audit resulting in this independent auditor's report is Kieren Cummings.

Ernst & Young

Ernst & Young

Sydney
8 April, 2021

FINANCIAL STATEMENTS

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

for the year ended 31 December 2020

	Notes	2020 NZD	2019 NZD
Gross premiums earned	6.1	35,515,409	29,838,492
Ceded premiums earned	6.2	(16,879,652)	(14,486,791)
Net premiums earned		**18,635,757**	**15,351,701**
Fees and reinsurance commission income	7	2,057,029	1,543,379
Other revenue		**2,057,029**	**1,543,379**
Total revenue		**20,692,786**	**16,895,080**
Gross claims incurred	8.1	(16,757,437)	(5,162,840)
Ceded claims incurred	8.2	3,386,436	5,248,901
Net claims incurred		**(13,371,001)**	**86,061**
Other operating and administrative expenses	9	(7,135,206)	(6,424,448)
Other expenses		**(7,135,206)**	**(6,424,448)**
Total claims and other expenses		**(20,506,207)**	**(6,338,387)**
Profit before income tax		**186,580**	**10,556,693**
Income tax expense / (credit)	4.16	-	-
Profit after income tax		**186,580**	**10,556,693**
Other comprehensive income for the year, net of tax		-	-
Total comprehensive income for the year, net of tax		**186,580**	**10,556,693**

The accompanying accounting policies and explanatory notes form an integral part of the financial statements.

STATEMENT OF FINANCIAL POSITION

as at 31 December 2020

	Notes	2020 NZD	2019 NZD
Assets			
Cash and cash equivalents	10	43,324,236	34,849,995
Insurance receivables	11	9,901,765	5,341,150
Other receivables	12	58,147	2,107,686
Deferred acquisition costs	13	-	-
Reinsurance assets	17.1	9,929,036	6,815,576
Total assets		**63,213,184**	**49,114,407**
Equity and liabilities			
Equity			
Head Office Account		6,000,000	6,000,000
Retained earnings		4,159,256	8,063,657
Total equity		**10,159,256**	**14,063,657**
Liabilities			
Other payables and accruals	14	2,012,633	206,350
Insurance payables	15	5,454,978	4,455,696
Liabilities for contracts with customers		95,857	111,975
Deferred reinsurance commission income	16	1,129,202	736,874
Insurance contract liabilities	17.1	44,361,258	29,539,855
Total liabilities		**53,053,928**	**35,050,750**
Total equity and liabilities		**63,213,184**	**49,114,407**

The accompanying accounting policies and explanatory notes form an integral part of the financial statements.

STATEMENT OF CHANGES IN EQUITY

2020	Head Office Account NZD	Retained earnings NZD	Total NZD
As at 1 January	**6,000,000**	**8,063,657**	**14,063,657**
Profit for the year	-	186,580	186,580
Other comprehensive income	-	-	-
Total comprehensive income	**6,000,000**	**8,250,237**	**14,250,237**
Capital (repatriations)	-	(4,090,981)	(4,090,981)
As at 31 December	**6,000,000**	**4,159,256**	**10,159,256**

2019	Head Office Account NZD	Retained earnings NZD	Total NZD
As at 1 January	**6,000,000**	**7,052,422**	**13,052,422**
Profit for the year	-	10,556,693	10,556,693
Other comprehensive income	-	-	-
Total comprehensive income	**6,000,000**	**17,609,115**	**23,609,115**
Capital (repatriations)	-	(9,545,458)	(9,545.458)
As at 31 December	**6,000,000**	**8,063,657**	**14,063,657**

The accompanying accounting policies and explanatory notes form an integral part of the financial statements.

STATEMENT OF CASH FLOWS

for the year ended 31 December 2020

	Notes	2020 NZD	2019 NZD
Operating activities:			
Profit before taxation		186,580	10,556,693
Adjustments to reconcile profit before tax to net cash flows:			
(Write-back of) / Impairment losses on insurance receivables	19.2.1	27,014	(8,934)
Increase in reinsurance assets		(3,113,461)	(1,992,905)
Increase in deferred reinsurance commission income		392,328	95,893
Increase in insurance contract liabilities		14,821,403	3,207,934
Working capital adjustments:			
Decrease / (increase) in insurance receivables		(4,587,629)	2,604,169
Decrease / (increase) in other receivables		2,049,539	(2,107,686)
Increase / (decrease) in other payables and accruals		1,806,283	(9,694,542)
Increase in insurance payables		999,282	725,552
Decrease in liabilities for contracts with customers		(16,117)	(36,176)
Cash flows from operations		**12,565,222**	**3,349,998**
Net cash flows from operating activities		**12,565,222**	**3,349,998**
Investing activities:		-	-
Net cash flows from / (used in) investing activities		-	-
Financing activities:			
Capital repatriations to owner		(4,090,981)	(9,545,458)
Net cash flows from (used in) financing activities		**(4,090,981)**	**(9,545,458)**
Net increase / (decrease) in cash and cash equivalents		**8,474,241**	**(6,195,460)**
Cash and cash equivalents at 1 January		**34,849,995**	**41,045,455**
Cash and cash equivalents at 31 December	10	**43,324,236**	**34,849,995**

The accompanying accounting policies and explanatory notes form an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS

CORPORATE AND BUSINESS INFORMATION

1 Reporting entity

Factory Mutual Insurance Company, New Zealand Branch (the “Branch”) was registered with the New Zealand Companies Office on 1 October 2015 and was licensed by the Reserve Bank New Zealand (RBNZ) on 1 January 2016 to carry out general insurance business.

The registered office of the Branch is C/-KPMG Centre, 18 Viaduct Harbour Avenue, Auckland, New Zealand.

The principal activity of the Branch is the insurance of commercial property risks held by corporate clients.

2 Corporate information

The Branch is a part of Factory Mutual Insurance Company (“FMIC” or the “Company”). The Company is incorporated in the United States of America.

The registered office of the Company is 270 Central Avenue, Johnston, RI, 02919-4923 USA.

The Company has a financial strength rating of A+ (Superior) issued by A M Best, A+ issued by S&P Global and AA (Very Strong) issued by Fitch Ratings.

3 Segment information

The whole of the Branch is an operating segment for the purposes of segment reporting.

SIGNIFICANT ACCOUNTING POLICIES, JUDGEMENTS, ESTIMATES & ASSUMPTIONS

4 Significant accounting policies

4.1 Basis of preparation

The financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand (NZ GAAP) and the requirements of the Financial Markets Conduct Act 2013.

The financial statements comply with the New Zealand Equivalents to International Financial Reporting Standards (NZIFRS), International Financial Reporting Standards (IFRS) and other applicable Financial Reporting Standards.

For the purposes of complying with NZ GAAP the Branch is a for-profit entity.

The financial statements have been prepared on an historical cost basis, except for financial assets that have been initially measured at fair value and, after initial measurement, are measured at amortised cost.

The financial statements are presented in New Zealand Dollars ("NZD"), unless otherwise stated.

The Branch presents its statement of financial position broadly in order of liquidity on the basis that it provides information that is more reliable and relevant for the Branch.

The comparative year amounts have been re-grouped and re-classified wherever necessary in line with current year disclosure presentation. There were no material re-groupings or re-classifications during the year.

The Branch continues to monitor developments related to the Covid-19 pandemic and take appropriate safeguarding steps to mitigate impacts to the business and its stakeholders. Underwriting risk related to the Covid-19 pandemic was limited due to specific policy limits on communicable disease coverage, mitigating any potential adverse material impact to operating results. The Branch has continued to successfully deliver its service offering to policyholders during the pandemic, in strict adherence with government guidance and with remote servicing replacing some physical site visits

4.2 Product classification

Insurance contracts are those contracts where the Branch (the insurer) has accepted significant insurance risk from another party (the policyholders) by agreeing to compensate the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, the Branch determines whether it has significant insurance risk by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risks.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire.

4.3 Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Branch.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming market participants act in their economic best interest.

A fair value measurement of a non-financial asset considers a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Branch uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

4.4 Foreign currency translation

The Branch's financial statements are presented in New Zealand Dollars ("NZD"), which is also the Branch's functional currency.

Transactions in foreign currencies are initially recorded at the functional currency spot rates at the date the transaction first qualifies for recognition. Insurance revenue and expense transactions are then retranslated at the end of the month in which they are initially recorded using the monthly average rate for that month.

Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rate of exchange at the reporting date.

Differences arising on settlement or translation of monetary items are recognised in profit or loss.

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

The gain or loss arising on translation of non-monetary items measured at fair value is treated in line with the recognition of the gain or loss on the change in fair value of the item (i.e., translation differences on items whose fair value gain or loss is recognised in other comprehensive income ("OCI") or profit or loss are also recognised in OCI or profit or loss, respectively).

4.5 Revenue recognition

4.5.1 Gross premiums

Gross premiums written comprise the total premiums receivable for the whole period of cover provided by contracts entered into during the reporting period. They are recognised on the date on which the policy commences. Premiums include any adjustments arising in the reporting period for premiums receivable in respect of business written in prior accounting periods. Membership credits are deducted from gross premiums.

Unearned premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned premiums are calculated on a pro rata basis. The proportion attributable to subsequent periods is deferred as an unearned premium liability.

4.5.2 Ceded premiums

Outward reinsurance premiums ceded to reinsurers comprise the total premiums payable for the whole cover provided by contracts entered into in the period and are recognised on the date on which the reinsurance policy incepts. Premiums include any adjustments arising in the accounting period in respect of reinsurance contracts incepting in prior accounting periods.

Unearned ceded premiums are those proportions of premiums ceded in a year that relate to periods of risk after the reporting date. Ceded premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts and over the term of the reinsurance contract for losses-occurring contracts, with the exception of the intercompany stop loss reinsurance treaty, which is recognised as a period cost for the accounting year in which cover is provided with no unearned premiums recognised at the end of the year.

Reinsurance premiums and claims on the face of the statement of profit or loss have been presented as negative items within net premiums earned and net claims incurred, respectively, because this is consistent with how the business is managed.

4.5.3 Fee and commission income

Revenue from contracts with customers

In certain circumstances, insurance policyholders may be separately charged for loss prevention engineering services. These fees are recognised as revenue over the period in which the related services are performed. If fees are for services provided in future periods, then they are deferred and recognised over those future periods.

Reinsurance commission income

In certain circumstances, commission income is received in respect of premiums ceded to reinsurers. Commission income is recognised as revenue on the date on which the reinsurance policy incepts. Unearned commission income is deferred and recognised over the term of the related reinsurance policies.

4.6 Claims and expense recognition

4.6.1 Gross claims incurred

Gross claims incurred includes all claims occurring during the year, whether reported or not, internal and external claims handling costs that are directly related to the processing and settlement of claims, a reduction for the value of salvage and other recoveries, and any adjustments to claims from previous years.

4.6.2 Ceded claims incurred

Incurred claims ceded to reinsurers are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

4.7 Cash and cash equivalents

Cash and cash equivalents in the statement of financial position comprise cash at bank and where applicable, cash on hand and cash in short-term deposits with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

4.8 Insurance receivables

Insurance receivables are recognised when due and measured on initial recognition at the fair value of the consideration receivable. Subsequent to initial recognition, insurance receivables are measured at amortised cost, using the effective interest rate ("EIR") method. The carrying value of insurance receivables is reviewed for impairment. The Branch applies the simplified approach in calculating the Expected Credit Losses (ECL). The Branch calculates ECL based on historical credit loss experience, adjusted for forward looking factors specific to the policyholder in the economic environment.

Insurance receivables are derecognised when the derecognition criteria for financial assets have been met.

4.9 Deferred acquisition costs ("DAC")

Those direct costs incurred during the financial period arising from acquiring or renewing of insurance contracts are deferred to the extent that they are recoverable out of future premiums from insurance contracts. All other acquisition costs are recognised as an expense when incurred.

Subsequent to initial recognition, the DAC asset is amortised over the period in which the related revenues are earned.

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 profit or loss. DACs are also considered in the liability adequacy test for each reporting period.

DACs are derecognised when the related contracts are either settled or disposed of.

4.10 Reinsurance assets

The Branch cedes insurance risk in the normal course of business. Reinsurance assets represent balances due from reinsurance companies. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claim liability or settled claims associated with the reinsurers' policies and are in accordance with the related reinsurance contract.

Reinsurance assets are reviewed for impairment at each reporting date, or more frequently, when an indication of impairment arises during the reporting period. Impairment occurs when there is objective evidence because of an event that occurred after initial recognition of the reinsurance asset that the Branch may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Branch will receive from the reinsurer. The impairment loss is recorded in the statement of profit or loss.

Ceded reinsurance arrangements do not relieve the Branch from its obligations to policyholders.

Reinsurance assets or liabilities are derecognised when the contractual rights are extinguished or expired or when the contract is transferred to another party.

4.11 Contracts with customers

In certain circumstances, insurance policyholders may be separately charged for loss prevention engineering services.

These fees are recognised as revenue over the period in which the related services are performed. If fees are for services provided in future periods, then they are deferred and recognised over those future periods.

A contract asset is initially recognised for revenue earned from engineering services because the receipt of consideration is conditional on successful completion of the services. Upon completion of the services, the amount recognised as contract assets is reclassified to receivables. Contract assets are subject to impairment assessment.

A receivable is recognised if an amount of consideration that is unconditional is due from the customer (i.e., only the passage of time is required before payment of the consideration is due).

A contract liability is recognised if a payment is received or a payment is due (whichever is earlier) from a customer before the Branch performs the services. Liabilities for contracts with customers are recognised as revenue when the Branch performs under the contract (i.e., performs the services to the customer).

4.12 Insurance contract liabilities

Insurance contract liabilities include the outstanding claims liability, the unearned premium liability and the unexpired risk liability. The outstanding claims liability is based on the estimated ultimate cost of all claims incurred but not settled at the reporting date, whether reported or not, together with related claims handling costs and a reduction for the expected value of salvage and other recoveries. Delays can be experienced in the notification and settlement of certain types of claims. Therefore, the ultimate cost of these cannot be known with certainty at the reporting date. The liability is calculated at the reporting date using a range of standard actuarial claim projection techniques, based on empirical data and current assumptions that may include a margin for adverse deviation. No provision for equalisation or catastrophe reserves is recognised. The liabilities are derecognised when the obligation to pay a claim expires, is discharged or is cancelled. The liabilities are discounted for the time value of money.

The unearned premium liability represents that portion of premiums received or receivable that relates to risks that have not yet expired at the reporting date. The liability is recognised when contracts are entered into and premiums are charged, and is brought to account as premium income over the term of the contract in accordance with the pattern of insurance service provided under the contract.

At each reporting date, the Branch reviews its unexpired risk and a liability adequacy test is performed in accordance with NZ IFRS 4 accounting requirements to determine whether there is any overall excess of expected claims and deferred acquisition costs over unearned premiums. This calculation uses current estimates of future contractual cash flows after taking account of the investment return expected to arise on assets relating to the relevant insurance contract liabilities and any statutorily required risk margin for adverse deviation. If these estimates show that the carrying amount of the unearned premiums (less related deferred acquisition costs) is inadequate, the deficiency is recognised in the statement of profit or loss by setting up an unexpired risk liability.

4.13 Insurance payables

Insurance payables include amounts owing to reinsurers and policyholders, and are recognised when due and measured on initial recognition at fair value of the consideration received less directly attributable transaction costs. Subsequent to initial recognition, they are measured at amortised cost using the EIR method.

4.14 Deferred fee and commission income

Initial and other front-ended reinsurance commissions are deferred and recognised as revenue when the related services are rendered.

Fees received for rendering future engineering services relating to insurance contracts, are deferred and recognised as revenue when the related services are rendered.

4.15 Provisions

4.15.1 General

Provisions are recognised when the Branch has a present obligation (legal or constructive) where, as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Branch expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to a provision is presented in the statement of profit or loss net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

4.15.2 Onerous contracts

If the Branch has a contract that is onerous, the present obligation under the contract is recognised and measured as a provision. However, before a separate provision for an onerous contract is established, the Branch recognises any impairment loss that has occurred on assets dedicated to that contract.

An onerous contract is a contract under which the unavoidable costs (i.e., the costs that the Branch cannot avoid because it has the contract) of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. The cost of fulfilling a contract comprises the costs that relate directly to the contract (i.e., both incremental costs and an allocation of costs directly related to contract activities).

4.16 Taxes

The income of the Branch is taxed in Australia as the Branch is classified as non-resident for New Zealand tax purposes and therefore no income tax expense / benefit has been recognised in the financial statements of the New Zealand Branch.

4.17 Financial instruments

4.17.1 Overview

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

4.17.2 Financial assets

<u>Initial recognition</u>

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments.

Financial instruments are initially recognised on the trade date measured at their fair value. Except for financial assets and financial liabilities recorded at FVPL, transaction costs are added to this amount.

Measurement categories

The Branch classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms. The categories include the following:

- Amortised cost;
- FVOCI; and
- FVPL.

Debt instruments measured at amortised cost

Debt instruments are held at amortised cost if both of the following conditions are met:

- The instruments are held within a business model with the objective of holding the instrument to collect the contractual cash flows; and
- The contractual terms of the debt instrument give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

This is the measurement category most relevant to the Branch.

The Branch's financial assets at amortised cost are other receivables and cash and cash equivalents.

The details of these conditions are outlined below.

Business model assessment

The Branch determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Branch holds financial assets to generate returns and provide a capital base to provide for settlement of claims as they arise. The Branch considers the timing, amount and volatility of cash flow requirements to support insurance liability portfolios in determining the business model for the assets as well as minimum regulatory capital requirements.

The Branch's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios that is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the Branch's key management personnel;
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed;
- How managers of the business are compensated; and
- The expected frequency, value and timing of asset sales are also important aspects of the Branch's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Branch's original expectations, the Branch does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

The SPPI test

As a second step of its classification process the Branch assesses the contractual terms to identify whether they meet the SPPI test.

'Principal' for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a debt arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Branch applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

Debt instruments measured at fair value through other comprehensive income

The Branch does not hold any debt instruments at FVOCI.

Financial assets measured at fair value through profit or loss

The Branch does not hold any financial assets at FVPL.

Subsequent measurement

Debt instruments at amortised cost

After initial measurement, debt instruments are measured at amortised cost, using the effective interest rate (EIR) method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR. ECLs are recognised in the statement of profit or loss when the investments are impaired.

Reclassification of financial assets and liabilities

The Branch does not reclassify its financial assets subsequent to their initial recognition.

Derecognition

Derecognition other than for substantial modification

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

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

The Branch considers control to be transferred if and only if, the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer.

When the Branch has neither transferred nor retained substantially all of the risks and rewards and has retained control of the asset, the asset continues to be recognised only to the extent of the Branch's continuing involvement, in which case, the Branch also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Branch has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration the Branch could be required to pay.

Derecognition due to substantial modification of terms and conditions

The Branch derecognises a financial asset when the terms and conditions have been renegotiated to the extent that, substantially, it becomes a new instrument, with the difference recognised as a derecognition gain or loss. In the case of debt instruments at amortised cost, the newly recognised loans are classified as Stage 1 for ECL measurement purposes.

When assessing whether or not to derecognise an instrument, amongst others, the Branch considers the following factors:

- Change in currency of the debt instrument;
- Introduction of an equity feature;
- Change in counterparty; and
- If the modification is such that the instrument would no longer meet the SPPI criterion.

If the modification does not result in cash flows that are substantially different, the modification does not result in derecognition. Based on the change in cash flows discounted at the original EIR, the Branch records a modification gain or loss.

Impairment of financial assets

The Branch recognises an allowance for ECLs for all debt instruments not held at fair value through profit or loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Branch expects to receive, discounted at the appropriate effective interest rate.

ECLs are recognised in two stages. For credit exposures for which there has not been a significant increase in credit risk since initial recognition, ECLs are provided for credit losses that result from default events that are possible within the next 12-months (12-month ECL). For those credit exposures for which there has been a significant increase in credit risk since initial recognition, a loss allowance is required for credit losses expected over the remaining life of the exposure, irrespective of the timing of the default (a lifetime ECL).

The Branch considers a financial asset to be in default (credit impaired) when contractual payments are 90 days past due. However, in certain cases, the Branch may also consider a financial asset to be in default when internal or external information indicates that the Branch is unlikely to receive the outstanding contractual amounts. A financial asset is written off when there is no reasonable expectation of recovering the contractual cash flows.

The calculation of ECLs

The Branch calculates ECLs based on scenarios to measure the expected cash shortfalls, discounted at an appropriate EIR. A cash shortfall is the difference between the cash flows that are due to the Branch in accordance with the contract and the cash flows that the entity expects to receive.

When estimating the ECLs, the Branch considers four scenarios (a base case, an upside, a mild downside and a more extreme downside). When relevant, the assessment of multiple scenarios also incorporates the probability that the defaulted loans will cure.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

PD	The *Probability of Default* is an estimate of the likelihood of default over a given time horizon. It is estimated with consideration of economic scenarios and forward-looking information.
EAD	The *Exposure at Default* is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, whether scheduled by contract or otherwise, and accrued interest from missed payments.
LGD	The *Loss Given Default* is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the Branch would expect to receive. It is usually expressed as a percentage of the EAD.

The Branch allocates its assets subject to ECL calculations to one of these categories, determined as follows:

12mECL	The 12mECL is calculated as the portion of long term ECLs (LTECLs) that represent the ECLs that result from default events on a financial instrument that are possible within 12 months after the reporting date. The Branch calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an appropriate EIR. This calculation is made for each of the four scenarios, as explained above.
LTECL	When an instrument has shown a significant increase in credit risk since origination, the Branch records an allowance for the LTECLs. The mechanics are similar to those explained above, including the use of multiple scenarios, but PDs and LGDs are estimated over the lifetime of the instrument. The expected losses are discounted by an appropriate EIR.
Impairment	For debt instruments considered credit-impaired, the Branch recognises the lifetime expected credit losses for these instruments. The method is similar to that for LTECL assets, with the PD set at 100%.

Forward looking information

In its ECL models, the Branch relies on forward-looking information as economic inputs.

The branch’s financial assets arising under insurance contracts are impaired by reducing the carrying amount through the use of an allowance account and the loss is recognised in the statement of profit or loss.

Write-offs

Financial assets are written off either partially or in their entirety only when the Branch has stopped pursuing the recovery. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. Any subsequent recoveries are credited to credit loss expense.

There were no write-offs over the periods reported in these financial statements.

4.17.3 Recognition of interest income

The Branch did not receive interest income in 2019 and 2020.

4.17.4 Financial liabilities

Initial recognition and measurement

Financial liabilities are classified, at initial recognition, as financial liabilities at FVPL, financial liabilities at amortised cost, or as derivatives designated as hedging instruments in an effective hedge, as appropriate.

All financial liabilities are recognised initially at fair value and, in the case of financial liabilities at amortised costs, net of directly attributable transaction costs.

The Branch's financial liabilities consist of insurance payables and other payables and accruals, subsequently measured at amortised cost.

Subsequent measurement

Subsequent measurement of financial liabilities depends on their classification, as described below:

Financial liabilities at amortised cost:
This is the category most relevant to the Branch. After initial measurement, the financial liabilities are subsequently measured at amortised cost. Gains and losses are recognised in profit or loss when the financial liabilities are derecognised.

Financial liabilities at FVPL:
The Branch does not hold any financial liabilities at FVPL.

Derecognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. On derecognition, the difference between the carrying amounts and the consideration paid is recognised in the statement of profit or loss. When an existing financial liability is replaced by another from the same party on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the statement of profit or loss.

4.17.5 Offsetting financial instruments

Financial assets and financial liabilities are offset, and the net amount is reported in the statement of financial position, if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, to realise the assets and settle the liabilities simultaneously.

4.18 Changes in accounting policy and disclosures

The Branch has not changed any accounting policy during the reporting period.

The Branch has applied for the first time certain standards, interpretations and amendments that became effective during the reporting period as described below.

The Branch has not early adopted any standard, interpretation or amendment that has been issued but is not yet effective.

4.18.1 Amendments to IAS 1 and IAS 8 Definition of Material

NZASB issued amendments to NZ IAS 1 Presentation of Financial Statements and NZ IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to align the definition of 'material' across the standards and to clarify certain aspects of the definition. The new definition states that, 'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity'. The amendments to the definition of material had no significant impact on the Branch's financial statements.

5 Significant accounting judgements, estimates & assumptions

5.1 General

The preparation of the Branch's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosures of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future reporting periods.

Other disclosures relating to the Branch's exposure to risks and uncertainties include:

- Capital management
- Financial risk management and policies
- Sensitivity analysis disclosures

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below. The Branch based its assumptions and estimates on parameters available when the financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Branch. Such changes are reflected in the assumptions when they occur.

5.2 Valuation of insurance contract liabilities

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 reported ("IBNR") and incurred but not enough reported ("IBNER").

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques, such as Chain Ladder and Bornheutter-Ferguson methods.

The main assumption underlying these techniques is that the Branch'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 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 the unearned premium liability.

The carrying value at the reporting date of insurance contract liabilities is $44,361,258 (2019: $29,539,856).

DETAILED INFORMATION ON STATEMENT OF PROFIT OR LOSS AND OCI ITEMS

6 Net premiums earned

6.1 Gross premiums earned

	Notes	2020 NZD	2019 NZD
Gross premiums written	17.3	39,045,781	31,934,272
Change in unearned premium liability		(3,530,372)	(2,095,780)
Gross premiums earned	**17.3**	**35,515,409**	**29,838,492**

6.2 Ceded premiums earned

	Notes	2020 NZD	2019 NZD
Ceded premiums written	17.3	(18,312,672)	(14,623,433)
Change in ceded unearned premium liability		1,433,020	136,642
Ceded premiums earned	**17.3**	**(16,879,652)**	**14,486,791**

7 Fees and reinsurance commission income

	Notes	2020 NZD	2019 NZD
Engineering fee income		215,621	237,236
Revenue from contracts with customers		**215,621**	**237,236**
Reinsurance commission income written		2,242,472	1,402,036
Change in deferred reinsurance commission income		(401,064)	(95,893)
Reinsurance commission income earned	16	**1,841,408**	**1,306,143**
Fees and reinsurance commission income		**2,057,029**	**1,543,379**

8 Net claims incurred

8.1 Gross claims incurred

	2020 NZD	2019 NZD
Gross claims paid	(6,091,096)	(4,261,081)
Gross external loss adjustment expenses	(260,149)	(175,862)
Gross internal loss adjustment expenses	673,423	(115,034)
Gross claims paid	**(5,677,822)**	**(4,551,977)**
Change in outstanding claims liability	(11,079,615)	(610,863)
Gross claims incurred	**(16,757,437)**	**(5,162,840)**

8.2 Ceded claims incurred

	2020 NZD	2019 NZD
Ceded claims paid	1,581,050	2,700,605
Ceded external loss adjustment expenses	124,945	692,034
Ceded claims paid	**1,705,995**	**3,392,639**
Change in ceded outstanding claims liability	1,680,441	1,856,262
Ceded claims incurred	**3,386,436**	**5,248,901**

9 Other operating and administrative expenses

	Notes	2020 NZD	2019 NZD
Premium taxes		(1,021,230)	(856,950)
Commission expenses		(111,810)	(86,373)
Change in deferred acquisition costs	13	8,262	-
Change in unexpired risk liability		(211,416)	(501,290)
Acquisition costs		**(1,336,194)**	**(1,444,613)**
(Impairment loss on) / write-back of insurance receivables		(23,156)	(8,934)
Bad debts written (off) / back		(65)	-
Auditor's remuneration fees		(21,193)	(23,173)
Other administrative expenses		(90,268)	(77,072)
Administrative expenses		**(134,682)**	**(109,179)**
Loss adjustment expense reclassification		(673,422)	115,034
Net foreign exchange gains		211,829	177,315
Related party service agreement charges	21.1	(5,202,737)	(5,163,004)
Other expenses		**(5,664,330)**	**(4,870,656)**
Total other operating and administrative expenses		**(7,135,206)**	**(6,424,448)**

DETAILED INFORMATION ON STATEMENT OF FINANCIAL POSITION ITEMS

10 Cash and cash equivalents

For the purpose of the statement of cash flows, cash and cash equivalents comprise the following at 31 December:

	2020 NZD	2019 NZD
Cash at banks	43,324,236	34,849,995
Total cash and cash equivalents	**43,324,236**	**34,849,995**

Cash at banks represent current accounts that are non-interest bearing.

Cash at Bank is considered as an asset backing general insurance liability.

Short-term deposits may be made for varying periods of between one day and three months, depending on the immediate cash requirements of the Branch, and earn interest at the respective short-term deposit rates.

The carrying amounts disclosed above reasonably approximate fair value at the reporting date.

11 Insurance receivables

	2020 NZD	2019 NZD
Due from policyholders and brokers	9,922,517	4,852,283
Less: Allowance for impairment losses	(89,670)	(62,656)
Sub-total	9,832,847	4,789,627
Due from reinsurers – third parties	68.918	551,523
Sub-total	68,918	551,223
Total insurance receivables	**9,901,765**	**5,341,150**

Insurance receivables from policyholders and brokers are non-interest bearing and are generally on terms of 90 days from issue of invoice or inception of the policy, whichever is later.

The carrying amounts disclosed above approximate fair value at the reporting date.

12 Other receivables

	Notes	2020 NZD	2019 NZD
Amounts due from related parties	21.2	30,133	2,107,686
GST Receivable		28,014	-
Total other receivables		**58,147**	**2,107,686**

Other receivables are non-interest bearing and are generally settled within one year.

13 Deferred acquisition costs ("DAC")

	Notes	2020 NZD	2019 NZD
At 1 January		-	-
Acquisition costs during the year	9	(8,262)	(13,099)
Acquisition costs written off		8,262	13,099
At 31 December		**-**	**-**

14 Other payables and accruals

	Notes	2020 NZD	2019 NZD
Amounts due to related parties	21.2	1,423,540	-
Accrued expenses		73,585	(71,393)
Other payables		515,508	(134,957)
Total other payables and accruals		**2,012,633**	**(206,350)**

Other payables and accruals are unsecured and non-interest bearing. The balance has not been discounted because the effect of the time value of money is not material. Related party payables are settled at least annually. Other payables are normally settled on 30-day terms.

The carrying amounts disclosed above approximate fair value at the reporting date.

15 Insurance payables

	Notes	2020 NZD	2019 NZD
Due to reinsurers – third parties		3,696,039	2,720,279
Due to reinsurers – related parties	21.2	1,758,939	1,732,090
Other		-	3,327
Total insurance payables		**5,454,978**	**4,455,696**

Insurance payables are unsecured and non-interest bearing. The balance has not been discounted because the effect of the time value of money is not material. Insurance payables to related parties are normally settled on 90-day terms. Insurance payables to third parties typically do not have credit terms and are normally settled within 90 days of being invoiced.

The carrying amounts disclosed above approximate fair value at the reporting date.

16 Deferred reinsurance commission income

	Notes	2020 NZD	2019 NZD
At 1 January		736,874	640,981
Reinsurance commission income during the year	7	2,242,472	191,483
Reinsurance commission income earned	7	(1,841,408)	(95,590)
Foreign exchange movement		(8,736)	-
At 31 December		**1,129,202**	**736,874**

17 Insurance contract liabilities and reinsurance assets

17.1 Overview

2020

	Notes	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
Reported by policyholders		14,989,309	(3,656,318)	11,332,991
IBNR / IBNER		2,361,789	(458,546)	1,903,243
External loss adjustment expenses		696,927	(59,949)	636,978
Internal loss adjustment expenses		291,394	-	291,394
Outstanding claims liability – undiscounted		**18,339,419**	**(4,174,813)**	**14,164,606**
Discount to present value		(45,415)	3,931	(41,484)
Outstanding claims liability – discounted		**18,294,004**	**(4,170,882)**	**14,123,122**
Risk margin		3,051,315	(259,832)	2,791,483
Outstanding claims liability	17.2	21,345,319	(4,430,714)	16,914,605
Unearned premium liability	17.3	19,400,680	(5,498,322)	13,902,358
Unexpired risk liability	17.4	3,615,259	-	3,615,259
Total insurance contract liabilities		**44,361,258**	**(9,929,036)**	**34,432,222**

2019

	Notes	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
Reported by policyholders		5,695,777	(1,552,296)	4,143,481
IBNR / IBNER		2,020,567	(554,449)	1,466,118
External loss adjustment expenses		153,855	(93,820)	60,035
Internal loss adjustment expenses		342,227	-	342,227
Outstanding claims liability – undiscounted central estimate		**8,212,426**	**(2,200,565)**	**6,011,861**
Discount to present value		(74,811)	20,425	(54,386)
Outstanding claims liability – discounted central estimate		**8,137,615**	**(2,180,140)**	**5,957,475**
Risk margin		2,128,089	(570,134)	1,557,955
Outstanding claims liability	17.2	10,265,704	(2,750,274)	7,515,430
Unearned premium liability	17.3	15,870,308	(4,065,302)	11,805,006
Unexpired risk liability	17.4	3,403,843	-	3,403,843
Total insurance contract liabilities		**29,539,855**	**(6,815,576)**	**22,724,279**

17.2 Outstanding claims liability

2020

	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
At 1 January	10,265,704	(2,750,274)	7,515,430
Claims incurred in current accident year	14,454,942	(2,946,419)	11,508,523
Adjustments to claims incurred in prior accident years	2,398,710	(357,730)	2,040,980
Claims paid during the year	(5,677,822)	1,705,995	(3,971,827)
Foreign exchange (gains)	(96,215)	(82,286)	(178,501)
At 31 December	**21,345,319**	**(4,430,714)**	**16,914,605**

2019

	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
At 1 January	9,654,840	(894,011)	8,760,829
Claims incurred in current accident year	2,400,590	(3,541,690)	(1,141,100)
Adjustments to claims incurred in prior accident years	2,335,179	(1,125,667)	1,209,512
Claims paid during the year	(4,261,081)	2,700,605	(1,560,476)
Foreign exchange losses	136,176	110,489	246,665
At 31 December	**10,265,704**	**(2,750,274)**	**7,515,430**

17.3 Unearned premium liability

2020

	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
At 1 January	15,870,308	(4,065,302)	11,805,006
Premiums written during the year	39,045,781	(18,312,672)	20,733,109
Premiums earned during the year	(35,515,409)	16,879,652	(18,635,757)
At 31 December	**19,400,680**	**(5,498,322)**	**13,902,358**

2019

	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
At 1 January	13,774,528	(3,928,660)	9,845,868
Premiums written during the year	31,934,272	(14,623,433)	17,310,839
Premiums earned during the year	(29,838,492)	14,486,791	(15,351,701)
At 31 December	**15,870,308**	**(4,065,302)**	**11,805,006**

17.4 Unexpired risk liability

	2020 NZD	2019 NZD
Gross unearned premium liability	19,400,680	15,870,308
Reinsurers' share of unearned premium liability	(5,498,322)	(4,065,302)
Net unearned premium liability	**13,902,358**	**11,805,006**
DAC	-	(33,863)
Net unearned premium liability less DAC	**13,902,358**	**11,771,143**
Gross central estimate of expected future cash flows for future claims	15,746,306	13,425,667
Reinsurers' share of expected future cash flows for future claims	(2,630,461)	(2,177,863)
Net central estimate of expected future cash flows for future claims	**13,115,845**	**11,247,804**
Risk margin	4,401,772	3,927,182
Net premium liability, including risk margin	**17,517,617**	**15,174,986**
Net unexpired risk liability	**3,615,259**	**3,403,843**

17.5 Unexpired risk liability movement

2020

	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
At 1 January	3,403,843	-	3,403,843
Incurred during the year	211,416	-	211,416
Utilised during the year	-	-	-
At 31 December	**3,615,259**	**-**	**3,615,259**

2019

	Insurance contract liabilities NZD	Reinsurance assets NZD	Net NZD
At 1 January	2,902,553	-	2,902,553
Incurred during the year	501,290	-	501,290
Utilised during the year	-	-	-
At 31 December	**3,403,843**	**-**	**3,403,843**

RISK MANAGEMENT AND OTHER DISCLOSURES

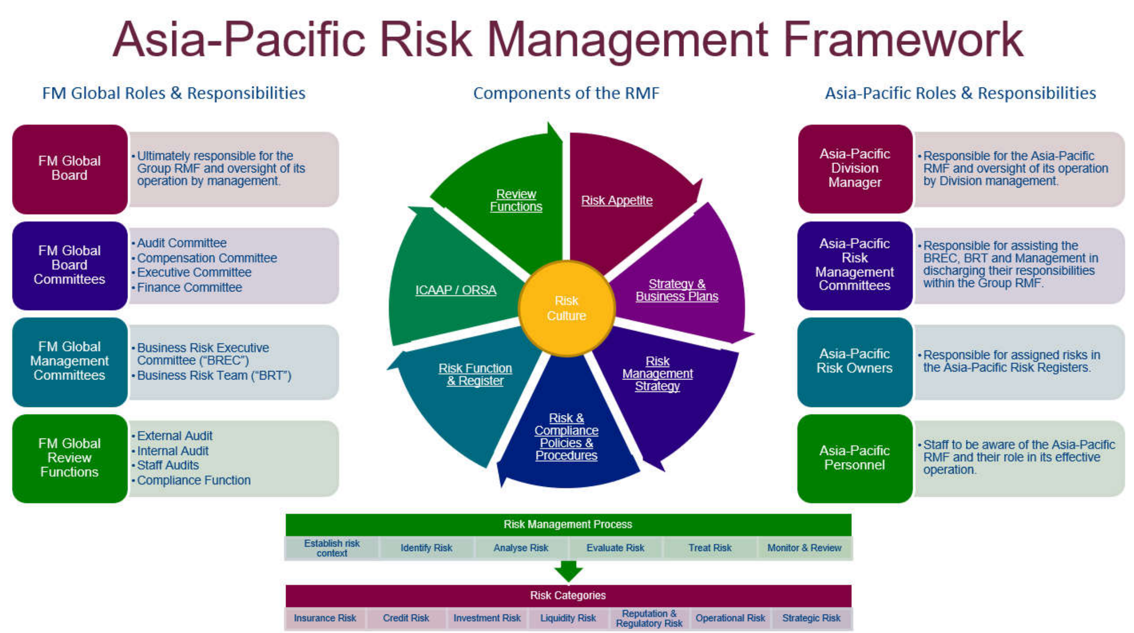
18 Risk management framework

18.1 Governance framework

The risk management framework ("RMF") enables FMIC in the Asia-Pacific region, including the Branch, to appropriately develop and implement strategies, policies, procedures and controls to manage different types of material risks. The risk management framework encompasses the systems, structures, policies, processes and people within the operations that identify, measure, monitor, report and control or mitigate all internal and external sources of material risk. Material risks are those that could have a material impact, both financial and non-financial, on operations or the interests of policyholders. The risk management framework provides reasonable assurance that each material risk to operations is being prudently and soundly managed, having regard to the size, business mix and complexity of operations.

The Asia-Pacific risk management framework covers all entities within the region and is summarised in Figure 1 below.

Figure 1



18.2 Capital management

The Reserve Bank of New Zealand ("RBNZ") is the prudential regulator of the Branch in New Zealand. The RBNZ has exempted the Branch from the need to comply with local solvency requirements described in section 55 of the Insurance (Prudential Supervision) Act 2010, in accordance with section 59 of the Act. These exemptions mean that reliance is placed on the prudential supervision, capital management practices and solvency outcomes of the Company in its home jurisdiction, rather than of the Branch.

The regulatory solvency position of the Company is as follows:

	2020 NZD '000	2019 NZD '000
Actual capital resources	21,251,834	20,352,867
Capital resources requirement	(2,769,062)	(2,611,964)
Solvency margin	18,482,772	17,740,903
Solvency ratio	**767%**	**779%**

The solvency position reported above is converted from the Company's functional currency of USD to NZD using the spot rate published by the RBNZ as at the reporting date.

18.3 Regulatory framework

A key consideration for the prudential regulator is in protecting the rights of policyholders and monitoring the activities of the Branch to ensure that the Branch is satisfactorily managing affairs for their benefit. The prudential regulator is also interested in ensuring an appropriate solvency position is maintained to meet losses arising from economic shocks or natural disasters.

18.4 Asset liability management

Financial risks may arise from interest rate and currency exposures. The Branch manages these risks within an asset liability management framework by ensuring that net insurance contract liabilities are approximately matched by backing cash and investments.

19 Insurance and financial risks

19.1 Insurance risk

19.1.1 Overview

The Branch issues property damage and business interruption insurance contracts. Risks usually cover a twelve-month duration and are predominately concentrated in New Zealand Risks associated with such contracts may vary in relation to the location of the risk, type of risk insured and by industry. Such risks may arise from exposures to fire or natural disasters such as windstorm, flood or earthquake.

The principal risk the Branch faces under insurance contracts is that the actual claims and benefit payments or timing thereof, differ from expectations. This is influenced by the frequency of claims, severity of claims and actual benefits paid. Therefore, an objective of the Branch is to ensure that sufficient reserves are available to cover these liabilities.

The risk exposure is mitigated by careful selection and implementation of underwriting guidelines, as well as reinsurance arrangements. A key purpose of these underwriting and reinsurance strategies is to limit exposure to large losses or catastrophe event losses based on the Branch's risk appetite and tolerances. The Branch has a tolerance limit to restrict the impact of large losses or catastrophe event losses such that the combined ratio of the Branch does not exceed 125% in any given year.

Reinsurance includes participation in the Company's worldwide Excess of Loss programme, various automatic facilities, facultative reinsurance, client captive reinsurance and the Branch's intercompany stop loss reinsurance treaty with related party entity Affiliated FM Insurance Company. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims liability and are in accordance with the reinsurance contracts. Although the Branch has reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus credit exposure exists with respect to ceded insurance, to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements. With the exception of the intercompany stop loss reinsurance treaty, the placement of reinsurance is diversified such that it is not dependent on a single reinsurer.

Risk exposure is also mitigated by claim assessment policies for all new and ongoing claims, regular detailed review of claims handling procedures, active management of claims and prompt settlement of liabilities. Inflation risk is mitigated by taking expected inflation into account when estimating insurance contract liabilities.

19.1.2 Process to determine outstanding claims liabilities

<u>Future cash flows</u>

The estimation of the outstanding claims liability is based on actuarial techniques that analyse experience, trends and other relevant factors. The actuarial claims estimate process commences with the projection of the future payments relating to claims incurred at the reporting date. The expected future payments include those in relation to claims IBNR and IBNER, and the anticipated direct and indirect claims handling costs.

The Branch's claims are characterised by low frequency and high variability in claim size. Accordingly, it is not considered appropriate to rely on aggregate payment patterns to project future claims costs. Instead, estimates are based on analysis of incurred costs, and the performance of estimates, over time.

The different components of the outstanding claims liability are subject to different levels of uncertainty. The estimation of the cost of claims reported but not yet paid or not yet paid in full is made on a case by case basis by claims personnel having regard to the facts and circumstances of the claims as reported, any information available from loss adjusters / consultants and information on the cost of settling based on past experience with the accuracy of initial claims estimates. With IBNR, the estimate is generally subject to a greater degree of uncertainty as IBNR claims may often not be apparent until some time after the events giving rise to the claim having occurred.

Reserves are not established for catastrophes in advance of such events and so these events may cause volatility in the results for a period and in the level of the outstanding claims liability, subject to the effects of reinsurance recoveries.

The valuation of the outstanding claims liability is performed by the appointed actuary who does not have any role in the pricing function, so as to ensure that an objective and independent assessment of the outstanding claims liability is maintained.

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 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 liability will ultimately prove to be adequate to 75%.

A risk margin is held to allow for uncertainty surrounding the outstanding claims liability 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.

19.1.3 Key assumptions

The table below summarises the key assumptions made by the appointed actuary in determining the outstanding claims liability.

	2020 %	2019 %
Internal loss adjustment expense rate (to gross claims reported by policyholders and IBNR))	1.68%	2.01%
External loss adjustment expense rate (to net claims incurred)	4.03%	4.48%
Inflation rate	2.00%	2.47%
Discount rate	0.25%	0.82%
Risk margin rate	16.7%	26.20%

Internal loss adjustment expense rate

In respect of claims incurred up to the reporting date, it is known that external and internal loss adjustment expenses will be incurred in the management of claims to finalisation. The external loss adjustment expenses, e.g. external loss adjusters for specific claims, are already included in the claims data and are therefore also implicitly included in the Initial Expected Loss Ratio (“IELR”) selection, so no explicit allowance is needed for external loss adjustment expenses in the liability projections. The internal loss adjustment expenses which do not relate to any single claim, e.g. salaries from personnel in claims handling, are first calculated for the premium liabilities assuming that the amount which will be incurred for the run-off of the remaining on-risk policies will be similar to 2020 year-to-date internal LAE pro-rated for the remaining gross exposure (i.e. 2020 year-to-date internal LAE multiplied by the ratio of gross UPR to the gross earned premiums in 2020 year-to-date). The resulting internal loss adjustment expense rate (as a proportion of the gross attritional claims reserves in the premium liabilities) of 4.03% is then applied to the gross unpaid claims reserves in the claim liabilities calculation.

Inflation rate

Insurance costs are subject to inflationary pressures. Economic inflation assumptions are set to current economic indicators. When making assumptions about the future claim inflation, assumptions have been made around the causative link between the type of claim and the expected growth. Fire claims may be expected, on average, to be driven by construction costs, which in turn may be expected to be driven by some factors that increase with average weekly earnings ("AWE") inflation and some that increase with the consumer price index (CPI). Business interruption claims may be expected, on average, to be driven by Company profits for which the most appropriate measure is gross operating surplus ("GOS") forecasts. A weighted average of all these measures has been adopted in determining the inflation rate.

Discount rate

Because the outstanding claims liability 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 liabilities, and the level of reinsurance cover, the approach adopted for determining the risk inherent in the liability, 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.

19.1.4 Sensitivities

The claim and premium liabilities are sensitive to the key assumptions in the tables below. It has not been possible to quantify the sensitivity of certain assumptions such as legislative changes or uncertainty in the estimation process. The following analysis is performed for reasonably possible movements in key assumptions with all other assumptions held constant, showing the impact on gross and net liabilities. The correlation of assumptions will have a significant effect in determining the ultimate claims liabilities and premium liabilities, but to demonstrate the impact due to changes in assumptions, each assumption has been changed on a stand-alone basis. It should be noted that movements in these assumptions are non-linear. Unless specified otherwise, the movements are stated in absolute terms where the base assumption is a percentage, for example, if the base inflation rate assumption was 3.5%, a 1% increase would mean assuming a 4.5% inflation rate. All movements would be recognised directly through the Statement of Profit or Loss.

Claim liabilities for 2020

Item	Effect
Increase discount rate by 0.3%	Reduce outstanding claim liabilities by $0.057 million (0.3% of outstanding claims central estimates)
Decrease discount rate by 0.3%	Increase outstanding claim liabilities by $0.057 million (0.3% of outstanding claims central estimates)
Increase inflation rate by 2%	Increase outstanding claim liabilities by $0.341 million (2.0% of outstanding claims central estimates)
Decrease inflation rate by 2%	Reduce outstanding claim liabilities by $0.335 million (2.0% of outstanding claims central estimates)
Increase risk margin by 5%	Increase outstanding claim liabilities by $0.837 million (4.9% of outstanding claims central estimates)
Decrease risk margin by 5%	Reduce outstanding claim liabilities by $0.837 million (4.9% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for FMG to $2.5 million	Increase outstanding claim liabilities by $2.145 million (12.7% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for FMG to $0.015 million	Reduce outstanding claim liabilities by $0.825 million (4.9% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for AFM to $1 million	Increase outstanding claim liabilities by $0.669 million (4.0% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for AFM to $0.05 million	Reduce outstanding claim liabilities by $0.454 million (2.7% of outstanding claims central estimates)
Approximate impact of a 25% adverse movement in exchange rates (approx 25% claims impacted)	Increase outstanding claim liabilities by $1.057 million (6.3% of outstanding claims central estimates)
Approximate impact of a 25% favourable movement in exchange rates (approx 25% claims impacted)	Reduce outstanding claim liabilities by $1.057 million (6.3% of outstanding claims central estimates)

Claim liabilities for 2019

Item	Effect
Increase discount rate by 0.3%	Reduce outstanding claim liabilities by $0.026 million (0.3% of outstanding claims central estimates)
Decrease discount rate by 0.3%	Increase outstanding claim liabilities by $0.026 million (0.3% of outstanding claims central estimates)
Increase inflation rate by 2%	Increase outstanding claim liabilities by $0.181 million (2.4% of outstanding claims central estimates)
Decrease inflation rate by 2%	Reduce outstanding claim liabilities by $0.176 million (2.3% of outstanding claims central estimates)
Increase risk margin by 5%	Increase outstanding claim liabilities by $0.298 million (4.0% of outstanding claims central estimates)
Decrease risk margin by 5%	Reduce outstanding claim liabilities by $0.298 million (4.0% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for FMG to $2.5 million	Increase outstanding claim liabilities by $2.627 million (35.0% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for FMG to $0.015 million	Reduce outstanding claim liabilities by $1.083 million (14.4% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for AFM to $1 million	Increase outstanding claim liabilities by $0.877 million (11.7% of outstanding claims central estimates)
Change incremental incurred cost movement for development quarter 2 for AFM to $0.05 million	Reduce outstanding claim liabilities by $0.419 million (5.6% of outstanding claims central estimates)
Approximate impact of a 25% adverse movement in exchange rates (approx 26% claims impacted)	Increase outstanding claim liabilities by $0.489 million (6.5% of outstanding claims central estimates)
Approximate impact of a 25% favourable movement in exchange rates (approx 26% claims impacted)	Reduce outstanding claim liabilities by $0.489 million (6.5% of outstanding claims central estimates)

Premium liabilities for 2020

Item	Effect
Increase discount rate by 0.3%	Reduce premium liabilities by $0.047 million (0.3% of premium liability central estimates)
Decrease discount rate by 0.3%	Increase premium liabilities by $0.048 million (0.3% of premium liability central estimates)
Increase inflation rate by 2%	Increase premium liabilities by $0.322 million (1.8% of premium liability central estimates)
Decrease inflation rate by 2%	Reduce premium liabilities by $0.311 million (1.8% of premium liability central estimates)
Increase risk margin by 5%	Increase premium liabilities by $0.656 million (3.7% of premium liability central estimates)
Decrease risk margin by 5%	Reduce premium liabilities by $0.656 million (3.7% of premium liability central estimates)
Increase adopted loss ratio by 15%	Increase premium liabilities by $2.712 million (15.5% of premium liability central estimates)
Decrease adopted loss ratio by 15%	Reduce premium liabilities by $2.780 million (15.9% of premium liability central estimates)
Approximate impact of a 25% adverse movement in exchange rates (approx 30% claims impacted)	Increase premium liabilities by $1.314 million (7.5% of premium liability central estimates)
Approximate impact of a 25% favourable movement in exchange rates (approx 30% claims impacted)	Reduce premium liabilities by $1.314 million (7.5% of premium liability central estimates)

Premium liabilities for 2019

Item	Effect
Increase discount rate by 0.3%	Reduce premium liabilities by $0.050 million (0.3% of premium liability central estimates)
Decrease discount rate by 0.3%	Increase premium liabilities by $0.050 million (0.3% of premium liability central estimates)
Increase inflation rate by 2%	Increase premium liabilities by $0.341 million (2.3% of premium liability central estimates)
Decrease inflation rate by 2%	Reduce premium liabilities by $0.326 million (2.1% of premium liability central estimates)
Increase risk margin by 5%	Increase premium liabilities by $0.562 million (3.7% of premium liability central estimates)
Decrease risk margin by 5%	Reduce premium liabilities by $0.562 million (3.7% of premium liability central estimates)
Increase adopted loss ratio by 15%	Increase premium liabilities by $2.802 million (18.5% of premium liability central estimates)
Decrease adopted loss ratio by 15%	Reduce premium liabilities by $2.802 million (18.5% of premium liability central estimates)
Approximate impact of a 25% adverse movement in exchange rates (approx 21% claims impacted)	Increase premium liabilities by $0.804 million (5.3% of premium liability central estimates)
Approximate impact of a 25% favourable movement in exchange rates (approx 21% claims impacted)	Reduce premium liabilities by $0.804 million (5.3% of premium liability central estimates)

19.1.5 Claims development table

The following tables show the estimates of cumulative incurred claims, including both claims notified and IBNR for each successive accident year at each reporting date, together with cumulative payments to date.

Gross outstanding claims liability 2020

Accident year	Notes	Before 2016 NZD'000	2016 NZD'000	2017 NZD'000	2018 NZD'000	2019 NZD'000	2020 NZD'000	Total NZD'000
At end of accident year		-	63,402	4,682	9,436	5,616	16,940	
One year later		-	60,199	5,809	8,194	4,369		
Two years later		-	61,754	5,807	8,231			
Three years later		-	62,099	5,807				
Four years later		-	62,099					
Five or more years later		-						
Current estimate of cumulative ultimate claims incurred		**-**	**62,099**	**5,807**	**8,231**	**4,369**	**16,940**	**97,447**
At end of accident year		-	52	320	1,994	97	1,988	
One year later		-	30,188	5,807	5,859	2,100		
Two years later		-	30,159	5,807	8,102			
Three years later		-	62,099	5,807				
Four years later		-	62,099					
Five or more years later		-						
Cumulative payments to date		**-**	**62,099**	**5,807**	**8,102**	**2,100**	**1,988**	**80,096**
Gross outstanding claims liability at 31 December			**-**	**-**	**129**	**2,269**	**14,952**	**17,351**

Net outstanding claims liability 2020

Accident year	Notes	Before 2016 NZD'000	2016 NZD'000	2017 NZD'000	2018 NZD'000	2019 NZD'000	2020 NZD'000	Total NZD'000
At end of accident year		-	16,975	3,146	7,998	4,568	13,011	
One year later		-	13,728	2,853	3,863	3,612		
Two years later		-	15,154	2,850	3,950			
Three years later		-	15,336	2,850				
Four years later		-	15,336					
Five or more years later		-						
Current estimate of cumulative ultimate claims incurred			**15,336**	**2,850**	**3,950**	**3,612**	**13,011**	**38,759**
At end of accident year		-	27	295	1,335	30	1,816	
One year later		-	6,757	2,850	2,653	1,700		
Two years later		-	8,762	2,850	3,820			
Three years later		-	15,336	2,850				
Four years later		-	15,336					
Five or more years later		-						
Cumulative payments to date		**-**	**15,336**	**2,850**	**3,820**	**1,700**	**1,816**	**25,523**
Net outstanding claims liability at 31 December		**-**	**-**	**-**	**130**	**1,912**	**11,195**	**13,236**

19.2 Financial risk

The Branch's investment objective is to ensure that it maintains adequate levels of solvency capital in accordance with local regulatory capital requirements and have sufficient financial resources available in cash to meet it's obligations, in particular those relating to policyholders, as they fall due.

19.2.1 Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

The Branch is primarily exposed to credit risk via insurance receivables, other receivables and deposit accounts with financial institutions.

Various policies and procedures are in place to prevent, minimise or mitigate exposure to credit risk, including:

- Premium receivables ageing analysis is performed regularly with overdue premiums actively pursued;
- Reinsurance is placed with external reinsurers that have good credit rating and concentration of risk is avoided by following guidelines in respect of counterparty limits that are set and reviewed annually by the reinsurance committee;
- Reinsurance placed with client captive reinsurers, which are unrated, is subject to policy clause conditions that prevent settlement of a claim by the Branch until the client captive reinsurer has settled its share of the loss to the Branch.
- Reinsurance is placed with related party reinsurers Affiliated FM Insurance Company and Risk Engineering Insurance Company Ltd., which enjoy the same rating of the parent; and
- Deposit accounts are all held with highly rated financial institutions with no recent history of default.

The tables below provide information regarding the credit risk exposure of the Branch by classifying financial assets by counterparty rating as published by rating agency AM Best. All amounts are shown before any allowance for impairment.

2020

	AA+, AA, AA-	A+, A, A-	BBB+, BBB, BBB-	BB+, BB, BB-	Not rated	Total
	NZD	NZD	NZD	NZD	NZD	NZD
Cash and cash equivalents	43,324,236	-	-	-	-	43,324,236
Insurance receivables	55,112	4,510,653	2,023,456	8,675	3,303,869	9,901,765
Other receivables	58,147	-	-	-	-	58,147
Reinsurance assets	-	8,430,387	-	-	1,498,649	9,929,036
Total	**43,437,495**	**12,941,040**	**2,023,456**	**8,675**	**4,802,518**	**63,213,184**

2019

	AA+, AA, AA-	A+, A, A-	BBB+, BBB, BBB-	BB+, BB, BB-	Not rated	Total
	NZD	NZD	NZD	NZD	NZD	NZD
Cash and cash equivalents	34,849,995	-	-	-	-	34,849,995
Insurance receivables	1,513,053	-	3,140,672	-	135,902	4,789,627
Other receivables	2,107,686	-	-	-	-	2,107,686
Reinsurance assets	515,231	-	6,356	29,936	-	551,523
Total	**38,985,965**	**-**	**3,147,028**	**29,936**	**135,902**	**42,298,831**

Impairment assessment

The Branch's ECL assessment and measurement method is set out below.

Significant increase in credit risk, default and cure

The Branch continuously monitors assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Branch assesses whether there has been a significant increase in credit risk since initial recognition.

The Branch considers that there has been a significant increase in credit risk when any contractual payments are more than 30 days past due. In addition, the Branch also considers a variety of instances that may indicate unlikeliness to pay by assessing whether there has been a significant increase in credit risk. Such events include:

- Rating of the counterparty indicating default or near-default;
- The counterparty having past due liabilities to public creditors or employees;
- The counterparty (or any legal entity within the debtor's group) filing for bankruptcy application; or
- Counterparty's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties.

The Branch considers a financial instrument defaulted and, therefore, credit-impaired for ECL calculations in all cases when the counterparty becomes 90 days past due on its contractual payments. The Branch may also consider an instrument to be in default when internal or external information indicates that the Branch is unlikely to receive the outstanding contractual amounts in full. In such cases, the Branch recognises a lifetime ECL.

In rare cases when an instrument identified as defaulted, it is the Branch's policy to consider a financial instrument as 'cured' and, therefore, re-classified out of credit-impaired when none of the default criteria have been present for at least twelve consecutive months.

There has been no significant increase in credit risk or default for financial assets during the year.

The tables below provide information regarding the credit risk exposure of the Branch by classifying receivables by age.

2020

	< 90 days NZD	90 – 180 days NZD	180 days to 1 year NZD	More than 1 year NZD	Total NZD
Insurance receivables	6,823,049	1,145,470	1,917,579	105,337	9,991,435
Impairment allowance	-	-	-	(89,670)	(89,670)
Other receivables	58,147	-	-	-	58,147
Total	**6,881,196**	**1,145,470**	**1,917,579**	**15,667**	**9,959,912**

2019

	< 90 days NZD	90 – 180 days NZD	180 days to 1 year NZD	More than 1 year NZD	Total NZD
Insurance receivables	4,384,010	209,693	810,103	-	5,403,806
Impairment allowance	-	-	-	(62,656)	(62,656)
Other receivables	2,107,686	-	-	-	2,107,686
Total	**6,491,696**	**209,693**	**810,103**	**(62,656)**	**7,448,836**

Set out below is the change in the allowance for impairment losses. No collateral is held as security for any insurance or reinsurance receivable balances.

	2020 NZD	2019 NZD
At 1 January	(62,656)	(53,722)
Impairment on Insurance receivables (from policyholders / brokers)	(27,014)	(8,934)
At 31 December	**(89,670)**	**(62,656)**

19.2.2 Liquidity risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. In respect of catastrophe claim events there is also a liquidity risk associated with the timing differences between gross cash outflows and expected reinsurance recoveries.

The major liquidity risk confronting the Branch is the daily calls on its available cash resources in respect of claim payments arising from insurance contracts.

Various policies and procedures are in place to prevent, minimise or mitigate exposure to liquidity risk, including:

- An Asia-Pacific region liquidity risk policy. The policy includes guidelines for asset allocations and maturity profiles of assets. The policy is reviewed annually for relevance and changes in the risk environment. The policy is approved by the Risk Management Committee (“RMC”) and forms part of the Risk Management Framework of the region. Any liquidity risk breaches are reported to the RMC;
- The intercompany stop loss reinsurance treaty with Affiliated FM Insurance Company provides for quarterly (or more frequent) settlement in the event the combined ratio of the Branch exceeds the attachment point of 125%; and
- Contingency funding plans are in place, including access to the capital of the Company.

The effectiveness of these policies and procedures have enabled the Branch to avoid entering into any bank overdrafts, bank loans, convertible bonds and other interest-bearing loans during the year.

The following table summarises the maturity profile of the financial assets, financial liabilities and insurance contract liabilities of the Branch based on remaining undiscounted contractual obligations, including interest payable and receivable.

For outstanding claims liabilities and reinsurance assets, maturity profiles are determined based on estimated timing of net cash outflows from the recognised insurance liabilities. Unearned premium liabilities have been excluded from the analysis as they are not contractual obligations.

2020

	Up to 1 year NZD	More than 1 year NZD	Total NZD
Assets			
Cash and cash equivalents	43,324,236	-	43,324,236
Insurance receivables	9,886,098	105,337	9,991,434
Other receivables	58,147	-	58,147
Reinsurance assets (Outstanding claims)	1,082,780	3,347,934	4,430,714
Total	**54,351,261**	**3,3453,271**	**57,804,531**
Liabilities			
Other payables and accruals	2,012,633	-	2,012,633
Insurance payables	5,454,978	-	5,454,978
Insurance contract liabilities (Outstanding claims)	13,385,307	7,960,012	21,345,319
Total	**20,852,918**	**7,960,012**	**28,812,930**

2019

	Up to 1 year NZD	More than 1 year NZD	Total NZD
Assets			
Cash and cash equivalents	34,849,995	-	34,849,995
Insurance receivables	5,341,150	-	5,341,150
Other receivables	1,617,146	1,133,128	2,750,274
Reinsurance assets (Outstanding claims)	2,107,686	-	2,107,686
Total	**43,915,977**	**1,133,128**	**45,049,105**
Liabilities			
Other payables and accruals	206,350	-	206,350
Insurance payables	4,455,696	-	4,455,696
Insurance contract liabilities (Outstanding claims)	6,054,986	4,210,718	10,265,704
Total	**10,717,032**	**4,210,718**	**14,927,750**

19.2.3 Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk and price risk.

Various policies and procedures are in place to prevent, minimize or mitigate exposure to market risk, including an Asia-Pacific region market and investment risk policy. The policy is reviewed annually for relevance and changes in the risk environment. The policy is approved by the RMC and forms part of the Risk Management Framework of the region. Any market risk breaches are reported to the RMC.

Currency risk

Currency risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Branch's principal transactions are carried out in NZD in New Zealand and its exposure to foreign exchange risk arise primarily with respect to the US dollar.

Currency risk is managed through risk limits and polices approved by the Branch. In order to ensure that assets and liabilities are highly correlated with changes in currency movements, deposits with financial institutions that match insurance contract liabilities shall generally be held in the typical currency profile of the Branch's insurance contract liabilities, except where required to match specific short-term liabilities in another currency. Deposits held in excess of those required to match insurance contract liabilities may be converted into US dollars in order to limit the currency risk of the Company. In doing so, it is acknowledged that the Branch may therefore be exposed to residual currency risk at a local level. This risk is tolerated subject to the ongoing requirement to ensure adequate regulatory solvency levels are maintained. The Branch does not use derivatives, hedging or other financial transactions to reduce this residual currency risk exposure at a local level.

The tables below provide information regarding the currency risk exposure of the Branch by classifying the Branch's assets and liabilities by major currencies. All amounts are unhedged. All amounts have been converted to NZD at the rate of exchange prevailing for the year ended.

2020

	NZD	USD	Other	Total
Assets				
Cash and cash equivalents	31,400,036	11,082,474	841,726	43,324,236
Insurance receivables	5,350,538	4,223,931	327,296	9,901,765
Other receivables	129,208	-	(71,061)	58,147
Reinsurance assets (Outstanding claims)	1,817,623	2,613,091	-	4,430,714
Assets	**38,697,405**	**17,919,496**	**1,097,961**	**57,714,862**
Liabilities				
Other payables and accruals	833,504	1,288,253	(109,125)	2,012,632
Insurance payables	4,508,121	662,019	284,838	5,454,978
Liabilities for contracts with customers	59,061	17,470	19,327	95,858
Insurance contract liabilities (Outstanding Claims)	21,345,319	-	-	21,345,319
Liabilities	**26,746,005**	**1,967,742**	**195,040**	**28,908,787**

2019

	NZD	USD	Other	Total
Assets				
Cash and cash equivalents	24,954,195	8,590,329	1,305,471	34,849,995
Insurance receivables	3,200,534	1,198,014	942,603	5,341,151
Other receivables	(26,581)	583,545	1,550,721	2,107,685
Reinsurance assets (Outstanding claims)	4,478,785	1,952,147	384,644	6,815,576
Assets	**32,606,933**	**12,324,035**	**4,183,439**	**49,114,407**
Liabilities				
Other payables and accruals	605,226	186,139	151,859	943,224
Insurance payables	3,543,819	687,986	223,891	4,455,696
Liabilities for contracts with customers	82,017	19,085	10,873	111,975
Insurance contract liabilities (Outstanding Claims)	22,950,849	3,373,839	3,215,167	29,539,855
Liabilities	**27,181,911**	**4,267,049**	**3,601,790**	**35,050,750**

The table below demonstrates the Branch's sensitivity to reasonably possible movements in the exchange rate for USD to the functional currency of the Branch, showing the impact on profit before tax, with all other variables held constant.

Currency	**Change in variable %**	**2020 NZD**	**2019 NZD**
USD	+ 10%	1,595,175	(805,699)
USD	- 10%	(1,595,175)	732,453

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. In order to ensure that assets and liabilities are highly correlated with changes in interest rate movements, deposits with financial institutions that match insurance contract liabilities shall generally be held in at call or short duration term deposits (of no more than twelve months duration), broadly consistent with the short tail settlement profile of the Branch's insurance contract liabilities. As at the end of the reporting period, the Branch does not hold any variable loans and borrowing, nor fixed rate financial assets classified as available-for-sale or fair value through profit or loss, and thus the interest rate risk for the Branch is considered by management as minimal.

<u>Equity price risk</u>

Equity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in equity prices (other than those arising from interest rate or foreign exchange rate risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or by factors affecting all similar financial instruments traded in the market. The Branch may not hold equities, thus avoiding equity price risk. The Branch does not hold any financial assets and liabilities whose value fluctuate due to changes in market prices.

19.3 Operational risks

Operational risk is the risk of loss arising from system failure, human error, fraud or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications or can lead to financial loss. The Branch cannot expect to eliminate all operational risks, but by maintaining a rigorous risk management and control framework and by monitoring and responding to potential risks, the Branch is able to effectively manage those risks. Controls include segregation of duties, access controls, authorisation and reconciliation procedures, staff training and assessment processes, including the use of internal audit. Business risks such as changes in environment, technology and the industry are monitored through the Branch's risk register.

20 Contingencies and commitments

20.1 Legal proceedings and regulations

The Branch operates in the insurance industry and may be subject to legal proceedings in the normal course of business. There are no current contingencies associated with legal proceedings.

The Branch is also subject to insurance solvency regulations with the prudential regulator. There are no current contingencies associated with the Branch's compliance or lack of compliance with such regulations.

20.2 Commitments

The Branch has no capital commitments at the reporting date.

The Branch has no lease commitments relating to lease contracts that have not yet commenced as at year-end.

20.3 Guarantees

The Branch has no guarantees at the reporting date.

20.4 Contingent liabilities

The Branch has no contingent liabilities at the reporting date.

21 Related party disclosures

Note 2 provides information about the Company's structure. The following tables provide the total amount of transactions and balances with related parties for the relevant year.

Related party transactions include provision of reinsurance, and provision of underwriting, policy administration, claims support and finance/administrative services to facilitate the operation of the branch.

21.1 Transactions with related parties

The Branch enters into transactions with related party entities in the normal course of business. Transactions with related parties are made on terms agreed between the parties.

Details of transactions carried out during the year with related parties are, as follows:

		Relationship	2020 NZD	2019 NZD
Income from related parties:				
Ceded claims paid	Affiliated FM Ins. Co.	Subsidiary	-	-
	Risk Engineering Insurance Company Ltd.	Subsidiary	-	-
	New Provident Mutual Ltd.	Subsidiary	-	-
	WatchHill Ins. Co.	Subsidiary	-	-
Sub-total ceded claims paid			-	-
Reinsurance commission income	Risk Engineering Insurance Company Ltd.	Subsidiary	229,780	-
	New Provident Mutual Ltd.	Subsidiary	-	-
	WatchHill Ins. Co.	Subsidiary		
Sub-total reinsurance commission income			229,780	-
Total income			229,780	-
Expenses from related parties:				
Ceded premiums written	Affiliated FM Ins. Co.	Subsidiary	5,206,227	4,331,139
	Risk Engineering Insurance Company Ltd.	Subsidiary	1,140,827	893,743
	New Provident Mutual Ltd.	Subsidiary	24,755	26,185
	WatchHill Ins, Co.	Subsidiary	1,606	-
Sub-total ceded premiums written			6,373,415	5,251,067
Service agreement charges	Factory Mutual Insurance Company	Company	5,202,737	5,163,004
	Other related parties	Subsidiary	-	-
Sub-total service agreement charges and other expenses			5,202,737	5,163,004
Total expenses			**11,576,152**	**10,414,071**

21.2 Balances with related parties

Outstanding balances with related parties at the year-end are unsecured, interest free and repayable on demand, with settlement typically occurring on a quarterly basis. The carrying value of balances with related companies as at year-end approximates fair value. There have been no guarantees provided or received for any balances with related companies. No allowance for impairment has been recorded as at year-end in respect of receivables from related parties, nor has any expense been recognised for bad or doubtful debts during the period.

Details of receivables from and payables to related parties are, as follows:

		Relationship	2020 NZD	2019 NZD
Asset balances with related parties:				
Insurance receivables (from reinsurers)	Affiliated FM Ins. Co.	Subsidiary	-	-
	Risk Engineering Insurance Company Ltd.	Subsidiary	-	-
	New Provident Mutual Ltd.	Subsidiary	-	-
	WatchHill Ins. Co.	Subsidiary		
Sub-total Insurance receivables			-	-
Reinsurance assets	Affiliated FM Ins. Co.	Subsidiary	-	-
	Risk Engineering Insurance Company Ltd.	Subsidiary	554,874	542,325
	New Provident Mutual Ltd.	Subsidiary	5,910	6,879
	WatchHill Ins. Co.	Subsidiary	2,017	-
Sub-total reinsurance assets			562,801	549,204
Other receivables	Factory Mutual Insurance Company	Company	-	-
	Other related parties	Subsidiary	30,133	-
Sub-total Other receivables			30,133	-
Total asset balances with related parties			**592,934**	**549,204**
Liability balances with related parties:				
Insurance payables (to reinsurers)	Affiliated FM Ins. Co.	Subsidiary	(1,364,793)	(1,203,450)
	Risk Engineering Insurance Company Ltd.	Subsidiary	(394,147)	(447,122)
	New Provident Mutual Ltd.	Subsidiary	-	-
Sub-total Insurance payables			(1,758,940)	(1,650,572)
Other payables and accruals	Factory Mutual Insurance Company	Company	(1,386,536)	(2,313,839)
	Other related parties	Subsidiary	(37,004)	4,397,357
Sub-total Other payables and accruals			(1,423,540)	2,083,518
Total liability balances with related parties			**(3,182,480)**	**432,946**

21.3 Compensation of key management personnel

The Branch did not bear the remuneration of key management personnel in respect of their services rendered during the year. Key management personnel are employed by other reporting entities in the Company.

22 Standards issued but not yet effective

22.1 NZ IFRS 17 Insurance contracts

In May 2017, the IASB issued IFRS 17 Insurance Contracts (NZ IFRS 17 as adopted by NZASB), a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, NZ IFRS 17 will replace NZ IFRS 4 Insurance Contracts (NZ IFRS 4) that was issued in 2005. NZ IFRS 17 applies to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance), regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. A few scope exceptions will apply. The overall objective of NZ IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. In contrast to the requirements in NZ IFRS 4, which are largely based on grandfathering previous local accounting policies, NZ IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of NZ IFRS 17 is the general model, supplemented by:

- a specific adaptation for contracts with direct participation features (the variable fee approach); and
- a simplified approach (the premium allocation approach) mainly for short-duration contracts.

NZ IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2023, with comparative figures required. Early application is permitted, provided the entity also applies NZ IFRS 9 and NZ IFRS 15 on or before the date it first applies NZ IFRS 17. Retrospective application is required. However, if full retrospective application for a group of insurance contracts is impracticable, then the entity is required to choose either a modified retrospective approach or a fair value approach.

The Branch is part of a Company led project evaluating the impact of the new standard, including identifying changes to accounting policies and procedures, insurance and accounting systems, as well as financial statement presentation and related disclosures. Preliminary assessments performed by the NZ IFRS 17 project team and the appointed actuary indicate that the Branch may be eligible to adopt the simplified premium allocation approach for measuring both insurance contracts held and reinsurance contracts issued. The Branch plans to adopt the new standard on the required effective date.

22.2 Amendments to IAS 1: Classification of Liabilities as Current or Non-current

In January 2020, the IASB issued amendments to paragraphs 69 to 76 of IAS 1 to specify the requirements for classifying liabilities as current or non-current. The amendments clarify:

- What is meant by a right to defer settlement;
- That a right to defer must exist at the end of the reporting period;
- That classification is unaffected by the likelihood that an entity will exercise its deferral right; and
- That only if an embedded derivative in a convertible liability is itself an equity instrument would the terms of a liability not impact its classification

The amendments are effective for annual reporting periods beginning on or after 1 January 2023 and must be applied retrospectively. The amendments are not expected to have a material impact on the Branch.

8 April 2021

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Appointed actuary's report to the Directors of Factory Mutual Insurance Company – New Zealand Branch

Report in respect of a review of actuarial information in, or used in the preparation of, financial statements

This report is provided under section 78 of the *Insurance (Prudential Supervision) Act 2010* ("the Insurance Act"), and relates to a review of the actuarial information in, or used in the preparation of, the financial statements of Factory Mutual Insurance Company (New Zealand) ("FMIC (NZ)") for the year ended 31 December 2020.

The financial statements were authorised for issue by the Board of Directors of Factory Mutual Insurance Company ("FMIC (US)") on 8 April 2021 and the accompanying independent auditors' report was issued on 8 April 2021.

Name of appointed actuary conducting the review

I, Daniel Smith, of Taylor Fry Consulting Actuaries ("Taylor Fry") am a Fellow of the New Zealand Society of Actuaries. This review has been conducted by me in my role as appointed actuary to FMIC (NZ).

Other than that of actuary, I confirm that I have no relationship with, or any other interests in, FMIC (NZ).

Exemption from solvency standard

FMIC (US) has been granted a Section 59 exemption under the Insurance Act, which applies to overseas insurers of approved jurisdictions. This provides an exemption from compliance with the New Zealand Solvency Standard for Non-life Insurance Business and was dated 5 October 2015. I understand that under this exemption, the Reserve Bank of New Zealand considers the solvency of FMIC (NZ) based on the solvency requirements of FMIC (US) under the regulatory requirements of the State of Rhode Island. I have been provided with a Letter of Representation from the Chairman of FMIC (US) to the independent auditors of FMIC (US), which attests that FMIC (US) has complied with the rules and requirements of the State of Rhode Island and Providence Plantations Department of Business Regulation relating to statutory-basis financial information for the period covered by the financial statements for the year ended 31 December 2020. I have not reviewed the calculations underlying the solvency data supplied to the State of Rhode Island but have relied on the attestation of FMIC (US) and the report of the auditors as to their accuracy.

Work done in relation to actuarial information used in the financial statements

The actuarial information used in the financial statements comprises the outstanding claims liability as at 31 December 2020 shown in the statement of financial position. This amount was determined in accordance with the New Zealand Equivalent to International Financial Reporting Standard 4 ("NZ IFRS 4"), and represents the net central estimate plus a risk margin to provide a 75% probability of sufficiency. I confirm that this amount was calculated by me and advised to FMIC (NZ) in a Financial Condition Report dated 25 March 2021.

I have carried out a Liability Adequacy Test, and confirm that the unearned premium less deferred acquisition costs plus unexpired risk liability is not less than my actuarial estimate of the net premium liability.

In carrying out this review, I confirm that I have been provided with all required information and explanations from FMIC (NZ).

Opinion

In my opinion:

- The actuarial information contained in the financial statements for FMIC (NZ) has been appropriately included in those statements, and
- The actuarial information used in the preparation of the financial statements for FMIC (NZ) has been used appropriately.

Scope and limitations of review

This report is prepared for the Directors of FMIC (NZ), solely for the purposes set out in section 78 of the Insurance Act and for no other purpose.

Daniel Smith
Fellow of the New Zealand Society of Actuaries