QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

ANNUAL REPORT – 31 DECEMBER 2020

CONTENTS

This financial report includes separate financial statements for QBE Insurance (Australia) Limited, New Zealand Branch (the Branch) as an individual entity.

The Branch is a branch of QBE Insurance (Australia) Limited (Company or Head Office) and is a reporting entity for the purposes of the Financial Reporting Act 2013 and the Financial Markets Conduct Act 2013. Its principal place of business is:

125 Queen Street
Level 21 QBE Centre
Auckland Central 1010
New Zealand

The financial report was authorised for issue by the directors on 12 February 2021. The directors have the power to amend and reissue the financial report.

QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

STATEMENT BY DIRECTORS
For the year ended 31 December 2020

We, being two directors of QBE Insurance (Australia) Limited (Company or Head Office), certify that the Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Balances Due To Head Office, Statement of Cash Flows and notes set out on pages 5 to 52 fairly present the Financial Statements of the New Zealand Branch of the Company for the year ended 31 December 2020.

The Board of Directors of QBE Insurance (Australia) Limited authorised these statements for issue on 12 February 2021.

Director

FRANK COSTIGAN

Director

CHRIS ESSON

Independent auditor's report

To the Directors of QBE Insurance (Australia) Limited

We have audited the financial statements, which comprise:

- the balance sheet as at 31 December 2020;
- the statement of comprehensive income for the year then ended;
- the statement of changes in balances due to Head Office for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

In our opinion, the accompanying financial statements of QBE Insurance (Australia) Limited New Zealand Branch (the Branch), present fairly, in all material respects, the financial position of the Branch as at 31 December 2020, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and International Financial Reporting Standards (IFRS).

Basis for opinion

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

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

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

Our firm carries out other services for the Branch in the areas of tax compliance and consulting. The provision of these other services has not impaired our independence as auditor of the Branch.

PricewaterhouseCoopers, ABN 52 780 433 757
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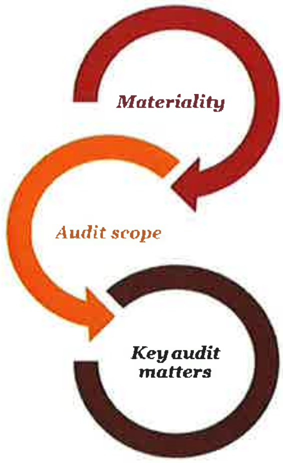
Our audit approach

Overview



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

Overall materiality: $4.7 million, which represents approximately 1% of gross earned premium.

We chose gross earned premium as the benchmark because, in our view, it is the benchmark against which the performance of the Branch is most commonly measured by users, it is not as volatile as other profit and loss measures, and is a generally accepted benchmark for insurance entities.

We have determined that there is one key audit matter:

- Valuation of outstanding claims liability

Materiality

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

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

Audit scope

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

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

Key audit matters

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

Key audit matter	How our audit addressed the key audit matter
Valuation of outstanding claims liability *(2020: $514,208,000, 2019: $520,872,000)* We considered the valuation of outstanding claims liability a key audit matter because of the complexity involved in the estimation process, the significant judgements that management makes in determining the balance and the inherent uncertainty in estimating the expected future payments for claims incurred, including those not yet reported. The valuation of outstanding claims involves significant judgement given the number of claims and the inherent uncertainty in estimating the expected present value of future payments for claims incurred. It involves complex and subjective assumptions about future events, both internal and external to the business, for which small changes in assumptions can result in material impacts on the estimate. In particular, judgement arises over the estimation of payments for claims that have been incurred at the reporting date but not yet reported to management as there is generally less information available in relation to these claims, and there is uncertainty over the amount which will be settled ultimately. Liability and other long tail classes of business where there is a greater length of time between the initial claim event and settlement, typically display greater variability between initial estimates and final settlement. There is also additional uncertainty for catastrophe events, particularly those occurring closer to year end. The estimate of future payments is discounted to present value using a risk free rate of return, in order to reflect the time value of money. Judgement is involved in estimating the period over which claims are expected to settle. The outstanding claims liability includes a risk margin that allows for the inherent uncertainty in the estimation of the present value of expected future payments. In determining the risk margin, various factors are considered, such as the variability of business, macroeconomic factors affecting uncertainty. Management considers the Probability of Adequacy, a measure of the estimated overall sufficiency of reserves in light of that variability, in determining the appropriate risk margin.	Our audit procedures included evaluating the design effectiveness and implementation of relevant key actuarial controls. Our procedures also included an assessment of the adequacy of the Appointed Actuary's review of the estimate adopted. Historical claims data was a key input to the actuarial estimates. Accordingly, we tested the underlying data used in the valuation of the outstanding claim liability by agreeing a sample of items back to supporting documentation, including case reserves, payments and expenses. To evaluate the methodologies and assumptions utilised by management, together with our PwC actuarial experts, we: • Considered the work and findings of the actuaries engaged by management, including the Appointed Actuary • Evaluated the actuarial models and methodologies used by comparing with generally accepted models and methodologies applied in the sector and with the prior year, seeking justification for any significant differences • For material classes of business, assessed key actuarial judgements and assumptions, including initial expected loss ratios, inflation rates, discount rates, claims expenses ratios and weighted average term to settlement, and challenged them by comparing with our expectations based on management's experience, our own sector knowledge and independently observable trends • For other classes, performed a key indicator review over trends by accident year, including factors such as exposure, claim numbers, size and frequency, loss ratios and aggregate indicators such as payment development • Tested the discount rates applied for classes of business where there is a greater length of time between the initial claim event and settlement • Assessed the risk margin by comparing to known industry practices.

Information other than the financial statements and auditor's report

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

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

Responsibilities of the Directors and management for the financial statements

The Directors and management are responsible, on behalf of the Branch, for the preparation and fair presentation of the financial statements in accordance with NZ IFRS and IFRS, and for such internal control as the Directors and management 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 and management are responsible for assessing the Branch's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors and management either intend to liquidate the Branch or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

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

https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-2/

This description forms part of our auditor's report.

Who we report to

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

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
16 February 2021

Sydney

QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

FINANCIAL REPORT CONTENTS

QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2020

	NOTE	2020 $'000	2019 $'000
Gross written premium		**493,064**	451,333
Unearned premium movement	2.5	**(26,280)**	(17,051)
Gross earned premium		**466,784**	434,282
Outward reinsurance premium		**(212,526)**	(189,339)
Deferred reinsurance premium movement	2.5	**2,501**	407
Net reinsurance premium expense		**(210,025)**	(188,932)
Net earned premium (a)		**256,759**	245,350
Gross claims incurred	2.2	**(353,272)**	(372,397)
Reinsurance and other recoveries	2.2	**214,826**	256,474
Net claims expense (b)	2.2	**(138,446)**	(115,923)
Gross commission expense		**(69,228)**	(70,097)
Reinsurance commission		**31,615**	29,969
Net commission expense (c)		**(37,613)**	(40,128)
Underwriting and other expenses (d)		**(36,688)**	(37,627)
Underwriting result (a)+(b)+(c)+(d)		**44,012**	51,672
Investment and other income	3.1	**9,939**	14,778
Investment expenses	3.1	**(463)**	(440)
Insurance profit		**53,488**	66,010
Restructuring and related expenses		**(1,539)**	(1,075)
Depreciation and amortisation	2.1.2	**(2,550)**	(2,846)
Financing and other costs		**(510)**	(539)
Profit before income tax		**48,889**	61,550
Income tax expense	6.1	**(13,822)**	(17,208)
Profit after income tax		**35,067**	44,342
Other comprehensive income			
Other comprehensive income after income tax		**-**	-
Total comprehensive income after income tax		**35,067**	44,342
Profit after income tax attributable to:			
Head Office Account		**35,067**	44,342
		35,067	44,342
Total comprehensive income after income tax attributable to:			
Head Office Account		**35,067**	44,342
		35,067	44,342

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

QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

BALANCE SHEET
As at 31 December 2020

	NOTE	2020 $'000	2019 $'000
Assets			
Cash and cash equivalents	5.1	**3,379**	20,415
Investments	3.2	**614,437**	541,270
Trade and other receivables	2.6	**212,895**	160,684
Deferred insurance costs	2.5	**60,361**	54,497
Reinsurance and other recoveries on outstanding claims	2.3	**329,165**	381,059
Right-of-use lease assets	2.8	**9,755**	11,451
Property, plant and equipment		**4,740**	5,401
Current tax assets		**4,174**	-
Total assets		**1,238,906**	1,174,777
Liabilities			
Trade and other payables	2.7	**57,510**	42,017
Current tax liabilities		**-**	8,995
Lease liabilities	2.8	**12,147**	13,706
Unearned premium	2.5	**278,710**	252,430
Outstanding claims	2.3	**514,208**	520,872
Deferred tax liabilities	6.2	**10,252**	8,480
Total liabilities		**872,827**	846,500
Net assets		**366,079**	328,277
Due to Head Office - Australia		**366,079**	328,277

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

QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

STATEMENT OF CHANGES IN BALANCES DUE TO HEAD OFFICE
For the year ended 31 December 2020

HEAD OFFICE – AUSTRALIA	NOTE	2020 $'000	2019 $'000
Balance as at 1 January		**328,277**	294,245
Profit for the year attributable to Head Office Account		**35,067**	44,342
Total comprehensive income		**35,067**	44,342
Net current transactions with Head Office		**2,735**	(10,310)
Balance at 31 December		**366,079**	328,277

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

QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

STATEMENT OF CASH FLOWS
For the year ended 31 December 2020

	NOTE	2020 $'000	2019 $'000
Operating activities			
Premium received		**549,174**	513,209
Reinsurance and other recoveries received		**262,057**	203,947
Outward reinsurance paid		**(202,858)**	(212,635)
Claims paid		**(395,911)**	(301,895)
Insurance and other underwriting costs paid		**(151,565)**	(140,800)
Interest received		**18,349**	12,915
Other operating income received		**(1,681)**	16,576
Other operating payments		**5,701**	268
Interest paid for leases		**(510)**	(539)
Income taxes paid		**(25,219)**	(28,740)
Net cash flows from operating activities	7.3	**57,537**	62,306
Investing activities			
Proceeds from sale of investments		**583,420**	417,432
Payments for purchase of investments		**(658,514)**	(453,177)
Payments for purchase of property, plant and equipment		**(148)**	970
Net payments to related entities		**(461)**	(2,007)
Net cash flows from investing activities		**(75,703)**	(36,782)
Financing activities			
Payments relating to principal element of lease liabilities		**(1,605)**	444
Net parent company settlements		**2,735**	(10,310)
Net cash flows from financing activities		**1,130**	(9,866)
Net movement in cash and cash equivalents		**(17,036)**	15,658
Cash and cash equivalents at the beginning of the year		**20,415**	4,757
Cash and cash equivalents at the end of the year	5.1	**3,379**	20,415

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

1. OVERVIEW

1.1 About the Branch

About QBE Insurance (Australia) Limited, New Zealand Branch
QBE Insurance (Australia) Limited (Company or Head Office) is a general insurance company incorporated in Australia and operating in New Zealand as a Branch (the Branch).

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

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

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

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

1.2 About this report

This financial report includes the financial statements of QBE Insurance (Australia) Limited, New Zealand Branch as an individual entity.

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

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

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

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

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

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

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

1.2.1 Basis of preparation

This financial report is a general purpose financial report which:

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

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

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

New and amended Accounting Standards and Interpretations issued by the New Zealand Accounting Standards Board (NZASB) that are now effective are detailed in note 7.1.

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

The Branch is an FMC reporting entity under Part 7 of the Financial Markets Conduct Act 2013 and it is a Licenced Insurer under the Insurance (Prudential Supervision) Act 2010.

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

1.2.2 Critical accounting judgements and estimates

The preparation of the Branch's financial statements requires management to make judgements and estimates that affect reported amounts. The diversity and complexity of the Branch is evidenced by its operations and the broad product range as shown in note 4.2.

In view of its geographic and product diversity, QBE Group has developed a centralised risk management and policy framework, designed to ensure consistency of approach across a number of operational activities. The Branch adopts these subject to the specific requirements of local markets, legislation and regulation. Such operational activities include underwriting, claims management, actuarial assessment of the outstanding claims liability and investment management. Sensitivity analyses in respect of critical accounting estimates and judgements are presented in order to provide information and analysis which is meaningful, relevant, reliable and comparable year on year. Sensitivity disclosure at product level would not provide a meaningful overview given the complex interrelationships between the variables underpinning the Branch's operations.

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

- net outstanding claims liability (note 2.3);
- unearned premium and deferred insurance costs (note 2.5);
- liability adequacy test (note 2.5.1); and
- recoverability of deferred tax assets (note 6.2.1)

COVID-19

COVID-19 was declared a pandemic by the World Health Organisation in March 2020. The virus itself, as well as measures to slow its spread, have had a significant impact on the global economy. The Branch has considered a broad range of factors to inform an assessment of the impact of the resulting uncertainty and general market volatility on the consolidated financial statements.

While the areas of critical accounting judgements and estimates did not materially change from last year, the impact of COVID-19 resulted in the application of further judgement within those identified areas. Given the evolving and uncertain impact of COVID-19, we anticipate that there will be changes in market conditions in the future and that the impact of these changes will be accounted for in future reporting periods as they arise and/or are able to be reasonably predicted.

The significant accounting estimates impacted by these associated uncertainties are predominantly related to the valuation of the outstanding claims, risk margin and the liability adequacy test. The impact of the COVID-19 pandemic on each of these accounting estimates is discussed further below.

• **Net discounted central estimate (note 2.3):**

COVID-19 has caused heightened uncertainty in the net discounted central estimate. Whilst this estimate has been based on a detailed review of the exposures, significant uncertainty remains around potential claims emergence.

The company will continue to monitor market developments closely, to ensure that the net discounted central estimate is reflective of the best estimate of expected future claims.

• **Risk margin (note 2.3.3):** The company aims to maintain a probability of adequacy in excess of 85%, reflecting the level of uncertainty in the net discounted central estimate. In response to the significantly heightened level of uncertainty created by COVID-19 claims as described above, the company has increased the risk margin which resulted in a probability of adequacy at the balance date of 86.6%.

• **Liability adequacy test (note 2.5.1):** This assessment is informed by the expectation of future net claims including a risk margin and is therefore subject to the same uncertainties summarised above. Future claims assumptions used in the liability adequacy test have been prepared on a basis that is consistent with the COVID-19 assumptions informing the determination of the net discounted central estimate.

1.2.3 Foreign currency

Translation of foreign currency transactions and balances

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

2. UNDERWRITING ACTIVITIES

Overview

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

2.1 Revenue and expenses

Overview

Revenue mainly comprises premiums charged for providing insurance coverage. Premiums are classified as either:

- Intermediated, being business generated through broker network.
- direct, being those paid by the policyholder to the insurer,
- facultative, being reinsurance of an individual (usually significant) risk by a ceding insurer or reinsurer; or
- inward reinsurance premiums, being coverage provided to an insurer or reinsurer in relation to a specified grouping of policies or risks.

Other sources of revenue include amounts recovered from reinsurers under the terms of reinsurance contracts, commission income from reinsurers and salvage or third party recoveries.

2.1.1 Revenue

	NOTE	2020 $'000	2019 $'000
Gross earned premium revenue			
Intermediated		**466,784**	434,282
Total revenue		**466,784**	434,282

How we account for the numbers

Premium revenue
Premium written comprises amounts charged to policyholders, but excluding taxes collected on behalf of third parties. Premium is recognised from the date of attachment of risk associated with the insurance policy, and recognised as revenue in profit or loss based on the expected pattern of incidence of risk, adjusted for policy terminations. The earned portion of premium on unclosed business, being business that is written at the balance date but for which detailed policy information is not yet booked, is also included in premium revenue. Premium on unclosed business is brought to account based upon the pattern of booking of renewals and new business.

Reinsurance and other recoveries revenue
Reinsurance and other recoveries on paid claims, reported claims not yet paid, claims incurred but not reported (IBNR), and claims incurred but not enough reported (IBNER) are recognised as revenue. Recoveries are measured as the present value of the expected future receipts.

2.1.2 Expenses

	NOTE	2020 $'000	2019 $'000
Underwriting and other expenses include the following items:			
Management fee income		**687**	600
Other fee income		**2,748**	3,236
Revenue from contracts with customers		**3,435**	3,836
Less: Costs incurred to fulfil contracts with customers		**336**	352
Net revenue from contracts with customers		**3,099**	3,484
Depreciation comprise the following items:			
Depreciation of property, plant & equipment		**809**	1,036
Depreciation of right-of-use asset		**1,741**	1,810
Depreciation		**2,550**	2,846

2.2 Net claims expense

Overview

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

	NOTE	2020 $'000	2019 $'000
Gross claims incurred and related expenses			
Direct		**353,272**	372,397
Reinsurance and other recoveries			
Direct		**(214,826)**	(256,474)
Net claims expense	2.4.2	**138,446**	115,923
Analysed as follows:			
Movement in net discounted central estimate		**136,946**	115,923
Movement in risk margin		**1,500**	-
Net claims expense	2.4.2	**138,446**	115,923

2.3 Net outstanding claims liability

Overview

The net outstanding claims liability comprises the elements described below.

- The gross central estimate (note 2.3.1). This is the provision for expected future claims payments and includes claims reported but not yet paid, claims incurred but which have not yet been reported (IBNR), claims incurred but not enough reported (IBNER) and estimated claims handling costs.
- Less reinsurance and other recoveries (note 2.3.2). Insurance companies may elect to purchase reinsurance to manage their exposure to any one claim or series of claims. When an insurance Branch incurs a claim as a result of an insured loss, it may be able to recover some of that claim from the reinsurers. An insurer may also be entitled to non-reinsurance recoveries under the insurance contract such as salvage, subrogation and sharing arrangements with other insurers.
- Less an amount to reflect the discount to present value using risk-free rates of return. The net central estimate is discounted to present value recognising that the claim and/or recovery may not be settled for some time. The weighted average risk-free rate used to discount the outstanding claims liability is summarised in note 2.3.4.

- Plus a risk margin (note 2.3.3). A risk margin is added to reflect the inherent uncertainty in the net discounted central estimate of outstanding claims.

	NOTE	2020 $'000	2019 $'000
Gross discounted central estimate		**489,563**	497,727
Risk margin	2.3.3	**24,645**	23,145
Gross outstanding claims liability	2.3.1	**514,208**	520,872
Reinsurance and other recoveries on outstanding claims	2.3.2	**(329,165)**	(381,059)
Net outstanding claims liability		**185,043**	139,813

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

	2020			2019		
	GROSS $'000	REINSURANCE $'000	NET $'000	GROSS $'000	REINSURANCE $'000	NET $'000
At 1 January	**520,872**	**(381,059)**	**139,813**	417,877	(303,190)	114,687
Current accident year development in net discounted central estimate (Note 2.4.2)	**203,430**	**(79,591)**	**123,839**	317,389	(195,324)	122,065
Prior accident year development in net discounted central estimate (Note 2.4.2)	**69,613**	**(55,006)**	**14,607**	55,008	(61,150)	(6,142)
Incurred claims recognised in profit or loss (note 2.2)	**273,043**	**(134,597)**	**138,446**	372,397	(256,474)	115,923
Claims payments	**(279,707)**	**186,491**	**(93,216)**	(269,402)	178,605	(90,797)
At 31 December	**514,208**	**(329,165)**	**185,043**	520,872	(381,059)	139,813

2.3.1 Gross discounted central estimate

	NOTE	2020 $'000	2019 $'000
Gross undiscounted central estimate excluding claims settlement costs		**485,313**	498,499
Claims settlement costs		**5,848**	6,203
Gross undiscounted central estimate		**491,161**	504,702
Discount to present value		**(1,598)**	(6,975)
Gross discounted central estimate	2.3	**489,563**	497,727
Payable within 12 months		**289,667**	172,494
Payable in greater than 12 months		**199,896**	325,233
Gross discounted central estimate	2.3	**489,563**	497,727

How we account for the numbers

The gross discounted central estimate is the present value of the expected future payments for claims incurred and includes reported but unpaid claims, IBNR, IBNER and claims handling costs. The central estimate is determined by the Appointed Actuary, supported by a team of actuaries. The valuation process includes extensive consultation with claims and underwriting staff as well as senior management. The central estimate of outstanding claims is subject to a comprehensive independent review at least annually. The risk management procedures related to the actuarial function are explained further in note 4.2.

Critical accounting judgements and estimates

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

- changes in patterns of claims incidence, reporting and payment;
- volatility in the estimation of future costs for long tail insurance classes due to the longer period of time that can elapse before a claim is paid in full;
- the existence of complex underlying exposures;
- the incidence of catastrophic events close to the balance date;
- changes in the legal environment, including the interpretation of liability laws and the quantum of damages; and
- changing social, political and economic trends, for example price and wage inflation.

The estimation of IBNR and IBNER is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims that have been reported to the Branch but not yet paid, for which some information about the claims is generally available. The notification and settlement of claims relating to liability and other long tail classes of business may not happen for many years after the event giving rise to the claim. As a consequence, liability and other long tail classes typically display greater variability between initial estimates and final settlement due to delays in reporting claims and uncertainty in respect of court awards and future claims inflation. Claims in respect of property and other short tail classes are typically reported and settled soon after the claim event, giving rise to more certainty.

Central estimates for each class of business are determined using a variety of estimation techniques, generally based on an analysis of historical experience and with reference to external benchmarks where relevant. The gross central estimate is discounted to present value using the appropriate risk-free rate.

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

2.3.2 Reinsurance and other recoveries on outstanding claims

	NOTE	2020 $'000	2019 $'000
Reinsurance and other recoveries on outstanding claims - undiscounted		**330,062**	386,812
Discount to present value		**(897)**	(5,753)
Reinsurance and other recoveries on outstanding claims	2.3	**329,165**	381,059
Receivable within 12 months		**213,662**	131,826
Receivable in greater than 12 months		**115,503**	249,233
Reinsurance and other recoveries on outstanding claims	2.3	**329,165**	381,059

How we account for the numbers
The recoverability of amounts due from reinsurers is assessed at each balance date to ensure that the balances properly reflect the amounts ultimately expected to be received, taking into account counterparty credit risk and the contractual terms of the reinsurance contract. Counterparty credit risk in relation to reinsurance assets is considered in note 4.3. Recoveries are discounted to present value using the appropriate risk-free rate.

2.3.3 Risk Margin

Overview

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

The risk margin and the net discounted central estimate are key inputs in the determination of the probability of adequacy, which is a statistical measure of the relative adequacy of the net outstanding claims liability to ultimately be able to pay claims. For example, a 90% probability of adequacy indicates that the net outstanding claims liability is expected to be adequate 9 years in 10.

	NOTE	2020 $'000	2019 $'000
Risk margin ($'000)	2.3	**24,645**	23,145
Risk margin as a percentage of the net discounted central estimate (%)		**15.4%**	19.8%
Probability of adequacy (%)		**86.6%**	91.2%

Both the Reserve Bank of New Zealand (RBNZ) and the Australian Prudential Regulation Authority (APRA) require a probability of adequacy of 75% for the determination of minimum capital.

How we account for the numbers

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

Critical accounting judgements and estimates

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

- mix of business, in particular the mix of short tail and long tail business and the overall weighted average term to settlement; and
- the level of uncertainty in the central estimate due to estimation error, data quality, variability of key inflation assumptions and possible economic and legislative changes.

The variability by class of business is measured using techniques that determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. These techniques generally use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation.

At a fixed probability of adequacy, the appropriate risk margin for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in general insurance. The statistical measure used to determine diversification is called the correlation. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. For example, high correlation exists between classes of business affected by court cases involving bodily injury claims such as motor third party liability, workers' compensation and public liability, particularly in the same jurisdiction.

The probability of adequacy for the Branch is determined by analysing the variability of each class of business and the correlation between classes of business. Correlations are determined for aggregations of classes of business, where appropriate. The correlations adopted by the Branch are generally derived from industry analysis, the Branch's historical experience and the judgement of experienced and qualified actuaries.

2.3.4 Discount rate used to determine the outstanding claims liability

Overview

Claims in relation to long tail classes of business, for example professional indemnity and workers' compensation typically may not settle for many years. As such, the liability is discounted to reflect the time value of money. The table below summarises the first year discount rate used to discount the outstanding claims liability.

	2020 %	2019 %
Discount Rate	**0.18**	0.97

How we account for the numbers

NZ IFRS 4 *Insurance Contracts* requires that the outstanding claims provision shall be discounted for the time value of money using risk-free rates that are based on current observable, objective rates that relate to the nature, structure and terms of the future obligations. The standard also states that government bond rates may be an appropriate starting point in determining a risk-free rate. The Branch uses New Zealand discount rates.

2.3.5 Weighted average term to settlement

Overview

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

	2020 YEARS	2019 YEARS
Weighted average term to settlement	**1.56**	1.98

2.3.6 Net discounted central estimate including risk margin at 86.6% PoA maturity profile

Overview

The maturity profile is the Branch's expectation of the period over which the net central estimate including risk margin at 86.6% PoA will be settled. The Branch uses this information to ensure that it has adequate liquidity to pay claims as they are due to be settled and to inform the Branch's investment strategy. The expected maturity profile of the Branch's net discounted central estimate including risk margin at 86.6% PoA is analysed below.

		1 YEAR OR LESS	13 TO 24 Months	25 TO 36 MONTHS	37 TO 48 MONTHS	49 TO 60 MONTHS	OVER 5 YEARS	TOTAL
2020	**$'000**	**90,744**	**37,845**	**27,724**	**16,564**	**7,882**	**4,284**	**185,043**
2019	$'000	49,977	32,477	25,236	15,895	9,158	7,070	139,813

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

Overview

The impact of changes in key variables used in the calculation of the outstanding claims liability is summarised in the table below. Each change has been calculated in isolation from the other changes and shows the after tax impact on profit assuming that there is no change to any of the other variables. In practice, this is considered unlikely to occur as, for example, an increase in interest rates is normally associated with an increase in the rate of inflation. Over the medium to longer term, the impact of a change in discount rates is expected to be largely offset by the impact of a change in the rate of inflation.

The sensitivities below assume that all changes directly impact net profit after income tax, with the exception of the sensitivity on the coefficient of variation which shows impact on the 75th percentile risk margin after tax. In practice, however, if the central estimate was to increase, at least part of the increase may result in an offsetting change in the level of risk margins rather than in a change to net profit after income tax, depending on the nature of the change in the central estimate. Likewise, if the coefficient of variation were to increase, it is possible that the probability of adequacy would reduce from its current level rather than result in a change to net profit after income tax.

		PROFIT (LOSS)[1,2]	
	SENSITIVITY %	2020 $'000	2019 $'000
Net discounted central estimate	+5.0	**(5,763)**	(4,196)
	-5.0	**5,763**	4,196
Risk margin	+5.0	**(887)**	(833)
	-5.0	**887**	833
Inflation rate	+1.0	**(1,827)**	(1,647)
	-1.0	**1,796**	1,615
Discount rate	+1.0	**1,801**	1,604
	-1.0	**(1,869)**	(1,669)
Coefficient of variation	+1.0	**(658)**	(476)
	-1.0	**668**	484
Probability of adequacy	+1.0	**(874)**	(957)
	-1.0	**825**	831
Weighted average term to settlement	+10.0	**51**	221
	-10.0	**(51)**	(222)

[1] Net of tax at the Branch's prima facie income tax rate of 28%.
[2] The impact of a change in interest rates on profit after income tax due to market value movements on fixed interest securities is shown in note 4.4.

2.4 Claims development - net undiscounted central estimate

Overview

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

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

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

The claims development table is presented net of reinsurance, with a diverse range of insurance products and reinsurance arrangements and with the Branch's risk tolerance managed on a net basis.

Claims development - net undiscounted central estimate

	Prior	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
Net ultimate claims payments												
(a) Original estimate of net ultimate claims payments		52,500	44,970	53,734	55,905	66,220	123,686	103,545	105,099	105,317	111,808	822,784
(b) One year later		54,416	40,954	58,347	61,531	70,634	122,378	108,524	107,880	124,980		749,644
Two years later		53,258	47,757	57,699	57,670	67,690	116,640	108,651	104,978			614,343
Three years later		56,515	46,218	54,426	55,239	60,285	116,219	103,213				492,115
Four years later		54,073	44,060	51,474	54,486	61,671	111,436					377,200
Five years later		52,510	42,714	54,282	54,567	65,761						269,834
Six years later		52,330	36,847	54,246	55,249							198,672
Seven years later		53,164	37,472	54,279								144,915
Eight years later		53,016	47,882									100,898
Nine years later		50,730										50,730
(c) Current estimate of net ultimate claims payments		50,730	47,882	54,279	55,249	65,761	111,436	103,213	104,978	124,980	111,808	830,316
(d) Cumulative net payments to date		45,016	41,423	53,283	53,579	69,643	106,705	89,494	81,956	91,612	44,271	676,982
(e) Net undiscounted central estimate as at 31 Dec 2020	1,918	5,714	6,459	996	1,670	(3,882)	4,731	13,719	23,022	33,368	67,537	155,252
Discount to present value	(1)	(2)	(1)	(1)	(3)	53	10	(57)	(106)	(213)	(381)	(702)
Risk Margin	192	571	1,198	174	242	(783)	3,412	1,863	3,723	5,048	9,005	24,645
Claims settlement costs			225	98	41	92	473	669	616	1,879	1,754	5,847
(f) Net outstanding claims liability at 31 Dec 2020 (note 2.3)	-	-	-	-	-	-	-	-	-	-	-	185,042
(g) Movements in accident year undiscounted net claims estimate (note 2.4.1)	(1,980)	(2,286)	10,410	33	682	4,090	(4,783)	(5,438)	(2,902)	19,663	111,808	129,297

The material unfavourable development was driven by prior years, in particular 2019, 2015 and 2012. There were significant large losses in the Professional Indemnity and Liability portfolios, and reserving assumptions were strengthened in 2020.

How we account for the numbers

The Branch writes business in New Zealand dollar. All estimates of ultimate claims payments for the 10 most recent accident years are reported in functional currencies .

2.4.1 Reconciliation of claims development table to profit or loss

Overview

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

	2020			**2019**		
	CURRENT ACCIDENT YEAR $'000	**PRIOR ACCIDENT YEARS $'000**	**TOTAL $'000**	**CURRENT ACCIDENT YEAR $'000**	**PRIOR ACCIDENT YEARS $'000**	**TOTAL $'000**
Movement in net undiscounted central estimate (note 2.4)	**111,808**	**17,489**	**129,297**	105,317	1,576	106,893
Movement in claims settlement costs	**5,848**	**1,392**	**7,240**	7,173	1,141	8,314
Movement in discount	**221**	**188**	**409**	(734)	1,450	716
Movement in risk margin	**5,962**	**(4,462)**	**1,500**	10,309	(10,309)	-
Movement in net discounted central estimate (note 2.4.2)	**123,839**	**14,607**	**138,446**	122,065	(6,142)	115,923

2.4.2 Net outstanding claims development

Overview

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

	2020			2019		
	CURRENT ACCIDENT YEAR $'000	PRIOR ACCIDENT YEARS $'000	TOTAL $'000	CURRENT ACCIDENT YEAR $'000	PRIOR ACCIDENT YEARS $'000	TOTAL $'000
Gross outstanding claims development						
Undiscounted	**202,129**	**65,537**	**267,666**	318,982	43,519	362,501
Discount	**1,301**	**4,076**	**5,377**	(1,593)	11,489	9,896
	203,430	**69,613**	**273,043**	317,389	55,008	372,397
Reinsurance and other recoveries						
Undiscounted	**(78,511)**	**(51,317)**	**(129,828)**	(196,183)	(51,229)	(247,412)
RI Impairment	**-**	**199**	**199**	-	118	118
Discount	**(1,080)**	**(3,888)**	**(4,968)**	859	(10,039)	(9,180)
	(79,591)	**(55,006)**	**(134,597)**	(195,324)	(61,150)	(256,474)
Net outstanding claims development						
Undiscounted	**123,618**	**14,419**	**138,037**	122,799	(7,592)	115,207
Discount	**221**	**188**	**409**	(734)	1,450	716
Net outstanding claims estimate development (Note 2.4.1)	**123,839**	**14,607**	**138,446**	122,065	(6,142)	115,923

2.5 Unearned premium and deferred insurance costs

Overview

Unearned Premium

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

Deferred insurance costs

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

Acquisition costs are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised and amortised on the same basis as the pattern of the related premium. Commissions are a type of acquisition cost but are disclosed separately.

Summary of unearned premium and deferred insurance costs balances

	2020 $'000	2019 $'000
Unearned premium (a)	**278,710**	252,430
To be earned within 12 months	**263,227**	244,399
To be earned in greater than 12 months	**15,483**	8,031
Unearned premium	**278,710**	252,430
Deferred reinsurance premium	**11,469**	8,968
Deferred commission	**37,192**	33,829
Deferred acquisition costs	**11,700**	11,700
Deferred insurance costs (b)	**60,361**	54,497
To be expensed within 12 months	**57,992**	53,560
To be expensed in greater than 12 months	**2,369**	937
Deferred insurance costs	**60,361**	54,497
Unearned premium	**278,710**	252,430
Deferred insurance costs	**(60,361)**	(54,497)
Net premium liabilities (a) – (b)	**218,349**	197,933

Unearned premium movements

	2020 $'000	2019 $'000
At 1 January	**252,430**	235,379
Deferral of unearned premium on contracts written in the financial year	**270,679**	244,174
Earning of premium written in previous financial years	**(244,399)**	(227,123)
At 31 December	**278,710**	252,430

Deferred insurance costs movements

	DEFERRED REINSURANCE PREMIUM		DEFERRED COMMISSION		DEFERRED ACQUISITION COSTS	
	2020 $'000	2019 $'000	2020 $'000	2019 $'000	2020 $'000	2019 $'000
At 1 January	**8,968**	8,561	**33,829**	31,374	**11,700**	11,400
Costs deferred in financial year	**10,753**	8,116	**36,650**	33,294	**11,529**	11,315
Amortisation of costs deferred in previous financial years	**(8,252)**	(7,709)	**(33,287)**	(30,839)	**(11,529)**	(11,015)
At 31 December	**11,469**	8,968	**37,192**	33,829	**11,700**	11,700

How we account for the numbers

Unearned premium

Unearned premium is calculated based on the coverage period of the insurance or reinsurance contract in accordance with the related pattern of the incidence of risk, using either the daily pro-rate or the 24ths method, adjusted where appropriate to reflect different risk patterns.

Deferred insurance costs

Deferred reinsurance premium is calculated based on the period of indemnity provided to the Branch by the reinsurance contracts and in accordance with the related pattern of the incidence of risk.

Acquisition costs are capitalised when they relate to new business or the renewal of existing business and are amortised on the same basis as the earning pattern for that business. At the balance date, deferred acquisition costs represent the capitalised acquisition costs that relate to the unearned premium and are carried forward to a subsequent accounting period in recognition of their future benefit. The carrying value of deferred acquisition costs is subject to impairment testing in the form of the liability adequacy test (note 2.5.1).

Critical accounting judgements and estimates

A recognition (earning) pattern is determined for each product based on the expected pattern of the incidence of risk over the policy coverage period. Determination of the pattern requires estimating both the total amount of claims expense expected under the contract and when those claims are expected to arise. The Branch estimates the expected pattern of the incidence of risk using either the daily pro-rata method or the 24ths method, adjusted where appropriate to reflect different risk emergence patterns.

Acquisition costs incurred in obtaining and recording general insurance contracts are eligible to be deferred where they can be reliably measured and associated to unearned premium revenue. Direct acquisition costs such as commission and brokerage are readily measurable. Other costs are attributed to policy acquisition activities based on analyses of the type of expense and the nature of work performed. These analyses are updated annually.

2.5.1 Liability adequacy test

Overview

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

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

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

	2020 $'000	2019 $'000
Undiscounted net central estimate	**78,799**	72,851
Discount to present value	**(231)**	(1,005)
	78,568	71,846
Risk margin at the 75th percentile of insurance liabilities	**7,193**	7,330
Expected present value of net future cash flows for future claims including risk margin	**85,761**	79,176

How we account for the numbers

At each balance date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future claims cash flows, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. The assessment is carried out at the portfolio level, being a portfolio of contracts subject to broadly similar risks and which are managed together as a single portfolio.

The application of the liability adequacy test in respect of net unearned premium liabilities identified a surplus at 31 December 2020 and 31 December 2019.

Critical accounting judgements and estimates

The Branch has adopted a risk margin of 9.2% (2019: 10.2%) for the purpose of the liability adequacy test to produce a 75% probability of adequacy in respect of total insurance liabilities. The 75% basis is a recognised industry benchmark in New Zealand and Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA.

2.6 Trade and other receivables

Overview

Trade and other receivables are principally amounts owed to the Branch by policyholders and related entities.

	2020 $'000	2019 $'000
Trade receivables		
Premium receivable[1]	**115,559**	93,593
Reinsurance and other recoveries on paid claims[2]	**43,647**	7,369
Unclosed premium, net of unclosed commission	**41,722**	44,725
	200,928	145,687
Amounts due from related entities	**729**	129
Other receivables	**2,842**	2,704
Accrued interest income	**7,745**	11,287
Prepayments	**651**	877
Trade and other receivables	**212,895**	160,684
Receivable within 12 months	**212,895**	160,684
Receivable in greater than 12 months	**-**	-
Trade and other receivables	**212,895**	160,684

[1] Net of a provision for impairment of $1.6m (2019: $0.4m).
[2] Net of a provision for impairment of $0.2m (2019: nil).

Amounts due from related entities are interest free and repayable on demand.

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

The maximum exposure to credit risk at the reporting date is the fair value of each class of receivables. No receivables are pledged by the Branch as collateral for liabilities or contingent liabilities. Information on the ageing and credit rating of these balances is included in note 4.3.

How we account for the numbers

Amounts owed to the Branch are financial assets within the scope of NZ IFRS 9 *Financial Instruments* except for those amounts which represent rights due under an insurance contract as defined in NZ IFRS 4 *Insurance Contracts.*

Premium and reinsurance receivables are excluded from the scope of NZ IFRS 9. These are initially recognised at fair value and are subsequently measured at amortised cost less any impairment. Premium receivables include unclosed premiums, which are estimated amounts due to the Branch in relation to business for which the Branch is on risk but where the policy is not billed to the counterparty at the balance date.

A provision for impairment on premium or reinsurance receivables is established when there is objective evidence that the Branch will not be able to collect all amounts due according to the original term of the receivable. Any increase or decrease in the provision for impairment is recognised in profit or loss within underwriting and other expenses for those losses attributable to premiums, and within reinsurance and other recoveries revenue for those losses attributable to reinsurance recoveries on paid claims.

Receivables within the scope of NZ IFRS 9 are managed to collect contractual cash flows and their contractual terms generate cash flows that are solely payments of principal (and interest thereon, where applicable). Receivables are initially recognised at fair value and are subsequently measured at amortised cost less an allowance for impairment.

Impairment of receivables within the scope of NZ IFRS 9 is calculated as an allowance for expected credit losses (ECLs). Any increase or decrease in the allowance for ECLs is recognised in profit or loss within underwriting and other expenses.

For assets with low credit risk or where credit risk has not significantly increased, expected credit losses are limited to those within the next 12 months. For assets where credit risk has significantly increased, expected credit losses are those across the asset's lifetime. For assets where there is evidence of current impairment, incurred credit losses are also recognised in addition to the expected credit losses previously described.

Critical accounting judgements and estimates

For receivables outside the scope of NZ IFRS 9, an allowance for impairment is established when there is objective evidence that the Branch will not be able to collect all amounts due according to the original term of the receivable. The Branch regularly reviews the collectability of receivables and the adequacy of allowances for impairment. Information on the ageing of these balances is included in note 4.3.

For receivables within the scope of NZ IFRS 9, the allowance for ECLs is based on the difference between the cash flows due in accordance with the contract and the cash flows that the Branch expects to receive. The allowance for ECL's reflects judgements and assumptions that take into account prior credit risk and loss history, current and expected future market conditions and individual debtor circumstances. Any shortfall is discounted at an approximation to the asset's original effective interest rate.

The Branch has applied the simplified approach permitted by NZ IFRS 9 with regard to customer contract assets and has calculated the allowance for impairment with reference to lifetime ECLs.

For all other receivables within the scope of NZ IFRS 9, the allowance is based on the portion of lifetime ECLs that result from possible default events within 12 months from reporting date, unless there has been a significant increase in credit risk since initial recognition, in which case the allowance is based on the lifetime ECLs.

The Branch considers that credit risk on receivables within the scope of NZ IFRS 9 has not increased significantly since initial recognition, and that these assets represent low credit risks, taking into account the credit standing of the counterparties, the nature of the exposures, and QBE Group policies and procedures surrounding settlement of intra-group balances.

The Branch foresees negligible credit losses arising on these receivables from possible default events and considers that no allowance for impairment is required at 31 December 2020.

Goods and services tax (GST)

The Statement of Comprehensive Income and Statement of Cash Flows have been prepared on a GST exclusive basis. All items in the Balance Sheet are stated net of GST, with the exception of receivables and payables, which include GST invoiced.

QBE INSURANCE (AUSTRALIA) LIMITED
New Zealand Branch

NOTES TO THE FINANCIAL STATEMENTS
For the year ended 31 December 2020

2.7 Trade and other payables

Overview

Trade payables primarily comprise amounts owed to reinsurance counterparties and cedants and related entities.

	2020 $'000	2019 $'000
Trade payables	**25,074**	21,070
Reinsurance premium payables	**11,593**	1,934
Amounts due to related entities	**139**	-
Accrued expenses	**1,635**	1,266
Other payables[1]	**19,069**	17,747
Trade and other payables	**57,510**	42,017
Payable within 12 months	**51,576**	36,731
Payable in greater than 12 months	**5,934**	5,286
Trade and other payables	**57,510**	42,017

[1] Includes dismantling provision of $0.3m (2019: $0.3m).

Amounts due to reinsurers and third parties are settled under standard terms and conditions. Amounts due to related entities are repayable on demand and interest fee.

How we account for the numbers

Amounts owed by the Branch are financial liabilities within the scope of NZ IFRS 9 except for those amounts which represent obligations under an insurance contract as defined in NZ IFRS 4 *Insurance Contracts.* and lease liabilities as defined under NZ IFRS 16 *Leases.*

Reinsurance premium payables represent obligations under an insurance contract as defined in NZ IFRS 4 and are outside the scope of NZ IFRS 9. They are initially recognised at fair value and are subsequently measured at amortised cost.

Amounts due to related entities and other payables within the scope of NZ IFRS 9 are recognised at amortised cost.

There were no customer contract liabilities at 31 December 2020 (2019: nil). The Branch has no obligations to fulfill services to customers for which it has already received consideration (or an amount of consideration is due) from the customers.

2.8 Leases

Overview

The Branch leases various premises and motor vehicles. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. Leases are typically made for fixed periods of 3 to 12 years but may have extension options.

a) Right-of-use assets

2020	BUILDINGS $'000	OTHERS $'000	TOTAL $'000
Right-of-use assets at 1 January 2020	13,225	991	14,216
Additions during the year	39	15	54
Disposals during the year	-	(32)	(32)
Right-of-use assets at 31 December 2020	13,264	974	14,238
Accumulated depreciation at 1 January 2020	(2,451)	(314)	(2,765)
Depreciation charge for the year	(1,427)	(315)	(1,742)
Disposals during the year	-	24	24
Accumulated depreciation at 31 December 2020	(3,878)	(605)	(4,483)
Net right-of-use assets at 31 December 2020	9,386	369	9,755

2019	BUILDINGS $'000	OTHERS $'000	TOTAL $'000
Right-of-use assets at 1 January 2019	-	-	-
Adjustment on initial application of NZ IFRS 16	12,795	932	13,727
Additions during the year	430	125	555
Disposals during the year	-	(66)	(66)
Right-of-use assets at 31 December 2019	13,225	991	14,216
Accumulated depreciation at 1 January 2019	-	-	-
Transition adjustment	(994)	-	(994)
Depreciation charge for the year	(1,457)	(353)	(1,810)
Disposals during the year	-	39	39
Accumulated depreciation at 31 December 2019	(2,451)	(314)	(2,765)
Net right-of-use assets at 31 December 2019	10,774	677	11,451

b) Lease liabilities

	2020 $'000	2019 $'000
Lease liabilities at 1 January	13,706	-
Adjustment on initial application of NZ IFRS 16	-	13,857
Additions during the year	47	555
Disposals during the year	-	(19)
Principal repayments	(1,606)	(687)
Lease liabilities at 31 December	12,147	13,706
Principal repayments	1,606	687
Interest	498	529
Total repayments	2,104	1,216

The maturity profile of the discounted lease liability at 31 December 2020 is disclosed below.

	DISCOUNTED 2020 $'000	DISCOUNTED 2019 $'000
Payable:		
Not later than one year	**1,597**	1,607
Later than one year but less than five years	**5,090**	5,418
Later than five years	**5,460**	6,681
Total future minimum lease payments under non-cancellable operating leases	**12,147**	13,706

How we account for the numbers

Until the 2019 financial year, leases were classified as either finance leases or operating leases. All the Branch leases were classified as operating leases.

NZ IFRS 16 *Leases* was adopted with effect from 1 January 2019 and established new accounting requirements for leases. The new standard was adopted in accordance with its transitional provisions which did not require restatement of comparative periods.

Lease liabilities are measured as the present value of future lease payments net of incentives, discounted using the Branch's incremental borrowing rate. The weighted average incremental borrowing rate as of 31 December 2020 was 4.00% (2019: 3.69%). Lease payments to be made under reasonably certain extension options are also included in the measurement of the liability.

Right-of-use assets are measured at cost, which principally comprises the amount of the lease liability and the estimated restoration cost at the end of the lease. Right-of-use assets are depreciated over the shorter of the asset's useful life and the lease term, on a straight-line basis.

Lease liabilities of $13,857,000 and right-of-use lease assets of $13,727,000 were recognised on initial application of NZ IFRS 16 16 on 1 January 2019. The permitted practical expedients in relation to determining whether leases are onerous and the use of hindsight to assess lease terms were utilised on initial application. There was no material difference between lease liabilities recognised in the statement of financial position on initial application of NZ IFRS 16 and operating lease commitments as disclosed under NZ IAS 117 at 31 December 2018 discounted using the incremental borrowing rates.

Lease payments are allocated between principal and finance cost. The finance cost is charged to profit or loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The Branch is required to restore the leased assets to their original condition at the end of the respective lease terms. A provision of $318,531 has been recognised for the present value of the estimated expenditure required to remove any leasehold improvements (2019: $308,687) (Note 2.7).

Additions to right-of-use assets during the year amounting to $55,000 (2019: $555,000) pertains to new contracts during the year. Disposals amounting to $32,000 (2019: $39,000) pertains to retirements and expirations of right of use assets for the period.

In the statement of comprehensive income, the depreciation charge associated with right-of-use lease assets of $1,741,702 (2019: $1,811,227) and lease finance costs of $510,228 (2019: $538,540) are recognised under expenses.

Costs of leases of low value assets and leases with a term of 12 months or less (which do not give rise to right-of-use lease assets or lease liabilities on the balance sheet) are recognised in other expenses.

In the statement of cash flows, payments of interest relating to lease liabilities are recognised as interest paid on finance liabilities under cash flows from operating activities and payments of principal relating to lease liabilities are recognised as lease payments under cash flows from financing activities.

These replace operating lease payments which were previously recognised entirely in acquisition and other underwriting costs paid. The impact of these changes on the previous period was not material.

Critical accounting judgements and estimates

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option. Extension options are only included in the lease term if the lease is reasonably certain to be extended.

The incremental borrowing rate used to discount future lease payments is a proxy for the interest rate implicit in the lease, and is the rate that the Branch would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

2.9 Property, plant and equipment

2020	LEASEHOLD IMPROVEMENTS $'000	OFFICE EQUIPMENT / FURNITURE & FITTINGS $'000	TOTAL $'000
Cost or valuation			
At 1 January	**5,071**	**3,642**	**8,713**
Additions	**30**	**192**	**222**
Disposals	**-**	**(407)**	**(407)**
At 31 December	**5,101**	**3,427**	**8,528**
Accumulated depreciation and impairment losses			
At 1 January	**(1,774)**	**(1,538)**	**(3,312)**
Disposals	**-**	**333**	**333**
Depreciation charged for the year	**(427)**	**(382)**	**(809)**
At 31 December	**(2,201)**	**(1,587)**	**(3,788)**
Carrying amount			
At 31 December	**2,900**	**1,840**	**4,740**

2019	LEASEHOLD IMPROVEMENTS $'000	OFFICE EQUIPMENT / FURNITURE & FITTINGS $'000	TOTAL $'000
Cost or valuation			
At 1 January	6,160	3,525	9,685
Transitional adjustment	(1,152)	-	(1,152)
Additions	63	119	182
Disposals	-	(2)	(2)
At 31 December	5,071	3,642	8,713
Accumulated depreciation and impairment losses			
At 1 January	(1,145)	(1,133)	(2,278)
Disposals	-	2	2
Depreciation charged for the year	(629)	(407)	(1,036)
At 31 December	(1,774)	(1,538)	(3,312)
Carrying amount			
At 31 December	3,297	2,104	5,401

All items of property, plant and equipment are used to fulfil contracts with customers. Depreciation is included in the amount of expenses used to determine management fee income.

How we account for the numbers

All property, plant and equipment is stated at historical cost less accumulated depreciation and impairment. An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Items of property, plant and equipment are depreciated over their estimated useful life in accordance with the expected pattern in which the asset's future economic benefits are expected to be consumed by the Branch. The Branch has adopted the straight-line method of depreciation as most reflective of the expected pattern of consumption.

The Branch has adopted the following useful lives:

- Furniture and Fittings — up to 10 years
- Leasehold Improvements — term of the lease, subject to a maximum of 10 years
- Motor Vehicles — up to 8 years
- Office equipment — up to 10 years

3. INVESTMENT ACTIVITIES

Overview

Premiums collected from policyholders are invested to meet the Branch's cash flow needs to pay claims and other expenses, as well as generate a return that contributes to the Branch's profitability. A sound investment strategy is therefore integral to the success of an insurer's operations.

The Branch invests across a diversified range of instruments to achieve an appropriate balance between risk and return. Decisions on where to invest are dependent on expected returns, cash flow requirements of the Branch, liquidity of the instrument, credit quality of the instrument and the overall risk appetite of the Branch. Further details on the management of risk associated with investment assets can be found in note 4.

3.1 Net investment income

	2020 $'000	2019 $'000
Income on growth assets	-	78
Income on fixed interest securities, short-term money and cash	14,807	16,276
Net fair value gains on financial assets	(1,926)	(1,531)
Gross investment income	12,881	14,823
Investment expenses	(463)	(440)
Net investment income	12,418	14,383
Foreign exchange losses	(2,942)	(45)
Net investment income	9,476	14,338

How we account for the numbers

Interest income is recognized in the period in which it is earned. Dividends are recognized when the right to receive payment is established. Investment income includes realized and unrealized gains or losses on financial assets which are reported on a combined basis as fair value gains or losses on financial assets.

3.2 Investment assets

	2020 $'000	2019 $'000
Fixed income		
Short-term money	**80,208**	144,106
Government bonds	**134,736**	127,976
Corporate bonds	**399,493**	264,148
	614,437	536,230
Growth assets		
Developed market equity	**-**	5,040
Total investments	**614,437**	541,270
Amounts maturing within 12 months	**366,673**	240,196
Amounts maturing in greater than 12 months	**247,764**	301,074
Total investments	**614,437**	541,270

How we account for the numbers

Investment assets are financial assets within the scope of NZ IFRS 9. The Branch's investments were designated as at fair value through profit or loss on initial recognition and subsequently remeasured to fair value at each reporting date, reflecting the Branch's business model for managing and evaluating the investment portfolio. The fair value hierarchy and the Branch's approach to measuring the fair value of each investment instrument is disclosed in note 3.3.

Assets that are subsequently measured at fair value through profit or loss are not subject to impairment considerations under the ECL methodology.

All purchases and sales of investments that require delivery of the asset within the time frame established by regulation or market convention are recognised at trade date, being the date on which the Branch commits to buy or sell the asset. Investments are derecognised when the right to receive future cash flows from the asset has expired or has been transferred and the Branch has transferred substantially all the risks and rewards of ownership.

3.3 Fair value hierarchy

Overview

The QBE Group Valuation Committee is responsible for the governance and oversight of the valuation process. The fair value of investments is determined in accordance with the QBE Group's investment valuation policy which has been adopted by the Branch.

The investments of the Branch are disclosed in the table below using a fair value hierarchy which reflects the significance of inputs into the determination of fair value as follows:

Level 1: Valuation is based on quoted prices in active markets for the same instruments.

Level 2: Valuation is based on quoted prices for identical instruments in markets which are not active, quoted prices for similar instruments, or valuation techniques for which all significant inputs are based on observable market data, for example, consensus pricing using broker quotes or valuation models with observable inputs.

Level 3: Valuation techniques are applied in which one or more significant inputs are not based on observable market data.

	2020				2019			
	LEVEL 1 $'000	LEVEL 2 $'000	LEVEL 3 $'000	TOTAL $'000	LEVEL 1 $'000	LEVEL 2 $'000	LEVEL 3 $'000	TOTAL $'000
Fixed income								
Short-term money	**208**	**80,000**	-	**80,208**	134,148	9,958	-	144,106
Government Bonds	**107,146**	**27,589**	-	**134,735**	41,832	86,144	-	127,976
Corporate Bonds	-	**399,494**	-	**399,494**	-	264,148	-	264,148
	107,354	**507,083**	-	**614,437**	175,980	360,250	-	536,230
Growth assets								
Developed market equity	-	-	-	-	5,040	-	-	5,040
Total investments	**107,354**	**507,083**	-	**614,437**	181,020	360,250	-	541,270

The Branch's approach to measuring the fair value of investments is described below:

Short-term money
Term deposits are valued at par plus accrued interest and are categorised as level 2 fair value measurements. Other short-term money (bank bills, certificates of deposit, treasury bills and other short-term instruments) are priced using interest rates and yield curves observable at commonly quoted intervals, and is categorised as level 1 investments.

Government bonds and corporate bonds
Bonds which are traded in active markets and have quoted prices from external data providers are categorised as level 1 fair value measurements. Bonds which are not traded in active markets are priced using broker quotes, using comparable prices for similar instruments or using pricing techniques set by local regulators or exchanges.

Developed market equity
Listed equities traded in active markets are valued by reference to quoted bid prices.

4. RISK MANAGEMENT

Overview

The Company is in the business of managing risk, and its ability to satisfy customers' risk management needs is central to what we do. The Company aims to generate wealth and maximise returns for its shareholders by pursuing opportunities that involve risk. Our people are responsible for ensuring that the Company's risks, including those of the Branch, are managed and controlled on a day-to-day basis. The Company aims to use its ability to properly manage risk to provide more certainty and improved outcomes for all stakeholders.

The Australia Pacific division of QBE Group (QBE AusPac), of which the Company is a part, applies a consistent and integrated approach to enterprise risk management (ERM). QBE AusPac's risk management framework sets out the approach to managing key risks and meeting strategic objectives whilst taking into account the creation of value for our shareholders. QBE AusPac's risk management framework is articulated in the Risk Management Strategy (RMS) and Reinsurance Management Strategy (REMS), both of which are approved annually by the Company Board and lodged with APRA.

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

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

QBE Group's strategy for managing risk is to:

- achieve competitive advantage by better understanding the risk environments in which the Branch operates;
- give confidence to the business to make objective, risk-based decisions to optimise returns; and
- avoid unwelcome surprises to the achievement of business objectives by reducing uncertainty and volatility through the identification and management of risks.

The framework is supported by a suite of policies that detail QBE AusPac's approach to the key risk categories used by companies within the division to classify risk:

- Strategic risk (note 4.1)
- Insurance risk (note 4.2)
- Credit risk (note 4.3)
- Market risk (note 4.4)
- Liquidity risk (note 4.5)
- Operational risk (note 4.6)
- Compliance risk (note 4.7)
- Group risk (note 4.8)

The Company has adopted the risk management approach and framework set by QBE Group and QBE AusPac, and applied them to the activities of the Branch, where applicable.

4.1 Strategic risk

Overview

Strategic risk is the current and prospective impact on earnings and/or capital as a result of strategic business decisions or responsiveness to external change. QBE AusPac classifies strategic risk into five sub-categories, that have been adopted by the Company, as follows:

- business, product, market and distribution approach;
- capital structure, organisational structure, strategic asset planning and management;
- acquisition/disposal decision and negotiation;
- tax planning and decisioning; and
- external environment, including disruption from competitors; economic, social and governance risks; reputational impact; and geo-political and regulatory uncertainty.

The Company's approach to managing strategic risk is underpinned by the QBE AusPac's strategic risk appetite statement that has been adopted by the Company Board and is summarised below.

Business, product and market distribution

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

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

Market distribution approach: The Company makes use of distributed networks of insurance agents and brokers to undertake sales and marketing of its insurance products. The Company also markets and distributes insurance products directly by telephone and on the internet.

Capital structure and management

The Internal Capital Adequacy Assessment process (ICAAP) outlines the Company's approach for ensuring adequate capital is maintained over time and for monitoring compliance with regulatory capital requirements and targets.

The ICAAP includes:

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

The ICAAP also sets out the Company's actions and procedures for monitoring compliance with its regulatory capital requirements and capital targets. These include:

- the setting of triggers to alert management to potential breaches of these requirements; and
- actions to avert and rectify potential breaches of these requirements.

Achieving capital targets is dependent on an appropriate level and mix of capital, and effective capital management to yield adequate returns. Oversight of the Company's capital management framework is performed by senior management, the the QBE AusPac Executive Risk and Capital Committee and the Company Board Risk and Capital Committee.

Management has a focus on the following performance indicators:

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

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

Tax risk management

The Company's approach to managing taxation risk is underpinned by QBE Group Tax Risk Policy.

. The Company's approach to tax management is based on the following guiding principles:

- the Company seeks open, honest and transparent relationships with tax authorities in all relevant jurisdictions;
- the Company will comply with all applicable tax laws, regulations and disclosure requirements and pay the amount of tax that is legally required to be paid in all the jurisdictions in which the Company operates;
- the Company engages in efficient tax planning that supports our business and reflects commercial and economic activity – no transaction will be entered into where obtaining a tax benefit is the primary purpose; and
- the Company conducts transactions with other QBE companies on an arm's length basis in accordance with current Organisation for Economic Cooperation and Development (OECD) principles.

External environment, including disruption from competitors; economic, social and governance (ESG) risks; reputational impact; and geo-political and regulatory uncertainty

The QBE Group Strategic Risk Policy governs the management of risks arising from the external environment.

Competitor actions, geo- political and regulatory uncertainty are monitored and regularly reported to the Company Board.

QBE Group's ESG Risk and Emerging Risk standards operationalise the Company's approach to managing ESG and emerging risks respectively, including climate change. Biannual horizon scans are performed on ESG and emerging risks, including assessment of potential financial and reputational impacts. Risk treatment plans are developed for material risks, which include development of underwriting and investment policy, monitoring frameworks and stress and scenario analysis. ESG risks and emerging risks are regularly reported to the QBE AusPac Executive Risks and Capital Committee and the Company Board Risk and Capital Committee.

Climate change is a material business risk for the Company, potentially impacting our business and customers in the medium to long-term. We have considered potential short-term scenarios that could affect our insurance business written to date and our current investments, and we expect no material impact on the amounts recognised or disclosed in the financial statements.

Investment strategy

The Company's approach to investment risk is underpinned by the QBE AusPac's investment strategy, which is designed to achieve absolute return targets within pre-defined risk and capital constraints whilst meeting regulatory requirements. The strategy requires the Company to invest in a range of asset classes with portfolios consisting mainly of investment grade fixed income securities. The mix of assets is subject to the appetite set by the Company's Board.

4.2 Insurance risk

Overview

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

QBE AusPac classifies insurance risk into four subcategories:

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

The Company's approach to managing insurance risk is underpinned by QBE AusPac's insurance risk appetite statement and Insurance Risk Policy, which have been approved by the Company Board and is summarised below.

Underwriting risk

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

The Branch's underwriting strategy aims to diversify and limit the type of insurance risks accepted and reduce the variability of the expected outcome. The underwriting strategy is implemented through the Branch's annual business planning process, supported by underwriting authorities. These authorities reflect the level of risk that the Branch is prepared to take with respect to each permitted insurance class.

Pricing of risks is controlled by the use of in-house pricing models relevant to specific portfolios and the markets in which the Branch operates. Underwriters and actuaries maintain pricing and claims analysis for each portfolio, combined with a knowledge of current developments in the respective markets and classes of business.

Insurance concentration risk

The Branch's exposure to concentration of insurance risk is mitigated by maintaining a portfolio that is diversified across several classes of business. Product diversification is pursued through a strategy of developing strong underwriting skills in a wide variety of classes of business.

The table below demonstrates the diversity of the Branch's operations.

GROSS EARNED PREMIUM	2020 $'000	2019 $'000
Commercial accident	**3,105**	2,777
Commercial motor	**89,200**	84,436
Engineering	**25,389**	21,570
Householders	**164**	567
Marine	**6,139**	6,179
Personal accident	**369**	417
Private motor	**120**	532
Professional indemnity	**67,026**	63,052
Property	**199,752**	179,918
Public liability	**65,889**	63,184
Surety	**122**	231
Travel	**4**	2,484
Trade credit	**9,505**	8,935
	466,784	434,282

Concentration risk includes the risks from natural or man-made events that have the potential to produce claims from many of the Branch's policyholders at the same time, for example catastrophes. The Branch currently uses a variety of methodologies to monitor aggregates and manage catastrophe risk. These include the use of catastrophe models such as probable maximum loss and realistic disaster scenarios (RDS). The Branch sets the risk appetite relating to catastrophe risk with reference to the insurance concentration risk charge (ICRC). The Branch's maximum risk tolerance for an individual natural catastrophe, measured using the ICRC methodology, is determined annually and is linked to budgeted net earned premium.

Reserving risk

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

Reinsurance risk

The Branch limits its exposure to an individual catastrophe or an accumulation of claims by reinsuring a portion of risks underwritten. This allows the Branch to control exposure to insurance losses, reduce volatility of reported results and protect capital. Risks associated with reinsurance counterparty credit risk are discussed in note 4.3.

4.3 Credit risk

Overview

Credit risk is the risk of not recovering money owed to the Branch by third parties as well as the loss of value of assets due to deterioration in credit quality. The Branch's exposure to credit risk arises from financial transactions with securities issuers and/or a reduction or delay in repayments or interest payments from the default of counterparties such as debtors, brokers, policyholders, reinsurers and guarantors. The Branch categorises credit risk into three sub-categories, as follows:

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

The Company's approach to managing credit risk is underpinned by the QBE AusPac's credit risk appetite and Credit Risk Policy,which has been approved by the Company Board and is summarised below.

Reinsurance counterparty credit risk

The Company's objective is to place reinsurance, including that for the Branch, with highly rated counterparties. Concentration of risk with reinsurance counterparties is monitored strictly and regularly by QBE Group Security Committee and is controlled by reference to the following protocols:

- treaty or facultative reinsurance is placed in accordance with the requirements of the Company's REMS and security committee guidelines;
- reinsurance arrangements are regularly reassessed to determine their effectiveness based on current exposures, historical claims and potential future losses based on the Company's insurance concentrations; and
- exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored.

The following table provides information about the quality of the Branch's credit risk exposure in respect of reinsurance recoveries on outstanding claims at the balance date. The analysis classifies the assets according to Standard & Poor's (S&P) counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

		CREDIT RATING					
		AAA	AA	A	BBB	NOT RATED	TOTAL
		$'000	$'000	$'000	$'000	$'000	$'000
Reinsurance recoveries on outstanding claims	**2020**	**-**	**37,899**	**285,795**	**368**	**-**	**324,062**
	2019	-	23,660	363,152	-	-	386,812
Reinsurance recoveries on paid claims	**2020**	**-**	**721**	**42,923**	**3**	**-**	**43,647**
	2019	-	1,577	5,792	-	-	7,369

The following table provides further information regarding the ageing of reinsurance recoveries on paid claims at the balance date.

			PAST DUE BUT NOT IMPAIRED				
		NEITHER PAST DUE NOR IMPAIRED $'000	0 TO 3 MTHS $'000	4 TO 6 MTHS $'000	7 MTHS TO 1 YEAR $'000	GREATER THAN 1 YEAR $'000	TOTAL $'000
Reinsurance recoveries on paid claims[1]	**2020**	**-**	**43,593**	**35**	**19**	**-**	**43,647**
	2019	6,801	234	317	17	-	7,369

[1] Net of a provision for impairment of $0.2m (2019: nil).

Investment counterparty credit risk

The Company, including the Branch, only transacts with investment counterparties within the limits outlined in the delegated authorities. Investment counterparty exposure limits are applied to individual counterparty exposures and to multiple exposures within the one group of related companies in relation to investments, cash deposits and forward foreign exchange exposures. Counterparty exposure limit compliance is monitored daily.

The following table provides information regarding the Branch's aggregate credit risk exposure at the balance date in respect of the major classes of financial assets. The analysis classifies the assets according to S&P counterparty credit ratings. AAA is the highest possible rating. Rated assets falling outside the range of AAA to BBB are classified as speculative grade.

	CREDIT RATING						
	AAA $'000	AA $'000	A $'000	BBB $'000	SPECULATIVE GRADE $'000	NOT RATED $'000	TOTAL $'000
As at 31 December 2020							
Cash and cash equivalents	**-**	**3,379**	**-**	**-**	**-**	**-**	**3,379**
Interest-bearing investments	**10,194**	**604,094**	**149**	**-**	**-**	**-**	**614,437**
As at 31 December 2019							
Cash and cash equivalents	-	20,415	-	-	-	-	20,415
Interest-bearing investments	-	541,270	-	-	-	-	541,270

The carrying amount of the relevant asset classes in the balance sheet represents the maximum amount of credit exposure. The fair value of derivatives shown on the balance sheet represents the current risk exposure but not the maximum risk exposure that could arise in the future as a result of changing values.

Premium and other counterparty credit risk

The Company, including the Branch, only transacts with brokers that are reputable, suitable and approved in accordance with local broker policies. The continuous due diligence over brokers involves an assessment of the broker's reputation, regulatory standing and financial strength.

The Branch regularly reviews the collectability of receivables and the adequacy of associated provisions for impairment. Concentration risk for larger brokers is also monitored. Balances are monitored on the basis of uncollected debt and debt outstanding in excess of six months. Brokers are also subject to regular due diligence to ensure adherence to local broker policies and associated requirements.

The following table provides information regarding the ageing of the Branch's financial assets that are past due but not impaired and which are largely unrated at the balance date.

		PAST DUE BUT NOT IMPAIRED				
	NEITHER PAST DUE NOR IMPAIRED $'000	0 TO 3 MTHS $'000	3 TO 6 MTHS $'000	6 MTHS TO 1 YEAR $'000	GREATER THAN 1 YEAR $'000	TOTAL $'000
At 31 December 2020						
Amounts due from related entities	**729**	-	-	-	-	**729**
Premium receivable[1]	**106,979**	**6,727**	**1,853**	-	-	**115,559**
Interest accrued and other receivables	**10,587**	-	-	-	-	**10,587**
At 31 December 2019						
Amounts due from related entities	129	-	-	-	-	129
Premium receivable[1]	88,979	3,377	813	-	424	93,593
Interest accrued and other receivables	13,991	-	-	-	-	13,991

[1] Net of a provision for impairment of $ 1.6m (2019: $0.4m).

4.4 Market risk

Overview

Market risk is the risk of variability in the value of investments due to:

- investment market movement (including equity prices, interest rates and credit spreads); and
- foreign exchange rate movement.

The Company's approach to managing market risk is underpinned by its market risk appetite and the Market Risk Policy, which has been approved by the Company Board and is summarised below.

The Company's approach to managing investment market movements is underpinned by the QBE AusPac's investment strategy which outlines QBE Group's view of the markets and its corresponding investment approach.

Investment market risk is managed through the application of exposure and asset limits. These limits are based on the market risk appetite as determined by the Company Board and apply to:

- losses generated on the investment portfolio under a market stress scenario. The scenario assumes adverse movements in market factors and is designed to reflect a significant market stress event;
- sensitivities to changes in interest rate and credit spreads, measured in terms of modified duration and spread duration; and

- total combined holdings in equity and other growth assets as a proportion of the Branch's total investment portfolio.

Interest rate risk

The Branch is exposed to interest rate risk through its holdings in interest-bearing assets. Financial instruments with a floating interest rate expose the Branch to cash flow interest rate risk, whereas fixed interest rate instruments expose the Branch to fair value interest rate risk.

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

The net central estimate of outstanding claims is discounted to present value by reference to risk-free interest rates. The Branch is therefore exposed to potential underwriting result volatility as a result of interest rate movements. In practice, over the longer term, an increase or decrease in interest rates is normally offset by a corresponding increase or decrease in inflation. Details are provided in note 2.3.7. The Branch maintains a relatively short asset duration relative to policyholders' funds. At 31 December 2020, the average modified duration of cash and fixed interest securities was 1.06 years (2019: 1.20 years).

All investments are financial assets measured at fair value through profit or loss. Movements in interest rates impact the value of interest-bearing financial assets and therefore impact reported profit after tax. The impact of a 0.5% increase or decrease in interest rates on interest-bearing financial assets owned by the Branch at the balance date is shown in the table below.

	SENSITIVITY %	PROFIT (LOSS)[1] 2020 $'000	2019 $'000
Interest rate movement – interest-bearing financial assets	+0.5	**(2,364)**	(2,409)
	-0.5	**2,159**	2,409

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

Price risk

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

At 31 December 2020, the Branch had nil investments in listed equities trusts (2019: $5m). The Branch is exposed to price risk on its investment in corporate fixed interest securities. All corporate securities are measured at fair value through profit or loss. Movements in credit spreads impact the value of corporate fixed interest and floating rate securities and therefore impact reported profit after tax.

The Branch is also exposed to price risk on its interest-bearing financial assets. All securities are measured at fair value through profit or loss. Movements in credit spreads impact the value of corporate interest-bearing securities and therefore impact reported profit after tax. This risk is managed by investing in high quality, liquid interest-bearing securities and by managing the credit spread duration of the corporate securities portfolio.

The impact of either a 0.5% increase or decrease in credit spreads on interest-bearing financial assets held by the Branch at the balance date is shown in the table below.

		PROFIT (LOSS)[1]	
	SENSITIVITY	**2020**	**2019**
	%	**$'000**	**$'000**
Credit spread movement – corporate interest-bearing financial assets	+0.5	**(159)**	(371)
	-0.5	**76**	346

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

Foreign exchange

The Branch's approach to foreign exchange management is underpinned by the QBE AusPac's foreign currency strategy. The Company's foreign exchange exposure generally arises as a result of either the translation of foreign currency amounts to the functional currency (operational currency risk).

Operational currency risk

Operational currency risk is managed as follows:

- the Branch manages the volatility arising from changes in foreign exchange rates by matching liabilities with assets of the same currency, as far as is practicable, thus ensuring that any exposures to foreign currencies are minimised; and
- forward foreign exchange contracts are used where possible to protect residual currency positions. These forward foreign exchange contracts are accounted for in accordance with the derivatives accounting policy set out in note 5.4.

Foreign exchange gains or losses arising from operational foreign currency exposures are reported in profit or loss consistent with the gains or losses from related forward foreign exchange contracts. The risk management process covering the use of forward foreign exchange contracts involves close senior management scrutiny, including regular Board and other management reporting. All forward foreign exchange contracts are subject to delegated authority levels provided to management and the levels of exposure are reviewed on an ongoing basis.

The Branch's aim is to mitigate, where possible, its operational foreign currency exposures. From time to time, the Branch may maintain an operational foreign currency exposure to offset currency volatility arising from translation of foreign currency forecast profits, subject to senior management approval and adherence to the Branch's Board approved limits.

The analysis below demonstrates the impact on profit after income tax of a 10% strengthening or weakening of the major currencies to which the Branch is exposed. The sensitivity is measured with reference to the Branch's residual (or unmatched) operational foreign currency exposures at the balance date. Operational foreign exchange gains or losses are recognised in profit or loss in accordance with the policy set out in note 1.2.3. The sensitivities provided demonstrate the impact of a change in one key variable in isolation whilst other assumptions remain unchanged.

The sensitivities shown in the table below are relevant only at the balance date, as any unmatched exposures are actively monitored by management and the exposure matched.

	2020			2019		
EXPOSURE CURRENCY	RESIDUAL EXPOSURE $'000	SENSITIVITY %	PROFIT (LOSS)[1] $'000	RESIDUAL EXPOSURE $'000	SENSITIVITY %	PROFIT (LOSS)[1] $'000
US dollar	**889**	**10%**	**89**	465	10%	50
		-10%	**(89)**		-10%	(50)
Australian dollar	**3,655**	**10%**	**246**	3,109	10%	215
		-10%	**(246)**		-10%	(215)

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

4.5 Liquidity risk

Overview

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

The Company's approach to managing liquidity risk is underpinned by QBE AusPac's liquidity risk appetite and Liquidity Risk Policy, which have been approved by the Company Board.

The Company, including the Branch, manages liquidity risk using a number of tools, as follows:

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

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

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

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

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

	1 YEAR OR LESS $'000	13 TO 36 MONTHS $'000	37 TO 60 MONTHS $'000	OVER 5 YEARS $'000	TOTAL $'000
As at 31 December 2020					
Reinsurance premium payables	**11,593**	-	-	-	**11,593**
Trade payables	**25,074**	-	-	-	**25,074**
Amounts due to related entities	**139**	-	-	-	**139**
Accrued expenses	**1,635**	-	-	-	**1,635**
Other payables	**13,135**	**5,934**	-	-	**19,069**
As at 31 December 2019					
Reinsurance premium payables	1,934	-	-	-	1,934
Trade payables	21,070	-	-	-	21,070
Accrued expenses	1,266	-	-	-	1,266
Other payables	12,461	5,286	-	-	17,747

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

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

		INTEREST BEARING FINANCIAL ASSETS MATURING IN						
		1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 TO 5 YEARS	OVER 5 YEARS	TOTAL
As at 31 December 2020								
Fixed rate	**$'000**	**366,464**	**173,860**	**33,700**	-	**29,416**	**10,789**	**614,229**
Weighted average interest rate	**%**	**1.48**	**1.00**	**0.33**	-	**0.41**	**0.84**	**1.22**
Floating rate	**$'000**	**3,587**	-	-	-	-	-	**3,587**
Weighted average interest rate	**%**	**0.33**	-	-	-	-	-	**0.33**
As at 31 December 2019								
Fixed rate	**$'000**	235,131	174,738	61,088	52,094	-	8,113	531,164
Weighted average interest rate	**%**	2.85	2.07	1.61	1.33	-	2.02	2.29
Floating rate	**$'000**	30,521	-	-	-	-	-	30,521
Weighted average interest rate	**%**	0.01	-	-	-	-	-	0.01

4.6 Operational risk

Overview

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

Operational risk can materialise in a number of forms including internal fraud, external fraud, employment practices and workplace safety, improper business practices, damage to physical assets, business disruption and system failures and execution, delivery and process management. The The Company's approach to managing operational risk is underpinned by QBE AusPac's operational risk appetite and Operational Risk Policy, which have been approved by the Company Board.

The Company, including the Branch, identifies and assesses operational risk through:

- The Risk and Control Self-Assessment (RCSA) process, which identifies and assesses the key risks to achieving business objectives and is conducted at business unit level.
- The Operational Risk Appetite Statement, which sets out the nature and level of risk the Company Board is willing to take in pursuit of the organisation's objectives. The Operational Risk Appetite Statement is measured through an assessment of the control environment, key risk indicators, issues and incidents.
- The emerging risk process, which identifies and assesses new risks, which are characterised by incomplete but developing knowledge or existing risks that develop in new or surprising ways.
- The scenario analysis process, which assesses the impact of potentially extreme scenarios and the appropriateness of our contingency planning.

4.7 Compliance risk

Overview

Compliance risk is the risk of legal or regulatory penalties, financial loss or impacts and non-financial loss or impacts (including reputational damage) resulting from a breach of obligations. Obligations refers to those in legislation, regulation, industry codes and standards, internal polices and ethical and business standards.

The Company's approach to managing compliance risk is underpinned by QBE AusPac's compliance risk appetite, which have been approved by the Company Board and is summarised below.

The Company, including the Branch, manages compliance risk through its governance, culture, stakeholder management and strategy approach. There are six components for managing compliance risk with defined responsibilities across the three lines of defence:

- identify compliance obligations and controls;
- embed compliance obligations across systems and process;
- communicate and train staff on compliance requirements;
- monitor obligations and controls;
- identify and rectify issues, incidents and breaches; and
- report on and assess the state of compliance.

Compliance management is subject to continuous improvement, recognising changes in the regulatory and legal environment and industry, customer and community expectations.

4.8 Group risk

Overview

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

The Company's approach to managing group risk is underpinned by QBE AusPac's risk appetite, which have been approved by the Company Board and is summarised below.

Sources of group risk may include group initiatives or strategies with a material impact on one or more divisions, shared global reinsurance programs, inter-Branch loans and shared use of centralised Group functions (e.g. Group Procurement and Group IT). Group risk also includes the potential risk from reputational contagion.

The Company, including the Branch, manages group risk through various systems, controls and processes, including the use of interBranch transactions and balances accounting guidance, transfer pricing guidelines and investment management agreements.

5. CAPITAL STRUCTURE

Overview

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

Details of the Branch's approach to capital risk management are disclosed in note 4.1.

5.1 Cash and cash equivalents

	2020 $'000	2019 $'000
Floating interest rate	3,379	20,415

How we account for the numbers

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

Cash and cash equivalents are initially measured at fair value then subsequently at amortised cost and are subject to an insignificant risk of change in value.

Cash and cash equivalents are subjected to impairment testing using the ECL methodology. The Branch considers that credit risk has not increased significantly since initial recognition, and that these assets represent low credit risks, taking into account the credit standing of the counterparties and the nature of the exposures. The Company foresees negligible credit losses arising on cash and cash equivalents from possible default events within 12 months from the reporting date, and considers that no allowance for impairment is required at 31 December 2020 (2019: $nil).

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

The reconciliation of profit after income tax to cash flows from operating activities is included in note 7.3.

5.2 Solvency

Overview

On 18 December 2015 the Branch was granted a full licence under the Insurance (Prudential Supervision) Act 2010 ("the Act"). As the Branch is a branch of an overseas insurer it is exempt under the Act from complying with the Solvency Standard for Non-Life Insurance Business subject to the condition that the Company meets the equivalent Australian non-Life solvency standard being Australian APRA requirements.

The following table shows the capital adequacy calculated in accordance with the APRA prudential framework. The 2019 and 2020 position reflect the year to date 31 December quarter APRA return (unaudited).

	2020 AUD$'000	2019 AUD$'000
Eligible Tier 1 capital as defined by APRA		
Contributed equity	**1,359,483**	1,259,483
Retained profits[1]	**661,194**	859,946
Insurance liability surplus	**285,564**	249,724
Total equity	**2,306,241**	2,369,153
Less: APRA deductions	**(195,599)**	(149,160)
Total APRA capital base	**2,110,642**	2,219,993
APRA prudential capital requirement	**1,608,197**	1,553,634
APRA capital adequacy multiple	**1.31**	1.43

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

6. TAX

Overview

Income tax expense is the accounting tax charge for the period and is calculated as the tax payable on the current period taxable income based on the applicable income tax rate, adjusted for changes in deferred tax assets and liabilities attributable to temporary differences and unused tax losses. The relationship between accounting profit and income tax expense is provided in the reconciliation of prima facie tax to income tax expense (note 6.1). Income tax expense does not equate to the amount of tax actually paid to tax authorities as it is based upon the accrual accounting concept.

Accounting income and expenses do not always have the same recognition pattern as taxable income and expenses, creating a timing difference as to when a tax expense or benefit can be recognised. These differences usually reverse over time but until they do, a deferred tax asset or liability is recognised on the balance sheet. Note 6.2 details the composition and movements in deferred tax balances and the key management assumptions applied in recognising tax losses.

The Branch's approach to managing tax risk is disclosed in note 4.1.

6.1 Income tax

Reconciliation of prima facie tax to income tax expense

	NOTE	2020 $'000	2019 $'000
Profit before income tax		**48,889**	61,551
Prima facie tax payable at 28%		**13,689**	17,234
Tax effect of non-temporary differences:			
Non-allowable expenses and non-taxable income		**41**	58
Prima facie tax adjusted for non-temporary differences		**13,730**	17,292
(Over) under provision in prior years		**(58)**	(84)
Tax credit		**150**	-
Income tax expense		**13,822**	17,208
Analysed as follows:			
Current tax		**13,852**	19,012
Deferred tax		**28**	(1,804)
(Over) under provision in prior years		**(58)**	-
		13,822	17,208
Deferred tax (credit) expense comprises:			
Deferred tax assets recognised in profit or loss	6.2.1	**(914)**	(1,112)
Deferred tax liabilities recognised in profit or loss	6.2.2	**942**	(692)
		28	(1,804)

How we account for the numbers

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

Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends to either settle on a net basis or to realise the asset and settle the liability simultaneously. Current and deferred tax is recognised in profit or loss, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, as appropriate.

6.2 Deferred income tax

	NOTE	2020 $'000	2019 $'000
Deferred tax assets	6.2.1	**3,438**	2,805
Deferred tax liabilities	6.2.2	**(13,690)**	(11,285)

How we account for the numbers

Deferred income tax is provided in full using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill or if they arise from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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

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

Deferred tax assets and liabilities are offset in the financial statements when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority.

6.2.1 Deferred tax assets

The balance comprises temporary differences attributable to:

	NOTE	2020 $'000	2019 $'000
Amounts recognised in profit or loss			
Provision for impairment		**596**	114
Employee benefits		**2,015**	1,905
Others		**827**	786
Deferred tax assets	6.2	**3,438**	2,805
Deferred tax assets analysed as follows:			
Recoverable within 12 months		**3,438**	2,805
Recoverable in greater than 12 months		**-**	-
		3,438	2,805

Movements:

	NOTE	2020 $'000	2019 $'000
At 1 January		**2,805**	1,693
Amounts recognised in profit or loss	6.1	**914**	634
Prior year adjustment		**(281)**	478
At 31 December		**3,438**	2,805

6.2.2 Deferred tax liabilities

The balance comprises temporary differences attributable to:

	NOTE	2020 $'000	2019 $'000
Amounts recognised in profit or loss			
Insurance provisions	6.2.1	**13,690**	11,285
	6.2	**13,690**	11,285
Deferred tax liabilities analysed as follows:			
Payable within 12 months		**13,690**	11,285
Payable in greater than 12 months		**-**	-
		13,690	11,285

Movements:

	NOTE	2020 $'000	2019 $'000
At 1 January		**11,285**	11,977
Amounts recognised in profit or loss	6.1	**942**	(692)
Prior year adjustment		**1,463**	-
At 31 December		**13,690**	11,285

6.2.3 Tax losses

The Branch has brought to account nil tax losses (2019: Nil).

Critical accounting judgements and estimates

Recoverability of deferred tax assets

The Branch assesses the recoverability of deferred tax assets at each balance date. In making this assessment, the Branch considers in particular its future business plans, history of generating taxable profits, whether the unused tax losses resulted from identifiable causes which are unlikely to recur and if any tax planning opportunities exist in the period in which the taxable losses can be utilised.

7. OTHER

Overview

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

7.1 Other accounting policies

7.1.1 New and amended standards adopted by the Branch

The Branch adopted the following new or revised accounting standards which became effective for the annual reporting period commencing on 1 January 2020.

TITLE		OPERATIVE DATE
NZ IFRS 3 amendments	*Definition of a Business*	1 January 2020
NZ IAS 1 and NZ IAS 8 amendments	*Definition of Material*	1 January 2020
2018 NZ Conceptual Framework	*New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting*	1 January 2020
	Amendments to Conceptual Framework for Financial Reporting	1 January 2020

7.1.2 New accounting standards and amendments issued but not yet effective

TITLE		OPERATIVE DATE
NZ IFRS 17	*Insurance Contracts*	1 January 2023

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

The Branch currently plans to apply the standards and amendments detailed above for the reporting periods beginning on the operative dates set out above. An initial assessment of the financial impact of the standards and amendments has been undertaken and they are not expected to have a material impact on the Branch's financial statements, except where noted below.

NZ IFRS 17 *Insurance Contracts*

NZ IFRS 17 was adopted by the New Zealand Accounting Standards Board (NZ ASB) in August 2017. The IASB subsequently issued Amendments to IFRS 17 in June 2020 to address feedback and implementation issues raised by stakeholders. The amendments were adopted by the NZ ASB in August 2020 and include the deferral of the mandatory effective date to reporting periods beginning on or after 1 January 2023 (previously 1 January 2021).

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

The Company has completed an initial impact assessment and additional analysis on key areas of interpretation. The Company anticipates that the simplified approach will be the most appropriate basis for measuring the liability for remaining coverage for the Branch.

This analysis also identified requirements of NZ IFRS 17 where the technical interpretation remains unclear. Given the recent significant amendments to the Standard and the broad scope, complexity and lack of general consensus on the interpretation of key components of the standard, the impact of NZ IFRS 17 on the Branch's financial statements is still being determined; however, significant disclosure changes and some impact on reported profit or loss are expected. The Company continues to monitor market developments in order to assess the impact of changes and evolving interpretations on the Company and the Branch and to prepare financial reporting systems for the required changes.

In addition, recent indications from APRA regarding the impact of AASB 17 (the Australian equivalent standard) on both reporting to APRA and the measurement of capital required by APRA are under consideration and the impacts on the Company's implementation project are being assessed.

7.2 Contingent liabilities

Overview

Contingent liabilities are disclosed when the possibility of resulting in an outflow of resources is considered to be less than probable but more likely than remote. If the expected settlement of the liability becomes probable, a provision is recognised.

The Branch had no contingent liabilities as at 31 December 2020 (2019: nil).

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

Overview

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

	2020 $'000	2019 $'000
Profit after income tax	**35,067**	44,342
Adjustments for:		
Depreciation of property, plant and equipment	**809**	1,036
Depreciation of ROU	**1,742**	1,810
Net fair value gains on financial assets	**1,926**	1,531
(Decrease) increase in net outstanding claims	**(6,664)**	102,995
Increase in unearned premiums	**26,280**	17,051
Increase in deferred insurance costs	**(5,864)**	(2,641)
Decrease (increase) in reinsurance and other recoveries	**51,894**	(77,869)
(Increase) decrease in trade and other receivables	**(51,612)**	48
Increase (decrease) in trade and other payables	**15,356**	(14,465)
Decrease (increase) in deferred tax assets	**1,772**	(1,804)
Increase in current tax assets	**(4,174)**	-
Decrease in current tax liabilities	**(8,995)**	(9,728)
Cash flows from operating activities	**57,537**	62,306

7.4 Key management personnel

Overview

NZ IAS 24 *Related Party Disclosures* requires disclosure of the compensation of directors (executive and non-executive) and those persons having authority and responsibility for planning, directing and controlling the activities of the Branch, either directly or indirectly. This group is collectively defined as key management personnel.

Remuneration of executive directors and other executives, is paid by a related Branch. Where this remuneration is recharged on a time proportional basis it is disclosed below, along with an appropriate allocation of fees paid to independent non-executive directors by QBE Group companies for services provided to the Branch. Where the Branch also receives management services from the related Branch which includes the provision of key management personnel, these services are not recharged on a time proportional basis and are excluded from the disclosure below. They are included in an overall management fee from the related Branch, refer note 7.6.2.

	2020 $'000	2019 $'000
Short-term employee benefits	**4,374**	4,057
Post-employment benefits	**-**	729
Share based payments	**179**	587
	4,553	5,373

How we account for the numbers

Short-term employee benefits – profit sharing and bonus plans
A provision is recognised for profit sharing and bonus plans where there is a contractual obligation or where past practice has created a constructive obligation at the end of each reporting period. Bonus or profit-sharing obligations are settled within 12 months from the balance date.

Post-employment benefits – defined contribution plans
Defined contribution plans are post-employment benefit plans under which an entity pays a fixed contribution into a fund during the course of employment and has no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Contributions to defined contribution plans are expensed as incurred.

Short-term and post-employment benefits are accounted for and paid by a related Branch. The related expense is recharged to the Branch as part of the overall management fee.

7.5 Remuneration of auditors

Overview

The Branch may engage the external auditor for non-audit services other than excluded services subject to the general principle that fees for non-audit services should not exceed 50% of all fees paid to the external auditor in any one financial year at the ultimate parent entity level. The Board believes some non-audit services are appropriate given the external auditor's knowledge of the Branch. External tax services are generally provided by an accounting firm other than the external auditor. Consistent with prior periods, the external auditor cannot provide the excluded services of preparing accounting records or financial reports or acting in a management capacity.

	2020 $'000	2019 $'000
PricewaterhouseCoopers (PwC) – Australian firm		
Audit of financial reports of the Branch	**288**	260
Taxation compliance and advisory services	**30**	45
	318	305

7.6 Related parties

7.6.1 Parent entity

The Branch forms part of QBE Insurance (Australia) Limited, a Company incorporated and domiciled in Australia.

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

7.6.2 Transactions with related parties

The following material transactions occurred with related parties:

	2020 $'000	2019 $'000
Revenue		
Reinsurance recoveries received or receivable from related entity	**171,711**	165,099
Reinsurance commission received from related entities	**31,610**	29,795
Reimbursement of transactions with related parties	**-**	4,345
Expenses		
Reinsurance premium paid to related entity	**211,842**	188,588
Management fees paid to related entity	**9,524**	5,157

Remuneration of key management personnel is disclosed in note 7.4.

7.6.3 Outstanding balances arising from transactions with related parties

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

	2020 $'000	2019 $'000
Current assets		
Reinsurance receivables on paid claims from related entities	**43,482**	14,624
Reinsurance recoveries on outstanding claims from related entities	**279,262**	275,843
Amounts due from related entities	**729**	913
Current liabilities		
Reinsurance premium payable to related entities	**11,593**	-
Amounts due to related entities	**139**	-

How we account for the numbers

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

Outstanding balances are unsecured and repayable on demand, except for reinsurance recoveries and the loan to a related entity. Reinsurance recoveries are secured by a combination of letters of credit and funds held subject to a trust deed and disclosed at note 4.3. The loan to a related entity is unsecured and has an initial maturity of 1 year from inception.

7.7 Events occurring after reporting date

At the date of this report, no matter or circumstance has arisen since 31 December 2020 that has significantly affected or may significantly affect the financial statements.

QBE Insurance (Australia) Limited
ABN 78 003 191 035 (incorporated in Australia).
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www.qbe.com/nz

28 March 2021

Mr Zak Abro
CFO NZ & Pacific
QBE Centre
125 Queen Street
AUCKLAND

Dear Mr Abro

Re: New Zealand Operations Actuarial Report at 31 December 2020

Section 77 and 78 of the Insurance (Prudential Supervision) Act 2010 requires a licensed insurer to ensure the actuarial information included in the financial statements has been reviewed by the insurer's Appointed Actuary. As the Appointed Actuary for QBE New Zealand (QBENZ), I, Francois Rademeyer have conducted this review for QBENZ's financial statements for the period ending 31 December 2020.

This review involved ascertaining whether actuarial information used in the preparation of the financial statements has applied appropriately. No limitations were placed on me in conducting this review, and all information requested has been made available to me.

For the purpose of this review, actuarial information includes: -

- Outstanding Claims Liabilities;
- Premium Liabilities;
- Application of the Liability Adequacy Test; and
- Deferred Acquisition costs.

I am an employee of QBE Management Services (QMS), which is a related company to QBENZ in that both companies are fully owned by QBE Insurance Group. In addition to this, I held equity positions (current or deferred) in QBE Insurance Group securities at the date of this report. This holding is an immaterial proportion of the total shares issued by QBE.

From my review, it is my opinion that: -

- The actuarial information included in QBENZ's financial statements has been appropriately included;
- The actuarial information used to prepare the financial statements has been appropriately used; and
- It is understood that QBENZ was grated exemption from complying with the RBNZ solvency standards for non-life insurance business under Section 59 of the Insurance Act. QBENZ is a branch of QBE Insurance (Australia) Limited (QIA) which is an APRA regulated entity. QBENZ is therefore dependent on QIA's capital management plan.

Yours sincerely

Francois Rademeyer

Francois Rademeyer
New Zealand Appointed Actuary of QBE Insurance (Australia) Limited
Member of the Institute of Actuaries of Australia