QBE LENDERS' MORTGAGE INSURANCE LIMITED

ANNUAL REPORT – 31 DECEMBER 2020

(A.C.N. 000 511 071)

CONTENTS

This financial report includes separate financial statements for QBE Lenders' Mortgage Insurance Limited (the Company) as an individual entity.

QBE Lenders' Mortgage Insurance Limited is a Company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is:

Level 27, 8-12 Chifley Square
Sydney NSW 2000
Australia

A description of the nature of the Company's operations and its principal activities is included in the directors' report on pages 1 to 3, which is not part of the financial report.

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 LENDERS' MORTGAGE INSURANCE LIMITED

DIRECTORS' REPORT
For the year ended 31 December 2020

Your directors present their report on QBE Lenders' Mortgage Insurance Limited (the Company) as at 31 December 2020 and for the year then ended.

Directors

The following directors held office during the financial year and up to the date of this report:

K A Bailey-Lord
V K Bhatia (resigned on 3 September 2020)
F Costigan (appointed on 3 September 2020)
D T Curran (appointed on 13 August 2020)
C J Esson (appointed on 4 November 2020)
G J Gilbert
M Joiner
C Killourhy (resigned on 4 November 2020)
M Long
H P Nott
P J White
M V R Willis (appointed on 13 August 2020)

Results and review of operations

The results of the Company for the year were as follows:

	2020 $M	2019 $M
Gross written premium	**238.7**	218.3
Gross earned premium	**243.9**	254.8
Net earned premium	**101.2**	137.3
Net claims expense	**(87.1)**	(45.9)
Net commission revenue	**40.6**	30.4
Underwriting and other expenses	**(50.4)**	(56.4)
Underwriting result	**4.3**	65.4
Net investment income on policyholders' funds	**3.5**	16.7
Insurance profit	**7.8**	82.1
Net investment income on shareholder's funds	**13.0**	38.6
Profit before income tax	**20.8**	120.7
Income tax expense	**(4.4)**	(34.3)
Profit after income tax	**16.4**	86.4

The increase in Gross Written Premium in 2020 principally reflects improved consumer demand for home loans in the historically low interest rate environment. Recent stimulus measures including eased mortgage serviceability, government grants and home loan interest rate cuts along with improving property prices have created some uplift in property market activity, with buyers returning to the market and application levels at two-year highs. The outlook for the Australian lending market remains positive.

During the year, as required by accounting standards, the Company reviewed the expected pattern of risk emergence over the life of its portfolio to reflect updated claims experience. For 2020, the review did not lead to any additional release or deferral of previously deferred income or expenditure.

Reduced gross earned premium in 2020 is due to lower earnings from policies written in prior underwriting years.

Net earned premium in 2020 is further impacted by higher reinsurance costs as a result of additional quota share reinsurance in the year.

The reduction in profit before tax was influenced by reduced investment income from historically low interest rates, realised losses on the sale of assets, and provisions related to the impact of the COVID-19 pandemic.

DIRECTORS' REPORT

For the year ended 31 December 2020

Controlling entities

The entity is a Company limited by shares, incorporated and domiciled in Australia. The parent entity is QBE Holdings (AAP) Pty Limited (QBE AAP), incorporated in Australia, and the ultimate parent entity is QBE Insurance Group Limited (QBE Group), incorporated in Australia.

The parent entity's registered office is at Level 27, 8-12 Chifley Square, Sydney, NSW 2000, Australia.

Employee numbers

At the reporting date, the Company employed nil persons (2019: nil).

A related entity, QBE Management Services Pty Limited (QMS), is the employer of most of the QBE Group employees residing in Australia. As such, it is responsible for their salary and wage payments and employer superannuation contributions. QMS charges a management fee to the Company in order to recover employee costs.

Another related entity, QBE Insurance (Australia) Limited (QIA) New Zealand branch, performs a similar role in respect of all persons engaged in the activities of the Company residing in New Zealand.

Dividends

Dividends paid or proposed during the year totalled $177.4 million (2019: $113.0 million).

The directors did not declare a final dividend prior to the end of the year for the financial year ended 31 December 2020 (2019: nil).

Activities

The principal activity of the Company continued to be underwriting of residential lenders' mortgage insurance. There were no significant changes to the principal activity during the year.

Presentation currency

The financial report is presented in Australian dollars because the majority of its underwriting activity is denominated in Australian dollars.

Directors' and officers' insurance

During the year, a related Company paid insurance premiums in respect of a contract insuring directors and officers of the Company. The officers of the Company covered by the insurance contract include the directors listed on page 1 and the Company secretaries, P Smiles and T Virgara. In accordance with normal commercial practice, disclosure of the total amount of premium payable under, and the nature of liabilities covered by, the insurance contract is prohibited by a confidentiality clause in the contract.

No such insurance cover has been provided for the benefit of any external auditor of the Company.

Options

There were no options granted by the Company during the year (2019: nil).

Significant changes

There were no significant changes to the state of affairs of the Company during the financial year.

Likely developments

Information on likely developments in the Company's operations in future financial years and the expected results of those operations has not been included in this report because disclosure of the information would be likely to result in unreasonable prejudice to the Company.

However, the operating environment remains highly uncertain as a result of the COVID-19 pandemic and the associated economic impacts.

Events after balance date

There is, at the date of this report, no other matter or circumstance that has arisen since 31 December 2020 that, in the opinion of the directors, has significantly affected or may significantly affect the Company's operations, the results of those operations, or the Company's state of affairs in future financial periods.

Directors' benefits

No director of the Company has received or become entitled to receive a benefit (other than a remuneration benefit) by reason of a contract made or proposed by the Company or a related entity with a director or with a firm of which the director is a member or with an entity in which the director has a substantial financial interest.

Environmental regulation

The Company is not currently required to report under any significant environmental regulations under either Commonwealth, State or Territory legislation.

Auditor

PricewaterhouseCoopers, Chartered Accountants, continue in office in accordance with Section 327B of the *Corporations Act 2001*.

A copy of the auditor's independence declaration as required under Section 307C of the *Corporations Act 2001* is set out on page 4.

Rounding of amounts

The Company is of a kind referred to in the *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*. Amounts have been rounded off in the Directors' report to the nearest one hundred thousand dollars or, in certain cases, to the nearest thousand dollars in accordance with that instrument.

Signed in SYDNEY this 12th day of February 2021 in accordance with a resolution of directors.

Director..

FRANK COSTIGAN

Director..

CHRIS ESSON

Auditor's Independence Declaration

As lead auditor for the audit of QBE Lenders' Mortgage Insurance Limited for the year ended 31 December 2020, I declare that to the best of my knowledge and belief, there have been:

(a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and

(b) no contraventions of any applicable code of professional conduct in relation to the audit.

Christopher Verhaeghe
Partner
PricewaterhouseCoopers

Sydney
12 February 2021

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QBE LENDERS' MORTGAGE INSURANCE LIMITED

FINANCIAL REPORT CONTENTS

FINANCIAL STATEMENTS

STATEMENT OF COMPREHENSIVE INCOME
For the year ended 31 December 2020

	NOTE	2020 $M	2019 $M
Gross written premium		**238.7**	218.3
Unearned premium movement		**5.2**	36.5
Gross earned premium	2.1	**243.9**	254.8
Outward reinsurance premium		**(178.0)**	(148.2)
Deferred reinsurance premium movement		**35.3**	30.7
Outward reinsurance premium expense		**(142.7)**	(117.5)
Net earned premium (a)		**101.2**	137.3
Gross claims incurred	2.2	**(180.7)**	(96.6)
Reinsurance and other recoveries	2.2	**93.6**	50.7
Net claims expense (b)		**(87.1)**	(45.9)
Gross commission expense		**(0.9)**	(2.0)
Reinsurance commission revenue	2.1	**41.5**	32.4
Net commission revenue (c)		**40.6**	30.4
Underwriting and other expenses (d)		**(50.4)**	(56.4)
Underwriting result (a)+(b)+(c)+(d)		**4.3**	65.4
Investment income - policyholders' funds		**3.8**	17.1
Investment expenses - policyholders' funds		**(0.3)**	(0.4)
Insurance profit		**7.8**	82.1
Investment income - shareholder's funds		**13.7**	39.3
Investment expenses - shareholder's funds		**(0.7)**	(0.7)
Profit before income tax		**20.8**	120.7
Income tax expense	6.1	**(4.4)**	(34.3)
Profit after income tax		**16.4**	86.4
Other comprehensive income			
Items that may be reclassified to profit or loss			
Net movement in foreign currency translation reserve		**-**	-
Other comprehensive income after income tax		**-**	-
Total comprehensive income after income tax		**16.4**	86.4
Profit after income tax attributable to:			
Ordinary equity holder of the Company		**16.4**	86.4
		16.4	86.4
Total comprehensive income after income tax attributable to:			
Ordinary equity holder of the Company		**16.4**	86.4
		16.4	86.4

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

QBE LENDERS' MORTGAGE INSURANCE LIMITED

BALANCE SHEET
As at 31 December 2020

	NOTE	2020 $M	2019 $M
Assets			
Cash and cash equivalents	5.1	**21.4**	10.3
Investments	3.2	**1,054.5**	1,225.6
Trade and other receivables	2.6	**121.1**	96.9
Deferred insurance costs	2.5	**333.4**	303.0
Reinsurance and other recoveries on outstanding claims	2.3	**135.3**	79.5
Deferred tax assets	6.2	**2.5**	1.7
Investments in controlled entities	7.1	**73.5**	73.5
Total assets		**1,741.7**	1,790.5
Liabilities			
Trade and other payables	2.7	**72.1**	76.8
Outstanding claims	2.3	**304.4**	192.1
Unearned premium	2.5	**533.5**	538.7
Unearned reinsurance commission	2.5	**77.3**	67.5
Total liabilities		**987.3**	875.1
Net assets		**754.4**	915.4
Equity			
Share capital	5.2.1	**364.3**	364.3
Reserves	5.2.2	**0.5**	0.5
Retained profits		**389.6**	550.6
Total equity		**754.4**	915.4

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

QBE LENDERS' MORTGAGE INSURANCE LIMITED

STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2020

2020	NOTE	SHARE CAPITAL $M	RESERVES $M	RETAINED PROFITS $M	TOTAL EQUITY $M
At 1 January		**364.3**	**0.5**	**550.6**	**915.4**
Profit after income tax		–	–	**16.4**	**16.4**
Other comprehensive income		–	–	–	–
Total comprehensive income		–	–	**16.4**	**16.4**
Transactions with owners in their capacity as owners:					
Dividends paid on ordinary shares	**5.3**	–	–	**(177.4)**	**(177.4)**
At 31 December		**364.3**	**0.5**	**389.6**	**754.4**

2019	NOTE	SHARE CAPITAL $M	RESERVES $M	RETAINED PROFITS $M	TOTAL EQUITY $M
At 1 January		364.3	0.5	577.2	942.0
Profit after income tax		-	-	86.4	86.4
Other comprehensive income		-	-	-	-
Total comprehensive income		-	-	86.4	86.4
Transactions with owners in their capacity as owners:					
Dividends paid on ordinary shares	5.3	-	-	(113.0)	(113.0)
At 31 December		364.3	0.5	550.6	915.4

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

QBE LENDERS' MORTGAGE INSURANCE LIMITED

STATEMENT OF CASH FLOWS
For the year ended 31 December 2020

	NOTE	2020 $M	2019 $M
Operating activities			
Premiums received		**261.5**	239.7
Reinsurance and other recoveries received		**38.0**	41.9
Reinsurance commissions received		**45.7**	39.6
Outward reinsurance paid		**(187.2)**	(156.0)
Claims paid		**(70.0)**	(73.4)
Insurance costs paid		**(12.3)**	(22.7)
Other underwriting costs paid		**(40.5)**	(49.3)
Interest and dividends received		**28.7**	32.5
Income taxes paid		**(18.5)**	(37.6)
Net cash flows from operating activities	8.3	**45.4**	14.7
Investing activities			
Proceeds from sale of fixed interest investments		**932.1**	754.2
Purchase of fixed interest investments		**(952.0)**	(721.2)
Net payments to related entities		**(19.8)**	(54.2)
Dividends received from controlled entity		**6.1**	9.3
Net cash flows from investing activities		**(33.6)**	(11.9)
Financing activities			
Dividends paid	5.3	**(0.7)**	(1.0)
Net cash flows from financing activities		**(0.7)**	(1.0)
Net movement in cash and cash equivalents		**11.1**	1.8
Cash and cash equivalents at the beginning of the year		**10.3**	8.5
Cash and cash equivalents at the end of the year	5.1	**21.4**	10.3

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

1. OVERVIEW

1.1 About the Company

About QBE Lenders' Mortgage Insurance Limited

QBE Lenders' Mortgage Insurance Limited (the Company) is a residential lenders' mortgage insurance company, underwriting business in Australia and New Zealand.

About insurance

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

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

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

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

1.2 About this report

This financial report includes the financial statements of QBE Lenders' Mortgage Insurance Limited. The parent entity is QBE Holdings (AAP) Pty Limited (QBE AAP), incorporated in Australia, and the ultimate parent entity is QBE Insurance Group Limited (QBE Group), incorporated in Australia.

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 equity and statement of cash flows, as well as associated notes as required by Australian Accounting Standards. 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 Company's insurance activities.
3. **Investment activities** includes all results and balance sheet disclosures relevant to the Company's investments.
4. **Risk management** provides commentary on the Company's exposure to various financial and capital risks, explaining the potential impact on the results and balance sheet and how the Company manages these risks.
5. **Capital structure** provides information about the cash and equity components of the Company's capital.
6. **Tax** includes disclosures in relation to the Company's tax balances.
7. **Company structure** provides a summary of the Company's structure and any changes therein.
8. **Other** includes disclosures required in order to comply with Australian Accounting Standards.

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 analysis of balances as required by Australian Accounting Standards.
- **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 Company. 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 Company;
- it helps to explain the impact of significant changes in the Company's business; or
- it relates to an aspect of the Company'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 Australian Accounting Standards and Interpretations as issued by the Australian Accounting Standards Board (AASB), International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and the *Corporations Act 2001*;
- has been prepared on a historical cost basis as modified by certain exceptions, the most significant of which are the measurement of investments at fair value and the measurement of the net outstanding claims liability at present value;
- is presented in Australian dollars; and
- is presented with values rounded to the nearest one hundred thousand dollars or, in certain cases, to the nearest thousand dollars in accordance with *ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191*.

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

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

New and amended Accounting Standards and Interpretations issued by the AASB that are now effective are detailed in note 8.1.

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

These financial statements are separate financial statements and the Company is exempt from preparing consolidated financial statements under AASB10 *Consolidated Financial Statements*. The ultimate parent Company, QBE Group produces consolidated financial statements in accordance with AASB and IFRS for public use, which can be obtained at www.qbe.com or Level 27, 8-12 Chifley Square, Sydney, NSW 2000, Australia.

1.2.2 Critical accounting judgements and estimates

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

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

Sensitivity analyses in respect of critical accounting estimates and judgements are presented in order to provide information and analysis which is meaningful, relevant, reliable and comparable year on year.

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

- net outstanding claims liability (note 2.3);
- unearned premium and deferred insurance costs (note 2.5);
- liability adequacy test (note 2.5.1);
- impairment of receivables (note 2.6); and
- recoverability of deferred tax assets (note 6.2)

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 Company has considered a broad range of factors to inform an assessment of the impact of the resulting uncertainty and general market volatility on the 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, the liability adequacy test, and earning patterns. The impact of the COVID-19 pandemic on each of the significant accounting estimates are discussed further below.

• Net discounted central estimate (note 2.3):

COVID-19 has caused a material increase in the net discounted central estimate despite the low number of claims notified and uncertain economic conditions. 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 87.5%.

• 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 entity 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.

Translation of foreign operations

The results and balance sheets of all foreign operations that have a functional currency different from the Company's presentation currency of Australian dollars are translated into Australian dollars as follows:

- income, expenses and other current period movements in comprehensive income are translated at average rates of exchange; and
- balance sheet items are translated at the closing balance date rates of exchange.

On consolidation, exchange differences arising from the translation of foreign operations are taken to shareholder's equity and recognised in other comprehensive income. When a foreign operation is sold in whole or part and capital is repatriated, exchange differences on translation from the entity's functional currency to the parent entity's functional currency of Australian dollars are reclassified out of other comprehensive income and recognised in profit or loss as part of the gain or loss on sale.

Exchange rates

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

	2020		2019	
	PROFIT OR LOSS	BALANCE SHEET	PROFIT OR LOSS	BALANCE SHEET
US$/A$	**1.453**	**1.297**	1.439	1.425
NZ$/A$	**0.943**	**0.933**	0.948	0.959

2. UNDERWRITING ACTIVITIES

Overview

This section provides analysis and commentary on the Company'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

Overview

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

- direct, being those paid by the policyholder to the insurer; or
- inward reinsurance, being for coverage provided to an insurer or reinsurer in relation to a specified grouping of policies or risks.

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

	NOTE	2020 $M	2019 $M
Gross earned premium			
Direct		**233.1**	240.0
Inward reinsurance		**10.8**	14.8
		243.9	254.8
Other revenue			
Reinsurance and other recoveries revenue	2.2	**93.6**	50.7
Reinsurance commission revenue		**41.5**	32.4
Management fees from related entity	8.6.2	**0.7**	0.8
		135.8	83.9
Total revenue		**379.7**	338.7

How we account for the numbers

Premium revenue
Premium written comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. Premium revenue is recognised in profit or loss from the date of attachment of risk over the period of the insurance contract in accordance with the pattern of the expected incidence of risk, adjusted for policy terminations.

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

Reinsurance commission revenue
Reinsurance commission revenue comprises exchange commissions that are a fixed percentage of reinsurance premiums payable, and variable commissions the level of which depend on the future profitability of reinsured business. Exchange commissions are recognised in profit or loss on the same basis as reinsurance written premiums, reflecting the pattern of the expected incidence of risk over the period of indemnity, adjusted for policy terminations. Variable commissions are brought to account in consideration of the expected performance of the reinsured policies.

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 $M	2019 $M
Gross claims incurred and related expenses			
Direct		**172.2**	81.3
Inward reinsurance		**8.5**	15.3
		180.7	96.6
Reinsurance and other recoveries revenue			
Direct		**(92.4)**	(47.9)
Inward reinsurance		**(1.2)**	(2.8)
	2.1	**(93.6)**	(50.7)
Net claims expense		**87.1**	45.9
Analysed as follows:			
Movement in net discounted central estimate	2.4.1	**67.8**	45.1
Movement in risk margin	2.3.3	**19.3**	0.8
Net claims expense		**87.1**	45.9

2.3 Net outstanding claims liability

Overview

The net outstanding claims liability comprises the elements described below.

- The gross central estimate (note 2.3.1). This is the provision for expected future claims payments and includes claims reported but not yet paid, claims incurred but which have not yet been reported (IBNR) and estimated claims handling costs.
- Less reinsurance and other recoveries (note 2.3.2). Insurance companies may elect to purchase reinsurance to manage their exposure to any one claim or series of claims. When an insurance company incurs a claim as a result of an insured loss, it may be able to recover some of that claim from the reinsurers.
- 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 $M	2019 $M
Gross discounted central estimate	2.3.1	**252.3**	159.3
Risk margin	2.3.3	**52.1**	32.8
Gross outstanding claims liability		**304.4**	192.1
Reinsurance and other recoveries on outstanding claims	2.3.2	**(135.3)**	(79.5)
Net outstanding claims liability		**169.1**	112.6

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

	2020			2019		
	GROSS $M	REINSURANCE $M	NET $M	GROSS $M	REINSURANCE $M	NET $M
At 1 January	**192.1**	**(79.5)**	**112.6**	167.5	(67.1)	100.4
Current accident year development in net discounted outstanding claims (note 2.4.2)	**156.3**	**(98.3)**	**58.0**	92.1	(47.5)	44.6
Prior accident year development in net discounted outstanding claims (note 2.4.2)	**5.1**	**4.7**	**9.8**	3.7	(3.2)	0.5
Movement in risk margin (note 2.3.3)	**19.3**	**-**	**19.3**	0.8	-	0.8
Incurred claims recognised in profit or loss (Note 2.2)	**180.7**	**(93.6)**	**87.1**	96.6	(50.7)	45.9
Claims payments	**(68.4)**	**37.8**	**(30.6)**	(72.0)	38.3	(33.7)
At 31 December	**304.4**	**(135.3)**	**169.1**	192.1	(79.5)	112.6

2.3.1 Gross discounted central estimate

	NOTE	2020 $M	2019 $M
Gross undiscounted central estimate excluding claims settlement costs		**247.0**	157.6
Claims settlement costs		**5.9**	3.6
Gross undiscounted central estimate		**252.9**	161.2
Discount to present value		**(0.6)**	(1.9)
Gross discounted central estimate	2.3	**252.3**	159.3
Payable within 12 months		**112.4**	82.8
Payable in greater than 12 months		**139.9**	76.5
Gross discounted central estimate	2.3	**252.3**	159.3

How we account for the numbers

The gross discounted central estimate is the present value of the expected future payments for claims incurred and includes reported but unpaid claims, IBNR and claims settlement costs. The net discounted central estimate is determined by the Appointed Actuary, supported by a team of actuaries. The valuation process includes extensive consultation with claims and underwriting staff as well as senior management. The 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.

Critical accounting judgements and estimates

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

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

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims that have been reported to the Company but not yet paid, for which some information about the claims is generally available. The longer the delay between the event giving rise to the claim and final claim settlement, the greater the variability between initial estimates of the loss incurred and the final settlement amount, as a result of additional financing and settlement costs incurred by the lender and changes in property valuations.

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

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

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

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

2.3.2 Reinsurance and other recoveries on outstanding claims

	NOTE	2020 $M	2019 $M
Reinsurance and other recoveries on outstanding claims - undiscounted		**135.6**	80.5
Discount to present value		**(0.3)**	(1.0)
Reinsurance and other recoveries on outstanding claims	2.3	**135.3**	79.5
Receivable within 12 months		**60.3**	41.2
Receivable in greater than 12 months		**75.0**	38.3
Reinsurance and other recoveries on outstanding claims	2.3	**135.3**	79.5

How we account for the numbers

The recoverability of amounts due from reinsurers and others is assessed at each balance date to ensure that the balances properly reflect the amounts that are ultimately expected to be received, taking into account counterparty credit risk and the terms of the reinsurance contracts. 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's 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 (POA), 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% POA indicates that the outstanding claims liability is expected to be adequate 9 years in 10.

	2020 $M	2019 $M
Risk margin ($M)	**52.1**	32.8
Risk margin as a percentage of the net discounted central estimate (%)	**44.5%**	41.1%
Probability of adequacy (%)	**87.5%**	86.5%

The overall POA has been increased to 87.5% (2019 86.5%) as at 31 December 2020 to allow for numerous factors including the degree of uncertainty due to COVID-19. The risk margin has increased by $19.3m compared to the balance at 31 December 2019.

How we account for the numbers

AASB 1023 *General Insurance Contracts* requires an entity to adopt an appropriate risk margin. The resulting probability of adequacy is not of itself an accounting policy as defined by AASB 108 *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, however the Company aims to maintain a probability of adequacy in excess of 87.5% (2018: 85%).

The Board reviews a number of factors when determining the appropriate risk margin, including any changes in the level of uncertainty in the net discounted central estimate, the resulting probability of adequacy and the risk margin as a percentage of the net discounted central estimate.

Critical accounting judgements and estimates

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

The key drivers of uncertainty unique to QBE LMI's insurance liability are as follows:

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

2.3.4 Discount rate used to determine the outstanding claims liability

Overview

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

	2020 %	2019 %
Australia and New Zealand	**0.1**	0.9

How we account for the numbers

AASB 1023 requires that the net central estimate is discounted to reflect the time value of money using risk-free rates that are based on current observable, objective rates that relate to the nature, structure and terms of the future obligations.

2.3.5 Weighted average term to settlement

Overview

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

	2020 YEARS	2019 YEARS
Australia and New Zealand	**1.5**	1.3

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2.3.6 Net discounted central estimate maturity profile

Overview

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

		1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 TO 5 YEARS	OVER 5 YEARS	TOTAL
2020	**$M**	**52.1**	**36.4**	**15.7**	**6.0**	**3.1**	**3.7**	**117.0**
2019	$M	41.5	23.5	8.6	3.0	1.4	1.6	79.6

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 impact on profit (after tax, at the 75th percentile) assuming that there is no change to any of the other variables. In practice, this is considered unlikely to occur.

The sensitivities below do not consider the impact on the additional risk margin, that is they have been calculated at the 75th percentile (apart from the change in probability of adequacy). This does not represent the final impact to profit after tax.

	SENSITIVITY %	PROFIT (LOSS)[1,2] 2020 $M	2019 $M
Severity	+20	**(14.0)**	(13.2)
	-20	**14.1**	13.2
Claim rates	+20	**(17.6)**	(6.0)
	-20	**17.2**	7.4
Discount rate	+5	**-**	-
	-5	**-**	-
Coefficient of variation	+20	**(6.2)**	(3.8)
	-20	**6.7**	4.2
Probability of adequacy	+1	**(2.0)**	(1.2)
	-1	**1.9**	1.2

[1] Net of tax at the prima facie rate of 30%.
[2] The impact of a change in in interest rates on profit (after tax, at the 75th percentile) 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 table below) has subsequently developed favourably (that is, claims cost estimates have reduced) or unfavourably (i.e. further claims expense has been recognised in subsequent years). This table therefore illustrates the variability and inherent uncertainty in estimating the central estimate each year. The ultimate claims cost for any particular accident year is not known until all claims payments have been made, which could be some time into the future. The estimated ultimate claims payments at the end of each subsequent accident year demonstrates how the original estimate has been revised over time (b).

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

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

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

	2016 & PRIOR YEARS $M	2017 $M	2018 $M	2019 $M	2020 $M	TOTAL $M
Net ultimate claims payments:						
(a) Original estimate of net ultimate claims payments		37.4	43.9	42.8	54.4	
(b) One year later		38.3	44.5	49.3	-	
Two years later		36.5	46.1	-	-	
Three years later		36.6	-	-	-	
(c) Current estimate of net ultimate claims payments		36.6	46.1	49.3	54.4	186.4
(d) Cumulative net payments to date		(32.3)	(27.3)	(14.3)	(3.7)	(77.6)
(e) Net undiscounted central estimate at 31 Dec 2020	2.6	4.3	18.8	35.0	50.7	111.4
Discount to present value						(0.3)
Claims settlement costs						5.9
Risk margin						52.1
(f) Net outstanding claims liability at 31 Dec 2020 (note 2.3)						169.1
(g) Movement in accident year net undiscounted central estimate (note 2.4.1)	0.2	0.1	1.6	6.5	54.4	62.8

Uncertainty surrounding claims development is materially resolved within four years.

The development of claims from prior accident years was worse than expected at 31 December 2020, leading to an overall strengthening of the central estimate for prior years of $8.4m. This strengthening is impacted by higher than expected frequency of claims and the approach used to allocate reinsurance by accident years.

How we account for the numbers

The Company writes business in Australian dollars and in the case of the New Zealand branch, New Zealand dollars. The translation of ultimate claims estimates denominated in foreign currencies gives rise to foreign exchange movements which have no direct bearing on the development of the underlying claims. All estimates of ultimate claims payments for the 4 most recent accident years reported in functional currencies other than Australian dollars have been translated to Australian dollars using the 2020 average rate of exchange.

2.4.1 Reconciliation of claims development table to profit or loss

Overview

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

	2020			2019		
	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M
Movement in net undiscounted central estimate movement (note 2.4)	**54.4**	**8.4**	**62.8**	42.8	(1.1)	41.7
Movement in claims settlement costs	**3.7**	**0.6**	**4.3**	2.2	0.4	2.6
Movement in discount	**(0.1)**	**0.8**	**0.7**	(0.4)	1.2	0.8
Movement in net discounted central estimate (note 2.4.2)	**58.0**	**9.8**	**67.8**	44.6	0.5	45.1

2.4.2 Net central estimate development

Overview

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

	2020			2019		
	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M	CURRENT ACCIDENT YEAR $M	PRIOR ACCIDENT YEARS $M	TOTAL $M
Gross central estimate development						
Undiscounted	**156.6**	**3.4**	**160.0**	92.9	1.2	94.1
Discount	**(0.3)**	**1.7**	**1.4**	(0.9)	2.5	1.6
	156.3	**5.1**	**161.4**	92.0	3.7	95.7
Reinsurance and other recoveries						
Undiscounted	**(98.5)**	**5.6**	**(92.9)**	(47.9)	(1.9)	(49.8)
Discount	**0.2**	**(0.9)**	**(0.7)**	0.5	(1.3)	(0.8)
	(98.3)	**4.7**	**(93.6)**	(47.4)	(3.2)	(50.6)
Net central estimate development						
Undiscounted	**58.1**	**9.0**	**67.1**	45.0	(0.7)	44.3
Discount	**(0.1)**	**0.8**	**0.7**	(0.4)	1.2	0.8
Net discounted central estimate development (note 2.4.1)	**58.0**	**9.8**	**67.8**	44.6	0.5	45.1

2.5 Unearned premium and deferred insurance costs

Overview

Unearned premium

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

Deferred insurance costs

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

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

Summary of unearned premium and deferred insurance costs balances

	2020 $M	2019 $M
Unearned premium (a)	**533.5**	538.7
To be earned within 12 months	**184.5**	188.5
To be earned in greater than 12 months	**349.0**	350.2
Unearned premium	**533.5**	538.7
Unearned reinsurance commission (b)	**77.3**	67.5
To be earned within 12 months	**26.9**	24.1
To be earned in greater than 12 months	**50.4**	43.4
Unearned reinsurance commission	**77.3**	67.5
Deferred reinsurance premium	**271.0**	235.7
Deferred commission expense	**4.9**	5.5
Deferred acquisition costs	**57.5**	61.8
Deferred insurance costs (c)	**333.4**	303.0
To be expensed within 12 months	**116.5**	112.1
To be expensed in greater than 12 months	**216.9**	190.9
Deferred insurance costs	**333.4**	303.0
Net premium liabilities (a)+(b)-(c)	**277.4**	303.2

Unearned premium movements

	2020 $M	2019 $M
At 1 January	**538.7**	575.2
Deferral of premium on contracts written in the financial year	**209.7**	191.3
Earning of premium written in previous financial years	**(214.9)**	(227.8)
At 31 December	**533.5**	538.7

Unearned reinsurance commission income movements

	2020 $M	2019 $M
At 1 January	**67.5**	58.6
Deferral of commission on contracts written in the financial year	**42.0**	35.7
Earning of commission written in previous financial years	**(32.2)**	(26.8)
At 31 December	**77.3**	67.5

Deferred insurance costs movements

	DEFERRED REINSURANCE PREMIUM		DEFERRED COMMISSION		DEFERRED ACQUISITION COSTS	
	2020 $M	2019 $M	2020 $M	2019 $M	2020 $M	2019 $M
At 1 January	**235.7**	205.0	**5.5**	6.8	**61.8**	66.4
Costs deferred in financial year	**156.9**	132.0	**1.8**	1.6	**20.4**	21.0
Amortisation of costs deferred in previous financial years	**(121.6)**	(101.3)	**(2.4)**	(2.9)	**(24.7)**	(25.6)
At 31 December	**271.0**	235.7	**4.9**	5.5	**57.5**	61.8

How we account for the numbers

Unearned premium

Unearned premium on insurance contracts at balance date is calculated by applying the premium earning pattern to premium written on active policies. There was no change to the earning pattern in 2020.

Unearned reinsurance commission income

Unearned reinsurance commission income is calculated by applying the premium earning pattern, adjusted where necessary for varying indemnity periods, to reinsurance commission received or receivable on active reinsurance polices. There was no change to the pattern in 2020.

Deferred insurance costs

Deferred reinsurance premium is calculated by applying the premium earning pattern, adjusted where necessary for varying indemnity periods, to reinsurance premiums paid or payable on active reinsurance policies. There was no change to the pattern in 2020.

Deferred acquisition costs are calculated by applying the premium earning pattern to acquisition costs incurred on acquiring and recording insurance policies that are still active. The carrying value of deferred acquisition costs is subject to impairment testing in the form of the liability adequacy test (note 2.5.1). There was no change to the pattern in 2020.

Critical accounting judgements and estimates

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

The earning pattern is subject to a high level of uncertainty. Some of the uncertainties impacting the pattern of claims incidence are:

- changes in the legal environment, including the interpretation of liability laws and the quantum of damages;
- changes in the social, political and economic trends, for example, house price inflation, unemployment and interest rates and

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 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 Company 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 $M	2019 $M
Undiscounted net central estimate	**139.9**	187.9
Discount to present value	**(3.0)**	(8.2)
	136.9	179.7
Risk margin at the 75th percentile of insurance liabilities	**34.2**	43.7
Expected present value of future cash flows for future claims including risk margin	**171.1**	223.4

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 the net premium liabilities identified a surplus at 31 December 2020 and 2019.

Critical accounting judgements and estimates

In assessing the adequacy of net premium liabilities, AASB 1023 requires the inclusion of a risk margin but does not prescribe a minimum level of margin. Whilst there is established practice in the calculation of the probability of adequacy of the outstanding claims liability, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities.

The long duration of policy terms and premium earning pattern mean that the central estimate of future claims arising under insurance and reinsurance contracts is highly uncertain. Some of the uncertainties are:

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

The Company has adopted a risk margin of 25.0% (2019: 24.3%) 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 Australia, being the minimum probability of adequacy required for Australian licensed insurers by Australian Prudential Regulation Authority (APRA).

2.6 Trade and other receivables

Overview

Trade and other receivables are principally amounts owed to the Company by reinsurance counterparties and related entities.

	2020 $M	2019 $M
Reinsurance premium receivables	**10.4**	10.6
Reinsurance recoveries on paid claims	**7.9**	8.1
Trade receivables	**18.3**	18.7
Accrued interest income	**5.0**	7.5
Loan to related entity	**80.0**	60.0
Amounts due from related entities	**6.6**	6.4
Other receivables and prepayments	**11.2**	4.3
Trade and other receivables	**121.1**	96.9
Receivable within 12 months	**121.1**	96.9
Receivable in greater than 12 months	**-**	-
Trade and other receivables	**121.1**	96.9

Amounts due from reinsurers and third parties are settled under standard terms and conditions.

The loan to a related entity bears interest at a commercial rate and has an initial maturity within 12 months.

Other 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.

How we account for the numbers

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

Trade receivables are outside the scope of AASB 9. They are initially recognised at fair value and are subsequently measured at amortised cost less any impairment. 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 reinsurance premiums, and within reinsurance and other recoveries revenue for those losses attributable to reinsurance recoveries on paid claims.

Receivables within the scope of AASB 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 AASB 9 is calculated as an allowance for expected credit losses (ECL). Any increase or decrease in the allowance for ECL is recognised in profit or loss within underwriting and other expenses.

Critical accounting judgements and estimates

For receivables outside the scope of AASB 9, an allowance for impairment is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original term of the receivable. The Company regularly reviews the collectability of receivables and the adequacy of allowances for impairment. Information on the credit quality of these balances is included in note 4.3. No allowance for impairment is required at 31 December 2020 (2019: nil).

For receivables within the scope of AASB 9, the allowance for ECL is based on the difference between the cash flows due in accordance with the contract and the cash flows that the Company expects to receive. The allowance for ECL reflects judgements and assumptions that take into account prior credit risk and loss history, current and expected future market conditions and individual debtor circumstances.

The allowance is based on the portion of lifetime ECL 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 or the receivable relates to revenue recorded in accordance with AASB 15 *Revenue from Contracts with Customers*, in which case the allowance is based on lifetime ECL.

The Company considers that credit risk on receivables within the scope of AASB 9 has not increased significantly since initial recognition. 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 balances. The Company 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)

Revenues, expenses and assets (except receivables and payables) are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Australian Taxation Office (ATO). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of expense. Receivables and payables in the balance sheet are shown inclusive of GST.

The net amount of GST recoverable from, or payable to, the ATO is included within other receivables or payables in the balance sheet.

Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flows.

The Company is part of a GST group headed by QBE Management Services Pty Limited, a related entity.

2.7 Trade and other payables

Overview

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

	2020 $M	2019 $M
Reinsurance premium payables	**29.6**	38.2
Amounts due to related entities	**12.8**	17.9
Other trade payables	**19.8**	12.6
Other payables	**9.9**	8.1
Trade and other payables	**72.1**	76.8
Payable within 12 months	**71.7**	72.6
Payable in greater than 12 months	**0.4**	4.2
Trade and other payables	**72.1**	76.8

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 free.

How we account for the numbers

Trade and other payables are initially recognised at fair value and are subsequently measured at amortised cost.

Reinsurance premium payables represent obligations under an insurance contract as defined in AASB 4 and are outside the scope of AASB 9.

Amounts due to related entities and other trade payables are financial liabilities within the scope of AASB 9.

3. INVESTMENT ACTIVITIES

Overview

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

The Company 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 Company, liquidity of the instrument, credit quality of the instrument and the overall risk appetite of the Company. Further details on the management of risk associated with investment assets can be found in note 4.

The Company's investment assets are categorised as either backing policyholders' or shareholder's funds, with the former being investment assets which back insurance liabilities whilst the latter comprises all other investment assets.

3.1 Net investment income

	2020 $M	2019 $M
Income on fixed interest securities, short-term money and cash	**11.2**	49.9
Dividend income from controlled entity	**6.3**	6.5
Gross investment income[1]	**17.5**	56.4
Investment expenses	**(1.0)**	(1.1)
Net investment income	**16.5**	55.3
Investment income – policyholders' funds	**3.8**	17.1
Investment expenses – policyholders' funds	**(0.3)**	(0.4)
Investment income – shareholder's funds	**13.7**	39.3
Investment expenses – shareholder's funds	**(0.7)**	(0.7)
Net investment income	**16.5**	55.3

[1] Includes net fair value loss of $13.5 million (2019: gain $12.3 million).

How we account for the numbers

Interest income is recognised in the period in which it is earned. Dividends are recognised when the right to receive payment is established.

Investment income includes realised and unrealised gains or losses on financial assets which are reported on a combined basis as net fair value gains or losses on financial assets.

3.2 Investment assets

	2020 $M	2019 $M
Fixed income		
Short-term money	**138.1**	26.6
Government bonds	**122.5**	201.0
Corporate bonds	**767.8**	980.1
Infrastructure debt	**26.1**	11.4
	1,054.5	1,219.1
Growth Assets		
Developed market equity	**-**	6.5
Total investments	**1,054.5**	1,225.6
Amounts maturing within 12 months	**351.0**	242.3
Amounts maturing in greater than 12 months	**703.5**	983.3
Total investments	**1,054.5**	1,225.6

How we account for the numbers

Investment assets are financial assets within the scope of AASB 9. The Company'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 Company's business model for managing and evaluating the investment portfolio. The fair value hierarchy and the Company's approach to measuring the fair value of each investment instrument is disclosed in note 3.2.1.

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 Company 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 Company has transferred substantially all the risks and rewards of ownership.

3.2.1 Fair value hierarchy

Overview

The QBE Group Investments 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 Company.

The investments of the Company 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.

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	2020				2019			
	LEVEL 1 $M	LEVEL 2 $M	LEVEL 3 $M	TOTAL $M	LEVEL 1 $M	LEVEL 2 $M	LEVEL 3 $M	TOTAL $M
Fixed income								
Short-term money	**0.1**	**138.0**	**-**	**138.1**	0.6	26.0	-	26.6
Government bonds	**16.5**	**106.0**	**-**	**122.5**	73.7	127.3	-	201.0
Corporate bonds	**-**	**767.8**	**-**	**767.8**	-	980.1	-	980.1
Infrastructure debt	**-**	**-**	**26.1**	**26.1**	-	-	11.4	11.4
Growth Assets								
Developed market equity	**-**	**-**	**-**	**-**	6.5	-	-	6.5
Total investments	**16.6**	**1,011.8**	**26.1**	**1,054.5**	80.8	1,133.4	11.4	1,225.6

The Company'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 1 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.

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 measurement. 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 and are categorised as level 2 fair value measurements.

Infrastructure debt
Infrastructure debt prices are sourced from the investment manager who may use a combination of observable market prices or comparable market prices where available and other valuation techniques.

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 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. The Company'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 we operate;
- 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.

4.1 Strategic risk

Overview

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

- **Products**: The Company reviews the structuring of its insurance products on an ongoing basis in line with market expectations and developments, legislation and claims trends.
- **Market distribution approach**: The Company makes use of banks and other financial institutions to market its insurance products.

Capital structure, organisational structure, strategic asset planning 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 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 QBE AusPac Executive Risk and Capital Committee and the Company Board Risk and Capital Committee.

Management has a particular focus on the following performance indicators:

- The Company actively manages the components of capital in order to maintain a level of eligible regulatory capital that exceeds APRA requirements. The Company Board set the target level of regulatory capital for 2020 at 1.32-1.44 times (2019: 1.32-1.44 times) the Prescribed Capital Amount (PCA).
- The Company is subject to regulatory requirements to maintain a minimum level of capital to meet obligations to policyholders. It is the Company's policy to maintain a capital base appropriate to its size, business mix, complexity and risk profile which fully complies with and meets or exceeds local regulatory requirements.
- Insurer financial strength ratings provided by the major rating agencies demonstrate the Company's financial strength and claims paying ability.

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

Tax risk management

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

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.

QBE AusPac classifies insurance risk into three subcategories:

- underwriting / pricing;
- insurance concentration; and
- reserving.

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/pricing risk

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

The Company is a monoline insurer providing residential lenders' mortgage insurance (LMI) in Australia and New Zealand. The New Zealand Branch ceased to write new policies in 2013.

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

The Company'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 Company's annual business planning process, supported by underwriting authorities. These authorities reflect the level of risk that the Company 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 Company 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

Insurance concentration risk for a lenders' mortgage insurer is the risk of catastrophic loss resulting from a prolonged economic downturn. The Company operates in Australia, New Zealand (in run-off since 2013) and has a subsidiary in Hong Kong. Its exposures are monitored and limits on maximum aggregate exposures to individual borrowers and per property, are contained in underwriting policies and embedded in systems and processes.

The Company is exposed to the possibility of large losses from economic events such as a significant increase in regional or nationwide unemployment levels, weakening in house prices, or a significant increase in interest rates over a short period of time. As required by APRA, the Company calculates its insurance concentration risk charge ("ICRC") which is the net probable maximum loss from a APRA prescribed three-year economic or property downturn equivalent to a 1-in-200 year event. As at 31 December 2020, the ICRC was $400.8 million (2019: $487.8 million).

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 is subject to a comprehensive independent external review at least annually.

4.3 Credit risk

Overview

Credit risk is the risk of financial loss where a customer, counterparty or issuer fails to meet their financial obligations to the Company in accordance to the agreed terms. The Company's exposure to credit risk results principally from financial transactions with securities issuers, debtors, reinsurers and underlying mortgagees.

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

Reinsurance credit risk

The Company's objective is to place reinsurance with highly rated counterparties. Concentration of risk with reinsurance counterparties is monitored strictly and regularly by the 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.

Credit risk exposures are calculated regularly and compared with authorised credit limits. In certain cases, the Company requires letters of credit or other collateral arrangements to be provided to guarantee the recoverability of the amount involved. The Company holds $184.5 million (2019: $192.0 million) in collateral to support reinsurance recoveries on outstanding claims.

The following table provides information about the quality of the Company'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 $M	AA $M	A $M	BBB $M	SPECULATIVE GRADE $M	NOT RATED $M	TOTAL $M
As at 31 December 2020							
Reinsurance recoveries on outstanding claims[1]	-	-	**122.4**	-	-	-	**122.4**
Reinsurance recoveries on paid claims	-	-	**7.9**	-	-	-	**7.9**
As at 31 December 2019							
Reinsurance recoveries on outstanding claims[1]	-	-	71.3	-	-	-	71.3
Reinsurance recoveries on paid claims	-	-	8.1	-	-	-	8.1

[1] Excludes other non-reinsurance recoveries of $12.8 million (2019: $8.2 million).

None of the Company's reinsurance recoveries are past due or impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2019: nil).

Insurance and other credit risk

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

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

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

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

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

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

The Company regularly reviews the collectability of receivables and the adequacy of associated provisions for impairment. Balances are monitored on the basis of uncollected debt.

None of the Company's receivables are past due, impaired or have terms that have been renegotiated and would otherwise have been past due or impaired (2019: nil).

Investment and Treasury credit risk

The Company 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 and cash deposits. Counterparty exposure limit compliance is monitored daily.

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

	CREDIT RATING						
	AAA $M	AA $M	A $M	BBB $M	SPECULATIVE GRADE $M	NOT RATED $M	TOTAL $M
As at 31 December 2020							
Cash and cash equivalents	-	**21.4**	-	-	-	-	**21.4**
Interest-bearing investments	**76.0**	**336.7**	**429.2**	**212.6**	-	-	**1,054.5**
As at 31 December 2019							
Cash and cash equivalents	-	10.3	-	-	-	-	10.3
Interest-bearing investments	254.1	400.8	361.4	202.8	-	-	1,219.1

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

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 QBE AusPac's market risk appetite and the Market Risk Policy, which have been approved by the Company Board and are summarised below.

The Company's approach to managing investment market movements is underpinned by QBE AusPac's investment strategy which outlines QBE AusPac'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 Company's total investment portfolio.

Interest rate risk

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

The Company'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 Company 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 Company Board and other management reporting. Derivatives are used only for approved purposes and are subject to Company 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.

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The net central estimate of outstanding claims is discounted to present value by reference to risk-free interest rates. The Company is therefore exposed to potential underwriting result volatility as a result of interest rate movements. 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 Company 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 1.4 years (2019: 2.0 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 income tax. The impact of a 0.5% increase or decrease in interest rates on interest-bearing financial assets owned by the Company at the balance date is shown in the table below.

		PROFIT (LOSS)[1]	
	SENSITIVITY	2020	2019
	%	$M	$M
Interest rate movement - interest-bearing financial assets	+0.5	**(5.1)**	(8.7)
	-0.5	**4.3**	8.5

[1] Net of tax at the prima facie rate of 30%.

Price risk

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

The Company is exposed to price risk on its interest-bearing fixed interest financial assets. All securities are measured at fair value through profit or loss. Movements in credit spreads impact the value of interest-bearing securities and therefore impact reported profit after income 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 Company at the balance date is shown in the table below.

		PROFIT (LOSS)[1]	
	SENSITIVITY	2020	2019
	%	$M	$M
Credit spread movement – corporate interest-bearing financial assets	+0.5	**(5.5)**	(6.6)
	-0.5	**4.1**	6.5

[1] Net of tax at the prima facie rate of 30%.

Foreign exchange

The Company's approach to foreign exchange management is underpinned by 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) or due to the translation of the Company's net investment in foreign operations to the presentation currency of Australian dollars (currency translation risk).

Operational currency risk

The Company has limited exposure to foreign currency and therefore the operational currency risk is minimal.

Foreign exchange gains or losses arising from operational foreign currency exposures are reported in profit or loss.

Currency risk in relation to translation of foreign operations

The Company is exposed to currency risk in relation to the translation of the New Zealand branch to the functional currency of Australian dollars.

The Company does not currently seek to use derivatives to mitigate currency translation risk on translation to the functional currency of Australian dollars for the following reasons:

- currency translation gains and losses generally have no cash flow;
- currency translation gains and losses are accounted for in the foreign currency translation reserve (a component of equity) and therefore do not impact profit or loss unless related to the disposal of an entity; and,
- management of translation risk needs to be balanced against the impact on capital requirements and liquidity risk.

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 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 Company's financial and contingent liabilities based on the remaining contractual obligations.

	1 YEAR OR LESS $M	1 TO 3 YEARS $M	3 TO 5 YEARS $M	OVER 5 YEARS $M	TOTAL $M
As at 31 December 2020					
Trade and other payables	**71.7**	**0.4**	-	-	**72.1**
Contingent liabilities (Note 8.2)	**64.9**	-	-	-	**64.9**
As at 31 December 2019					
Trade and other payables	72.6	4.2	-	-	76.8
Contingent liabilities (Note 8.2)	71.3	-	-	-	71.3

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

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

		INTEREST BEARING FINANCIAL ASSETS MATURING IN						
		1 YEAR OR LESS $M	1 TO 2 YEARS $M	2 TO 3 YEARS $M	3 TO 4 YEARS $M	4 TO 5 YEARS $M	OVER 5 YEARS $M	Total $M
As at 31 December 2020								
Fixed rate	$M	**264.3**	**100.5**	**106.7**	**35.6**	**17.7**	**101.1**	**625.9**
Weighted average interest rate	%	**0.2**	**0.3**	**0.7**	**0.5**	**1.5**	**0.9**	**0.5**
Floating rate	$M	**108.1**	**114.7**	**86.0**	**46.7**	**33.1**	**61.4**	**450.0**
Weighted average interest rate	%	**0.1**	**0.3**	**0.4**	**1.5**	**0.6**	**1.3**	**0.6**
As at 31 December 2019								
Fixed rate	$M	170.5	187.6	108.2	124.4	38.7	155.3	784.7
Weighted average interest rate	%	1.3	1.4	1.5	1.9	1.7	1.5	1.5
Floating rate	$M	82.0	116.1	115.3	17.2	45.3	68.7	444.6
Weighted average interest rate	%	1.2	1.4	1.5	1.6	2.2	1.9	1.6

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 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 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 has been approved by the Company Board and is summarised below.

The Company 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 to 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 has 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-company loans and shared use of centralised group functions (such as for procurement and information technology). Group risk also includes the potential risk from reputational contagion.

The Company manages group risk through various systems, controls and processes, including the use of intercompany 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 Company has adopted the capital management policies and framework of the QBE Group.

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

5.1 Cash and cash equivalents

	2020 $M	2019 $M
Cash at bank on hand	**20.6**	9.4
Overnight money	**0.8**	0.9
	21.4	10.3
Analysed as follows:		
Floating interest rate	**21.4**	10.3
	21.4	10.3

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 recognised at fair value and are subsequently measured at amortised cost.

Cash and cash equivalents are subjected to impairment testing using the AASB 9 ECL methodology. The Company 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.

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 8.3.

5.2 Equity and reserves

Overview

Ordinary shares in the Company rank after all creditors, have no par value and entitle the holder to participate in dividends and the proceeds on winding up of the Company in proportion to the number of shares held.

5.2.1 Share capital

	2020 NUMBER OF SHARES MILLIONS	2020 $M	2019 NUMBER OF SHARES MILLIONS	2019 $M
Issued ordinary shares, fully paid at 1 January	**327.8**	**364.3**	327.8	364.3
Issued ordinary shares, fully paid at 31 December	**327.8**	**364.3**	327.8	364.3

5.2.2 Reserves

	2020 $M	2019 $M
Foreign currency translation reserve		
At 1 January	**0.5**	0.5
Gain on translation	**-**	-
Total reserves at 31 December	**0.5**	0.5

5.3 Dividends

Overview

Provision is made for dividends which are declared, being appropriately authorised and no longer at the discretion of the Company, on or before the end of the financial year but not distributed at the balance date.

	2020 $M	2019 $M
Dividends paid or payable	**177.4**	113.0

During the year, dividends were paid through in-specie transfer of $176.7 million (2019: $108.7 million) investments, non-cash settlement (2020: $nil, 2019: $3.3 million) due from related entities and $0.7 million (2019: $1.0 million) cash.

5.4 APRA capital adequacy (Solvency)

Overview

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

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

	2020 $M	2019 $M
Eligible Tier 1 capital as defined by APRA		
Contributed equity	**364.3**	364.3
General reserves	**0.4**	0.5
Retained profits [1]	**389.9**	550.8
Insurance liability surplus	**94.2**	67.6
Total equity	**848.8**	983.2
Less: APRA deductions	**75.5**	75.2
Total APRA capital base	**773.3**	908.0
APRA prudential capital requirement	**515.6**	611.7
APRA Capital adequacy multiple	**1.50**	1.48

[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 Company'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 $M	2019 $M
Profit before income tax		**20.8**	120.7
Prima facie tax payable at 30%		**6.2**	36.2
Tax effect of non-temporary differences:			
Untaxed dividends		**(1.8)**	(1.9)
Prima facie tax adjusted for non-temporary differences		**4.4**	34.3
Income tax expense		**4.4**	34.3
Analysed as follows:			
Current tax		**5.2**	33.4
Deferred tax		**(0.8)**	0.9
		4.4	34.3
Deferred tax expense comprises:			
Deferred tax assets recognised in profit or loss	6.2.1	**(0.8)**	0.9
		(0.8)	0.9

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 $M	2019 $M
Deferred tax assets	6.2.1	**2.5**	1.7

6.2.1 Deferred tax assets

The balance comprises temporary differences attributable to:

	NOTE	2020 $M	2019 $M
Amounts recognised in profit or loss			
Insurance provisions		**1.9**	1.2
Other accrued expenses		**0.6**	0.5
Deferred tax assets	6.2	**2.5**	1.7
Deferred tax assets analysed as follows:			
Recoverable within 12 months		**1.3**	0.8
Recoverable in greater than 12 months		**1.2**	0.9
		2.5	1.7

Movements:

	NOTE	2020 $M	2019 $M
At 1 January		**1.7**	2.6
Amounts recognised in profit or loss	6.1	**0.8**	(0.9)
At 31 December		**2.5**	1.7

How we account for the numbers

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

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

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

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

6.2.2 Tax losses

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

Critical accounting judgements and estimates

Recoverability of deferred tax assets

The Company assesses the recoverability of deferred tax assets at each balance date. In making this assessment, the Company considers in particular its future business plans and 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.

6.2.3 Tax consolidation legislation

On adoption of the tax consolidation legislation, QBE Group and its wholly-owned Australian controlled entities in the tax consolidated group entered into a tax sharing and tax funding agreement under which the wholly-owned entities are required to fully compensate QBE Group for any current tax payable and are compensated by QBE Group for any current tax receivable and deferred tax assets relating to unused tax losses or unused tax credits that are transferred to QBE Group under the tax consolidation legislation.

The head entity, QBE Group, and the controlled entities in the tax consolidated group calculate these tax amounts based on a notional stand-alone tax calculation as if each entity in the tax consolidated group was a stand-alone taxpayer in its own right. The assets and liabilities arising under the arrangement are recognised as intercompany assets and liabilities in the balance sheet of each Australian company.

7. COMPANY STRUCTURE

Overview

This section provides information to help users understand the Company's structure, including the impact of any changes in the financial year.

7.1 Controlled entity

	COUNTRY OF INCORPORATION	CARRYING VALUE		EQUITY HOLDING	
		2020 $M	2019 $M	2020 %	2019 %
QBE Mortgage Insurance (Asia) Limited	Hong Kong	**73.5**	73.5	**100.0**	100.0

The controlled entity has a 31 December year end.

How we account for the numbers

Control exists when the parent entity is exposed, or has rights, to variable returns from its involvement with an entity and has the ability to affect those returns through its power over it. A change in ownership of a controlled entity without the gain or loss of control is accounted for as an equity transaction.

The investment in the controlled entity is stated at historical cost.

The investment is reviewed annually for indicators of potential impairment. Should the investment's carrying amount exceed its estimated recoverable amount, the asset would be impaired and the carrying amount would be written down to its recoverable amount.

8. OTHER

Overview

This section includes other information that must be disclosed to comply with the Australian Accounting Standards or the *Corporations Act 2001*.

8.1 Other accounting policies

8.1.1 New and amended standards adopted by the Company

The Company adopted the following new or revised accounting standards from 1 January 2020:

TITLE	
	Revised Conceptual Framework for Financial Reporting
AASB 2018-6	*Definition of a Business*
AASB 2018-7	*Definition of Material*
AASB 2019-1	*References to the Conceptual Framework*
AASB 2019-3	*Interest Rate Benchmark Reform*
AASB 2019-5	*Disclosure of the Effect of New IFRS Standards Not Yet Issued in Australia*

The adoption of the other new or revised standards detailed above did not materially affect the Company's accounting policies or financial statements.

8.1.2 New accounting standards and amendments issued but not yet effective

TITLE		OPERATIVE DATE
AASB 17	*Insurance Contracts*	1 January 2023

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

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

AASB 17 *Insurance Contracts*

AASB 17, a new accounting standard for insurance contracts, was adopted by the Australian Accounting Standards Board (AASB) in July 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 AASB in July 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 AASB 1023) 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 general model will be the most appropriate basis for measuring the liability for remaining coverage.

This analysis also identified key requirements of AASB 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 AASB 17 on the Company's financial statements is still being determined; however, significant disclosure changes and some impact on reported profit or loss are expected. The Company continues to monitor market developments in order to assess the impact of changes and evolving interpretations on the Company and to prepare financial reporting systems for the required changes.

In addition, recent indications from APRA regarding the impact of AASB 17 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.

8.2 Contingent liabilities

Overview

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

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

	2020 $M	2019 $M
Related party guarantees	**64.9**	71.3

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

Overview

AASB 1054 *Australian Additional Disclosures* requires a reconciliation of profit after income tax to cash flows from operating activities.

	2020 $M	2019 $M
Profit after income tax	**16.4**	86.4
Net fair value losses (gains) on financial assets	**14.1**	(12.0)
Dividends receivable from controlled entity	**(6.3)**	(6.5)
Increase in gross outstanding claims	**112.2**	24.6
Decrease in unearned premiums	**(5.2)**	(36.5)
Increase in unearned reinsurance commission	**9.8**	8.9
Increase in deferred insurance costs	**(30.4)**	(24.8)
Increase in reinsurance and other recoveries	**(55.8)**	(12.5)
Increase in trade and other receivables	**(2.9)**	(1.3)
Increase (decrease) in trade and other payables	**7.7**	(8.3)
(Increase) decrease in deferred tax assets	**(0.8)**	0.9
Decrease in amounts due to parent entity or tax authorities for current tax	**(13.4)**	(4.2)
Cash flows from operating activities	**45.4**	14.7

8.4 Key management personnel

Overview

AASB 124 *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 Company, either directly or indirectly. This group of people are collectively defined as key management personnel.

Remuneration of executive directors and other executives is paid by a related Company. 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 Company. Where the Company also receives management services from the related Company 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 Company, as detailed in note 8.6.2.

	2020 $'000	2019 $'000
Short-term employment benefits	**35**	29
Post-employment benefits	**3**	3
	38	32

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 company. The related expense is recharged to the Company as part of the overall management fee.

8.5 Remuneration of auditors

Overview

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

	2020 $'000	2019 $'000
PricewaterhouseCoopers (PwC) – Australian firm		
Audit of financial reports of the Company	**587**	555
Audit of statutory returns and other assurance services	**162**	162
	749	717

8.6 Related parties

8.6.1 Parent entity

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

8.6.2 Transactions with related parties

The following material transactions occurred with related parties:

	2020 $'000	2019 $'000
Revenue		
Management fees received from controlled entity	**715**	778
Reinsurance commission received from related entity	**25,927**	21,409
Reinsurance recoveries from related entity	**71,722**	38,588
Expenses		
Management fees paid to related entity	**31,028**	36,838
Reinsurance premium paid (refunded) to related entity	**106,340**	82,545
Other transactions		
Dividends received or receivable from controlled entity	**6,307**	6,538
Dividends paid or proposed to parent	**177,400**	113,000

Remuneration of key management is disclosed in note 8.4.

8.6.3 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 from related entity on paid claims	**6,267**	6,903
Reinsurance recoveries from related entity on outstanding claims	**104,875**	61,619
Loan to related entity	**80,016**	60,006
Other amounts due from related entities [1]	**6,617**	6,390
Non-current assets		
Investment in controlled entity	**73,504**	73,504
Current liabilities		
Amounts due to related entities	**12,775**	17,925
Contingent liabilities		
Guarantee in respect of controlled entity	**64,900**	71,300

[1] A prior period casting error was identified in relation to other amounts due from related parties, this has been corrected in the current period.

How we account for the numbers

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

Outstanding balances are unsecured.

The Company entered into a tax sharing and tax funding agreement with QBE Group and its wholly-owned Australian controlled entities, refer to note 6.2.3.

8.7 Events occurring after reporting date

There is, at the date of this report, no other matter or circumstance that has arisen since 31 December 2020 that, in the opinion of the directors, has significantly affected or may significantly affect the Company's operations, the results of those operations, or the Company's state of affairs in future financial periods.

QBE LENDERS' MORTGAGE INSURANCE LIMITED

DIRECTORS' DECLARATION

In the directors' opinion:

(a) the financial statements and notes set out on pages 5 to 48 are in accordance with the *Corporations Act 2001*, including:

  (i) complying with accounting standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements; and

  (ii) giving a true and fair view of the Company's financial position as at 31 December 2020 and of its performance for the financial year ended on that date; and

(b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Note 1.2.1 confirms that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Signed in SYDNEY, this 12th day of February 2021 in accordance with a resolution of the directors.

Director.. Director..

FRANK COSTIGAN CHRIS ESSON

Independent auditor's report

To the members of QBE Lenders' Mortgage Insurance Limited

Our opinion

In our opinion:

The accompanying financial report of QBE Lenders' Mortgage Insurance Limited (the Company) is in accordance with the *Corporations Act 2001*, including:

(a) giving a true and fair view of the Company's financial position as at 31 December 2020 and of its financial performance for the year then ended

(b) complying with Australian Accounting Standards and the *Corporations Regulations 2001*.

What we have audited

The financial report comprises:

- the balance sheet as at 31 December 2020
- the statement of comprehensive income for the year then ended
- the statement of changes in equity for the year then ended
- the statement of cash flows for the year then ended
- the notes to the financial statements, which include a summary of significant accounting policies
- the directors' declaration.

Basis for opinion

We conducted our audit in accordance with Australian Auditing Standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial report* section of our report.

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

Independence

We are independent of the Company in accordance with the auditor independence requirements of the *Corporations Act 2001* and the ethical requirements of the Accounting Professional & Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) that are relevant to our audit of the financial report in Australia. We have also fulfilled our other ethical responsibilities in accordance with the Code.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report for the year ended 31 December 2020, but does not include the financial report and our auditor's report thereon.

Our opinion on the financial report does not cover the other information and accordingly we do not express any form of assurance conclusion thereon.

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In connection with our audit of the financial report, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the directors for the financial report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that gives a true and fair view and is free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial report

Our objectives are to obtain reasonable assurance about whether the financial report as a whole is 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 the Australian Auditing Standards 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 the financial report.

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_responsibilities/ar4.pdf. This description forms part of our auditor's report.

PricewaterhouseCoopers

PricewaterhouseCoopers

CP Verhaeghe

Christopher Verhaeghe
Partner

Sydney
12 February 2021