SOUTHERN CROSS PET INSURANCE LIMITED
(formerly Southern Cross Healthcare Limited)

ANNUAL REPORT

FOR THE YEAR ENDED

30 June 2020

CONTENTS

ANNUAL REPORT DISCLOSURES
for the year ended 30 June 2020

The Directors present their annual report including the financial statements of Southern Cross Pet Insurance Limited (the "Company"), formerly known as Southern Cross Healthcare Limited, for the year ended 30 June 2020.

Dividend

No dividends were paid during the year.

Nature of business

The Company is in the business of providing pet insurance in the New Zealand market.

Results

The Company recorded a net loss from operations of $457,000.

Register of Directors

N J Astwick (appointed 31 January 2020)
G R W France (ceased 31 January 2020)
M J Gardiner (appointed 31 January 2020)
G W Gent (ceased 31 January 2020)
E M Hickey (ceased 31 December 2019)
M L James (appointed 31 January 2020)
J M Raue (appointed 31 January 2020)

Use of company information

The Board received no notices during the year to 30 June 2020 from Directors requesting to use Company information received in their capacity as Directors which would not have been otherwise available to them.

Share dealings

No Director acquired or disposed of any interest in shares in the Company during the year.

Directors' remuneration

The Directors received $24,011 remuneration from the Company during the year.

Indemnity and insurance

Southern Cross Medical Care Society (the "Society") has insured the Company's Directors and Officers for liabilities to other parties that may arise from their positions as Directors and Officers of the Company.

Auditor

KPMG.

Authorised on behalf of the Board of Directors on 31 August 2020

M L James	M J Gardiner
Director	Director

KPMG

STATEMENT OF COMPREHENSIVE INCOME
for the year ended 30 June 2020

	Note	2020 $000
Premium revenue	6	8,413
Less: outward reinsurance expense	6	(18)
Net premium revenue		8,395
Claims expense	4	(4,940)
Less: reinsurance recoveries	4	(9)
Net claims expense		(4,949)
Underwriting surplus		**3,446**
Operating expenses	7	(4,384)
Operating loss		**(938)**
Interest income		30
Loss before taxation		**(908)**
Income tax benefit	11	451
Loss after taxation		**(457)**
Other comprehensive income		-
Total comprehensive loss after taxation		**(457)**

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

KPMG

STATEMENT OF CHANGES IN EQUITY

for the year ended 30 June 2020

	Note	2020 $000
Share capital		
Opening balance		-
Share issue	14	15,000
Share capital closing balance		**15,000**
Retained earnings		
Opening balance		-
Total comprehensive loss after taxation		(457)
Retained loss closing balance		**(457)**
Total equity		**14,543**

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

KPMG

STATEMENT OF FINANCIAL POSITION
as at 30 June 2020

	Note	2020 $000
Assets		
Cash and cash equivalents	8	12,037
Premium and other receivables	9	11,217
Intangible assets	12	8,195
Total assets		**31,449**
Liabilities		
Payables and other liabilities	10	1,237
Deferred tax liabilities	11	1,036
Insurance contract liabilities	3,15	14,633
Total liabilities		**16,906**
Net assets		**14,543**
Equity		
Share capital	14	15,000
Retained earnings		(457)
Total equity		**14,543**

Authorised on behalf of the Board of Directors on 31 August 2020

M L James
Director

M J Gardiner
Director

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

KPMG

STATEMENT OF CASH FLOWS
for the year ended 30 June 2020

	Note	2020 $000
Cash flows from/(to) operating activities		
Premium revenue received		8,477
Interest received		30
Payment of claims		(4,320)
Payments to suppliers		(2,528)
Net cash flows from operating activities		**1,659**
Cash flows (to)/from investing activities		
Acquisition of pet insurance business	16	(8,033)
Cash and cash equivalents acquired with the pet insurance business	16	3,411
Net cash flows to investing activities		**(4,622)**
Cash flows from financing activities		
Share capital issue	14	15,000
Net cash flows from financing activities		**15,000**
Net increase in cash and cash equivalents		**12,037**
Opening cash and cash equivalents		-
Closing cash and cash equivalents		**12,037**

RECONCILIATION OF LOSS AFTER TAXATION TO NET CASH FLOWS FROM OPERATING ACTIVITIES

	Note	2020 $000
Total comprehensive loss after taxation		(457)
Adjustments for non-cash items included in comprehensive loss after taxation:		
Amortisation	12	1,306
Changes in assets and liabilities, post acquisition of pet insurance business:		
Premium and other receivables		82
Payables and other liabilities		551
Deferred tax liabilities	11	(451)
Insurance contract liabilities		628
Net cash flows from operating activities		**1,659**

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

KPMG

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2020

1 BASIS OF ACCOUNTING

INTRODUCTION

The notes to the financial statements contain detailed financial information and the accounting policies that are considered relevant and material to the understanding of the financial performance and financial position.

Additional signposting has been used throughout the notes to the financial statements to assist readers in understanding the key information in the financial statements.

Signpost
Basis of preparation
Accounting policy
Management judgements and estimates

REPORTING ENTITY

Southern Cross Pet Insurance Limited (the "Company"), formerly known as Southern Cross Healthcare Limited, is a limited liability company domiciled and incorporated in New Zealand. It is a wholly owned subsidiary of The Southern Cross Medical Care Society (the "Society"). The Company's registered office is Level 12, AMP Centre, 29 Customs Street West, Auckland. The Company's primary activity is the provision of pet insurance.

The Company was formerly known as Southern Cross Healthcare Limited (non-trading). The Company changed its name to Southern Cross Pet Insurance Limited on 29 July 2019. On 31 January 2020, the Company acquired the pet insurance business from Southern Cross Benefits Limited (refer to Note 16). Separately, on 31 January 2020, the identifiable assets and liabilities relating to the pet insurance business were transferred from Southern Cross Insurance Services Limited (refer Note 16). As the Company commenced operating on 31 January 2020, comparative financial statement amounts as at and for the year ended 30 June 2019 are nil.

The Company is a licenced insurer under the Insurance (Prudential Supervision) Act 2010 since 30 January 2020. It is deemed to be a financial markets conduct reporting entity under Part 7 of the Financial Markets Conduct Act 2013 and therefore a Tier 1 reporting entity for financial reporting purposes.

BASIS OF PREPARATION

The Company is a profit-oriented entity for financial reporting purposes.

The financial statements are:

- presented as at and for the year ended 30 June 2020.
- prepared in accordance with the statutory requirements of the Financial Markets Conduct Act 2013, the Insurance Prudential Supervision Act 2010, the Companies Act 1993 and the Financial Reporting Act 2013.
- prepared in accordance with New Zealand generally accepted accounting practice ("NZ GAAP").
- in compliance with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and International Financial Reporting Standards ("IFRS").
- presented in New Zealand dollars ("NZD"), which is the Company's functional currency. All financial information has been rounded to the nearest thousand ($000), unless otherwise stated.
- stated net of Goods and Services Tax ("GST"), with the exception of receivables and payables, which are stated inclusive of GST where applicable. The items in the cash flow statement are shown exclusive of GST.
- prepared using historical cost as the measurement basis except for insurance contract liabilities, which are measured at fair value.

ACCOUNTING POLICIES AND STANDARDS

The Company has applied NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards* in preparing the 30 June 2020 financial statements. The accounting policies adopted on transition have been applied on a consistent basis throughout the year ended 30 June 2020. The Company was not required to present financial statements for previous reporting periods as it did not commence operating until 31 January 2020.

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2020

1 BASIS OF ACCOUNTING (continued)

USE OF ESTIMATES AND JUDGEMENTS

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and assumptions are reviewed on a regular basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised.

Information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are described in the following notes:

- Note 3: Insurance contract liabilities
- Note 5a: Insurance risk
- Note 12: Intangible assets
- Note 15: Contingencies and subsequent events
- Note 16: Acquisition of pet insurance business

2 SOLVENCY

As a licensed insurer, the Solvency Standard for Non-life Insurance Business ("the Solvency Standard") issued by the Reserve Bank of New Zealand ("RBNZ") requires the Company to retain a positive solvency margin, meaning that the actual solvency capital position exceeds the minimum required under the Solvency Standard.

The Directors' policy for managing capital is to have a capital base to establish security for policyholders and enable the Company to conduct its business whilst maintaining financial soundness. The Company has a parental support resolution in place from the Society to support the pet insurance business. The Company has embedded in its capital management plan the necessary tests to ensure continuous and full compliance with the Solvency Standard.

The target range for the capital position of the Company is a solvency ratio of 1.20 to 1.50. The policy in respect of capital management is regularly reviewed by the Directors in line with the guidelines issued by the RBNZ.

The Company has complied with RBNZ imposed capital requirements from 30 January 2020 to 30 June 2020.

	2020
	$000
Disclosures of solvency required by the Solvency Standard as issued by the RBNZ	
Solvency capital	6,347
Minimum solvency capital	3,000
Solvency margin	3,347

	2020
Solvency ratio	2.12

On 3 February 2020, Standard & Poor's issued the Company's Insurer Financial Strength Rating at A, under its global insurance industry rating methodology.

3 INSURANCE CONTRACT LIABILITIES

Insurance contracts are defined as those containing significant insurance risk at the inception of the contract. Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during the period. The Company has determined that all pet insurance policies are insurance contracts.

Estimates of the outstanding claims and unexpired risk at 30 June 2020 have been determined by the Company's Appointed Actuary, John Smeed, a Fellow of the New Zealand Society of Actuaries. These were presented to the Directors of the Company in a report dated 24 August 2020. There were no qualifications to the report. The calculations of the provisions for outstanding claims and unexpired risk each comply with both NZ IFRS 4 *Insurance Contracts* , and Professional Standard No.30: *Valuations of General Insurance Claims* , of the New Zealand Society of Actuaries.

The Appointed Actuary is satisfied as to the nature, sufficiency and accuracy of the data used to determine these provisions.

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2020

3 INSURANCE CONTRACT LIABILITIES (continued)

	2020 $000
Insurance contract liabilities	
Opening balance at 1 July 2019	-
Provision for outstanding claims	2,820
Provision for unearned premium	11,762
Assessed claims payable	51
Total	14,633

Provision for outstanding claims

The provision for outstanding claims is the central estimate of the present value of expected future payments for claims incurred but not settled at the balance date. The central estimate has been calculated using historical experience to determine the pattern of claims development.

A payments per active policy approach is adopted to value outstanding claims. Future claim payments are not inflated or discounted due to the short tail nature of the liabilities.

A risk margin has been added to reflect the inherent uncertainty in the central estimate. The risk margin considers both historic and future sources of volatility. A risk margin of 10% of the central estimate was established as at 30 June 2020. The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the provision for outstanding claims. Included within the 10% risk margin is a 3% risk allowance to reflect the additional uncertainty in estimating the outstanding liability due to the impacts of the COVID-19 lock-down. Refer to Note 15c.

Key assumptions:

I. Future patterns of claims development will be similar to historical patterns depending on the type of policy, type of claim and development month.

ii. Historical claims inflation of nil, based on previous claims experience.

Claims handling costs include internal and external costs incurred in connection with the settlement of claims. Internal costs include all direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function. Claims handling costs were determined to be 7.0% of the underlying claims amounts based on an analysis of administration expenses.

The average weighted term from 30 June 2020 to the expected settlement date for claims included in the liability for outstanding claims is 4.3 months. Accordingly, expected future claims payments are not discounted due to the short tail nature of the liabilities.

	Note	2020 $000
Provision for outstanding claims		
Central estimate of outstanding claims liability		2,403
Claims handling costs		168
Risk margin		256
Total		2,827
Reinsurance recoveries on outstanding claims		
Central estimate of reinsurance recoveries on outstanding claims liability		7
Total		7

Reinsurance recoveries on outstanding claims liabilities are included in insurance contract liabilities in the statement of financial position.

	Note	2020 $000
Reconciliation of movement in provision for outstanding claims net of reinsurance recoveries		
Opening balance at 1 July 2019		-
Net outstanding claims liabilities acquired	16	2,243
Amounts utilised during the year		(1,558)
Additional provision during the year		26
Amounts provided during the year		1,831
Movement in claims handling costs		168
Movement in risk margin		110
Total		2,820

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2020

3 INSURANCE CONTRACT LIABILITIES (continued)

Provision for unexpired risk and liability adequacy test

The liability for unearned premiums arises from premiums received for risks that have not yet expired. The provision is released evenly over the duration of the pet insurance premium and is recognised as premium income. A liability adequacy test was performed to determine whether the provision for unearned premium is adequate to cover the present value of the expected future cash flows, plus a risk margin, from the current insurance contracts. The future cash flows are future claims, associated claims handling costs and other administration costs.

If the present value of the expected future cash outflows exceeds the provision for unearned premium then the provision for unearned premium is deemed to be deficient. Any deficiency is recognised as an expense in the statement of comprehensive income.

The provision for unexpired risk has been calculated as the projected premium deficiency for current in-force business until the next policy anniversary date on or after 1 July 2020. As at 30 June 2020, the liability adequacy test identified a surplus, therefore no deficiency in the unearned premium liability.

The calculation of the risk margin has been based on an analysis of the volatility of historical claims experience within the time period covered by the unearned premiums together with future sources of volatility. A risk margin of 15% of the present value of expected future cash flows has been applied at 30 June 2020, including an additional 5% allowance for uncertainty associated with COVID-19. The risk margin was determined with the objective of achieving at least 75% probability of sufficiency of the provision for unexpired risk. Refer to Note 15c.

Key assumptions:

i. Future claims development will be similar to historical patterns by the type of policy, type of claim and development month, with an additional 5% allowance to the risk margin due to the impacts of the COVID-19 lock-down.
ii. Expenses based on the business plan for 2019/20.

No explicit allowance has been made for cancellations. These are allowed for implicitly in the inflation assumption.

Expected future claims payments are not discounted due to the short tail nature of the liabilities.

	Note	2020 $000
Provision for unearned premium		
Opening balance at 1 July 2019		-
Unearned premium acquired	16	9,885
Premiums written during the year		10,290
Premiums earned during the year		(8,413)
Total		11,762

Premiums billed but unearned are recorded as a provision for unearned premium in the statement of financial position.

Liability adequacy test	
Present value of expected future cash flows for claims and expenses	9,255
Risk margin	1,035
Unearned premiums	(11,762)
Surplus	(1,472)

4 NET CLAIMS EXPENSE

The net claims expense represents payments made on claims and the movements in the provisions for outstanding claims and unexpired risk. Details of processes and assumptions used in calculating the provisions are disclosed in Note 3.

The component of net claims expense relating to risk ceded to reinsurers is recognised as reinsurance claim recoveries in the statement of comprehensive income and as reinsurance recoveries in insurance contract liabilities in the statement of financial position.

	2020 $000
Net claims expense	
Claims incurred relating to risks borne in current financial year	4,655
Reinsurance recoveries relating to risks borne in current financial year	(10)
Claims incurred relating to risks borne in previous financial years	7
Reinsurance recoveries relating to risks borne in previous financial years	19
Movement in provision for claims handling costs	168
Movement in risk margin	110
Total	4,949

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2020

5 RISK MANAGEMENT

The Company is exposed to a number of risks in the normal course of business, specifically insurance risk, credit risk, liquidity risk, and operational risk. The Directors and management recognise the importance of having effective risk management and have put in place a comprehensive risk management program.

a. Insurance risk

The Company is exposed to insurance risk through its pet insurance activities. The key risk is that of claims costs varying significantly from the assumptions made in the setting of premium rates and putting pressure on the solvency and liquidity of the Company.

i. Risk management objectives, policies and processes for mitigating risk

The primary objective in managing insurance risk is to reduce the magnitude and volatility of claims costs. A secondary objective is to ensure funds are available to pay claims and maintain the solvency of the organisation if there is adverse deviation in experience. Key policies and methods for mitigating insurance risk include:

- Each year, as part of the planning process, the Board and the Senior Leadership Team ("SLT") review the underwriting and pricing performance.
- Underwriting policies and processes which evaluate new risks and offer terms that do not endanger the portfolio.
- Policy terms and conditions which clearly specify which pet care costs are reimbursed and claims management procedures which ensure those terms and conditions are adhered to in claims administration.
- A long-term pricing strategy and guidelines adopted by the Board which supports pricing based on underlying risk.
- Regular monitoring of financial and operating results.
- Maintaining a target solvency margin in excess of the minimum required by the standard established by the RBNZ. The solvency margin ensures the Company is able to withstand a period of adverse insurance or investment experience and still maintain a satisfactory financial position (refer to Note 2).
- Cash flow projection model designed to forecast major inflow and outflow items.
- A minimum liquidity reserve buffer is maintained in excess of anticipated cash flow requirements.

ii. Sensitivity to insurance risk

The scope of insurance risk is managed by the terms and conditions of the policy. The main insurance benefits for the pet insurance business involves the reimbursement of medical and surgical expenses depending upon the plan product terms and conditions. The level of benefits specified in the contract is a key determinant of the amount of future claims, although the exact level of claims is uncertain.

iii. Concentration of insurance risk

Management defines concentration of risk by type of insurance business and geographic region. The pet insurance business in New Zealand represents a small and not well diversified risk base, therefore, the concentration of risk by type of insurance and geographic region cannot be avoided. Insurance risks are well diversified within the pet insurance portfolio with claims costs spread across many different types of medical procedures and health events, and animal demographics. There is no significant exposure to individual large claims.

b. Financial risks

i. Credit risk

Credit risk is the potential risk of loss arising from the failure of a debtor or counterparty to meet their contractual obligations.

In the normal course of its business the Company is exposed to credit risk from its pet insurance operations.

The Company maintains policies which are used to manage the exposure to credit risk. Premium receivables are due from a very large number of counter-parties. Analysing these by credit quality would not be feasible, as the majority of counter-parties will be non-rated. Credit risk for premium receivables is considered low as the Company is able to terminate or suspend policies for non-payment, at the Company's discretion.

The maximum exposure to credit risk at the end of the reporting period is the amount of financial assets stated in the statement of financial position. These exposures are net of any recognised provisions for impairment losses.

The cash and cash equivalents balances are held with a counter-party rated AA-.

ii. Liquidity risk

The Company is exposed to ongoing operational drawdowns on its available cash resources from claims and administration expenses. Liquidity risk is the risk that payment of obligations may not be met in a timely manner at a reasonable cost.

Financial liabilities are all short term. Investments can usually be liquidated at any time, under normal market conditions, to settle liabilities.

c. Operational risk

Operational risk is defined as the risk of loss (including financial, non-financial and lost opportunities) resulting from inadequate or failed internal processes, people and systems or from external events.

Management of the Company's operational risk is a continual cyclic process. This process is documented in the Risk Management framework, and includes risk identification, analysis, evaluation and implementation of risk controls, which results in acceptance, mitigation, or avoidance of risk.

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2020

6 NET PREMIUM REVENUE

Gross earned premiums from insurance contracts are recognised evenly over the annual contract period, which is considered to be in line with the pattern of the incidence of risk. Revenue is recognised on the date from which the policy is effective. Premiums written but unearned are recorded as unearned premiums. Where premiums are billed and paid by instalments, the premium to be billed up to the next renewal date is recognised as unbilled premium receivable. Premiums ceded to reinsurers are recognised as reinsurer's share of the premium and deducted from future gross premiums. The recognition of the expense in the statement of comprehensive income is in accordance with the pattern of reinsurance service received.

	2020 $000
Net premium revenue	
Premium income	8,413
Reinsurers' share of premium	(18)
Total	8,395

7 OPERATING EXPENSES

	2020 $000
Operating expenses consist of:	
Policy acquisition	472
Policy administration	2,352
Claims administration	346
Other operating expenses	1,214
Total	4,384

Other operating expenses includes the purchase of services from Society and Southern Cross Insurance Services Limited ("SCISL") for expenses for information technology, marketing, occupancy, governance, actuarial, and management.

	Note	2020 $000
Included within operating expenses are the following specific items:		
Auditor’s remuneration:		
• audit of annual financial statements		85
• audit of annual insurer solvency return		35
Purchase of services	13a	2,365
Directors' remuneration	13b	24
Amortisation	12	1,306

8 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand and current account balances in bank accounts, which are readily convertible to cash, with original maturities of less than three months, and are carried at amortised cost as proxy for fair value through profit or loss as they are subject to an insignificant risk of changes in value.

9 PREMIUM AND OTHER RECEIVABLES

Premium and other receivables are stated at their cost less any impairment losses, using an expected credit losses model. Impairment losses for uncollectible premiums are written off against premium revenue in the year in which they are incurred. Premium and other receivables are classified as financial assets at amortised cost. The recoverability of reinsurance recoveries receivable is assessed at the reporting date and impairment is recognised where there is objective evidence that the Company may not receive the amounts due to it and these amounts can be reliably measured. Premium and other receivables are current assets. The fair values of premium and other receivables approximate the carrying amounts.

	2020 $000
Premium and other receivables	
Premium receivable	11,148
Other receivables	69
Total	11,217

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2020

10 PAYABLES AND OTHER LIABILITIES

Payables and other liabilities are current liabilities, stated at cost.

	2020 $000
Payables and other liabilities	
Trade creditors and accruals	1,237
Total	1,237

11 TAXATION

The Company is subject to income tax, and is part of the Society and its' subsidiaries tax group. Deferred tax expense is recognised in respect of temporary differences between the carrying amount of assets and liabilities in the financial statements and the amounts used for taxation purposes. Deferred tax assets are only recognised to the extent it is probable it will be utilised.

Income tax

Tax expense comprises deferred tax, calculated using the tax rate enacted or substantively enacted at balance date and any adjustments to tax payable in respect of prior years. Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities in the financial statements and the amounts for taxation purposes.

	2020 $000
Reconciliation of income tax to loss before taxation	
Loss before taxation	(908)
Income tax at the domestic tax rate of 28%	(254)
Tax effect of permanent differences	1
Tax effect of group loss offsets	(198)
Total income tax benefit	(451)

Deferred tax

The Society tax group, including the Company, has accumulated tax losses carried forward of $41,620,000 at 30 June 2020 (30 June 2019: $35,552,000), of which the Company has accumulated tax losses carried forward of $nil (30 June 2019: $nil).

	Note	2020 $000
Deferred tax comprises temporary differences attributable to:		
Intangible assets		(1,122)
Payables and other liabilities		86
Total deferred tax liabilities		(1,036)
Expected to crystallise within 12 months		(228)
Expected to crystallise in greater than 12 months		(808)
Total deferred tax liabilities		(1,036)
Movements in deferred tax liabilities		
Opening balance at 1 July 2019		-
Net deferred tax liabilities recognised on acquisition	16	(1,487)
Recognised in the statement of comprehensive income		451
Closing deferred tax liabilities as at 30 June 2020		(1,036)

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2020

12 INTANGIBLE ASSETS

Intangible assets are measured at cost, less accumulated amortisation and impairment losses. As disclosed in Note 16, the Company acquired intangible assets of $5,309,000 representing customer base and portfolio-in-force upon acquisition of the pet insurance business from Southern Cross Benefits Limited on 31 January 2020. Goodwill arising on acquisition totalled $4,192,000.

Amortisation is recognised to allocate the assets' costs, net of any residual amounts, over their estimated useful lives. The assets' useful lives are reviewed and adjusted if appropriate at each balance date. An asset's carrying amount is written down to its recoverable amount if it is considered that the carrying amount is greater than its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Assets	Estimated useful lives
• Customer base	16 years
• Portfolio-in-force	1 year
• Goodwill	Indefinite

Intangible assets	Note	Customer base $000	Portfolio-in-force $000	Goodwill $000	Total $000
As at 30 June 2020					
Opening balance		-	-	-	-
Intangible assets acquired at 31 January 2020	16	3,761	1,548	4,192	9,501
Opening net book value		3,761	1,548	4,192	9,501
Amortisation		(284)	(1,022)	-	(1,306)
Closing net book value as at 30 June 2020		3,477	526	4,192	8,195
As at 30 June 2020					
Cost		3,761	1,548	4,192	9,501
Accumulated amortisation and impairment		(284)	(1,022)	-	(1,306)
Closing net book value as at 30 June 2020		3,477	526	4,192	8,195

Customer base

Customer base represents the value of a customer base acquired, through its ability to generate future cash flows from retained business. It is recognised as an intangible asset when a business is acquired and when the criteria for recognition are met. A customer base is initially recognised at cost, which is the fair value at the acquisition date, and subsequently carried at cost less accumulated amortisation and any accumulated impairment losses. The capitalised costs are amortised on a diminishing value basis, net of any residual amounts, over the period when future economic benefits are expected to flow to the Company. Useful life represents management's estimate of the period of time over which the asset is expected to generate future cash flows from the pet lives insured and customers acquired. Amortisation is recognised using a systematic allocation of the expected retention of insured pet lives acquired at 31 January 2020. The retention of insured pet lives acquired is used for the purposes of assessing impairment and remaining useful life.

The recoverable amount of the CGU is determined based on value-in-use calculations, determined by discounting the future cash flows to be generated from the CGU. These calculations use discounted cash flow projections based on past experience, actual operating results and profit forecasts approved by management as part of the operating budget and forecast process. The discounted cash flow model has used a 16 year projection with a terminal value, a discount rate of 12.5%, and annual growth rates for insured pets lives and customer base acquired.

Key assumptions underlying the valuation relate to management's assessment of new business growth, claims cost escalation, premium increases and operating expenses. Management utilised local market data as well as Society expertise and experience to validate key assumptions. The key assumptions described above may change as economic and market conditions change. The Company estimates that reasonably possible changes in these assumptions are not expected to cause the recoverable amount of the CGU to decline below the carrying amount.

Portfolio-in-force

Portfolio-in-force represents the difference between the fair value of acquired insurance liabilities, and the fair value of the future claim and administration obligations arising in respect of those contracts. A portfolio-in-force is initially recognised at cost, which is the fair value at the acquisition date, and subsequently carried at cost less accumulated amortisation and any accumulated impairment losses. The capitalised costs are amortised on a diminishing value basis, net of any residual amounts, over the period when future economic benefits are expected to flow to the Company.

Goodwill

Goodwill relates entirely to the pet insurance business acquired on 31 January 2020. The cost of an acquisition is measured as the fair value of the total identifiable net assets acquired. On acquisition of a business combination, the excess of purchase consideration over the fair value of identifiable net assets acquired is recognised as goodwill. Following initial recognition, goodwill is not amortised as it has an indefinite useful life, but is tested for impairment annually and assessed at each reporting date for indicators of impairment. For the purposes of impairment testing, goodwill is allocated to the CGU. No impairment losses on goodwill were recognised during the year to 30 June 2020.

NOTES TO THE FINANCIAL STATEMENTS (continued)

for the year ended 30 June 2020

13 RELATED PARTIES

a Identity of related parties:	Relationship	Balance Date
• The Southern Cross Medical Care Society ("Society")	Parent	30 June
• Southern Cross Health Services Limited ("Health Services")	100% subsidiary of Society	30 June
• Southern Cross Insurance Services Limited ("SCISL")	100% subsidiary of Society	30 June
• Southern Cross Healthcare Limited (non-trading)	100% subsidiary of Society	30 June
• Southern Cross Health Trust ("Trust")	Related party of Society	30 June
• Southern Cross Benefits Limited ("SCBL")	100% subsidiary of Trust	30 June
• Southern Cross Hospitals Limited ("Hospitals")	100% subsidiary of Trust	30 June

The Company, the Society, SCBL, Hospitals and the Trust (the "Group") are separate legal entities. All entities provide their normal services to other group entities on normal commercial terms. However, some goods and services are purchased by the Group and other related parties on a combined basis, and are on-charged to other related parties at cost.

All related party balances are payable on normal trading terms and unsecured. No related party transactions have taken place at nil or nominal value. No related party balances have been written off or forgiven during the year ended 30 June 2020.

	Note	2020 $000
Total amount of transactions with Society		
Purchase of services	7	2,365
Share capital issued	14	15,000
Total amount of transactions with other related parties		
Sale of services to SCISL	7	27
Acquisition of pet insurance business from SCBL	16	8,077
Transfer of pet insurance net liabilities from SCISL	16	(44)
Total outstanding balances with Society		
Payables		515
Total outstanding balances with other related parties		
Receivable from SCISL		27

b Remuneration of directors

From 31 January 2020, remuneration was paid by the Company to directors.

The Society has insured the Company's directors and officers with directors' and officers' liability insurance cover, for liabilities to other parties that may arise from their positions as directors of the Company. Other operating expenses in relation to governance are met by the Company. The Company does not provide loans or advances to directors or officers.

All directors, excluding M J Gardiner and M L James, have medical insurance policies with the Society. No Company directors have pet insurance policies with the Company.

Director	Board Amount	Audit & Risk Committee Amount	Total Remuneration Amount
Actual directors' remuneration paid by the Company for the year ended 30 June 2020 was as follows:			
N J Astwick	-	-	-
M J Gardiner	6,264	1,044 Chair	7,308
M L James	10,440 Chair	-	10,440
J M Raue	6,264	-	6,264
Total	22,967	1,044	24,011

c. Remuneration of personnel

The Company has no direct employees. Key management personnel are members of the Society Leadership Team. Society key management personnel and employees manage the operations of the pet insurance business under a management services agreement. Management services costs are recorded as purchase of services in the statement of comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2020

14 SHARE CAPITAL

Share capital comprises 15,000,100 authorised, issued and fully paid $1.00 ordinary shares. 15,000,000 shares were issued on 15 June 2020. All ordinary shares have equal voting rights, and share equally in dividends and surplus on winding up. No dividends were paid for the year to 30 June 2020.

15 CONTINGENCIES AND SUBSEQUENT EVENTS

a Contingent liabilities

The Company had no contingent liabilities at 30 June 2020.

b Subsequent events

There were no events subsequent to the reporting period which would materially affect the financial statements.

c COVID-19 pandemic

On 11 March 2020 the World Health Organisation announced that the coronavirus ("COVID-19") outbreak be classified as a pandemic. This has resulted in the New Zealand government introducing various measures to combat the outbreak, including travel restrictions, quarantines, closure on non-essential businesses and lock-down of the country.

The pandemic has caused significant economic uncertainty. As a result of the COVID-19 pandemic and the country lock-down measures, certain key inputs and assumptions that underpin insurance contract liabilities and revenue recognition have been re-assessed for any identifiable change in claims behaviour and the broader economic uncertainty. Management have concluded that the effects of the COVID-19 Level 3 and Level 4 lock-down have largely flowed through claims experience. As a result, there is no specific allowance for COVID-19 in the central estimate of outstanding claims liabilities or premium liabilities, but risk margins for each have been increased in response to COVID-19 uncertainty. Amounts recognised in the financial statements have been adjusted by an additional 3% in the risk margin for outstanding claims liabilities and an additional 5% in the risk margin for premium liabilities (refer to Note 3) to reflect management assessment of the impact of COVID-19 as at 30 June 2020. Based on scenario modelling, management has assessed the Company's solvency ratio for the next 5 years to remain above the minimum solvency capital as required by the RBNZ.

16 ACQUISITION OF PET INSURANCE BUSINESS

On 31 January 2020, the Company acquired the assets and liabilities relating to the pet insurance business from SCBL and SCISL. Since the purchase of the pet insurance business by SCBL in 2012, the day to day oversight and management of the pet insurance business has been outsourced to the Society, via its subsidiary SCISL. The Company has acquired the pet insurance business because it combines ownership within the Society with the existing management operation of the business.

The assets and liabilities acquired from SCBL were acquired via an Asset Sale Agreement for $8,077,000. An independent valuation of the business was obtained for the acquisition price. The acquisition of the control of the business from SCBL meets the definition of a business combination under NZ IFRS 3 *Business Combinations* .

The fair value of the assets and liabilities acquired are determined to be equivalent to the carrying value at the date of acquisition, except for customer base and portfolio-in-force.

Estimates of the fair value of the acquired insurance contract liabilities have been determined by an external actuary at the date of acquisition.

Goodwill arising on acquisition is not deductible for tax purposes.

The identifiable assets and liabilities relating to the pet insurance business as at 31 January 2020 were transferred from SCISL, using carrying value as the measurement basis.

NOTES TO THE FINANCIAL STATEMENTS (continued)
for the year ended 30 June 2020

16 ACQUISITION OF PET INSURANCE BUSINESS (continued)

The fair values of the identifiable assets and liabilities acquired are outlined below.

	Note	SCBL	SCISL	Elimination	Total
		$000	$000	$000	$000
Assets					
Cash and cash equivalents		3,411	-	-	3,411
Premium and other receivables		9,450	579	(606)	9,423
Intangible assets		5,309	-	-	5,309
Total assets		18,170	579	(606)	18,143
Liabilities					
Payables and other liabilities		670	623	(606)	687
Insurance contract liabilities	3	12,128	-	-	12,128
Deferred tax liabilities		1,487	-	-	1,487
Total liabilities		14,285	623	(606)	14,302
Total identifiable net assets/(liabilities) at fair value		**3,885**	**(44)**	**-**	**3,841**
Goodwill arising on acquisition*		4,192	-	-	4,192
Purchase consideration transferred		**8,077**	**(44)**	**-**	**8,033**

*No reconciliation of the carrying amount of goodwill is provided on the basis the Company had no opening goodwill.

Insurance contract liabilities acquired are comprised of provision for outstanding claims net of reinsurance recoveries $2,243,000 and provision for unearned premium $9,885,000.

	SCBL	SCISL	Elimination	Total
Analysis of cash flows on acquisition				
Net cash acquired with the subsidiary (included in cash flows from investing activities)	3,411	-	-	3,411
Cash paid	(8,077)	44	-	(8,033)
Net cash flow on acquisition	**(4,666)**	**44**	**-**	**(4,622)**

17 CHANGES IN FINANCIAL REPORTING STANDARDS

New accounting standards not yet effective

There are a number of standards, amendments and interpretations which have been approved but are not yet effective. The Company expects to adopt these when they become due for adoption. The impact of these is still to be determined. The most significant of these is NZ IFRS 17 *Insurance Contracts* ("NZ IFRS 17").

NZ IFRS 17 will replace NZ IFRS 4 Insurance Contracts for annual periods beginning on or after 1 January 2023. This means that the Company will be required to produce comparative financial information with effect from 1 July 2022 and a first set of full year financial statements under the new standard for the year ending 30 June 2024. The Company has commenced IFRS17 project activities, with impact assessment completed and activities underway to consider options to respond to the changes that will be required to systems, processes and controls. Significant impact on systems is not expected: changes to the core system will be limited but opportunities will be considered on a cost/ benefit basis to make improvements to systems and processes. The Company will pursue the application of the Premium Allocation Approach, given the short term nature of pet insurance products. The new standard establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. Disclosure and measurement under NZ IFRS 17 differs significantly from NZ IFRS 4, and the impact of this standard on the Company is still to be determined.

Independent Auditor's Report

To the shareholder of Southern Cross Pet Insurance Limited

Report on the audit of the financial statements

Opinion

In our opinion, the accompanying financial statements of Southern Cross Pet Insurance Limited (the 'Company') on pages 2 to 16:

i. present fairly in all material respects the Company's financial position as at 30 June 2020 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

We have audited the accompanying financial statements which comprise:

— the statement of financial position as at 30 June 2020;

— the statements of comprehensive income, changes in equity and cash flows for the year then ended; and

— notes, including a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) ('ISAs (NZ)'). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

Our responsibilities under ISAs (NZ) are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

Our firm has also provided other services to the Company in relation to the audit of the year-end solvency return. Subject to certain restrictions, partners and employees of our firm may also deal with the Company on normal terms within the ordinary course of trading activities of the business of the Company. These matters have not impaired our independence as auditor of the Company. The firm has no other relationship with, or interest in, the Company.

Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole. The materiality for the financial statements as a whole was set at $262,000 determined with reference to a benchmark of the Company's net assets. We chose the benchmark because, in our view, net assets is a key indicator of the Company's solvency and its ability to pay claims which is a primary area of focus for users of the financial statements.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements in the current period. We summarise below those matters and our key audit procedures to address those matters in order that the shareholder as a body may better understand the process by which we arrived at our audit opinion. Our procedures were undertaken in the context of and solely for the purpose of our statutory audit opinion on the financial statements as a whole and we do not express discrete opinions on separate elements of the financial statements.

The key audit matter	How the matter was addressed in our audit
Valuation of insurance contract liabilities	
Refer to note 3 to the financial statements. Valuation of the Company's provision for outstanding claims requires significant judgement from management and the Company's externally appointed actuarial specialist. The COVID-19 pandemic has created significant additional risks in the assessment of the outstanding claims liabilities. The expected claims experience is inherently more uncertain due to changes in claims incidence and potential delays in receipt of claims notifications from policyholders. This increased risk impacted the extent and nature of audit evidence that we had to gather, specifically in relation to the key actuarial assumptions and judgements applied.	Our audit procedures included: — comparing the data used in the actuary's valuation to the Company's underlying accounting records and systems; — testing a sample of claims payments and case estimates to check whether they had the appropriate level of authorisation and support; — with support from our actuarial specialists, assessing the work of the Company's appointed actuary in estimating the future claims costs on claims incurred prior to 30 June 2020, including: - the appropriateness of the valuation methodology, estimates and assumptions, against relevant accounting and actuarial standards; - the appropriateness of key assumptions including claims frequency, payment patterns and claims inflation against benchmark information; and - separate consideration of the impact of COVID-19 on the valuation methodology and assumptions. We did not identify material exceptions from procedures performed, and found the judgements and assumptions to be balanced and consistent with our understanding of the Company.
Acquisition of Pet Insurance business	
Refer to note 16 to the financial statements. On 31 January 2020, the Company purchased the assets and liabilities of a Pet Insurance business from related parties. The acquisition has been accounted for in accordance with NZ IFRS 3 *Business combinations* and includes a number of significant management estimations and complex judgements. These include determining the fair value of the assets and liabilities including the identification and measurement of	Our audit procedures included: — assessing the appropriateness of the accounting treatment applied to the acquisition; — with support from our specialists, assessing: - the fair value of assets and liabilities acquired; - the identification and measurement of separately identifiable intangible assets including the customer base and portfolio-in-force asset; - the appropriateness of key assumptions including cash flow assumptions and discount rates adopted by management supporting the valuation of separately identifiable intangible assets; and - the key inputs and data used in the valuation model.

The key audit matter	How the matter was addressed in our audit
separately identifiable assets, being the customer base and the portfolio-in-force asset.	— assessing the adequacy of financial statement disclosures as required by NZ IFRS 3. We did not identify material exceptions from procedures performed and found the judgements and assumptions to be balanced and consistent with our understanding of the Company.

Other information

The Directors, on behalf of the Company, are responsible for the other information included in the entity's financial statements. Other information includes annual report disclosures and the appointed actuary's report issued under section 78 of the Insurance (Prudential Supervision) Act 2010. Our opinion on the financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears materially misstated. If, based on the work we have performed, 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.

Use of this independent auditor's report

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

Responsibilities of the Directors for the financial statements

The Directors, on behalf of the Company, are responsible for:

— the preparation and fair presentation of the financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;

— implementing necessary internal control to enable the preparation of a set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and

— assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objective is:

— to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and

— to issue an independent auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of these financial statements is located at the External Reporting Board (XRB) website at:
http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-2/

This description forms part of our independent auditor's report.

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

For and on behalf of

KPMG

KPMG
Auckland
4 September 2020

2 September 2020

The Directors
Southern Cross Pet Insurance Limited
Auckland

Dear Directors

Review of Actuarial Information Contained in Financial Statements as at 30 June 2020

Finity Consulting Pty Limited (Finity) has been asked by Southern Cross Pet Insurance Limited (SCPI) to carry out a review of the 30 June 2020 Actuarial Information contained in the financial statements and used in their preparation and to provide an opinion as to the appropriateness of this information. John Smeed is an employee of Finity and is the Appointed Actuary to SCPI. Finity has no relationship with SCPI apart from being a provider of actuarial services.

SCPI's policy is to seek and adopt the advice of the Appointed Actuary in respect of the Actuarial Information contained in its financial statements. We confirm that the financial statements as at 30 June 2020 have been prepared in accordance with this policy, and as such this satisfies the requirements of the Insurance (Prudential Supervision) Act 2010.

Having carried out the Actuarial Review, nothing has come to our attention that would lead us to believe that the Actuarial Information used in the financial statements or their preparation, or the determination of the solvency position for the Society as at 30 June 2020 is inappropriate. No limitations were placed on us in performing our review and all data and information requested was provided.

In our opinion SCPI has maintained a solvency margin in excess of the minimum required as at the balance date.

This report is being provided for the sole use of SCPI for the purpose stated above. It is not intended, nor necessarily suitable, for any other purpose and should only be relied on for the purpose for which it is intended.

Yours sincerely

John Smeed
Appointed Actuary

Anagha Pasche

Fellows of the New Zealand Society of Actuaries