VIRGINIA SURETY COMPANY INC – NEW ZEALAND BRANCH

Annual financial report

For the year ended 31 December 2020

VIRGINIA SURETY COMPANY INC – NEW ZEALAND BRANCH

STATEMENT BY DIRECTORS
For the year ended 31 December 2020

Director's report

Review of operations

The profit for the financial year after tax of $9,505,231 (2019 restated profit: $1,982,397) reflects the maturity of its existing earnings profile and claims experience.

Likely developments

The COVID-19 pandemic announced by the World Health Organisation is having a negative impact on global markets and business activity, which may have a flow-on effect to the operations of Virginia Surety Company, Inc (VSC) New Zealand and its financial performance.

The timing and extent of the impact of the pandemic and the associated recovery process is unknown. VSC New Zealand continues to monitor the situation and no estimate of its financial effect can be made at this stage. The directors have concluded that there is no impact from COVID-19 on VSC New Zealand's financial statements for the year ended 31 December 2020.

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

The Board of Directors of VSC New Zealand branch authorised these statements for issue on 5 May 2021. The directors have the power to amend and reissue the financial statements.

On behalf of the board

Director
Date: 5 May 2021

Independent auditor's report

To the Directors of Virginia Surety Company Inc - New Zealand Branch

We have audited the financial statements, which comprise:

- the statement of financial position 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 cashflows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Our opinion

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

Basis for opinion

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

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

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

Our firm provides tax compliance services to the Branch. In addition, subject to certain restrictions, certain partners and employees of our firm may deal with the Branch on normal terms within the ordinary course of trading activities of the Branch. These matters have not impaired our independence as auditor of the Branch. The provision of these other services has not impaired our independence as auditor of the Branch.

Our audit approach

Overview

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

Overall materiality: $0.5 million, which represents approximately 1% of gross earned premium revenue.

We chose gross earned premium revenue as the benchmark because, in our view, it is a key metric used in assessing the performance of the Branch, is not as volatile as other profit and loss measures, and is a generally accepted benchmark for insurance companies. We selected 1% based on our professional judgement, noting that it is also within the range of commonly accepted revenue-related benchmarks.

We have determined that there is one key audit matter:

- Valuation of outstanding claims

Materiality

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

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

Audit scope

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

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

Key audit matters

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

Key audit matter	How our audit addressed the key audit matter
Valuation of outstanding claims (2020: $6,012,520, 2019: $4,384,809) We considered the valuation of outstanding claims a key audit matter because of the complexity involved in the estimation process and the significant judgements that the Branch makes in determining the balance. The valuation of outstanding claims involves significant judgement and inherent uncertainty in estimating the expected present value of future payments for the claims to be incurred. The valuation of outstanding claims relies on the quality of underlying data. It involves complex and subjective assumptions about future events, both internal and external to the business, for which small changes in assumptions can result in material impacts on the estimate. In particular, judgement arises over the estimation of claims that have been incurred at the reporting date but have not yet been reported to the Branch (IBNR – incurred but not reported) as there is generally less information available in relation to these claims. Judgement also arises over claims that have been reported but there is uncertainty over the amount which will be settled. The estimate of expected future payments is discounted to present value using a risk free rate of return in order to reflect the time value of money. Judgement is involved in estimating the period over which claims are expected to settle. Outstanding claims include a risk margin that allows for the inherent uncertainty in the central estimate of the future claim payments. In determining the risk margin,	Our audit procedures included developing an understanding of key controls, including key data reconciliations and management review of the estimates. We tested the valuation of outstanding claims liabilities including IBNR claims for each class of business and compliance with New Zealand prudential standard 30. Accordingly, we: • assessed the reasonableness of methodology and underlying assumptions used in the valuation such as (chain ladder method, average claim sizes, claims frequency, expenses, inflation and discount rates) to check that these methods and assumptions were supported by appropriate management assessment and documentation; • tested the reconciliation of the policy level claims data to the Trial balance; • performed calculation checks including testing of the assumptions used, comparison to case estimates and risk margins (including the impact of COVID-19) and performed a sensitivity analysis on the key assumptions to evaluate the impact on the outstanding liabilities. • inspected a sample of claims paid during the year to assess whether they were supported by appropriate documentation and approved within delegated authority limits; and • tested the integrity of data used in the actuarial models by agreeing a sample of key model inputs to source. Together with our PwC actuarial expert, we: • obtained an understanding of the checks performed by the independent actuaries engaged by the Branch to ensure claims data is reconciled to the general ledger and the data used by the independent actuary is appropriate for determining the insurance liabilities at the reporting date; • evaluated the actuarial models and methodologies used by the Branch by comparing with generally accepted models and methodologies applied in the sector and with the prior year including investigation for any significant differences;

Key audit matter	How our audit addressed the key audit matter
the Branch takes into account the required prudential guidance and various factors,, such as mix of business, historical experience and the level of uncertainty in the net discounted central estimate. *Relevant references in the financial statements* Refer to notes 4(b)(i), 4(b)(iii - v) and 18 to the financial statements, which describe the elements that make up the balance.	• assessed each of the key assumptions such as average claim size, claim frequency, claims handling expenses, inflation by class of business for reasonableness of these assumptions including consistency with the previous review and whether the movements are in line with recent experience, our own sector knowledge and independently observable trends; • compared the current and previous discount rates applied for classes of business by independent actuary and ensure they are based on monthly risk free interest rates produced by the New Zealand Department of Treasury and do not appear reasonable; and • assessed the approach to setting the risk margin in light of the requirements of the New Zealand Equivalents to International Financial Reporting Standards and by comparing to known industry practices. In particular we focused on the assessed level of uncertainty in the central estimate.

Information other than the financial statements and auditor's report

The Directors are responsible for the other information. The other information comprises the information included in the annual report but does include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information included in the annual report and we do not, and will not express any form of assurance conclusion on the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Responsibilities of Management for the financial statements

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

In preparing the financial statements, Management is responsible for assessing the Branch's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless Management either intend to liquidate the Branch or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

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

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

This description forms part of our auditor's report.

Who we report to

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

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

For and on behalf of:

Barlow

Chartered Accountants
5 May 2021

Melbourne

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Comprehensive Income

For the year ended 31 December 2020

	Notes	2020 $	2019 Restated $
Revenue			
Gross written premium		50,304,361	48,119,437
Unearned premium movement		(9,812,930)	(22,238,459)
Gross earned premium revenue		**40,491,431**	**25,880,978**
Outward reinsurance premium		(22,749,635)	(20,517,187)
Deferred reinsurance premium movement		877,267	5,684,838
Outward reinsurance premium expense		**(21,872,368)**	**(14,832,349)**
Net earned premium revenue		**18,619,063**	**11,048,629**
Expenses			
Gross claims incurred	7	16,755,703	14,632,373
Reinsurance claims and other recoveries revenue		(8,241,466)	(9,773,431)
Net claims incurred		8,514,237	4,858,942
Gross commission expense		16,900,771	10,782,404
Reinsurance commission revenue		(9,109,929)	(5,633,717)
Net commission expense	19a	7,790,842	5,148,687
Investment income	10	9,598,912	4,365,004
Unrealised gain/(loss) on investments		27,957	(86,374)
		9,626,869	**4,278,630**
Other operating and administration expenses	9	(2,476,872)	(3,478,821)
Profit before income tax		**9,463,981**	**1,840,809**
Income tax benefit/(expense)	11	41,250	141,588
Profit/(Loss) after income tax		**9,505,231**	**1,982,397**
Total comprehensive income/(loss)		**9,505,231**	**1,982,397**
Operating profit for the year attributable to:			
Non-controlling interest		-	-
Owners of the parent		9,505,231	1,982,397
Operating Profit after tax		9,505,231	1,982,397
Total comprehensive income is attributable to:			
Non-controlling interest		-	-
Owners of the parent		9,505,231	1,982,397
Operating Profit after tax		**9,505,231**	**1,982,397**

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

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Financial Position

As at 31 December 2020

	Notes	2020	2019 Restated
		$	$
Assets			
Cash and cash equivalents	13	4,892,549	11,140,069
Investments at fair value through profit or loss	16	71,943,930	63,460,426
Trade and other receivables	14	17,440,405	15,544,033
Deferred acquisition costs	19b	10,606,701	9,044,245
Reinsurance and other recoveries on outstanding claims	17	10,108,783	11,253,857
Current tax asset	12b(ii)	296,095	402,550
Deferred tax assets	12a	42,638	1,387
Total assets		115,331,101	110,846,567
Liabilities			
Trade and other payables	15	14,440,361	16,941,956
Gross unearned premiums	20a	46,724,177	36,911,220
Gross outstanding claims	18a	6,012,520	4,384,809
Total liabilities		67,177,058	58,237,985
Net assets		48,154,043	52,608,582
Total equity		48,154,043	52,608,582

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

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Changes in Equity

For the year ended 31 December 2020

	Notes	Share Capital	Retained Earnings	Reserves	Total
Opening balance 1 Jan 2019		**52,978,356**	**993,978**	**(43,795)**	**53,928,539**
Movement in FX		-	-	(79,736)	(79,736)
Profit for the year		-	2,127,815	-	2,127,815
Closing balance 31 Dec 2019		52,978,356	3,121,793	(123,531)	55,976,618
Effects of restatement in prior year	4a	-	(862,003)	(2,506,033)	(3,368,036)
Closing balance 31 Dec 2019 (Restated)		**52,978,356**	**2,259,790**	**(2,629,564)**	**52,608,582**
Opening balance 1 Jan 2020		**52,978,356**	**2,259,790**	**(2,629,564)**	**52,608,582**
Unrealised loss on FX		-	-	(7,529,065)	(7,529,065)
Profit for the year		-	9,505,231	-	9,505,231
Intercompany dividend paid		-	(6,430,705)	-	(6,430,705)
Closing balance 31 Dec 2020		**52,978,356**	**5,334,316**	**(10,158,629)**	**48,154,043**

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

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Statement of Cash Flows

For the year ended 31 December 2020

	Notes	2020	2019 Restated
		$	$
Cash flows from operating activities			
Premium received		48,473,220	39,889,567
Reinsurance and other recoveries received		9,386,540	945,743
Claims paid		(15,127,992)	(9,401,926)
Acquisition Costs		(1,562,456)	(5,536,643)
Other Operating and Administration Expenses		(19,826,965)	(7,638,180)
Outward reinsurance paid		(21,872,368)	(14,832,349)
Interest (paid)/received		9,626,869	4,278,630
Net cash flows generated from operating activities	13	**9,096,848**	**7,704,842**
Cash flows from investing activities			
Purchase of investment assets		(22,187,047)	(12,672,341)
Proceeds from sale of investments		13,703,543	5,354,039
Net cash flows used in investing activities		**(8,483,504)**	**(7,318,302)**
Cash flows from financing activities			
Intercompany dividend paid		(6,430,705)	-
2019 restatement in relation to intercompany dividend		-	(2,800,000)
Repayments (to)/from related parties		(430,159)	9,615,413
Net cash flows from financing activities		**(6,860,864)**	**6,815,413**
Net decrease in cash and cash equivalents		(6,247,520)	7,201,953
Cash and cash equivalents at beginning of period		11,140,069	3,938,116
Cash and cash equivalents at end of period	13	**4,892,549**	**11,140,069**

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

Notes to the financial statements for the year ended 31 December 2020

1 Corporate information

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

The registered office of Virginia Surety Company Inc New Zealand branch (the Branch) for the year ended 31 December 2020 is: -

73 Manchester Street,
Christchurch, 8011
New Zealand

Assurant, Inc is the Branch's ultimate holding company.

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

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

Reinsurance contracts

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

VSC New Zealand has the following reinsurance agreements with The Hollard Insurance Company Ltd to reinsure 100% of the risk associated with certain classes of business as described below and with American Bankers Insurance Company of Florida to reinsure 100% of the risk associated with new and used tractors: -

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

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

2 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of the financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

a) Basis of preparation

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). They comply with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable financial reporting standards, as appropriate for for-profit entities. VSC New Zealand is a for-profit entity registered under the Companies Act 1993. The financial statements are prepared in accordance with the requirements of Part 7 of the Financial Markets Conduct Act 2013.

The financial statements of VSC New Zealand comply with International Financial Reporting Standards (IFRS). 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 VSC New Zealand's notes to the financial statements. VSC New Zealand is an FMC reporting entity under Part 7 of the Financial Markets Conduct Act 2013 and it is a Licenced Insurer under the Insurance (Prudential Supervision) Act 2010.

Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by certain exceptions noted in the financial statements, with the principal exceptions being the measurement of financial assets at fair value and the measurement of the outstanding claims liability and related reinsurance and other recoveries at present value.

The preparation of the financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the Branch's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions or estimates are significant, are disclosed in note 4.

b) Premium Revenue

Premium revenue comprises amounts charged to policyholders, excluding taxes collected on behalf of third parties. The earned portion of premium received and receivable, including unclosed business, is recognised as revenue. Premium revenue on unclosed business is brought to account based upon the pattern of booking of renewals and new business.

c) Unearned premium

Unearned premium is calculated based on the term of the risk and in accordance with the expected pattern of the incidence of risks underwritten, using the straight-line or rule of 78 basis over the period of risk.

At each balance sheet date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims in respect of the relevant insurance contracts, plus an additional risk margin to reflect the inherent uncertainty of the central estimate. If the present value of the expected future cash flows relating to future claims plus the additional risk margin exceeds the unearned premium liability less related intangible assets and related deferred acquisition cost, then the unearned liability is deemed to be deficient. The resulting deficiency is recognised immediately in profit or loss.

d) Outward reinsurance

Premium ceded to reinsurers is recognised as an expense from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of the incidence of risk. Accordingly, a portion of outward reinsurance premium is treated as deferred reinsurance premium at the balance sheet date.

e) Reinsurance and other recoveries

Reinsurance and other recoveries on paid claims, reported claims not yet paid and IBNR are recognised as revenue. Amounts recoverable are assessed in a manner similar to the assessment of outstanding claims. Recoveries are measured as the present value of the expected future receipts, calculated on the same basis as the provision for outstanding claims.

f) Acquisition expenses

Acquisition costs (which include commission costs) are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalised when they relate to the acquisition of new business or the renewal of existing business and are referred to as deferred acquisition costs. These costs are amortised on the same basis as the earning pattern of the premium, over the period of the insurance contract to which they relate. At the balance sheet date, deferred acquisition costs represent the capitalised costs that relate to the unearned premium. Acquisition costs are deferred in recognition of their future benefit and are measured at the lower of cost and recoverable amount.

g) Outstanding claims

The provision for outstanding claims is measured as the central estimate of the present value of expected future claims payments plus a risk margin. The expected future payments include those in relation to claims reported but not yet paid, claims incurred but not reported (IBNR) and estimated claims handling costs. Claims expense represents claim payments adjusted for the movement in the outstanding claims liability.

The expected future payments are discounted to present value using a risk-free rate.

A risk margin is applied to the central estimate, net of reinsurance and other recoveries, to reflect the inherent uncertainty in the central estimate.

Notes to the financial statements for the year ended 31 December 2020

2 Summary of significant accounting policies (continued)

h) Taxation

The income tax expense for the year is the tax payable on the current year's taxable income, adjusted by changes in deferred tax assets and liabilities attributable to temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax is provided in full, using the liability method, on temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax assets and liabilities are recognised for temporary differences at the tax rate expected to apply when the assets are recovered or liabilities are settled. The relevant tax rates are applied to the cumulative amounts of deductible and taxable temporary differences to measure the deferred tax asset or liability. An exception is made for certain temporary differences arising from the initial recognition of an asset or liability. No deferred tax asset or liability is recognised in relation to these temporary differences if they arose in a transaction that is not a business combination and at the time did not affect either accounting profit or taxable loss.

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 offset when there is a legally enforceable right to offset current tax assets and liabilities. Current tax assets and liabilities are offset where the entity has a legally enforceable right to offset and intends either to settle on a net basis, or to realise the asset and settle the liability on a net basis, or to realise the asset and settle the liability simultaneously.

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

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

i) Goods and Services Tax (GST)

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

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

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

j) Investments income

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 in the Statement of Comprehensive Income.

k) Investments

Investment assets are financial assets within the scope of NZ IFRS 9. VSC New Zealand's investments are designated as at fair value through profit or loss on initial recognition and subsequently remeasured to fair value at each reporting date, reflecting the branch's business model for managing and evaluating the investment portfolio.

Assets that are subsequently measured at fair value through profit or loss are not subject to impairment considerations under the expected credit losses model.

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

l) Foreign currency translation

(i) Functional and presentation currency

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

(ii) Transactions & balances

Foreign currency transactions are translated into New Zealand dollars at the spot rates of exchange applicable at the dates of the transactions. At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are translated at the rates of exchange prevailing at that date. Resulting exchange gains and losses are included in profit or loss.

2 Summary of significant accounting policies (continued)

m) Trade and other receivables

Trade and other receivables are principally amounts owed to the branch by policyholders. Unclosed premium receivables are estimated amounts due to the branch in relation to business for which the branch is on risk but where the policy is not billed to the counterparty at the balance date.

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

Premium and reinsurance receivables are excluded from the scope of NZ IFRS 9. These are initially recognised at fair value and are subsequently measured at amortised cost less any impairment. Any increase or decrease in the provision for impairment is recognised in profit or loss within underwriting and other expenses.

A provision for impairment on Premium or reinsurance receivables is established when there is objective evidence that the branch will not be able to collect all amounts due according to the original term of the receivable.

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

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

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

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

VSC considers that the credit risk on other receivables within the scope of NZ IFRS 9 has not increased significantly since initial recognition, and these assets represent low credit risks. VSC New Zealand does not foresee losses arising on these receivables from possible default events within 12 months from the reporting date, and considers that no allowance for impairment is required at 31 December 2020.

For receivables outside the scope of NZ IFRS 9, an allowance for impairment is established when there is objective evidence that VSC New Zealand will not be able to collect all amounts due according to the original term of the receivable. VSC New Zealand regularly reviews the collectability of receivables and the adequacy of allowances for impairment.

n) Trade and other payables

Trade and other payables primarily comprise amounts related to intercompany balance, premium payable and taxes.

Amounts owed by VSC New Zealand are financial liabilities within the scope of NZ IFRS 9 except for those amounts which represent obligations under an insurance contract as defined in NZ IFRS 4 Insurance Contracts.

Reinsurance premium payables are outside the scope of NZ IFRS 9. They are initially recognised at fair value and are subsequently measured at amortised cost.

Other payables are within the scope of NZ IFRS 9. They are also initially recognised at fair value and are subsequently measured at amortised cost.

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.

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

o) Cash and cash equivalents

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

2 Summary of significant accounting policies (continued)

p) Critical Accounting Estimates and Judgements

The Branch makes estimates and assumptions in respect of certain key assets and liabilities. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Estimates of the outstanding claims as at 31 December 2020 and 31 December 2019, are the responsibility of James Pettifer, Fellow of the Institute of Actuaries of Australia.

The actuarial assessments are in accordance with the standards and guidance of the Institute of Actuaries of Australia and New Zealand Society of Actuaries.The Actuary is satisfied with the nature, sufficiency and accuracy of the data used to determine the outstanding claims liability.

The outstanding claims liability is set at a level that is appropriate and sustainable to cover the Branch's obligations after having regard to the prevailing market environment and prudent industry practice.

q) Valuation of outstanding claims provision

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

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

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

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

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

The carrying value at the reporting date of expected gross claims liabilities is $6,012,520 (2019 restated: $4,384,809).

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

r) Rounding of amounts

Amounts in the financial statements have been rounded off to the nearest dollar.

Notes to the financial statements for the year ended 31 December 2020

3. NEW ACCOUNTING STANDARDS AND AMENDMENTS

a) New and amended standards adopted by the Branch

There were no new accounting standards adopted in the financial year ending 31 December 2020.

b) New Accounting Standards and Interpretations

NZ IFRS 17, a new accounting standard for insurance contacts, was adopted by the New Zealand Accounting Standards Board on 10 August 2017. The IASB subsequently issued Amendments to IFRS 17 in June 2020 to address feedback and implementation issues raised by stakeholders. The amendments were adopted by the NZ ASB in August 2020 and include the deferral of the mandatory effective date to reporting periods beginning on or after 1 January 2023 (previously 1 January 2021).

Given the potential for changes in NZ IFRS 17 and the broad scope, complexity and lack of general consensus on the interpretation of key components of the standard, the impact of NZ IFRS 17 on the Branch's financial statements is still being determined; however, significant disclosure changes and some impact on reported profit or loss are expected. The Branch continues to monitor market developments in order to assess the impact of changes and evolving interpretations.

4. CRITICAL ESTIMATES, JUDGEMENTS AND ERRORS

a) Restatement

In December 2020, management discovered errors relating to an incorrect foreign exchange rate used in preparing the FY 2019 financial statements, a mismatch between the gross outstanding claims in the statutory account and the omission of the intercompany dividend which occurred in FY 2018.

An intercompany dividend was mistakenly omitted resulting in an overstatement of retained earnings and understatement of intercompany payable by $2,800,000. Gross outstanding claims was amended downward by $2,083,415 to agree with the ILVR report in line with the IFRS standards. VSC New Zealand holds a number of investments which are denominated in USD. In 2019, an incorrect foreign exchange rate was used to translate the foreign income and net assets leading to an overstatement of both investment income by $149,847 and the assets by $2,791,856.

The errors have been corrected by restating each of the affected financial statement line items for the prior periods as follows:

2019 Restated Statement of comprehensive income

	2019	2019 adjustment	2019 Restated
	$	$	$
Revenue			
Premium revenue	48,119,437	-	48,119,437
Change in unearned premium reserve related to reinsurance contract	(22,238,459)	-	(22,238,459)
Total Revenue	25,880,978	-	25,880,978
Reinsurance premium ceded	(20,517,187)	-	(20,517,187)
Change in unearned premium revenue related to reinsurance contract	5,684,838	-	5,684,838
Net insurance premum revenue	11,048,629	-	11,048,629
Expenses			
Claims incurred	14,632,373	-	14,632,373
Insurance claims recovered from reinsurer	(9,773,431)	-	(9,773,431)
Expenses for acquisition of insurance contracts	5,148,687	-	5,148,687
	10,007,629	-	10,007,629
Investment income	4,514,851	(149,847)	4,365,004
Unrealised loss on investments	(86,374)	-	(86,374)
	4,428,477	(149,847)	4,278,630
Other operating and administration expenses	(3,483,250)	4,429	(3,478,821)
Profit before income tax	1,986,227	(145,418)	1,840,809
Income tax benefit/(expense)	141,588	-	141,588
Profit/(Loss) after income tax	2,127,815	(145,418)	1,982,397

4. CRITICAL ESTIMATES, JUDGEMENTS AND ERRORS (continued)

a) Restatement (continued)

2019 Restated Statement of financial position

	2019	2019 adjustment	2019 Restated
	$	$	$
Assets			
Non-current assets			
Investments at fair value through profit or loss	66,122,642	(2,662,216)	63,460,426
Deferred tax assets	1,387	-	1,387
Total non-current assets	**66,124,029**	**(2,662,216)**	**63,461,813**
Current assets			
Cash and cash equivalents	11,201,549	(61,480)	11,140,069
Trade and other receivables	15,612,193	(68,160)	15,544,033
Deferred acquisition costs	9,044,245	-	9,044,245
Current tax asset	402,550	-	402,550
Reinsurance assets	11,253,857	-	11,253,857
Total current assets	**47,514,394**	**(129,640)**	**47,384,754**
Total assets	**113,638,423**	**(2,791,856)**	**110,846,567**
Liabilities			
Current liabilities			
Trade and other payables	14,283,848	2,658,108	16,941,956
Outstanding claims	6,468,224	-	6,468,224
Unearned premiums	36,911,220	-	36,911,220
Total current liabilities	**57,663,292**	**2,658,108**	**60,321,400**
Total liabilities	**57,663,292**	**2,658,108**	**60,321,400**
Net assets	**55,975,131**	**(5,449,964)**	**50,525,167**
	55,975,131	**(5,449,964)**	**50,525,167**

2019 restated Changes in Equity

	Share Capital	Retained Earnings	Reserves	Total
Opening balance 1 Jan 2019	**52,978,356**	**993,978**	**(43,795)**	**53,928,539**
Movement in FX	-	-	(79,736)	(79,736)
Profit for the year	-	2,127,815	-	2,127,815
Closing balance 31 Dec 2019	52,978,356	3,121,793	(123,531)	55,976,618
Impact from restatement of FY 2019	-	(862,003)	(2,506,033)	(3,368,036)
Adjusted closing balance 31 Dec 2019	**52,978,356**	**2,259,790**	**(2,629,564)**	**52,608,582**

4. CRITICAL ESTIMATES, JUDGEMENTS AND ERRORS (continued)

b) Outstanding claims provision

VSC New Zealand's net outstanding claims provision comprises:
- the gross central estimate of expected future claims payments;
- amounts recoverable from reinsurers based on the gross central estimate;
- a reduction to reflect the discount to present value using risk-free rates of return to reflect the time value of money; and
- a risk margin that reflects the inherent uncertainty in the net discounted central estimate.

A net discounted central estimate is intended to represent the mean of the distribution of the expected future cash flows. As VSC New Zealand requires a higher probability that estimates will be adequate over time, a risk margin is added to the net discounted central estimate to determine the outstanding claims provision.

i) Central estimates

The provision for expected future payments includes those in relation to claims reported but not yet paid, claims incurred but not reported (IBNR) and estimated claims handling costs, being the indirect expenses incurred in the settlement of claims.

The estimation of IBNR is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to VSC New Zealand, where more information about the claims is generally available. Claims in respect of property and other short tail classes are typically reported and settled sooner after the claim event, giving rise to more certainty. The estimation techniques and assumptions used in determining the central estimate are described below.

VSC New Zealand's process for establishing the central estimate involves extensive consultation with internal and external actuaries, claim managers, underwriters and other senior management.

The determination of the amounts that VSC New Zealand 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 for long tail insurance classes due to the longer period of time that elapses before a definitive determination of the ultimate claims cost can be made;
- incidence of catastrophic events close to the balance sheet date;
- changes in the legal environment including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example price and wage inflation and interest rates.

The potential impact of changes in key assumptions used in the determination of the central estimate and the probability of adequacy of the central estimate on VSC New Zealand's profit or loss are summarised in note 3(b)(iv) and (v). Central estimates for each class of business are determined by reference to a variety of estimation techniques, generally based on a statistical analysis of historical experience which assumes an underlying pattern of claims development and payment. The final selected central estimates are based on a judgmental consideration of the results of each method and qualitative information, for example, the class of business, the maturity of the portfolio and the expected term to settlement of the class. Projections are based on both historical experience and external benchmarks where relevant.

Central estimates are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts recoverable from reinsurers based on the gross central estimate.
The net central estimate is discounted at risk-free rates of return to reflect the time value of money. Details of the key assumptions applied in the discounting process are summarised in note 3(b)(iv).

ii) Assets arising from contracts with reinsurers

Assets arising from contracts with VSC New Zealand's reinsurers are determined using the same methods described above. In addition, the recoverability of these assets is assessed at each balance sheet date to ensure that the balances properly reflect the amounts that will ultimatelybe received, taking into account counterparty credit risk and the contractual terms of the reinsurance contract. Counterparty and credit risk in relation to reinsurance assets is considered in note 5(c)(ii).

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2020

4. CRITICAL ESTIMATES, JUDGEMENTS AND ERRORS (continued)

b) Outstanding claims provision (continued)

iii) Risk margin

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

- change in the mix of business, in particular the mix of business and the overall weighted average term to settlement;
- prior accident year claims development; and
- the level of uncertainty in the net discounted central estimate due to actuarial estimation, data quality issues, variability of key discount and inflation assumptions and legislative uncertainty.

The variability by class of business uses techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign a likelihood to outcomes at different levels. These techniques use standard statistical distributions, and the measure of variability is referred to as the coefficient of variation.

The appropriate risk margin for two or more classes of business combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification in general insurance. The statistical measure used to determine diversification is called the correlation. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class.

The risk margin for VSC New Zealand is determined by analysing the variability of each class of business and the correlation between classes of business and divisions. Correlations are determined for aggregations of classes of business. Whilst there are estimation techniques for determining correlations, they are difficult to apply. The correlations adopted by VSC New Zealand are normally derived from industry analysis and the judgement of experienced and qualified actuaries.

iv) Financial assumptions used to determine the outstanding claims provision discount rates

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

The New Zealand Society of Actuaries' Professional Standard No 4.1. requires a risk-free discount rate to be used in determining the present expected future claims payments. The discount rates used in the measurement of outstanding claims and reinsurance recoveries for the succeeding year was 0.20% and subsequent years was 0.30%.

Weighted average term to settlement

The relevant discount rate is applied to the anticipated cash flow profile of the central estimate, including related reinsurance recoveries, determined by reference to a combination of historical analysis and current expectations of when claims and recoveries will be settled. The weighted average term to settlement of the Branch's claims provision is 1.31 years (2019: 1.50 years).

Other Assumptions

The assumption for claims inflation by reserving class may differ by methodology a) the Paid Chain Ladder method implicity includes an assumption of inflation; b) the inflation used in the PPCI method is based on the increases in average payments by payment month at a reserving class level; c) the inflation used in the Nornhuetter-Ferguson method is based on the historical experience at an individual program level; and d) the inflation used in the Future Claims Liabilities is based on the historical experience at an individual program level combines with future expectations of the likely increases in Average Claim Size in the portfolio.

v) Impact of changes in key variables on the outstanding claims provision

A key parameter within the actuarial assessment of claims reserves is the initial expected loss ratio (IELR) for each class of business. The impact of adjusting IELRs parameters by 20% on the after-tax profit is summarised in the table below. In performing this analysis we have not allowed for excess of loss or facultative reinsurance that would be recovered on large losses. This sensitivity analysis is applied to all classes of business simultaneously and does not allow for the diversification benefit that occurs in practice.

	Outstanding claims provision - Central Estimate	% changes	Future claims provision - Central Estimate	% changes
Base Assumption	3,993,459	-	27,084,169	-
Increase in Discount Rate by 1%	3,985,725	-0.2%	26,765,944	-1.2%
Adoption of highest OCL Model	6,928,840	73.5%	-	-
1% higher inflation assumption	4,000,983	0.2%	27,408,536	1.2%
Increase Cancellation rate by 2%	-	-	27,262,532	0.7%
Increase in Loss Ratio for Protecta portfolios by 10%			28,342,418	4.6%

Due to the large difference in size between the Future Claims Liabilities and the Outstanding Claims Liabilities, minor variations in the Future Claims Liablities have a larger impact than significant variations in the Oustanding Claims Liabilities.

4. CRITICAL ESTIMATES, JUDGEMENTS AND ERRORS (continued)

c) Liability adequacy test

At each balance sheet date, the adequacy of the unearned premium liability is assessed on a net of reinsurance basis against the present value of the expected future cash flows relating to potential future claims, plus a risk margin to reflect the inherent uncertainty of the central estimate. Future claims are those claims expected to arise from claims events occurring after the balance sheet date.

Reported claims have been assessed in the light of the information available at balance date and after taking account of expected trends in future settlements. The outstanding claims liability is measured as the central estimate of the present value of expected future payments relating to claims incurred at the reporting date with an additional risk margin to allow for the inherent uncertainty in the central estimate. The liability is measured based on valuations performed by the Appointed Actuary. The liability is discounted to present value using a risk free rate. Refer to Note 2 (q).

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

5. RISK MANAGEMENT

Risk management is a key part of VSC New Zealand's governance structure and our strategic and business planning. It underpins the setting of limits and authorities and it is embedded in the monitoring and evaluation of performance. This holistic approach to risk management allows all of the Branch's risks to be managed in an integrated manner.

VSC New Zealand's risk management framework defines the risks that VSC New Zealand is exposed to and sets out the framework to manage those risks and meet strategic objectives whilst taking into account the creation of value for shareholders . The framework is made up of complementary elements that are embedded throughout the business management cycle and culture. Key aspects include: governance, risk appetite and tolerance, delegated authorities, risk policies, measurement and modelling, risk and control self-assessment, risk treatment, optimisation and ongoing improvement through management action plans, risk and performance monitoring.

VSC New Zealand is subject to extensive prudential and other forms of regulation in all jurisdictions in which they conduct business. Prudential regulation is generally designed to protect policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations. The regulatory environment in NZ, Australia and overseas continues to evolve in response to economic, political and industry developments. VSC New Zealand works closely with regulators and monitors regulatory developments across its global operations to assess their potential impact on its ability to meet solvency and other requirements.

VSC New Zealand's risk profile is described under the following broad risk categories:

- Strategic risk
- Insurance risk
- Credit risk
- Market risk
- Liquidity risk
- Operational risk

Each of these is described more fully in sections a) to f) below.

a)Strategic risk

Strategic risk refers to the current and prospective impact on earnings and or capital arising from strategic business decisions, implementation of decisions and responsiveness to external change. This includes risks associated with business strategy and change, tax planning, investment strategy and corporate governance. Of particular relevance is capital management risk.

Capital management risk

VSC New Zealand is subject to extensive prudential and other forms of regulation in all jurisdictions in which they conduct business. Prudential regulation is generally designed to protect policyholders. Regulation covers a number of areas including solvency, change in control and capital movement limitations. The regulatory environment in NZ, Australia and overseas continues to evolve in response to economic, political and industry developments. VSC New Zealand works closely with regulators and monitors regulatory developments across its global operations to assess their potential impact on its ability to meet solvency and other requirements.

b)Insurance risk

Insurance risk is the risk of fluctuations in the timing, frequency and severity of insured events and claims settlements, relative to the expectations at the time of underwriting. This includes underwriting, catastrophe, claims concentration and claims estimation risks. The risks inherent in any single insurance contract are the possibility of the insured event occuring and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, these risks are random and unpredicatble. In relation to the pricing of individual insuarnce contracts and the determination of the level of the outstanding claims provision in relation to a portfolio of insurance contracts, the princiapl risk is that the ultimate claims payments will exceed the carrying amount of the provision established.

Insurance and reinsurance policies are written in accordance with VSC New Zealand's management practices and New Zealand regulations taking into account VSC New Zealand's risk appetite and tolerance and underwriting standards. Pricing of risks is controlled by the use of in-house pricing models relevant to specific portfolios. Experienced underwriters and actuaries mantain historical pricing and claims analysis for each portfolio and this is combines with a detailed knowledge of the current developments in the respective marekts and classes of business.

5. RISK MANAGEMENT

c)Credit risk

Credit risk is the risk of default by transactional counterparties as well as the loss of value of assets due to deterioration in credit quality. Exposure to credit risk results from financial transactions with securities issuers, debtors, policyholders and reinsurers.

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

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

i) Credit quality of financial assets

The following tables provide information regarding VSC New Zealand's aggregate credit risk exposure at the balance sheet date in respect of the major classes of financial assets.

	CREDIT RATING				
	Aaa	Aa	A	BBB	TOTAL
At December 2020	$	$	$	$	$
Cash and cash equivalents	-	-	4,892,549	-	**4,892,549**
Interest bearing investments	2,711,640	10,479,025	1,369,468	57,383,797	**71,943,930**
At December 2019					
Cash and cash equivalents	-	-	11,140,069	-	**11,140,069**
Interest bearing investments	-	7,259,190	220,825	55,980,411	**63,460,426**

	TRADE AND OTHER RECEIVABLES AGING			
	0 to 3 MTHS	**3 TO 6 MTHS**	**6 MTHS TO 1 YEAR**	**TOTAL**
At December 2020	$	$	$	$
Premium receivable	15,856,452	18,765	27,186	15,902,403
Provision for Doubtful Debts	-	-	(24,828)	(24,828)
Prepayment	952,675	-	-	952,675
Other receivables	311,061	-	-	311,061
Investment income receivable	299,094	-	-	299,094
Total	**17,419,282**	**18,765**	**2,358**	**17,440,405**
At December 2019				
Premium receivable	13,885,154	41,459	96,322	14,022,935
Provision for Doubtful Debts	-	-	-	-
Other receivables	8,330	-	-	8,330
Investment income receivable	1,500,645	-	-	1,500,645
Deferred income	12,123	-	-	12,123
Total	**15,406,252**	**41,459**	**96,322**	**15,544,033**

ii) Reinsurance counterparty credit risk

The following table provides information about the quality of VSC New Zealand's credit risk exposure in respect of undiscounted reinsurance and other recoveries on outstanding claims at the balance sheet date. The analysis classifies the assets according to Standard and Poor's counterparty ratings. AAA is the highest possible rating.

	CREDIT RATING	
	A	TOTAL
At December 2020	$	$
Reinsurance recoveries on outstanding claims	10,108,783	10,108,783
Total		**10,108,783**
At December 2019		
Reinsurance recoveries on outstanding claims	11,253,857	11,253,857
Total		**11,253,857**

5. RISK MANAGEMENT (CONTINUED)

d)Market risk

Market risk is the risk of variability in the value of and returns on, investments and the risk associated with variability of interest rates, foreign exchange rates and economy wide inflation on both assets and liabilities excluding insurance liabilities.

i) Currency risk

VSC New Zealand's exposure to currency risk generally arises as a result of the translation of foreign currency amounts back to the functional currency of VSC New Zealand.

ii) Interest rate risk

Financial instruments with floating interest rate expose VSC New Zealand to cash flow interest rate risk, whereas fixed interest rate instruments expose the Branch to fair value interest rate risk.

VSC New Zealand's risk management approach 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. VSC New Zealand invests in high quality, liquid interest-bearing securities and cash and actively manages the duration of the fixed interest portfolio.

The claims provision is discounted to present value by reference to risk-free interest rates. VSC New Zealand is therefore exposed to potential underwriting result volatility as a result of interest rate movements. In practice, however, an increase or decrease in interest rates is normally offset by a corresponding increase or decrease in inflation. VSC New Zealand has a policy of maintaining a relatively short duration for assets backing insurance liabilities in order to minimise any further potential volatility affecting insurance profit.

The contractual maturity profile of VSC New Zealand's interest-bearing financial assets and hence its exposure to interest rate risk, and the effective weighted average interest rate for interest-bearing financial assets is analysed in the table below. The table includes investments at the maturity date of the security.

	INTEREST - BEARING FINANCIAL ASSETS MATURING IN					
	1 YEAR OR LESS	1 TO 2 YEARS	2 TO 3 YEARS	3 TO 4 YEARS	4 YEARS OR MORE	Total
At December 2020	**$**	**$**	**$**	**$**	**$**	
Fixed rate	60,347,049	-	4,804,947	2,570,937	4,220,997	**71,943,930**
Weighted average interest rate	%	0.51				
At December 2019						
Fixed rate	57,263,895	3,263,951	-	2,932,580	-	**63,460,426**
Weighted average interest rate	%	1.26				

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

		PROFIT/(LOSS) & EQUITY *	
	SENSITIVITY	**2020**	**2019**
	%	**$**	**$**
Interest rate movement - interest - bearing financial assets	+0.50	**359,720**	317,302
	-0.50	**(359,720)**	(317,302)

* Net of tax at the Branch's prima facie rate of 28%

5. RISK MANAGEMENT (CONTINUED)

d)Market risk (continued)

iii) 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.

e)Liquidity risk

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

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

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

f)Operational risk

Operational risk is the risk of financial loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk). VSC New Zealand manages operational risk within the same robust risk management framework as its other risks. The risk assessment and monitoring framework involves on-going:

- identification and review of the key risks to VSC New Zealand;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks throughout VSC New Zealand in terms of the acceptable level of risk (risk tolerance) and the residual risk remaining after having considered risk treatment;

- assessment of whether each risk is within the acceptable level of risk, or requires appropriate action be taken to mitigate any excess risk;
- transparent monitoring and reporting of risk management related matters on a timely basis; and
- alignment of internal audit programs with risks.

One of the cornerstones of VSC New Zealand's risk management framework is the recruitment and retention of high quality people who are entrusted with appropriate levels of autonomy within the parameters of disciplined risk management practices.

VSC New Zealand operates a system of delegated authorities based on expertise and proven performance, and compliance is closely monitored. Other controls include effective segregation of duties, access controls and authorisation and reconciliation procedures.

6. RELATED PARTY TRANSACTIONS

The following table provides the total amount of transactions that were entered into with related parties for the relevant financial year (for information regarding outstanding balances for trade and other receivables, refer to Note 14)

		Sales to Related Parties	Purchases from Related Parties	Expenses Charged by Related Parties
Fellow subsidiaries :		$	$	$
The Warranty Group Australasia Pty Ltd Expenses paid for on behalf of the Branch	2020	-	-	(3,459,491)
	2019	-	-	(5,064,361)
The Warranty Group Australasia Pty Ltd Marketing & administration fees	2020	-	-	(1,846,949)
	2019	-	-	(2,125,180)

During the year, The Warranty Group Australasia Pty Ltd, paid expenses of $3,459,491 (2019: $5,064,361) on behalf of the New Zealand Branch of Virginia Surety Company Inc. These expenses were recharged to the Branch at year end.

There was no KMP employed by VSC New Zealand.

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

	2020	2019 Restated
	$	$
VSC Australia	4,433,459	493,416
TWG Australasia	(15,293,895)	(11,387,756)
Total related party payable	(10,860,436)	(10,894,340)

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

Terms and conditions of transactions with related parties
Sales to and purchases from related parties are made in arm's length transactions both at normal market prices and on normal commercial terms. Outstanding balances at year-end are unsecured, interest free and settlement occurs in cash.

7. CLAIMS INCURRED

a) Claims Analysis

	2020 $	2019 Restated $
Gross claims incurred and related expenses		
Direct	16,755,703	14,632,373
Reinsurance and other recoveries		
Direct	(8,241,466)	(9,773,431)
Net claims incurred	8,514,237	4,858,942

b) Net claims incurred

Current year's claims relate to risks born in the current reporting year. Prior year claims relate to a reassessment of the risks borne in all previous years and include releases of risk margins as claims are paid.

	2020			2019		
	Current Year	Prior Year	Total	Current Year	Prior Year	Total
Gross claims incurred and related expenses						
Undiscounted	16,604,187	151,516	16,755,703	14,480,857	151,516	14,632,373
Discount	-	-	-	-	-	-
Gross claims incurred	16,604,187	151,516	16,755,703	14,480,857	151,516	14,632,373
Reinsurance and other recoveries						
Undiscounted	(8,241,466)	-	(8,241,466)	(9,773,431)	-	(9,773,431)
Discount	-	-	-	-	-	-
Reinsurance claims incurred	(8,241,466)	-	(8,241,466)	(9,773,431)	-	(9,773,431)
Net claims incurred						
Undiscounted	8,362,721	151,516	8,514,237	4,707,426	151,516	4,858,942
Discount	-	-	-	-	-	-
Net claims incurred	**8,362,721**	**151,516**	**8,514,237**	**4,707,426**	**151,516**	**4,858,942**

8. AUDITORS' REMUNERATION

The auditor of the Branch is PricewaterhouseCoopers.

Auditors' fees payable for the audit of the financial report of the company as at 31 December 2020 amounted to $73,500 (2019: $69,654).

Auditos' fees charged for the year comprises

	2020 $	2019 Restated $
Auditor Remuneration		
Audit fee	73,500	69,654
Tax compliance	12,000	12,000
	85,500	81,654

9. OTHER OPERATING AND ADMINISTRATION EXPENSES

Other Operating and administration expenses comprises:

	2020 $	2019 Restated $
Salaries & benefits	20,859	12,523
Intercompany cost allocation charge	1,897,367	6,596,558
Office & communication	110,231	130,299
Travel & entertainment	55,335	81,058
Bank charges	40,413	1,196
Bad debts	12,261	(507)
Legal fees	200,353	29,423
Auditors & professional fees	86,450	249,628
Loss on foreign exchange	22,319	(3,583,297)
Other expenses	31,284	(38,060)
	2,476,872	3,478,821

10. INVESTMENT INCOME

	2020 $	2019 Restated $
Interest on government bond	107,807	33,171
Dividend income	2,839,318	3,260,324
Gain/(loss) on investment disposals	6,650,655	1,069,427
Other interest	1,132	2,082
	9,598,912	4,365,004

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2020

11. INCOME TAX EXPENSE

(a) The components of tax expenses comprise:

	2020	2019 Restated
	$	$
Current Tax Expense	-	(556,144)
Deferred tax	41,250	82,339
Adjustments to current tax relation to prior years	-	615,393
Total Income tax benefit/(expense)	41,250	141,588

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

	2020	2019 Restated
	$	$
Profit before Taxation	**9,463,981**	**1,840,809**
Current Tax expense @28%	2,649,915	515,427
Foreign income	(1,887,373)	(621,222)
Entertainment expenses	734	6,481
Derecognition of deferred tax asset on losses carried forward	(804,526)	40,717
Losses not recognised on balance sheet	-	58,597
PPA - deferred tax	-	(141,588)
Total income tax benefit/(expense)	41,250	141,588

12. DEFERRED TAX ASSETS

(a) Asset

	2020	2019 Restated
	$	$
Deferred tax assets comprise:		
Provisions and accruals	42,848	1,226
Pension Plan	(210)	161
	42,638	1,387

(b) Reconciliation

(i) Deferred tax asset
The movement in deferred tax assets for each temporary difference during the year is as follows:

	2020	2019 Restated
	$	$
Opening balance	1,387	83,726
Movement in provision and accruals	41,251	1,202
Prior years restatement due to accounting policy change	-	(83,541)
Derecognition of losses to be carried forward	-	-
Deferred Tax Asset	42,638	1,387

(ii) Current tax asset

	2020	2019 Restated
	$	$
Tax installment	296,095	402,550
Current Tax Asset	296,095	402,550

VIRGINIA SURETY COMPANY INC - NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2020

13. CASH AND CASH EQUIVALENTS

	2020	2019 Restated
	$	$
Cash at bank and in hand	4,892,549	11,140,069

Amount in cash and cash equivalents are the same as those included in the cash flow statement.

Cash and cash equivalents include balances readily convertible to cash.

Reconciliation to Cash Flow Statement

For the purpose of the Cash Flow statement, cash and cash equivalents comprise the following at 31 December 2020:

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

	2020	2019 Restated
	$	$
Net profit	9,505,231	1,982,397
Adjustments for:		
Unrealised gain on foreign exchange	(7,529,065)	(2,585,769)
Changes in Assets and Liabilities:		
(Increase) in trade receivables	(1,896,372)	(8,033,190)
Decrease/(increase) in reinsurance asset	1,145,074	(8,827,688)
(Increase) in Deferred Acquisition Cost	(1,562,456)	(5,536,643)
(Decrease)/increase in outstanding claims	1,627,711	5,230,447
(Decrease)/increase in trade and other payables	(2,071,436)	3,433,509
Decrease/(increase) in deferred tax asset	65,204	(162,101)
Increase in gross unearned premium	9,812,957	22,203,880
Net cash flows generated from operating activities	9,096,848	7,704,842

14. TRADE AND OTHER RECEIVABLES

	2020	2019 Restated
	$	$
Investment Income Receivable	299,094	1,500,645
Premium Debtors	15,877,575	14,022,935
Prepayment	952,675	-
Other Receivables	311,061	8,330
Deferred income	-	12,123
	17,440,405	15,544,033
Receivable within 12 months	17,440,405	15,544,033
Receivable in greater than 12 months	-	-
Trade and other receivables	17,440,405	15,544,033

14. TRADE AND OTHER RECEIVABLES (CONTINUED)

a) Provision for impairment

	2020	2019 Restated
	$	$
Amounts recognised in statement of comprehensive income	24,828	-
	24,828	-

15. TRADE AND OTHER PAYABLES

	2020	2019 Restated
	$	$
Trade payables and accruals	3,976,180	6,047,616
Related party payable	10,464,181	10,894,340
	14,440,361	16,941,956
Payable within 12 months	14,440,361	16,941,956
Payable in greater than 12 months	-	-
Trade and other receivables	14,440,361	16,941,956

There were no contract liabilities at 31 December 2020 (2019: nil). VSC New Zealand has no obligations to fulfil services to customers for which it has already received consideratin (or an amount of consideration is due) from the customers.

16. INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2020	2019 Restated
	$	$
Government Stock	9,768,479	7,197,972
Corporate bond fund	62,175,451	56,262,454
Total investment at fair value through profit or loss	71,943,930	63,460,426

Government Bonds and corporate bonds

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

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). There were no level 2 investments.
- Level 3: Valuation techniques are applied for which any significant input is not based on observable market data. There were no level 3 investments.

31 December 2020	Level 1	Level 2	Total
Government stock	9,768,479	-	9,768,479
Corporate bond fund	62,175,451	-	62,175,451
Total			71,943,930

31 December 2019	Level 1	Level 2	Total
Government stock	7,197,972	-	7,197,972
Corporate bond fund	56,262,454	-	56,262,454
Total			63,460,426

INTEREST-BEARING FINANCIAL ASSETS MATURITY	2020	2019 Restated
	$	$
Amounts maturing within 12 months	2,967,563	1,287,733
Amounts maturing in greater than 12 months	68,976,367	62,172,693
Total investment at fair value through profit or loss	71,943,930	63,460,426

17. REINSURANCE AND OTHER RECOVERIES ON OUTSTANDING CLAIMS

	2020	2019 Restated
	$	$
Reinsurance premium payable	(9,569,152)	(4,087,538)
Reinsurance debtor receivable	19,677,935	15,341,395
Net receivable	10,108,783	11,253,857

Above is the recoveries expected from our reinsurance program.

18. CLAIMS PROVISIONS

a) Net outstanding claims

	2020	2019 Restated
	$	$
Gross outstanding claims	6,966,274	5,731,671
Loss adjustment expenses	(3,079,995)	(847,548)
Undiscounted central estimate	3,886,279	3,537,261
Discount to present value	168	(1,496)
Discounted central estimate	3,886,447	3,535,765
Discounted claims administration expenses	107,102	249,712
Claims expense – discounted	3,993,549	3,785,477
Risk margin	2,018,971	599,332
Gross outstanding claims – discounted including CHE and risk margin	6,012,520	4,384,809

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

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

b) Maturity profile of claims

The expected manturity of VSC New Zealand's discounted net outstanding claims provision 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
At 31 December 2020	**$000's**	**5,776**	**347**	**26**	**(33)**	**(30)**	**(74)**	**6,012**
At 31 December 2019	$000's	4,396	98	(9)	(28)	(24)	(48)	4,385

c) Risk Margin

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

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

18. CLAIMS PROVISIONS (CONTINUED)

c) Risk Margin (Continued)

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

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

d) Claims development - undiscounted net central estimate

$000's	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
End of Accident Year	-	-	1,586	1,335	1,181	845	678	740	1,695	12,585	16,048
1 year later	-	1,684	1,547	1,285	1,208	825	668	710	1,700	11,560	-
2 years later	1,316	1,683	1,504	1,280	1,209	822	670	705	1,587	-	-
3 years later	1,316	1,638	1,503	1,281	1,209	821	667	667	-	-	-
4 years later	1,294	1,638	1,504	1,281	1,209	822	659	-	-	-	-
5 years later	1,295	1,642	1,504	1,281	1,209	813	-	-	-	-	-

e) Claims reserve

	2020	2019 Restated
	$	$
At beginning of year	4,384,809	1,237,777
Gross claims incurred	16,755,703	14,632,373
Reinsurance recovery	(8,241,466)	(9,773,431)
Claims settled	(6,886,526)	(1,711,910)
At end of year	6,012,520	4,384,809

19. DEFERRED ACQUISITION COSTS

19a. Expenses for acquisition of insurance contracts

	2020	2019 Restated
	$	$
LAT write down	(4,036,198)	(2,484,604)
Recognised in Statement of comprehensive income	(3,754,644)	(2,664,083)
Expenses for acquisition of insurance contracts	(7,790,842)	(5,148,687)

19b. Deferred acquisition cost

	2020	2019 Restated
	$	$
At beginning of year	9,044,245	3,507,602
Costs incurred	9,353,298	10,685,330
LAT write down	(4,036,198)	(2,484,604)
Recognised in statement of comprehensive income	(3,754,644)	(2,664,083)
At end of year	10,606,701	9,044,245

Notes to the financial statements for the year ended 31 December 2020

20. UNEARNED PREMIUM

a) Unearned premium

	2020	2019 Restated
	$	$
Insurance Portfolio		
Gross unearned premium reserve	46,724,177	36,911,220
Unearned Premium related to Reinsurance contracts	(11,807,898)	(10,865,772)
Net unearned premium	34,916,279	26,045,448

b) Liability adequacy test

The probablity of adequacy of the unearned premium liability differs from the probability of adequacy adopted in determining the outstanding claimsprovision. Thereason for the difference is that the former is a benchmark used only to test the sufficiencyof net unearned premium liabilities whereas the latter is a measure of the adequacy of the outstanding claimsprovision actually carried by the Branch.

NZ IFRS requires the inclusion of a risk margin in insurance liabilities but does not prescribe a minimum level of margin. Whilst there is established practice in the calculaiton of the probablity of adequacy of the outstanding claims provisions, no such guidance exists in respect of the level of risk margin to be used in determining the adequacy of net premium liabilities. For the purposes of the liability adequacy test, a 75% probability of adequacy in respect of total insurance liabilities was used. The 75% basis is a recognised industry benchmark in New Zealand and Australia, being the minimum probability of adequacy required for Australian licensed insurers by APRA.

The liability adequacy test carried out on the insurance portfolio in the current year in accordance with NZ IFRS 4 identified a deficiency of $4,036,198 (2019: $2,484,604).

	2020	2019 Restated
	$	$
Future claims provision - discounted	(30,424,971)	(24,168,159)
Claims handling costs	(107,102)	(249,712)
Risk margin	(2,018,971)	(599,332)
Reinsurance recoveries	8,241,466	8,016,000
Expected future claims	(24,309,578)	(17,001,203)
Deferred acquisition costs		
Commission expense	(14,230,508)	(11,095,245)
Administration	(412,391)	(433,604)
LAT deficiency	4,036,198	2,484,604
Total deferred acquisition costs	(10,606,701)	(9,044,245)
Level of (deficiency)	(4,036,198)	(2,484,604)

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

21. INSURER FINANCIAL STRENGTH RATING AND SOLVENCY DISCLOSURE

Virginia Surety Company Inc has a financial strength rating of A+ issued by A.M. Best Rating Services (2019: A+) and the following solvency

	2020	2019 Restated
	$	$
Actual solvency capital	479,165,735	587,017,405
Minimum solvency capital	104,796,910	112,929,046
Solvency margin	374,368,825	474,088,359
Solvency ratio	4.57	5.20

22. EQUITY RETAINED FOR THE PURPOSES OF FINANCIAL SOUNDNESS

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