

**VIRGINIA SURETY COMPANY INC - NEW ZEALAND
BRANCH**

Annual Report

For the year ended 31 December 2022

Contents	Page
Statement by directors	1
Independent Auditor's Report	2-4
Statement of Comprehensive Income	5
Statement of Financial Position	6
Statement of Changes in Head Office Account	7
Statement of Cash Flows	8
Notes to the Financial Statements	9-28

VIRGINIA SURETY COMPANY, INC - NEW ZEALAND BRANCH

**STATEMENT BY DIRECTORS
For the year ended 31 December 2022**

I, being a director of Virginia Surety Company, Inc (Company), certify that the Statement of Comprehensive Income, Balance Sheet, Statement of Changes in Balances Due to Head Office, Statement of Cash Flows and notes set out on pages 10 to 29 fairly present the Financial Statements of the New Zealand Branch of the Company for the year ended 31 December 2022. No disclosure has been made in respect of Section 211 (a), and (e) to (j) of the Companies Act 1993 following a unanimous decision by the shareholders in accordance with Section 211 (3) of the Act.

The Board of Directors of Virginia Surety Company, Inc New Zealand branch authorized these statements for issue on 26 April 2023.

On behalf of the board



Gary Mann

Director

Date: 26 April 2023

INDEPENDENT AUDITOR'S REPORT

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

Opinion

We have audited the financial statements of Virginia Surety Company Inc – New Zealand Branch (the Branch), which comprise:

- the statement of financial position as at 31 December 2022;
- the statement of comprehensive income, statement of changes in head office account and statement of cash flows for the year then ended; and
- the notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements of the Branch, present fairly, in all material respects, the financial position of the Branch as at 31 December 2022, 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 are independent of the Branch 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 *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by the International Ethics Standards Board for Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Independence

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

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 of the current year. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We have determined the matter described below to be the key audit matters to be communicated in our report.

Valuation of Gross Outstanding Claims Liabilities (2022: \$4.2 million)

Refer to notes 4 and 17 to the financial statements, which describe the elements that make up the balance

Why a key audit matter	How our audit addressed the risk
<p>We considered the valuation of gross outstanding claims liability a key audit matter because of the complexity involved in the estimation process and the significant judgements applied by the Branch in estimating the amount.</p> <p>The valuation of outstanding claims liabilities involves the use of actuarial models and methodologies that rely on the quality of available historical claims experience 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.</p> <p>In particular, significant judgement is applied in the estimation of claims that have been incurred at the reporting date but have not yet been reported to the Branch (IBNR) as there is generally less information available in relation to these claims, and there is uncertainty over the amount which will be settled ultimately.</p>	<p>Together with our actuarial expert, we performed the following audit procedures, amongst others:</p> <ul style="list-style-type: none"> • Considered whether the valuation of outstanding claims liabilities including IBNR claims for each class of business is in compliance with New Zealand Prudential Standard 30; • Evaluated the actuarial models and methodologies applied by the Branch with reference to generally accepted models and methodologies applied in the sector and with the prior year; • Assessed the appropriateness of underlying significant methods and assumptions used in the valuation to check that these methods and assumptions were supported by appropriate documentation; • Assessed and tested the completeness, accuracy and appropriateness of source data used in the Branch’s actuarial valuation calculations including the reconciliation of data used to the general ledger and financial statements. We used substantive testing to test the underlying claims and premiums data by agreeing a sample of records to supporting documentation; • Compared the current and previous discount rates applied for classes of business by the Branch’s actuary and checked consistency with published risk free interest rate data; • Assessed the Branch’s 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. • We also assessed the reasonability and completeness of the Branch’s disclosures against the requirements of NZ IFRS and IFRS.

Table 1

Responsibilities of Management and the Directors 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 determines 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 has no realistic alternative but to do so.

The Directors are responsible for overseeing the Branch's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

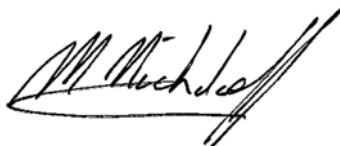
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee 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:

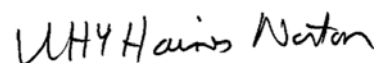
https://xrb.govt.nz/Site/Auditing_Assurance_Standards/Current_Standards/Description_Auditors_responsibilities.aspx.

This description forms part of our auditor's report.

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.



Mark Nicholaeff
Partner
Signed at Sydney, Australia
26 April 2023



UHY Haines Norton
Chartered Accountants

Statement of Comprehensive Income

For the year ended 31 December 2022

	Notes	2022	2021
		\$	\$
Revenue			
Gross written premium		49,580,144	49,848,100
Unearned premium movement		(891,954)	(8,646,342)
Gross earned premium revenue		48,688,190	41,201,758
Outward reinsurance premium		(163,584)	(11,939,092)
Deferred reinsurance premium movement		(4,842,735)	(6,965,162)
Outward reinsurance premium expense		(5,006,319)	(18,904,254)
Net earned premium revenue		43,681,871	22,297,504
Expenses			
Gross claims incurred		(20,898,415)	(18,573,767)
Reinsurance claims and other recoveries revenue		1,309,830	10,060,690
Net claims incurred	7	(19,588,585)	(8,513,077)
Gross commission expense	18a	(19,182,507)	(17,740,491)
Reinsurance commission revenue	18c	1,239,713	10,347,344
Net commission expense		(17,942,794)	(7,393,147)
Investment income		424,548	142,089
Distribution income		1,729,479	2,232,298
Interest income		32,696	772
(Loss)/gain on investments at fair value through profit or loss		(7,981,013)	(2,472,219)
		(5,794,290)	(97,060)
Other operating and administration expenses	9	(12,121,723)	(689,890)
Profit before Income tax		(11,765,521)	5,604,330
Income tax (expense)	10	12,909	(8,742)
Profit after income tax		(11,752,612)	5,595,588
Total comprehensive income		(11,752,612)	5,595,588
Operating profit for the year attributable to:			
Head office account		(11,752,612)	5,595,588
Operating Profit after tax		(11,752,612)	5,595,588
Total comprehensive income is attributable to:			
Head office account		(11,752,612)	5,595,588
Operating Profit after tax		(11,752,612)	5,595,588

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

Statement of Financial Position**As at 31 December 2022**

	Notes	2022	2021
		\$	\$
Assets			
Cash and cash equivalents	12	2,845,964	3,712,891
Investments at fair value through profit or loss	15	57,259,227	70,516,222
Trade and other receivables	13	15,667,679	16,736,087
Reinsurance and other recoveries on outstanding claims	16	732,650	10,048,869
Current tax assets	11b(ii)	—	306,247
Related party receivables	6	7,312,822	5,235,127
Deferred acquisition costs	18d	17,557,872	15,889,260
Deferred tax assets	11a	14,296	5,875
Total assets		<u>101,390,510</u>	<u>122,450,578</u>
Liabilities			
Trade and other payables	14	4,818,208	3,230,468
Gross outstanding claims	17a	4,219,674	5,066,575
Related party payables	6	5,753,820	16,984,518
Gross unearned premiums	19a	56,262,472	55,370,519
Total liabilities		<u>71,054,174</u>	<u>80,652,080</u>
Net assets		<u>30,336,336</u>	<u>41,798,498</u>
Due to Head Office		<u>30,336,336</u>	<u>41,798,498</u>

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

Statement of Changes In Head Office Account

For the year ended 31 December 2022

Head Office • USA	Notes	2022	2021
		\$	\$
Balance as at 1 January		41,798,498	50,926,022
Profit for the year attributable to Head Office Account		(11,752,612)	5,595,588
Total Comprehensive income		30,045,886	56,521,610
Net current transactions with Head Office		290,450	(14,723,112)
Balance as at 31 December		30,336,336	41,798,498

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

Statement of Cash Flows
For the year ended 31 December 2022

	Notes	2022	2021
		\$	\$
Cash flows from operating activities			
Premium received		46,170,011	50,551,008
Reinsurance and other recoveries received		10,626,049	10,120,604
Claims paid		(21,745,316)	(19,519,712)
Acquisition Costs		(19,611,406)	(5,282,559)
Other Operating and Administration Expenses		(11,139,932)	(10,116,861)
Outward reinsurance paid		—	(18,904,254)
Income taxes paid		310,735	—
Net cash flows generated from operating activities	12	<u>4,610,141</u>	<u>6,848,226</u>
Cash flows from investing activities			
Investment income		502,718	142,089
Distribution income		1,729,479	2,232,298
Interest income		32,696	772
Purchase of investment assets		(17,725,959)	(16,248,297)
Proceeds from sale of investments		23,292,390	16,879,411
Repayments to related parties		(12,796,073)	3,688,955
Net cash flows generated from/(used) in investing activities		<u>(4,964,749)</u>	<u>6,695,228</u>
Cash flows from financing activities			
Net parent company settlements		(512,319)	(14,723,112)
Net cash flows from financing activities		<u>(512,319)</u>	<u>(14,723,112)</u>
Net decrease in cash and cash equivalents		(866,927)	(1,179,658)
Cash and cash equivalents at beginning of period		3,712,891	4,892,549
Cash and cash equivalents at end of period	12	<u>2,845,964</u>	<u>3,712,891</u>

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

VIRGINIA SURETY COMPANY, INC· NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

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 2022 is:

73 Manchester Street,
Christchurch, 8011
New Zealand

Virginia Surety Company, Inc is the Branch's parent and Assurant, Inc is the ultimate controlling party.

COVID-19

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

COVID-19 has not had a material impact on the areas of critical accounting judgements and estimates. Given the evolving and uncertain impact of COVID-19, we anticipate that there will be changes in market conditions in the future and that the impact of these changes will be accounted for in future reporting periods as they arise and/or are able to be reasonably predicted.

Insurance Contract

All the insurance products offered or utilized 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 and are described below.

- Consumer. includes extended warranty and accidental damage products
- Retail Warranty. includes the Harvey Norman product care business
- Prestige Motor Vehicle Insurance
- Motorcycle Insurance
- Motor Vehicle Insurance
- Classic Motor Vehicle Insurance

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

Reinsurance contracts

Contracts are entered into by Virginia Surety Company, Inc. New Zealand Branch (VSCNZ) 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 recognized as reinsurance assets.

VSC NZ held the reinsurance agreement with Hollards Insurance Company Ltd to reinsure 100% of the risk associated with certain classes of business with Protecta as described below

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

Protecta is a specialist underwriting agency selling insurance products through motor vehicle and motorcycle dealers, finance companies and brokers and direct to the public. VSCNZ underwrites this business.

VSC NZ has ceased to reinsure this 100% risk with Hollards Insurance Company Ltd from 1 September 2021 and has subsequently entered into a motor comprehensive excess of loss reinsurance contract through the intermediary AON Reinsurance New Zealand Ltd.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

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. VSCNZ 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. VSCNZ is an FMC reporting entity under Part 7 of the Financial Markets Conduct Act 2013 and it is a Licensed Insurer under the Insurance (Prudential Supervision) Act 2010. VSCNZ has a 31 December year end and has a functional currency of New Zealand Dollars (NZD).

The financial statements of VSCNZ 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 VSCNZ notes to the financial statements.

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.

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.

b) Premium Revenue

Premium revenue comprises amounts charged to policyholders, excluding GST collected on behalf of third parties. The earned portion of premium received and receivable, including unclosed business, is recognized as revenue. Premium revenue on unclosed business is brought to account based upon the pattern of booking of renewals and new business. Earnings are aligned to the methodology defined for recording the unearned premiums in note c below.

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 for the Finance system and the Actuarial processes. For the Actuarial processes, we have also allowed for a mix method which is midway between the Rule of 78 and Straight Line methodologies. Percentage of portfolio using R078 is 28%.

Reserving Class	Methodology	% Portfolio
Consumer	SL	3.6%
Retail Warranty including Harvey Norman	SL	2.2%
NLG	SL	36.9%
Protecta Creditor	RO78	23.3%
Protecta Gap	RO78	4.7%
Protecta Comp Motor	SL	12.7%
Protecta Motor Warranty	Mix	9.3%
EPG	SL	7.3%

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.

d) Outward reinsurance

Premium ceded to reinsurers is recognized 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 recognized 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.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

2. Summary of significant accounting policies (continued)

f) Acquisition expenses

Acquisition costs (which include commission costs) are the costs associated with obtaining and recording insurance contracts. Acquisition costs are capitalized 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 amortized 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 capitalized 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.

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 recognized 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 recognized 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 recognized for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilize 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 realize the asset and settle the liability on a net basis, or to realize 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 recognized as a liability (or asset) to the extent that it is unpaid (or refundable).

Current and deferred tax is recognized 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 recognized directly in equity.

i) Goods and Services Tax (GST)

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

- Where the amount of GST incurred is not recoverable from the taxation authority, it is recognized 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 recognized 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 recognized in the period in which it is earned. Dividends are recognized when the right to receive payment is established. Investment income includes realized and unrealized gains or losses on financial assets which are reported on a combined basis as 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. VSCNZ investments are designated 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 recognized at trade date, being the date on which the branch commits to buy or sell the asset. Investments are recognized 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.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

2. Summary of significant accounting policies (continued)

l) Foreign currency

(i) Translation of foreign currency transactions and balances

Transactions included in the financial statements are measured using the currency of the primary economic environment in which the Branch operates (the functional currency NZ \$). Foreign currency transactions are translated into functional currencies 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. Any unrealized foreign exchange gain or loss on the China Bond Fund investment is included in profit or loss.

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 recognized at fair value and are subsequently measured at amortized cost less any impairment. Any increase or decrease in the provision for impairment is recognized 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 recognized at fair value and are subsequently measured at amortized 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 recognized 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 ECLs 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 allowance is based on the lifetime ECLs.

VSCNZ considers that the credit risk on other receivables within the scope of NZ IFRS 9 has not increased significantly fault events within 12 months from the reporting date, and considers that no allowance for impairment is required at 31 December 2022.

For receivables outside the scope of NZ IFRS 9, an allowance for impairment is established when there is objective evidence that VSCNZ 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 VSCNZ 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 recognized at fair value and are subsequently measured at amortized cost.

Other payables are within the scope of NZ IFRS 9. They are also initially recognized at fair value and are subsequently measured at amortized 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 2022 (2021: nil). VSCNZ 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.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

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 2022 and 31 December 2021, are the responsibility of the board and they are performed by 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 Bomheutter-Ferguson method.

The main assumption underlying these techniques is that a VSCNZ'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 analyzed by accident years, but can also be further analyzed 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 amortization of unearned premium on a basis other than time apportionment.

The carrying value all the reporting date of expected gross claims liabilities is \$4,219,674 (2021: \$5,066,575),

Claims provisions are expected to be settled inline with the maturity profile of claims found in Note 17 (a) and discounting has been applied accordingly.

r) Rounding of amounts

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

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

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 2022.

b) New Accounting Standards and Interpretations issued not yet adopted

NZ IFRS 17, a new accounting standard for insurance contracts, 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. The standard is effective for the periods beginning 1 January 2023 which is when VSC NZ plans to adopt the standard.

The Branch does not expect significant changes arising from the application of these changes. It is expected that insurance contracts issued, and reinsurance contracts held, by the Branch will meet the definition of an insurance contract, and be accounted for, in accordance with the requirements of NZ IFRS 17.

Recognition and measurement of insurance contracts

Recognition

NZ IFRS 17 requires an entity to recognise a group of insurance contracts it issues from the earliest of (a) the beginning of the coverage period of the group of contracts; (b) the date when the first payment from a policyholder in the group becomes due; and (c) for a group of onerous contracts, when the group becomes onerous.

The Branch does not expect significant changes arising from the application of these changes. It is expected that a group of insurance contracts issued shall be recognised from the beginning of the coverage period of the group of contracts, from 1 January of each financial reporting year. Individual contracts shall be added to each group based on the beginning of the coverage period of the contracts, through to 31 December of each financial reporting year

Contract boundary

NZ IFRS 17 requires that an entity shall include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group.

The Branch does not expect significant changes arising from the application of this requirement. The Branch considers cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the branch can compel the policyholder to pay the premiums or in which the Branch has a substantive obligation to provide the policyholder with insurance contract services.

The Branch shall not recognise as a liability or as an asset any amounts relating to expected premiums or expected claims outside the boundary of the insurance contract. Such amounts relate to future insurance contracts.

Measurement of insurance contracts

Measurement models

NZ IFRS 17 permits the use of a simplified approach referred to as the 'premium allocation approach' (which is similar to the current basis on which general insurance is brought to account under NZ IFRS 4) if the liability for remaining coverage under the premium allocation approach is not expected to materially differ from that under the general model, or if the coverage period of the contracts is not greater than one year.

VSC NZ has developed a model and methodology for assessing eligibility of contracts with coverage periods of greater than one year to apply the premium allocation approach. Our assessment, which involved detailed modelling under a range of scenarios as well as a qualitative assessment of contract features, has determined that the premium allocation approach is expected to apply to the entire portfolio of NZ business.

For contracts that apply the premium allocation approach and have a coverage period of one year or less, NZ IFRS 17 provides an option to recognise any insurance acquisition costs as expenses when incurred. VSC NZ does not plan to apply this option and expects to amortise acquisition costs over the coverage period of the related insurance contracts, consistent with current accounting under NZ IFRS 4.

Onerous contracts

NZ IFRS 17 requires the identification of 'groups' of onerous contracts which will be determined at a more granular level of aggregation than the level at which the liability adequacy test is performed under NZ IFRS 4. Contracts that are measured using the premium allocation approach are assumed not to be onerous unless facts and circumstances indicate otherwise.

VSC NZ has developed a framework for identifying relevant facts and circumstances that may be indicators of possible onerous contracts which includes consideration of management information for planning and performance management. If facts and circumstances that may be indicators of possible onerous contracts exist, the onerous contract losses are measured based on an estimation of fulfillment cash flows and are recognised in the profit or loss.

Onerous contract losses must be measured on a gross basis (excluding the effect of reinsurance), with the impact on equity and profit or loss mitigated by related income on reinsurance recoveries to the extent that the onerous contracts are covered by reinsurance. Where applicable, in isolation, the application of the onerous contracts requirements is expected to result in a decrease in opening equity on adoption of NZ IFRS 17.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

3. NEW ACCOUNTING STANDARDS AND AMENDMENTS

b) New Accounting Standards and Interpretations issued not yet adopted (Continued)

Risk adjustment

The measurement of insurance contract liabilities will include a risk adjustment which replaces the risk margin under NZ IFRS 4. The risk margin under NZ IFRS 4 reflects the inherent uncertainty in the net discounted central estimate, whereas the risk adjustment under NZ IFRS 17 is defined as the compensation required for bearing the uncertainty that arises from non-financial risk.

VSC NZ intends to apply a cost of capital approach as a key input to determining the risk adjustment for both the liability for incurred claims and the liability for remaining coverage. When applying the premium allocation approach, no explicit risk adjustment is determined for the liability for remaining coverage, except when measuring onerous contracts.

VSC NZ expects to adopt an NZ IFRS 17 risk adjustment from a target range (expressed as a percentage of expected future cash flows which are equivalent to the NZ IFRS 4 central estimate), a range that is expected to be lower than the equivalent NZ IFRS 4 risk margin range.

Similar to the risk margin, the risk adjustment includes the benefit of diversification. NZ IFRS 17 requires the disclosure of the confidence level that corresponds to the risk adjustment used in the measurement of insurance contract liabilities.

Discount rates

NZ IFRS 4 requires the net central estimate of outstanding claims to be discounted using risk-free rates as described in note 4 (a) (iv).

NZ IFRS 17 requires estimates of future cash flows to be discounted to reflect the time value of money and financial risks related to those cash flows but does not prescribe a methodology for determining the discount rates used.

VSC NZ will apply a 'bottom-up approach' which requires the use of risk-free rates adjusted to reflect the illiquidity characteristics of the insurance contracts, which will result in higher discount rates relative to current requirements and an increase in opening equity on adoption of NZ IFRS 17.

Presentation and disclosure

The standard introduces changes to the presentation and disclosure of insurance line items in the financial statements, introducing new line items on the statement of comprehensive income and balance sheet and increased disclosures compared with existing reporting requirements.

Existing insurance and reinsurance contract line items on the balance sheet (including trade debtors arising from general insurance contracts, unearned premium, deferred insurance costs, gross outstanding claims and reinsurance and other recoveries on outstanding claims) will be replaced by insurance contract assets and liabilities, and reinsurance contract assets and liabilities.

Insurance contract liabilities under NZ IFRS 17 will include all cash flows that directly relate to the fulfilment of insurance contracts (direct business and inward reinsurance), including acquisition, claims settlement, policy administration and maintenance costs. It also includes other costs such as direct overheads which are currently recognised in trade and other payables on the balance sheet.

Transition

NZ IFRS 17 will be applied retrospectively to all of VSC NZ insurance contracts on transition except to the extent that it is impracticable to do so, in which case either a modified retrospective or fair value approach may be applied. VSC NZ will apply a full retrospective approach.

Financial impact

The requirements of NZ IFRS 17 are complex, and the actual impact is not yet reasonably estimable as it is currently subject to the finalisation of key assumptions in relation to each of these components mentioned above.

VSC NZ's implementation of NZ IFRS 17 is well progressed, and work is ongoing to finalise the impacts and to restate comparative information for reporting on this basis in the financial statements for the year ended 31 December 2023.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

4. CRITICAL ESTIMATES AND JUDGEMENTS

a) Outstanding claims liability (OCL)

VSCNZ's net outstanding claims liability 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 VSCNZ 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 VSCNZ, where more information about the claims is generally available. Claims in respect of comprehensive motor 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 VSCNZ 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.

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

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.

ii) Assets arising from contracts with reinsurers

Assets arising from contracts with VSCNZ'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 ultimately be 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).

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 VSCNZ is determined by analyzing 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 VSCNZ are normally derived from industry analysis and the judgement of experienced and qualified actuaries.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

4. CRITICAL ESTIMATES AND JUDGEMENTS (continued)

a) Outstanding claims liability (OCL) (continued)

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 discount rates used in the measurement of outstanding claims and reinsurance recoveries for the succeeding year was an overall discount factor of 1.011 on gross Outstanding Claims Liabilities and 0.995 on net Outstanding Claims Liabilities for the measurement of the Actuarial related liabilities.

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 1.42 years (2021: 1.31 years).

Other Assumptions

The assumption for claims inflation by receiving class may differ by methodology

- a) the Paid Chain Ladder method implicit includes an assumption of inflation;
- b) the inflation used in the PPCL method is based on the increases in average payments by payment month at a receiving class level;
- c) the inflation used in the Bomhuetter-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

Each of the variations illustrated in the below table are regarded as a potential variation in VSCNZ's ultimate liabilities for outstanding or future claims. Variations wider than those below are possible.

	Outstanding claims provision - Central Estimate	% changes	Future claims provision - Central Estimate	% changes
Base Assumption	4,142,987	—	29,479,681	—
Increase in Discount Rate by 1%	4,136,374	-0.2%	29,155,666	-1.1%
Adoption of highest OCL Model	5,849,368	41.2%	—	—
1% higher inflation assumption	4,149,207	0.2%	29,809,711	1.1%
Increase Cancellation rate by 2%	—	—	29,965,783	1.6%
Increase in Loss Ratio for Protecta portfolios by 10%			30,741,913	4.3%

Based on the sensitivity analysis, the adoption of the highest OCL model would result in an increase in the OCL of \$1,706,381 and an increase of 10% in the reserve loss ratio for the Protecta portfolios would result in an increase in the future claims liabilities by \$1,262,231.

b) 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) fees 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 or surplus arising from the test is recognized in the profit or loss with the corresponding impact on the Statement of Financial Position recognized first through the adjustment of deferred acquisition costs (if any) for the relevant portfolio of contracts, with any remaining balance being recognized on the Statement of Financial Position as an unexpired risk liability.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

5. RISK MANAGEMENT

Risk management is a key part of VSCNZ'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 an of the Branch's risks to be managed in an integrated manner.

VSCNZ's risk management framework defines the risks that VSCNZ 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, optimization and ongoing improvement through management action plans, risk and performance monitoring.

VSCNZ 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. VSCNZ 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.

VSCNZ'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

VSCNZ 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. VSCNZ 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 occurring and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, these risks are random and unpredictable. In relation to the pricing of individual insurance contracts and the determination of the level of the outstanding claims provision in relation to a portfolio of insurance contracts, the principal 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 VSCNZ's management practices and New Zealand regulations taking into account VSCNZ'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 maintain historical pricing and claims analysis for each portfolio and this is combined with a detailed knowledge of the current developments in the respective markets and classes of business.

The Branch limits its exposure to an individual catastrophe or an accumulation of claims by reinsuring a portion of risks undertaken. This allows the Branch to control exposure to insurance losses, reduce volatility of reported results and protect capital. Further detail of our reinsurance contracts are discussed under Note 1.

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 VSCNZ 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 VSCNZ.

Of the interest bearing investments balance at the end of the year, 10.9 million (2021: 13.4 million) is due from the New Zealand Government, the Group's single largest credit exposure. Apart from this, VSCNZ does not have significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics. The concentration of credit risk is limited due to the fact that the customer base is large and unrelated, and through appropriate risk management applied to investment activities.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

5. RISK MANAGEMENT {continued}

c) Credit risk (continued)

i) Credit quality of financial assets

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

	CREDIT RATING							TOTAL
	Aaa	Aa	A	BBB	BB	B	CCC and Below	
At December 2022	\$	\$	\$	\$				\$
Cash and cash equivalents	—	2,201,113	644,852	—	—	—	—	2,845,965
Investments at fair value through profit or loss	14,168,689	5,231,595	13,329,304	19,079,187	3,898,337	1,263,350	288,765	57,259,227
At December 2021								
Cash and cash equivalents	—	—	3,712,891	—	—	—	—	3,712,891
Investments at fair value through profit or loss	17,340,510	1,707,093	4,275,192	47,193,427	—	—	—	70,516,222

	TRADE AND OTHER RECEIVABLES AGING			
	0 to 3 MTHS	3 to 6 MTHS	6 MTHS TO 1 YEAR	TOTAL
At December 2022	\$	\$	\$	\$
Premium receivable	13,322,810	353,070	29,128	13,705,008
Provision for Doubtful Debts	—	—	(9,530)	(9,530)
Prepayment	1,688,242	—	—	1,688,242
Other receivables	47,142	—	—	47,142
Investment income receivable	236,817	—	—	236,817
Total	15,295,011	353,070	19,598	15,667,679
At December 2021				
Premium receivable	15,317,596	7,746	5,399	15,330,741
Provision for Doubtful Debts	—	—	(5,120)	(5,120)
Prepayment	1,082,293	—	—	1,082,293
Other receivables	13,186	—	—	13,186
Investment income receivable	314,987	—	—	314,987
Total	16,728,062	7,746	279	16,736,087

ii) Reinsurance counterparty credit risk

The following table provides information about the quality of VSCNZ'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 2022	\$	\$
Reinsurance recoveries on outstanding claims	732,649	732,649
Total	732,649	732,649
At December 2021		
Reinsurance recoveries on outstanding claims	10,048,869	10,048,869
Total	10,048,869	10,048,869

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

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

VSCNZ's exposure to foreign currency risk at the end of the reporting period, expressed in New Zealand dollar, was as follows.

	2022	2021
	\$	\$
	NZD	NZD
Cash & Cash Equivalents	163,698	281,209
Investments	36,095,667	47,193,428
Trade and other payables	(478,669)	5,158,303
Trade and other receivables	4,825,069	163,654
Due to head office account	(42,088,944)	(51,289,876)

The aggregate net foreign exchange gains/losses recognised in profit or loss were:

	2022	2021
	\$	\$
Net foreign exchange gain/(loss) included in other gains/(losses)	6,489,171	1,675,625

Sensitivity

VSCNZ is primarily exposed to changes in US/NZD exchange rates. The sensitivity of profit or loss to changes in the exchange rates arises mainly from US dollar-denominated financial assets.

	Impact on post- tax profit	Impact on post- tax profit	Impact on other components of equity	Impact on other components of equity
	2022	2021	2022	2021
	\$	\$	\$	\$
US/NZD exchange rate - increase 11% (2021 - 9%)	3,333,444	3,323,584	(3,215,977)	(3,421,219)
US/NZD exchange rate - decrease 11% (2021 - 9%)	(3,333,444)	(3,323,584)	3,215,977	3,421,219

ii) Interest rate risk

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

VSCNZ's risk management approach is to minimize interest rate risk by actively managing investment portfolios to achieve a balance between cash flow interest rate risk and fair value interest rate risk. VSCNZ 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. VSCNZ 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. VSCNZ has a policy of maintaining a relatively short duration for assets backing insurance liabilities in order to minimize any further potential volatility affecting insurance profit.

The contractual maturity profile of VSCNZ'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 analyzed 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 2022	\$	\$	\$	\$	\$	
Fixed rate	36,841,000	10,749,022	5,756,834	793,440	3,118,931	57,259,227
Weighted average interest rate	%	4.2				
At December 2021						
Fixed rate	47,039,406	8,971,267	5,707,543	5,382,131	3,415,875	70,516,222
Weighted average interest rate	%	6.3				

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 3.5% 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.

SENSITIVITY	PROFIT/(LOSS) *	
	2022	2021
%	\$	\$
+3.50	(2,804,578)	(4,020,981)
-3.50	2,426,895	3,807,142

Interest rate movement - interest bearing financial assets

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

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

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 VSCNZ's short, medium and long term funding and liquidity management requirements.

VSCNZ 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.

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

As at 31 December 2022	1 year or less	13 to 36 months	37 to 60 months	Over 5 years	Total
Trade Payables	3,039,948				3,039,948
Amounts due to related parties	5,753,820				5,753,820
Accrued Expenses	1,778,260				1,778,260
As at 31 December 2021					
Trade Payables	2,009,130				2,009,130
Amounts due to related parties	16,984,518				16,984,518
Accrued Expenses	1,221,338				1,221,338

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). VSCNZ 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 VSCNZ;
- definition of the acceptable level of risk appetite and tolerance;
- assessment of those risks throughout VSCNZ 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 VSCNZ'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.

VSCNZ 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 authorization and reconciliation procedures.

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

6. RELATED PARTY TRANSACTIONS AND BALANCES

The following material transactions occurred with related parties.

		Sales to Related Parties	Purchases from Related Parties	Expenses Charged by Related Parties
		\$	\$	\$
Fellow subsidiaries:				
The Warranty Group Asia Pacific Holdings PTE.LTD	2022	—	—	268,220
The Warranty Group Australasia Pty Ltd		—	5,021,663	—
Virginia Surety Company, Inc - USA		—	—	3,420
	2021			
The Warranty Group Australasia Pty Ltd		—	—	1,622,352

During the year, The Warranty Group Australasia Pty Ltd, paid expenses of \$1,622,352 (2020: \$1,897,367) on behalf of the VSCNZ.

Short-term employee benefits

The Key Management Personnel benefits are paid by The Warranty Group Australasia Pty Ltd and are included in the management fees charged to the branch.

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

	2022	2021
	\$	\$
Virginia Surety Company, Inc -Australia Branch	7,312,822	5,202,106
The Warranty Group Asia Pacific Holdings PTE.LTD	—	33,021
Total related party receivables	7,312,822	5,235,127
American Banking Insurance Group	(66,122)	—
The Warranty Group Asia Pacific Holdings PTE.LTD	(163,185)	—
The Warranty Group Holdings Inc.	(403,301)	—
The Warranty Group Australasia Pty Ltd	(5,121,213)	(16,472,199)
Virginia Surety Company, Inc - USA	—	(512,319)
Total related party payables	(5,753,821)	(16,984,518)

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.

7. CLAIMS INCURRED

a) Claims Analysis

	2022	2021
	\$	\$
Gross claims Incurred and related expenses	20,898,415	18,573,767
Direct		
Reinsurance and other recoveries		
Direct	(1,309,830)	(10,060,690)
Net claims incurred	19,588,585	8,513,077

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.

	2022			2021		
	Current Year	Prior Year	Total	Current Year	Prior Year	Total
Undiscounted	21,789,937	(1,113,639)	20,676,298	20,193,623	(1,585,579)	18,608,044
Discount	233,575	(11,458)	222,117	(20,425)	(13,852)	(34,277)
Gross claims incurred	22,023,512	(1,125,097)	20,898,415	20,173,198	(1,599,431)	18,573,767
Reinsurance and other recoveries						
Undiscounted	(1,489,288)	386,232	(1,103,056)	(10,957,861)	882,825	(10,075,036)
Discount	(279,176)	72,402	(206,774)	1,696	12,650	14,346
Reinsurance claims incurred	(1,768,464)	458,634	(1,309,830)	(10,956,165)	895,475	(10,060,690)
Net claims incurred						
Undiscounted	20,300,649	(727,407)	19,573,242	9,235,762	(702,754)	8,533,008
Discount	(45,601)	60,944	15,343	(18,729)	(1,202)	(19,931)
Net claims incurred	20,255,048	(666,463)	19,588,585	9,217,033	(703,956)	8,513,077

VIRGINIA SURETY COMPANY, INC· NEW ALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

8. AUDITORS' REMUNERATION

The auditor of the VSCNZ is UHY Haines Norton Chartered Accountants.

Auditors' fees payable for the audit of the financial report of the company as at 31 December 2022 amounted to \$170,000 (2021: \$150,626). Auditors' fees charged for the year comprises

	2022	2021
	\$	\$
Auditor Remuneration		
Audit fee	170,000	150,626
Tax compliance	44,800	30,150
	214,800	180,776

9. OTHER OPERATING AND ADMINISTRATION EXPENSES

Other Operating and administration expenses comprises:

	2022	2021
	\$	\$
Salaries & benefits	—	7,387
Intercompany cost allocation charge	5,293,304	1,622,352
Office & communication	26,502	116,912
Travel & entertainment	—	59,467
Bank charges	6,492	3,377
Bad debts	4,596	(18,932)
Legal fees	215	198,010
Auditors & professional fees	170,000	180,776
(Gain)/loss on foreign exchange	6,489,275	(1,675,625)
Other expenses	86,539	196,166
	12,076,923	689,890

10. INCOME TAX EXPENSE

(a) Tho components of tax expenses comprise:

	2022	2021
	\$	\$
Current Tax Expense	—	—
Deferred tax	(12,909)	(28,021)
Total income tax (expense)/benefit	(12,909)	(28,021)

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

	2022	2021
	\$	\$
(Loss)/Profit before Taxation	(11,765,521)	5,604,330
Prima facie tax	(3,294,346)	1,569,212
DTA on tax losses not recognised	1,762,787	(1,159,838)
Entertainment add back	—	1,365
Under/(over) provided in prior period	—	—
Expenses not deductible of tax	1,518,650	(401,997)
Total income tax benefit/(expense)	(12,909)	(8,742)

11. DEFERRED TAX ASSETS

(a) Asset

	2022	2021
	\$	\$
Deferred tax assets comprise:		
Provisions and accruals	14,296	5,875
	14,296	5,875

VIRGINIA SURETY COMPANY, INC· NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

11. DEFERRED TAX ASSETS (continued)

(b) Reconciliation

(i) Deferred tax asset

The movement in deferred tax asset for each temporary difference during the year is as follows:

	2022	2021
	\$	\$
Opening balance	5,875	14,617
Current year movement	8,387	(8,742)
Deferred Tax - prior period adjustment	—	—
Deferred Tax Asset	14,262	5,875

Deferred tax assets have not been recognized in respect of tax loss carry-forwards totaling \$441,436 (2021: \$4,583,715) relating to the New Zealand operations on the basis that it is not probable that future taxable profit will be available against which the company can use the benefits therefrom.

(ii) Current Tax liability

	2022	2021
	\$	\$
Tax installment	—	298,909
Foreign withholding tax	—	7,338
Current Tax (Liability)/Asset	—	306,247

12. CASH AND CASH EQUIVALENTS

	2022	2021
	\$	\$
Cash at bank and in hand	2,845,964	3,712,891

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

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

	2022	2021
Net profit after tax	(11,752,612)	5,595,588
Adjustments for:		
Investment income	(424,548)	(142,089)
Distribution income	(1,729,479)	(2,232,298)
Interest income	(32,696)	(772)
(Loss)/gain on investments at fair value through profit or loss	7,981,013	2,472,219
Foreign exchange (gain)/loss	—	(1,675,625)
Changes in Assets and Liabilities:		
Decrease/(Increase) In trade receivables	990,238	704,318
Decrease in reinsurance asset	9,316,219	59,914
Increase in Deferred Acquisition Cost	(1,668,612)	(5,282,559)
(Decrease)/Increase in outstanding claims	(846,901)	(945,945)
(Decrease) in trade and other payables	1,587,740	(349,457)
(Increase)/Decrease in deferred tax asset	(8,421)	(1,410)
(Increase)/Decrease in current tax asset	306,247	—
Increase in gross unearned premium	891,953	8,646,342
Net cash flows generated from operating activities	4,610,141	6,848,226

VIRGINIA SURETY COMPANY, INC· NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

13. TRADE AND OTHER RECEIVABLES

	2022	2021
	\$	\$
Investment Income Receivable	236,817	314,987
Premium Debtors	13,695,478	15,325,621
Prepayment	1,688,242	1,082,293
Other Receivables	47,142	13,186
	15,667,679	16,736,087
Receivable within 12 months	15,667,679	16,736,087
Receivable in greater than 12 months	—	—
Total and other receivables	15,667,679	16,736,087
a) Provision for impairment		
	2022	2021
	\$	\$
Amounts recognised in statement of comprehensive income	9,530	5,120
	9,530	5,120

14. TRADE AND OTHER PAYABLES

	2022	2021
	\$	\$
Trade payables and accruals	4,818,208	3,230,468
Payable within 12 months	4,818,208	3,230,468
Payable in greater than 12 months	—	—
Trade and other payables	4,818,208	3,230,468

There were no contract liabilities at 31 December 2022 (2021: nil). VSCNZ has no performance obligations to fulfil services to customers for which it has already received consideration (or an amount of consideration is due) from the customers.

15. INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2022	2021
	\$	\$
Direct investment in bonds	21,163,560	23,322,794
Corporate bond fund	36,095,667	47,193,428
Total Investment at fair value through profit or loss	57,259,227	70,516,222

Direct investment in 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 2022	Level 1	Level 2	Total
Direct investment in bonds	—	21,163,560	21,163,560
Corporate bond fund	36,095,667	—	36,095,667
Total			57,259,227
31 December 2021	Level 1	Level 2	Total
Direct investment in bonds	—	23,322,794	23,322,794
Corporate bond fund	47,193,428	—	47,193,428
Total			70,516,222

INTEREST-BEARING FINANCIAL ASSETS MATURITY

	2022	2021
	\$	\$
Amounts maturing within 12 months	36,840,484	47,520,162
Amounts maturing in greater than 12 months	20,418,743	22,996,060
Total Investment at fair value through profit or loss	57,259,227	70,516,222

VIRGINIA SURETY COMPANY, INC· NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

16. REINSURANCE AND OTHER RECOVERIES ON OUTSTANDING CLAIMS

	2022	2021
	\$	\$
Reinsurance premium payable	50,437	(3,010,293)
Reinsurance debtor receivable	682,213	13,059,162
Net receivable	732,650	10,048,869

Above is the recoveries expected from our reinsurance program.

17. CLAIMS PROVISIONS

a) Net outstanding claims

	2022	2021
	\$	\$
Gross outstanding claims	4,219,674	5,066,575
Loss adjustment expenses	(553,899)	(1,080,273)
Undiscounted central estimate	3,665,775	3,986,302
Discount to present value	39,561	(24,729)
Discounted central estimate	3,705,336	3,961,573
Discounted claims administration expenses	106,437	101,686
Claims expense - discounted	3,811,773	4,063,259
Risk margin	407,901	1,003,316
Gross outstanding claims - discounted including CHE and risk margin	4,219,674	5,066,575

Claims provisions are expected to be settled in line with the maturity profile in Note 17(b).

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

Gross outstanding claim liability	1 year or less	1-2 years	2-3 years	3-4 years	4-5 years	5+ years	
At December 2021	4,391,108	441,997	164,167	49,787	19,371	145	5,066,575
At December 2022	4,340,821	146,885	-12,305	-47,985	-39,715	-168,027	4,219,674

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 recognized in the financial statements is greater than 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% probability of sufficiency.

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.

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 recognizing 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 New Zealand government securities. Based on the risk free rates from the New Zealand Treasury Department, an overall discount factor of 1.011 on gross Outstanding Claims Liabilities and 0.995 on net Outstanding Claims Liabilities has been applied which implies an adopted risk-free discount rate of 3.5% per annum on gross Outstanding Claims Liabilities and 5.2% on net Outstanding Claims Liabilities.

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.

VIRGINIA SURETY COMPANY, INC· NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

17. CLAIMS PROVISIONS (CONTINUED)

d) Claims development - undiscounted net central estimate

The claims development table is presented net of reinsurance with the Branch's risk tolerance managed on a net basis.

\$000's	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
End of Accident Year	—	1,586	1,335	1,181	845	678	740	1,695	12,585	16,048	19,567	22,198
1 year later	1,684	1,547	1,285	1,208	825	667	714	1,698	11,959	16,434	19,536	
2 years later	1,683	1,504	1,280	1,209	822	670	705	1,587	12,008	16,362	—	
3 years later	1,638	1,503	1,281	1,209	821	667	667	1,600	11,972	—	—	
4 years later	1,638	1,504	1,281	1,209	822	659	666	1,597	—	—	—	
5 years later	1,642	1,504	1,281	1,209	813	658	667	—	—	—	—	

e) Claims reserve

	2022	2021
	\$	\$
At beginning of year	5,066,575	6,012,520
Gross claims incurred	20,898,415	18,573,767
Reinsurance recovery	(1,309,830)	(10,060,690)
Claims settled	(20,435,486)	(9,459,022)
At end of year	4,219,674	5,066,575

18. DEFERRED ACQUISITION COSTS

18a. Expenses for acquisitions of Insurance Contracts

	2022	2021
	\$	\$
LAT deficiency	—	—
Amortised during the year	(19,182,507)	(17,740,491)
Expenses for acquisition of insurance contracts	(19,182,507)	(17,740,491)

18b. Gross deferred acquisition cost

	2022	2021
	\$	\$
At beginning of year	17,709,140	15,139,251
Costs incurred	20,655,874	20,310,380
LAT deficiency	—	—
Amortised during the year	(19,182,507)	(17,740,491)
Gross deferred acquisition cost	19,182,507	17,709,140

18c. Reinsurance deferred acquisition cost

	2022	2021
	\$	\$
At beginning of year	(1,819,880)	(4,532,550)
Costs incurred	(1,044,468)	(7,634,674)
Amortised during the year	1,239,713	10,347,344
Reinsurance deferred acquisition cost	(1,624,635)	(1,819,880)

18d. Net deferred acquisition cost

	2022	2021
	\$	\$
Gross deferred acquisition cost	19,182,507	17,709,140
Reinsurance deferred acquisition cost	(1,624,635)	(1,819,880)
Net deferred acquisition costs	17,557,872	15,889,260

VIRGINIA SURETY COMPANY, INC· NEW ZEALAND BRANCH

Notes to the financial statements for the year ended 31 December 2022

19. UNEARNED PREMIUM

a) Unearned premium

	2022	2021
	\$	\$
Insurance Portfolio		
Gross unearned premium reserve	56,262,472	55,370,519
Unearned Premium related to Reinsurance contracts	—	(4,842,735)
Net unearned premium	56,262,472	50,527,784

b) Liability adequacy test (LAT)

The probability of adequacy of the unearned premium liability differs from the probability of adequacy adopted in determining the outstanding claims provision. The reason for the difference is that the former is a benchmark used only to test the sufficiency of net unearned premium liabilities whereas the latter is a measure of the adequacy of the outstanding claims provision 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 calculation of the probability 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 recognized 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 surplus of \$3,207,908 (2021 surplus of \$4,808,509).

	2022	2021
	\$	\$
Discounted Central Estimate	(26,385,088)	(23,848,292)
Discounted Claims Handling Expenses	(1,341,258)	(947,126)
Discounted Policy Maintenance Expenses	(168,842)	(132,459)
Provision for future cancellations	(1,584,527)	(1,432,078)
Risk Margin	(6,016,977)	(6,492,915)
Expected future claims	(35,496,692)	(32,852,870)
Deferred acquisition costs		
Commission expense	15,237,784	13,911,933
Administration Fee	3,944,723	3,797,207
LAT surplus/(deficiency)	—	—
Total deferred acquisition costs	19,182,507	17,709,140
Reinsurance deferred acquisition costs	(1,624,635)	(1,819,880)
Net deferred acquisition costs	17,557,872	15,889,260
Level of surplus/(deficiency)	3,207,908	4,808,509

The liability adequacy test carried out on the insurance portfolio in the current year identified no deficiency (2021 surplus \$4,808,509).

20. 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 (2021: A+) and the following solvency information:

	2022	2021
	\$	\$
Actual solvency capital	541,268,309	555,831,648
Minimum solvency capital	104,587,163	124,882,463
Solvency margin	436,681,146	430,949,185
Solvency ratio	5.18	4.45

21. EVENTS OCCURRING AFTER REPORTING DATE

At the date of this report, no other matter or circumstance has occurred subsequent to year end that has significantly, or may significantly affect, the operations of VSCNZ, the results of those operations or the state of affairs of VSCNZ.