

SOUTHERN CROSS BENEFITS LIMITED

ANNUAL REPORT

FOR THE YEAR ENDED

30 June 2019

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SOUTHERN CROSS BENEFITS LIMITED

ANNUAL REPORT DISCLOSURES
year ended 30 June 2019

The Directors present their Annual Report including the Financial Statements of Southern Cross Benefits Limited (the "Company") for the year ended 30 June 2019.


Dividend	No dividends were paid during the year ended 30 June 2019 (2018: \$0). Subsequent to balance date, the Directors have declared a final dividend of \$3,500,000.
Nature of business	The Company is in the business of providing a range of travel insurance products. The Company has a branch in Australia which provides outbound travel insurance in Australia. The Company also operates in the New Zealand Pet Insurance market.
Results	The Company recorded a net profit from operations of \$5,970,000. (2018: \$3,690,000.)
Register of Directors	G W Gent E M Hickey K B Taylor T D Moore C M Drayton M P Misur A J Morris M P Jordan (appointed 1 August 2019)
Use of Company Information	The Board received no notices during the year from Directors requesting to use Company information received in their capacity as Directors which would not have been otherwise available to them.
Share Dealings	No Director acquired or disposed of any interest in shares in the Company during the year.
Directors' Remuneration	The Directors received no remuneration from the Company.
Indemnity and Insurance	The Company has insured its Directors and Officers for liabilities to other parties that may arise from their positions as Directors and Officers.
Auditor	KPMG, a New Zealand Partnership.

For and on behalf of the Board



G W Gent
Chairman

Date: 25 September 2019



E M Hickey
Director

Date: 25 September 2019

SOUTHERN CROSS BENEFITS LIMITED

GOVERNANCE STATEMENT

The Directors of the Company ensure that robust corporate governance policies, practices and processes are in place. Responsibility for the day-to-day operation and administration of the Company is delegated by the Board to the Chief Executive Officer (CEO) and senior management. The CEO is authorised to make decisions in accordance with the strategy, plans, budgets and the specific delegation framework approved by the Board. The Company maintains a healthy risk culture under the frameworks of formal risk management, compliance, capital, investment, and delegated authority policies. Management report on these and other operational matters to the Board.

The Board delegates certain powers, duties and responsibilities to the Audit and Risk Committee and Remuneration Committee. All Directors of the Company are considered to be independent per Reserve Bank of New Zealand guidelines with the exception of Terry Moore who holds the position of CEO for the Company's sole shareholder, Southern Cross Health Trust. No executives of the Company hold a seat on the Board. All Directors and senior managers are required to meet Fit and Proper standards as prescribed by company policy.

Some key functions of the Board include:

- ensuring the Company's goals are clearly established and that strategies and business plans are in place for achieving them
- ensuring the Company's financial statements are true and fair and otherwise conform with legal requirements
- identifying steps necessary to protect the Company's financial position and brand
- appointing the CEO
- monitoring the performance of management
- ensuring the Board and management adhere to high ethical standards

The Company employs a Head of Legal, Risk and Compliance, reporting to the CEO, who holds the role of Branch Risk Officer in Australia. The Company's Chief Risk Officer in New Zealand is the CEO. The associated responsibilities with these roles is formally imbedded into the position descriptions. The Company has a Management Risk Committee which meets monthly and consists of the Senior Leadership and Risk Teams. In addition, the Company engages PWC as their Internal Auditor (outsourced) and the Board and Audit and Risk Committee approve an annual plan for independent review of the key risk areas of the business.

The Company monitors on a monthly basis its compliance with prudential capital requirements in accordance with RBNZ and APRA regulatory requirements.

Profiles of the Company's Directors are noted below.

Greg Gent

ONZM

Chairman

Greg Gent joined the Southern Cross Benefits Board and was elected Chairman in 2014. Mr Gent is a Northland dairy farmer with a wealth of governance experience. He is chairman of Dairy Holdings Limited and of New Zealand Institute for Plant and Food Research. Mr Gent is also Chairman of Southern Cross Health Trust and the Southern Cross Medical Care Society.

Elizabeth Hickey

MNZM, MCom(Hons), FCA, CMInstD

Ms Hickey is a chartered accountant and chartered member of the Institute of Directors who joined the Southern Cross Benefits Board in 2014. She is a Fellow and past President of Chartered Accountants Australia and New Zealand. Ms Hickey is a trustee of the University of Auckland Foundation and is also a Trustee of Southern Cross Health Trust and a Director of the Southern Cross Medical Care Society.

Keith Taylor

ONZM, BSc, BCA, FIA, FInstD

Keith Taylor was appointed to the Southern Cross Benefits Board in 2014 and is also a Trustee of the Southern Cross Health Trust and a Director of Southern Cross Medical Care Society. He has over 30 years' experience in the insurance and financial services industries as a chief executive, chief financial officer and actuary. Mr Taylor is chair of Butland Holdings Limited and Port Marlborough. He is also a Director of Gough, Gough & Hamer Limited.

Terry Moore

ACA

Terry Moore is the CEO of Southern Cross Benefits parent organisation Southern Cross Health Trust and is also CEO of Southern Cross Hospitals Limited. He was appointed to the Southern Cross Benefits Board in 2017. Mr Moore is an executive member of the New Zealand Private Surgical Hospitals Association (NZPSHA) and he is a Director of a number of medical services joint ventures and private hospital companies.

GOVERNANCE STATEMENT (continued)

Catherine Drayton

BCom, LLB, FCA

Catherine Drayton was appointed to the Southern Cross Benefits Board in 2018. Ms Drayton is Chair of Christchurch International Airport and a director of Genesis Energy, BECA Group Limited and Fronde Systems Group, and was recently appointed as a board member of the Guardians of New Zealand Superannuation. She is a member of the University of Canterbury Council and a fellow of the Chartered Accountants Australia and New Zealand. Ms Drayton is also a Trustee of Southern Cross Health Trust and a Director of the Southern Cross Medical Care Society.

Dr Martin Misur

BHB, MBChB, FANZCA

Dr Martin Misur was appointed to the Southern Cross Benefits Board in 2018. He is a Specialist Anaesthetist at Auckland City Hospital and in private practice at Epsom Anaesthetic Partnership. Dr Misur is also a Trustee of the Southern Cross Health Trust and a Director of Southern Cross Hospitals.

Dr Arthur Morris

BSc(Hons), MD, Dip ABMM, FRCPA

Dr Arthur Morris was appointed to the Southern Cross Benefits Board in 2018. He is an Auckland-based clinical microbiologist who also works with the Health Quality and Safety Commission as a Clinical Lead. He is a current Director of Mercy Healthcare Auckland, a trustee of the Auckland School of Medicine Foundation. Dr Morris is also a Trustee of the Southern Cross Health Trust and a Director of Southern Cross Hospitals.

Murray Jordan

MProp

Murray Jordan joined the Southern Cross Benefits Board in August 2019. He is a former Managing Director of Foodstuffs North Island and an experienced company director. Mr Jordan currently serves on the Boards of Metcash Limited (an ASX listed company), Chorus, SkyCity, Stevenson Group, and Starship Foundation. His early career was in the property sector, and he holds a Masters degree in Property Administration from the University of Auckland.

SOUTHERN CROSS BENEFITS LIMITED

STATEMENT OF COMPREHENSIVE INCOME AND CHANGES IN EQUITY
for the year ended 30 June 2019

	Note	2019 \$000	2018 \$000
Net premiums	6	76,016	70,836
Net claims expense	5	(44,168)	(41,695)
Underwriting surplus		31,848	29,141
Operating expenses	8	(27,487)	(26,671)
Other operating income		222	175
Operating profit		4,583	2,645
Investment and other income	7	1,387	1,045
Net profit from operation		5,970	3,690
Other comprehensive income:			
Movement on foreign currency translation reserve		(400)	392
Net comprehensive income		5,570	4,082
Equity opening balance		26,615	22,533
Dividend paid	9	-	-
Equity closing balance		32,185	26,615

The accompanying notes form part of these financial statements


SOUTHERN CROSS BENEFITS LIMITED

STATEMENT OF FINANCIAL POSITION

as at 30 June 2019

	Note	2019 \$000	2018 \$000
Assets			
Cash and cash equivalents	10	16,470	10,078
Premium receivable and other assets	11	16,540	18,435
Investments	7	42,217	38,921
Fixed assets	12	767	797
Intangible assets	12	4,220	3,226
Total assets		80,214	71,457
Liabilities			
Payables and other liabilities	13	4,912	4,706
Insurance contract liabilities	3	43,117	40,136
Total liabilities		48,029	44,842
Net assets		32,185	26,615
Equity			
Share capital	9	4,600	4,600
Retained earnings		29,107	23,137
Foreign currency translation reserve		(1,522)	(1,122)
Equity		32,185	26,615

For and on behalf of the Board

G W Gent Chairman _____ 

Date: 25 September 2019

E M Hickey Director _____ 

Date: 25 September 2019

The accompanying notes form part of these financial statements

SOUTHERN CROSS BENEFITS LIMITED

STATEMENT OF CASH FLOWS

for the year ended 30 June 2019

	2019	2018
	\$000	\$000
Cash flows from / (to) operating activities		
Receipt of premiums from customers	80,842	76,717
Receipts of reinsurance recoveries	3,770	2,631
Distribution, interest and other income received	1,263	1,070
Payment of claims	(46,870)	(42,942)
Payment of reinsurance premiums	(5,881)	(4,060)
Payments to employees	(7,977)	(7,205)
Payments to suppliers	(18,092)	(18,315)
Net cash flows from operating activities	7,055	7,896
Cash flows to investing activities		
Payments for fixed assets	(231)	(201)
Payments for intangible assets	(1,820)	(362)
Net receipts / (payments) for investments	1,536	(5,431)
Net cash flows to investing activities	(515)	(5,994)
Net increase / (decrease) in cash and cash equivalents	6,540	1,902
Opening cash and cash equivalents	10,078	8,178
Effect of exchange rate movement on foreign currency balances	(148)	(2)
Closing cash and cash equivalents	16,470	10,078

RECONCILIATION OF NET PROFIT WITH NET CASH FLOWS FROM OPERATING ACTIVITIES

	2019	2018
	\$000	\$000
Net profit from operations	5,970	3,690
Adjustments for:		
Depreciation and amortisation	1,088	1,033
Foreign currency exchange movement	110	121
Movement in valuation of investments	(350)	(124)
Changes in assets and liabilities:		
Receivables and accrued interest	(3,025)	(2,417)
Payables and employee benefits	222	619
Insurance contract liabilities	3,040	4,974
Net cash flows from operating activities	7,055	7,896

The accompanying notes form part of these financial statements

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

1 STATEMENT OF ACCOUNTING POLICIES

REPORTING ENTITY

Southern Cross Benefits Limited (the "Company") is a limited liability company domiciled and incorporated in New Zealand. It is a wholly owned subsidiary of the Southern Cross Health Trust. The Company's primary activity is the provision of travel and pet insurance and its registered office is Level 12 AMP Centre, 29 Customs Street West, Auckland.

The Company is a licenced insurer under the Insurance (Prudential Supervision) Act 2010.

The Company also operates in Australia selling outbound travel insurance and is regulated by the Australian Prudential Regulation Authority ("APRA") and the Australian Securities and Investment Commission ("ASIC").

The Company is registered as a charity under the Charities Act 2005, as part of the Southern Cross Health Trust group registration.

The Company, with its shareholder's approval, has applied the exemption available under section 211 (3) of the Companies Act 1993 in not disclosing the information required under section 211 (1) paragraphs (e), (g) and (h) of the Companies Act 1993.

BASIS OF PREPARATION

Under financial reporting standards, the Company is deemed to be a Tier 1 for-profit entity for financial reporting purposes.

The financial statements are:

- presented as at and for the year ended 30 June 2019.
- presented for the Company, including the Australian branch and pet insurance business.
- prepared in accordance with New Zealand generally accepted accounting practice ("NZ GAAP").
- in compliance with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and International Financial Reporting Standards ("IFRS").
- prepared in compliance with the Insurance (Prudential Supervision) Act 2010, Companies Act 1993, the Financial Markets Conduct Act 2013 and the Financial Reporting Act 2013.
- prepared on the historical cost basis except that the following are stated at their fair value: Investments, cash and cash equivalents and insurance contract liabilities.
- presented in New Zealand dollars, which is the functional and presentation currency. The functional currency for the Australian branch is Australian dollars. Transactions in the branch are translated to New Zealand dollars as discussed in the foreign currency transactions accounting policy. All financial information presented in New Zealand dollars has been rounded to the nearest thousand, unless otherwise stated.
- stated net of GST, with the exception of receivables and payables which include GST invoiced.

ACCOUNTING POLICIES AND STANDARDS

No changes to accounting policies have been made during the year, with the exception of the adoption of new standards. Policies have been consistently applied to all periods presented in these financial statements.

NEW ACCOUNTING STANDARDS ADOPTED ON 1 JULY 2018

The financial statements include the first time adoption of NZ IFRS 15 Revenue from Contracts with Customers ("NZ IFRS 15") and NZ IFRS 9 Financial Instruments ("NZ IFRS 9"), applicable for the Company for annual reporting periods beginning on or after 1 January 2018, and do not have a material impact to the Company.

- NZ IFRS 15 - the new standard replaces NZ IAS 18 Revenue ("NZ IAS 18") and is applicable to all entities with revenue from contracts with customers. The new standard provides a single five-step model for revenue recognition to be applied to all contracts with customers to depict the transfer of promised goods and services to customers at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services.

There is no material impact on the financial performance and financial position of the Company as only a small portion of the Company's revenue is within the scope of the new standard, due to the exclusion of certain types of contracts that are covered by other standards, including NZ IFRS 4 Insurance Contracts ("NZ IFRS 4") and NZ IFRS 9. Full disclosures as required by NZ IFRS 15 have not been presented on the basis that these are not material in the context of the Company.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

NEW ACCOUNTING STANDARDS ADOPTED ON 1 JULY 2018 (continued)

- NZ IFRS 9 - the new standard replaces NZ IAS 39 Financial Instruments: Recognition and Measurement ("NZ IAS 39") relating to the classification and measurement of financial instruments. There is no impact to the Company on the classification and measurement of hedge accounting methodologies as the Company does not apply hedge accounting. The impact to the Company on the classification and measurement of other financial instruments is as follows:

Financial instruments	New classification under NZ IFRS 9	Original classification under NZ IAS 39
Cash and cash equivalents	Amortised cost	Loans and receivables
Premium and other receivables	Amortised cost	Loans and receivables
Investments	Fair value through profit or loss	Fair value through profit or loss

The Company is impacted by a new forward-looking expected credit losses model that replaces the incurred loss impairment model for financial assets previously applied under NZ IAS 39. The expected credit losses model applies to premium and other receivables financial assets that are measured at amortised cost. The Company has applied the simplified approach as these items have no significant financing component. Macro-economic factors are not considered to be relevant to the financial assets measured at amortised cost. Historical loss rates have been used as estimates of expected future loss rates to determine the expected credit losses. The impact to the Company is not material.

FINANCIAL REPORTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

The impact of the following reporting standards on the Company is outlined below.

- NZ IFRS 16 Leases: effective for annual reporting periods beginning on or after 1 January 2019. NZ IFRS 16 removes the classification of leases as either operating or finance leases for the lessee, effectively treating all leases as finance leases. NZ IFRS 16 requires a lessee to recognise a 'right-of-use asset' and a lease liability reflecting future lease payments for virtually all lease contracts. Based on the preliminary assessment completed by the Company, the treatment of operating leases for office buildings and company vehicles will change. The estimated financial impact is the recognition of a 'right-of-use asset' and a corresponding lease liability of approximately \$1.8 million.

Lessees are required to recognise a finance charge on the liability and a depreciation charge on the asset which may affect the timing of the recognition of expenses on leased assets. The new standard may result in a higher expense in the earlier years of the lease, and a lower expense in the later years of a lease compared to a straight-line operating lease expense.

- NZ IFRS 17 Insurance Contracts ("NZ IFRS 17") will replace NZ IFRS 4 Insurance Contracts for periods beginning on or after 1 January 2021, becoming mandatory for the Company's financial statements for the year ending 30 June 2022. However, in June 2019 the International Accounting Standards Board ("IASB") released an exposure draft, Amendments to IFRS 17, proposing various amendments to IFRS 17 which includes deferring the effective date by one year to 1 January 2022. The IASB aims to finalise these amendments in mid-2020, with the expectation that the XRB will also adopt this one-year deferral for NZ IFRS 17. The new standard establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. Disclosure and measurement under NZ IFRS 17 differs significantly from NZ IFRS 4, and the impact of this standard on the Group is still to be determined.

USE OF ESTIMATES AND JUDGEMENTS

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

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

Information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements relate to note 3 insurance contract liabilities and note 4a insurance risk.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

FOREIGN CURRENCY TRANSACTIONS

Transactions in foreign currencies that are settled in the reporting period are translated at the settlement rate. Transactions in foreign currency that are not settled in the reporting period, resulting in monetary assets and liabilities denominated in foreign currencies at the reporting date, are translated to New Zealand dollars at the foreign exchange rate at that date. Foreign exchange differences arising on their translation are recognised in the profit or loss.

Foreign operations

Activities of the Australian Branch are recorded in Australian dollars, its functional currency. Profit or loss items are translated to New Zealand dollars at an average exchange rate for each month. The assets and liabilities of the branch are initially translated to New Zealand dollars at the foreign exchange rate on the date they arise. At balance date, all the assets and liabilities are re-translated at the exchange rate on that date.

Foreign exchange differences arising from this translation are recognised in other comprehensive income and the foreign currency translation reserve.

TAXATION

The Company is exempt from New Zealand income tax due to its charitable status and the Australian Tax Office has ruled income taxes are not payable by the Australian branch.

2 FINANCIAL SOUNDNESS

The minimum solvency capital the Company is required to retain under the Solvency Standard for Non-life Insurance Business issued by the RBNZ is per the table below. The Company has adopted a formal capital management plan to maintain a strong capital base and satisfy capital adequacy standards as prescribed by the RBNZ and by APRA for the Australian branch. An additional capital buffer of \$2.7 million (2018: \$2.4 million) for the Company has been determined by the Directors as sufficient for maintaining financial soundness.

During the year the Company has complied with all externally imposed capital requirements.

Actual solvency capital at 30 June 2019 for the Australia branch was AUD \$9.0m (2018: AUD \$ 7.2m) calculated in accordance with APRA requirements. Minimum solvency capital required to be retained by the Branch to satisfy APRA requirements is AUD \$5 million.

Solvency capital requirements for the Company are detailed below.

	2019	2018
	\$000	\$000
Minimum solvency capital	12,039	11,124
Actual Solvency capital	18,146	18,390
Solvency Margin	6,107	7,266
Solvency Ratio	1.51	1.65

In April 2019 Standard & Poor's reaffirmed the Company's Insurer Financial Strength Rating of A. This signifies the insurer "has strong financial security characteristics".

3 INSURANCE CONTRACT LIABILITIES

Insurance contracts are defined as those containing significant insurance risk at the inception of the contract.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during the period.

The Company has determined that all travel and pet insurance policies provided to customers are insurance contracts.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

3 INSURANCE CONTRACT LIABILITIES (continued)

Estimates of the provision for outstanding claims for Southern Cross Benefits Limited as at 30 June 2019 have been determined by the Company's Appointed Actuary, Win-Li Toh, MA (Oxon) of Taylor Fry Consulting Actuaries, a Fellow of the New Zealand Society of Actuaries and a Fellow of the Institute of Actuaries of Australia. The calculation of the provision for outstanding claims complies with both NZ IFRS 4: Insurance Contracts and Professional Standard No. 30: General Insurance Business of the New Zealand Society of Actuaries.

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

Insurance contract liabilities

	2019	2018
	\$000	\$000
Provision for outstanding claims (refer note 3a)	13,494	11,490
Provision for unearned premium (refer note 3b)	29,623	28,646
	43,117	40,136

a. Provision for outstanding claims

For travel insurance, claims outstanding for two months or more are determined using a standard chain ladder method. Claims outstanding in respect of the most recent two months for the majority of the travel insurance products, are determined by applying an estimated loss ratio and the percentage estimated as unpaid to the gross earned premiums for the month. Additional allowance is made in the New Zealand and Australian outstanding claims provisions for large claims and associated reinsurance recoveries. For Pet insurance, a payments per active policy approach is adopted to value outstanding claims. Future claim payments are not inflated or discounted, as the expected duration to settlement is relatively short, and virtually all claims are settled within a year.

An additional margin of 9% (2018: 9%) has been added to the central estimate of the outstanding claim costs for the New Zealand travel business and 12% (2018: 12%) for the Australian business, to take account of the uncertainties inherent in the setting of claim provisions. The additional margin for the pet insurance business is 7% (2018: 7%).

These additional risk margins provide a 75% probability of adequacy.

A further provision of 7.5% (2018: 7.5%) of the central estimate of the outstanding claims has been made for direct and indirect claim management costs for the New Zealand travel business, 8.25% (2018: 8.25%) for the Australian business and 0% (2018: 0%) for the pet insurance business.

The pet insurance business has an agreement with Southern Cross Insurance Services Limited (SCISL) whereby SCISL pays all costs relating to claims handling and policy administration incurred by the Company in return for 32% of gross earned premium, and as a result the Company will not incur future expenses associated with the administration of claims already incurred.

	2019	2018
	\$000	\$000
Central estimate of outstanding claims liability	11,563	9,855
Claims handling costs	756	641
Risk margin	1,175	994
Provision for outstanding claims	13,494	11,490

Claims are predominantly short-term in nature and are generally settled within twelve months of being incurred. Accordingly, amounts are not discounted.

	2019	2018
	\$000	\$000
Central estimate of reinsurance recoveries on outstanding claims liability	1,766	497
Risk margin	196	50
Reinsurance recoveries on outstanding claims	1,962	547

Reinsurance recoveries on outstanding claims liabilities are included in other assets in the statement of financial position.

SOUTHERN CROSS BENEFITS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

3 INSURANCE CONTRACT LIABILITIES (continued)

Reconciliation of movement in provision for outstanding claims net of reinsurance recoveries	2019 \$000	2018 \$000
Opening balance	10,943	9,102
Amounts utilised during the year	(8,920)	(7,914)
Additional provision / (reversal of unused provision)	(60)	405
Amounts provided during the year	9,419	9,108
Increase in claims handling costs	115	81
Increase in risk margin	35	161
Closing balance	11,532	10,943

b. Provision for unearned premium	2019 \$000	2018 \$000
Opening balance	28,646	25,267
Premiums written in the year	82,624	78,640
Premiums earned during the year	(81,647)	(75,261)
Closing balance	29,623	28,646

Unexpired risk provision and liability adequacy test

The liability for unearned premiums arises from premiums received for risks that have not yet expired. The provision is released evenly over the duration of the travel period for travel insurance contracts and the duration of the insurance contract for pet insurance contracts and is recognised as premium income.

The Appointed Actuary has reviewed the adequacy of the unearned premium provision at 30 June 2019. In performing this test, an additional margin has been added to the central estimate of the future claim costs, to take account of the uncertainties inherent in the central estimate. A further allowance has been made for direct and indirect claim management costs and also policy administration costs.

A liability adequacy test is performed on each of the travel and pet insurance businesses to assess whether there is any deficiency in the unearned premium liability arising from expected claims and administration costs during the period covered by the unearned premium. For the New Zealand travel insurance business, the test has been performed on the aggregate portfolio as risks are broadly similar and are managed together as a single portfolio. The Pet and Australian operations are mono-lined businesses so the test has been performed on each of them as a whole.

For the travel insurance businesses, if the loss ratio was to increase by 10%, the premium liability will also increase by 10%. As there is a significant margin between the premium liability and the unearned premium provision, the liability adequacy test in respect of unearned premiums can cover quite significant levels of variability in the loss ratio. For the pet insurance business there was no premium deficiency resulting from the liability adequacy test (2018 deficiency: \$168,000).

In the Actuary's view, the liability adequacy tests (LAT) identified surpluses for the travel and pet insurance businesses. Accordingly, there was no write down of deferred acquisition costs for the pet insurance business (2018: \$8,500). The unexpired risk liability was assessed at \$0 (2018: \$159,000).

	2019			2018		
	Pet	New Zealand	Australia	Pet	New Zealand	Australia
Percentage Risk margin on expected future cash flows relating to future claims	12.3%	15.8%	21.0%	12.3%	15.8%	21.0%
Probability of adequacy (LAT and Outstanding Claims Reserve)	75.0%	75.0%	75.0%	75.0%	75.0%	75.0%

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

3 INSURANCE CONTRACT LIABILITIES (continued)

	2019		2018	
	New Zealand \$000	Australia \$000	New Zealand \$000	Australia \$000
Sensitivity				
Net Incurred But Not Paid (including margins)	7,217	2,428	6,542	2,766
20% increase in the initial claims ratio for recent event months	8,577	2,843	7,825	3,334
20% decrease in the initial claims ratio for recent event months	5,857	2,013	5,259	2,198

For the pet insurance business, a 10% increase / decrease in the payment per active policy method would give rise to a 9.85% increase / decrease in the outstanding claims provision.

This sensitivity analysis does not indicate upper or lower bounds of all possible outcomes. Future experience could be considerably more adverse (or favourable) than the scenarios presented.

4 RISK MANAGEMENT

The Company is exposed to a number of risks in the normal course of business. Primarily there is the risk of conducting an insurance business (insurance risk). Other risks include financial risks (credit risk and liquidity risk), market risks (foreign currency risk, interest rate risk and price risk), and non-financial risks (operational risk and compliance risk). The directors and management recognise the importance of having an effective risk management policy. The risks and any objectives, policies and processes to manage the risks are described below in summary; a detailed risk register and risk management framework underpin this summary.

a. Insurance risk

The Company assumes insurance risk through its travel and pet insurance activities. The key risk arises in respect of claims costs and, in particular, those costs varying from what was assumed in the setting of premium rates.

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

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

- * Underwriting policies and processes which evaluate new risks and offer terms that do not endanger the portfolio.
- * Strict claims management procedures to ensure the payment of claims is in accordance with policy conditions and the Delegated Authority Policy.
- * Maintaining a reinsurance programme for the travel insurance business which protects the Company against single large claims in excess of the Company's retention, and against a catastrophic event involving multiple claims.
- * A long-term pricing strategy which supports pricing based on underlying risk.
- * Monthly monitoring of financial and operating results and detailed investigations into the claims experience of the portfolio.
- * Adherence to a formal capital management plan monitored monthly to ensure minimum prudential capital requirements are complied with.
- * Implementation of a risk management strategy, which is in accordance with the prudential standards issued by RBNZ and APRA.

II. Sensitivity to insurance risk

The financial results of the Company are primarily affected by the level of claims incurred relative to that assumed when pricing the premiums of the policies. The assumptions used in the valuation of the outstanding claims provision and the liability adequacy test directly affect the level of estimated claims incurred. The key assumptions used are detailed in note 3.

The scope of insurance risk is managed by the terms and conditions of the policy. The main insurance benefit for the travel insurance business involves the reimbursement of losses during travel for medical expenses in addition to the losses relating to personal property, cancellation, personal accident, personal liability, and rental vehicle excesses. The main insurance benefits for the Pet insurance business involves the reimbursement of medical and surgical expenses depending upon the plan. The level of benefits specified in the contract is a key determinant of the amount of future claims, although the exact level of claims is uncertain.

NOTES TO THE FINANCIAL STATEMENTS
for the year ended 30 June 2019

4 RISK MANAGEMENT (continued)

III. Concentration of insurance risk

The Company transacts travel insurance business in New Zealand for inbound and outbound customers, and in Australia for outbound customers. The nature of its business means that this concentration of risk cannot be avoided. Management defines concentration of risk by geographic region, specific destination, and unknown and unforeseen accumulations of insured on a single transport carrier. The Company is most at risk to the global commercial aviation industry and its ability to offer continuous operations given the impacts of oil prices, pandemics, natural disasters and terrorism, which lends itself to a single event resulting in a high volume of relatively low dollar value cancellation / delay claims.

The Company's travel related concentration risks are mitigated by its catastrophe, pandemic and terrorism reinsurance treaties for the travel insurance business, to protect it from high severity losses and catastrophic events. Reinsurance is placed to cover losses in excess of agreed retentions.

The Pet insurance business has little to no concentration risk given it's New Zealand based nature and limitation to cats and dogs only. High impact events such as pandemics or conditions which are concentrated in certain breeds are excluded under the policy.

b. Financial risks

I. Credit risk

Credit risk is the potential risk of loss arising from the failure of a debtor or counterparty to meet their contractual obligations. In the normal course of its business the Company incurs credit risk from its travel and pet insurance operations and from investment in financial assets. There are no significant concentrations of credit risk other than the \$29.6 million (2018 \$31.0 million) invested in AMP Capital Cash and Short Duration Funds and \$12.6 million (2018 \$12.9 million) invested in Colonial First State Cash Fund.

The Company has internal controls in place to manage premium accounts receivable credit risk and an investment policy is also maintained which is used to manage the exposure to credit risk. The Company has a reinsurance management strategy in place to manage the credit risk from its reinsurance programme.

The maximum exposure to credit risk at reporting date is the amount of financial assets reported in the statement of financial position.

These exposures are net of any recognised provisions for impairment losses. There were no impairments at 30 June 2019 (2018: none). The Company does not require any collateral or security to support financial assets due to the quality of the counter-party organisations. The credit quality of counter-parties is assessed based on published credit ratings, issued by Standard & Poor's or equivalent ratings agencies. The credit ratings of the invested managed funds are calculated by looking through the underlying funds.

The credit quality of counter-parties is as follows:	2019 \$000	2018 \$000
AAA	2,819	1,531
AA	40,680	36,363
A	15,071	13,512
BBB	3,759	3,518
Non-rated	11,868	11,416
	74,197	66,340

The cash and cash equivalents balances are held with a counter-party rated AA - (30 June 2018: AA -). The BBB rated counter-parties are related to the invested funds managed by AMP Capital.

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

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

4 RISK MANAGEMENT (continued)

II. Liquidity risk

The Company is exposed to daily calls on its available cash resources from claims and administration expenses. Liquidity risk is the risk that payment of obligations may not be met in a timely manner at a reasonable cost. The investment policy sets out criteria to ensure funds are available to meet calls to cover claims and expenses at unexpected levels of demand.

For the New Zealand operation invested funds are managed by AMP Capital and for the Australian operation funds are invested in the Colonial First State Cash Fund. These funds are available on call. Cash and cash equivalents are also available on call. The majority of premium accounts receivable, with the exception of unbilled premiums on pet policies and seasonal worker policies, are due within one month of balance date for the travel insurance business and within two months of balance date for the pet insurance business. Unbilled premiums of \$8.0 million are paid by instalments and are due within 12 months of balance date (30 June 2018: \$6.2 million). Substantially all liabilities are payable within one year of balance date.

Lease payments are made monthly in advance and closely align with the contractual cash flow obligations of the lease (refer note 15).

c. Market risks

I. Foreign currency risk

At 30 June 2019, the New Zealand operations had assets of NZD \$14,000 and no liabilities denominated in foreign currencies (30 June 2018: assets of \$14,000 and no liabilities).

A movement of 100 basis points on these exchange rates would have an immaterial impact on the statement of profit or loss and other comprehensive income (2018: immaterial).

The Company's Australian branch exposes it to currency risk, as the branch's functional currency is Australian dollars. The New Zealand dollar equivalents of the Australian assets and liabilities at reporting date amounted to \$16.9 million and \$7.9 million respectively (2018: assets of \$16.0 million and liabilities of \$8.5 million).

As the Australian operation is considered an ongoing investment, no hedging of the foreign currency exposure is undertaken. Any movement in the Australian dollar exchange rate is reflected in the foreign currency translation reserve. A movement of 100 basis points on the Australian dollar exchange rate at year end would have an impact of \$91,000 (2018: \$75,000) on the net assets of the Company and the foreign currency translation reserve.

II. Interest rate risk

During the year, the Company invested in AMP Capital Funds and Colonial First State Cash Fund and through the underlying investments in these funds has indirect exposure to interest rate risk. There is a risk that any movement in interest rates can have an effect on the profitability and cash flows of the Company. The Company maintains an investment policy to mitigate this risk.

(i) Cash flow interest rate risk

The cash flows from investments of the Company in the short term are susceptible to changes in interest rates.

(ii) Fair value interest rate risk (unit price risk)

The Company is exposed to price risk through unit price changes of its investments in the AMP Capital and Colonial First State funds. The Company manages its price risk by ensuring all activities are transacted in accordance with the funds investment statements and the Company's investment policy which focuses on low risk investments.

Impact of change in interest rates	2019	2018	2019	2018
	\$000	\$000	\$000	\$000
	Increase / (decrease)		Increase / (decrease)	
	in cash flows		in profitability	
Increase by 100 basis points	410	334	362	300
Decrease by 100 basis points	(410)	(334)	(362)	(300)

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

4 RISK MANAGEMENT (continued)

d. Fair values of financial assets and financial liabilities

All financial assets and financial liabilities included in the statement of financial position are carried at amounts that approximate fair value. The fair value hierarchy below measures financial assets by the level into which the fair value measurement is categorised.

Definition of the fair value hierarchy

Level 1: Valuation based on quoted market prices (unadjusted) in an active market.

Level 2: Valuation techniques based on observable market data, either directly (as prices) or indirectly (derived from prices).

Level 3: Valuation techniques not based on observable market data.

The Company's investments in funds are level 2 investments. The fair value of the funds is derived from the fair value of the underlying investments within the funds, which are calculated based on inputs that are based on observable market data. The fair value of the funds is calculated and supplied by AMP Capital Investors (New Zealand) Limited for the New Zealand travel operation and Colonial First State Asset Management for the Australian Branch.

5 NET CLAIMS EXPENSE

The net claims expense represents payments made on claims and the movements in the outstanding claims and unexpired risk provisions.

The component of claims expense relating to risk ceded to reinsurers is recognised as reinsurance claim recoveries in the profit or loss and as reinsurance recoveries in the statement of financial position.

	2019 \$000	2018 \$000
Claims expense	47,517	44,649
Reinsurance claims recovery	(3,349)	(2,954)
Net claims expense	44,168	41,695
Claims incurred relating to risk borne in current financial year (gross)	47,262	44,000
Claim recoveries relating to risk borne in current financial year	(3,269)	(2,858)
Claims incurred relating to risk borne in the current financial year (net)	43,993	41,142
Claims incurred relating to risk borne in previous financial year (gross)	(44)	406
Claim recoveries relating to risk borne in previous financial year	68	(95)
Claims incurred relating to risk borne in previous financial year (net)	24	311
Increase / (decrease) in provision for claims handling cost	115	81
Increase / (decrease) in risk margin	36	161
Net claims expense	44,168	41,695

6 PREMIUM REVENUE

Gross written premiums from insurance contracts are recognised evenly over the period covered by the contract. For the travel operations, revenue is recognised from the date on which the travel period commences. Premiums written but unearned are recorded as unearned premiums. Premiums are stated net of fire service levies and stamp duty. Where premiums are billed and paid by instalments, the premium to be billed up to the next renewal date is recognised as a receivable and unearned premium liability.

For the pet operations, revenue is recognised from the date on which the policy is effective. Premiums written but unearned are recorded as unearned premium liability. Where premiums are billed and paid by instalments, the premium to be billed up to the next renewal date is recognised as unbilled premium receivable.

Premiums ceded to reinsurers are recognised as reinsurer's share of the premium and deducted from gross premiums. The recognition of the expense in the profit or loss is in accordance with the pattern of reinsurance service received.

	2019 \$000	2018 \$000
Premium income	81,647	75,261
Reinsurers' share of premium	(5,631)	(4,425)
Net premiums	76,016	70,836

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

7 INVESTMENTS

The Company designates its investments as "financial assets at fair value through the profit or loss" at inception and they are held to match insurance contract liabilities. This eliminates or significantly reduces a measurement or recognition inconsistency between assets and liabilities.

All investments are carried at fair value using the market bid price or valuation based on market observable data with changes in fair value recognised in the profit or loss. Transaction costs are recognised in the profit or loss on transaction date.

The Company is required to hold designated levels of investments in Australia to comply with the capital adequacy requirements of APRA in relation to the activities of the Australian branch (refer note 2). Restrictions are imposed on these investments and the Company's ability to utilise them. At balance date \$12.6 million (2018: \$12.9 million) in a cash fund was held in this category.

All purchases of investments are recognised on the date of the trade.

Interest income is recognised in the profit or loss as it accrues using the effective interest rate method. Distributions from investments in funds are recognised on a present entitlement basis.

Investment and other income	2019 \$000	2018 \$000
Interest income	157	134
Distribution income	881	787
Net gain on investment at fair value through profit or loss	349	124
	1,387	1,045

8 OPERATING EXPENSES

	2019 \$000	2018 \$000
Auditor's remuneration:		
– Audit of financial statements	121	120
– Other services	53	37
Depreciation (note 12)	261	220
Amortisation of intangibles (note 12)	827	813
Employee benefits expense	8,204	7,319
Rental of premises	740	721
Bank charges	707	727
Acquisition costs	2,481	2,641
Other direct expenses	6,877	8,269
Other overhead expenses	7,216	5,804
	27,487	26,671

Other direct expenses include items such as IT costs, marketing and underwriting expenses.

Auditor's remuneration for other services consists of auditing the year end regulatory solvency return to the RBNZ and annual APRA reporting on the Australian branch.

9 SHARE CAPITAL

Share capital comprises 4,600,000 (2018: 4,600,000) authorised, issued and fully paid ordinary shares. All ordinary shares have equal voting rights, and share equally in dividends and surplus on winding up. No dividends were paid during the year (30 June 2018: \$0).

10 CASH AND CASH EQUIVALENTS

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

11 PREMIUM RECEIVABLE AND OTHER ASSETS

The recoverability of reinsurance recoveries receivable is assessed at the reporting date and impairment is recognised where there is objective evidence that the Company may not receive the amounts due to it and these amounts can be reliably measured.

For the travel operations, the costs incurred in acquiring insurance contracts are deferred in recognition that they represent future benefits. Acquisition costs are initially recorded in the profit or loss. For the pet operations, the costs in acquiring insurance contracts are immaterial and recorded in the profit or loss.

SOUTHERN CROSS BENEFITS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

11 PREMIUM RECEIVABLE AND OTHER ASSETS (continued)

Any amounts that give rise to premium income in subsequent reporting periods are deferred as an asset and amortised over the period covered by the insurance contract.

Premium and other receivables are stated at their cost less impairment losses. Impairment losses for uncollectable premiums are recorded as bad debt expense in the profit or loss. Under the NZ IFRS 9 definition of financial assets, premium and other receivables are classified as "financial assets at amortised cost". Refer to Note 1 for the impact of changes in financial reporting standards on assessment of impairment losses.

	2019	2018
	\$000	\$000
Premium accounts receivable	9,385	7,499
Reinsurance recoveries receivable (note 11a)	338	775
Deferred acquisition costs (note 11b)	924	1,091
Deferred reinsurance assets	1,352	1,157
Advance to Southern Cross Health Trust (note 14)	2,000	2,000
Other assets	2,541	5,913
	16,540	18,435

a. Reconciliation of movements in reinsurance recoveries receivable	2019	2018
	\$000	\$000
Opening balance	775	372
Gross reinsurance recoveries on claims paid during the year	2,496	3,117
Reinsurance recoveries settled by reinsurer during the year	(2,933)	(2,714)
Closing balance	338	775

b. Reconciliation of movements in deferred acquisition cost	2019	2018
	\$000	\$000
Opening balance	1,091	1,139
Gross commissions paid during the year	2,314	2,602
Pet deferred acquisition cost write down	-	(9)
Commissions incurred during the year	(2,481)	(2,641)
Closing balance	924	1,091

Premium and other receivables is a current asset. Other assets includes an investment settlement pending of \$0 million (2018: \$5 million). The fair value of premium and other receivables approximates the carrying amount.

12 FIXED AND INTANGIBLE ASSETS

Fixed assets and intangibles are non-current assets.

FIXED ASSETS	Leasehold Improvement	Other fixed assets	Total
	\$000	\$000	\$000
At 30 June 2019			
Cost	966	2,220	3,186
Accumulated depreciation	(602)	(1,817)	(2,419)
Closing balance	364	403	767
At 30 June 2018			
Cost	944	2,011	2,955
Accumulated depreciation	(497)	(1,661)	(2,158)
Closing balance	447	350	797

Other fixed assets include furniture and fittings, office equipment and computer equipment.

NOTES TO THE FINANCIAL STATEMENTS
 for the year ended 30 June 2019

12 FIXED ASSETS AND INTANGIBLES (continued)

INTANGIBLE ASSETS	Other Intangibles \$000	Computer Software \$000	Work in progress \$000	Total \$000
At 30 June 2019				
Cost	918	11,865	534	13,317
Accumulated amortisation and impairment	(601)	(8,496)	-	(9,097)
Closing balance	317	3,369	534	4,220
At 30 June 2018				
Cost	918	10,277	302	11,497
Accumulated amortisation and impairment	(545)	(7,726)	-	(8,271)
Closing balance	373	2,551	302	3,226

Other intangibles include Goodwill and Customer Base.

Recognition and measurement, including impairment

The carrying amounts of the Company's assets are reviewed at each balance date to determine whether there is any objective evidence of impairment. If any such indication exists, the asset's recoverable amount is estimated.

An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses directly reduce the carrying amount of the asset and are recognised in the profit or loss. The estimated recoverable amount of assets is the greater of fair value less costs to sell, or value in use.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

Fixed Assets

Fixed assets are measured at cost, less accumulated depreciation and impairment losses.

Where material parts of an item of fixed assets have different useful lives, they are accounted for as separate items of fixed assets.

Subsequent costs are added to the carrying amount of an item of fixed assets when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Company and the cost of the item can be measured reliably. All other costs are recognised in the profit or loss as an expense as incurred.

Depreciation is recognised in the profit or loss on a straight-line basis over the estimated useful lives of each part of an item of fixed assets. The depreciation rates for the current and comparative periods are as follows:

- Computer equipment 25% - 33% per annum
- Furniture and fittings 15% - 20% per annum
- Office equipment 15% - 20% per annum
- Leasehold improvements 8% - 20% per annum

Computer Software and Work in Progress

Most of the computer software and work in progress is internally generated.

Computer software is recognised as an intangible asset when it is not an integral part of the computer hardware. Software development expenditure that meets the criteria for recognition as an intangible asset is capitalised and amortised over its expected useful life, subject to impairment testing. All capitalised costs are deemed to have an expected useful life of five years, unless it can be clearly demonstrated that the net benefits are to be generated over either a longer or shorter period. The capitalised costs are amortised on a straight line basis over the period following completion of a project or implementation of part of a project.

Capital expenditure on major projects is initially recorded as work in progress. On completion of the project the asset is transferred to computer software. Work in progress is not depreciated.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

12 FIXED ASSETS AND INTANGIBLES (continued)

Customer Base

Customer base represents the value of a customer base acquired, through its ability to generate future cash flows from retained business. It is recognised as an intangible asset when a business is acquired and when the criteria for recognition are met. A customer base is initially recognised at cost which is the fair value at the acquisition date and subsequently carried at cost less accumulated amortisation and any accumulated impairment losses. The capitalised costs are amortised on a straight line basis over the period when future economic benefits are expected to flow to the Company. This period is determined to be ten years.

Goodwill

Goodwill is attributable mainly to the opportunities for growth enabled by marketing the Pet insurance product to the members of the Southern Cross Medical Care Society ("Society") and relates entirely to the pet insurance business purchased in 2012, being the cash-generating unit (CGU) as defined in NZ IAS 36. The carrying amount of Goodwill that relates to this CGU at 30 June 2019 is \$168,000 (2018: \$168,000). Refer to Note 18 for information on the proposed sale of the Pet insurance business.

Goodwill is assessed at each reporting date for indicators of impairment as it is not amortised. No impairment losses on goodwill were recognised during 2019 (2018: nil).

The recoverable amount of the CGU is determined based on value-in-use calculations, determined by discounting the future cash flows to be generated from the CGU. These calculations use discounted cash flow projections based on past experience, actual operating results and profit forecasts approved by management as part of the rolling operating plan process. The rolling operating plan covers a detailed three year time frame, approved by management. Profit forecasts greater than three years are estimated by management based on their assessment of sustainable growth. The discounted cash flow model has used a five year profit projection, a discount rate (pre-tax) of 8% (2018: 8%) and annual growth rates for pets covered (as detailed in the following table). The discount rates were based on the average risk-free rate obtained from the yield on 10-year bonds issued by the New Zealand Government adjusted for a risk premium to reflect the risk of the specific CGU. The projected growth in pets covered and cash flows were based on realising the opportunities for growth enabled by marketing the product to the members of the Society in conjunction with technology improvements enabling higher capacity.

Growth rate projections:

	Year 1	Year 2	Year 3	Year 4	Year 5
Pets Covered 2019	20.7%	18.9%	16.0%	15.2%	15.8%
Pets Covered 2018	23.0%	21.8%	18.1%	16.8%	15.9%

Key assumptions underlying the valuation relate to management's assessment of new business growth, claims cost escalation, premium increases and operating expenses. Management utilise local market data as well as Group expertise and experience to validate key assumptions.

The key assumptions described above may change as economic and market conditions change. The Company estimates that reasonably possible changes in these assumptions are not expected to cause the recoverable amount of the CGU to decline below the carrying amount.

13 PAYABLES AND OTHER LIABILITIES

Payables are measured at cost. Under NZ IFRS definition of financial liabilities, payables are classified as "other liabilities at amortised cost".

	2019 \$000	2018 \$000
Accounts payable	2,717	2,467
Employee benefits	908	682
Other liabilities	1,287	1,557
	4,912	4,706

Payables is a current liability except for \$135,000 (2018: \$177,000) of non-current deferred lease income within other liabilities.

Employee benefits represent the current obligation to employees in respect of outstanding salaries, leave entitlements and other short term benefits.

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

14 RELATED PARTIES

a. Identity and relationship of related parties:

◆ Southern Cross Health Trust ("Health Trust")	Parent of the Company
◆ Southern Cross Hospitals Limited ("Hospitals")	100% subsidiary of Health Trust
◆ Southern Cross Medical Care Society ("Society")	Related party to Parent
◆ Southern Cross Insurance Services Limited	Subsidiary of Society

All these related entities have 30 June balance dates.

The Company, the Hospitals and the Society are separate legal entities which work together in certain areas such as legal, payroll and HR, under fully costed service level agreements which dictate the expectations of each entity. In 2019, such costs to the Company totalled \$7,000 (2018: \$7,000).

Any other costs incurred by one entity on behalf of another are reimbursed monthly.

The Company purchased health insurance for its employees from the Society, to the value of \$74,000 (2018: \$71,000).

No advances to the Health Trust were made during 2019 (2018: none).

The handling of policy and administration expenses for the pet insurance business is managed by Southern Cross Insurance Services Limited by way of a management agreement with the Company and costs are reimbursed monthly as a percentage of gross earned premiums. The total value of this contract for the year were \$4,592,000 (2018: \$3,515,000). Overhead costs incurred by the pet insurance business were recharged to Southern Cross Insurance Services Limited totalling \$275,000 (2018: \$287,000).

<i>The amount of transactions with other related parties</i>	2019	2018
	\$000	\$000
Sales of services	275	287
Purchase of services	4,886	3,882
<i>The outstanding balances with other related parties</i>		
Receivables	2,036	2,032
Payables	499	436

b. Remuneration of Directors

The Company did not pay any Directors' fees for 2019 (2018: nil). The Company provides Directors with directors' and officers' liability insurance cover for liabilities to other parties that may arise from their positions as directors.

c. Remuneration of key management personnel	2019	2018
	\$000	\$000
Salaries and other short-term benefits	1,775	1,375

Key management personnel include the chief executive officer and senior executives. The number of senior executives increased during the year. The Company does not provide loans, advances or post-employment benefits to key management personnel. At each reporting date there are amounts outstanding to key management personnel comprising salaries, earned leave and short-term incentives.

15 LEASE COMMITMENTS

Leases are defined as an operating lease where they do not transfer substantially all the risks and rewards incidental to ownership.

Payments made under operating leases are recognised in the profit or loss on a straight-line basis over the term of the lease.

	2019	2018
	\$000	\$000
Within 1 year	629	595
Between 1 and 2 years	658	625
Between 2 and 5 years	749	1,379
Greater than 5 years	-	0
	<u>2,036</u>	<u>2,599</u>

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 30 June 2019

16 CONTINGENT LIABILITIES

The Company has a standby letter of credit arrangement as a requirement of its merchant acquiring facility in Australia. The maximum value of this facility is \$200,000 Australian dollars. The letter of credit expires in January 2020 but has the ability to be extended annually (2018: \$200,000 Australian dollars).

The Company has two bank bonds in place as requirements of the premises lease agreements. The maximum value of these bonds is currently \$145,000 (2018: \$145,000).

17 CAPITAL COMMITMENTS

The Company had no capital commitments at 30 June 2019 (2018: Nil)

18 PROPOSED SALE OF PET INSURANCE BUSINESS

On 28 June 2019, the Board of Southern Cross Healthcare Limited approved and entered into a sale and purchase agreement to purchase the relevant assets and liabilities of the Southern Cross Pet Insurance business from Southern Cross Benefits Limited. As the transaction is conditional on regulatory approval by the Reserve Bank of New Zealand (RBNZ), the transaction does not meet the criteria to be classified as held for sale and a discontinued operation as at 30 June 2019. If the RBNZ approves the transaction, the completion date of sale is likely to occur in the Financial year ending 30 June 2020.

The agreed sale price for the Pet insurance business is an initial amount of \$6.3 million subject to an adjustment amount, equal to the profit or loss generated by the business from 1 July 2018 to the completion Date. The transaction is expected to result in a gain on sale of approximately \$7.9m, subject to the adjustment calculation. The business contributed \$1.4m of Southern Cross Benefits Limited profit in the year ending 30 June 2019 and has assets of \$11.3m and liabilities of \$11.5m.

19 SIGNIFICANT EVENTS AFTER BALANCE DATE

On 25 September 2019 the Directors declared a final dividend of \$3.5 million for the year ended 30 June 2019. As the final dividend was approved after balance date, the financial effect of the dividend payable of \$3.5 million has not been recognised in the Balance Sheet.

The declared dividend has been treated as a deduction in the calculation of actual solvency capital at 30 June 2019 in accordance with the Solvency Standard for Non-life Insurance Business issued by the Reserve Bank of New Zealand (refer note 2).



Independent Auditor's Report

To the shareholder of Southern Cross Benefits Limited

Report on the audit of the financial statements

Opinion

In our opinion, the accompanying financial statements of Southern Cross Benefits Limited (the 'company') on pages 4 to 21:

- i. present fairly in all material respects the company's financial position as at 30 June 2019 and its financial performance and cash flows for the year ended on that date; and
- ii. comply with New Zealand Equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

We have audited the accompanying financial statements which comprise:

- the statement of financial position as at 30 June 2019;
- the statements of comprehensive income and changes in equity, and cash flows for the year then ended; and
- notes, including a summary of significant accounting policies and other explanatory information.



Basis for opinion

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

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

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

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



Key audit matters

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



The key audit matter

How the matter was addressed in our audit

Valuation of insurance contract liabilities and reinsurance recoveries on outstanding claims

Refer to Note 3, Note 4a, and Note 11 to the financial statements.

Valuation of the company's provision for outstanding claims (included within insurance contract liabilities in Note 3), and valuation of reinsurance recoveries on outstanding claims (included within other assets in Note 11) requires significant judgement from management and the company's externally appointed actuarial specialist.

Our audit procedures included:

- testing a sample of claims to check whether they had the appropriate level of authorisation and support;
- testing the reconciliation of claims data from the underlying claims systems to the data used in the actuary's valuation of outstanding claims and reinsurance recoveries;
- comparing a sample of reinsurance recoveries recognised to the terms of the underlying reinsurance contracts and claims data;
- assessing the recoverability of balances owed by reinsurer counterparties by considering their credit worthiness and capital strength, based on external sources of information and historical experience; and
- with support from our actuarial specialists, assessing the work of the company's appointed actuary in estimating the future claims costs on claims incurred by 30 June 2019 and associated reinsurance recoveries, including:
 - the appropriateness of the valuation methodology, estimates and assumptions, against relevant accounting and actuarial standards;
 - the appropriateness of key assumptions including claims frequency, payment patterns and claims inflation against benchmark information; and
 - comparing previous estimates to actual claims development in the current year (i.e. performing a hindsight analysis).

We did not identify any material exceptions from procedures performed, and found the judgements and assumptions to be balanced and consistent with our understanding of the company.

Other information

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

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



Use of this independent auditor's report

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



Responsibilities of the Directors for the financial statements

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

- the preparation and fair presentation of the financial statements in accordance with generally accepted accounting practice in New Zealand (being New Zealand Equivalents to International Financial Reporting Standards) and International Financial Reporting Standards;
- implementing necessary internal control to enable the preparation of a set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and
- assessing the ability to continue as a going concern. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.



Auditor's responsibilities for the audit of the financial statements

Our objective is:

- to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- to issue an independent auditor's report that includes our opinion.

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

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

A further description of our responsibilities for the audit of these financial statements is located at the External Reporting Board (XRB) website at:

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

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

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

For and on behalf of



KPMG
Auckland

26 September 2019

Appointed Actuary's report to the Directors of Southern Cross Benefits Limited

Report in respect of a review of actuarial information in, or used in the preparation of, financial statements

This report is provided under section 78 of the Insurance (Prudential Supervision) Act 2010 ("the Insurance Act"), and relates to a review of the actuarial information in, or used in the preparation of, the financial statements of Southern Cross Benefits Limited ("SCBL") for the year ended 30 June 2019.

I have been advised by SCBL that the financial statements for SCBL are scheduled to be authorised for issue by the Board of Directors on 25 September 2019 and that the accompanying independent auditors' report is scheduled to be issued on 25 September 2019.

Name of Appointed Actuary conducting the review

I, Win-Li Toh, of Taylor Fry Consulting Actuaries ("Taylor Fry") am a Fellow of the New Zealand Society of Actuaries and have conducted this review in my role as appointed actuary to SCBL.

Work done in relation to actuarial information used in the financial statements

The actuarial information used in the financial statements comprises the following items, determined in accordance with the New Zealand Equivalent to International Financial Reporting Standard 4 ("NZ IFRS 4") as at 30 June 2019:

- » Outstanding claims provision at a 75% probability of sufficiency;
- » Unearned premium / unexpired risk provision;
- » Deferred acquisition cost asset;
- » Solvency capital requirement, calculated in accordance with the Solvency Standard for Non-life Insurance Business issued by the Reserve Bank of New Zealand ("RBNZ").

The Statement of Financial Position consolidates the outstanding claims provision and the unearned premium / unexpired risk provision as a single line item "insurance contract liabilities". The information received, methods, assumptions and limitations of the estimation of insurance liabilities are set out in two reports:

- » "Southern Cross Benefits Limited – New Zealand Insurance Liabilities at 30 June 2019" dated 6 September 2019 and
- » "Southern Cross Benefits Limited – Australian Branch Insurance Liabilities at 30 June 2019" dated 6 September 2019.

These reports set out the results of applying the Liability Adequacy Test. I note the financial statements include the results of applying the Liability Adequacy Test for the Travel Insurance and Pet Insurance businesses separately.

The components of the solvency capital requirement were advised to SCBL in the form of the Insurer Solvency Return on 13 September 2019. This is to be submitted to the RBNZ.

Scope and limitations of review

This report is prepared for the Directors of SCBL, solely for the purposes set out in section 78 of the Insurance Act and for no other purpose.

Confirmation of independence

Other than that of appointed actuary, I confirm that I have no relationship with, or any other interests in SCBL.

Information received

I consider that I have been provided with all relevant information and explanations from SCBL.

Opinion

In my opinion:

- » SCBL is maintaining the solvency margin that applies under section 21(2)(b) of the Insurance Act at 30 June 2019;
- » The actuarial information contained in the financial statements for SCBL has been appropriately included in those statements; and
- » The actuarial information used in the preparation of the financial statements for SCBL has been used appropriately.



Win-Li Toh
Fellow of the New Zealand Society of Actuaries

13 September 2019

