WESTPAC LENDERS MORTGAGE INSURANCE LIMITED

ABN 60 074 042 934

Annual Report

For the year ended 30 September 2019

WESTPAC LENDERS MORTGAGE INSURANCE LIMITED

CONTENTS

This financial report covers Westpac Lenders Mortgage Insurance Limited (the Company) as an individual entity. The financial report is presented in Australian dollars.

Westpac Lenders Mortgage Insurance Limited is a company limited by shares, incorporated and domiciled in Australia.

The financial report was authorised for issue by the Directors of the Company on 11 December 2019. The Directors have the power to amend and reissue the financial report. The Company's registered office is:

Level 18, Westpac Place
275 Kent Street
Sydney NSW 2000

DIRECTORS' REPORT

The Directors of Westpac Lenders Mortgage Insurance Limited (the Company) present their report together with the financial statements of the Company for the year ended 30 September 2019.

Directors

The following persons were Directors of the Company during the period since 1 October 2018 and up to the date of this report unless otherwise stated:

Justin Breheny	
Helen Conway	
Allan Griffiths	
Susan Houghton	
Yvonne Le Bas	(resigned on 1 August 2019)
Kitrina Shanahan	(appointed on 1 August 2019)
Lindsay Smartt	

Principal activities

The principal activities of the Company during the financial year ended 30 September 2019 consisted of underwriting lenders mortgage insurance on residential mortgages issued by Westpac Banking Corporation (Westpac).

There have been no significant changes in the nature of the principal activities of the Company during 2019.

Operating and financial review

The net profit attributable to owners of the Company for the year ended 30 September 2019 was $26.6 million (2018: $31.3 million).

The decrease in profit is predominantly as a result of the following:

- a decrease in reinsurance commission to $42.2 million (2018: $48.2 million) mainly due to the decrease in gross written premium as compared to FY2018.
- an increase in acquisition costs to $13.4 million (2018: $10.7million) mainly resulting from the Liability Adequacy Test (LAT) write down during the year.

Dividends

Details of dividends paid in respect of the Company for the current financial year are disclosed in Note 22.

Significant changes in state of affairs and events during and since the end of the 2019 financial year

During the course of the year, Westpac reset its wealth strategy and made a number of changes to its wealth business. This resulted in the realignment of the Company into the Consumer division of Westpac from 1 April 2019. This did not have a material financial impact on the Company.

There were no other significant changes in the state of affairs of the Company during the year.

The Directors are not aware of any matter or circumstance that has occurred since the end of the financial year that has significantly affected or may significantly affect the operations of the Company, the results of its operations or the state of affairs of the Company in subsequent financial years.

Developments and expected results

Information on likely developments in the operations and the expected results of the operations have not been included in this report because the Directors believe it would be likely to result in unreasonable prejudice to the Company.

Shares or interests

No shares or options were issued or granted by the company to the Directors during the year ended 30 September 2019.

Indemnities and insurance

Under the Constitution, the ultimate parent entity, Westpac Banking Corporation (Westpac), unless prohibited by statute, indemnifies each of the Directors and Company Secretaries of Westpac and of each of its related bodies corporate (except related bodies corporate listed on a recognised stock exchange), each employee of Westpac or its subsidiaries (except subsidiaries listed on a recognised stock exchange), and each person acting as a responsible manager under an Australian Financial Services Licence of any of Westpac's wholly-owned subsidiaries against every liability (other than a liability for legal costs) incurred by each such person in their capacity as director, company secretary, employee or responsible manager, as the case may be; and all legal costs incurred in defending or resisting (or otherwise in connection with) proceedings, whether civil or criminal or of an administrative or investigatory nature, in which the person becomes involved because of that capacity.

Each of the Directors named in this Directors' report and each of the Company Secretaries has the benefit of this indemnity.

Westpac also executed a deed poll in September 2009 providing indemnification equivalent to that provided under the Westpac Constitution to individuals acting as directors and other statutory officers of wholly-owned subsidiaries of Westpac (including the Company).

Under the September 2009 deed poll, Westpac also agrees to provide directors' and officers' insurance to Directors of Westpac and Directors of Westpac's wholly-owned subsidiaries.

For the year ended 30 September 2019, Westpac and the entities it controls (Westpac Group) has insurance cover which, in certain circumstances, will provide reimbursement for amounts which the Westpac Group or the Company has to pay under the indemnities set out above. That cover is subject to the terms and conditions of the relevant insurance, including but not limited to the limit of the indemnity provided by the insurance. The insurance policies prohibit disclosure of the premium payable and the nature of the liabilities covered.

DIRECTORS' REPORT (CONTINUED)

Proceedings on behalf of the Company

No application has been made and no proceedings have been brought or intervened in on behalf of the Company under section 237 of the Corporations Act 2001.

Environmental disclosure

The operations of the Company are not subject to any significant environmental regulation under any law of the Commonwealth of Australia or of any state or territory of Australia. The Company has not incurred any liability (including for rectification costs) under any environmental legislation.

Rounding of amounts

The Company is an entity to which ASIC Corporations Instrument 2016/191 dated 24 March 2016, relating to the rounding of amounts in directors' reports and financial reports, applies.

Pursuant to this Instrument, amounts in this Directors' report and the accompanying financial report have been rounded to the nearest hundred thousand dollars, unless indicated to the contrary.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 4 and forms part of this report.

Signed in accordance with a resolution of the Board.

Director

Director

Sydney 11 / 12 /2019

Auditor's Independence Declaration

As lead auditor for the audit of Westpac Lenders Mortgage Insurance Limited for the year ended 30 September 2019, I declare that to the best of my knowledge and belief, there have been:

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

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

R Balding
Partner
PricewaterhouseCoopers

Sydney
11 December 2019

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WESTPAC LENDERS MORTGAGE INSURANCE LIMITED

Statement of profit or loss and other comprehensive income for the year ended 30 September 2019

	Note	2019[1] $m	2018 $m
Premium revenue		182.8	158.4
Outwards reinsurance premium expense	12	(165.4)	(142.3)
Net premium revenue		**17.4**	**16.1**
Claims expense	5	(31.0)	(25.1)
Reinsurance and other recoveries revenue	5	18.7	14.8
Net claims incurred		**(12.3)**	**(10.3)**
Reinsurance commission		42.2	48.2
Acquisition costs	13	(13.4)	(10.7)
Other underwriting expenses	6	(6.2)	(5.3)
Underwriting expenses		**(19.6)**	**(16.0)**
Underwriting result		**27.7**	**38.0**
Investment income	7	14.1	11.0
Interest expense		(3.8)	(4.3)
Profit before income tax		**38.0**	**44.7**
Income tax expense	8	(11.4)	(13.4)
Net profit for the year		**26.6**	**31.3**
Other comprehensive income		-	-
Total comprehensive income for the year attributable to owners of Westpac Lenders Mortgage Insurance Limited		**26.6**	**31.3**

The above statement of profit or loss and other comprehensive income should be read in conjunction with the accompanying notes.

[1] The Company has adopted AASB 9 and AASB 15 from 1 October 2018. Comparatives have not been restated. Refer to Note 1 for further information.

WESTPAC LENDERS MORTGAGE INSURANCE LIMITED

Balance sheet as at 30 September 2019

	Note	2019[1] $m	2018 $m
Assets			
Cash and cash equivalents	27(a)	12.9	10.7
Financial assets measured at fair value	9	450.4	457.8
Trade and other receivables	10	26.4	26.2
Reinsurance and other recoveries receivables	11	34.1	22.9
Deferred reinsurance expense	12	497.5	518.3
Deferred acquisition costs	13	5.5	10.4
Deferred tax assets	14	0.3	0.4
Other assets		0.4	0.4
Total assets		**1,027.5**	**1,047.1**
Liabilities			
Trade and other payables	15	9.7	8.3
Reinsurance premium payables		21.4	22.1
Unearned premium liability	16	561.5	584.0
Outstanding claims liability	17	61.3	48.1
Provisions	18	-	0.6
Debt issues	20	80.0	80.0
Total liabilities		**733.9**	**743.1**
Net assets		**293.6**	**304.0**
Shareholders' equity			
Share capital	21	140.6	140.6
Retained profits		153.0	163.4
Total shareholders' equity		**293.6**	**304.0**

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

[1] The Company has adopted AASB 9 and AASB 15 from 1 October 2018. Comparatives have not been restated. Refer to Note 1 for further information.

WESTPAC LENDERS MORTGAGE INSURANCE LIMITED

Statement of changes in equity for the year ended 30 September 2019

	Note	Share capital $m	Retained profits $m	Total $m
Balance at 1 October 2017		**140.6**	**138.1**	**278.7**
Net profit for the year		**-**	**31.3**	**31.3**
Net other comprehensive income for the year		-	-	-
Total comprehensive income for the year		**-**	**31.3**	**31.3**
Transaction in capacity as equity holders				
Dividends on ordinary shares	22	-	(6.0)	(6.0)
Balance at 30 September 2018		**140.6**	**163.4**	**304.0**
Impact of adoption of new accounting standards[1]		-	-	-
Restated opening balance		**140.6**	**163.4**	**304.0**
Net profit for the year		**-**	**26.6**	**26.6**
Net other comprehensive income for the year		-	-	-
Total comprehensive income for the year		**-**	**26.6**	**26.6**
Transaction in capacity as equity holders				
Dividends on ordinary shares	22	-	(37.0)	(37.0)
Balance at 30 September 2019		**140.6**	**153.0**	**293.6**

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

[1] The Company has adopted AASB 9 and AASB 15 from 1 October 2018. Comparatives have not been restated. Refer to Note 1 for further information.

WESTPAC LENDERS MORTGAGE INSURANCE LIMITED

Cash flow statement for the year ended 30 September 2019

	Note	2019[1] $m	2018 $m
Cash flows from operating activities			
Premiums received		159.5	175.6
Reinsurance and other recoveries received		7.5	7.8
Claims paid		(17.8)	(18.0)
Outward reinsurance premiums paid		(145.3)	(168.3)
Interest received	7	0.1	0.1
Reinsurance commission and other income received		42.8	49.1
Expenses paid		(12.8)	(15.8)
Payments to head entity under tax funding agreement		(12.3)	(13.7)
Net cash provided by/(used in) operating activities	27(b)	**21.7**	**16.8**
Cash flows from investing activities			
Proceeds from financial assets measured at fair value	9	135.1	124.5
Payments for financial assets measured at fair value	9	(113.7)	(132.3)
Net cash provided by/(used in) investing activities		**21.4**	**(7.8)**
Cash flows from financing activities			
Payment of dividends	22	(37.0)	(6.0)
Interest expense	27(c)	(3.9)	(3.9)
Net cash provided by/(used in) financing activities	27(c)	**(40.9)**	**(9.9)**
Net (decrease)/increase in cash and cash equivalents		**2.2**	**(0.9)**
Cash and cash equivalents as at beginning of the year		10.7	11.6
Cash and cash equivalents as at end of the year	27(a)	**12.9**	**10.7**

The above cash flow statement should be read in conjunction with the accompanying notes. Details of the reconciliation of net cash provided by/ (used in) operating activities to net profit are provided in Note 27.

[1] The Company has adopted AASB 9 and AASB 15 from 1 October 2018. Comparatives have not been restated. Refer to Note 1 for further information.

NOTES TO THE FINANCIAL STATEMENTS

Note 1. Financial statements preparation

a. Basis of accounting

(i) General

Westpac Lenders Mortgage Insurance Limited (the Company) is a for-profit entity for the purpose of preparing this financial report.

This general purpose financial report has been prepared in accordance with Australian Accounting Standards (AAS) and Interpretations as issued by the Australian Accounting Standards Board (AASB), and the Corporations Act 2001.

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

This financial report also complies with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

(ii) Historical cost convention

The financial report has been prepared under the historical cost convention, as modified by applying fair value accounting to financial assets and financial liabilities measured at fair value through profit or loss.

(iii) Comparative revisions

Comparative information has been revised where appropriate to conform to changes in presentation in the current year and to enhance comparability.

(iv) Standards adopted during the year ended 30 September 2019

AASB 9 Financial Instruments (December 2014) (AASB 9)

The Company adopted AASB 9 on 1 October 2018. The adoption of AASB 9 has been applied retrospectively by adjusting the opening balance sheet at 1 October 2018, with no restatement of comparatives as permitted by the standard.

Impairment

AASB 9 introduces a revised impairment model which requires entities to recognise expected credit losses based on unbiased forward looking information, replacing the incurred loss model under AASB 139 Financial instruments: Recognition and Measurement (AASB 139) which only recognised impairment if there was objective evidence that a loss had been incurred. The revised impairment model applies to all financial assets at amortised cost.

Classification and measurement

AASB 9 replaced the classification and measurement model in AASB 139 with a new model that categorises financial assets based on a) the business model within which the assets are managed, and b) whether the contractual cash flows under the instrument represents solely payment of principal and interest (SPPI).

The accounting policies for the classification and measurement of financial assets and financial liabilities are located in the relevant notes to the financial statements for financial assets and financial liabilities.

The adoption of AASB 9 has had no material impact on the Company.

AASB 15 Revenue from Contracts with Customers (AASB 15)

The Company adopted AASB 15 on 1 October 2018 with no restatement of comparatives as permitted by the standard. It replaced AASB 118 Revenue and related interpretations and applies to all contracts with customers, except leases, financial instruments and insurance contracts.

The adoption of AASB 15 has had no material impact on the Company.

(v) Functional and presentational currency

The financial statements are presented in Australian dollars, which is the Company's functional and presentation currency. The functional currency is the main currency of the economy it operates in.

(vi) Insurance contracts

All of the insurance products offered or utilised by the Company meet the definition of insurance contracts under AASB 1023 General Insurance Contracts (AASB 1023), and are accounted for and reported in accordance with this standard. These products do not contain embedded derivatives or deposits that are required to be unbundled.

Insurance contracts that meet the definition of financial guarantee products are accounted for as insurance contracts under AASB 1023, rather than as financial instruments under AASB 139 Financial Instruments: Recognition and Measurement.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 1. Financial statements preparation (continued)

b. Revenue recognition

(i) Premium

Premium revenue comprises premiums from direct lenders mortgage insurance business.

The earned portion of premiums received and receivable, including unclosed business, is recognised as revenue. Premiums are treated as earned from the date of attachment of risk. The pattern of recognition over the policy or indemnity periods is based on the incidence of risk attaching to the policies underwritten.

Where time does not approximate the pattern of risk, previous claims experience is used to derive the incidence of risk.

The proportion of premium received or receivable not earned in the income statement at the reporting date is recognised in the balance sheet as an unearned premium liability.

Premiums on unclosed business are brought to account using estimates based on the previous year's actual unclosed business with due allowance made for any changes in the pattern of new business and renewals.

(ii) Reinsurance commission income

Reinsurance commission income is recognised on an accruals basis in line with the terms of the contractual arrangements with reinsurers.

(iii) Investment income

Dividends, trust distributions and interest income are recognised as they accrue or are receivable. The profit or loss on disposal of investments is brought to account at the date of the contract for sale. Unrealised gains or losses on investments revalued at year end are taken to the statement of profit or loss and other comprehensive income at that date.

Interest income from bank accounts is recognised on an accruals basis using the effective interest rate method.

(iv) Unexpired risk liability

At each reporting date the Company assesses whether the unearned premium liability is sufficient to cover all expected future cash flows relating to future claims against current insurance contracts. This assessment is referred to as the liability adequacy test (LAT). For the purposes of conducting the LAT, all policies within the Company are treated as a single group of contracts subject to broadly similar risks as these are managed together as a single portfolio.

If the present value of the expected future cash flows relating to future claims and expenses plus the additional risk margin to reflect the inherent uncertainty in the central estimate exceeds the unearned premium liability less related deferred acquisition costs then the unearned premium liability is deemed to be deficient.

Being a test of adequacy, the LAT uses a probability of sufficiency that is set to highlight deficiencies in product pricing following an analysis of the Company's profit margins that equate to the Company's cost of capital.

The probability of sufficiency for outstanding claims liabilities is set at a level that the Company considers to be appropriate to cover the Company's claims obligations having regard to the prevailing market environment and prudent industry practice.

Results of the LAT are outlined at Note 16(d).

(v) Reinsurance claim recoveries

Reinsurance claim recoveries are recognised as revenue for claims incurred, reported claims not yet paid, claims incurred but not reported, claims incurred but not enough reported and unexpired risk liabilities. Recoveries receivables are measured as the present value of the expected future receipts, calculated on the same basis as the liability for outstanding claims.

c. Expense recognition

(i) Claims

Claims incurred expense and liabilities for outstanding claims are recognised in respect of direct insurance business. The liability covers claims incurred but not yet paid, incurred but not reported, claims incurred but not enough reported and the anticipated direct and indirect costs of settling those claims.

Claims handling costs include costs that can be associated directly with individual claims, such as legal and other professional fees, and costs that can only be indirectly associated with individual claims, such as claims administration costs.

Claims outstanding are assessed by reviewing individual claim files and estimating un-notified claims and settlement costs using statistics based on past experience and trends. The liability for outstanding claims is measured as the present value of the expected future payments, reflecting the fact that all the claims may not be paid in the immediate future. The expected future payments are estimated on the basis of the ultimate cost of settling claims, which is affected by factors arising during the period of settlement such as normal inflation and "superimposed inflation". Superimposed inflation arises from non-economic factors such as developments of legal precedent. The expected future payments are then discounted to a present value at the reporting date using risk free rates. A risk margin is applied to the outstanding claims liability, net of reinsurance and other recoveries to reflect the inherent uncertainty in the central estimate of the outstanding claims liability.

The details of rates applied are included in Note 4(a).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 1. Financial statements preparation (continued)

c. Expense recognition (continued)

(ii) Outwards reinsurance premium

Premium ceded to reinsurers is recognised as an expense in the statement of profit or loss and other comprehensive income from the attachment date over the period of indemnity of the reinsurance contract in accordance with the expected pattern of incidence of risk ceded. Accordingly, a portion of outward reinsurance premium is treated as a prepayment and presented as deferred reinsurance expense on the balance sheet at the reporting date.

Unpaid reinsurance premium at the reporting date is shown as reinsurance premium payables.

(iii) Impairment charges

As comparatives have not been restated upon the adoption of AASB 9 the accounting policy applied in 2019 differs to that applied in comparative periods. The accounting policy applied in comparative periods is discussed in Note 30. The accounting policy applied in 2019 is as follows.

Impairment charges are based on an expected loss model which measures the difference between the current carrying amount and the present value of expected future cash flows taking into account past experience, current conditions and multiple probability-weighted macroeconomic scenarios for reasonably supportable future economic conditions.

Impairment charges are recognised in the statement of profit or loss and other comprehensive income, with a corresponding amount recognised as a reduction of the carrying value of the financial asset through an offsetting provision account.

d. Income tax

The Company is part of a tax consolidated group, of which Westpac Banking Corporation (Westpac) is the head entity. As a consequence of tax consolidation accounting, the Company does not recognise any current tax payable balances in its own financial statements, unless the head entity is in default of its obligations, or a default is probable under the tax consolidation legislation, or the tax amounts relate to taxable income incurred prior to the implementation of the tax consolidation regime. Amounts payable or receivable under a tax funding agreement with the head entity are recognised in accordance with the terms and conditions of the agreement as tax-related amounts receivable or payable. Expenses and revenues arising under this agreement are recognised as income tax (expense)/revenue.

The Company has entered into tax funding and tax sharing arrangements with Westpac. Under the terms of the tax funding agreement, the Company reimburses Westpac for any current tax payable by Westpac in respect of the Company's activities. The Company will also be reimbursed by Westpac for any reduction in current tax payable by Westpac in respect of the Company's activities. The reimbursements are payable at the same time as the associated income tax liability falls due and have therefore been recognised as a current tax-related payable by the Company. In the opinion of management, the tax sharing agreement is a valid agreement under the tax consolidation legislation and limits the joint and several liability of the Company in the case of a default by Westpac.

The tax expense for the year comprises current and deferred tax. Tax is recognised in the statement of profit or loss and other comprehensive income.

Current tax is the tax payable for the year using enacted or substantively enacted tax rates and laws for each jurisdiction. Current tax also includes adjustments to tax payable for previous years.

Deferred tax accounts for temporary differences between the carrying amounts of assets and liabilities in the financial statements and their values for taxation purposes. Deferred tax is determined using the enacted or substantively enacted tax rates and laws for each jurisdiction which are expected to apply when the assets will be realised or the liabilities settled. Deferred tax assets and liabilities have been offset where they relate to the same taxation authority, and where there is a legal right and intention to settle on a net basis. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available to utilise the assets.

Deferred tax is not recognised for temporary differences where the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither the accounting nor taxable profit or loss.

e. Assets

(i) Financial assets

Recognition

Purchases and sales of regular way financial assets, except for receivables, are recognised on trade-date; the date on which the Company commits to purchase or sell the asset.

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the asset have expired, or when the Company has either transferred substantially all the risks and rewards of ownership.

Classification and measurement

As comparatives have not been restated upon the adoption of AASB 9 the accounting policy applied in 2019 differs to that applied in comparative periods. The accounting policy applied in comparative periods is discussed in Note 30. The accounting policy applied in 2019 is as follows.

The Company classifies its financial assets into the following categories: cash and cash equivalents, financial assets measured at fair value, trade and other receivables, reinsurance and other recoveries receivable.

Financial assets measured at fair value through profit or loss are recognised initially at fair value. All other financial assets are recognised initially at fair value plus directly attributable transaction costs.

Financial assets backing insurance liabilities

The Company has determined that financial assets held to back insurance liabilities are designated at fair value through profit or loss. As part of its investment strategy, the Company actively manages its investment portfolio to ensure that investments mature in accordance with the expected pattern of future cash flows arising from insurance liabilities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 1. Financial statements preparation (continued)

e. Assets (continued)

(i) Financial assets (continued)

Classification and measurement (continued)

Financial assets not backing insurance liabilities

The Company has determined that financial assets held to back the shareholders' funds are designated at fair value through profit or loss.

The accounting policy for each category of financial asset mentioned above and the determination of its fair value is set out below in the note for the relevant item.

(a) Cash and cash equivalents

For the purpose of presentation in the cash flow statement, cash and cash equivalents includes deposits at call, managed cash and bills of exchange which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value.

For the current and previous financial years, the cash and cash equivalents of the Company consists solely of cash on deposit with banks and other financial institutions.

(b) Financial assets measured at fair value

Financial assets measured at fair value are composed of:

- Financial assets held for trading or those acquired principally for the purpose of selling in the short term with the intention of making a profit; and
- Financial assets designated at fair value through profit or loss at inception are those that are not held for trading purposes but may be sold when the need arises. These include investments in unlisted unit trusts which are managed and their performance evaluated on a fair value basis in accordance with the Company's investment strategy.

Financial assets measured at fair value are subsequently carried at fair value. Gains and losses arising from changes in the fair value of financial assets measured at fair value, including interest and dividend income, are included in the statement of profit or loss and other comprehensive income in the period in which they arise.

(c) Trade and other receivables

Receivables (including amounts due from related entities) are recognised initially at fair value and subsequently measured at amortised cost, less provision for expected credit losses (in 2019 based on AASB 9) or provision for impairment losses (prior to 2019 based on AASB 139). Trade and other receivables are presented as current assets unless payment is not due within 12 months from the reporting date.

(d) Provision for expected credit losses

As comparatives have not been restated upon the adoption of AASB 9 the accounting policy applied in 2019 differs to that applied in comparative periods. The accounting policy applied in comparative periods is discussed in Note 30. The accounting policy applied in 2019 is as follows.

Impairment under AASB 9 applies to all financial assets at amortised cost.

The expected credit losses for receivables, amounts due from related entities and other financial assets determined under AASB 9 are recognised as a reduction of the carrying value of the financial asset through an offsetting provision account.

Measurement

The provision for expected credit losses (ECL) is a probability-weighted estimate of the cash shortfalls expected to result from defaults over the relevant timeframe. They are determined by evaluating a range of possible outcomes and taking into account the time value of money, past events, current conditions and forecasts of future economic conditions.

For assets with low credit risk or where credit risk has not significantly increased, credit losses are limited to those within the next 12 months. For assets where credit risk has significantly increased, expected credit losses are those across the assets lifetime. For assets where there is evidence of current impairment, incurred credit losses are recognised in addition to the expected credit losses previously described.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 1. Financial statements preparation (continued)

e. Assets (continued)

(ii) Non-financial assets

Impairment of non-financial assets

The carrying amount of the Company's non-financial assets, other than deferred tax assets, are reviewed as at each balance sheet date to determine whether there is any indication of impairment. If such an 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. With the exception of goodwill, for which impairment losses cannot be reversed, where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior years. Impairment losses and reversals of impairment losses are recognised in profit or loss.

The recoverable amount of an asset is the greater of its fair value less costs to sell and value-in-use. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

(a) Deferred acquisition costs

Acquisition costs incurred in obtaining general insurance contracts are deferred and recognised as assets where they can be reliably measured and where it is probable that they will give rise to premium revenue that will be recognised in the statement of profit or loss and other comprehensive income in subsequent reporting periods.

Deferred acquisition costs are amortised systematically in accordance with the expected pattern of the incidence of risk under the general insurance contracts to which they relate.

f. Liabilities

(i) Financial liabilities

Recognition

Financial liabilities are recognised when an obligation arises.

Derecognition

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires.

Classification and measurement

The accounting policy for classification and measurement has not changed with the adoption of AASB 9. The accounting policy applied in 2019 is as follows.

The Company classifies financial liabilities into the following categories: trade and other payables, reinsurance premiums payable, outstanding claims liability and debt issues.

Financial liabilities are measured at amortised cost if they are not held for trading or designated at fair value through profit or loss otherwise they are measured at fair value through statement of profit or loss and other comprehensive income.

Financial liabilities measured at fair value through profit or loss are recognised initially at fair value. All other financial liabilities are recognised initially at fair value plus directly attributable transaction costs.

The accounting policy for each category of financial liability mentioned above and the determination of its fair value is set out below in the note for the relevant item.

(a) Trade and other payables

Trade and other payables (including amounts due to related entities) represent liabilities for goods and services provided to the Company prior to the end of the financial year which are unpaid. The amounts are unsecured and are usually paid within normal credit terms. Trade and other payables are presented as current liabilities unless payment is not due within 12 months from the reporting date.

(b) Provisions

Provisions are recognised for present obligations arising from past events where a payment (or other economic transfer) is likely to be necessary to settle the obligation and can be reliably estimated.

(c) Debt issues

These are notes that have been issued by the Company. Debt issues are initially measured at fair value and then subsequently measured at amortised cost using the effective interest rate method. Finance costs incurred on the debt issuances are recognised in the statement of profit or loss and other comprehensive income as interest expense.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 1. Financial statements preparation (continued)

g. Shareholders' equity

Shareholders' equity consists of share capital and reserves. Ordinary shares are recognised at the amount paid up per ordinary share net of directly attributable issue costs. Reserves consist of retained earnings and other reserves.

h. Goods and Services Tax (GST)

The Company is part of a GST consolidated group, of which Westpac is the head entity. Any GST payable or recoverable is presented on the balance sheet as a net payable to or receivable from Westpac.

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not deemed recoverable from the Australian Taxation Office (ATO). In this case it is recognised as part of the cost of acquisition of the asset or as part of the expense.
Receivables and payables are recognised inclusive of GST.
Cash flows are presented on a net basis. The GST components of cash flows arising from investing or financing activities which are ultimately recoverable from, or payable to the ATO, are presented as operating cash flows.

Commitments are disclosed net of the amount of GST ultimately recoverable from, or payable to, the ATO.

i. Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events, and present obligations where the transfer of economic resources is not probable or cannot be reliably measured. Contingent liabilities are not recognised on the balance sheet but are disclosed unless the outflow of economic resources is remote.

j. Offsetting

Financial assets and liabilities are presented net in the balance sheet when the Company has a legally enforceable right to offset them in all circumstances and there is an intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously.

k. Rounding of amounts

All amounts have been rounded in accordance with ASIC Corporation (Rounding in Financial/Directors' Reports) Instrument 2016/191, to the nearest hundred thousand dollars, unless otherwise stated.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 1. Financial statements preparation (continued)

I. Future developments in accounting standards

The following new standards and interpretations which may have a material impact on the Company have been issued but are not yet effective, and unless otherwise stated, have not been early adopted by the Company:

(i) AASB 17 Insurance Contracts

AASB 17 *Insurance Contracts* (AASB 17) was issued on 19 July 2017 and will be effective for the 30 September 2022 year end unless early adopted. This will replace AASB 4 *Insurance Contracts* and AASB 1023 *General Insurance Contracts*. The main changes under the standard are:

- the scope of the standard may result in some contracts that are currently "unbundled", i.e. accounted for separately as insurance and investment contracts being required to be "bundled" and accounted for as an insurance contract;
- portfolios of contracts (with similar risks which are managed together) will be required to be disaggregated to a more granular level by both the age of a contract and the likelihood of the contract being onerous in order to determine the recognition of profit over the contract period (i.e. the contractual service margin). The contractual service margin uses a different basis to recognise profit to the current Margin on Services approach for life insurance and therefore the pattern of profit recognition is likely to differ;
- risk adjustments, which reflect uncertainties in the amount and timing of future cash flows, are required for both general and life insurance contracts rather than just general insurance contracts under the current accounting standards;
- the contract boundary, which is the period over which profit is recognised, differs and is determined based on the ability to compel the policyholder to pay premiums or the substantive obligation to provide coverage/services. For some general insurance contracts (e.g. some lender mortgage insurance and reinsurance contracts) this may result in the contract boundary being longer. For life insurance, in particular term renewable contracts, the contract boundary is expected to be shorter. Both will be impacted by different patterns of profit recognition compared to the current standards;
- a narrower definition of what acquisition costs may be deferred;
- an election to recognise changes in assumptions regarding discount rate in other comprehensive income rather than in profit and loss;
- an election to recognise changes in the fair value of assets supporting policy liabilities in other comprehensive income rather than through profit and loss;
- reinsurance contracts and the associated liability are to be determined separately to the gross contract liability and may have different contract boundaries; and
- additional disclosure requirements.

The standard is expected to result in a reduction in the level of deferred acquisition costs, however the quantum of this and the profit and loss impacts to the Company are not yet practicable to determine.

On 26 June 2019, the IASB issued an exposure draft proposing a number of amendments to the insurance contracts standard. If approved, these amendments would allow entities to:

- defer acquisition costs for anticipated renewals outside of the initial contract boundary; and
- recognise a gain in the profit or loss for reinsurance contracts, to offset losses from onerous contracts on initial recognition (to the extent the reinsurance contracts held covers the losses of each contract on a proportionate basis).

In addition, the effective date of the standard would be deferred by one year to be applicable to the Company for the 30 September 2023 financial year.

(ii) AASB 16 Leases

AASB 16 Leases (AASB 16) was issued on 23 February 2016 and will be effective for the 30 September 2020 financial year. The standard will not result in significant changes for lessor accounting. The main changes under the standard are:

- all operating leases of greater than 12 months duration will be required to be presented on balance sheet by the lessee as a right-of-use asset and lease liability. The asset and liability will initially be measured at the present value of non-cancellable lease payments and payments to be made in optional periods where it is reasonably certain that the option will be exercised; and
- all leases on balance sheet will give rise to a combination of interest expense on the lease liability and depreciation of the right-of-use asset.

Alternative methods of calculating the right-of-use asset are allowed under AASB 16 which impact the size of the transition adjustment.

The application of AASB 16 will not have an impact on the Company as the Company has no leasing arrangements.

Note 2. Critical accounting assumptions and estimates

Applying the Company's accounting policies require the use of judgement, assumptions, and estimates which impact the financial information.

The significant assumptions and estimates used are actuarial derived liabilities, which are described in Note 3 and Note 4. Estimates and assumptions have also been made in relation to unclosed business, unearned premium liability, deferred reinsurance premium, deferred acquisition costs (DAC) and the LAT in Note 16 (d). This includes amortisation period, upfront costs and fees to be included and products over which the DAC applies. The amortisation period was determined by considering the earning pattern of premium income.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 3. Actuarial methods

(a) The ultimate liability arising from claims made under insurance contracts

The Company writes one class of general insurance business being lenders mortgage insurance. For the purposes of claims assumptions the majority of business is considered as being of a short tail nature. Provision is made at the year end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Company. The estimated cost of claims includes direct expenses to be incurred in the settling of claims, gross of the expected value of salvage and other recoveries. The outstanding claims provision comprises the central estimate and a risk margin which is added to the central estimate to achieve a desired probability of sufficiency. The outstanding claim provision is discounted to reflect the time value of money. A central estimate is an estimate of the level of claims provision that is intended to contain no intentional under or over estimation. A risk margin is added to the central estimate of outstanding claims in order to increase the probability that estimates will be adequate.

(b) Central estimates

Central estimates for each class of business are derived from analysis of the results of several different actuarial models. These include projection of:

- chain ladder models;
- future average claim sizes; and
- reporting and payment patterns.

Projections are based on both historical experience and external benchmarks where relevant.

Other considerations include:

- changes in the Company's process which might accelerate or slow down the development and/or recording of paid or incurred claims, compared with the statistics from previous periods;
- changes in the economic environment, in particular the property market, unemployment levels and interest rates; and
- changes in the mix of business.

Claims inflation is incorporated into the resulting projected payments, to allow for both general economic inflation as well as any superimposed inflation detected in the modelling of payments experience. Superimposed inflation arises from non-economic factors such as developments of legal precedent.

Central estimates are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts recoverable from reinsurers. Projected payments are discounted to allow for the time value of money.

(c) Risk margin

The determination of the appropriate level of risk margin takes into account the uncertainty or variability of the future claim payments.

The measurement of variability uses techniques similar to those used in determining the central estimate. These techniques determine a range of possible outcomes of ultimate payments and assign likelihood to outcomes at different levels. The use of a range of outcomes allows a determination of the risk margin required to provide an estimate at a given probability of sufficiency.

(d) Assets arising from reinsurance contracts

Assets arising from reinsurance contracts are also computed using the above methods. In addition, the recoverability of these assets is assessed on a periodic basis to ensure that the balance is reflective of the amounts that will ultimately be received, taking into consideration factors such as counterparty and credit risk. Impairment is recognised where there is objective evidence that the Company may not receive amounts due to it and these amounts can be reliably measured.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 4. Actuarial assumptions

(a) *Actuarial assumptions*

The following assumptions have been made in determining the outstanding claims liabilities:

Direct business	2019	2018
Discount rate	0.8% p.a.	2.0% p.a.
Claim handling expense rate	1.8%	1.8%
Risk margin	15.8%	16.0%
Average weighted term to settlement from reporting date (years)	1.13	1.11

(b) *Process used to determine assumptions*

A description of the processes used to determine these assumptions is provided below:

(i) Discount rate

The outstanding claims liability is discounted at a rate equivalent to that inherent in a portfolio of risk free Commonwealth Government fixed interest securities with coupon and redemption cash flows exactly matching the projected claim cash flows.

(ii) Claims handling expense rate

An estimate of outstanding claims liabilities will typically incorporate an allowance for the future cost of administering the claims. This allowance is determined after analysing claim related expenses incurred by the business and is expressed in proportion to the gross claim payments.

(iii) Risk margin

The assumptions regarding uncertainty are applied to the net central estimates (including the expense allowance) in order to arrive at a net provision that is intended to provide a probability of sufficiency of 80%.

(iv) Average weighted term to settlement

The average weighted term to payment is calculated based on the projected cash flows of the outstanding claims liabilities.

Note 4. Actuarial assumptions (continued)

(c) ***Sensitivity analysis – insurance contracts***

The Company conducts sensitivity analysis to quantify the exposure to the risk of changes in the underlying assumptions used in the financial statements. The table below describes how a change in each assumption will affect insurance liabilities:

Impact of change in assumptions

30 September 2019	Movement in variable	Profit/(loss) Gross of reinsurance $m	Profit/(loss) Net of reinsurance $m	Equity $m
Direct business				
Discount rate	+100 basis points p.a.	0.5	0.2	0.2
	-100 basis points p.a.	(0.5)	(0.2)	(0.2)
Claims handling expense rate	+100 basis points p.a.	(0.4)	(0.4)	(0.4)
	-100 basis points p.a.	0.4	0.4	0.4
Risk margin	+100 basis points p.a.	(0.4)	(0.2)	(0.2)
	-100 basis points p.a.	0.4	0.2	0.2
Average weighted term to settlement (years)	+0.5 years	0.2	0.1	0.1
	-0.5 years	(0.2)	(0.1)	(0.1)

30 September 2018	Movement in variable	Profit/(loss) Gross of reinsurance $m	Profit/(loss) Net of reinsurance $m	Equity $m
Direct business				
Discount rate	+100 basis points p.a.	0.4	0.2	0.2
	-100 basis points p.a.	(0.4)	(0.2)	(0.2)
Claims handling expense rate	+100 basis points p.a.	(0.3)	(0.3)	(0.3)
	-100 basis points p.a.	0.3	0.3	0.3
Risk margin	+100 basis points p.a.	(0.3)	(0.1)	(0.1)
	-100 basis points p.a.	0.3	0.1	0.1
Average weighted term to settlement (years)	+0.5 years	0.3	0.2	0.2
	-0.5 years	(0.3)	(0.2)	(0.2)

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 5. Net claims incurred

	2019 Current year $m	2019 Prior years $m	2019 Total $m	2018 Current year $m	2018 Prior years $m	2018 Total $m
Gross claims incurred and related expenses - undiscounted	33.5	(3.0)	30.5	28.2	(2.9)	25.3
Discount movement	(0.3)	0.8	0.5	(0.6)	0.4	(0.2)
Gross claims incurred and related expenses - discounted	**33.2**	**(2.2)**	**31.0**	**27.6**	**(2.5)**	**25.1**
Reinsurance and other recoveries						
Reinsurance and other recoveries - undiscounted	(18.7)	0.2	(18.5)	(13.8)	(1.2)	(15.0)
Discount movement	0.2	(0.4)	(0.2)	0.3	(0.1)	0.2
Reinsurance and other recoveries - discounted	**(18.5)**	**(0.2)**	**(18.7)**	**(13.5)**	**(1.3)**	**(14.8)**
Net claims incurred - direct business	**14.7**	**(2.4)**	**12.3**	**14.1**	**(3.8)**	**10.3**
Direct business	14.7	(2.4)	12.3	14.1	(3.8)	10.3
Net claims incurred	**14.7**	**(2.4)**	**12.3**	**14.1**	**(3.8)**	**10.3**

Current year amounts relate to claims occurring in the current financial year. Prior period amounts relate to a reassessment of the claims occurring in all previous financial years.

Note 6. Other underwriting expenses

	2019 $m	2018 $m
Administration expenses	6.2	5.3
Total other underwriting expenses	**6.2**	**5.3**

Note 7. Investment income

	2019 $m	2018 $m
Interest - ultimate parent entity	0.1	0.1
Distributions from financial assets measured at fair value	12.9	12.7
Net gains/(losses) on financial assets measured at fair value	1.1	(1.8)
Total investment income	**14.1**	**11.0**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 8. Income tax

The income tax expense for the year reconciles to the profit before income tax as follows:

	2019 $m	2018 $m
Profit before income tax	**38.0**	**44.7**
Tax at the Australian company tax rate of 30%	11.4	13.4
Total income tax expense	**11.4**	**13.4**

	Note	2019 $m	2018 $m
Income tax analysis			
Income tax expense comprises:			
Current income tax		11.3	13.6
Deferred income tax	14	0.1	(0.2)
Total income tax expense		**11.4**	**13.4**

The effective tax rate was 30% in 2019 (2018: 30%).

Note 9. Financial assets measured at fair value

	2019 $m	2018 $m
Balance at beginning of the year	457.8	439.1
Additions	113.7	132.3
Interest and distributions reinvested	12.9	12.7
Disposals	(135.1)	(124.5)
Unrealised gains/(losses)	1.1	(1.8)
Balance at end of the year	**450.4**	**457.8**
Held as investments in:		
Pendal Long Term Income Fund	450.4	457.8
Total financial assets measured at fair value	**450.4**	**457.8**

The Pendal Long Term Income Fund that the Company invests into, is considered to be a structured entity for the purposes of AASB 12 Disclosure of Interests in Other Entities. A structured entity is one which has been designed such that voting or similar rights are not the dominant factor in determining who controls the entity (for example, when voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements). Structured entities are generally created to achieve a specific and well defined objective with restrictions over their ongoing activities. The Company enters into transactions with unconsolidated structured entities to facilitate specific investment opportunities and its interest in the structured entity comprises of any form of contractual or non-contractual involvement which creates variability in returns arising from the performance of the entity. This includes the holding of units in unlisted funds.

The objective of the Pendal Long Term Income Fund is to seek long term gains and invests primarily in floating rate notes, discount securities and cash deposits. The fund issues units which are redeemable at the holder's option and entitles the holder to a proportional share of the fund's net assets.

The carrying value of the investment in the funds represents the Company's maximum exposure to loss and is 100% (2018: 100%) of the total funds under management in the Pendal Long Term Income Fund. The Company does not provide any material financial or other support to the unconsolidated structured entity.

Note 10. Trade and other receivables

	2019 $m	2018 $m
Premiums receivable from ultimate parent entity	19.1	18.3
Trade receivables	6.6	6.9
Amounts due from:		
Other related entities	0.7	1.0
Total trade and other receivables	**26.4**	**26.2**

Note 11. Reinsurance and other recoveries receivables

	2019 $m	2018 $m
Expected reinsurance and other recoveries - undiscounted		
Reinsurance recoveries on claims paid - undiscounted	1.2	0.6
Reinsurance recoveries on outstanding claims - undiscounted	32.9	22.6
Other recoveries on outstanding claims - undiscounted	0.3	0.3
	34.4	23.5
Discount to present value	(0.3)	(0.6)
Total reinsurance and other recoveries receivables	**34.1**	**22.9**
Reinsurance and other recoveries receivables on incurred claims - discounted	32.9	22.3
Reinsurance and other recoveries receivables on paid claims - discounted	1.2	0.6
Expected reinsurance and other recoveries – discounted	**34.1**	**22.9**
Reinsurance and other recoveries		
Current	18.4	12.4
Non-current	15.7	10.5
Total reinsurance and other recoveries receivables	**34.1**	**22.9**

The minimum rated reinsurer's Standard & Poor's credit rating relating to reinsurance treaties was A- in the current year (2018: A-).

Note 12. Deferred reinsurance expense

	2019 $m	2018 $m
Balance at beginning of the year	518.3	497.3
Reinsurance expense deferred	144.6	163.3
Amortisation charged to statement of profit and loss and other comprehensive income	(165.4)	(142.3)
Balance at end of the year	**497.5**	**518.3**
Current	165.4	172.5
Non-current	332.1	345.8
Total deferred reinsurance expense	**497.5**	**518.3**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 13. Deferred acquisition costs

	2019 $m	2018 $m
Balance at beginning of the year	10.4	14.7
Acquisition costs deferred	8.5	6.4
Amortisation charged to statement of profit or loss and other comprehensive income	(13.4)	(10.7)
Balance at end of the year	**5.5**	**10.4**
Deferred acquisition costs to be realised within 12 months	1.1	2.8
Deferred acquisition costs to be realised after more than 12 months	4.4	7.6
Total deferred acquisition costs	**5.5**	**10.4**

Note 14. Deferred tax assets

The balance comprises temporary differences attributable to:

	2019 $m	2018 $m
Amounts recognised in the statement of profit or loss and other comprehensive income		
Provisions	0.3	0.4
Total deferred tax assets	**0.3**	**0.4**

Movements	Provisions $m	Total $m
Balance at 1 October 2017	**0.2**	**0.2**
Recognised in the statement of profit or loss and other comprehensive income	0.2	0.2
Balance at 30 September 2018	**0.4**	**0.4**
Recognised in the statement of profit or loss and other comprehensive income	(0.1)	(0.1)
Balance at 30 September 2019	**0.3**	**0.3**

Note 15. Trade and other payables

	2019 $m	2018 $m
Trade payables	5.2	5.7
Amounts due to:		
Ultimate parent entity - current tax liabilities	0.3	1.3
Ultimate parent entity – other	4.2	1.3
Total trade and other payables	**9.7**	**8.3**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 16. Unearned premium liability

		Note	2019 $m	2018 $m
(a)	**Unearned premium**			
	Balance at beginning of the year		584.0	562.7
	Deferral of premiums on contracts written in the current period		160.3	179.7
	Earnings of premiums written in previous period		(182.8)	(158.4)
	Balance at end of the year		**561.5**	**584.0**
	Current		182.7	189.7
	Non-current		378.8	394.3
	Total unearned premium liability as at 30 September		**561.5**	**584.0**
(b)	**Net unearned premium liability**			
	Unearned premium (net of reinsurance)		64.0	65.8
	Deferred acquisition costs	13	(5.5)	(10.4)
	Net unearned premium liability as at 30 September		**58.5**	**55.4**
(c)	**Expected present value of future cash flows for future claims including risk margin**			
	Discounted central estimate (net of reinsurance)		31.4	28.2
	Risk and expense margins		26.8	27.0
	Expected present value of future cash flows for future claims including risk margin		**58.2**	**55.2**

(d) Liability adequacy test (LAT)

AASB 1023 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 sufficiency of the claims provision, no such guidance exists in respect of the level of risk margin to be used in determining the sufficiency of net premium liabilities. The Company has adopted a risk margin for the purpose of the liability sufficiency test to produce a probability of sufficiency of 75% (2018: 75%), which is consistent with APRA requirements in respect of total insurance liabilities, while 80% (2018: 80%) probability of sufficiency is adopted in determining the outstanding claims liabilities.

During the year ended 30 September 2019, there was a LAT write down of $11.6 million (2018: $4.7 million). The application of the LAT in respect of the net premium liabilities identified a surplus of $0.3 million as at 30 September 2019 (2018: surplus of $0.2 million).

(e) Risk margin

The process used to determine the risk margin is explained in Note 3(c). The risk margin in expected future cash flows for future claims as a percentage of the central estimate is 24% (2018: 30%). This is the risk margin required to give a probability of sufficiency of 75% (2018: 75%) for total insurance liabilities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 17. Outstanding claims liability

(a) Outstanding claims

	2019 $m	2018 $m
Direct business		
Gross		
Central estimate	54.4	42.1
Discount to present value	(0.5)	(0.9)
Total gross claims - discounted	**53.9**	**41.2**
Claims handling costs - discounted	0.9	0.7
Gross risk margin - discounted	6.5	6.2
Total claims handling costs and risk margins	**7.4**	**6.9**
Total gross outstanding claims liability - discounted	**61.3**	**48.1**
Direct business		
Current - gross outstanding claims - discounted	33.1	26.1
Non-current - gross outstanding claims - discounted	28.2	22.0
Total gross outstanding claims liability - discounted	**61.3**	**48.1**

(b) Risk margin

The process used to determine the risk margin is explained in Note 3(c). The probability of sufficiency at 30 September 2019 is 80% (2018: 80%). The risk margin included in net outstanding claims is 15.8% of the net central estimate (2018: 16.0%).

	2019	2018
Risk margins applied		
Direct business	15.8%	16.0%
Overall margin	15.8%	16.0%

(c) Reconciliation of movement in net discounted outstanding claims liability

	2019 $m			2018 $m
Direct business	**Gross**	**Reinsurance and other recoveries**	**Net**	**Net**
Balance at beginning of the year	**48.1**	**(22.3)**	**25.8**	**26.0**
Increase in net claims incurred current accident year	33.2	(18.5)	14.7	14.1
Discount movement in prior accident years	0.9	(0.4)	0.5	0.2
Risk margin movement in prior accident years	(3.2)	1.7	(1.5)	(1.6)
Other movements in prior accident years	0.1	(1.6)	(1.5)	(2.4)
Incurred claims recognised in the statement of profit or loss and other comprehensive income	**31.0**	**(18.8)**	**12.2**	**10.3**
Net claim payments	(17.8)	8.2	(9.6)	(10.6)
Balance at end of the year	**61.3**	**(32.9)**	**28.4**	**25.8**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 17. Outstanding claims liability (continued)

(d) Claims development table

The following table shows the development of net undiscounted outstanding claims relative to the current estimate of ultimate claims costs for the six most recent accident years.

	Accident year							
	Prior	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**Total**
	$m	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**	**$m**
Ultimate claims cost estimate:								
At end of accident year		14.3	11.9	13.8	12.4	12.2	12.5	
One year later		13.6	9.3	14.4	10.2	11.1	-	
Two years later		12.8	8.8	13.1	10.1	-	-	
Three years later		12.8	8.1	14.0	-	-	-	
Four years later		13.3	8.6	-	-	-	-	
Five years later		13.3	-	-	-	-	-	
Current estimate of ultimate claims cost estimate:	98.0	-	-	-	-	-	-	**98.0**
Cumulative payments	98.0	13.1	7.8	12.4	7.1	4.0	1.3	**143.7**
Undiscounted central estimate	0.1	0.2	0.8	1.6	3.0	7.1	11.2	**24.0**
Discount to present value	-	-	-	-	-	(0.1)	(0.1)	**(0.2)**
Discounted central estimate	0.1	0.2	0.8	1.6	3.0	7.0	11.1	**23.8**
Claims handling expenses	-	-	-	-	0.1	0.3	0.5	**0.9**
Net risk margin	-	0.1	0.1	0.3	0.4	1.1	1.8	**3.8**
Net outstanding claims liabilities	**0.1**	**0.3**	**0.9**	**1.9**	**3.5**	**8.4**	**13.4**	**28.5**

The reconciliation of the movement in outstanding claims liabilities and the claims development table have been presented on a net of reinsurance and other recoveries basis to give the most meaningful insight into the impact on the statement of profit or loss and other comprehensive income.

Note 18. Provisions

	2019	**2018**
	$m	**$m**
Provisions for:		
Non-lending losses	-	0.6
Total provisions	**-**	**0.6**

Movements	**Non-lending losses $m**	**Total $m**
Balance at 1 October 2017	**-**	**-**
Additions	0.6	0.6
Balance at 30 September 2018	**0.6**	**0.6**
Utilisations	(0.6)	(0.6)
Balance at 30 September 2019	**-**	**-**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management

An integrated risk management framework has been implemented to bring together the various component parts of the risk framework. The framework is the totality of the systems, processes, structures, policies and people involved in identifying, assessing, treating and monitoring risks. The Risk Management Strategy (RMS) sets out the strategy to be adopted by the Company for managing risk and is a key element of the risk management framework. The framework overall, including the RMS, incorporates the requirements of APRA's Prudential Standard for Risk Management (CPS220).

The Company operates within, and is governed by the Westpac Group risk management framework, and aligns with Westpac Group risk appetite, policies and frameworks that are designed to manage risk effectively and efficiently. Adherence to these frameworks is essential to ongoing management of its risks.

Governance Framework

The Company's governance framework overseeing effective risk management consists of:

- Defined roles and responsibilities for the Board, its committees and various management committees and forums that oversee particular aspects of the business;
- Various governance-related documents setting out the policies, practices and procedures adopted by the Company to ensure it operates in accordance with prudential requirements and good governance principles; and
- A dedicated risk management function that supports the risk management framework and execution of the Company's RMS.

The Company has adopted the Westpac Group Delegated Authority Policy Framework. This framework enables management to make decisions which are not reserved for the Board. The Board has delegated certain risk management responsibilities to the following committees.

Board Committees

Insurance Board Audit Committee

The primary role of the Committee is to assist the Board by providing an objective, non-executive review of the effectiveness of the Board's financial reporting and financial risk management framework. Ultimate responsibility for the integrity of the Company's financial reporting and audit rests with the Board. The duties of the Committee include:

- Oversight of statutory reporting requirements, financial reporting requirements, professional accounting requirements and internal and external audit and make recommendations to the Board;
- Review and assess the integrity of the financial statements and the financial reporting framework;
- Review regular reports from management and external auditor regarding the Company's internal financial controls and compliance, disclosure, legal and regulatory requirements;
- Review the policies and procedures for employees to submit, confidentially, information about accounting, internal control, compliance, audit and other matters about which an employee has concerns, and establish a process for ensuring employees are aware of the policies and for dealing with such matters; and
- Consider advice from the Appointed Actuary in respect of the valuation of insurance liabilities, including an assessment of the overall financial condition of the Company.

Insurance Board Risk Committee

The Board is ultimately responsible for the integrity of the risk and compliance processes. The role of the Committee is to assist the Board discharge its responsibilities by having oversight of the implementation and operation of the risk management framework.

The duties of the Committee include:

- Oversight of the risk management frameworks and making recommendations to the Board;
- Oversight of senior management's implementation of the Insurance Risk Management Strategy;
- Review the compliance processes that are in place to anticipate and effectively manage the impact of regulatory change on operations;
- Oversee for reporting or recommendation to the Board the Internal Capital Adequacy Assessment Process (ICAAP) and in doing so review the stress testing outcomes; the target capital ranges for regulatory capital; and review and monitor capital levels for consistency with the Company's risk appetite; and
- Advising the Board on current and future risk appetite, capital strength and Risk Management Strategy.

Westpac Board Remuneration Committee

The Board has delegated remuneration matters to the Westpac Board Remuneration Committee. The primary role of this Committee is to review and make recommendations to the Westpac Board that ensure coherent remuneration policies and practices that fairly and responsibly reward individuals having regard to performance, the Risk Management Framework, the law and the highest standards of governance.

The Appointed Actuary

The Appointed Actuary is responsible for providing a report on the financial condition of the Company (FCR) to the Board. The report is considerate of current solvency and capital adequacy, together with consideration of a range of factors such as the premium rates, policy conditions, reinsurance arrangements, risks faced by the insurer and other related matters.

The Appointed Actuary also provides advice in respect of the value of the insurance liabilities calculated in accordance with APRA Prudential Standards.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management (continued)

Approach to risk management

The Company has adopted the Three Lines of Defence model to ensure it practices holistic end-to-end management of risk. The Company's Three Lines of Defence approach is designed on a functional basis and covers all employees. The delineation of responsibilities between the Three Lines of Defence are set out below.

1st Line of Defence – Risk identification, risk management and self-assurance

The First Line proactively identifies, evaluates, owns and manages the risks in their business/domain. It also ensures that business activities are within approved risk appetite and policies. This accountability cannot be abrogated. The First Line of defence is accountable for 'self-certification'.

In managing its risk, the First Line is required to establish and maintain appropriate governance structures, controls, resources and self-assessment processes, including issue identification recording and escalation procedures.

2nd Line of Defence – Establishment of risk management frameworks and policies and risk management oversight

The Second Line sets frameworks, controls (including policies and limits), and standards for use across the Company. They can require remediation or cessation of activity where these are not adhered to. Their approach will be risk-based and proportionate.

The Second Line reviews and challenges First Line activities and decisions that may materially affect the Company's risk position, and independently evaluates the effectiveness of the First Line's controls, monitoring, compliance, and monitors progress towards mitigating risks. In addition, the Second line provides insight to the First Line, assisting in developing, maintaining and enhancing the business' approach to risk management.

The Second Line understands and reports the aggregated risk profile of the business to ensure end-to-end oversight of risk and and is required to endorse the acceptance of any risks outside of the business' risk appetite before being considered by the Board .

3rd Line of Defence – Independent assurance

The Third Line is an independent assurance function that evaluates and opines on adequacy and effectiveness of both First and Second Line risk management approaches and tracks remediation progress, with the aim of providing the Board, and Senior Executives, with comfort that governance, risk management and internal controls are operating effectively.

Financial Risks

(a) Insurance risk

Insurance risk is the risk of claims costs being greater than expected, due to a failure in product design, underwriting, reinsurance arrangements or an increase in severity and frequency of insured events. This exposure is transferred to the Company through its underwriting process.

The sole insurance product underwritten by the Company is lenders mortgage insurance on residential mortgages issued by Westpac Banking Group. These are upfront premium products providing cover against certain losses incurred by mortgage providers that are caused by defaults, typically resulting from economic factors, e.g. declining property values, rising interest rates or rising unemployment.

All contracts are written within Australia.

Through its insurance contracts the Company is exposed to the possibility of loss due to uncertainty in the frequency of the occurrence of the insured event as well as the severity of the resulting claim.

The determination of the amounts that the Company will ultimately pay for claims arising under insurance 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;
- changes in the legal environment including the interpretation of liability laws and the quantum of damages; and
- social and economic trends, for example property prices, unemployment and interest rates.

To mitigate its exposure to insurance risk the Company has embedded a number of key controls in its operations.

The design, development and distribution of products carrying insurance risk is managed so that policy wording and promotional materials are clear. The Company undertakes comprehensive market research to capture and understand potential risks associated with the insurance product. Product prices are set through a process of financial analysis, including a review of previous experience and specific product design features. All product design features and pricing are reviewed by the Company's legal, risk and actuarial functions.

The Company's underwriting strategy is to maximise opportunities for diversification of risks across geographical locations within which the Company operates. Underwriting is managed through a dedicated underwriting department, with formal underwriting limits and appropriate training and development of underwriting staff.

Claims are managed through a dedicated claims management team, with a formalised claims acceptance process, including claims acceptance limits and appropriate training of staff. Claims experience is regularly assessed and appropriate reserves are established to reflect up to date experience and any anticipated future events. The Appointed Actuary provides advice on the insurance liabilities inclusive of a risk margin which aligns the reserves held to the probability of sufficiency approved by management and the Board. The advice of the Appointed Actuary is subject to triennial external peer reviews and annual external audit.

In addition, the sufficiency of the outstanding claims provision and the unearned premium liability are subject to an actuarial review by the Appointed Actuary.

The Company also reinsures (cedes) insurance risk to manage its exposure within predetermined risk tolerance limits, and to reduce the Company's exposure to catastrophes. Reinsurance arrangements are regularly assessed to determine their ongoing effectiveness based on current exposures, historical losses and potential future losses.

The sensitivity of profit after tax and equity to insurance risk arising from changes in key outstanding claims variables before and after reinsurance is measured in Note 4(c).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management (continued)

(a) Insurance risk (continued)

Concentration of insurance risk

The Company is a mono line insurer which derives all of its business from the Westpac Banking Group.

Risk	Source of concentration	Risk management measures
Economic downturn	Mortgage insured properties that are subject to economic downturn concentrated on:	Aggregated risks are modelled by postcode using commercially available catastrophe models. Based on the probable maximum loss per the models, catastrophe reinsurance is purchased to limit exposure to any single event.
	- The Australian economy as a whole - Individual geographical segments within the Australian economy	Aggregate exposures are also monitored by using publicly available catastrophe models. Catastrophe reinsurance has been purchased to limit exposure losses arising from a downturn in the Australian economy as a whole.

Development of claims

There is a possibility that changes may occur in the estimate of the Company's obligations at the end of a contract period. The tables in Note 17(d) show the estimates of total claims outstanding for each accident year at successive year ends.

Asset liability management

The investments for the Company are governed by a Board approved investment policy. The investment objective of the Company is to optimise returns subject to there being sufficient liquidity for the business to meet its obligations to policyholders in a timely manner. The investment policy specifies the minimum counterparty ratings allowed and details the approach adopted by management for assets backing liabilities in the Company. This policy provides enough flexibility for the Company to manage liability mismatch risk through the purchase of assets that match, as closely as possible, the duration of the liabilities, with rebalancing occurring as required. This risk is limited by the short-tail nature of the company's liabilities.

(b) Credit risk

Credit risk is the risk of financial loss where a customer or counterparty fails to meet their financial obligations to the Company or the broader Westpac Group. The Company is subject to the Westpac Credit Risk Management Framework. This framework defines what constitutes credit risk for the Company and provides the basis for managing credit risk. A key driver of credit risk is in the Company's reinsurance activities, particularly counterparty exposure and counterparty performance management.

The following policies and procedures established through the Risk Management Strategy, Credit Risk Management Framework and Reinsurance Management Strategy are used to mitigate the Company's exposure to credit risk.

(i) Exposures to counterparties are monitored and controlled to ensure:
- significant deterioration in credit quality is identified;
- credit risk management information is accurate and complete; and
- excessive concentrations of credit risk are identified and controlled.

(ii) Credit risk limits, counterparty exposure limits and acceptable credit quality ratings for investment assets of the Company are defined within the Credit Risk Management Framework and managed for the Company by the appointed investment portfolio managers. Compliance with these limits is monitored.

(iii) Credit risk in respect of customer balances is actively monitored and losses incurred on non-payment of premiums or contributions will only persist during the grace period specified in the policy document until expiry, when the policy is either paid up or terminated.

(iv) As part of its overall risk management strategy the Company cedes a proportion of its insurance risk. While these cessions mitigate insurance risk, the recoverable from reinsurers expose the Company to credit risk. Exposure to reinsurance counterparties and the credit quality of those counterparties is actively monitored. Reinsurance is placed according to a pre-approved panel of reinsurers that have a strong credit rating.

Maximum credit risk exposure

The Company's maximum exposure to credit risk, in respect of its financial assets, without taking account of any collateral or other credit enhancements as of 30 September 2019 is $523.8 million (2018: $517.6 million).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management (continued)

(b) Credit risk (continued)

Credit quality of financial assets that are neither past due nor impaired

The following table provides information regarding the credit risk exposure of the Company. The credit quality of those financial assets that are neither past due nor impaired is shown by classifying those assets according to Standard & Poor's counterparty credit ratings. AAA is the highest possible rating.

30 September 2019	Neither past due nor impaired					Past due and impaired	
	AAA $m	AA $m	A $m	Not rated $m	Total $m	$m	Total $m
Cash and cash equivalents	-	12.9	-	-	12.9	-	12.9
Financial assets measured at fair value	-	-	-	450.4	450.4	-	450.4
Trade and other receivables							
Premiums receivable	-	19.1	-	-	19.1	-	19.1
Other receivables	-	-	6.6	-	6.6	-	6.6
Amounts due from other related entities	-	-	-	0.7	0.7	-	0.7
Reinsurance and other recoveries receivables	-	-	34.1	-	34.1	-	34.1
	-	32.0	40.7	451.1	523.8	-	523.8

30 September 2018	Neither past due nor impaired					Past due and impaired	
	AAA $m	AA $m	A $m	Not rated $m	Total $m	$m	Total $m
Cash and cash equivalents	-	10.7	-	-	10.7	-	10.7
Financial assets measured at fair value	-	-	-	457.8	457.8	-	457.8
Trade and other receivables							
Premiums receivable	-	18.3	-	-	18.3	-	18.3
Other receivables	-	-	6.9	-	6.9	-	6.9
Amounts due from other related entities	-	-	-	1.0	1.0	-	1.0
Reinsurance and other recoveries receivables	-	-	22.9	-	22.9	-	15.9
	-	29.0	29.8	458.8	517.6	-	517.6

Past due but not impaired financial assets

None of the financial assets as at 30 September 2019 and 30 September 2018 are past due but not impaired.
There has also been no material history of default with respect to the Company's trade receivables. Amounts due from related parties are covered by existing agreements and are settled on a regular basis.

*(c) **Liquidity risk***

Liquidity risk is the risk of being unable to fund assets and meet obligations as they fall due.

The Company is subject to the Westpac Group Liquidity Risk Management Framework to provide coverage across all businesses. This framework and policies define what constitutes liquidity risk and provides the basis for managing liquidity risk. Liquidity risk management focuses primarily on ensuring sufficient cash is available to meet liabilities arising from insurance and investment policies.

The primary means the Company uses to manage liquidity risk are:

- Ensuring the investment of assets that are backing insurance liabilities are held in liquid assets that closely match the maturity of liabilities;
- Ensuring the investment of assets backing capital are held in appropriately liquid assets;
- Defining the minimum level of liquid funds at call within 48 hours to be held by the Company;
- Monitoring of liquid asset levels to ensure that holdings of liquid assets, together with other cash inflows, are sufficient to meet cash flow obligations to policyholders and other creditors; and
- Liquidity modelling is carried out which considers the Company's ability to fund under both normal conditions and during a crises situation.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management (continued)

(c) Liquidity risk (continued)

Maturity profiles

The following table summarises the maturity profile of the financial liabilities of the Company based on remaining undiscounted repayment obligations except for outstanding claims liability, where maturity profiles are determined on the discounted estimated timing of net cash outflows:

	Up to 1 year[1] $m	Over 1 year to 5 years $m	Over 5 years $m	Total $m
At 30 September 2019				
Trade and other payables	9.7	-	-	9.7
Reinsurance premium payables	21.4	-	-	21.4
Outstanding claims liability	33.1	28.2	-	61.3
Debt issues	-	80.0	-	80.0
	64.2	**108.2**	**-**	**172.4**
At 30 September 2018				
Trade and other payables	8.3	-	-	8.3
Reinsurance premium payables	22.1	-	-	22.1
Outstanding claims liability	26.1	22.0	-	48.1
Debt issues	-	-	80.0	80.0
	56.5	**22.0**	**80.0**	**158.5**

(1) "Up to 1 year" are all commitments which are either contractually due within the timeframe or payable on demand. The estimated timing of associated cash flows is expected within the timeframe.

(d) Market risk

Market risk is the risk of an adverse impact on earnings resulting from changes in market factors such as foreign exchange rates (currency risk), interest rates (interest rate risk), commodity prices and equity prices This includes interest rate risk – the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities. The main risks that the Company faces due to the nature of its investments and liabilities are interest rate and price risk.

The Company is subject to the Westpac Market Risk Management Framework. This framework defines what constitutes market risk for the Company and provides the Company with a framework for managing its market risk.

The following policies and procedures are established to mitigate the Company's exposure to market risk:

- Trading authorities and responsibilities are clearly delineated at all levels to ensure accountability;
- A structured system of limits and reporting of exposures against these exists for all trading activities; and
- Models are used to determine risk and profit/loss and are independently reviewed on a regular basis.

(i) Interest rate risk

Interest rate risk is the risk of loss resulting from changes in interest rates, including changes in the shapes of yield curves.

Financial instruments with floating rate interest expose the Company to cash flow interest rate risk, whereas financial instruments with fixed rate interest expose the Company to fair value interest rate risk. The Company has invested solely in floating rate financial instruments through its holdings in cash managed trusts.

The Company is also exposed to interest rate risk on obligations arising from its insurance contracts where a 'risk free' interest rate is applied in the calculation of the outstanding claims provision.

The Company's net exposure to interest rate risk is detailed below.

Interest rate risk sensitivity analysis

The table below shows the estimated impact on the Company's profit after tax and equity as at 30 September 2019 and 30 September 2018, of a 1% reasonably possible change in interest rates with all other variables held constant.

	30 September 2019		30 September 2018	
	$m Impact on profit after tax	$m Impact on equity	$m Impact on profit after tax	$m Impact on equity
Change in variable interest rate exposure				
+100 basis points	3.2	3.2	3.3	3.3
-100 basis points	(3.2)	(3.2)	(3.3)	(3.3)

The method used in deriving sensitivity information and significant variables did not change from the previous period.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management (continued)

(d) Market risk (continued)

(ii) 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 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 in the market.

The Company is exposed to price risk as it holds an investment in the Pendal Long Term Income Fund.

The table below shows the estimated impact on the Company's profit after tax and equity as at 30 September 2019 and 30 September 2018, of a 3% reasonably possible change in market prices within Pendal Long Term Income Fund, with all other variables held constant.

	30 September 2019		30 September 2018	
	$m Impact on profit after tax	$m Impact on equity	$m Impact on profit after tax	$m Impact on equity
Change in variable interest rate exposure				
+300 basis points	9.5	9.5	9.6	9.6
-300 basis points	(9.5)	(9.5)	(9.6)	(9.6)

(e) Fair value measurements

The fair value of financial assets and financial liabilities must be estimated for recognition and measurement or for disclosure purposes.

AASB 13 Fair Value Measurement requires disclosure of fair value measurements by level of the following fair value measurement hierarchy.

The Company has adopted the amendment to AASB 7 Financial Instruments: Disclosures which requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- unadjusted quoted prices in active markets for identical assets and liabilities (level 1);
- inputs other than quoted prices included within level 1 that are observable for assets or liabilities, either directly (as prices) or indirectly (derived from prices) (level 2); and
- inputs for assets and liabilities that are not based on observable market data (unobservable inputs) (level 3).

Fair value is determined as follows:

- Cash assets at face value of the amounts deposited;
- Investments in unlisted unit trusts by reference to the prevailing redemption prices at the reporting date, which inherently includes transaction costs;
- Receivables at amortised cost less provision for impairment losses, which is the best estimate of their fair value, as they are settled within a short time; and
- Payables at amortised cost, which is the best estimate of their fair value, as they are settled within a short time.

	30 September 2019		30 September 2018	
Assets	Level 2 $m	Total $m	Level 2 $m	Total $m
Financial assets measured at fair value				
Pendal Long Term Income Fund	450.4	450.4	457.8	457.8
Total assets	**450.4**	**450.4**	**457.8**	**457.8**

Investments whose values are based on quoted market prices in active markets, and therefore classified within level 1, include active listed equities. The Company did not have any level 1 investments as at year end.

Financial instruments that trade in markets that are not considered to be active but are valued based on quoted market prices, dealer quotations or alternative pricing sources supported by observable inputs are classified within level 2. These include, investment-grade corporate bonds, certain unlisted unit trusts, and over-the-counter derivatives. As level 2 investments include positions that are not traded in active markets and/or are subject to transfer restrictions, valuations may be adjusted to reflect illiquidity and/or non-transferability, which are generally based on available market information.

Investments classified within level 3 have significant unobservable inputs, as they are infrequently traded. The Company did not have any level 3 investments as at year end. There were no transfers between levels during the financial year.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management (continued)

(e) Fair value measurements (continued)

For financial instruments that are not carried at fair value, fair value is provided for disclosure purposes only. For financial instruments that are considered short term in nature such as trade receivables and payables, the carrying value is a reasonable approximation of fair value.

The following table shows the estimated fair value of financial instruments not carried at fair value.

30 September 2019	Carrying value	Quoted market prices (Level 1)	Valuation techniques (Market observable) (Level 2)	Valuation techniques (Non-Market observable (Level 3)	Total
	($m)	($m)	($m)	($m)	($m)
Financial liabilities:					
Debt issues[1]	80.0	-	90.2	-	**90.2**

30 September 2018	Carrying value	Quoted market prices (Level 1)	Valuation techniques (Market observable) (Level 2)	Valuation techniques (Non-Market observable (Level 3)	Total
	($m)	($m)	($m)	($m)	($m)
Financial liabilities:					
Debt issues[1]	80.0	-	92.2	-	**92.2**

[1] Fair value is derived using a discounted cash flow model. The discount rates applied reflect the terms of the instrument, the timing of the estimated cash flows and are adjusted for Westpac credit spreads.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal and regulatory risk but excludes strategic risk. The Company is subject to the Westpac Operational Risk Management Framework. The framework establishes roles and responsibilities and the measurement, management, monitoring and reporting of operational risks, including risk and control management, and scenario analysis. The Company is also subject to Westpac Incident Management Policy and Westpac Issue and Action Management Policy.

The key components of the Operational Risk Management Framework are:

- Governance, Projects, Capital, Data, Acceptance, Indicators and Reporting;
- Incident, Issues and Action Management; and
- Scenario analysis and External Loss Events.

Consistent with the three lines of defence model, roles and responsibilities are documented for each line of defence.

Complementing this framework, the Company maintains a database of operational incidents. An analysis of the causes of operational incidents is used to enable the Company to implement measures to avoid or reduce future losses. The measures adopted may include revising processes, improving failed or inappropriate controls or strengthening emergency plans.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 19. Financial risk management (continued)

Internal capital adequacy assessment process (ICAAP)

The ICAAP is the over-arching process through which the level of capital is determined and maintained to ensure it is adequate and commensurate with the Board's risk appetite and complies with all prudential requirements. The ICAAP is a key element of, and is governed by, the Risk Management Framework.

In the course of protecting policyholder interests, the Company seeks to manage capital to ensure it is adequate to provide for the risks that arise from operations conducted by the Company. The ICAAP is an important tool that assists the Company to achieve this and provides crucial insights into the Company's approach to managing capital.

The ICAAP uses regulatory capital requirements prescribed by the Australian Prudential Regulation Authority (APRA) as the foundation upon which a target capital structure is built. The ICAAP is integrated into the Risk Management Framework. While the ICAAP is governed within the Risk Management Framework, other policies also support the ICAAP.

The Board is fundamentally responsible for the ICAAP of the Company and retains responsibility for approval and implementation of the process. The Board Risk Committee, Consumer Division Chief Executive Officer, Appointed Actuary, Consumer Division Chief Financial Officer, Consumer Division Chief Risk & Compliance Officer, the GM Insurance supported by Senior Management play key roles, assisting the Board in applying the ICAAP to the Company.

Capital and regulatory risk

As an APRA authorised general insurance entity that conducts insurance business in Australia, the Company is subject to a risk-based approach for measuring and holding the required regulatory level of capital, referred to as the Prudential Capital Requirement (PCR). The PCR is the minimum level of capital that APRA deems must be held to meet policyowner obligations and consists of the Prescribed Capital Amount (PCA) and any supervisory adjustment determined by APRA. The Company uses APRA's standardised method for calculating the PCA in accordance with the relevant Prudential Standards and holds regulatory capital of the PCA plus a Target Surplus to ensure the Company has sufficient assets to maintain its PCA under adverse potential scenarios including prolonged periods of underwriting losses, catastrophe events and/or events involving business interruption.

The Company's capital position is monitored on a regular basis and reported to the Board quarterly.

Regulatory prescribed capital amount and compliance

The Company's capital base, PCA and PCA coverage is disclosed in the following table:

Capital adequacy	2019 $m	2018 $m
Tier 1 capital		
Contributed equity	140.6	140.6
Dividends paid	(37.0)	(6.0)
Retained earnings at the beginning of the financial year	163.4	138.1
Profit attributable to shareholders	26.6	31.3
Technical provisions in excess of those required by GPS320	0.7	0.6
Regulatory adjustments in calculation of capital base	(0.2)	(0.4)
Tier 2 capital		
Debt issues	80.0	80.0
Total capital base	374.1	384.2
Prescribed capital amount (PCA)	283.7	291.6
Prescribed capital amount coverage	1.32	1.32

Note 20. Debt issues

	2019 $m	2018 $m
Subordinated notes	80.0	80.0
Total debt issues	**80.0**	**80.0**

The balance of debt issued to the ultimate parent entity at 30 September 2019 is $80.0 million (2018: $80.0 million). All notes are fully paid, redeemable and unsecured. Interest payable on the notes is bank bill rate plus 3% margin. The interest charged during the year was $3.8 million (2018: $3.9 million). The notes are redeemable after 29 October 2018 with a maturity of 29 October 2023 and must be converted to ordinary shares upon certain non-viability trigger events. Non-viability trigger events are notified by APRA, when it determines that the capital position of the entity is insufficient to make the entity viable. Any redemption of notes must be approved by APRA. There is no right of set-off against obligations to the note holders.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 21. Share capital

	2019 $m	2018 $m
Share capital		
Ordinary share capital, fully paid	140.6	140.6
Total share capital	**140.6**	**140.6**

Movements in share capital	$m	$m
Opening balance	140.6	140.6
Closing balance	**140.6**	**140.6**

	2019 No.	2018 No.
Ordinary shares at beginning of the year	140,600,000	140,600,000
Ordinary shares at end of the year	**140,600,000**	**140,600,000**

Ordinary shares entitle the holder to participate in dividends and, in the event of the Company winding up, to a share of the proceeds in proportion to the number of and amount paid on the shares held.

Each ordinary share entitles the holder to one vote, either in person or by proxy, at a shareholder meeting.

The Company's capital management objectives are to:
- ensure sufficient capital resource to support the Company's business and operational requirements;
- safeguard the Company's ability to continue as a going concern; and
- maintain sufficient capital to exceed externally imposed capital requirements.

Periodic reviews of the Company's capital requirements are performed to ensure the Company is meeting its objectives. Capital is defined as share capital plus reserves.

Note 22. Dividends

	2019 $m	2018 $m
Ordinary dividend of $0.11 per fully paid share paid in September 2019	15.0	-
Ordinary dividend of $0.04 per fully paid share paid in June 2019	6.0	-
Ordinary dividend of $0.03 per fully paid share paid in March 2019	4.0	-
Ordinary dividend of $0.09 per fully paid share paid in December 2018	12.0	-
Ordinary dividend of $0.04 per fully paid share paid in September 2018	-	6.0
Total dividends	**37.0**	**6.0**

Note 23. Economic dependency

The normal trading activities of the Company depend significantly on the product sales generated by the distribution channels of the ultimate parent entity, Westpac and its controlled entities.

Note 24. Auditor's remuneration

The auditor's remuneration for audit of the financial statements $169,454 (2018: $161,385) was paid by the ultimate parent entity, Westpac.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 25. Related party disclosures

(a) Parent entities

Westpac Financial Services Group Limited is the immediate parent entity. Westpac Banking Corporation is the ultimate parent entity.

(b) Key management personnel (KMP)

Key management personnel are those, who directly or indirectly, have authority and responsibility for planning, directing and controlling the activities of the Company. This includes all Executive and Non-Executive Directors.

	2019 $	2018 $
Remuneration of KMP		
Short-term benefits	609,517	660,379
Post-employment benefits	36,942	35,619
Other long-term benefits	(21,989)	(7,158)
Share-based payments	137,332	80,825
Total Remuneration of KMP	**761,802**	**769,665**

Key management personnel remuneration was paid by the relevant employing entities within the Westpac Group, with the exception of share-based payments which consist of shares, options and other equity instruments issued by the ultimate parent entity. In addition to the remuneration disclosed above, the Directors of the Company also receive remuneration for their role as key management personnel of related responsible entities and trustee companies. The remuneration is separately disclosed in the financial statement of those responsible entities.

(c) Transactions with related parties

The following transactions occurred with related parties:

Type of transaction	Class of related party	Note	2019 $	2018 $
Interest income	Ultimate parent entity	7	95,421	108,053
Interest expense	Ultimate parent entity	20	3,771,088	3,876,719
Distribution from unit trust	Other related entities	7	12,870,792	12,688,885
Premium revenue	Ultimate parent entity		182,759,478	158,382,456
Claims expense	Ultimate parent entity		30,992,063	25,129,194
Acquisition costs	Ultimate parent entity		(285,445)	264,053
Service and management fees expense	Ultimate parent entity		7,345,590	4,416,253
Service and management fees expense	Other related entities		4,633,708	4,409,355
Dividends paid	Parent entity	22	37,000,000	6,000,000

(d) Outstanding balances

The following balances are outstanding at the reporting date in relation to transactions with related parties:

Balance type	Class of related party	Note	2019 $	2018 $
Cash and cash equivalents	Ultimate parent entity	27(a)	12,945,536	10,725,069
Financial assets measured at fair value	Other related entities	9	450,387,592	457,832,065
Trade and other receivables	Ultimate parent entity	10	19,099,082	18,317,516
Trade and other receivables	Other related entities	10	692,810	1,026,876
Trade and other payables	Ultimate parent entity	15	4,231,692	1,285,666
Current tax liabilities	Ultimate parent entity	15	260,507	1,288,147
Debt issues	Ultimate parent entity	20	80,000,000	80,000,000

(e) Terms and conditions

All transactions have been made on normal commercial terms and conditions.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 26. Offsetting financial assets and financial liabilities

Financial assets and liabilities are presented net in the balance sheet when the Company has a legally enforceable right to offset them in all circumstances and there is an intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously. The gross assets and liabilities behind the net amounts reported in the balance sheet are disclosed in the table below.

		Effects of offsetting on balance sheet		
		Gross amounts	Amounts offset	Net amounts reported on the balance sheet
30 September 2019	**Note**	**$m**	**$m**	**$m**
Financial assets:				
Trade and other receivables	10	26.4	-	26.4
Financial liabilities:				
Trade and other payables	15	9.7	-	9.7

		Effects of offsetting on balance sheet		
		Gross amounts	Amounts offset	Net amounts reported on the balance sheet
30 September 2018	**Note**	**$m**	**$m**	**$m**
Financial assets:				
Trade and other receivables	10	26.6	0.4	26.2
Financial liabilities:				
Trade and other payables	15	8.7	0.4	8.3

Note 27. Notes to the cash flow statement

	2019	2018
	$m	**$m**
(a) Reconciliation of cash and cash equivalents		
Cash with ultimate parent entity	12.9	10.7
Cash and cash equivalents at end of the year	**12.9**	**10.7**

	2019	2018
(b) Reconciliation of net cash provided by/(used in) operating activities to net profit for the year is set out below:		
Net profit for the year	26.6	31.3
Adjustments:		
Distributions from financial assets measured at fair value reinvested	(12.9)	(12.7)
Net (gains)/losses on financial assets measured at fair value	(1.1)	1.8
Interest expense on financing activities	3.8	3.9
Changes in operating assets and liabilities:		
Decrease/(increase) in assets		
Trade and other receivables	(0.2)	(3.2)
Reinsurance and other recoveries receivable	(11.2)	(7.0)
Deferred reinsurance expense	20.8	(21.0)
Deferred acquisition costs	4.9	4.3
Deferred tax assets	0.1	(0.2)
Other assets	-	(0.1)
(Decrease)/increase in liabilities		
Trade and other payables	2.5	(4.2)
Provisions	(0.6)	0.6
Current tax liabilities	(1.0)	(0.1)
Reinsurance premium payables	(0.7)	(5.0)
Unearned premium liability	(22.5)	21.3
Outstanding claims liability	13.2	7.1
Net cash provided by/(used in) operating activities	**21.7**	**16.8**

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 27. Notes to the cash flow statement (continued)

(c) Reconciliation of liabilities arising from financing activities

	Debt issue $m	Accrued interest payable - debt issue $m	Total $m
Balance as at 1 October 2017	**80.0**	**0.7**	**80.7**
Repayments	-	-	-
Other cash movements	-	(3.9)	(3.9)
Total cash movements	**-**	**(3.9)**	**(3.9)**
Other non-cash movements	-	3.9	3.9
Total non-cash movements	**-**	**3.9**	**3.9**
Balance as at 30 September 2018	**80.0**	**0.7**	**80.7**
Repayments	-	-	-
Other cash movements	-	(3.9)	(3.9)
Total cash movements	**-**	**(3.9)**	**(3.9)**
Other non-cash movements	-	3.8	3.8
Total non-cash movements	**-**	**3.8**	**3.8**
Balance as at 30 September 2019	**80.0**	**0.6**	**80.6**

Note 28. Contingent liabilities and commitments

Regulatory actions

Regulators and other bodies routinely conduct investigations and reviews involving the financial services sector, both in Australia and overseas. These investigations and reviews may consider a range of subject matters, and in Australia, a number of investigations and reviews have recently considered, and continue to consider, potential misconduct in credit and financial services.

Domestic regulators such as ASIC, APRA, ACCC, AUSTRAC, the OAIC and the ATO are also currently conducting investigations and reviews and inquiries (some of which are industry-wide) that involve or may involve the Westpac Group (the Group) in the future. These investigations and reviews are separately considering a range of matters, including matters such as ongoing advice services fees, responsible lending, residential mortgages, credit portfolio management, consumer credit insurance, privacy and information governance, the provision of financial advice, competition law conduct, anti-money laundering and counter-terrorism financing processes and procedures, and financial markets conduct.

The Group has also received various notices and requests for information from regulators as part of both industry- wide and the Group-specific investigations and reviews and inquiries.

These investigations and reviews and inquiries, which may be conducted by a regulator, and in some cases also an external third party retained either by the regulator or by the Group (including where a matter has been self- identified by the Group), may result in litigation (including class action proceedings against the Group), fines, imposition of additional capital, civil or criminal penalties, revocation, suspension or variation of conditions of relevant regulatory licences or other enforcement or administrative action being taken by regulators or other parties. An assessment of the likely cost to the Company of these investigations and reviews and actions has been made on a case-by-case basis for the purpose of the financial statements but cannot always be reliably estimated.

Internal reviews and remediation

The Group is currently undertaking a number of reviews to identify and resolve prior issues that have the potential to impact our customers and reputation. These internal reviews have identified, and may continue to identify, issues in respect of which we are, or will be, taking steps to put things right (including in relation to areas of industry focus such as compliance with responsible lending obligations and the way some product terms and conditions are operationalised) so that our customers are not at a disadvantage from certain past practices. By undertaking these reviews we can also improve our processes and controls. An assessment of the Company's likely loss has been made on a case-by-case basis for the purpose of the financial statements but cannot always be reliably estimated. Contingent liabilities may exist in respect of actual or potential claims, compensation payments and/or refunds identified as part of these reviews.

Australian Financial Complaints Authority

Contingent liabilities may also exist in relation to customer complaints brought before the Australian Financial Complaints Authority (AFCA). AFCA has the power to make determinations about complaints and can award compensation up to certain thresholds. AFCA has a broader jurisdiction than previous dispute resolution bodies which it has replaced and, up until 30 June 2020, can also consider customer complaints dating back to 1 January 2008.

The Company does not have any other contingent liabilities or commitments.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note 29. Subsequent events

No matters have arisen since the year ended 30 September 2019 which is not otherwise dealt with in this report, that has significantly affected or may significantly affect the operations of the Company, the results of its operations or the state of affairs of the Company in subsequent periods.

Note 30. Accounting policies relating to prior years

Due to the adoption of AASB 9, the accounting policies relating to the accounting for some financial instruments and related balances have changed. The policies applicable to the current year are provided in the relevant note to the financial statements above. As prior comparative years have not been restated, the accounting policies detailed below reflect the policies applicable to financial years prior to 2019 based on AASB 139. Refer to Note 1 for further information.

Trade & other receivables (Note 1c(iii))/ (Note 1e(i)(d))

A receivable is impaired when there is objective evidence that receivables may not be recoverable. An impairment charge is recognised when the financial impact of the non-recoverable receivables can be reliably measured. At each balance sheet date, the Company assesses whether any receivables are impaired, recognising an impairment charge if required.

The impairment charge is recognised in the statement of profit or loss and other comprehensive income with a corresponding reduction of the carrying value of the receivables through an offsetting provision account.

In subsequent periods, objective evidence may indicate that an impairment charge should be reversed. The impairment charge is reversed in the statement of profit or loss and other comprehensive income of that future period and the related provision for impairment is reduced.

WESTPAC LENDERS MORTGAGE INSURANCE LIMITED

DIRECTORS' DECLARATION

For the year ended 30 September 2019

In the Directors' opinion:

a. the financial statements and notes for the year ended 30 September 2019 are in accordance with the Corporations Act 2001, including :
   (i) complying with Australian Accounting Standards, the Corporations Regulations 2001 and other mandatory professional reporting requirements; and
   (ii) giving a true and fair view of the Company's financial position as at 30 September 2019 and its performance for the financial year ended on that date; and

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

Note 1(a) includes a statement that the financial statements also comply with International Financial Reporting Standards as issued by the International Accounting Standards Board.

This declaration is made in accordance with a resolution of the Directors.

Director

Director

Sydney 11 / 12 /2019

pwc

Independent auditor's report

To the members of Westpac Lenders Mortgage Insurance Limited

Our opinion

In our opinion:

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

(a) giving a true and fair view of the Company's financial position as at 30 September 2019 and of its financial performance for the year then ended

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

What we have audited

The financial report comprises:

- the balance sheet as at 30 September 2019
- the statement of changes in equity for the year then ended
- the cash flow statement for the year then ended
- the statement of profit or loss and other comprehensive income for the year then ended
- the notes to the financial statements, which include a summary of significant accounting policies
- the directors' declaration.

Basis for opinion

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

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

Independence

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

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report for the year ended 30 September 2019, but does not include the financial report and our auditor's report thereon.

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

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

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

Responsibilities of the directors for the financial report

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

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

Auditor's responsibilities for the audit of the financial report

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

A further description of our responsibilities for the audit of the financial report is located at the Auditing and Assurance Standards Board website at:

http://www.auasb.gov.au/auditors_responsibilities/ar3.pdf.

This description forms part of our auditor's report.

PricewaterhouseCoopers

R Balding
Partner

Sydney
11 December 2019