HEARTLAND

NZX/ASX release
24 August 2021

Heartland announces full year NPAT of $87.0 million

(or $87.9 million on an underlying basis after removing the impacts of one-offs)

Heartland Group Holdings Limited (**Heartland**) (**NZX/ASX: HGH**) is pleased to announce a net profit after tax (**NPAT**) of $87.0 million for the financial year ended 30 June 2021 (**FY2021**), an increase of $15.1 million (20.9%) compared with the financial year ended 30 June 2020 (**FY2020**)[1]. On an underlying[2] basis, FY2021 NPAT was $87.9 million, an increase of $11.0 million (14.3%) compared with the FY2020 underlying NPAT.

Highlights for FY2021

- NPAT of $87.0 million, up 20.9% ($15.1 million). Underlying NPAT of $87.9 million, up 14.3% ($11.0 million) on FY2020 underlying NPAT.
- One-off items had a $0.8 million net[3] impact on NPAT, consisting of $4.1 million of one-off net gains and $6.9 million of one-off expenses (net of tax).
- Gross finance receivables (**Receivables**)[4] of $5.0 billion, up 7.9%[5] ($368.5 million).
- Return on equity (**ROE**) of 11.9%, up 144 basis points (**bps**).
- Net interest margin (**NIM**)[6] of 4.35%, up 2 bps.
- Net interest income (**NII**) of $233.5 million, up 7.8%.
- Cost to income (**CTI**) ratio of 46.8%, up 1.5 percentage points (**pps**). Underlying CTI ratio of 44.8%, down 0.1 pps, and CTI ratio of 43.9% for the second half of FY2021 (**2H2021**).
- Impairment expense as a percentage of average receivables decreased from 0.65% in FY2020 to 0.31% in FY2021.
- FY2021 final dividend of 7.0 cents per share (**cps**), taking FY2021 total dividend to 11.0 cps – an increase of 4.0 cps from FY2020 due to the easing of restrictions imposed by the Reserve Bank of New Zealand (**RBNZ**) on distributions by banks in New Zealand.
- Earnings per share (**EPS**) of 14.9 cps, up 2.4 cps.
- Heartland Bank Limited (**Heartland Bank**) remains one of two Australasian banks to have no reduction or adverse change to its ratings or outlook by Fitch Ratings since January 2020.
- Further digitalisation and continuous integration of product applications and platforms in New Zealand and Australia.
- New Zealand Reverse Mortgages awarded Consumer Trusted Accreditation (fourth consecutive year).
- Australian Reverse Mortgages awarded Your Magazine's 5-Star Lender Award and InfoChoice's Best Reverse Mortgage Award.
- Heartland Bank awarded Canstar Savings Bank of the Year 2021 (fourth consecutive year), and 5-Star Ratings for Outstanding Value for its Direct Call and YouChoose accounts.
- Heartland Bank became the National Foundation for Deaf and Hard of Hearing's first Hearing Accredited Workplace.

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[1] All comparative results are based on the audited full year consolidated financial statements of Heartland and its subsidiaries (the **Group**) for FY2020.
[2] Underlying results exclude the impacts of one-offs. Refer to the Profitability section on pages 3 and 4 for details about FY2021 one-offs. A detailed reconciliation between reported and underlying financial information is set out on page 33 of the accompanying FY2021 investor presentation. General information about the use of non-GAAP financial measures is set out on page 2 of that presentation.
[3] Includes tax impact on one-offs.
[4] Receivables include Reverse Mortgages.
[5] Excluding the impact of changes in foreign currency exchange (**FX**) rates.
[6] NIM is calculated based on average gross interest earning assets.

Strategic vision

Heartland's strategic vision is to create sustainable growth and differentiation through providing best or only products via scalable digital platforms. There are four strategic elements to the fulfilment of this:

1. Business as Usual growth (reported on below)
2. Frictionless Service at the Lowest Cost
3. Expansion in Australia
4. Acquisitions which fit with and add value to the above.

Frictionless Service at the Lowest Cost

Heartland's digital strategy reached a stage of maturity where digitalisation is now embedded, as opposed to being a separate activity.

Digitalisation began with the front-end – online mobile platforms providing access for customers. This allowed Heartland to extend reach beyond the constraints of physical distribution while also reducing onboarding costs. These platforms have been integrated into business units as the prime means of distribution. The next stage is to create scale and take out friction, i.e. processes that cause customer inconvenience and delay.

Providing frictionless service at each stage of a customer's journey not only eases inconvenience, but also removes costly operational processes. This produces a virtuous circle of enhanced customer experience and reduced operational costs, allowing Heartland to provide customers with better value through lower rates or time-savings.

Heartland Home Loans demonstrates this in action. Through the provision of an online-only application with automated decisioning, identity verification and documentation, the cost of onboarding is significantly reduced. This allows savings to be passed on to the borrower through low mortgage rates and allows customers to apply as and when they want. In this way, Heartland is providing frictionless service at the lowest cost.

Expansion in Australia

Growth in Australia is a strategic priority.

Heartland has helped more than 22,000 Australians to live a more comfortable retirement by releasing equity from their homes, and recently achieved a significant milestone as the Reverse Mortgage loan book surpassed A$1 billion. Research by the Royal Melbourne Institute of Technology (**RMIT**) University, supported by Heartland, found that 90% of Australians wish to age in their homes, but that limited superannuation and the rising cost of living is restricting their ability to do so.[7] As Australasia's leading provider of reverse mortgages (with market share in Australia recently increasing from 28.5%[8] to 29.3%[9]), there is substantial opportunity for Heartland to support a greater number of older Australians.

Heartland's product offerings will continue to expand, including adjustments to the age requirements for Heartland's Reverse Mortgage to enable access to funds sooner – applications can now be accepted for couples where someone aged 60 or over has a partner aged 55-59. In February 2021, Heartland launched Well-Life Loans to help those aged 60 and over to get an extra financial boost when taking their next step in life, without having to mortgage the family home.

[7] Reverse mortgages: Financing ageing in place, RMIT University, cur.org.au/cms/wp-content/uploads/2020/11/financing-ageing-in-place.pdf.
[8] Based on APRA ADI Property Exposure and Heartland Seniors Finance data as at 31 December 2020.
[9] Based on APRA ADI Property Exposure and Heartland Seniors Finance data as at 31 March 2021.

Heartland continues to explore expansion into other asset classes in Australia both through existing relationships with intermediaries that lend to businesses and consumers, as well as Heartland's own digital platforms. Further opportunities where Heartland has a compelling service and/or product proposition will also be progressed where available.

Operating environment

New Zealand and Australia continue to experience flow on effects from the pandemic, through border closures, restrained supply-chains and lockdowns. In addition, there is evidence of rising inflation and increasing costs of employment.

Subdued growth in the first half of FY2021 (**1H2021**) reflected reduced business and consumer confidence. 2H2021 achieved higher levels of growth across most portfolios. Any direct adverse impacts of the pandemic have been absorbed within business as usual impairments, noting that the demographics most affected by COVID-19 are under-represented in Heartland's customer base.[10]

Heartland Bank was one of 14 providers of the Government's Business Finance Guarantee Scheme (**BFGS**), brought in to provide access to funds for businesses affected by the pandemic. Heartland's BFGS book is at $60.3 million.

Heartland's COVID-19 economic overlay of $9.6 million, taken in respect of FY2020, remains unutilised. The overlay does not represent any actual losses, but was taken to provide a buffer against any future losses that the uncertainty of COVID-19 may give rise to. The overlay remains in place.

Heartland continues to exercise a degree of caution. Heartland's COVID-19 economic overlay remains available to be applied to any losses as a consequence of the pandemic. For further discussion, see the 'Impact of COVID-19' section on page 5.

Financial results

Profitability

NPAT was $87.0 million, a $15.1 million (20.9%) increase on FY2020. Underlying NPAT was $87.9 million, a $11.0 million (14.3%) increase on FY2020.

ROE was 11.9%, up 144 bps from FY2020. Underlying ROE was 12.0%, up 86 bps from FY2020.

EPS was 14.9 cps, up 2.4 cps from FY2020. Underlying EPS was 15.1 cps, up 1.8 cps from FY2020.

FY2021 one-offs included in the reported result

1. *Fair value gain on equity investment in Harmoney Corp Limited (**Harmoney**)*:[11] A $3.9 million fair value gain was recognised on Heartland's equity investment in Harmoney. Harmoney listed on the ASX, and the NZX as a foreign exempt listing, in November 2020, with approximately 72% of shares (including those owned by Heartland, other major shareholders, employees and directors) subject to escrow arrangements. The fair value as at 30 June 2021 takes into consideration the impact of the restriction imposed by the escrow arrangements on observed trading volumes and market prices (including bid

[10] Heartland's total exposure to the retail, accommodation and transport (excluding road freight transport) industries at 30 June 2021, based on borrower ANZSIC codes, was 2.68%, 1.71% and 1.19% respectively. Heartland's exposure to customers aged 15-24 years (those most affected by increases in unemployment) at 30 June 2021 was 4.35% in Motor and 1.47% in personal lending.

[11] Refer to Note 20 – Fair Value (page 42) in the FY2021 Heartland Financial Statements for further detail.

and ask spreads) of Harmoney's shares.

2. *Fair value gain on investment property*: A $0.7 million fair value gain was recognised following updated external valuations received on Heartland Bank's investment property portfolio.

3. *Fair value loss on equity investment in Fuelled Limited (**Fuelled**):* A $0.5 million fair value loss was recognised following Heartland Bank acquiring the remaining shares in Fuelled in April 2021.

4. *Voluntarily accelerated amortisation of intangible assets*: A $4.3 million expense was recognised, reflecting an acceleration of amortisation of software assets held on the balance sheet.

5. *Write-off and provisioning of aged suspense account items*: $1.7 million of aged legacy suspense account transactions were written off or provisioned where collectability is uncertain.

6. *Other non-recurring expenses*: $0.9 million.

The impact of these one-off items on the respective financial metrics is outlined in the table below.

	Reported			**Underlying**		
	FY2021	FY2020	Movement	FY2021	FY2020	Movement
NOI[12] ($m)	251.2	235.3	15.8	247.1	229.8	17.3
Operating expenses	117.7	106.8	10.9	110.8	103.2	7.5
NPAT ($m)	87.0	72.0	15.1	87.9	76.9	11.0
NIM	4.35%	4.33%	2 bps	4.35%	4.33%	2 bps
NIM excl. liquid assets[13]	4.69%	4.59%	10 bps	4.69%	4.59%	10 bps
CTI ratio	46.8%	45.4%	1.5 pps	44.8%	44.9%	(0.1 pps)
Impairment expense ratio	0.31%	0.65%	(34 bps)	0.31%	0.44%	(13 bps)
ROE	11.9%	10.5%	144 bps	12.0%	11.1%	86 bps
EPS	14.9 cps	12.5 cps	2.4 cps	15.1 cps	13.3 cps	1.8 cps

Income

Total NOI was $251.2 million, an increase of $15.8 million (6.7%) from FY2020.

Underlying NOI was $247.1 million, $17.3 million (7.5%) higher than FY2020. This was largely due to a $16.8 million (7.8%) increase in NII, driven by $366.2 million (7.3%) higher average interest earning assets in FY2021 than FY2020, and a 2 bps increase in NIM compared with FY2020 to 4.35%.

Underlying other operating income increased by $0.4 million (3.1%) compared with FY2020, primarily due to a higher treasury result.

[12] Net operating income (**NOI**) includes fair value gains/losses on investments.
[13] NIM is calculated based on average gross interest earning assets excluding liquid assets.

Expenses

Operating expenses were $117.7 million, an increase of $10.9 million (10.2%) on FY2020. Excluding the impact of one-offs (described above), underlying operating expenses were $110.8 million, $7.5 million (7.3%) higher compared with FY2020.

Higher underlying operating expenses were primarily due to the following.

1. A $6.7 million (12.2%) increase in staff expenses. On average, Heartland employed 63 more full-time equivalent (**FTE**) employees in permanent or fixed term roles compared with FY2020 to provide additional support to customers in response to COVID-19, and to support digital and technology capability, enabling Heartland to accelerate its evolution as a digitally-led financial services group. The teams are now well resourced to deliver on Heartland's strategic objectives, and the number of people employed in response to COVID-19 has been reduced.

2. A $2.1 million (17.1%) increase in IT and communication expenses (as a result of software amortisation and licencing costs for additional FTE).

3. Other non-recurring expenses: $0.9 million.

The CTI ratio increased to 46.8%, up 1.5 pps compared with FY2020. The underlying CTI ratio remained flat at 44.8%, a 0.1 pps decrease on prior year. Heartland's continued focus on creating end-to-end processing efficiencies through digitalisation has resulted in the underlying CTI ratio trending downwards in 2H2021, at 43.9% in 2H2021 vs 45.8% in 1H2021.

Impairment expense

Impairment expense was $15.0 million, a $14.4 million decrease (49.1%) on FY2020. On an underlying basis, which excludes the impact of the $9.6 million COVID-19 economic overlay in FY2020, impairment expense was $4.8 million (24.4%) lower than FY2020. This was mainly due to remediation activity in 1H2021 together with retraction in the Harmoney and personal lending portfolios which attract higher rates of provisioning.

Impairment expense in 2H2021 was $5.5 million higher than 1H2021, reflecting the benefit of post COVID-19 remediation activity which occurred in the 1H2021 together with a return to more normal levels of asset growth and associated provisioning in 2H2021.

Impact of COVID-19

The impact of COVID-19 on Heartland's portfolios has been more benign than initially forecast, and the COVID-19 economic overlay remains unutilised. However, there remains significant uncertainty. In particular, the continued prevalence of COVID-19 (including the emergence of new variants), vaccination rates, lockdowns in Australia and now in New Zealand, and continued uncertainty regarding when borders will re-open.

Furthermore, economic stimulus has given rise to the potential for inflationary pressures, a steepening interest rate environment, and a higher cost of labour and inputs in the medium term. In the circumstances, a release of the COVID-19 economic overlay is not appropriate at this stage and the overlay has been retained in full.

Financial position

Total assets increased by $365.0 million (6.9%) during FY2021, driven by a $371.8 million (8.0%) increase in Receivables.

Receivables growth was experienced primarily in Motor, Australian Reverse Mortgages, Asset Finance, Business Relationship, digital Home Loans and New Zealand Reverse Mortgages, partly offset by decreases in

Harmoney and other personal lending, Rural Relationship, Open for Business (**O4B**) and Livestock. Momentum in lending and a strong pipeline supported growth in 2H2021 of $312.4 million (13.4%)[14], a significant uplift from $59.3 million (2.5%)[15] in 1H2021.

Borrowings[16] increased by $332.0 million (7.3%). Funding other than deposits increased $412.7 million, mainly driven by an increase in wholesale and securitised funding. This resulted in deposits decreasing $80.7 million. See further information under 'Funding and liquidity' on page 8.

Net assets increased by $61.7 million to $761.7 million. Net tangible assets (**NTA**) increased by $68.3 million to $678.4 million, resulting in an NTA per share of $1.16 (30 June 2020: $1.05).

Business performance

Asset Finance[17]

Asset Finance lending NOI was $28.5 million, an increase of $6.6 million (30.1%) compared with FY2020.

Asset Finance Receivables increased $71.9 million (14.4%) to $570.9 million, reflecting Heartland Bank's focus on this portfolio through deepening and expanding the intermediary network, and distributor/vendor and point of sale support. Strong demand from partners in the transport and logistics sector assisted growth following increased demand in the aftermath of the COVID-19 restrictions.

Business Relationship

Business Relationship lending NOI was $26.1 million, an increase of $1.0 million (4.1%) compared with FY2020.

Business Relationship Receivables increased $58.7 million (11.8%)[18] to $555.1 million. Through the BFGS, Heartland supported more than 150 businesses to access over $60 million in funding to meet their business needs. In addition, Heartland Bank also provided a funding facility to Go Car Finance in 2H2021 for its New Zealand loan book. This aligns with its strategy to diversify distribution in motor vehicle finance.

The residual portfolio's continued downward trend reflects Heartland's strategy to reduce non-core low margin Relationship lending or risk concentrations.

O4B

O4B NOI was $14.6 million, a decrease of $0.2 million (1.1%) compared with FY2020.

O4B Receivables decreased $10.8 million (6.9%)[19] to $144.5 million. COVID-19 disruptions and the availability of Government-backed funding for small businesses slowed down O4B growth from 2H2020. This trend continued in 1H2021, resulting in O4B Receivables decreasing $14.4 million (9.3%)[19] to $140.7 million.

2H2021 saw growth of $3.6 million in line with improved business confidence and economic sentiment, which is expected to fuel return to pre-COVID-19 levels of growth.

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[14] Annualised 2H2021 growth including the impact of changes in FX rates.
[15] Annualised 1H2021 growth including the impact of changes in FX rates.
[16] Includes retail deposits and other borrowings.
[17] Previously referred to as Business Intermediated.
[18] Excluding the impact of changes in FX rates.
[19] Excluding the impact of changes in FX rates.

Motor

Motor NOI was $69.2 million, an increase of $8.6 million (14.2%) compared with FY2020. Motor Receivables increased $168.1 million (14.9%) to $1,293.7 million. The growth was mainly from the Motor dealer book via car dealerships, brokers and partnerships such as Kia Finance and Jaguar/Land Rover Financial Services. In July 2021, a new vehicle finance service iOWN, provided exclusively by Heartland Bank, was launched in partnership with Auto Distributors New Zealand Limited (**ADNZ**) enabling the purchase of a new or used Peugeot or Citroen from authorised dealerships.

Harmoney and other personal lending

Harmoney NOI was $16.6 million, a decrease of $4.8 million (22.4%) compared with FY2020.

Harmoney Receivables decreased by $79.9 million (37.7%)[16], with the New Zealand Harmoney portfolio contracting $69.1 million (47.4%) to $76.7 million, while the Australian Harmoney portfolio decreased by $5.2 million (9.5%)[16] to $48.8 million. Both New Zealand and Australian portfolios continued to contract in FY2021 as a result of high repayments combined with greater utilisation by Harmoney of its own on-balance sheet funding facilities. Heartland is in the latter stages of completing its transition to offer Harmoney on-balance sheet funding facilities in both New Zealand and Australia.

Home Loans

Following a successful pilot, Heartland's digital Home Loans product was launched in October 2020 with conservative lending criteria targeting high quality applicants. Loan drawdowns slowed over the summer holiday period in 1H2021, however strong application rates have continued in 2H2021. Online enquiries totalled $895.2 million and more than $200 million was approved from applications received during FY2021.

Growth in the Home Loans market was supported by Heartland's low interest rates, currently market-leading for 2- and 3-year fixed rates, as well as for its standard floating rate. In addition, Heartland launched a new revolving credit home loan product in 2H2021 with the lowest rate in the market at the time. Momentum in the book is pleasing, with the book expected to continue growing beyond the current rate of $12 million a month.

Converting applications to drawdowns is driven by the time taken to process refinances from other banks and, in particular, the struggle faced by approved purchasers to find and secure their desired property in a buoyant market.

Rural

Rural lending NOI was $32.2 million, an increase of $1.5 million (4.7%) compared with FY2020.

Rural Receivables decreased by $19.0 million (3.1%) to $586.6 million. Rural Relationship Receivables reduced by $13.1 million (2.7%) to $477.3 million, while Livestock Receivables decreased by $5.9 million (5.1%) to $109.4 million. The downward trend reflects Heartland's strategy to reduce non-core low margin Rural Relationship lending.

Whilst in its infancy, the Sheep & Beef Direct platform has seen a pleasing volume of high-quality applications since its launch in late 2020. At 5 August 2021, eligible applications totalled $48.0 million, with $40.5 million approved online and $30.4 million drawn down.

New Zealand Reverse Mortgages

New Zealand Reverse Mortgages NOI was $24.4 million, an increase of $0.9 million (3.6%) compared with FY2020. Excluding the impact of one-offs (described above) from FY2020, underlying NOI increased $0.4 million (1.5%) compared with FY2020.

New Zealand Reverse Mortgages had a record year for new business, up 30.4% from FY2020 where the final quarter (**Q4**) was impacted by COVID-19, and 26.2% ahead of FY2019. Performance was driven by investment in marketing to increase awareness, education and lead nurturing activity, supported by lower interest rates and higher property prices.

Receivables increased by $41.6 million (7.4%) to $601.5 million, impacted by elevated repayments in 1H2021 due to:

- comparatively lower repayments in Q4 of FY2020 with property sales restricted by COVID-19 related lockdowns and the built-up demand associated with this
- a buoyant property market with higher sales volumes.

Australia

Australian Reverse Mortgages NOI was $36.2 million, an increase of $1.9 million (5.5%) compared with FY2020.

Australian Reverse Mortgages Receivables increased by $92.7 million (9.5%)[20] to $1,071.4 million, although impacted by historically high repayments due to a combination of factors, including:

- comparatively lower repayments in Q4 of FY2020 with property sales restricted by COVID-19 related lockdowns
- a buoyant property market in 1H2021
- seniors moving in with family and pooling financial resources
- higher value homes being more cost effective to sell and downsize compared with ‘average’ homes.

Heartland’s Reverse Mortgages received support from mortgage aggregators in Australia, including partnerships with Australian Finance Group, Choice Aggregation and PLAN Australia.

Funding and liquidity

New Zealand

Heartland Bank increased borrowings by $94.4 million (2.6%), primarily as a result of an increase in other borrowings of $144.2 million (40.2%) which partly offset a decrease in deposits of $49.7 million (1.5%).

Money market borrowings for short term funding and liquidity management purposes increased by $110.2 million and secured funding increased by $42.6 million.

Heartland Bank continues its focus on reducing risk concentrations in its deposit book while shifting the mix towards lower rate call deposits where Heartland is relatively underweight. This resulted in the call to total deposit ratio increasing to 30% as at 30 June 2021 (30 June 2020: 25%).

Heartland Bank’s savings products have also received market recognition, being awarded Canstar’s Bank of the Year – Savings Award in 2021 (fourth consecutive year), and Canstar’s 5-Star Rating for Outstanding Value Savings Account for its Direct Call (sixth consecutive year) and YouChoose accounts (second consecutive year). Heartland Bank also expanded its savings products with the introduction of a 32-day Notice Saver account.

Heartland Bank decreased total liquidity by $99.1 million (13.7%) primarily due to a $72.5 million (18.6%) decrease in investments for liquidity management purposes.

[20] Excluding the impact of changes in FX rates.

Heartland Bank increased its committed auto warehouse facility from $150 million to $300 million in May 2020, and its target holding of cash and cash equivalents in response to the uncertain economic and liquidity impacts of COVID-19 in 2H2020, which it continued to maintain in 2H2021. As a result, Heartland Bank holds liquidity well in excess of regulatory minimums.

Heartland Bank's capital position has progressively increased during 2H2021, reflecting its continued strong profitability and the RBNZ restrictions on distributions imposed in 2H2020. Heartland Bank's regulatory capital ratio was 13.88% as at 30 June 2021 (30 June 2020: 12.67%), well in excess of regulatory minimums and providing a strong platform for Heartland Bank to meet RBNZ's future higher capital requirements.

Australia

The Heartland Australia group (comprising Heartland Australia Holdings Pty Ltd and its subsidiaries) increased borrowings by A$247.6 million (29.1%), largely as a result of A$36 million further drawdowns of the existing warehouse funding, new issuance of a A$75 million MTN and, in a first-of-its-kind transaction, a A$142 million new long-term mortgage-backed syndicated loan for the Australian Reverse Mortgage business funded by established offshore institutional investors. This transaction achieved another milestone in executing Heartland's strategy to diversify type, source and tenor of its Australian funding and, importantly, evidences market liquidity to existing warehouse funders.

The Heartland Australia group continues to successfully execute on its strategic funding programme to cater for strong growth in its portfolios, with a further A$45 million MTN issued in July 2021, adding further diversity to the funding base.

Heartland Australia group has access to A$1.25 billion of committed funding in aggregate. Further expansion of existing warehouse funding through increased senior limits and the introduction of mezzanine funding is well advanced, and focus will continue to be on sourcing optimal long-term duration matched funding.

Regulatory update

A significant volume of regulatory change has been signalled, including changes to the New Zealand Credit Contracts and Consumer Finance Act 2003 and the Credit Contracts and Consumer Finance Regulations 2004 (**CCCFA**), the Financial Markets (Conduct of Institutions) Amendment Bill (**Conduct Bill**), Australia's new Design and Distribution Obligations, the Deposit Takers Bill, and the RBNZ capital implementation review.

On 1 October 2021, changes to the CCCFA will come into force. These changes touch on a number of aspects of Heartland's processes for promotion, origination and fulfilment of its consumer loans. In particular, Heartland will require more information to satisfy itself as to suitability and affordability. Heartland will employ technologies that will allow this to be done in a seamless and user-friendly way.

In Australia, issuers and distributors of certain financial products are required to comply with new Design and Distribution Obligations which come into force on 5 October 2021. The main impact requires Australian Seniors Finance Pty Ltd to prepare 'Target Market Determinations' for its Reverse Mortgage and Well-Life Loan products, and review its existing processes in relation to marketing, third-party distribution, record keeping, and ongoing monitoring and assurance activities.

Following the conclusion of Phase 2 of the review of the Reserve Bank of New Zealand Act 1989 (**RBNZ Act**), new legislation (to be known as the Deposit Takers Act) is now being developed to strengthen the regulatory framework for all institutions that take deposits (including Heartland Bank), and introduce a new deposit insurance scheme, overseen by the RBNZ. An exposure draft of the Deposit Takers Act is expected to be available for submission later this year, and Heartland will continue to monitor progress.

The RBNZ published the finalised bank capital adequacy requirements, outlined in the new Banking Prudential Requirements (**BPRs**) documents on 17 June 2021. The new BPRs come into force from October 2021 and provide further detail regarding the upcoming increased bank capital requirements. Increases in capital will be phased in over a seven-year period, starting from 1 July 2022, requiring minimum total capital ratio to gradually be increased from the current 10.5% to 16.0% (Heartland Bank is currently at 13.88%).

Sustainability update

Heartland made significant progress in its sustainability strategy in FY2021, including announcing its Greenhouse Gas (**GHG**) emissions reduction targets in March. Heartland's sustainability framework sets out the three pillars of its strategy to ensure it is operating sustainably for the communities it serves, the environment and its stakeholders – those pillars are environmental conservation, social equity and economic prosperity.

Key achievements in each area of sustainability are noted below. More information and goals for the year ahead will be included in Heartland's FY2021 Annual Report, to be published on 27 September 2021 and available at shareholders.heartland.co.nz.

Environmental conservation

- Ambitious emissions reduction targets set to reduce GHG emissions by 35% by 2026.
- Reduction in vehicle fleet size by 7%, and transition to a primarily hybrid and electric fleet underway.
- Established an internal Green Team to champion environmental initiatives and drive change.
- Digitalising paper-based customer letters.

Social equity

- Completion of Heartland's Conduct and Culture Work Plan.
- Heartland Bank became New Zealand's first Hearing Accredited Workplace.
- Heartland Trust[21] grants totalled $448,183 to community groups and organisations.
- Implementation of Heartland's Iho Pūmanawa recruitment strategy which supports more equitable recruitment and selection outcomes.
- A 3% increase in the number of Heartland employees who identify as Māori to 7%, compared with 2% industry average.

Economic prosperity

- Launched Rocket, an app for school leavers designed to bridge financial literacy gaps in New Zealand.
- Developed a self-serve online home loan application, passing cost-savings to customers in the form of market-leading rates.
- To-date, enabled more than 40,000 seniors across New Zealand and Australia to release equity from their homes to live a more comfortable retirement.
- Sheep & Beef Direct self-serve online application launched allowing farmers to apply in minutes for finance to buy or refinance a sheep or beef farm – saving time, and providing increased finance options for farmers.
- Delivered total shareholder return (**TSR**) of 107.2% over the last five years (20 August 2016 – 20 August 2021), compared with the NZX50 Index TSR of 81.9% in the same period.

[21] The Heartland Trust is a registered charitable trust which is independent from, but closely supported by, Heartland and Heartland Bank.

Final dividend

Heartland is pleased to declare a FY2021 final dividend of 7.0 cps, up 4.5 cps from FY2020 due to the easing of restrictions imposed by the RBNZ on distributions by banks in New Zealand. The dividend yield of 7.1%[22] compares with 8.2%[23] in FY2020.

The final dividend will be paid on Wednesday 15 September 2021 (**Payment Date**) to shareholders on the company's register as at 5.00pm on Wednesday 1 September 2021 (**Record Date**) and will be fully imputed. Heartland has a Dividend Reinvestment Plan (**DRP**), giving eligible shareholders the opportunity to reinvest some or all of their dividend payments into new ordinary shares. The DRP will apply to the final dividend with a 2.0% discount.[24] The DRP offer document and participation form is available on Heartland's shareholder website at shareholders.heartland.co.nz/shareholder-resources/dividends.

Looking forward

The second half of FY2021 saw growth exceed expectations. Initial anticipation was for this momentum to continue into the financial year ending 30 June 2022 (**FY2022**). However, the duration of the current lockdown may impact on this. Higher growth in Reverse Mortgages, Home Loans and the transition of Harmoney to an on-balance sheet model will result in NIM contracting. However this will also drive an offsetting benefit of reduced impairment expenses, reflecting improved quality of the lending portfolio. The CTI ratio trend downwards as a result of ongoing digitalisation and automation is expected to continue.

FY2022 will see Heartland continuing to extend its best or only product reach through its digital platforms. At the same time, frictionless service at each stage of the journey will provide better customer experience.

Noting uncertainties associated with the ongoing impacts of COVID-19, Heartland expects its NPAT for FY2022 to be in the range of $93 million to $96 million.

– ENDS –

For further information, please contact the person(s) who authorised this announcement:

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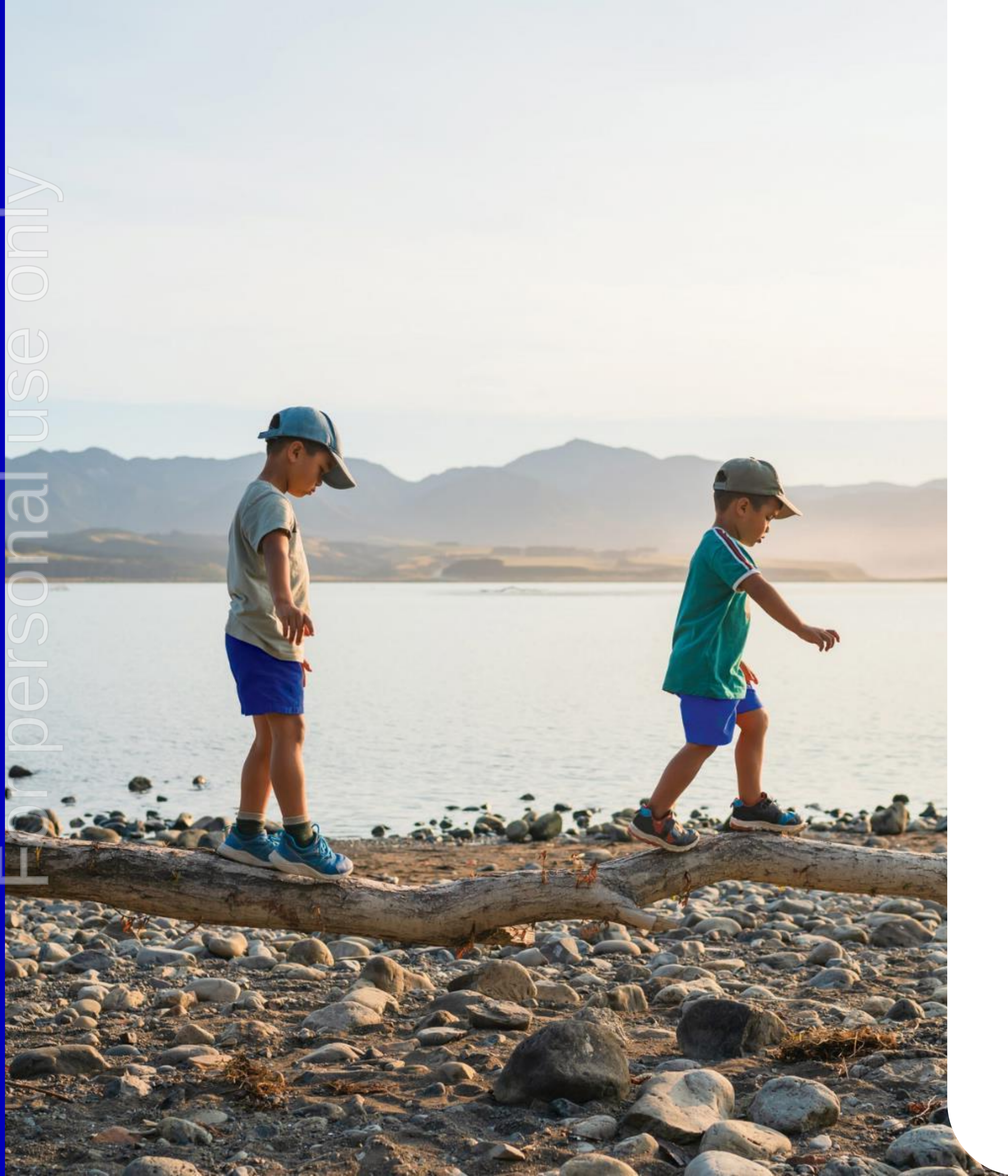
[22] FY2021 total fully imputed dividends divided by the closing share price as at 20 August 2021 of $2.16.
[23] FY2020 total fully imputed dividends divided by the closing share price as at 16 September 2020 of $1.19.
[24] That is, the strike price under the DRP will be 98.0% of the volume weighted average sale price of Heartland shares over the five trading days following the Record Date. For the full details of the DRP and the Strike Price calculation, refer to Heartland Group Holdings Limited DRP offer document dated 10 December 2018.



2021 Annual Results

24 August 2021

HEARTLAND

Important notice

This presentation has been prepared by Heartland Group Holdings Limited (**NZX/ASX: HGH**) (the **Company** or **Heartland**) for the purpose of briefings in relation to its financial statements.

The presentation and the briefing (together the **Presentation**) contain summary information only, which should not be relied on in isolation from the full detail in the financial statements.

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Non-GAAP measures

This presentation contains references to non-GAAP measures including underlying profit or loss, underlying ROE, underlying CTI ratios and underlying EPS. A reconciliation between reported and the non-GAAP measure of underlying financial information is included on page 33.

Because Heartland complies with accounting standards, investors know that comparisons can be made with confidence between reported profits and those of other companies, and there is integrity in Heartland's reporting approach. These non-GAAP figures are provided as a supplementary measure for readers to assess Heartland's performance alongside NZ GAAP reported measures, where one-offs, both positive and negative, can make it difficult to compare profits between years. However, these do not have standardised meanings and should not be viewed in isolation nor considered a substitute for measures reported in accordance with NZ GAAP.

Non-GAAP financial information has been subject to review by KPMG.

FY2021 highlights

Financial performance highlights

$5,018m
GROSS FINANCE RECEIVABLES[3]
+8.0% vs June 2020

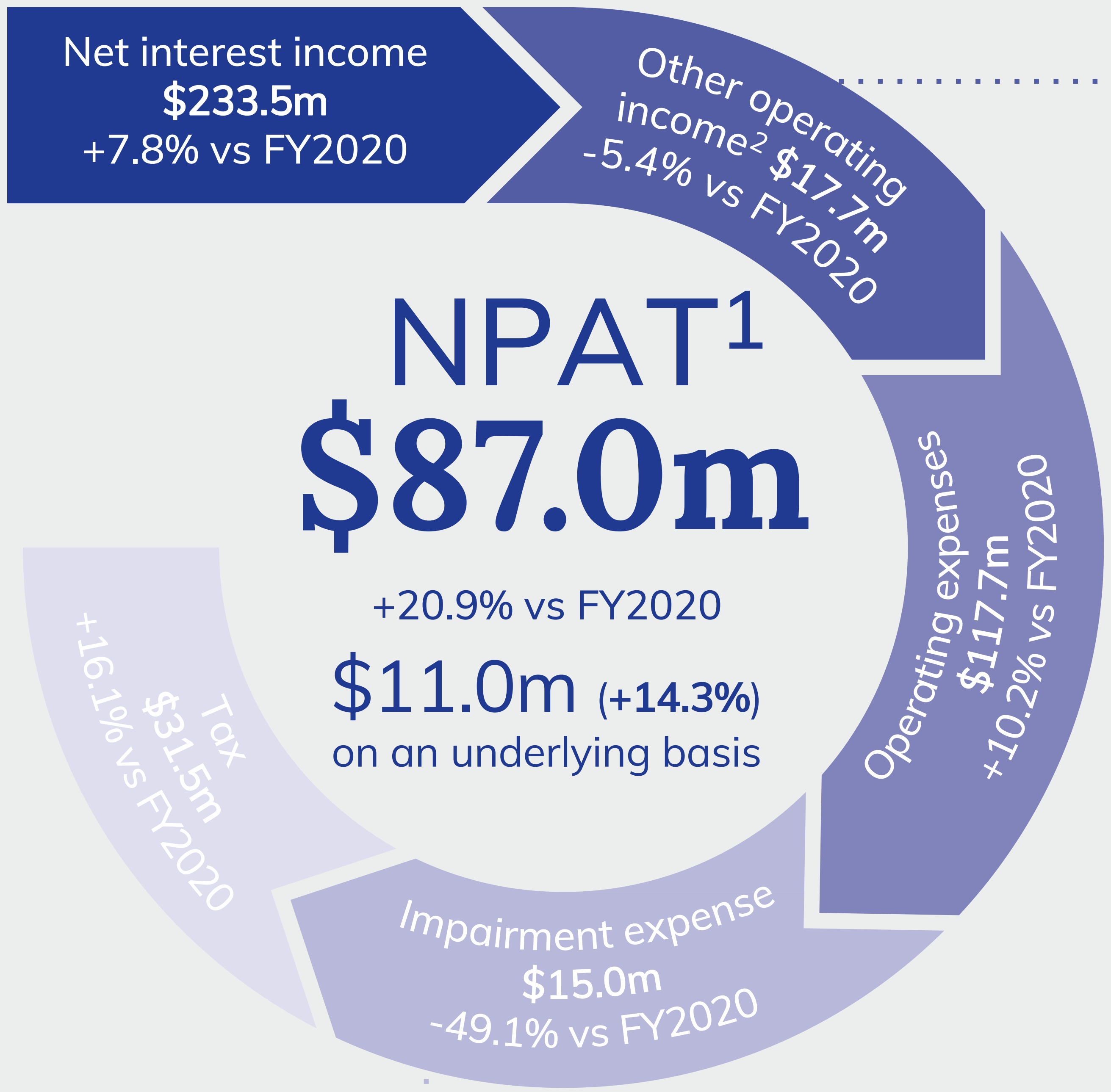
$4,864m
BORROWINGS
+7.3% vs June 2020

$762m
EQUITY
+8.8% vs June 2020

0.31%
IMPAIRMENT EXPENSE RATIO[4]
-34 bps vs June 2020

Net interest margin (**NIM**) 4.35% (+2 bps vs FY2020)

Average interest earning assets +$366.2m (7.3%) vs FY2020



Underlying other operating income (**OOI**) $13.6m (+3.1% vs FY2020)

CTI 46.8% (+1.5 percentage points (**pps**) vs FY2020)

Underlying operating expenses (**OPEX**) $110.8m (+7.3% vs FY2020)

Underlying CTI 44.8% (-0.1 pps vs FY2020)

Underlying impairment expense movement -24.4% vs FY2020

KEY HIGHLIGHTS

- Continued Receivables growth in core lending portfolios (Motor, Reverse Mortgages, Asset Finance[5]).
- Strong NIM maintained, an increase of 2 bps on FY2020 to 4.35%.
- Downward trend in FY2021 underlying cost to income ratio (**CTI**), critical to achieving scalability for the future (43.9% in 2H2021 vs 45.8% in 1H2021).
- Improved arrears position due to repayments, refinancing and ordinary restructures.

11.9%
RETURN ON EQUITY
+144 bps vs FY2020

14.9 cps
EARNINGS PER SHARE
+2.4 cps vs FY2020

[1] Refer to Appendix 3 for reconciliation between reported and underlying net profit after tax (**NPAT**) result.
[2] OOI includes fair value gains/losses on investments.
[3] Gross finance receivables (**Receivables**) also include Reverse Mortgages.
[4] Impaired asset expense as a percentage of average receivables.
[5] Previously referred to as Business Intermediated.

FY2021 significant one-off items

FY2021 one-offs included in the reported result

- *Net fair value gains/losses on investments:*
  - a $3.9m fair value gain was recognised on Heartland's equity investment in Harmoney
  - a $0.7m fair value gain was recognised following updated external valuations received on Heartland Bank's investment property portfolio
  - a $0.5m fair value loss was recognised following Heartland Bank acquiring remaining shares in Fuelled Limited in April 2021.
- *Voluntarily accelerated amortisation of intangible assets:* $4.3m expense was recognised, reflecting an acceleration of amortisation of software assets held on the balance sheet.
- *Aged items provision and write-off:* $1.7m of aged legacy suspense account transactions were written off or provisioned where collectability is uncertain.
- *Other non-recurring* expenses: $0.9m.

Strategic highlights

Further digitalisation and integration of platforms in New Zealand and Australia.

Quality of loan book improved despite COVID-19 pressures.

More than $200m approved from Home Loans self-serve digital applications received during FY2021.

Heartland Bank one of two Australasian banks to have **no reduction or adverse change to its ratings or outlook** by Fitch Ratings since Jan 2020.

Australian Reverse Mortgages **loan book surpassed A$1bn**.

Australian Reverse Mortgages awarded **Your Magazine's 5-Star Lender Award** and **InfoChoice's Best Reverse Mortgage Award**.

Heartland Bank awarded **Canstar's 2021 Savings Bank of the Year** (fourth year), and awards for Direct Call and YouChoose accounts.

NZ Reverse Mortgages remains **Consumer Trusted** for the fourth year in a row.

Impairments and provisioning

Impairment expense was $15.0m, a $14.4m decrease (49.1%), decreasing the impairment expense ratio[1] from 0.65% in FY2020 to 0.31% in FY2021.

On an underlying[2] basis, impairment expense decreased by $4.8m (24.4%), decreasing the FY2021 impairment expense ratio by 13 bps from 0.44% in FY2020.

This was driven by:

- remediation of accounts previously in arrears, and release of provisions held against those borrowers largely due to repayments, refinancing and ordinary restructures
- growth in portfolios that attract lower rates of provisioning (Motor, Asset Finance) or are subject to fair value (Reverse Mortgages), and contraction in portfolios that attract higher rates of provisioning (Open for Business, Harmoney).

[1] Impaired asset expense as a percentage of average receivables.

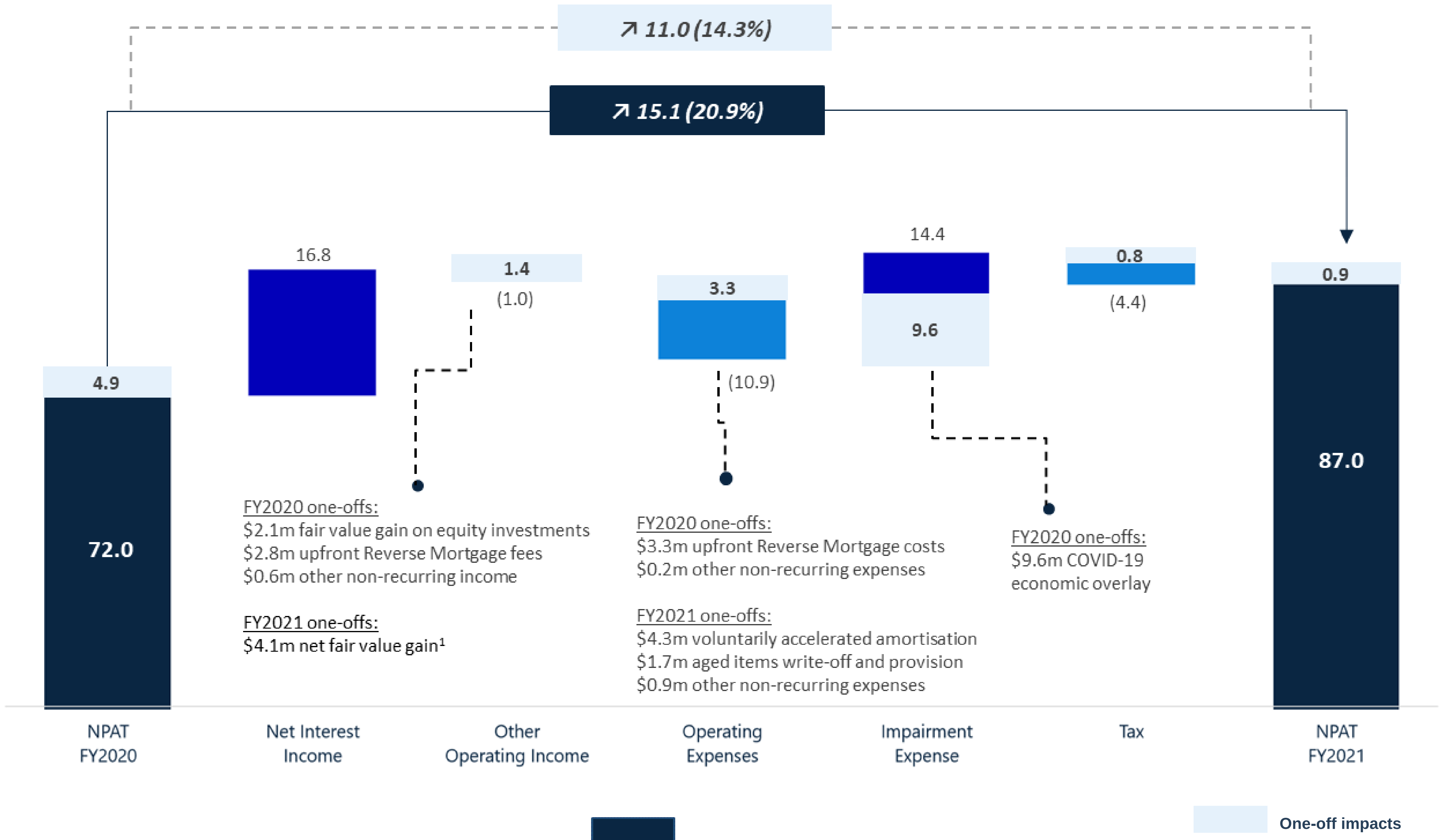
[2] FY2020 excluding the impact of NZ$9.6m pre-tax economic overlay due to COVID-19.

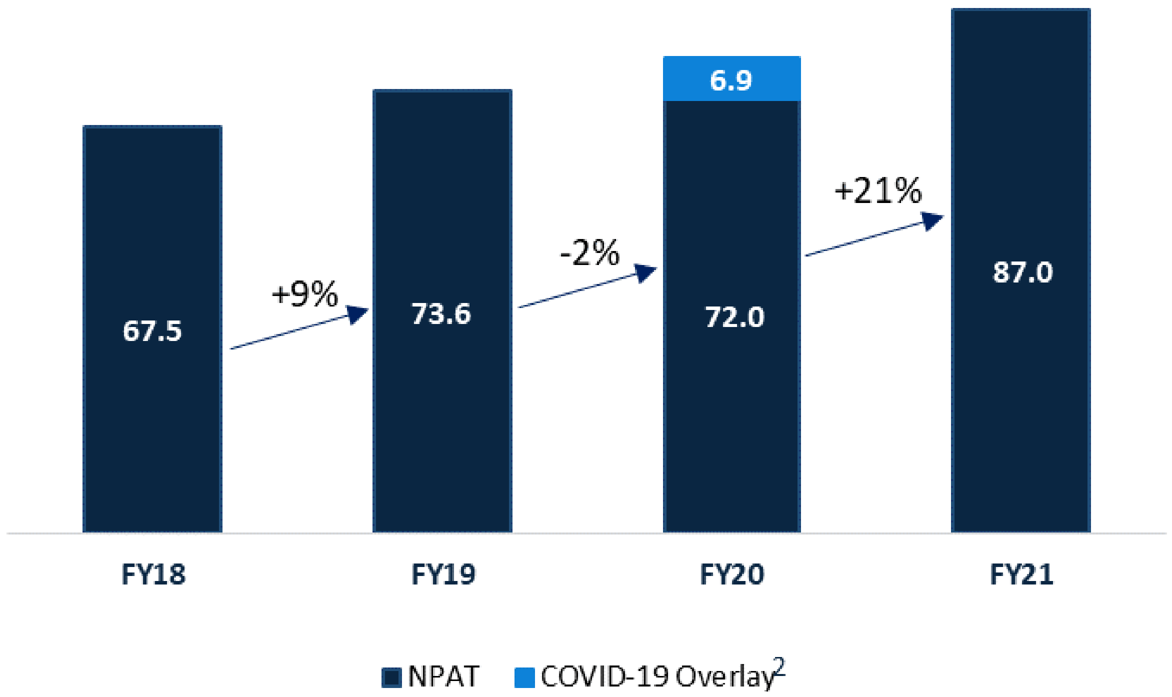
Impact of COVID-19

- Direct impact of COVID-19 has been absorbed within business as usual activity.
- The COVID-19 economic overlay remains unutilised.
- Business Finance Guarantee Scheme (**BFGS**) and Extend customers performing at normal levels:
  - BFGS book at $60.3m.
- Given the recent lockdown and remaining uncertainty regarding the border closure, any release of the overlay is not yet appropriate.
- Heartland continues to exercise a degree of caution due to the ongoing economic impacts of COVID-19 that continue to be experienced across New Zealand and Australia.

Financial results

Growth in profitability

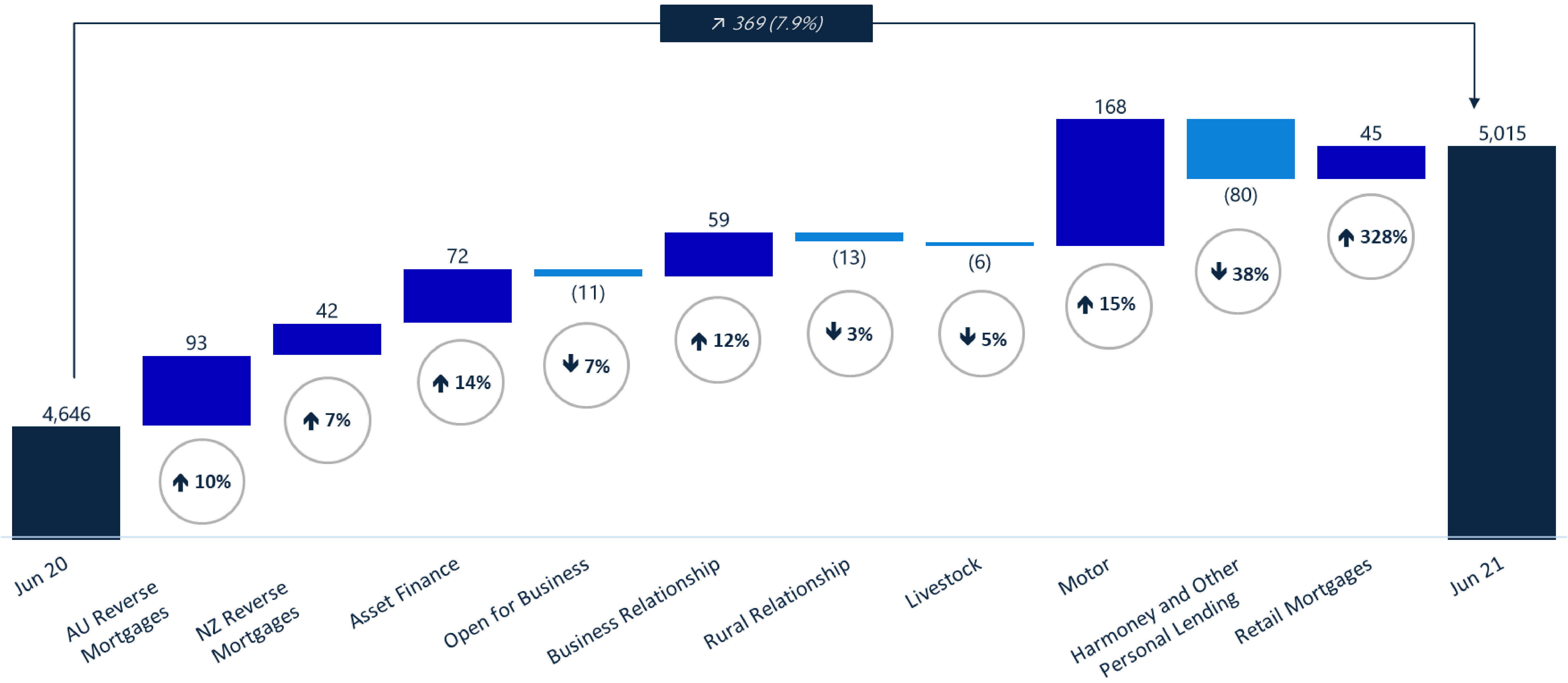




Note: All figures in NZ$m.

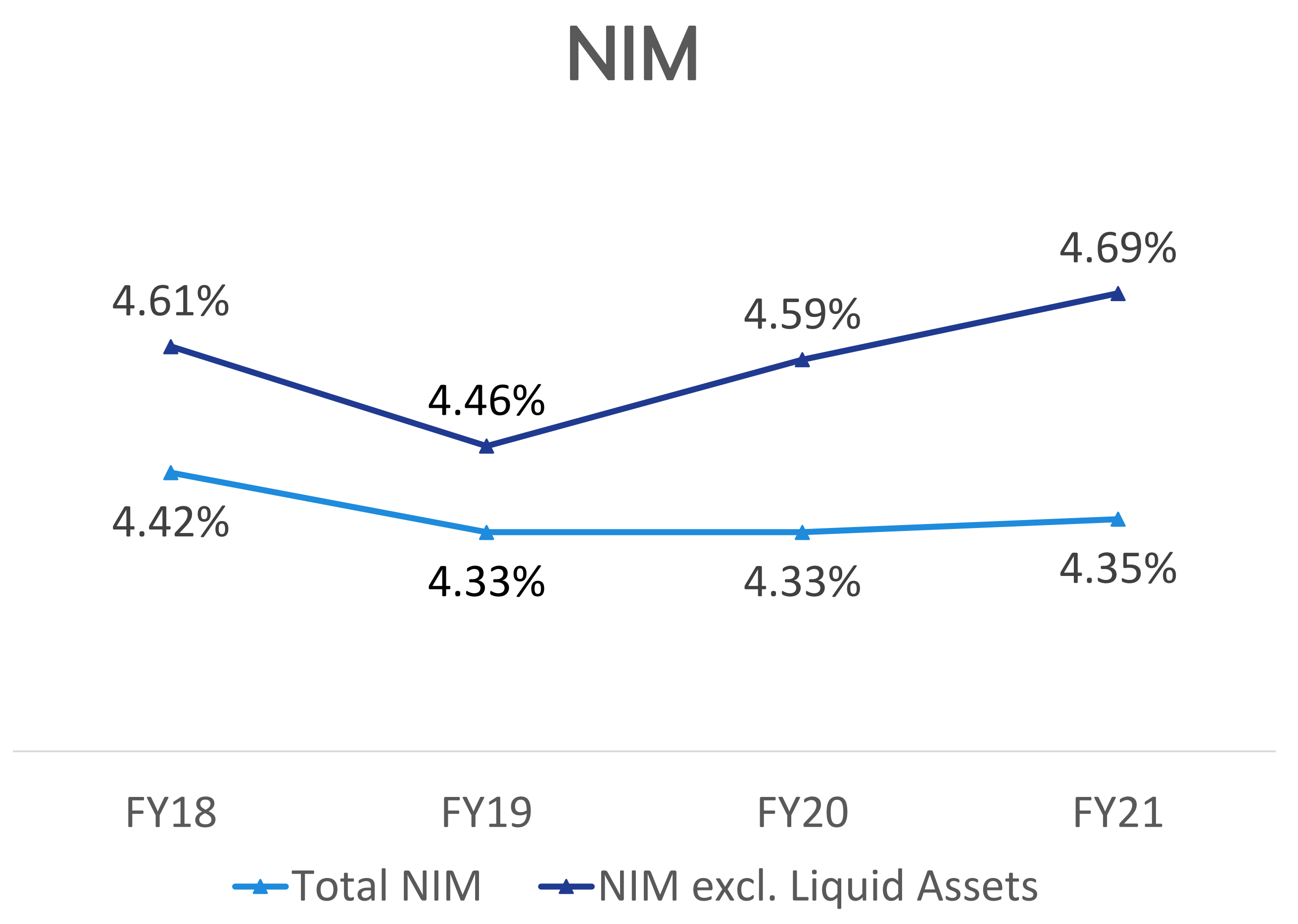
1. Includes net gain on equity investments and investment properties.
2. Post-tax impact of $9.6m economic overlay due to COVID-19.

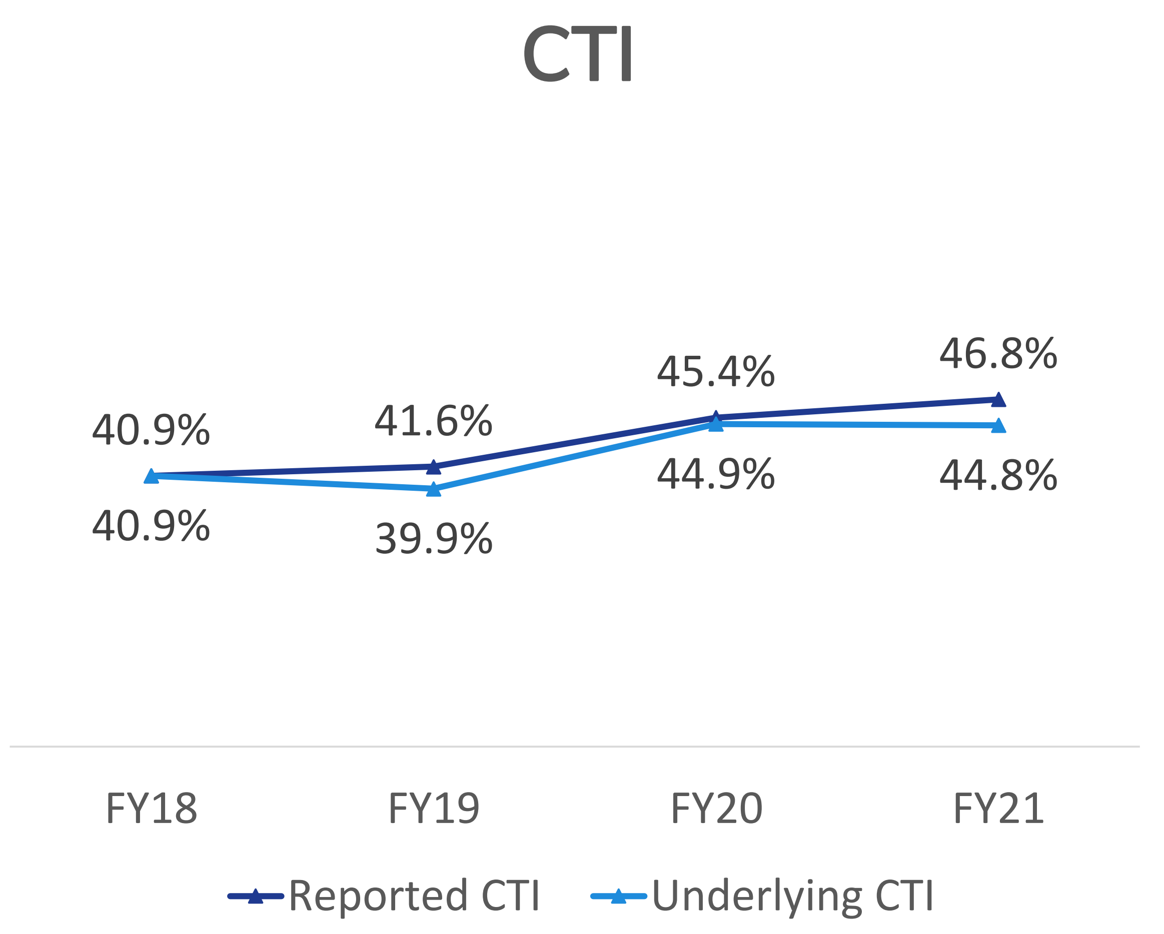
Growth in receivables

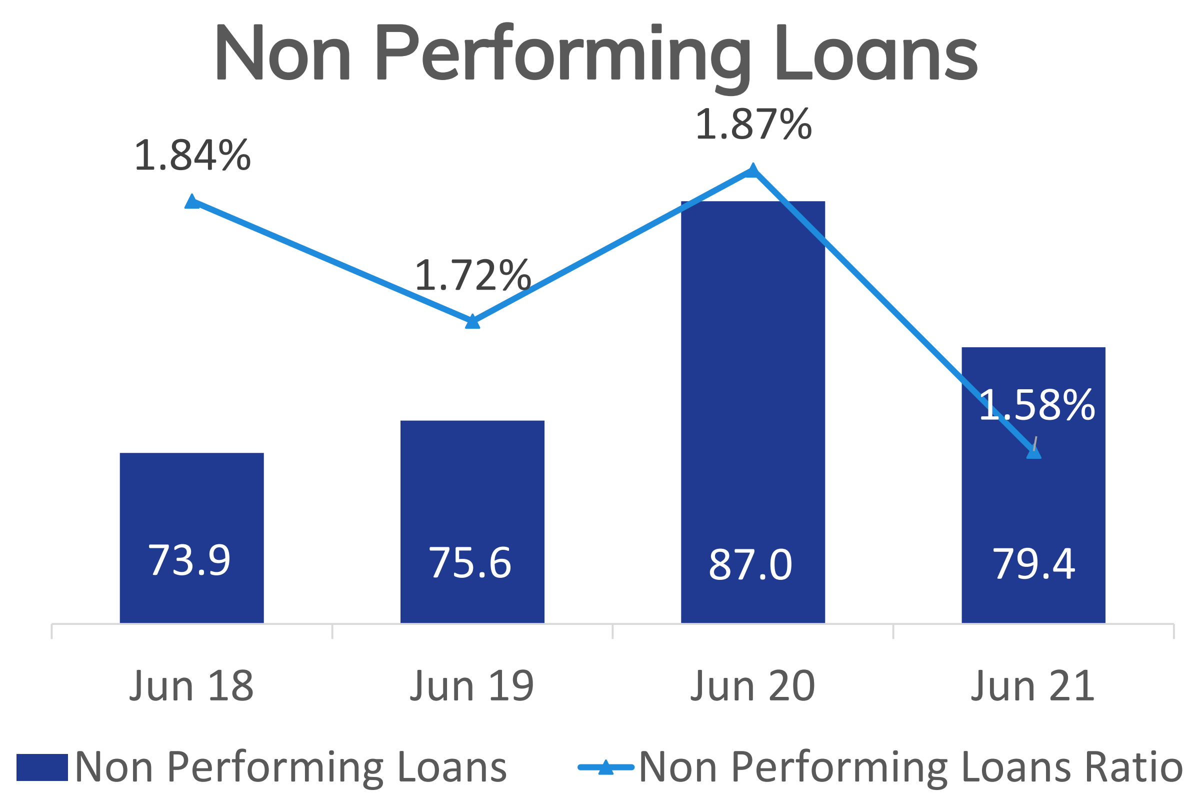


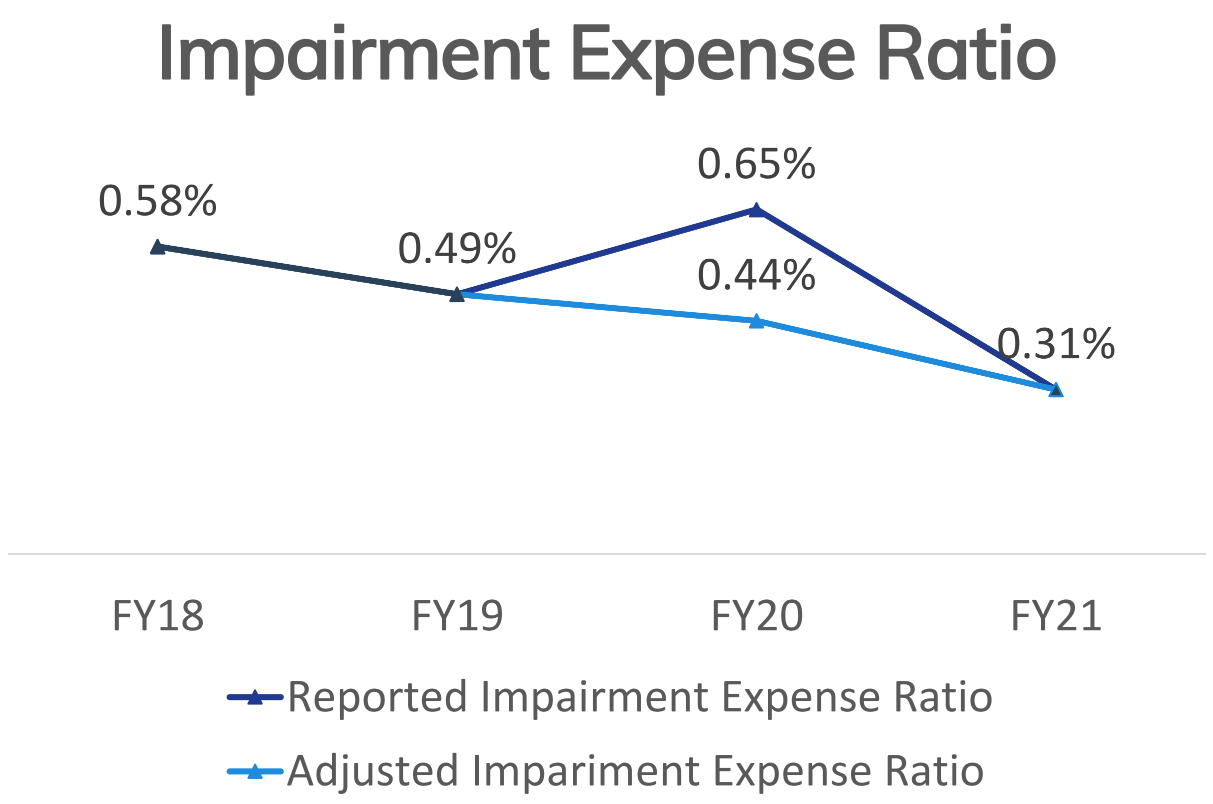
Note: The graph shows year-to-date (**YTD**) movement in receivables by portfolio excluding the impact of changes in FX rates. All figures in NZ$m.

Key performance measures









Note:

NIM is calculated as net interest income/average gross interest earning assets.

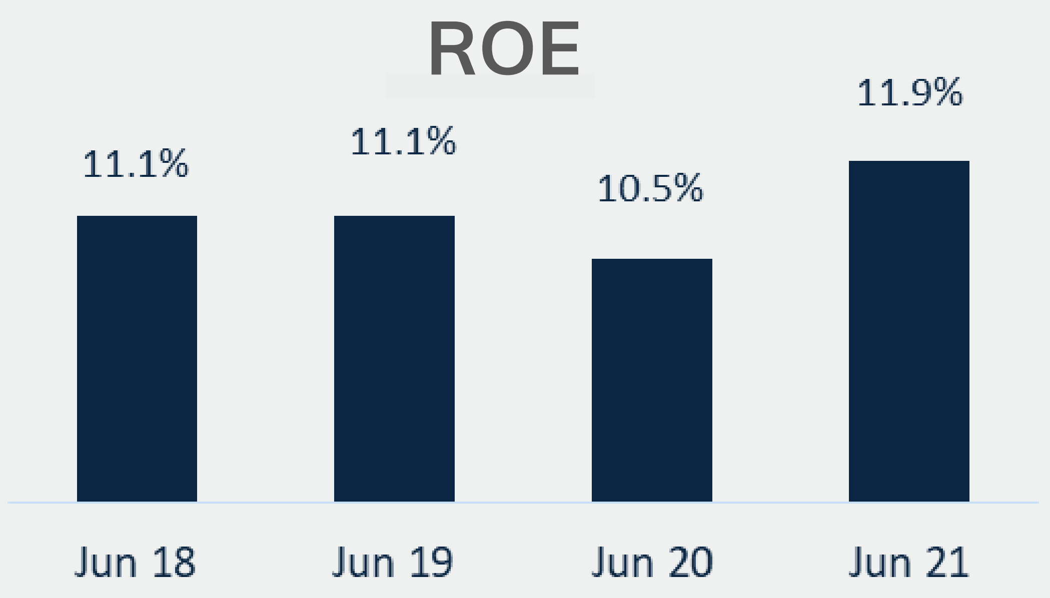
Underlying CTI excludes one-off impacts. Refer to Appendix 3 for reconciliation between reported and underlying result.

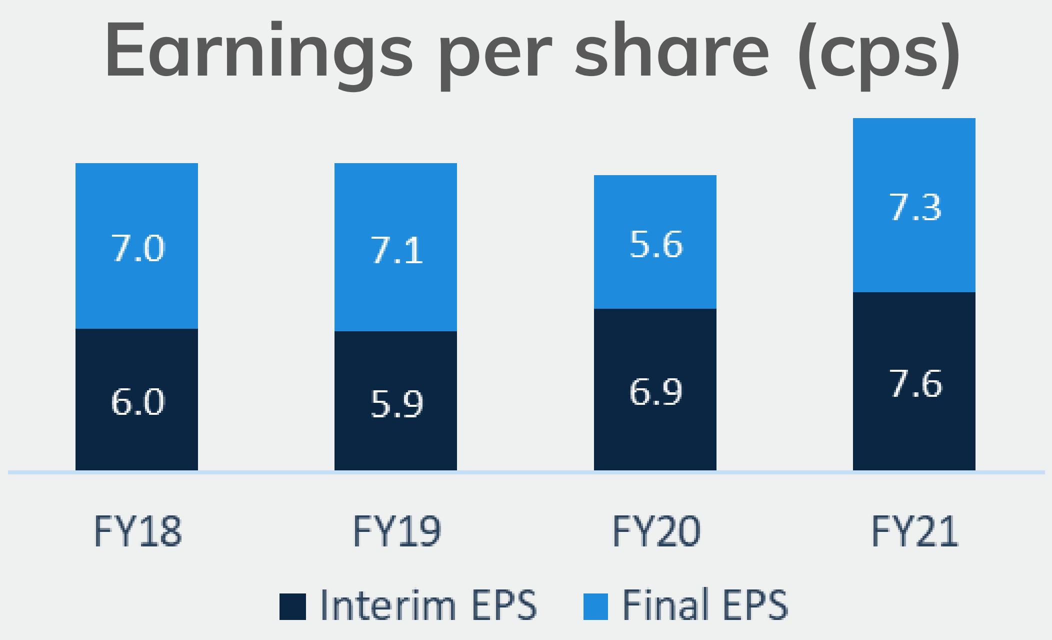
Impairment expense ratio is calculated as impairment expense/average gross finance receivables.

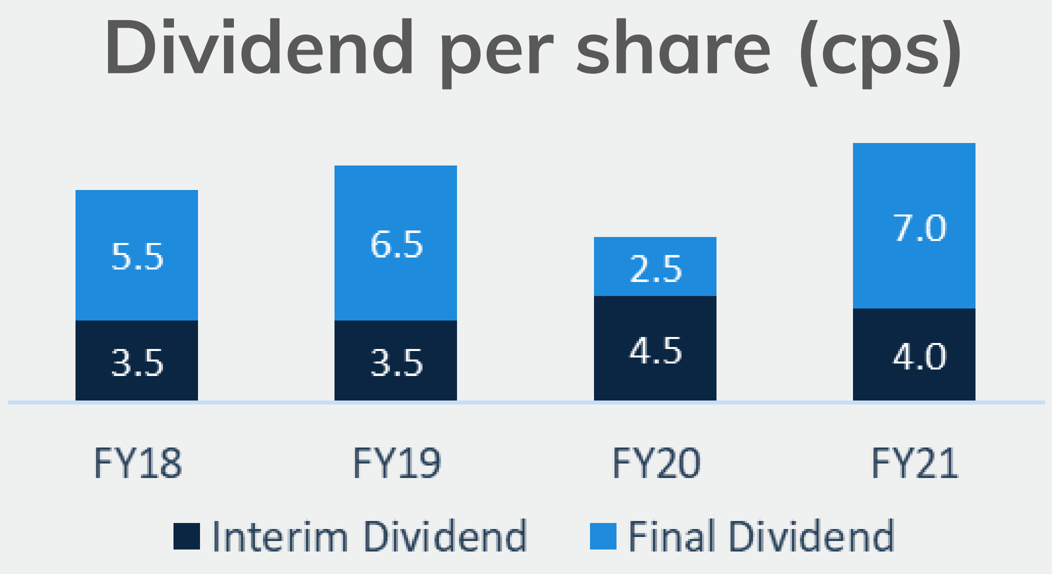
Adjusted impairment expense ratio excludes the impact of the $9.6m pre- tax economic overlay due to COVID-19.

Shareholder return

- Return on equity (**ROE**) of 11.9% (up 144 bps vs FY2020).
- Earnings per share (**EPS**) of 14.9 cps, up 2.4 cps compared to FY2020.
- Final dividend of 7.0 cps, up 4.5 cps on FY2020 as pay-out ratio returns to historical levels with easing of RBNZ restrictions.
- Dividend yield of 7.1%.[1]
- Five year total shareholder return (**TSR**) of 107.2%, compared with the NZX50 Index TSR of 81.9% in the same period.[2]







[1] Total fully imputed dividends divided by the closing share price as at 20 August 2021 of $2.16.

[2] TSR for the period 20 August 2016 – 20 August 2021.

Divisional summary

Reverse mortgages portfolio analytics

602M
NZ Reverse Mortgages
+$42m (7.4%)
vs June 2020

NZ	
Average loan size	$109,417
Weighted average borrowers' age	79
Average origination LVR	10.1%
Weighted average LVR	21.5%
Proportion of the loan book over 75% LVR	0%
Origination	$102m (+$24m vs FY2020)
Total repayments in FY2021	$93m (+$29m vs FY2020)
FY2021 repayment rate	16.5% (vs 12.5% in FY2020)
Compounded annual growth rate[1]	10.5%
Repayments from vintage loans (+11 years)	37% (vs 38% in FY2020)

1,001M
AU Reverse Mortgages
+A$86m (9.4%)
vs June 2020

AU	
Average loan size	A$136,472
Weighted average borrowers' age	77
Average origination LVR	11.4%
Weighted average LVR	22.9%
Proportion of the loan book over 75% LVR	0.4%
Origination	A$189m (-A$15m vs FY2020)
Total repayments in FY2021	A$154m (+A$41m vs FY2020)
FY2021 repayment rate	16.9% (vs 14.6% in FY2020)
Compounded annual growth rate1	19.3%
Repayments from vintage loans (+11 years)	23.3% (vs 24.0% in FY2020)

ELEVATED REPAYMENTS IN FY2021 DUE TO:

- comparatively lower repayments in Q4 of FY2020 with property sales restricted by COVID-19 related lockdowns
- a buoyant property market in 1H2021
- seniors moving in with family and pooling financial resources (loneliness/high property prices)
- higher value homes being more cost effective to sell/downsize from compared with 'average' homes.

[1] Compounded annual growth rate for the period 1 January 2017 – 30 June 2021.

Au Reverse Mortgages

- Receivables growth impacted by elevated repayments (**39%** vs FY2020), more on p14.
- Australian Seniors Finance recently rebranded to Heartland Reverse Mortgages, with all Australian products now included under the Heartland Finance brand, ensuring greater brand alignment and consistency.
- Received support from mortgage aggregators, including partnerships with Australian Finance Group, Choice Aggregation and PLAN Australia.
- As Australia's leading provider of reverse mortgages (12-month market share increasing from 28.5%[2] to 29.3%[3]), there is still substantial opportunity to support more older Australians in retirement.
- Launched Well-Life Loans for Australians entering and in retirement.
- Exploring expansion into other asset classes through existing relationships with intermediaries that lend to businesses and consumers, as well as Heartland's own digital platforms.

$36.2m — NET OPERATING INCOME — As at 30 June 2021

+5.5% — increase since June 2020

$1,071.4m — RECEIVABLES — As at 30 June 2021

+9.5%[1] — growth since June 2020

[1] Excluding the impact of changes in FX rates.
[2] Based on APRA ADI Property Exposure and Heartland Seniors Finance data as at 31 December 2020.
[3] Based on APRA ADI Property Exposure and Heartland Seniors Finance data as at 31 March 2021.

NZ Reverse Mortgages

- New Zealand Reverse Mortgages had a record year for new business, up 30.4% from FY2020 where the final quarter (**Q4**) was impacted by COVID-19, and up 26.2% ahead of FY2019.
- Performance driven by investment in marketing to increase awareness, education and lead nurturing activity, supported by lower interest rates and higher property prices.
- Receivables growth was impacted by elevated repayments (**43%** vs FY2020). See p14 for more information.

$24.4m NET OPERATING INCOME

+3.6% increase since June 2020

As at 30 June 2021

$601.5m RECEIVABLES

+7.4% growth since June 2020

As at 30 June 2021

[1] FY2020 includes one-offs of $1.6m due to the required accounting standard change in respect of upfront reverse mortgage fees.

Open for Business (O4B)

- Growth slowed in 2H2020 as a result of COVID-19 disruptions and availability of Government-backed funding for small businesses. This trend continued in 1H2021.
- 2H2021 saw growth of $3.6m due to improving economic sentiment.
- Integration of front-end platforms and back-end processes will reduce friction for all customers, including O4B, which will enhance customer experience and speed up processes.

$14.6m NET OPERATING INCOME

As at 30 June 2021

-1.1% decrease since June 2020

$144.5m RECEIVABLES

As at 30 June 2021

-6.9%[1] decrease since June 2020

[1] Excluding the impact of changes in FX rates.

Asset Finance[1]

- Continued deepening and expansion of the intermediary network, and distributor/vendor and point of sale support.
- Strong demand from partners in the transport and logistics sector assisted growth following demand in the aftermath of the COVID-19 restrictions.
- To support trucking distributors, a digital quoting tool was developed and launched in FY2021 to more easily send finance referrals to Heartland Relationship Managers.
- Launch of Heartland Extend for Business customers, providing business owners with flexibility to manage and adjust loan repayments to meet their needs.

$28.5m

NET OPERATING INCOME

As at 30 June 2021

+30.1%

increase since June 2020

$570.9m

RECEIVABLES

As at 30 June 2021

+14.4%

growth since June 2020

[1] Previously referred to as Business Intermediated.

Business Relationship

- Supported more than 150 businesses to access over $60m in funding under NZ Government's Business Finance Guarantee Scheme.
- Provided Go Car Finance with funding for its New Zealand loan book, aligning with Heartland's strategy to diversify distribution in motor vehicle finance.
- New wholesale finance system now successfully implemented after a pilot in June 2021, allowing wholesale dealers to manage finance via a digital interface.
- The residual portfolio's continued downward trend reflects Heartland's strategy to reduce non-core low margin Relationship lending or risk concentrations.

$26.1m | **+4.1%**

NET OPERATING INCOME | increase since June 2020

As at 30 June 2021

$555.1m | **+11.8%**[1]

RECEIVABLES | growth since June 2020

As at 30 June 2021

[1] Excluding the impact of changes in FX rates.

Motor Finance

- Growth came mainly from the Motor dealer book via car dealerships, brokers and branded partnerships such as Kia Finance, Jaguar/Land Rover Financial Services.
- In July 2021, a new vehicle finance service iOWN, provided exclusively by Heartland Bank, was launched in partnership with Auto Distributors New Zealand Limited, for the purchase of a new or used Peugeot or Citroen from authorised dealerships.
- Guaranteed Future Value product, available through branded partners, now been rolled out to 11 vehicle brands across more than 140 dealerships, reducing barriers to entry for those buying a new or used vehicle.

$69.2m NET OPERATING INCOME

As at 30 June 2021

+14.2% increase since June 2020

$1,293.7m RECEIVABLES

As at 30 June 2021

+14.9% growth since June 2020

Harmoney and other personal lending

- The **New Zealand Harmoney portfolio** contracted $69.1m (47.4%) to $76.7m, while the **Australian Harmoney portfolio** decreased by $5.2m (9.5%)[1] to $48.8m.
- Both New Zealand and Australian Harmoney portfolios continued to contract in FY2021 as a result of high repayments, combined with greater use by Harmoney of its own on-balance sheet funding facilities.
- Heartland is in the latter stages of completing its transition to offer Harmoney on-balance sheet funding facilities in both New Zealand and Australia.

$16.6m
NET OPERATING INCOME
As at 30 June 2021

-22.4%
decrease since June 2020

$132.1m
RECEIVABLES
As at 30 June 2021

-37.7%[1]
decrease since June 2020

[1] Excluding the impact of changes in FX rates.

Rural

- **Rural Relationship** net operating income increased by 10.5% to $26.6m and **Livestock** net operating income decreased by 16.2% to $5.5m.
- **Rural Relationship** receivables reduced by 2.7% to $477.3m and **Livestock** receivables reduced by 5.1% to $109.4m.
- The downward trend reflects Heartland's strategy to reduce non-core low margin Rural Relationship lending.
- Sheep & Beef Direct platform launched late 2020. At 5 August 2021, eligible applications totaled $48.0m, with $40.5m approved online and $30.4m drawn down.
- Sheep & Beef platform reflects implementation of digitalisation strategy, allowing Heartland to write more loans.

$32.2m — NET OPERATING INCOME

+4.7% — increase since June 2020

As at 30 June 2021

$586.6m — RECEIVABLES

-3.1% — decrease since June 2020

As at 30 June 2021

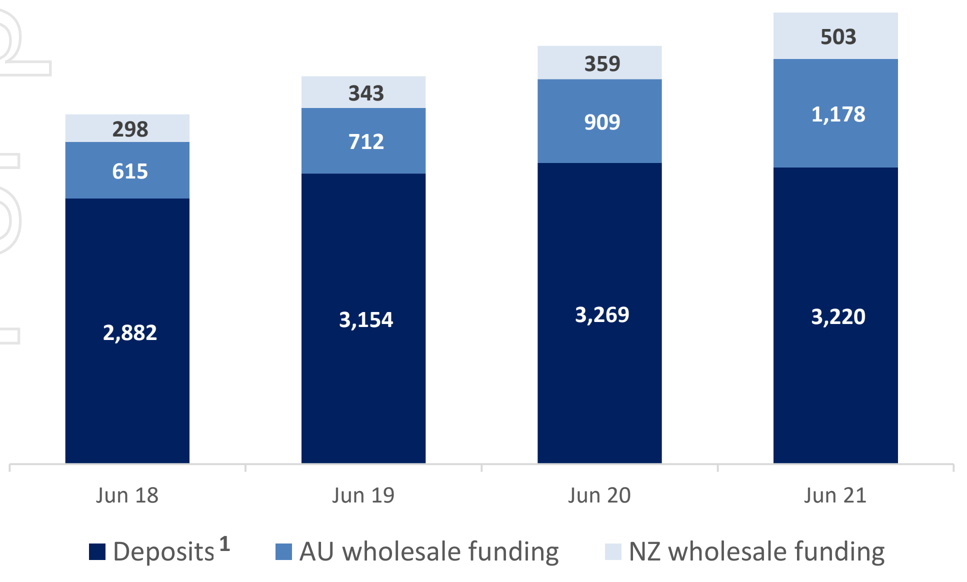
Home Loans[1]

- Home Loans[1] Receivables increased **$49.3m** in FY2021 to **$49.9m**.
- Following a successful pilot, Home Loans launched in October 2020 with conservative lending criteria targeting high quality applicants.
- Loan drawdowns slowed over the summer holiday period in 1H2021, however strong application rates have continued in 2H2021. Online enquiries totalled $895.2m and more than $200m was approved from applications received during FY2021.
- A demonstration of Heartland's digitalisation strategy in action. Online applications with automated decisioning and processing reduces cost of onboarding, allowing cost savings to be passed onto customers.

[1] Excludes legacy Retail Mortgages.

Funding and liquidity

Funding composition $m



New Zealand

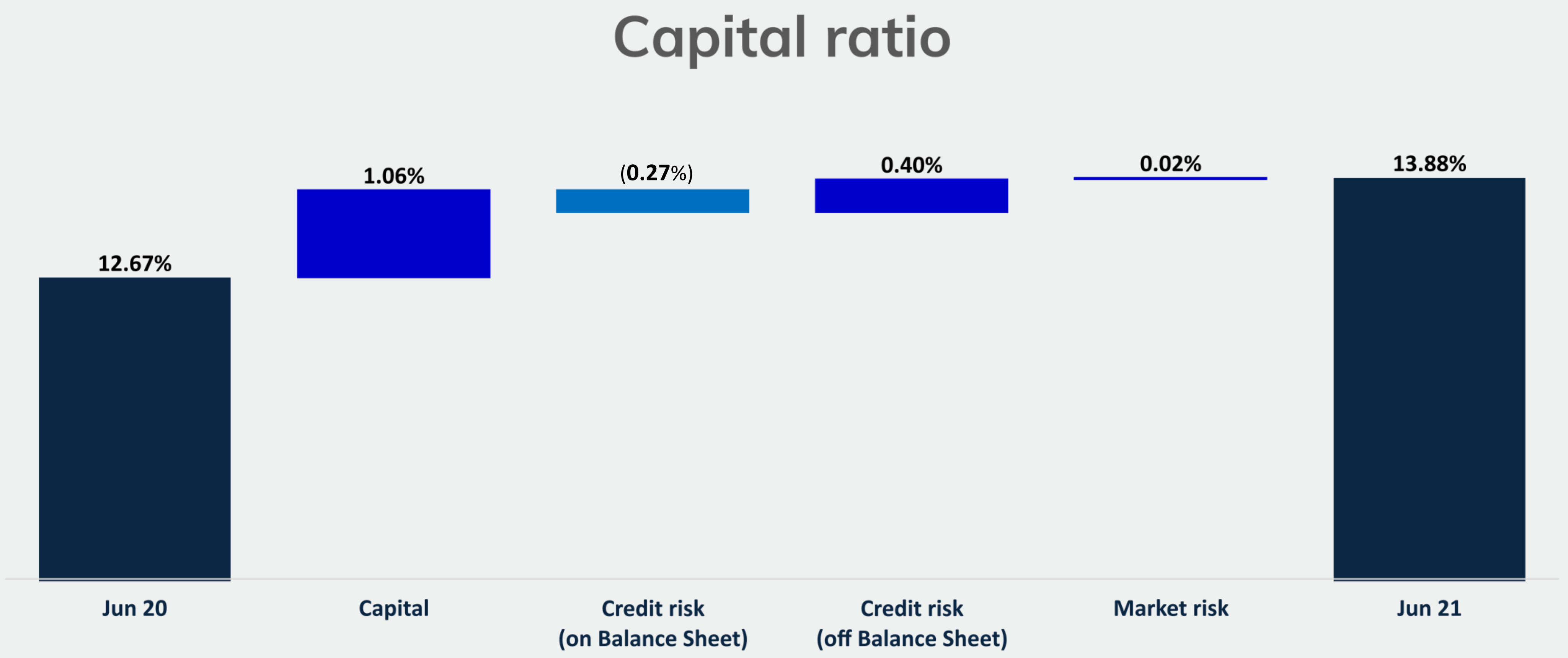
- Heartland Bank increased borrowings by $94.4m (2.6%) in FY2021.
- Deposits contracted $49.7m (1.5%).
- Decreased total liquidity by $99.1m (13.7%) primarily due to decrease in investments.
- Heartland Bank holds liquidity well in excess of regulatory minimums.
- Continued focus on reducing risk concentrations in the deposit book while shifting the mix towards lower rate call deposits.

Australia

- Heartland Australia increased borrowings by A$247.6m (29.1%) in FY2021 and has access to committed Australian reverse mortgage loan funding of A$1.25b in aggregate.
- Heartland completed an A$142m long-term reverse mortgage-backed syndicated loan funded by established offshore institutional investors. The first-of-its-kind transaction complements continued efforts to diversify type, source and tenor of funding and evidence market liquidity to existing warehouse funders.
- The Heartland Australia group continues to successfully execute on its strategic funding programme to cater for strong growth in its portfolios, with a further A$45m MTN issued in July, adding further diversity to the funding base.
- Further expansion of existing warehouse funding through increased senior limits and the introduction of mezzanine funding is well advanced, and focus will continue to be on sourcing optimal long-term duration matched funding.

[1] Includes intercompany deposits.

Capital



- Heartland Bank's capital ratio as at 30 June 2021 is 13.88% (up 121bps from 30 June 2020).
- As part of the RBNZ capital implementation review requiring an increase in capital, increases in capital will be phased in over a seven-year period, starting from 1 July 2022, requiring minimum total capital ratio to gradually be increased from the current 10.5% to 16.0%.
- Heartland Bank's current capital position and organic growth in capital is expected to be sufficient to meet future minimum requirements.

Strategic update

Regulatory update

A significant volume of regulatory change has been signalled, and Heartland continues to monitor this.

Key changes include:

- New Zealand Credit Contracts and Consumer Finance Act 2003 and the Credit Contracts and Consumer Finance Regulations 2004
- Financial Markets (Conduct of Institutions) Amendment Bill
- Deposit Takers Act
- RBNZ capital implementation review
- Australian Design and Distribution Obligations.

See the accompanying FY2021 full year results announcement for further detail about upcoming regulatory change.

Strategic objectives

Heartland's strategic vision to provide **best or only products via scalable digital platforms** will be achieved through:

1. Business as usual growth

- Broadening product offerings and achieving growth across business as usual activity, including through product and platform developments.

2. Frictionless service at the lowest cost

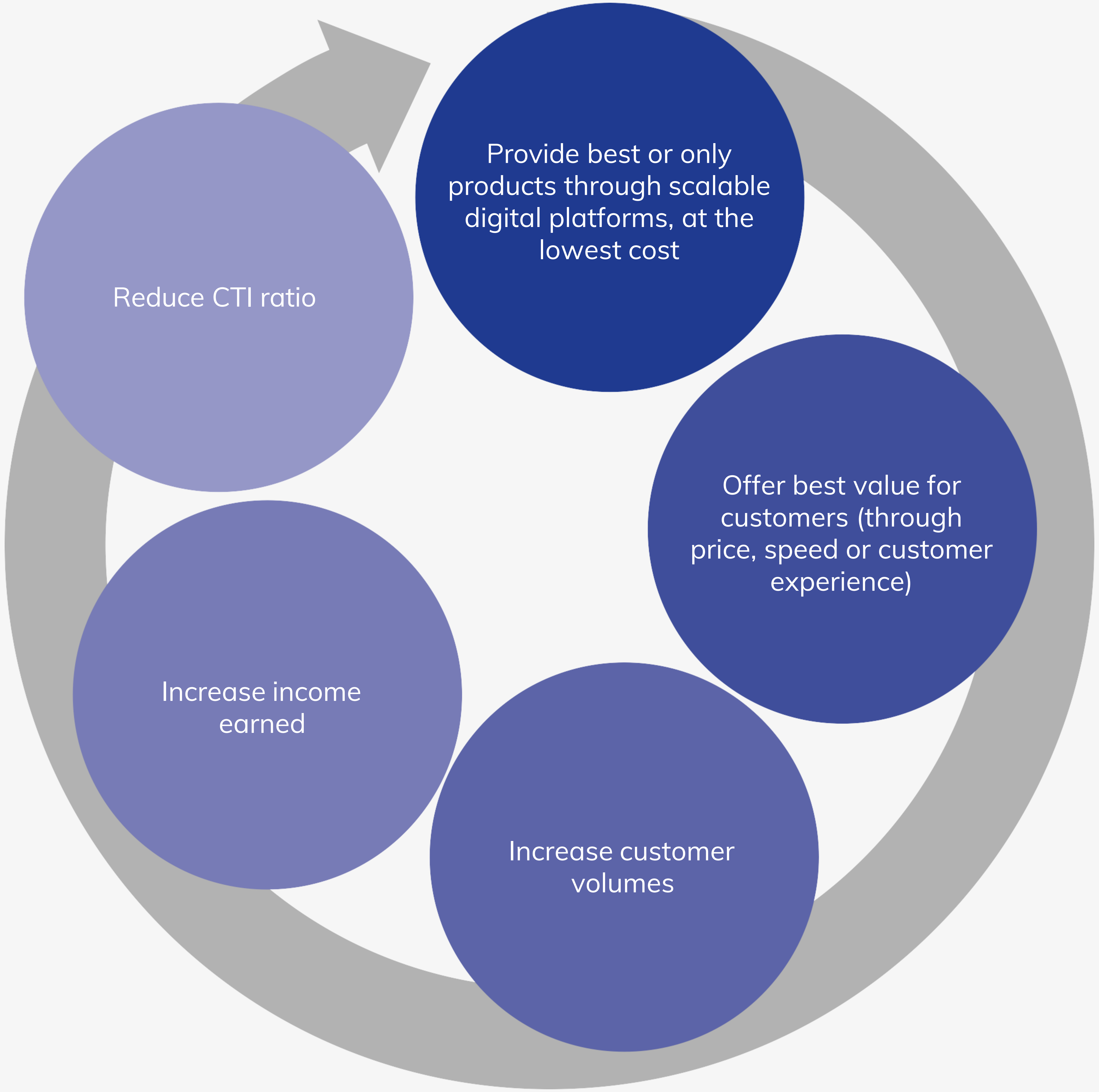
- Frictionless service at each stage of a customer's journey eases inconvenience and removes costly operational processes – enhancing customer experience and allowing savings to be passed onto customers.
- As described by the virtuous circle to the right.

3. Expansion in Australia

- Expanding product offerings to meet the wider needs of the demographic entering, as well as in, retirement.
- Exploring expansion into other asset classes through digital platforms and existing relationships with intermediaries that lend to businesses and consumers.

4. Acquisitions

- Where there is a fit with the above and the opportunity to add value, acquisitions will be explored.



Looking forward

- **Higher growth** in Reverse Mortgages, Home Loans and transition of Harmoney to on-balance sheet model will result in **NIM contracting**.
- However, this will drive an offsetting benefit of reduced impairment expenses, reflecting **improved lending portfolio quality**.
- Continuing to **extend best or only product reach through digital platforms**, providing **frictionless service** at each stage to provide better customer experience.
- **CTI ratio trend downwards** expected to continue, as a result of ongoing digitalisation and automation.

NPAT FOR FY2022

Noting uncertainties associated with the ongoing impacts of COVID-19, Heartland expects NPAT for FY2022 to **be in the range of $93m to $96m**.

Appendices

Appendix 1

Financial position

$m	30 June 2021	30 June 2020	Movement ($m)	Movement (%)
Liquid Assets	539	544	(5)	(0.9%)
Gross Finance Receivables	5,018	4,646	372	8.0%
Provisions	(54)	(63)	9	14.3%
Other Assets	179	190	(11)	(5.8%)
TOTAL ASSETS	**5,683**	**5,318**	**365**	**6.9%**
Retail Deposits	*3,183*	*3,264*	*(81)*	*(2.5%)*
Other Borrowings	*1,681*	*1,268*	*413*	*32.5%*
Total Funding	4,864	4,532	332	7.3%
Other Liabilities	57	86	(29)	(33.4%)
Equity	762	700	62	8.8%
TOTAL EQUITY & LIABILITIES	**5,683**	**5,318**	**365**	**6.9%**

Appendix 2

Financial performance

$m	FY2021	FY2020	Change ($)	Change (%)
Net Operating Income[1]	251.2	235.3	15.8	6.7%
Operating Expenses	117.7	106.8	10.9	10.2%
Impairment Expense	15.0	29.4	(14.4)	(49.1%)
Profit Before Tax	**118.6**	**99.1**	**19.4**	**19.6%**
Tax Expense	31.5	27.2	4.4	16.1%
Net Profit After Tax	**87.0**	**72.0**	**15.1**	**20.9%**

Net Interest Margin	4.35%	4.33%	2 bps
Cost to Income Ratio	46.8%	45.4%	1.5 pps
Return on Equity	11.9%	10.5%	144 bps
Earnings per Share	14.9 cps	12.5 cps	2.4 cps

[1] Includes fair value movements.

Appendix 3

Reconciliation of reported with underlying results

FY2021 one-offs included in the reported result are as detailed on page 5.

FY2020 one-offs included in the reported result:

- *Required accounting standard change in respect of upfront reverse mortgage income and expenses:* $2.8m recognised in other operating income and $3.3m recognised in operating expenses.
- *Net fair value gain on equity investments:* $2.1m fair value gain was recognised on Heartland's equity investment in Harmoney.
- *COVID-19 economic overlay:* $9.6m economic overlay to allow for the uncertainty created by COVID-19.

$m	FY2021	FY2020	Movement ($m)	Movement (%)
Reported NOI	251.2	235.3	15.8	6.7%
Less:				
Upfront Reverse Mortgage fees	-	(2.8)	2.8	
Net fair value gain on investments	(4.1)	(2.1)	(2.0)	
Other non-recurring items		(0.6)	0.6	
Underlying NOI	**247.1**	**229.8**	**17.3**	**7.5%**
Reported OPEX	117.7	106.8	10.9	10.2%
Less:				
Upfront Reverse Mortgage costs	-	(3.3)	3.3	
Voluntarily accelerated amortisation	(4.3)	-	(4.3)	
Aged items provision and write-off	(1.7)	-	(1.7)	
Other non-recurring items	(0.9)	(0.2)	(0.6)	
Underlying OPEX	**110.8**	**103.2**	**7.5**	**7.3%**
Reported impairment expense	15	29.4	(14.4)	(49.1%)
Less:				
COVID-19 economic overlay	-	(9.6)	9.6	
Underlying impairment expense	**15**	**19.8**	**(4.8)**	**(24.4%)**
Reported NPAT	87	72	15.1	20.9%
Less:				
Post-tax impact of one-offs	0.8	4.9	(4.1)	
Underlying NPAT	**87.9**	**76..9**	**11**	**14.3%**
Reported Average Equity	730.8	687.8	43	
Underlying Average Equity	**733.7**	**691.4**	**42**	**6.1%**
Reported CTI	46.8%	45.4%	1.5%	
Underlying CTI	**44.8%**	**44.9%**	**(0.1%)**	
Reported ROE	11.9%	10.5%	1.44%	
Underlying ROE	**12.0%**	**11.1%**	**0.86%**	

Thank you

For Heartland's FY2021 Annual Results announcement, please see shareholders.heartland.co.nz

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Results announcement

(for Equity Security issuer/Equity and Debt Security issuer)

Updated as at 17 October 2019

Results for announcement to the market		
Name of issuer	Heartland Group Holdings Limited	
Reporting Period	12 months to 30 June 2021	
Previous Reporting Period	12 months to 30 June 2020	
Currency	NZD	
	Amount (000s)	**Percentage change**
Revenue from continuing operations	$251,189	6.7%
Total Revenue	$251,189	6.7%
Net profit/(loss) from continuing operations	$87,026	20.9%
Total net profit/(loss)	$87,026	20.9%
Interim/Final Dividend		
Amount per Quoted Equity Security	$0.07000000	
Imputed amount per Quoted Equity Security	$0.02722222	
Record Date	01/09/2021	
Dividend Payment Date	15/09/2021	
	Current period	**Prior comparable period**
Net tangible assets per Quoted Equity Security	$1.16	$1.05
A brief explanation of any of the figures above necessary to enable the figures to be understood	Please refer to the audited financial statements that accompany this announcement for a further explanation of these figures.	
Authority for this announcement		
Name of person authorised to make this announcement	Andrew Dixson, Chief Financial Officer	
Contact person for this announcement	Andrew Dixson, Chief Financial Officer	
Contact phone number	09 927 9274	
Contact email address	Andrew.Dixson@heartland.co.nz	
Date of release through MAP	24/08/2021	

Audited financial statements accompany this announcement.

Financial Statements

For the year ended 30 June 2021

HEARTLAND

Contents

Financial Statements

General Information

These financial statements are issued by Heartland Group Holdings Limited (**HGH**) and its subsidiaries (the **Group**) for the year ended 30 June 2021.

Name and address for service

The Group's address for service is Level 3, Heartland House, 35 Teed Street, Newmarket, Auckland 1023.

Details of incorporation

HGH was incorporated in New Zealand under the Companies Act 1993 on 19 July 2018.

Auditor

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland 1010

Other Material Matters

There are no material matters relating to the business or affairs of the Group that are not disclosed in these consolidated financial statements which, if disclosed, would materially affect the decision of a person to subscribe for debt or equity instruments of which the Group is the issuer.

Directors

All Directors of HGH reside in New Zealand with the exception of Ellen Frances Comerford who resides in Australia. Communications to the Directors can be sent to Heartland Group Holdings Limited, Level 3, Heartland House, 35 Teed Street, Newmarket, Auckland 1023. At the time of the signing of these consolidated financial statements the Directors of HGH and their details were:

Name: Geoffrey Thomas Ricketts CNZM
Chairman - Board of Directors
Type of Director: Independent Non-Executive Director
Qualifications: LLB (Hons), LLD *(honoris causa),* CFInstD
Occupation: Company Director
External Directorships:

Janmac Capital Limited, Maisemore Enterprises Limited, MCF2 Message4U Limited, MCF3 Amplify Limited, MCF3 Green Limited, MCF3 E&P Holdco Limited, MCF 10 Limited, MCF2 (Fund 1) Limited, MCF2A General Partner Limited, MCF2 GP Limited, MCF3 GP Limited, MCF3B General Partner Limited, MCF3A General Partner Limited, MCF2 FFF-GK Limited, MCF3 Cook Limited, MCF3 TEG Limited, MCF3 Resourceco Limited, MCF3 Squiz Limited, MC Medical Properties Limited, Mercury Capital No.1 Fund Limited, Mercury Capital No. 1 Trustee Limited, Mercury Medical Holdings Limited, New Zealand Catholic Education Office Limited, NZCEO Finance Limited, O & E Group Services Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, Oceania North Limited, Oceania Securities Limited, Quartet Equities Limited.

Name: Ellen Frances Comerford
Type of Director: Independent Non-Executive Director
Qualifications: BEc
Occupation: Company Director
External Directorships:

Airtasker Limited, Comerford Gohl Holdings Pty Limited, Hollard Holdings Australia Pty Limited, Lendi Group Pty Limited, The Hollard Insurance Company Pty Limited.

Name: Sir Christopher Robert Mace KNZM
Type of Director: Independent Non-Executive Director
Qualifications: CMInstD
Occupation: Company Director
External Directorships:

Akitu Equities Limited, Akitu Capital Limited, Akitu Group Company No 1 Limited, Akitu Group Company No 2 Limited, Akitu Group Company No 3 Limited, Akitu Health Services Limited, Akitu Investments Limited, Akitu Investments No 2 Limited, Goldburn Resources Limited, Helicopter Enterprises Limited, Janik Equities Limited, Janmac Capital Limited, J N S Capital Limited, Mace Capital Limited, Mace Construction Limited, Mace Developments Limited, Mace Enterprises Limited, Mace Investments Limited, Maisemore Enterprises Limited, Nuffield Forestry Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, O & E Group Services Limited, Paroa Bay Station Limited, PPT Trustee (NZ) Limited, Quartet Equities Limited, St. Just Enterprises Limited, Te Puia Tapapa GP Limited, The Aotearoa Circle.

Name: Gregory Raymond Tomlinson
Type of Director: Non-Independent Non-Executive Director
Qualifications: AME
Occupation: Company Director
External Directorships:

Alta Cable Holdings Limited, Chippies Vineyard Limited, Indevin Group Limited, Little Ngakuta Trust Company Limited, Mountbatten Trustee Limited, Nearco Stud Limited, Oceania Healthcare Limited, Pelorus Finance Limited, St Leonards Limited, Tomlinson Group Argenta GP Limited, Tomlinson Group NZ Limited, Tomlinson Holdings Limited, Tomlinson Group Investments Limited, Tomlinson Ventures Limited.

Name: Jeffrey Kenneth Greenslade
Type of Director: Non-Independent Executive Director
Qualifications: LLB
Occupation: Chief Executive Officer of HGH
External Directorships:

Henley Family Investments Limited.

Directors' Statements

The consolidated financial statements are dated 23 August 2021 and have been signed by all the Directors.

G T Ricketts (Chair)

E F Comerford

J K Greenslade

Sir C R Mace

G R Tomlinson

Consolidated Statement of Comprehensive Income

For the year ended 30 June 2021

$000's	Note	June 2021	June 2020
Interest income	3	327,935	346,802
Interest expense	3	94,418	130,129
Net interest income		**233,517**	**216,673**
Operating lease income	4	5,004	5,946
Operating lease expense	4	3,149	4,063
Net operating lease income		**1,855**	**1,883**
Lending and credit fee income		8,090	10,811
Other income	5	3,634	3,882
Net operating income		**247,096**	**233,249**
Operating expenses	6	117,658	106,794
Profit before impaired asset expense and income tax		**129,438**	**126,455**
Fair value gain on investments		4,092	2,097
Impaired asset expense	8	14,974	29,419
Profit before income tax		**118,556**	**99,133**
Income tax expense	9	31,530	27,161
Profit for the year		**87,026**	**71,972**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss, net of income tax:			
Effective portion of change in fair value of derivative financial instruments		8,940	(2,179)
Movement in fair value reserve		(5,646)	766
Movement in foreign currency translation reserve		(68)	114
Other comprehensive income/(loss) for the year, net of income tax		**3,226**	**(1,299)**
Total comprehensive income for the year		**90,252**	**70,673**
Earnings per share			
Basic earnings per share	10	15c	12c
Diluted earnings per share	10	15c	12c

Total comprehensive income for the year is attributable to the owners of the Group.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the year ended 30 June 2021

		June 2021				June 2020			
$000's	**Note**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**
Balance at beginning of year		**576,257**	**(5,500)**	**129,223**	**699,980**	**558,970**	**(4,297)**	**120,995**	**675,668**
NZ IFRS 16 adjustment		-	-	-	-	-	-	(751)	(751)
Restated balance at beginning of year		**576,257**	**(5,500)**	**129,223**	**699,980**	**558,970**	**(4,297)**	**120,244**	**674,917**
Total comprehensive income for the year									
Profit for the year		-	-	87,026	87,026	-	-	71,972	71,972
Other comprehensive income/ (loss), net of income tax		-	3,226	-	3,226	-	(1,299)	-	(1,299)
Total comprehensive income for the year		**-**	**3,226**	**87,026**	**90,252**	**-**	**(1,299)**	**71,972**	**70,673**
Contributions by and distributions to owners									
Dividends paid	16	-	-	(37,861)	(37,861)	-	-	(62,993)	(62,993)
Dividend reinvestment plan	16	7,524	-	-	7,524	16,895	-	-	16,895
Transaction costs associated with capital raising		-	-	-	-	(28)	-	-	(28)
Share based payments		-	1,797	-	1,797	-	516	-	516
Shares vested		-	-	-	-	420	(420)	-	-
Total transactions with owners		**7,524**	**1,797**	**(37,861)**	**(28,540)**	**17,287**	**96**	**(62,993)**	**(45,610)**
Balance at end of the year		**583,781**	**(477)**	**178,388**	**761,692**	**576,257**	**(5,500)**	**129,223**	**699,980**

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Consolidated Statement of Financial Position

As at 30 June 2021

$000's	Note	June 2021	June 2020
Assets			
Cash and cash equivalents		182,333	147,179
Investments	11	377,823	413,340
Investment properties		11,832	11,132
Derivative financial instruments	12	14,139	17,246
Finance receivables	13	3,288,466	3,045,195
Finance receivables - reverse mortgages	13	1,676,073	1,538,585
Operating lease vehicles	14	10,865	17,603
Right of use assets	18	15,985	18,362
Other assets	18	16,815	19,558
Intangible assets	18	69,165	72,813
Deferred tax asset	9	14,117	17,123
Total assets		**5,677,613**	**5,318,136**
Liabilities			
Deposits	15	3,183,454	3,264,192
Other borrowings	15	1,675,133	1,267,931
Tax liabilities		7,440	12,303
Derivative financial instruments	12	4,802	17,012
Lease liabilities	18	18,166	20,456
Trade and other payables	18	26,926	36,262
Total liabilities		**4,915,921**	**4,618,156**
Equity			
Share capital	16	583,781	576,257
Retained earnings and reserves		177,911	123,723
Total equity		**761,692**	**699,980**
Total equity and liabilities		**5,677,613**	**5,318,136**

Total interest earning and discount bearing assets		5,432,181	5,114,348
Total interest and discount bearing liabilities		4,840,310	4,518,174

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 30 June 2021

$000's	Note	June 2021	June 2020
Cash flows from operating activities			
Interest received		233,447	258,665
Operating lease income received		5,046	5,934
Lending, credit fees and other income received		4,625	16,037
Operating inflows		**243,118**	**280,636**
Interest paid		(85,058)	(117,313)
Payments to suppliers and employees		(97,205)	(92,861)
Taxation paid		(34,004)	(24,619)
Operating outflows		**(216,267)**	**(234,793)**
Net cash flows from operating activities before changes in operating assets and liabilities		**26,851**	**45,843**
Proceeds from sale of operating lease vehicles		6,821	4,969
Purchase of operating lease vehicles		(1,788)	(9,938)
Net movement in finance receivables		(296,754)	(171,617)
Net movement in deposits		(74,608)	110,993
Net cash flows (applied to) operating activities[1]		**(339,478)**	**(19,750)**
Cash flows from investing activities			
Sale of property, plant and equipment and intangible assets		-	118
Total cash provided from investing activities		**-**	**118**
Purchase of property, plant and equipment and intangible assets		(7,562)	(6,739)
Net decrease/(increase) in investments		23,276	(45,562)
Total cash from/(applied to) investing activities		**15,714**	**(52,301)**
Net cash flows from/(applied to) investing activities		**15,714**	**(52,183)**
Cash flows from financing activities			
Net increase in wholesale funding		309,680	85,795
Proceeds from issue of Unsubordinated Notes		81,801	106,952
Total cash provided from financing activities		**391,481**	**192,747**
Dividends paid	16	(30,337)	(46,098)
Payment of lease liabilities		(2,226)	(2,005)
Transaction costs associated with capital raising		-	(28)
Total cash (applied to) financing activities		**(32,563)**	**(48,131)**
Net cash flows from financing activities		**358,918**	**144,616**
Net increase in cash held		**35,154**	**72,683**
Opening cash and cash equivalents		147,179	74,496
Closing cash and cash equivalents		**182,333**	**147,179**

[1]Cash flows from operating activities do not include cash flows from wholesale funding which are included as part of financing activities.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Consolidated Statement of Cash Flows (Continued)

For the year ended 30 June 2021

Reconciliation of profit after tax to net cash flows from operating activities

$000's	Note	June 2021	June 2020
Profit for the year		**87,026**	**71,972**
Add/(less) non-cash items:			
Depreciation and amortisation expense		14,615	9,161
Depreciation on lease vehicles	14	2,801	3,634
Capitalised net interest income and fee income		(68,755)	(77,429)
Impaired asset expense	8	14,974	29,419
Investment fair value movement		(4,092)	(2,097)
Other non-cash items		(24,538)	2,488
Total non-cash items		**(64,995)**	**(34,824)**
Add/(less) movements in operating assets and liabilities:			
Finance receivables		(296,754)	(171,617)
Operating lease vehicles		5,033	(4,969)
Other assets		3,448	9,528
Current tax		(4,863)	4,771
Derivative financial instruments		(163)	931
Deferred tax		3,006	(7,592)
Deposits		(74,608)	110,993
Other liabilities		3,392	1,057
Total movements in operating assets and liabilities		**(361,509)**	**(56,898)**
Net cash flows applied to operating activities[1]		**(339,478)**	**(19,750)**

[1]Cash flows from operating activities do not include cash flows from wholesale funding which are included as part of financing activities.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

KPMG

1 Financial statements preparation

Reporting entity

The financial statements presented are the consolidated financial statements comprising Heartland Group Holdings Limited (**HGH)** and its subsidiaries (the **Group**). Refer Note 25 – Significant subsidiaries for further details.

As at 30 June 2021, HGH is a company incorporated in New Zealand under the Companies Act 1993 and a Financial Market Conduct (**FMC**) reporting entity for the purposes of the Financial Markets Conduct Act 2013.

Basis of preparation

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**) and the New Zealand's Exchange (**NZX**) Main Board Listing Rules and the Australian Securities Exchange (**ASX**) Listing Rules. The financial statements comply with New Zealand equivalents to International Financial Reporting Standards (**NZ IFRS**) and other applicable Financial Reporting Standards as appropriate for profit-oriented entities. The financial statements also comply with International Financial Reporting Standards (**IFRS**) as issued by the International Accounting Standards Board.

The financial statements are presented in New Zealand dollars which is the Group's functional and presentation currency. Unless otherwise indicated, amounts are rounded to the nearest thousand dollars.

The financial statements have been prepared on a going concern basis after considering the Group's funding and liquidity position.

The accounting policies adopted have been applied consistently throughout the periods presented in these financial statements.

Certain comparative balances have been reclassified to align with the presentation used in the current financial year. These reclassifications have no impact on the overall financial performance or financial position of the comparative year.

Basis of measurement

The financial statements have been prepared on the basis of historical cost, except for certain financial instruments and investment properties, which are measured at their fair values as identified in the accounting policies set out in the accompanying notes to the financial statements.

Principles of consolidation

The consolidated financial statements of the Group incorporate the assets, liabilities and results of all controlled entities. Controlled entities are all entities in which the Group is exposed to, or has rights to, variable returns from its involvement with the entities and has the ability to affect those returns through its power over the entities. Intercompany transactions, balances and any unrealised income and expense (except for foreign currency translation gains or losses) between controlled entities are eliminated.

Assets and liabilities in a transactional currency that is not the New Zealand dollar, are translated at the exchange rates ruling at balance date. Revenue and expense items are translated at the average rate at the balance date. Exchange differences are taken to the consolidated statement of comprehensive income.

1 Financial statements preparation (continued)

Changes in accounting standards

Accounting standards issued and effective

There have been no changes to accounting policies or other new or amended standards that are issued and effective that are expected to have a material impact on the Group.

Accounting standards issued but not yet effective

NZ IFRS 17 Insurance Contracts was issued in July 2017 and is applicable to general and life insurance contracts. NZ IFRS 17 will replace NZ IFRS 4 Insurance Contracts. In March 2020, the effective date of NZ IFRS 17 was deferred by one year. As such the standard will be effective for the Group's reporting for the financial year ending 30 June 2024, including 30 June 2023 comparatives.

MARAC Insurance Limited (**MIL**), a subsidiary of Heartland Bank Limited (**HBL**), no longer conducts insurance business as HBL entered into a distribution agreement with DPL Insurance Limited (**DPL**) to distribute DPL's insurance products through HBL's network. MIL stopped writing insurance policies in the prior year with the last policies expected to expire in 2025.

Other amendments to existing standards that are not yet effective are not expected to have a material impact on the Group.

Estimates and judgements

The preparation of the Group's consolidated financial statements requires the use of estimates and judgements. This note provides an overview of the areas that involve a higher degree of judgement or complexity. Detailed information about each of these estimates and judgements is included in the relevant notes together with the basis of calculation for each affected item in the financial statements.

- Provisions for impairment - The effect of credit risk is quantified based on the Group's best estimate of future cash repayments and proceeds from any security held or by reference to risk profile groupings, historical loss data and forward-looking information. Refer to Note 8 - Impaired asset expense, and Note 13 - Finance receivables for further details.
- Investment in equity securities - Judgements have been applied in techniques to determine the fair value of Harmoney equity securities to reflect the underlying characteristics. Refer to Note 20 - Fair value for further details.
- Fair value of reverse mortgages - Fair value is quantified by the transaction price and the Group's subsequent best estimate of the risk profile of the reverse mortgage portfolio. Refer to Note 20 - Fair value for further details.
- Goodwill - Determining the fair value of assets and liabilities of acquired businesses requires the Group to exercise judgement. The carrying value of goodwill is tested annually for impairment, refer to Note 18 - Other balance sheet items.

Assumptions made at each reporting date (e.g. the calculation of the provision for impairment and fair value adjustments) are based on best estimates as at that date. Although the Group has internal controls in place to ensure that estimates can be reliably measured, actual amounts may differ from these estimates. The estimates and judgements used in the preparation of the Group's financial statements are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity. Revisions to accounting estimates are recognised in the reporting period in which the estimates are revised and in any future periods affected.

1 Financial statements preparation (continued)

COVID-19 pandemic - impact on estimates and judgements

The COVID-19 pandemic resulted in the Group adopting an economic overlay for expected credit losses (**ECL**) to its portfolios as at 30 June 2020 of pre-tax $9.6 million in response to the uncertain but potential economic impact of COVID-19 on HBL's borrowers (**COVID Overlay**). The COVID Overlay was sized based on a range of techniques including stress testing, benchmarking, scenario analysis and expert judgement.

To date, the impact of COVID-19 on HBL's borrowers has been more benign than was initially forecast, and the COVID Overlay has not been utilised. However, the continued prevalence of COVID-19 in other countries (including the emergence of new variants), together with vaccination rates and border closures provides an ongoing risk of further economic disruption in New Zealand. Furthermore, Government stimulus has given rise to the potential for inflationary pressures, a steepening interest rate environment, and a higher cost of labour and inputs in the medium term.

Management notes the uncertainties associated with the ongoing economic impacts of COVID-19 and consequently have decided to retain the COVID Overlay in full at this stage.

The accounting judgement that is most impacted by the COVID Overlay is the ECL on finance receivables at amortised cost. The Group measures the allowance for ECL using an ECL impairment model in compliance with NZ IFRS 9 Financial Instruments.

The estimates and judgements considered to apply the COVID Overlay adequately in the ECL on finance receivables at amortised cost is further discussed in Note 8 Impaired asset expense.

1 Financial statements preparation (continued)

Financial assets and liabilities

Financial Assets

Financial assets are classified based on:

- The business model within which the assets are managed; and
- Whether the contractual cash flows of the instrument represent solely payment of principal and interest (**SPPI**).

The Group determines the business model at the level that reflects how groups of financial assets are managed. When assessing the business model, the Group considers factors including how performance and risks are managed, evaluated and reported and the frequency and volume of, and reason for sales in previous periods.

Financial assets are classified into the following measurement categories:

Financial Assets	Measurement Category	Note
Bank bonds and floating rate notes	Fair value through other comprehensive income (**FVOCI**)	11
Public sector securities and corporate bonds	FVOCI	11
Equity investments	Fair value through profit or loss (**FVTPL**)	11
Finance receivables – reverse mortgages	FVTPL	13
Finance receivables	Amortised cost	13

Financial assets measured at amortised cost
Financial assets are measured at amortised cost if they are held within a business model whose objective is achieved through holding the financial asset to collect contractual cash flows which represent SPPI on the principal balance.

Financial assets at amortised cost are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

Financial assets measured at FVOCI
Financial assets are measured at FVOCI if they are held within a business model whose objective is achieved both through collecting contractual cash flows which represent SPPI on the principal balance or selling the financial asset.

Financial assets at FVOCI are measured at fair value with unrealised gains and losses recognised in other comprehensive income except for interest income, impairment charges and foreign exchange gains and losses, which are recognised in profit or loss.

1 Financial statements preparation (continued)

Financial Assets (continued)

Financial assets measured at FVTPL
Financial assets are measured at FVTPL if:

- They are held within a business model whose objective is achieved through selling or repurchasing the financial asset in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or
- They are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

Financial assets at FVTPL are measured at fair value with subsequent changes in fair value recognised in profit or loss.

Financial Liabilities

Financial liabilities are classified into the following measurement categories:

- Those to be measured at amortised cost;
- Those to be measured at FVTPL.

Financial liabilities measured at amortised cost
Financial liabilities are measured at amortised cost if they are not held for trading or not designated at FVTPL.

Financial liabilities measured at amortised cost are accounted for using the effective interest rate method.

Financial liabilities measured at FVTPL
Financial liabilities are measured at FVTPL if:

- They are held for trading whose principal objective is achieved through selling or repurchasing the financial liability in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or
- They are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

Financial liabilities at FVTPL are measured at fair value with subsequent changes in fair value recognised in profit or loss.

Further details of the accounting policy for each category of financial asset or financial liability mentioned above is set out in the note for the relevant item.

The Group's policies for determining the fair value of financial assets and financial liabilities are set out in Note 20 - Fair value.

Recognition

The Group initially recognises finance receivables and borrowings on the date that they are originated. All other financial assets and liabilities (including assets and liabilities designated at FVTPL) are initially recognised on the trade date at which the Group becomes a party to the contractual provisions of the instrument.

1 Financial statements preparation (continued)

Derecognition

The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognised as a separate asset.

The Group enters into transactions whereby it transfers assets recognised on its consolidated statement of financial position, but retains either all risks or rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the consolidated statement of financial position. Transfers of assets with the retention of all or substantially all risks and rewards include, for example, securitised assets and repurchase transactions.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, the exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, with the difference in the respective carrying amounts recognised in profit or loss.

Offsetting financial instruments

The Group offsets financial assets and financial liabilities and reports the net balance in the balance sheet where there is currently a legally enforceable right to set off and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Performance

2 Segmental analysis

Segment information is presented in respect of the Group's operating segments which are those used for the Group's management and internal reporting structure.

Operating segments

The Group operates within New Zealand and Australia and comprises the following main operating segments:

Motor	Motor vehicle finance.
Reverse mortgages	Reverse mortgage lending in New Zealand.
Other personal	A range of financial services - including term, transactional and personal loans to individuals.
Business	Term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized businesses.
Rural	Specialist financial services to the farming sector primarily offering livestock finance, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.
Australia	Reverse mortgage lending and other financial services within Australia.

Certain operating expenses, such as premises, IT, support centre costs and tax expense are not allocated to operating segments and are included in Other. Finance receivables are allocated across the operating segments as assets and liabilities are managed centrally and therefore are not allocated across the operating segments.

The Group's operating segments are different from the industry categories detailed in Note 22 - Credit risk exposure. The operating segments are primarily categorised by sales channel, whereas Note 22 - Credit risk exposure categorises exposures based on credit risk concentrations.

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Australia	Other	Total
June 2021								
Net interest income	65,829	22,257	12,073	63,898	30,579	39,348	(467)	233,517
Net other income	3,343	2,143	1,946	2,723	881	2,684	(141)	13,579
Net operating income	**69,172**	**24,400**	**14,019**	**66,621**	**31,460**	**42,032**	**(608)**	**247,096**
Operating expenses	3,787	4,284	6,833	11,340	2,124	12,390	76,900	117,658
Profit/(loss) before impaired asset expense and income tax	**65,385**	**20,116**	**7,186**	**55,281**	**29,336**	**29,642**	**(77,508)**	**129,438**
Fair value gain on investment	-	-	-	-	700	-	3,392	4,092
Impaired asset expense	5,298	-	2,081	5,649	1,649	297	-	14,974
Profit/(loss) before income tax	**60,087**	**20,116**	**5,105**	**49,632**	**28,387**	**29,345**	**(74,116)**	**118,556**
Income tax expense	-	-	-	-	-	-	31,530	31,530
Profit/(loss) for the year	**60,087**	**20,116**	**5,105**	**49,632**	**28,387**	**29,345**	**(105,646)**	**87,026**
Total assets	**1,287,978**	**601,505**	**137,910**	**1,225,710**	**586,318**	**1,149,610**	**688,582**	**5,677,613**
Total liabilities								**4,915,921**

2 Segmental analysis (continued)

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Australia	Other	Total
June 2020								
Net interest income	56,957	20,118	18,365	57,950	29,674	30,127	3,482	216,673
Net other income	3,622	3,430	3,055	3,465	1,028	4,214	(2,238)	16,576
Net operating income	**60,579**	**23,548**	**21,420**	**61,415**	**30,702**	**34,341**	**1,244**	**233,249**
Operating expenses	3,248	4,804	6,776	11,283	2,648	11,680	66,355	106,794
Profit/(loss) before impaired asset expense and income tax	**57,331**	**18,744**	**14,644**	**50,132**	**28,054**	**22,661**	**(65,111)**	**126,455**
Fair value gain on investment	-	-	-	-	-	-	2,097	2,097
Impaired asset expense/ (benefit)	10,160	-	11,119	10,110	(1,970)	-	-	29,419
Profit/(loss) before income tax	**47,171**	**18,744**	**3,525**	**40,022**	**30,024**	**22,661**	**(63,014)**	**99,133**
Income tax expense	-	-	-	-	-	-	27,161	27,161
Profit/(loss) for the year	**47,171**	**18,744**	**3,525**	**40,022**	**30,024**	**22,661**	**(90,175)**	**71,972**
Total assets	**1,125,295**	**559,934**	**214,759**	**1,126,632**	**604,938**	**979,496**	**707,082**	**5,318,136**
Total liabilities								**4,618,156**

3 Net interest income

Policy

Interest income and expense on financial instruments is measured using the effective interest rate method that discounts the financial instruments' future cash flows to their present value and allocates the interest income or expense over the life of the financial instrument. The effective interest rate is established on initial recognition of the financial assets or liabilities and is not subsequently revised. For financial instruments at amortised cost, the calculation of the effective interest rate includes all yield related fees and commissions paid or received that are an integral part of the underlying financial instrument.

$000's	June 2021	June 2020
Interest income		
Cash and cash equivalents	119	499
Investments	6,979	8,496
Finance receivables	232,845	250,606
Finance receivables - reverse mortgages	87,992	87,201
Total interest income	**327,935**	**346,802**
Interest expense		
Deposits	55,273	90,739
Other borrowings	35,609	35,888
Net interest expense on derivative financial instruments	3,536	3,502
Total interest expense	**94,418**	**130,129**
Net interest income	**233,517**	**216,673**

4 Net operating lease income

Policy

As a lessor, the Group retains substantially all the risks and rewards incidental to ownership of the assets and therefore classifies the leases as operating leases. Rental income and expense from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term. Profits on the sale of operating lease assets are included as part of operating lease income. Current year depreciation and losses on the sale of operating lease assets are included as part of operating lease expenses. The leased assets are depreciated over their useful lives on a basis consistent with similar assets.

$000's	June 2021	June 2020
Operating lease income		
Lease income	3,908	5,194
Gain on disposal of lease assets	1,096	752
Total operating lease income	**5,004**	**5,946**
Operating lease expense		
Depreciation on lease assets	2,801	3,634
Direct lease costs	348	429
Total operating lease expense	**3,149**	**4,063**
Net operating lease income	**1,855**	**1,883**

5 Other income

Policy

Rental income from investment property

Rental income from investment properties is recognised on a straight-line basis over the term of the relevant lease.

Insurance income

Insurance premium income and commission expense are recognised in profit or loss from the date of attachment of the risk over the period of the insurance contract. Claim expense is recognised in the profit or loss on an accrual basis once our liability to the policyholder has been confirmed under the terms of the contract.

$000's	June 2021	June 2020
Rental income from investment properties	1,055	1,125
Insurance income	1,096	1,610
Gain on sale of investments	157	-
Other income	1,117	774
FX gain	209	373
Total other income	**3,634**	**3,882**

6 Operating expenses

Policy

Operating expenses are recognised as the underlying service is rendered or over a period in which an asset is consumed or a liability is incurred.

$000's	**June 2021**	**June 2020**
Personnel expenses	61,476	54,511
Directors' fees	1,129	1,059
Superannuation	1,535	1,069
Depreciation - property, plant and equipment	2,995	2,380
Legal and professional fees	2,876	3,615
Advertising and public relations	5,138	6,729
Depreciation - right of use asset	2,312	2,324
Technology services	7,262	6,372
Telecommunications, stationery and postage	1,843	1,886
Customer acquisition costs	6,982	7,419
Amortisation of intangible assets	9,308	4,456
Other operating expenses[1]	14,802	14,974
Total operating expenses	**117,658**	**106,794**

[1]Other operating expenses include compensation of auditor which is further disclosed in Note 7.

7 Compensation of auditor

$000's	**June 2021**	**June 2020**
Audit and review of the financial statements[1]	790	774
Other assurance services paid to auditor[2]	103	133
Total compensation of auditor	**893**	**907**

[1] Audit and review of the financial statements includes fees paid for both the audit of the annual financial statements and the review of the interim financial statements.

[2] Other assurance services paid to auditor comprise regulatory assurance services, agreed upon procedures engagements and supervisor reporting.

8 Impaired asset expense

Policy

Impairment of finance receivables

At each reporting date, the Group applies a three stage approach to measuring ECL to finance receivables not carried at fair value. The ECL model assesses whether there has been a significant increase in credit risk since initial recognition.

The ECL model is a forward looking model where impairment allowances are recognised before losses are actually incurred. On initial recognition, an impairment allowance is required, based on events that are possible in the next 12 months.

Assets may migrate through the following stages based on their change in credit quality:

Stage 1 - 12 months ECL (past due 30 days or less)

Where there has been no evidence of increased credit risk since initial recognition, and finance receivables are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

Stage 2 - Lifetime ECL not credit impaired (greater than 30 but less than 90 days past due)

Where there has been a significant increase in credit risk.

Stage 3 - Lifetime ECL credit impaired (90 days past due or more)

Objective evidence of impairment, so are considered to be in default or otherwise credit impaired.

In determining whether credit risk has increased all available information relevant to the assessment of economic conditions at the reporting date are taken into consideration. To do this the Group considers its historical loss experience and adjusts this for current observable data. In addition to this the Group uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. Future economic conditions consider macroeconomic factors such as unemployment, interest rate, gross domestic product, and inflation, and requires an evaluation of both the current and forecast direction of the economic cycle. The methodology and assumptions including any forecasts of future economic conditions are reviewed regularly as incorporating forward-looking information increases the level of judgement as to how changes in these macroeconomic factors will affect the ECL.

The calculation of ECL is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

For assets that are individually assessed for ECL, the allowance for ECL is calculated directly as the difference between the defaulted assets carrying value and the recoverable amount (being the present value of expected future cash flows, including cash flows from the realisation of collateral or guarantees, where applicable).

$000's	**June 2021**	**June 2020**
Non-securitised		
Individually impaired asset expense	9,131	3,385
Collectively impaired asset expense	6,001	25,637
Total non-securitised impaired asset expense	**15,132**	**29,022**
Securitised		
Collectively impaired asset expense	(158)	397
Total securitised impaired asset expense	**(158)**	**397**
Total		
Individually impaired asset expense	9,131	3,385
Collectively impaired asset expense	5,843	26,034
Total impaired asset expense	**14,974**	**29,41**

8 Impaired asset expense (continued)

The Group's models for estimating ECL for each of its portfolios are based on the historic credit experience of those portfolios. The models assume that economic conditions (such as GDP growth, unemployment rates, and house price index forecasts) remain static over time. If the Group forecasts that economic conditions may change in the foreseeable future, the Group applies judgement to determine whether the modelled output should be subject to an economic overlay. Judgment is required because analysis has been unable to establish any clear correlation between key economic indicators and the credit performance of the Group's unique portfolios.

The onset of COVID-19 caused a deterioration in economic conditions, creating uncertainty regarding the impact on HBL's borrowers over and above the modelled ECL. Accordingly, a COVID Overlay was sized based on a range of techniques (including stress testing, benchmarking, scenario analysis and expert judgement) and adopted by the Group.

The COVID-19 Overlay has not been utilised at this stage. Despite forecasts showing improvements in the economic conditions, new variants of COVID-19 have emerged and vaccination strategies are varied and as yet unproven across a sufficient population. Furthermore, Government stimulus has given rise to the potential for inflationary pressures, a steepening interest rate environment, and a higher cost of labour in the medium term. Management considers that sufficient uncertainty remains such that the COVID Overlay should be retained in full at this stage.

9 Taxation

Policy

Income tax

Income tax expense for the year comprises current tax and movements in deferred tax balances, including any adjustment required for prior years' tax expense. Income tax expense is recognised in profit and loss except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in equity or other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to the tax payable or receivable in respect of previous years. Current tax for current and prior years is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. As required by NZ IAS 12 Income Taxes, a deferred tax asset is recognised only to the extent that it is probable that a future taxable profit will be available to realise the asset.

Goods and services tax (GST)

Revenues, expenses and assets are recognised net of GST. As the Group is predominantly involved in providing financial services, only a proportion of GST paid on inputs is recoverable. The non-recoverable proportion of GST is treated as an expense or, if relevant, as part of the cost of acquisition of an asset.

Income tax expense

$000's	June 2021	June 2020
Income tax recognised in profit or loss		
Current tax		
Current year	30,584	30,868
Adjustments for prior year	(1,854)	1,834
Tax other rates	426	335
Deferred tax		
Current year	1,283	(3,568)
Adjustments for prior year	1,145	(2,289)
Tax other rates	(54)	(19)
Total income tax expense recognised in profit or loss	**31,530**	**27,161**
Income tax recognised in other comprehensive income		
Current tax		
Derivatives at fair value reserve	(2,197)	768
Fair value movements of cash flow hedge	3,457	(1,477)
Total income tax expense recognised in other comprehensive income	**1,260**	**(709)**

Reconciliation of effective tax rate:

$000's	June 2021	June 2020
Profit before income tax	**118,556**	**99,133**
Tax at New Zealand income tax rate of 28%	33,196	27,757
Higher tax rate for overseas jurisdiction	372	316
Adjusted tax effect of items not taxable/deductible	(1,330)	(457)
Adjustments for prior year	(708)	(455)
Total income tax expense	**31,530**	**27,161**

9 Taxation (continued)

Deferred tax assets comprise the following temporary differences:

$000's	June 2021	June 2020
Employee expenses	1,647	1,942
Share based payment	503	692
Provision for impairment	15,097	17,739
Intangibles and property, plant and equipment	(3,816)	(4,576)
Deferred acquisition costs	(475)	(936)
Operating lease vehicles	479	731
Other temporary differences	682	1,531
Total deferred tax assets	**14,117**	**17,123**
Opening balance of deferred tax assets	**17,123**	**9,531**
Movement recognised in profit or loss	(3,006)	7,336
Movement recognised in retained earnings	-	256
Closing balance of deferred tax assets	**14,117**	**17,123**

Imputation credit account

$000's	June 2021	June 2020
Imputation credit account	19,990	5,676

10 Earnings per share

	June 2021			June 2020		
	Earnings Per Share Cents	Net Profit After Tax $000's	Weighted Average No. of Shares 000's	Earnings Per Share Cents	Net Profit After Tax $000's	Weighted Average No. of Shares 000's
Basic earnings	15	87,026	583,467	12	71,972	576,929
Diluted earnings	15	87,026	583,467	12	71,972	576,929

KPMG

Financial Position

11 Investments

Policy
Investments are classified into one of the following categories:

Fair value through profit or loss
Investments under this category include equity investments and are measured at fair value plus transaction costs. Changes in fair value of these investments are recognised in profit or loss in the period in which they occur.

Fair value through other comprehensive income
Investments under this category include bank bonds, floating rate notes, local authority stock, public securities and corporate bonds. These are initially measured at fair value, including transaction costs, and subsequently carried at fair value. Changes in fair value of these investments are recognised in other comprehensive income and presented within the fair value reserve.

Amortised cost
Investments under this category include bank deposits and are measured using effective interest rate method. They are held to collect contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

$000's	June 2021	June 2020
Bank deposits, bank bonds and floating rate notes	351,613	366,289
Public sector securities and corporate bonds	5,543	30,716
Equity investments	20,667	16,335
Total investments	**377,823**	**413,340**

Refer to Note 20 - Fair value for details of the split between investments measured at fair value through profit or loss, fair value through other comprehensive income and amortised cost.

12 Derivative financial instruments

Policy
The Group uses derivatives for risk management purposes. Derivatives held for risk management purposes include hedges that either meet the hedge accounting requirements set out in NZ IAS 39, or economic hedges not placed into an accounting hedge relationship.

Derivatives are recognised at their fair value, with the derivatives being carried as assets when their fair value is positive and as liabilities when their fair value is negative.

A hedged item is an asset, liability, firm commitment or highly probable forecast transaction that exposes the Group to risk of changes in fair value or cash flows, and that is designated as being hedged. The Group applies fair value hedge accounting to hedge movements in the value of fixed interest rate assets and liabilities subject to interest rate risk. The Group applies cash flow hedge accounting to hedge the variability in highly probable forecast future cash flows attributable to interest rate risk on variable rate assets and liabilities.

Fair value hedge accounting
The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments or counterparty must be a third party external to the Group.

12 Derivative financial instruments (continued)

The Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value of hedged items.

Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify for fair value hedge accounting are recorded through profit or loss alongside any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

Where the hedged item is carried at amortised cost, the movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to carrying amount of a hedged item carried at amortised cost is amortised to the consolidated statement of comprehensive income on an effective yield basis over the remaining period to maturity of the hedged item. Where a hedged item carried at amortised cost is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the consolidated statement of comprehensive income.

Cash flow hedge accounting
The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments or counterparty must be a third party external to the Group.

The Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

A fair value gain or loss associated with the effective portion of a derivative designated as a cash flow hedge is recognised initially in the hedging reserve. The ineffective portion of a fair value gain or loss is recognised immediately in the consolidated statement of comprehensive income.

When a hedging derivative expires or is sold, the hedge no longer meets the criteria for hedge accounting, or the Group elects to revoke the hedge designation, the cumulative gain or loss on the hedging derivative remains in the cash flow hedging reserve until the forecast transaction occurs and affects income, at which point it is transferred to the corresponding income or expense line. If a forecast transaction is no longer expected to occur, the cumulative gain or loss on the hedging derivative previously reported in the cash flow hedging reserve is immediately transferred to the consolidated statement of comprehensive income.

12 Derivative financial instruments (continued)

	June 2021			June 2020		
$000's	**Notional Principal**	**Fair Value Assets**	**Fair Value Liabilities**	**Notional Principal**	**Fair Value Assets**	**Fair Value Liabilities**
Held for risk management						
Interest rate related contracts						
Swaps	1,121,179	14,122	4,533	1,140,422	17,238	16,938
Foreign currency related contracts						
Forwards	69,525	17	269	237,900	8	74
Total derivative financial instruments	**1,190,704**	**14,139**	**4,802**	**1,378,322**	**17,246**	**17,012**

The Group has entered into credit support annexes (**CSAs**) which form a part of International Swaps and Derivatives Association (**ISDA**) Master Agreement, in respect of certain exposures relating to derivative transactions. As per these CSAs, the Group or the counterparty needs to collateralise the market value of outstanding derivative transactions. As at 30 June 2021, the Group has received $4.09 million of cash collateral (2020: nil) and advanced $0.59 million of cash collateral (2020: nil) against derivative assets and liabilities respectively. The cash collateral received or advanced is not netted off against the balance of derivative assets and derivative liabilities disclosed in the consolidated statement of financial position.

13 Finance receivables

(a) Finance receivables held at amortised cost

Policy

Finance receivables are initially recognised at fair value plus incremental direct transaction costs and are subsequently measured at amortised cost using the effective interest method, less any impairment loss.

Fees and direct costs relating to loan origination, financing and loan commitments are deferred and amortised to interest income over the life of the loan using the effective interest rate method. Lending fees not directly related to the origination of a loan are recognised over the period of service.

Past due but not impaired assets are any assets which have not been operated by the counterparty within their key terms but are not considered to be impaired by the Group.

Individually impaired assets are those loans for which the Group has evidence that it will incur a loss, and will be unable to collect all principal and interest due according to the contractual terms of the loan.

In determining whether credit risk has increased all available information relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date are taken into consideration.

The calculation of ECL is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

13 Finance receivables (continued)

(a) Finance receivables held at amortised cost (continued)

$000's	June 2021	June 2020
Non-securitised		
Neither at least 90 days past due nor impaired	3,140,489	2,945,858
At least 90 days past due	36,882	58,876
Individually impaired	38,143	24,667
Gross finance receivables	**3,215,515**	**3,029,401**
Less provision for impairment	(53,448)	(62,272)
Total non-securitised finance receivables	**3,162,067**	**2,967,129**
Securitised		
Neither at least 90 days past due nor impaired	126,638	78,059
At least 90 days past due	-	404
Individually impaired	-	-
Gross finance receivables	**126,638**	**78,463**
Less provision for impairment	(239)	(397)
Total securitised finance receivables	**126,399**	**78,066**
Total		
Neither at least 90 days past due nor impaired	3,267,128	3,023,917
At least 90 days past due	36,882	59,280
Individually impaired	38,143	24,667
Gross finance receivables	**3,342,153**	**3,107,864**
Less provision for impairment	(53,687)	(62,669)
Total finance receivables	**3,288,466**	**3,045,195**

13 Finance receivables (continued)

(a) Finance receivables held at amortised cost (continued)

Movement in provision

The following table details the movement from the opening balance to the closing balance of the provision for impairment losses by class.

$000's	12 - Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2021					
Non-securitised					
Impairment allowance as at 30 June 2020	**32,160**	**2,143**	**22,668**	**5,301**	**62,272**
Changes in loss allowance					
Transfer between stages	(2,485)	(1,090)	(22)	3,597	-
New and increased provision (net of collective provision releases)	(3,207)	1,329	13,715	6,034	17,871
Recovery of amounts written off	-	-	(2,739)	-	(2,739)
Credit impairment charge	**(5,692)**	**239**	**10,954**	**9,631**	**15,132**
Recovery of amounts previously written off	-	-	2,739	-	2,739
Write offs	-	-	(19,729)	(7,303)	(27,032)
Effect of changes in foreign exchange rate	(10)	1	3	-	(6)
Acquisition of portfolio	133	22	188	-	343
Impairment allowance as at 30 June 2021	**26,591**	**2,405**	**16,823**	**7,629**	**53,448**
Securitised					
Impairment allowance as at 30 June 2020	**260**	**23**	**114**	**-**	**397**
Changes in loss allowance					
Transfer between stages	(4)	(3)	7	-	-
New and increased provision (net of collective provision releases)	(40)	2	(120)	-	(158)
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**(44)**	**(1)**	**(113)**	**-**	**(158)**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Impairment allowance as at 30 June 2021	**216**	**22**	**1**	**-**	**239**
Total					
Impairment allowance as at 30 June 2020	**32,420**	**2,166**	**22,782**	**5,301**	**62,669**
Changes in loss allowance					
Transfer between stages	(2,489)	(1,093)	(15)	3,597	-
New and increased provision (net of collective provision releases)	(3,247)	1,331	13,595	6,034	17,713
Recovery of amounts written off	-	-	(2,739)	-	(2,739)
Credit impairment charge	**(5,736)**	**238**	**10,841**	**9,631**	**14,974**
Recovery of amounts previously written off	-	-	2,739	-	2,739
Write offs	-	-	(19,729)	(7,303)	(27,032)
Effect of changes in foreign exchange rate	(10)	1	3	-	(6)
Acquisition of portfolio	133	22	188	-	343
Impairment allowance as at 30 June 2021	**26,807**	**2,427**	**16,824**	**7,629**	**53,687**

13 Finance receivables (continued)

(a) Finance receivables held at amortised cost (continued)

Movement in provision (continued)

$000's	12 - Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2020					
Non-securitised					
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Changes in loss allowance					
Transfer between stages	(1,190)	(294)	(109)	1,593	-
New and increased provision (net of collective provision releases)	2,901	2,090	25,047	1,792	31,830
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**1,711**	**1,796**	**22,130**	**3,385**	**29,022**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,705)	(5,947)	(28,090)
Effect of changes in foreign exchange rate	27	4	10	-	41
Impairment allowance as at 30 June 2020	**32,160**	**2,143**	**22,668**	**5,301**	**62,272**
Securitised					
Impairment allowance as at 30 June 2019	**-**	**-**	**-**	**-**	**-**
Changes in loss allowance					
Transfer between stages	(19)	11	8	-	-
New and increased provision (net of collective provision releases)	279	12	106	-	397
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**260**	**23**	**114**	**-**	**397**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Impairment allowance as at 30 June 2020	**260**	**23**	**114**	**-**	**397**
Total					
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Changes in loss allowance					
Transfer between stages	(1,209)	(283)	(101)	1,593	-
New and increased provision (net of collective provision releases)	3,180	2,102	25,153	1,792	32,227
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**1,971**	**1,819**	**22,244**	**3,385**	**29,419**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,705)	(5,947)	(28,090)
Effect of changes in foreign exchange rate	27	4	10	-	41
Impairment allowance as at 30 June 2020	**32,420**	**2,166**	**22,782**	**5,301**	**62,669**

13 Finance receivables (continued)

(a) Finance receivables held at amortised cost (continued)

Impact of changes in gross finance receivables held at amortised cost on allowance for ECL

$000's	12 - month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2021					
Gross finance receivables as at 30 June 2020	2,826,208	183,260	73,729	24,667	3,107,864
Transfer between stages	(103,233)	67,419	13,314	22,499	-
Additions	1,435,408	-	-	955	1,436,363
Deletions	(1,065,730)	(84,886)	(20,337)	(466)	(1,171,419)
Write offs	-	-	(21,142)	(9,512)	(30,655)
Gross finance receivables as at 30 June 2021	**3,092,653**	**165,793**	**45,564**	**38,143**	**3,342,153**
June 2020					
Gross finance receivables as at 30 June 2019	2,799,282	206,882	57,043	26,412	3,089,619
Transfer between stages	(61,191)	12,570	41,245	7,376	-
Additions	1,497,073	87,843	23,610	-	1,608,526
Deletions	(1,402,340)	(118,572)	(37,334)	(3,174)	(1,561,420)
Write offs	(6,616)	(5,463)	(10,835)	(5,947)	(28,861)
Gross finance receivables as at 30 June 2020	**2,826,208**	**183,260**	**73,729**	**24,667**	**3,107,864**

(b) Finance receivables held at fair value

Policy

Finance receivables – reverse mortgages are initially recognised, and subsequently measured, at fair value through profit or loss.

$000's	June 2021	June 2020
Finance receivables - reverse mortgages	1,676,073	1,538,585
Total finance receivables - reverse mortgages	1,676,073	1,538,585

Note 20 (a) - Financial instruments measured at fair value discloses further information regarding the Group's valuation policy.

Note 22 - Credit risk exposure discloses further information regarding how reverse mortgages operate.

Credit risk adjustments on financial assets designated at fair value through profit or loss

There were no credit risk adjustments on individual financial assets.

14 Operating lease vehicles

Policy

Operating lease vehicles are stated at cost less accumulated depreciation.

Operating lease vehicles are depreciated on a straight line basis over their expected useful life after allowing for any residual values. The estimated lives of these vehicles vary up to five years. Vehicles held for sale are not depreciated but are tested for impairment.

$000's	**June 2021**	**June 2020**
Cost		
Opening balance	24,098	21,623
Additions	1,788	9,938
Disposals	(9,772)	(7,463)
Closing balance	**16,114**	**24,098**
Accumulated depreciation		
Opening balance	6,495	6,107
Depreciation charge for the year	2,801	3,634
Disposals	(4,047)	(3,246)
Closing balance	**5,249**	**6,495**
Opening net book value	17,603	15,516
Closing net book value	**10,865**	**17,603**

The future minimum lease payments receivable under operating leases not later than one year is $2.141 million (2020: $3.487 million), within one to five years is $1.406 million (2020: $2.053 million) and over five years is nil (2020: nil).

15 Borrowings

Policy

Borrowings and deposits are initially recognised at fair value including incremental direct transaction costs. They are subsequently measured at amortised cost using the effective interest method.

$000's	June 2021	June 2020
Deposits	3,183,454	3,264,192
Total deposits	**3,183,454**	**3,264,192**
Unsubordinated Notes	521,399	448,228
Securitised borrowings	1,043,516	819,703
Certificate of deposit	69,853	-
Repurchase agreement[1]	40,365	-
Total other borrowings	**1,675,133**	**1,267,931**

[1]The amounts disclosed as securities sold under arrangements to repurchase include $40.0 million (face value) of high quality liquid assets. The cash consideration received (recognised as a liability) was $40.4 million.

Deposits and unsubordinated notes rank equally and are unsecured.

The Group has the following unsubordinated notes on issue at reporting date. Australian (**AU**) borrowings are stated in their functional currency AU dollars.

Principal	Valuation	Issue Date	Maturity Date	Frequency of Interest Repayment
$150 million	Amortised cost	21 September 2017	21 September 2022	Semi annually
$125 million	Amortised cost	12 April 2019	12 April 2024	Semi annually
AU $100 million	Amortised cost	13 November 2019	13 May 2022	Quarterly
AU $45 million	Amortised cost	8 March 2021	21 April 2023	Quarterly
AU $75 million	Amortised cost	15 January 2021	21 April 2023	Quarterly

At 30 June 2021 the Group had the following securitised borrowings outstanding:

- Heartland Auto Receivables Warehouse Trust 2018-1 securitisation facility $300 million, drawn $108 million (2020: $300 million, drawn $66 million). Notes issued to investors are secured over the assets of the Heartland Auto Receivables Warehouse Trust 2018-1. The facility has a maturity date of 29 August 2022.

- Senior Warehouse Trust securitisation facility AU $600 million, drawn AU $556 million (2020: AU $600 million, drawn AU $544 million). Notes issued to investors are secured over the assets of Seniors Warehouse Trust. The facility has a maturity date of 30 September 2022.

- Senior Warehouse Trust No. 2 securitisation facility AU $250 million, drawn AU $182 million (2020: AU $250 million, drawn AU $160 million). Notes issued to investors are secured over the assets of Seniors Warehouse Trust No. 2. The facility has a maturity date of 1 July 2022.

- Atlas 2020-1 Trust securitisation facility AU $137 million, drawn AU $137 million (2020: nil). Loans issued to investors are secured over the assets of Atlas 2020-1 Trust and has a maturity date of 24 September 2050.

16 Share capital and dividends

Policy

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effect.

000's	June 2021 Number of Shares	June 2020 Number of Shares
Issued shares		
Opening balance	580,979	569,338
Shares issued - performance rights plan	-	817
Shares issued - dividend reinvestment plan	4,925	10,824
Closing balance	**585,904**	**580,979**

Under dividend reinvestment plans, 2,482,921 new shares were issued at $1.8035 per share on 16 March 2021 and 2,442,338 new shares at $1.2470 per share on 9 October 2020 (2020: 7,313,501 new shares were issued at $1.5444 per share on 6 September 2019 and 3,511,020 at $1.5948 on 11 March 2020).

Dividends paid

	June 2021			June 2020		
	Date Declared	Cents Per Share	$000's	Date Declared	Cents Per Share	$000's
Final dividend	17 September 2020	2.5	14,524	15 August 2019	6.5	37,007
Interim dividend	22 February 2021	4.0	23,337	18 February 2020	4.5	25,986
Total dividends paid			**37,861**			**62,993**

17 Other reserves

$000's	Employee Benefits Reserve	Foreign Currency Translation Reserve (FCTR)	Fair Value Reserve	Defined Benefit Reserve	Cash Flow Hedge Reserve	Total
June 2021						
Balance as at 30 June 2020	934	(3,907)	5,324	171	(8,022)	(5,500)
Other comprehensive income, net of income tax	-	(68)	(5,646)	-	8,940	3,226
Share based payments	1,797	-	-	-	-	1,797
Balance as at 30 June 2021	**2,731**	**(3,975)**	**(322)**	**171**	**918**	**(477)**
June 2020						
Balance as at 30 June 2019	838	(4,021)	4,558	171	(5,843)	(4,297)
Other comprehensive income, net of income tax	-	114	766	-	(2,179)	(1,299)
Share based payments	516	-	-	-	-	516
Shares vested	(420)	-	-	-	-	(420)
Balance as at 30 June 2020	**934**	**(3,907)**	**5,324**	**171**	**(8,022)**	**(5,500)**

18 Other balance sheet items

Policy

Property, plant and equipment are stated at cost less accumulated depreciation and impairment (if any). Depreciation is calculated on a straight line basis to write off the net cost or revalued amount of each asset over its expected life to its estimated residual value.

$000's	June 2021	June 2020
Other assets		
Trade receivables	643	1,952
GST receivable	1,763	985
Prepayments	3,699	4,857
Property, plant and equipment	9,061	10,153
Other receivables	1,059	1,611
Collateral paid on derivatives	590	-
Total other assets	**16,815**	**19,558**

18 Other balance sheet items (continued)

Policy

Intangible assets

Intangible assets with finite useful lives

Software acquired or internally developed by the Group is stated at cost less accumulated amortisation and any accumulated impairment losses. Expenditure on software assets is capitalised only when it increases the future economic value of that asset. Amortisation of software is on a straight line basis, at rates which will write off the cost over the assets' estimated useful lives. The expected useful life of the software varies up to ten years.

Goodwill

Goodwill arising on acquisition represents the excess of the cost of the acquisition over the Group's interest in the fair value of the identifiable net assets acquired. Goodwill that has an indefinite useful life is not subject to amortisation and is tested for impairment annually. Goodwill is carried at cost less accumulated impairment losses.

$000's	June 2021	June 2020
Computer software		
Cost	44,371	42,534
Accumulated amortisation	20,349	14,864
Net carrying value of computer software	**24,022**	**27,670**
Goodwill		
Cost	45,143	45,143
Net carrying value of goodwill	**45,143**	**45,143**
Total intangible assets	**69,165**	**72,813**

For the purposes of impairment testing, goodwill is allocated to cash generating units (**CGU**'s). A CGU is the smallest identifiable group of assets that generate independent cash inflows. The Group has assessed that goodwill should be allocated to the following smallest identifiable CGUs:

- Heartland Australia Holdings Pty Limited: $15.3 million (2020: $15.3 million).
- Heartland Bank Limited: $29.8 million (2020: $29.8 million).

Goodwill is tested for impairment at a cash generating unit (CGU) level. The recoverable amounts are determined on a value in use basis using a five-year discounted cash flow methodology based on financial budget and forecasts. Key assumptions used in the models included a discount rate of 10% and a terminal growth rate of 2% which reflect both past experience and external sources of information. The recoverable amounts for each CGU are compared to the respective carrying value of net assets.

There was no indication of impairment and no impairment losses have been recognised against the carrying amount of goodwill for the year ended 30 June 2021 (30 June 2020: nil). Uncertainty associated with the effects from the COVID-19 pandemic were considered in the impairment tests to determine the resilience of the headroom and no impairment was identified from the assessments.

18 Other balance sheet items (continued)

Policy

Employee benefits

Annual leave entitlements are accrued at amounts expected to be paid. Long service leave is accrued by calculating the probable future value of the entitlements and discounting back to present value. Obligations to defined contribution superannuation schemes are recognised as an expense when the contribution is paid.

$000's	June 2021	June 2020
Trade and other payables		
Trade payables	11,243	20,657
Insurance liability	3,353	6,094
Employee benefits	7,616	8,223
Other tax payables	623	1,288
Collateral received on derivatives	4,091	-
Total trade and other payables	**26,926**	**36,262**

Policy

Leases

The Group leases office space, car parks, equipment and cars. Rental contracts are typically made for fixed periods but may have extension options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions.

In determining the lease term, all facts and circumstances that create an economic incentive to exercise an extension option are considered. Extension options are only included in the lease term if the lease is reasonably certain to be extended.

Lease liabilities are measured at the present value of the remaining lease payments and discounted using the Group's incremental borrowing rate (**IBR**). Lease liabilities are measured using the effective interest method. Carrying amounts are remeasured only upon reassessments and lease modifications.

Right of use assets are depreciated at the shorter of lease term or the Group's depreciation policy for that asset class.

$000's	June 2021	June 2020
Right of use assets		
Balance at beginning of year	18,362	10,728
Depreciation charge for the year, included within depreciation expense in the income statement	(2,313)	(2,324)
(Terminations)/additions to right of use assets	(64)	9,958
Total right of use assets	**15,985**	**18,362**
Lease liability		
Current	2,339	2,222
Non-current	15,827	18,234
Total lease liability	**18,166**	**20,456**
Interest expense relating to lease liability	**568**	**570**

19 Related party transactions and balances

Policy

A person or entity is a related party under the following circumstances:

a) A person or a close member of that person's family if that person:
   - i) has control or joint control over HGH;
   - ii) has significant influence over HGH; or
   - iii) is a member of the key management personnel of HGH.

b) An entity is related to HGH if any of the following conditions applies:
   - i) The entity and HGH are members of the same group;
   - ii) One entity is an associate or joint venture of the other entity;
   - iii) Both entities are joint ventures of the same third party;
   - iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity;
   - v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to HGH;
   - vi) The entity is controlled, or jointly controlled by a person identified in (a); and
   - vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

(a) Transactions with key management personnel

Key management personnel (**KMP**), are those who, directly or indirectly, have authority and responsibility for planning, directing and controlling the activities of the Group. This includes all executive staff, Directors and their close family members.

KMP receive personal banking and financial investment services from the Group in the ordinary course of business. The terms and conditions, for example interest rates and collateral, and the risks to the Group are comparable to transactions with other employees and did not involve more than the normal risk of repayment or present other unfavourable features.

All other transactions with KMPs and their related entities are made on terms equivalent to those that prevail in arm's length transactions.

$000's	**June 2021**	**June 2020**
Transactions with key management personnel		
Interest income receivable	39	18
Interest expense payable	(22)	(47)
Key management personnel compensation		
Short-term employee benefits	(9,384)	(8,814)
Share-based payment expense	(1,797)	(828)
Total transactions with key management personnel	**(11,181)**	**(9,671)**
Due (to)/from key management personnel		
Lending	415	239
Borrowings - deposits	(23,409)	(1,646)
Total due (to) key management personnel	**(22,994)**	**(1,407)**

19 Related party transactions and balances (continued)

(b) Transactions with related parties

HGH is the ultimate parent company of the Group.

Entities within the Group have regular transactions between each other on agreed terms. The transactions include the provision of administrative services, tax transactions, and customer operations and call centre. Banking facilities are provided by Heartland Bank Limited to other Heartland Group entities on normal commercial terms as with other customers. There is no lending from subsidiaries within the Group to HGH.

Related party transactions between the Group eliminate on consolidation. Related party transactions outside of the Group are as follows:

$000's	June 2021	June 2020
Southern Cross Building Society Staff Superannuation (SCBS)		
Interest expense payable to SCBS	12	33
Management fees receivable from SCBS	10	10
ASF Custodians Pty Limited		
Audit fees	7	7
Heartland Trust (HT)		
Dividends paid	421	712

HT held 6,475,976 shares in HGH (2020: 6,475,976 shares).

The Trustees of HT and certain employees of the Group provided their time and skills to the oversight and operation of HT at no charge.

(c) Other balances with related parties

$000's	June 2021	June 2020
Southern Cross Building Society Staff Superannuation		
Deposits	1,760	1,934

20 Fair value

Policy

Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

On initial recognition, the transaction price generally represents the fair value of the financial instrument, unless there is observable information from an active market that provides a more appropriate fair value.

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Group determines fair value using other valuation techniques.

The Group measures fair values using the following fair value hierarchy, which reflects the observability of the inputs used in measuring fair value:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Group recognises transfers between levels of the fair value hierarchy as at the end of the reporting period during which the change has occurred.

Investments in equity securities are classified as fair value through profit or loss unless an irrevocable election is made by the Group to measure at FVOCI. Investments in listed equity securities that trade on a liquid, active market (e.g. stock exchange) where quoted prices are readily observable are measured under Level 1 of the fair value hierarchy without adjustment. A liquid, active market is one in which transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

Investments in listed equity securities that trade on an illiquid, inactive market, and investments in unlisted equity securities are measured under Level 3 of the fair value hierarchy. In these cases, fair value is measured through market based valuation techniques using unobservable inputs that reflect assumptions market participants would use when pricing the investment in an equity security, including assumptions about risk.

(a) Financial instruments measured at fair value

The following methods and assumptions were used to estimate the fair value of each class of financial asset and liability measured at fair value on a recurring basis in the consolidated statement of financial position.

The Group has an established framework in performing valuations required for financial reporting purposes including level 3 fair values. The Group regularly reviews and calibrates significant unobservable inputs and valuation adjustments in accordance with market participants' views. If external valuation specialists are engaged to measure fair values, the Group assesses the evidence obtained from these specialists to support the conclusion of these valuations. All significant valuations are reported to the Group's Board Audit and Risk Committee for approval prior to its adoption in the financial statements.

Investments

Investments in public sector securities and corporate bonds are classified at FVOCI, with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using observable market inputs (Level 2 under the fair value hierarchy). Refer to Note 11 - Investments for more details.

Investments valued under Level 2 of the fair value hierarchy are valued either based on quoted market prices or dealer quotes for similar instruments, or discounted cash flows analysis.

20 Fair value (continued)

(a) Financial instruments measured at fair value (continued)

Investments (continued)

Equity Investment in Harmoney Corp Limited

Harmoney Corp Limited (**Harmoney**) listed on the ASX with a foreign exempt listing on the NZX on 19 November 2020, raising AU $92.5 million as part of its Initial Public Offering (**IPO**). As part of the IPO, HGH, alongside other major shareholders, employees and directors, entered into escrow arrangements that restrict the ability to sell its Harmoney shares, with approximately 72% of the shares being in escrow (**Escrow Restrictions**). The escrowed shares are released from escrow in two stages, with the first 50% of escrow shares released in August 2021 and the final 50% of escrowed shares released in February 2022.

The Escrow Restrictions have significantly reduced the available trading pool of shares, resulting in an illiquid market for the instrument, wide bid-ask spreads and volume that is insufficient to meet the definition of an active market under New Zealand Equivalent to International Financial Reporting Standard 13 Fair Value Measurement (**NZ IFRS 13**) for purposes of Harmoney shares traded. As such the quoted price of Harmoney as at 30 June 2021 is not considered the most reliable evidence of fair value and accordingly HGH's equity investment in Harmoney has not been measured under Level 1 of the fair value hierarchy.

Instead, and consistent with prior reporting periods, the fair value of HGH's investment in Harmoney has been measured under Level 3 of the fair value hierarchy using unobservable inputs under a market approach valuation technique. Factors considered relevant to market participants such as observed trading volumes, bid-ask spreads, market prices of Harmoney's shares, revenue multiples, analyst valuations, the impact of Escrow Restrictions, as well as publicly available financial information for Harmoney have all been taken into account when measuring fair value at reporting date.

The investment is primarily measured using the volume weighted average price (**VWAP**) of Harmoney shares traded on the ASX across a period required to capture sufficient volume and moderate share price volatility attributable to the aforementioned factors. The VWAP period considered to be the most appropriate, reflecting the characteristics of the underlying share trading that has occurred, is 6 months to reporting date. This VWAP has been further evaluated through a composite valuation weighting the closing price of Harmoney shares, revenue multiples of comparable public companies, IPO price and analyst valuations. Both the VWAP and composite valuation approaches derive consistent outcomes.

The fair value measurement of HGH's equity investment in Harmoney was AU $1.90 per share as at reporting date. This was a 26% premium to the market closing price of AU $1.51 as at 30 June 2021, which if used as the basis for measuring fair value would result in a $3.9 million lower fair value than that reported. The fair value of the Investment was previously measured at AU $2.11 per share at 31 December 2020.

Investment properties

Investment properties are initially recorded at their fair value, with subsequent changes in fair value recognised in profit or loss. Fair value are determined by qualified independent valuers or other similar external evidence, adjusted for changes in market conditions.

Investment properties have been acquired through the enforcement of security over finance receivables and are held to earn rental income or for capital appreciation (or both).

20 Fair value (continued)

(a) Financial instruments measured at fair value (continued)

Finance receivables - reverse mortgages

Reverse mortgage loans are classified at fair value through profit or loss. On initial recognition the Group considers the transaction price to represent the fair value of the loan.

For subsequent measurement the Group has considered if the fair value can be determined by reference to a relevant active market or observable inputs, but has concluded relevant support is not currently available. In the absence of such market evidence the Group has used valuation techniques (income approach) including actuarial assessments to consider the fair value.

When the Group enters into a reverse mortgage loan the Group has set expectations regarding the loan's current and future risk profile and expectation of performance. This expectation references a wide range of assumptions including:

- Mortality and move to care;
- Voluntary exits;
- House price changes;
- No negative equity guarantee; and
- Interest rate margin.

At balance date the Group does not consider any of the above expectations to have moved outside of the original expectation range. Therefore the Group has continued to estimate the fair value of the portfolio at transaction price. There has been no fair value movement recognised in profit or loss during the period. Given the nature of the loan terms and tenor, the fair value as recorded is regarded as not being highly sensitive to the above assumptions, particularly to house prices and interest rates, that would impact the fair value at balance date. While noting the uncertainty around future economic conditions, based on current judgement there is no evidence that COVID-19 has impacted and will have a long-term adverse impact on market conditions, particularly regarding the key elements of house prices or interest rates, that would materially influence the fair value of the reverse mortgage portfolio at balance date.

The Group will continue to reassess the existence of a relevant active market and movements in expectations on an on-going basis.

Derivative financial instruments

Interest rate and foreign currency related contracts are recognised in the financial statements at fair value. Fair values are determined from observable market prices as at the reporting date, discounted cash flow models or option pricing models as appropriate. (Level 2 under the fair value hierarchy).

20 Fair value (continued)

(a) Financial instruments measured at fair value (continued)

The following table analyses financial instruments measured at fair value at the reporting date by the level in the fair value hierarchy into which each fair value measurement is categorised. The amounts are based on the values recognised in the consolidated statement of financial position.

$000's	Level 1	Level 2	Level 3	Total
June 2021				
Assets				
Investments	259,041	92,476	20,667	372,184
Investment properties	-	-	11,832	11,832
Derivative financial instruments	-	14,139	-	14,139
Finance receivables - reverse mortgages	-	-	1,676,073	1,676,073
Total financial assets measured at fair value	**259,041**	**106,615**	**1,708,572**	**2,074,228**
Liabilities				
Derivative financial instruments	-	4,802	-	4,802
Total financial liabilities measured at fair value	**-**	**4,802**	**-**	**4,802**
June 2020				
Assets				
Investments	295,300	94,354	16,335	405,989
Investment properties	-	-	11,132	11,132
Derivative financial instruments	-	17,246	-	17,246
Finance receivables - reverse mortgages	-	-	1,538,585	1,538,585
Total financial assets measured at fair value	**295,300**	**111,600**	**1,566,052**	**1,972,952**
Liabilities				
Derivative financial instruments	-	17,012	-	17,012
Total financial liabilities measured at fair value	**-**	**17,012**	**-**	**17,012**

20 Fair value (continued)

(a) Financial instruments measured at fair value (continued)

There were no transfers between levels in the fair value hierarchy in the year ended 30 June 2021 (2020: nil).

The movement in Level 3 assets measured at fair value are below:

$000's	Finance Receivables - Reverse Mortgages	Investments	Investment Properties	Total
June 2021				
As at 30 June 2020	1,538,585	16,335	11,132	1,566,052
New loans	300,689	-	-	300,689
Repayments	(257,999)	-	-	(257,999)
Capitalised interest and fees	91,812	-	-	91,812
Purchase of investments	-	940	-	940
Fair value gain on investment	-	3,392	700	4,092
Other	2,986	-	-	2,986
As at 30 June 2021	**1,676,073**	**20,667**	**11,832**	**1,708,572**
June 2020				
As at 30 June 2019	1,318,677	12,435	11,132	1,342,244
New loans	290,488	-	-	290,488
Repayments	(182,653)	-	-	(182,653)
Capitalised Interest and fees	91,288	-	-	91,288
Purchase of investments	-	1,803	-	1,803
Fair value gain on investment	-	2,097	-	2,097
Other	20,785	-	-	20,785
As at 30 June 2020	**1,538,585**	**16,335**	**11,132**	**1,566,052**

(b) Financial instruments not measured at fair value

The following assets and liabilities of the Group are not measured at fair value in the consolidated statement of financial position.

Cash and cash equivalents

Cash and cash equivalents are measured at amortised cost and their carrying value is considered equivalent to their fair value due to their short term nature.

Finance receivables

The fair value of the Group's finance receivables is calculated using a valuation technique which assumes the Group's current weighted average lending rates for loans of a similar nature and term.

The current weighted average lending rate used to fair value finance receivables with a fixed interest rate was 7.08% (2020: 8.06%). Finance receivables with a floating interest rate are deemed to be at current market rates. The current amount of credit provisioning has been deducted from the fair value calculation of finance receivables as a proxy for future losses.

Borrowings

The fair value of deposits, bank borrowings and other borrowings is the present value of future cash flows and is based on the current market interest rates payable by the Group for the debt of similar maturities. The average current market rate used to fair value borrowings is 1.23% (2020: 2.24%).

20 Fair value (continued)

(b) Financial instruments not measured at fair value (continued)

Other financial assets and financial liabilities

Financial instruments such as short-term trade receivables and payables are considered equivalent to their carrying value due to their short term nature.

The following table sets out financial instruments not measured at fair value, compares their carrying value against their fair value and analyses them by level in the fair value hierarchy.

$000's	June 2021 Fair Value Hierarchy	June 2021 Total Fair Value	June 2021 Total Carrying Value	June 2020 Fair Value Hierarchy	June 2020 Total Fair Value	June 2020 Total Carrying Value
Assets						
Cash and cash equivalents	Level 1	182,333	182,333	Level 1	147,179	147,179
Investments[1]	Level 2	5,640	5,639	Level 2	7,375	7,351
Finance receivables	Level 2	3,362,536	3,288,466	Level 2	3,092,150	3,045,195
Other financial assets	Level 3	2,292	2,292	Level 3	3,563	3,563
Total financial assets		**3,552,801**	**3,478,730**		**3,250,267**	**3,203,288**
Liabilities						
Deposits	Level 2	3,192,708	3,183,454	Level 2	3,278,483	3,264,192
Other borrowings	Level 2	631,617	631,617	Level 2	448,626	448,228
Borrowings - securitised	Level 2	1,043,516	1,043,516	Level 2	819,305	819,703
Other financial liabilities	Level 3	18,687	18,687	Level 3	26,751	26,751
Total financial liabilities		**4,886,528**	**4,877,274**		**4,573,165**	**4,558,874**

[1]Included within investments are bank deposits which are held to support the Group's contractual cash flows. Such investments are measured at amortised cost.

(c) Classification of financial instruments

The following table summarises the categories of financial instruments and the carrying value and fair value of all financial instruments of the Group:

$000's	FVOCI	FVTPL	Amortised Cost	Total Carrying Value	Total Fair Value
June 2021					
Assets					
Cash and cash equivalents	-	-	182,333	182,333	182,333
Investments	351,517	20,667	5,639	377,823	377,824
Investment properties	-	11,832	-	11,832	11,832
Finance receivables	-	-	3,288,466	3,288,466	3,362,536
Finance receivables - reverse mortgages	-	1,676,073	-	1,676,073	1,676,073
Derivative financial instruments	3,230	10,909	-	14,139	14,139
Other financial assets	-	-	2,292	2,292	2,292
Total financial assets	**354,747**	**1,719,481**	**3,478,730**	**5,552,958**	**5,627,029**
Liabilities					
Deposits	-	-	3,183,454	3,183,454	3,192,708
Other borrowings	-	-	1,675,133	1,675,133	1,675,133
Derivative financial instruments	4,408	394	-	4,802	4,802
Other financial liabilities	-	-	18,687	18,687	18,687
Total financial liabilities	**4,408**	**394**	**4,877,274**	**4,882,076**	**4,891,330**

(c) Classification of financial instruments (continued)

$000's	FVOCI	FVTPL	Amortised Cost	Total Carrying Value	Total Fair Value
June 2020					
Assets					
Cash and cash equivalents	-	-	147,179	147,179	147,179
Investments	389,654	16,335	7,351	413,340	413,364
Investment properties	-	11,132	-	11,132	11,132
Finance receivables	-	-	3,045,195	3,045,195	3,092,150
Finance receivables - reverse mortgages	-	1,538,585	-	1,538,585	1,538,585
Derivative financial instruments	32	17,213	-	17,246	17,246
Other financial assets	-	-	3,563	3,563	3,563
Total financial assets	**389,686**	**1,583,265**	**3,203,288**	**5,176,240**	**5,223,219**
Liabilities					
Deposits	-	-	3,264,192	3,264,192	3,278,483
Other borrowings	-	-	1,267,931	1,267,931	1,267,931
Derivative financial instruments	15,408	1,604	-	17,012	17,012
Other financial liabilities	-	-	26,751	26,751	26,751
Total financial liabilities	**15,408**	**1,604**	**4,558,874**	**4,575,886**	**4,590,177**

21 Enterprise risk management program

The board of directors (the **Board**) sets and monitors the Group's risk appetite across the primary risk domains of credit, capital, liquidity, market (including interest rate), operational and compliance and general business risk. Management are, in turn, responsible for ensuring appropriate structures, policies, procedures and information systems are in place to actively manage these risk domains, as outlined within the Enterprise Risk Management Framework (**ERMF**). Collectively, these processes are known as the Group's Enterprise Risk Management Program (**RMP**).

Role of the Board and the Board Audit Risk Committee

The Board, through its Board Audit Risk Committee (**BARC**) is responsible for oversight and governance of the development of the RMP. The role of the BARC is to assist the Board to formulate its risk appetite, and to monitor the effectiveness of the RMP. The BARC has the following specific responsibilities:

- Financial reporting and application of accounting policies as part of the internal control and risk assessment framework.
- Monitors the identification, evaluation and management of all significant risks through the Group. This work is supported by internal audit, which provides an independent assessment of the design, adequacy and effectiveness of internal controls. The BARC receives regular reports from internal audit.
- To advise the Board on the formulation of the Board's Risk Appetite Statement at least annually.
- To review any reports, policies, standards, other risk documents or matters, or minutes which have been prepared by or in respect of the HGH's Board.
- To advise and make recommendations to the Board as to the key parameters for Internal Capital Adequacy Assessment Process (**ICAAP**), delegated authorities, risk appetite and stress testing for its subsidiary, Heartland Bank Limited.

Internal Audit

The Group has an Internal Audit function, the objective of which is to provide independent, objective assurance over the internal control environment. In certain circumstances, Internal Audit will provide risk and control advice to Management provided the work does not impede the independence of the Internal Audit function. The function assists the Group in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal Audit is allowed full, free and unfettered access to any and all of the organisation's records, personnel and physical properties deemed necessary to accomplish its activities.

A regular cycle of review has been implemented to cover all areas of the business, focused on assessment, management and control of risks identified. The audit plan takes into account cyclical review of various business units and operational areas, as well as identified areas of higher identified risk. The audit methodology is designed to meet the International Standards for the Professional Practice of Internal Auditing of The Institute of Internal Auditors.

Each audit has specific audit procedures tailored to the area of business that is being reviewed. The audit procedures are updated during each audit to reflect any process changes. Audit work papers are completed to evidence the testing performed in accordance with the audit procedures.

Audit reports are addressed to the manager of the relevant area that is being audited in addition to other relevant stakeholders within the Group. Management comments are obtained from the process owner(s) and are included in the report.

21 Enterprise risk management program (continued)

Internal Audit (continued)

The Head of Internal Audit has a direct reporting line to the Chairman of the BARC. Internal audit has accountability to the BARC of the Group. A schedule of all outstanding internal control issues is maintained and presented to the BARC to assist the and track the resolution of previously identified issues. Any issues raised that are categorised as high risk are specifically reviewed by internal audit during a follow up review once the issue is considered closed by management. The follow up review is performed with a view to formally close out the issue.

Asset and Liability Committee (ALCO)

The ALCO comprises the CEO HGH, CEO HBL, CFO HGH, Chief Legal & Bank Risk Officer, Head of Retail, Financial Controller HBL and Chief Distribution Officer. The ALCO generally meets monthly, and provides reports to the BARC. ALCO's specific responsibilities include decision making and oversight of risk matters in relation to:

- Market risk (including non-traded interest rate risk and the investment of capital);
- Liquidity risk (including funding);
- Foreign exchange rate risk;
- Balance sheet structure; and
- Capital management;

Operational and compliance risk

Operational and compliance risk is the risk arising from day to day operational activities in the execution of the Group's strategy which may result in direct or indirect losses. Operational and compliance risk losses can occur as a result of fraud, human error, missing or inadequately designed processes, failed systems, damage to physical assets, improper behaviour, or from external events. The losses range from direct financial losses, to reputational damage, unfavourable media attention, injury to or loss of staff or clients or as a breach of laws or banking regulations. Where appropriate, risks are mitigated by insurance.

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational and compliance risk, the Group operates a “three lines of defence” model which outlines principles, responsibilities and accountabilities for operational and compliance risk management:

- The first line of defence is the business line management of the identification, management and mitigation of the risks associated with the products and processes of the business. This accountability includes regular testing and attestation of the adequacy and effectiveness of controls and compliance with the Group's policies.
- The second line of defence is the Risk and Compliance function, responsible for the design and ownership of the Operational Risk Management Framework. It incorporates key processes including Risk and Control Self-Assessment (**RCSA**), incident management, independent evaluation of the adequacy and effectiveness of the internal control framework, and the attestation process.
- The third line of defence is Internal Audit which is responsible for independently assessing how effectively the Group is managing its risk according to the stated risk appetite.

Market risk

Market risk is the possibility of experiencing losses or gains due to factors affecting the overall performance of financial markets in which the Group is exposed. The primary market risk exposures for the Group are interest rate risk and foreign exchange risk. The risk being that market interest rates or foreign exchange rates will change and adversely impact on the Group’s earnings due to either adverse moves in foreign exchange market rates or in the case of interest rate risks mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates.

21 Enterprise risk management program (continued)

Interest rate risk

Interest rate risk refers to exposure of an entity's earnings and / or capital because of a mismatch between the interest rate exposures of its assets and liabilities. Interest rate risk for the Group arises from the provision of non-traded retail banking products and services and from traded wholesale transactions entered into to reduce aggregate interest rate risk (known as hedges). This risk arises from four key sources:

- Mismatches between the repricing dates of interest bearing assets and liabilities (yield curve and repricing risk);
- Banking products repricing differently to changes in wholesale market rates (basis risk);
- Loan prepayment or deposit early withdrawal behaviour from customers that deviates from the expected or contractually agreed behaviour (optionality risk); and
- The effect of internal or market forces on a bank's net interest margin where, for example, in a low rate environment any fall in rates will further decrease interest income earned on the assets whereas funding cost cannot be reduced as it is already at the minimum level (margin compression risk).

Refer Note 24 - Interest rate risk for further details regarding interest rate risk.

Foreign exchange risk

Foreign exchange risk is the risk that the Group's earnings and shareholder equity position are adversely impacted from changes in foreign exchange rates. The Group has exposure to foreign exchange translation risks through its Australian subsidiaries (which have a functional currency of AUD), in the forms of profit translation risk and balance sheet translation risk.

Profit translation risk is the risk that deviations in exchange rates have a significant impact on the reported profit. Balance sheet translation risk is the risk that whilst the foreign currency value of the net investment in a subsidiary may not have changed, when translated back to the New Zealand dollars (NZD), the NZD value has changed materially due to movements in the exchange rates. Foreign exchange revaluation gains and losses are booked to the foreign currency translation reserve. Foreign exchange rate movements in any given year may have an impact on other comprehensive income. The Group manages this risk by setting and approving the foreign exchange rate for the upcoming financial year and entering into hedging contracts to manage the foreign exchange translation risks.

Counterparty Credit Risk

The Group has on-going credit exposure associated with:

- Cash and cash equivalents;
- Finance receivables;
- Holding of investment securities; and
- Payments owed to the Group from risk management instruments.

Counterparty credit risk is managed against limits set in the Market Risk Policy including credit exposure on derivative contracts, bilateral set-off arrangements, cash and cash equivalents and investment securities.

22 Credit risk exposure

Credit risk is the risk that a borrower will default on any type of debt by failing to make payments which it is obligated to make. The risk is primarily that of the lender and includes loss of principal and interest, disruption to cash flows and increased collection costs.

Credit risk is managed to achieve sustainable risk-reward performance whilst maintaining exposures within acceptable risk “appetite” parameters. This is achieved through the combination of governance, policies, systems and controls, underpinned by commercial judgement as described below.

To manage this risk, HBL's Executive Risk Committee (**ERC**) oversees the formal credit risk management strategy. The ERC reviews the Group's credit risk exposures typically on a monthly basis. The credit risk management strategies aim to ensure that:

- Credit origination meets agreed levels of credit quality at point of approval;
- Sector concentrations are monitored;
- Maximum total exposure to any one debtor is actively managed; and
- Changes to credit risk are actively monitored with regular credit reviews.

The BARC also oversees the Group's credit risk exposures to monitor overall risk metrics having regard to risk appetite set by the Board.

HBL's Board Risk Committee (**BRC**) has authority for approval of all credit exposures. Lending authority has been provided to the HBL's Credit Committee, and to the business units under a detailed Delegated Lending Authority framework. Application of credit discretions in the business operation are monitored through a defined review and hindsight structure as outlined in the Credit Risk Oversight Policy. Delegated Lending Authorities are provided to individual officers with due cognisance of their experience and ability. Larger and higher risk exposures require approval of senior management, the Credit Committee and ultimately through to HBL's BRC.

The Group employs a process of hindsighting loans to ensure that credit policies and the quality of credit processes are maintained.

Reverse mortgage loans and negative equity risk

Reverse mortgage loans are a form of mortgage lending designed for the needs of people over 60 years. These loans differ to conventional mortgages in that they typically are not repaid until the borrower ceases to reside in the property. Further, interest is not required to be paid, it is capitalised into the loan balance and is repayable on termination of the loan. As such, there are no incoming cash flows and therefore no default risk to manage during the term of the loan. Negative equity risk arises from the promise by the Group that the maximum repayment amount is limited to the net sale proceeds of the borrowers' property.

The Group’s exposure to negative equity risk is managed by the Credit Risk Oversight Policy in conjunction with associated lending standards specific for this product. In addition to usual criteria regarding the type, and location, of security property that the Group will accept for reverse mortgage lending, a key aspect of the Group's policy is that a borrower’s age on origination of the reverse mortgage loan will dictate the loan-to-value ratio of the reserve mortgage on origination. Both New Zealand and Australia reverse mortgage operations are similarly aligned. The policy is managed and reviewed periodically to ensure appropriate consistency across locations.

Business Finance Guarantee Scheme (BFGS)

HBL, along with other registered banks in New Zealand, has entered into a Deed of Indemnity with the New Zealand Government to implement the New Zealand Government's Business Finance Guarantee Scheme. The purpose of the scheme is to provide short term credit to eligible small and medium size businesses, who have been impacted by economic effects of COVID-19. The scheme allows banks to lend to a maximum of $5 million for a maximum of five years. The New Zealand Government will guarantee 80% of any loss incurred (credit risk) with HBL holding the remaining 20%. As at 30 June 2021 the Group had a total exposure of $64.3 million (2020, $6.5 million) to its customers under the scheme. BFGS has concluded on 30 June 2021 with scheme loans no longer being available.

22 Credit risk exposure (continued)

Maximum exposure to credit risk at the relevant reporting dates

The following table represents the maximum credit risk exposure, without taking account of any collateral held. The on balance sheet exposures set out below are based on net carrying amounts as reported in the consolidated statement of financial position.

$000's	June 2021	June 2020
On balance sheet:		
Cash and cash equivalents	182,333	147,179
Investments	357,156	397,005
Finance receivables	3,288,466	3,045,195
Finance receivables - reverse mortgages	1,676,073	1,538,585
Derivative financial assets	14,139	17,246
Other financial assets	2,292	3,563
Total on balance sheet credit exposures	**5,520,459**	**5,148,773**
Off balance sheet:		
Letters of credit, guarantee commitments and performance bonds	13,484	6,515
Undrawn facilities available to customers	299,544	260,098
Conditional commitments to fund at future dates	19,083	58,045
Total off balance sheet credit exposures	**332,111**	**324,658**
Total credit exposures	**5,852,570**	**5,473,431**

As at 30 June 2021 there was $0.216 million undrawn lending commitments available to counterparties for whom drawn balances were classified as individually impaired (2020: nil).

Concentration of credit risk by geographic region

$000's	June 2021	June 2020
New Zealand	4,402,656	4,086,184
Australia	1,243,522	1,154,567
Rest of the world[1]	260,079	295,349
Total	**5,906,257**	**5,536,100**
Provision for impairment	(53,687)	(62,669)
Total credit exposures	**5,852,570**	**5,473,431**

[1]These overseas assets are primarily NZD-denominated investments in AA+ and higher rated securities issued by offshore supranational agencies ("Kauri Bonds").

22 Credit risk exposure (continued)

Concentration of credit risk by industry sector

The Australian and New Zealand Standard Industrial Classification (**ANZSIC**) codes have been used as the basis for categorising customer industry sectors.

$000's	**June 2021**	**June 2020**
Agriculture	670,428	695,661
Forestry and fishing	153,160	149,871
Mining	12,684	13,425
Manufacturing	76,951	80,776
Finance and insurance	674,854	609,657
Wholesale trade	56,522	48,055
Retail trade and accommodation	279,388	278,768
Households	2,994,980	2,752,641
Other business services	148,011	168,326
Construction	241,668	202,685
Rental, hiring and real estate services	185,320	154,318
Transport and storage	297,920	262,078
Other	114,371	119,839
Total	**5,906,257**	**5,536,100**
Provision for impairment	(53,687)	(62,669)
Total credit exposures	**5,852,570**	**5,473,431**

Credit risk grading

The Group's finance receivables are monitored either by account behaviour (**Behavioural portfolio**) or a regular assessment of their credit risk grade based on an objective review of defined risk characteristics (**Judgemental portfolio**).

Finance receivables - reverse mortgages have no arrears characteristics and are assessed on origination against a pre-determined criteria.

The Judgemental portfolio consists mainly of business and rural lending where an on-going and detailed working relationship with the customer has been developed while the Behavioural portfolio consists of consumer, retail and smaller business receivables.

Judgemental loans are individually risk graded based on loan status, financial information, security and debt servicing ability. Exposures in the Judgemental portfolio are credit risk graded by an internal risk grading mechanism where grade 1 is the strongest risk. Grade 8 and grade 9 are the weakest risk grades where a loss is probable. Behavioural loans are managed based on their arrears status.

Upon adoption of NZ IFRS 9 all loans past due but not impaired have been categorised into three impairments stages (see Note 8) which are in most cases based on arrears status. If a Judgemental loan is risk graded 6 or above it will be classified as stage 2 as a minimum and carry a provision based on lifetime ECL.

22 Credit risk exposure (continued)

Credit risk grading (continued)

$000's	12 Months ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specifically Provided	Fair Value	Total
June 2021						
Judgemental portfolio						
Grade 1 - Very Strong	34	-	-	-	-	34
Grade 2 - Strong	10,854	64	-	-	-	10,918
Grade 3 - Sound	50,816	163	-	-	-	50,979
Grade 4 - Adequate	580,289	4,675	1,734	-	-	586,698
Grade 5 - Acceptable	877,393	5,658	1,882	-	-	884,933
Grade 6 - Monitor	-	58,178	1,038	-	-	59,216
Grade 7 - Substandard	-	71,718	8,107	-	-	79,825
Grade 8 - Doubtful	-	-	-	33,228	-	33,228
Grade 9 - At risk of loss	-	-	-	4,915	-	4,915
Total judgemental portfolio	1,519,386	140,456	12,761	38,143	-	1,710,746
Total behavioural portfolio	1,573,267	25,337	32,803	-	1,676,073	3,307,480
Gross finance receivables	**3,092,653**	**165,793**	**45,564**	**38,143**	**1,676,073**	**5,018,226**
Provision for impairment	(26,807)	(2,427)	(16,824)	(7,629)	-	(53,687)
Total finance receivables	**3,065,846**	**163,366**	**28,740**	**30,514**	**1,676,073**	**4,964,539**
June 2020						
Judgemental portfolio						
Grade 1 - Very Strong	28	-	-	-	-	28
Grade 2 - Strong	9,323	-	-	-	-	9,323
Grade 3 - Sound	65,084	-	189	-	-	65,273
Grade 4 - Adequate	509,154	5,117	4,238	-	-	518,509
Grade 5 - Acceptable	817,190	4,613	1,938	-	-	823,741
Grade 6 - Monitor	-	112,586	2,558	-	-	115,144
Grade 7 - Substandard	-	27,289	17,652	-	-	44,941
Grade 8 - Doubtful	-	-	-	16,025	-	16,025
Grade 9 - At risk of loss	-	-	-	8,642	-	8,642
Total Judgemental portfolio	1,400,779	149,605	26,575	24,667	-	1,601,626
Total Behavioural portfolio	1,425,429	33,655	47,154	-	1,538,585	3,044,823
Gross finance receivables	**2,826,208**	**183,260**	**73,729**	**24,667**	**1,538,585**	**4,646,449**
Provision for impairment	(32,420)	(2,166)	(22,782)	(5,301)	-	(62,669)
Total finance receivables	**2,793,788**	**181,094**	**50,947**	**19,366**	**1,538,585**	**4,583,780**

23 Liquidity risk

Liquidity risk is the risk that the Group is unable to meet its payment obligations as they fall due. The timing mismatch of cash flows and the related liquidity risk in all banking operations are closely monitored by the Group.

Measurement of liquidity risk is designed to ensure that the Group has the ability to generate or obtain sufficient cash in a timely manner and at a reasonable price to meet its financial commitments on a daily basis.

The Group's exposure to liquidity risk is governed by the liquidity policy approved by the Board and managed by the ALCO. This policy sets out the nature of the risk which may be taken and aggregate risk limits. The objective of the ALCO is to derive the most appropriate strategy for the Group in terms of a mix of assets and liabilities given its expectations of future cash flows, liquidity constraints and capital adequacy to meet the requirements of the policy. The Group employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies.

Reserve Bank of New Zealand (RBNZ) facilities

In March 2020, HBL was onboarded by the RBNZ as an approved counterparty and executed a 2011 Global Master Repo Agreement providing an additional source for intra-day liquidity for the Group if required.

On 16 March 2020, as a result of COVID-19, the RBNZ announced that it would provide term funding through a Term Auction Facility (**TAF**) to give banks the ability to access term funding using repurchase agreements with qualifying collateral for a term of up to twelve months. On 10 March 2021, RBNZ announced to remove TAF and the final TAF tenders was held on 16 March 2021.

From 26 May 2020, the RBNZ also made available, for a period of 6 months, a Term Lending Facility (**TLF**) to offer loans for a fixed term of three years at the Official Cash Rate, with access to the funds linked to banks' lending under the Business Finance Guarantee Scheme. On 20 August 2020, RBNZ announced the change of the lending term to five years. The availability of TLF was extended to 1 February 2021, and further extended to 28 July 2021.

Additional stimulus provided through a funding for lending programme also commenced in December 2020 designed to enable banks to provide low-cost lending.

The Group had not utilised any of these facilities as at 30 June 2021.

The Group holds the following liquid assets and committed funding sources for the purpose of managing liquidity risk:

$000's	June 2021	June 2020
Cash and cash equivalents	182,333	147,179
Investments	357,156	397,005
Undrawn committed bank facilities	311,993	390,762
Total liquidity	**851,482**	**934,946**

Contractual liquidity profile of liabilities

The following tables present the Group's liabilities by relevant maturity groupings based upon contractual maturity date. The amounts disclosed in the tables represent undiscounted future principal and interest cash flows. As a result, the amounts in the tables below may differ to the amounts reported on the consolidated statement of financial position.

The contractual cash flows presented below may differ significantly from actual cash flows. This occurs as a result of future actions by the Group and its counterparties, such as early repayments or refinancing of term loans and borrowings. Deposits and other public borrowings include customer savings deposits and transactional accounts, which are at call. These accounts provide a stable source of long term funding for the Group.

23 Liquidity risk (continued)

Contractual liquidity profile of liabilities (continued)

$000's	On Demand	0-6 Months	6-12 Months	1-2 Years	2-5 Years	5+ Years	Total
June 2021							
Financial liabilities							
Deposits	971,924	1,291,863	560,232	292,091	91,107	-	3,207,217
Other borrowings	-	124,431	120,855	1,205,547	157,855	181,244	1,789,932
Lease liabilities	-	1,419	1,433	2,836	7,605	7,085	20,378
Derivative financial liabilities	-	2,499	1,564	516	4	-	4,583
Other financial liabilities	-	18,688	-	-	-	-	18,688
Total financial liabilities	**971,924**	**1,438,900**	**684,084**	**1,500,990**	**256,571**	**188,329**	**5,040,798**
Undrawn facilities available to customers	299,544	-	-	-	-	-	299,544
Undrawn committed bank facilities	311,993	-	-	-	-	-	311,993
June 2020							
Financial liabilities							
Deposits	813,140	1,418,656	833,440	162,221	86,615	-	3,314,072
Other borrowings	-	13,517	61,038	196,835	1,039,462	-	1,310,852
Lease liabilities	-	1,400	1,415	5,730	7,634	7,085	23,264
Derivative financial liabilities	-	5,722	4,665	5,297	1,354	-	17,038
Other financial liabilities	-	26,751	-	-	-	-	26,751
Total financial liabilities	**813,140**	**1,466,046**	**900,558**	**370,083**	**1,135,065**	**7,085**	**4,691,977**
Undrawn facilities available to customers	260,098	-	-	-	-	-	260,098
Undrawn committed bank facilities	390,762	-	-	-	-	-	390,762

24 Interest rate risk

The Group's market risk is derived primarily of exposure to interest rate risk, predominantly from raising funds through the retail and wholesale deposit market, the debt capital markets and committed and uncommitted bank funding, securitisation of receivables, and offering loan finance products to the commercial and consumer market in New Zealand and Australia.

The Group’s exposure to market risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ALCO must conform to this. The objective of the ALCO is to derive the most appropriate strategy for the Group in terms of the mix of assets and liabilities given its expectations of the future and the potential consequences of interest rate movements, liquidity constraints and capital adequacy.

The objective of the Group’s interest rate risk policies is to limit underlying net profit after tax (**NPAT**) volatility. The measurement comprises net interest income the Group generates from its interest earning assets and interest bearing liabilities.

The exposure to net interest income comes from a reduction in margins on interest earning assets or interest bearing liabilities and is managed when setting rates by taking into consideration wholesale rates, liquidity premiums, as well as appropriate lending credit margins.

An analysis of the Group’s sensitivity to an increase (+) or decrease (-) in market interest rates by 100 basis points (**BP**) is as follows. An (+)/(-) to market interest rates of 100 BP would result in a $0.45 million (+)/(-) to NPAT (2020: $1.5million (+)/(-)) with a corresponding impact to equity.

The Group also manages interest rate risk by:

- Monitoring maturity profiles and seeking to match the re-pricing of assets and liabilities;
- Monitoring interest rates daily and regularly (at least monthly) reviewing interest rate exposures; and
- Entering into derivatives to hedge against movements in interest rates.

24 Interest rate risk (continued)

Contractual repricing analysis

The interest rate risk profile of financial assets and liabilities that follows has been prepared on the basis of maturity or next repricing date, whichever is earlier.

$000's	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2+ Years	Non-Interest Bearing	Total
June 2021							
Financial assets							
Cash and cash equivalents	182,323	-	-	-	-	10	182,333
Investments	31,896	8,034	19,669	53,505	244,052	20,667	377,823
Finance receivables	1,587,718	151,674	299,305	462,900	715,032	71,837	3,288,466
Finance receivables - reverse mortgages	1,676,073	-	-	-	-	-	1,676,073
Derivative financial assets	-	-	-	-	-	14,139	14,139
Other financial assets	-	-	-	-	-	2,292	2,292
Total financial assets	**3,478,010**	**159,708**	**318,974**	**516,405**	**959,084**	**108,945**	**5,541,126**
Financial liabilities							
Deposits	1,670,667	570,068	554,340	285,025	85,077	18,277	3,183,454
Other borrowings	1,342,612	50,837	-	153,751	127,933	-	1,675,133
Derivative financial liabilities	-	-	-	-	-	4,802	4,802
Lease liabilities	-	-	-	-	-	18,166	18,166
Other financial liabilities	-	-	-	-	-	18,687	18,687
Total financial liabilities	**3,013,279**	**620,905**	**554,340**	**438,776**	**213,010**	**59,932**	**4,900,242**
Effect of derivatives held for risk management	474,010	(9,023)	(146,067)	(85,669)	(233,251)	-	-
Net financial assets/(liabilities)	**938,741**	**(470,220)**	**(381,433)**	**(8,040)**	**512,823**	**49,013**	**640,884**
June 2020							
Financial assets							
Cash and cash equivalents	147,172	-	-	-	-	7	147,179
Investments	43,863	18,425	52,708	59,296	222,713	16,335	413,340
Finance receivables	1,522,837	198,446	352,076	557,569	400,658	13,609	3,045,195
Finance receivables - reverse mortgages	1,538,585	-	-	-	-	-	1,538,585
Derivative financial assets	-	-	-	-	-	17,246	17,246
Other financial assets	-	-	-	-	-	3,563	3,563
Total financial assets	**3,252,457**	**216,871**	**404,784**	**616,865**	**623,371**	**50,760**	**5,165,108**
Financial liabilities							
Deposits	1,616,521	585,482	815,366	155,219	77,655	13,949	3,264,192
Other borrowings	976,638	970	-	-	290,323	-	1,267,931
Derivative financial liabilities	-	-	-	-	-	17,012	17,012
Lease liabilities	-	-	-	-	-	20,456	20,456
Other financial liabilities	-	-	-	-	-	26,751	26,751
Total financial liabilities	**2,593,159**	**586,452**	**815,366**	**155,219**	**367,978**	**78,168**	**4,596,342**
Effect of derivatives held for risk management	557,955	(51,349)	(239,137)	(237,212)	(30,257)	-	-
Net financial assets/(liabilities)	**1,217,253**	**(420,930)**	**(649,719)**	**224,434**	**225,136**	**(27,408)**	**568,766**

The tables above illustrate the periods in which the cash flows from interest rate swaps are expected to occur and affect profit or loss.

Other Disclosures

25 Significant subsidiaries

Significant Subsidiaries	Country of Incorporation and Place of Business	Nature of Business	Proportion of ownership and voting power held June 2021	June 2020
Heartland Bank Limited	New Zealand	Bank	100%	100%
VPS Properties Limited	New Zealand	Investment property holding company	100%	100%
MARAC Insurance Limited	New Zealand	Insurance services	100%	100%
Heartland Australia Holdings Pty Limited	Australia	Financial services	100%	100%
Heartland Australia Group Pty Limited	Australia	Financial services	100%	100%
Australian Seniors Finance Pty Limited	Australia	Management services	100%	100%

26 Structured entities

A structured entity is one which has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity. Structured entities are created to accomplish a narrow and well-defined objective such as the securitisation or holding of particular assets, or the execution of a specific borrowing or lending transaction. Structured entities are consolidated where the substance of the relationship is that the Group controls the structured entity.

(a) Heartland Cash and Term PIE Fund (Heartland PIE Fund)

The Group controls the operations of the Heartland PIE Fund which is a portfolio investment entity that invests in the Group's deposits. Investments of Heartland PIE Fund are represented as follows:

$000's	June 2021	June 2020
Deposits	153,244	166,676

(b) Heartland Auto Receivables Warehouse Trust 2018-1 (Auto Warehouse)

The Auto Warehouse securitises motor loan receivables as a source of funding.

The Group continues to recognise the securitised assets and associated borrowings in the consolidated statement of financial position as the Group remains exposed to and has the ability to affect variable returns from those assets and liabilities. Although the Group recognises those interests in Auto Warehouse, the loans sold to Auto Warehouse are set aside for the benefit of investors in Auto Warehouse and other depositors and lenders to the Group have no recourse to those assets.

$000's	June 2021	June 2020
Cash and cash equivalents	9,047	5,493
Finance receivables	126,399	78,066
Other borrowings	(128,125)	(79,012)

26 Structured entities (continued)

(c) Seniors Warehouse Trust, Seniors Warehouse Trust No.2 (together the SW Trusts) and ASF Settlement Trust (ASF Trust)

SW Trusts and ASF Trust (collectively the Trusts) form part of ASF's reverse mortgage business and were set up by ASF as asset holding entities. The Trustee for the Trusts is ASF Custodians Pty Limited and the Trust Manager is ASF. The reverse mortgage loans held by the Trusts are set aside for the benefit of the investors in the Trusts. The balances of SW Trusts and ASF Trust are represented as follows:

$000's	June 2021	June 2020
Cash and cash equivalents	29,170	26,491
Finance receivables - reverse mortgages	934,523	929,179
Other borrowings	(822,112)	(783,373)

(d) Atlas 2020-1 Trust (Atlas Trust)

Atlas Trust was set up on 11 September 2020 as part of ASF's reverse mortgage business similar to the existing SW Trusts and ASF Trust. The Trustee for the Trust is BNY Trust Company of Australia Limited and the Trust Manager is ASF. The balances of Atlas Trust are represented as follows:

$000's	June 2021
Cash and cash equivalents	17,592
Finance receivables - reverse mortgages	140,044
Other borrowings	(145,943)

27 Staff share ownership arrangements

The Group operates a number of share-based compensation plans that are equity settled. The fair value determined at the grant date is expensed on a straight line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest, with a corresponding increase in equity. At the end of each reporting period the Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the employee benefits reserve.

(a) Share-based compensation plan details

Heartland performance rights plan (PR plan)

The PR plan was established to enhance the alignment of participants' interests with those of the Group's shareholders. Under the PR plan participants are issued performance rights which will entitle them to receive shares in the Group. As at June 2020, there were 3 tranches being 2017, 2018 and 2022. The 2017 and 2018 tranche rules have been aligned to the PR Plan 2022, and therefore they all have the same terms and conditions applying regarding participants, awarding of PR, measurement date and vesting as outlined below:

27 Staff share ownership arrangements (continued)

(a) Share-based compensation plan details (continued)

PR Plan 2022 Tranche (PR plan 2022)

The number of performance rights offered is determined by the participant's long-term incentive (**LTI**) value over the volume weighted average price (**VWAP**) of the Group's ordinary shares on the NZX Main Board for the 20 business days immediately before (and excluding) the issue date. The issue date is 14 September 2019. Performance rights do not entitle participants to dividends or voting rights.

The performance rights are issued subject to the participants' continued employment with the Group until the measurement date and the Group achieving its financial measures, strategic objectives and culture and conduct objectives, over the period commencing 1 July 2019 and ending on 30 June 2022. The targets are dynamic and may be adjusted by the Board from time to time in order to account for unanticipated capital changes during the performance period. The measurement date is the business days following the date on which the Group announces its full year results for the financial year ended 2022.

Performance rights will vest on the measurement date to the extent these criteria have been met, but subject to caps and also to retesting on a later measurement date if the criteria are not met on the initial measurement date.

PR Plan 2023 Tranche (PR plan 2023)

PR plan 2023 was issued for period commencing 1 July 2020 and ending on 30 June 2023. The tranche rules have been aligned with PR plan 2022. The measurement date for this tranche is the business date on which the Group announces its full year results for the financial year ended 2023.

	June 2021 PR Plan Number of Rights	June 2020 PR Plan Number of Rights
Opening balance	**3,216,927**	**3,121,340**
Granted	-	(816,858)
Issued	5,342,289	1,230,740
Forfeited	(816,940)	(318,295)
Closing balance	**7,742,276**	**3,216,927**

(b) Effect of share-based payment transactions

$000's	**June 2021**	**June 2020**
Award of Shares		
PR Plan	1,797	516
Total expense recognised	**1,797**	**516**

As at 30 June 2021, $3.0 million of the share scheme awards remain unvested and not expensed (2020: $1.9 million). This expense will be recognised over the vesting period of the awards.

(c) Number of rights outstanding

	June 2021		June 2020	
000's	**Rights Outstanding**	**Remaining Years**	**Rights Outstanding**	**Remaining Years**
PR Plan - 2017	1,943	1	2,039	2
PR Plan - 2018	170	1	259	2
PR Plan - 2022	722	1	919	2
PR Plan - 2023	4,908	2	-	-
Total	**7,743**		**3,217**	

28 Insurance business, securitisation, funds management, other fiduciary activities

Insurance business

Marac Insurance Limited, a subsidiary of HBL, no longer conducts Insurance business as HBL entered into a distribution agreement with DPL Insurance Limited to distribute DPL's insurance products through HBL's network. MIL stopped writing insurance policies in the prior year with the last policies expected to expire in 2025.

The Group's aggregate amount of insurance business comprises the total consolidated assets of MIL of $8.5 million (2020: $10.9 million), which represents 0.15% of the total consolidated assets of the Group (2020: 0.20%).

Securitisation, funds management and other fiduciary activities

Changes to the Group's involvement in securitisation activities are set out in Note 26. There have been no material changes to the Group's involvement in funds management and other fiduciary activities during the year.

29 Concentrations of funding

(a) Concentrations of funding by industry

The Australian and New Zealand Standard Industrial Classification (**ANZSIC**) codes have been used as the basis for categorising customer industry sectors:

$000's	June 2021	June 2020
Agriculture	102,107	109,268
Forestry and fishing	14,226	14,901
Mining	94	35
Manufacturing	11,592	6,976
Finance and insurance	1,669,055	1,431,320
Wholesale trade	11,218	10,855
Retail trade and accommodation	28,521	20,423
Households	2,322,514	2,263,668
Rental, hiring and real estate services	46,245	41,348
Construction	24,231	19,702
Other business services	58,334	63,697
Transport and storage	4,337	4,552
Other	44,714	97,150
Total	**4,337,188**	**4,083,895**
Unsubordinated notes	521,399	448,228
Total borrowings	**4,858,587**	**4,532,123**

(b) Concentration of funding by geographical area

$000's	June 2021	June 2020
New Zealand	3,599,337	3,470,744
Overseas	1,259,250	1,061,379
Total borrowings	**4,858,587**	**4,532,123**

30 Contingent liabilities and commitments

The Group in the ordinary course of business will be subject to claims and proceedings against it whereby the validity of the claim will only be confirmed by uncertain future events. In such circumstances the contingent liabilities are possible obligations, or present obligations if known, where the transfer of economic benefit is uncertain or cannot be reliable measured. Contingent liabilities are not recognised, but are disclosed, unless they are remote. Where some loss is probable, provisions have been made on a case by case basis.

Contingent liabilities and credit related commitments arising in respect of the Group's operations were:

$000's	**June 2021**	**June 2020**
Letters of credit, guarantee commitments and performance bonds	13,484	6,515
Total contingent liabilities	**13,484**	**6,515**
Undrawn facilities available to customers	299,544	260,098
Conditional commitments to fund at future dates	19,083	58,045
Total commitments	**318,627**	**318,143**

31 Events after the reporting date

HGH subsidiary Heartland Australia Group Pty Limited completed a senior unsecured bond issuance of AU $45 million on 9 July 2021.

The Group declared a fully imputed final dividend of 7 cents per share on 23 August 2021.

On Tuesday 17 August 2021 the New Zealand Government, in response to a community outbreak of the Delta COVID variant, placed New Zealand into an immediate Level 4 lockdown. The Directors have considered the impact of this, on the reported performance of the Group, and consider the reported performance has adequately allowed for the potential impact of COVID at this time, and that the current lockdown does not affect the reported result for the 12 months ended 30 June 2021.

There have been no other material events after the reporting date that would affect the interpretation of the consolidated financial statements or the performance of the Group.

KPMG

Independent Auditor's Report

To the shareholders of Heartland Group Holdings Limited

Report on the audit of the consolidated financial statements

Opinion

We have audited the accompanying consolidated financial statements of Heartland Group Holdings Limited and its subsidiaries (the "Group") which comprise:

- the consolidated statement of financial position as at 30 June 2021;
- the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended; and
- notes, including a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements of the Group on pages 6 to 61:

i. present fairly in all material respects the Group's financial position as at 30 June 2021 and its financial performance and cash flows for the year ended on that date; and

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

Basis for opinion

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

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

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

Our firm has also provided other services to the Group in relation to the review of the Group's consolidated interim financial statements, regulatory assurance services, agreed upon procedure engagements and supervisor reporting. Subject to certain restrictions, partners and employees of our firm may also deal with the Group on normal terms within the ordinary course of trading activities of the business of the Group. These matters have not impaired our independence as auditor of the Group. The firm has no other relationship with, or interest in, the Group.

Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the consolidated financial statements as a whole. The materiality for the consolidated financial statements as a whole was set at $5,820,000 determined with reference to a benchmark of the Group's profit before tax. We chose the benchmark because, in our view, this is a key measure of the Group's performance.

We agreed with the Audit Committee that we would report to them, misstatements identified during our audit above $290,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

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

The key audit matter	How the matter was addressed in our audit

Provision for impairment of finance receivables

Refer to notes 1, 13 and 22 to the consolidated financial statements.

The key audit matter

The provision for impairment of finance receivables is a key audit matter due to the financial significance and the inherent complexity of the Group's expected credit loss ("ECL") models.

Significant judgement and estimates are required to incorporate forward-looking information to reflect future economic conditions.

The collective provision is estimated through the ECL models using historical data which is adjusted for forward looking information and the assigned risk grade or arrears status. Additionally, management apply judgement in the determination of provision overlays to adjust for future market conditions.

The level of judgement involved in determining the provision for collectively impaired assets requires us to challenge the appropriateness of management's assumptions.

The provision for individually impaired assets is based on the application of management judgement regarding expected future cashflows, which are inherently uncertain.

How the matter was addressed in our audit

Together with KPMG credit risk specialists we assessed the Group's collective and individual provisions. Our procedures, amongst others, included:

- Assessing the Group's governance and oversight, including the continuous reassessment of overall provisioning;
- Assessing the Group's significant accounting policies and expected credit loss ("ECL") modelling methodology against the requirements of the standards and underlying accounting records;
- Testing key controls including the arrears calculations, customer loan ratings, annual loan reviews, credit risk reviews and data reconciliations between the ECL models and source systems;
- Assessing the model output against actual losses incurred by the Group;
- Challenging the key assumptions, including forward looking economic assumptions, against external information including benchmarking management's estimates to a range of different market forecasts;
- Evaluating individual credit assessments for a sample of 'rural' and other 'corporate' loans on management's credit watchlist. This included inspection of the latest correspondence with the borrower, assessment of the provision estimates prepared by credit risk officers, and consideration of the resolution strategy. We challenged assumptions and assessed collateral values by comparing them to valuations performed by independent valuers; and
- Assessing the disclosures in the consolidated financial statements against the requirements of NZ IFRS.

From the procedures performed we consider the Group appropriately identified and considered the uncertainties in the provision estimates.

The key audit matter	How the matter was addressed in our audit
Valuation of finance receivables – reverse mortgages Refer to note 20 of the consolidated financial statements.	
The Group's reverse mortgage portfolio is held at fair value. The fair value calculation is based on the application of management judgement. In assessing the fair value, the Group continuously considers evidence of a relevant active market. In the absence of such a market, in the current period, the Group considered changes since loan origination and expected future cashflows. The inherent uncertainties include estimated exits, interest rates and security property values.	Our procedures over the fair value loan portfolios, amongst others, included: — Testing key controls over the accuracy of data impacting the fair value assessment; — Assessing evidence of a relevant active market or observable inputs; and — Challenging the key assumptions used by the Group in determining the portfolio's fair value. The estimates and assumptions used to determine the valuation of finance receivables are reasonable, with no evidence of management bias or influence identified from our procedures.
Operation of IT systems and controls	
The Group is reliant on complex IT systems for the processing and recording of significant volumes of transactions and other core banking activity. For significant financial statement balances, such as finance receivables and deposits, where relevant, our audit involves an assessment of the design of the Group's internal control environment. There are some areas of the audit where we seek to test and place reliance on IT systems, automated controls and reporting. The effective operation of these controls is dependent upon the Group's general IT control environment, which incorporates controls relevant to IT system changes and development, IT operations, and developer and user access.	Our audit procedures, amongst others, included: — Gaining an understanding of business processes, key controls and IT systems relevant to significant financial statement balances, including technology services provided by a third party; — Assessing the effectiveness of the IT control environment, including core banking IT systems, key automated controls and reporting; and — Evaluating general IT controls relevant to IT system changes and development, IT operations, and developer and user access. Where we noted design or operating effectiveness matters relating to IT system or application controls relevant to our audit, we performed alternative audit procedures. We also identified and tested mitigating controls in order to respond to the impact on our overall audit approach. We did not identify any material issues or exceptions from those additional procedures.

Other information

The Directors, on behalf of the Group, are responsible for the other information included in the entity's Annual Report. Other information may include the Chairman's Report, Chief Executive Officer's Report and disclosures relating to corporate governance. Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

The Annual Report is expected to be made available to us after the date of this Independent Auditor's Report. Our responsibility is to read the Annual Report when it becomes available and consider whether the other information it contains is materially inconsistent with the consolidated financial statements, or our knowledge obtained in the audit, or otherwise appear misstated. If so, we are required to report such matters to the Directors.

KPMG

Use of this independent auditor's report

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

Responsibilities of the Directors for the consolidated financial statements

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

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

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

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

Auditor's responsibilities for the audit of the consolidated financial statements

Our objective is:

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

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

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

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

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

http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

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

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

For and on behalf of

KPMG

KPMG
Auckland

23 August 2021

HEARTLAND

Distribution Notice

Updated as at 18 December 2019

Please note: all cash amounts in this form should be provided to 8 decimal places

Section 1: Issuer information				
Name of issuer	Heartland Group Holdings Limited			
Financial product name/description	Ordinary shares			
NZX ticker code	HGH			
ISIN (If unknown, check on NZX website)	NZHGHE0007S9			
Type of distribution (Please mark with an X in the relevant box/es)	Full Year	X	Quarterly	
	Half Year		Special	
	DRP applies	X		
Record date	01/09/2021			
Ex-Date (one business day before the Record Date)	31/08/2021			
Payment date (and allotment date for DRP)	15/09/2021			
Total monies associated with the distribution[1]	$41,013,305.55			
Source of distribution (for example, retained earnings)	Retained earnings			
Currency	NZD			
Section 2: Distribution amounts per financial product				
Gross distribution[2]	$0.09722222			
Gross taxable amount [3]	$0.09722222			
Total cash distribution[4]	$0.07000000			
Excluded amount (applicable to listed PIEs)	NIL			
Supplementary distribution amount	$0.01235294			
Section 3: Imputation credits and Resident Withholding Tax[5]				
Is the distribution imputed	Fully imputed - YES			
	~~Partial imputation~~			
	~~No imputation~~			

[1] Continuous issuers should indicate that this is based on the number of units on issue at the date of the form

[2] "Gross distribution" is the total cash distribution plus the amount of imputation credits, per financial product, before the deduction of Resident Withholding Tax (**RWT**).

[3] "Gross taxable amount" is the gross distribution minus any excluded income.

[4] "Total cash distribution" is the cash distribution excluding imputation credits, per financial product, before the deduction of RWT. This should *include* any excluded amounts, where applicable to listed PIEs.

[5] The imputation credits plus the RWT amount is 33% of the gross taxable amount for the purposes of this form. If the distribution is fully imputed the imputation credits will be 28% of the gross taxable amount with remaining 5% being RWT. This does not constitute advice as to whether or not RWT needs to be withheld.

If fully or partially imputed, please state imputation rate as % applied[6]	28%	
Imputation tax credits per financial product	$0.02722222	
Resident Withholding Tax per financial product	$0.00486111	
Section 4: Distribution re-investment plan (if applicable)		
DRP % discount (if any)	2.0%	
Start date and end date for determining market price for DRP	02/09/2021	08/09/2021
Date strike price to be announced (if not available at this time)	09/09/2021	
Specify source of financial products to be issued under DRP programme (new issue or to be bought on market)	New issue	
DRP strike price per financial product	$	
Last date to submit a participation notice for this distribution in accordance with DRP participation terms	02/09/2021, 5:00pm (NZT)	
Section 5: Authority for this announcement		
Name of person authorised to make this announcement	Andrew Dixson, Chief Financial Officer	
Contact person for this announcement	Andrew Dixson, Chief Financial Officer	
Contact phone number	09 927 9274	
Contact email address	Andrew.Dixson@heartland.co.nz	
Date of release through MAP	24/08/2021	

[6] Calculated as (imputation credits/gross taxable amount) x 100. Fully imputed dividends will be 28% as a % rate applied.

Disclosure Statement

For the year ended 30 June 2021

HEARTLAND BANK

Contents

General Information

This Disclosure Statement has been issued by Heartland Bank Limited (**HBL** or the **Bank**) and its subsidiaries (the **Banking Group**) for the year ended 30 June 2021 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the **Order**). The financial statements of the Bank for the year ended 30 June 2021 form part of, and should be read in conjunction with, this Disclosure Statement.

Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

Name and address for service

The name of the Registered Bank is Heartland Bank Limited.

The Banking Group consists of the Bank and all of its subsidiaries.

The Bank's address for service is Level 3, Heartland House, 35 Teed Street, Newmarket, Auckland 1023.

The address for service of the ultimate parent, Heartland Group Holdings Limited, is Level 3, Heartland House, 35 Teed Street, Newmarket, Auckland 1023.

Details of incorporation

The Bank was incorporated under the Companies Act 1993 on 30 September 2010.

Interests in 5% or more of voting securities of the Bank

Name	Percentage held
Heartland Group Holdings Limited	100%

Heartland Group Holdings Limited has the ability to appoint 100% of Directors, subject to Reserve Bank of New Zealand (**RBNZ**) restrictions and RBNZ Director approval.

Priority of Creditors' Claims

In the event of the Bank becoming insolvent or ceasing business, certain claims set out in legislation are paid in priority to others. These claims include secured creditors, taxes, certain payments to employees and any liquidator's costs. After payment of those creditors, the claims of all other creditors are unsecured and would rank equally, with the exception of holders of subordinated bonds and notes which rank below all other claims.

Guarantee Arrangements

As at the date this Disclosure Statement was signed, no material obligations of the Bank were guaranteed.

Auditor

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland 1010

Directors

All Directors of the Bank reside in New Zealand. Communications to the Directors can be sent to Heartland Bank Limited, Level 3, Heartland House, 35 Teed Street, Newmarket, Auckland 1023.

On 12 March 2021, Ellen Frances Comerford resigned as director of the Bank.

The Directors of the Bank and their details at the time this Disclosure Statement was signed were:

Chairman - Board of Directors
Name: Bruce Robertson Irvine
Qualifications: BCom, LLB, FCA, CF Inst D, FNZIM
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Air Rarotonga Limited, Amaia Day Spa (Tonga) Limited, Amaia Luxury Spa Limited, Amyes Road Limited (in liquidation), B R Irvine Limited, Blackbyre Horticulture Limited, Bowdens Mart Limited, Bray Frampton Limited, Britten Motorcycle Company 1992 Limited, Chambers @151 Limited, Clipper Investments (2002) Limited, Cockerill and Campbell (2007) Limited, Embassy Hotels Limited, GZ Capital Limited, GZ NZ Limited, GZ RES Limited, Hansons Lane International Holdings Limited, Hawling Holdings Limited, House of Travel Holdings Limited, J.S. Ewers Limited, Kaipaki Holdings Limited, Kaipaki Properties Limited, Lake Angelus Holdings Limited, Lamanna Bananas (NZ) Limited, Lamanna Premier Group Pty Limited, Lamanna Limited, Market Fresh Wholesale Limited, Market Gardeners Limited, MG Group Holdings Limited, MG Marketing Limited, MG New Zealand Limited, Monarch Hotels Limited, Noblesse Oblige Limited, Paradise Islands Limited; Phimai Holdings Limited, Quitachi Limited, Rakon ESOP Trustee Limited, Rakon Limited, Rakon PPS Trustee Limited, Scenic Hotels (Karapiro) Limited, Scenic Hotels (Hamilton) Limited, Scenic Circle Convention Services Limited, Scenic Hotel (Haast) Limited, Scenic Circle (Napier) Limited, Scenic Hotel Group Limited, Scenic Hotels (Ashburton) Limited, Scenic Hotels (International) Limited, Scenic Circle MLC Café & Bar Limited, Skope Industries Limited, Southland Produce Markets Limited, Stark Holdings (NZ) Limited, USC Investments Limited, Wavell Resources Limited.

Name: Jeffrey Kenneth Greenslade
Qualifications: LLB
Type of Director: Non-Independent Non-Executive Director
Occupation: Chief Executive Officer of Heartland Group Holdings
External Directorships:
Heartland Australia Group Pty Limited, Heartland Australia Holdings Pty Limited, Australian Seniors Finance Pty Limited, ASF Custodians Pty Limited, Heartland Group Holdings Limited, Henley Family Investments Limited.

Name: Edward John Harvey
Qualifications: BCom, FCA, CFInstD
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Investore Property Limited, Evnex Limited, Kathmandu Holdings Limited, Napier Port Holdings Limited, Pomare Investments Limited, Port of Napier Limited, Stride Holdings Limited, Stride Investment Management Limited, Stride Property Limited.

Name: Geoffrey Thomas Ricketts CNZM
Qualifications: LLB (Hons), LLD (*honoris causa*), CFInstD
Type of Director: Non-Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Heartland Group Holdings Limited, Janmac Capital Limited, Maisemore Enterprises Limited, MCF2 Message4U Limited, MCF3 Amplify Limited, MCF3 Green Limited, MCF3 E&P Holdco Limited, MCF3 Resourceco Limited, MCF 10 Limited, MCF2 (Fund 1) Limited, MCF2A General Partner Limited, MCF2 GP Limited, MCF3 GP Limited, MCF3B General Partner Limited, MCF3A General Partner Limited, MCF2 FFF-GK Limited, MCF3 Cook Limited, MCF3 TEG Limited, MCF3 Squiz Limited, MC Medical Properties Limited, Mercury Capital No.1 Fund Limited, Mercury Capital No. 1 Trustee Limited, Mercury Medical Holdings Limited, New Zealand Catholic Education Office Limited, NZCEO Finance Limited, O & E Group Services Limited, Oceania and Eastern Finance Limited, Oceania and Eastern Group Funds Limited, Oceania and Eastern Holdings Limited, Oceania and Eastern Limited, Oceania and Eastern Securities Limited, Oceania North Limited, Oceania Securities Limited, Quartet Equities Limited.

Directors (continued)

Name: Kathryn Mitchell
Qualifications: BA, CMInstD
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Chambers@151 Limited, Christchurch International Airport Limited, Farmright Limited, Firsttrax Limited, Helping Hands Holdings Limited, Link Engine Management Limited, Link Engine Management International (NZ) Limited, Morrison Horgan Limited, The New Zealand Merino Company Limited.

Name: Shelley Maree Ruha
Qualifications: BCom**,** DipBank
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Analey Holdings Limited, Analey Investment Limited, Hobson Wealth Holdings Limited, Hobson Wealth Partners Limited, IT & Business Consulting Limited, New Zealand Rural Land Management Limited, Partners Group Holdings Limited, Partners Life Limited, 9 Spokes International Limited, TaxGift Limited.

Conflicts of interest policy

All Directors are required to disclose to the Board any actual or potential conflicts of interest which may exist or is thought to exist upon appointment and are required to keep these disclosures up to date. The details of each disclosure made by a Director to the Board must be entered in the Interests Register.

Directors are required to take any necessary and reasonable measures to try to resolve the conflict and comply with the Companies Act 1993 by disclosing interests and restrictions on voting. Any Director with a material personal, professional or business interest in a matter being considered by the Board must declare their interest and, unless the Board resolves otherwise, may not be present during the boardroom discussions or vote on the relevant matter.

Interested transactions

There have been no transactions between the Bank or any member of the Banking Group and any Director or immediate relative or close business associate of any Director which either has been entered into on terms other than those which would, in the ordinary course of business of the Bank or any member of the Banking Group, be given to any other person of like circumstances or means, or could be reasonably likely to influence materially the exercise of the Directors' duties.

Audit committee composition

Members of the Bank's Audit Committee as at the date of this Disclosure Statement are as follows:

Edward John Harvey (Chairperson)	Independent Non-Executive Director
Bruce Robertson Irvine	Independent Non-Executive Director
Geoffrey Thomas Ricketts	Non-Independent Non-Executive Director
Shelley Maree Ruha	Independent Non-Executive Director

Directors' Statements

Each Director of the Bank states that he or she believes, after due enquiry, that:

1. As at the date on which this Disclosure Statement is signed:

   (a) the Disclosure Statement contains all the information that is required by the Order; and

   (b) the Disclosure Statement is not false or misleading.

2. During the year ended 30 June 2021:

   (a) the Bank complied with all Conditions of Registration applicable during the period except as noted on page 80;

   (b) credit exposures to connected persons were not contrary to the interests of the Banking Group; and

   (c) the Bank had systems in place to monitor and control adequately material risks of the Banking Group, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

Directors' Statements (continued)

This Disclosure Statement is dated 23 August 2021 and has been signed by all the Directors.

B R Irvine (Chair - Board of Directors)

G T Ricketts

J K Greenslade

K Mitchell

E J Harvey

S M Ruha

Consolidated Statement of Comprehensive Income

For the year ended 30 June 2021

$000's	Note	June 2021	June 2020
Interest income	3	272,562	297,512
Interest expense	3	73,753	108,476
Net interest income		**198,809**	**189,036**
Operating lease income	4	5,004	5,946
Operating lease expense	4	3,149	4,063
Net operating lease income		**1,855**	**1,883**
Lending and credit fee income		6,455	7,894
Other income	5	6,696	5,965
Net operating income		**213,815**	**204,778**
Operating expenses	6	100,852	90,782
Profit before impaired asset expense and income tax		**112,963**	**113,996**
Fair value gain on investments		215	-
Impaired asset expense	8	14,579	29,372
Profit before income tax		**98,599**	**84,624**
Income tax expense	9	27,090	23,924
Profit for the year		**71,509**	**60,700**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss, net of income tax:			
Effective portion of change in fair value of derivative financial instruments		8,928	(2,179)
Movement in fair value reserve		(5,646)	766
Other comprehensive income/(loss) for the year, net of income tax		**3,282**	**(1,413)**
Total comprehensive income for the year		**74,791**	**59,287**

Total comprehensive income for the year is attributable to the owner of the Bank.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the year ended 30 June 2021

		June 2021				June 2020			
$000's	**Note**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**
Balance at beginning of year		**553,239**	**(2,527)**	**46,325**	**597,037**	**553,239**	**(1,114)**	**51,265**	**603,390**
NZ IFRS 16 adjustment		-	-	-	-	-	-	(640)	(640)
Restated balance at beginning of year		**553,239**	**(2,527)**	**46,325**	**597,037**	**553,239**	**(1,114)**	**50,625**	**602,750**
Total comprehensive income for the year									
Profit for the year		-	-	71,509	71,509	-	-	60,700	60,700
Other comprehensive income /(loss), net of income tax	16	-	3,282	-	3,282	-	(1,413)	-	(1,413)
Total comprehensive income for the year		**-**	**3,282**	**71,509**	**74,791**	**-**	**(1,413)**	**60,700**	**59,287**
Contributions by and distributions to owners									
Dividend to Heartland Group Holdings Limited	15	-	-	(30,000)	(30,000)	-	-	(65,000)	(65,000)
Total transactions with owners		**-**	**-**	**(30,000)**	**(30,000)**	**-**	**-**	**(65,000)**	**(65,000)**
Balance at end of the year		**553,239**	**755**	**87,834**	**641,828**	**553,239**	**(2,527)**	**46,325**	**597,037**

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Consolidated Statement of Financial Position

As at 30 June 2021

$000's	Note	June 2021	June 2020
Assets			
Cash and cash equivalents		112,903	105,463
Investments	10	358,975	399,308
Investment properties		11,832	11,132
Derivative financial instruments	11	14,111	17,246
Due from related parties	18	146	1,481
Finance receivables	12	3,213,593	3,044,960
Finance receivables - reverse mortgages	12	601,505	609,346
Operating lease vehicles	13	10,865	17,603
Right of use assets	17	15,654	17,843
Other assets	17	14,822	17,380
Intangible assets	17	52,831	57,470
Deferred tax asset	9	12,251	15,327
Total assets		**4,419,488**	**4,314,559**
Liabilities			
Deposits	14	3,219,522	3,269,239
Other borrowings	14	502,885	358,732
Due to related parties	18	3,210	7,944
Lease liabilities	17	17,780	19,871
Tax liabilities		7,556	11,271
Derivative financial instruments	11	4,789	16,974
Trade and other payables	17	21,918	33,491
Total liabilities		**3,777,660**	**3,717,522**
Equity			
Share capital	15	553,239	553,239
Retained earnings and other reserves		88,589	43,798
Total equity		**641,828**	**597,037**
Total equity and liabilities		**4,419,488**	**4,314,559**
Total interest earning and discount bearing assets		4,215,116	4,143,158
Total interest and discount bearing liabilities		3,704,130	3,614,022

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

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Consolidated Statement of Cash Flows

For the year ended 30 June 2021

$000's	Note	June 2021	June 2020
Cash flows from operating activities			
Interest received		236,081	258,797
Operating lease income received		5,046	5,934
Lending, credit fees and other income received		8,431	17,422
Operating inflows		**249,558**	**282,153**
Interest paid		(88,635)	(103,793)
Payments to suppliers and employees		(86,261)	(77,904)
Taxation paid		(27,518)	(20,281)
Operating outflows		**(202,414)**	**(201,978)**
Net cash flows from operating activities before changes in operating assets and liabilities		**47,144**	**80,175**
Proceeds from sale of operating lease vehicles		6,821	4,969
Purchase of operating lease vehicles		(1,788)	(9,938)
Net movement in finance receivables		(136,202)	(51,372)
Net movement in deposits		(43,587)	116,040
Net movement in related party balances		(3,399)	27,640
Net cash flows (applied to)/from operating activities[1]		**(131,011)**	**167,514**
Cash flows from investing activities			
Sale of property, plant and equipment and intangible assets		-	95
Total cash provided from investing activities		**-**	**95**
Purchase of property, plant and equipment and intangible assets		(6,520)	(6,602)
Net decrease/(increase) in investments		24,215	(33,627)
Total cash from/(applied to) investing activities		**17,695**	**(40,229)**
Net cash flows from/(applied to) investing activities		**17,695**	**(40,134)**
Cash flows from financing activities			
Net increase in wholesale funding		152,783	5,745
Total cash provided from financing activities		**152,783**	**5,745**
Dividends paid	15	(30,000)	(65,000)
Payment of lease liabilities		(2,027)	(1,802)
Total cash (applied to) financing activities		**(32,027)**	**(66,802)**
Net cash flows from/(applied to) financing activities		**120,756**	**(61,057)**
Net increase in cash held		**7,440**	**66,323**
Opening cash and cash equivalents		105,463	39,140
Closing cash and cash equivalents		**112,903**	**105,463**

[1]Cash flows from operating activities do not include cash flows from wholesale funding which are included as part of financing activities.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Consolidated Statement of Cash Flows (Continued)

For the year ended 30 June 2021

Reconciliation of profit after tax to net cash flows from operating activities

$000's	Note	June 2021	June 2020
Profit for the year		**71,509**	**60,700**
Add/(less) non-cash items:			
Depreciation and amortisation expense		14,293	8,859
Depreciation on lease vehicles	13	2,801	3,634
Capitalised net interest income and fee income		(34,555)	(39,620)
Impaired asset expense	8	14,579	29,372
Investments fair value movement		(215)	-
Other non-cash items		(23,210)	6,310
Total non-cash items		**(26,307)**	**8,555**
Add/(less) movements in operating assets and liabilities:			
Finance receivables		(136,202)	(51,372)
Operating lease vehicles		5,033	(4,969)
Other assets		2,884	32,471
Current tax		(3,715)	5,604
Derivative financial instruments		(122)	869
Deferred tax		3,076	(5,379)
Deposits		(43,587)	116,040
Other liabilities		(3,580)	4,995
Total movements in operating assets and liabilities		**(176,213)**	**98,259**
Net cash flows applied to operating activities[1]		**(131,011)**	**167,514**

[1]Cash flows from operating activities do not include cash flows from wholesale funding which are included as part of financing activities.

The notes to the financial statements form an integral part of, and should be read in conjunction with, these consolidated financial statements.

Notes to the Financial Statements

For the year ended 30 June 2021

1 Financial statements preparation

Reporting entity

The financial statements presented are the consolidated financial statements comprising Heartland Bank Limited (**HBL** or the **Bank**) and its subsidiaries (the **Banking Group**). Refer Note 26 – Significant subsidiaries for further details.

As at 30 June 2021, the Bank is a company incorporated in New Zealand under the Companies Act 1993, a registered bank under the Reserve Bank of New Zealand Act 1989 and a Financial Market Conduct (**FMC**) reporting entity for the purposes of the Financial Markets Conduct Act 2013.

Basis of preparation

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (**NZ GAAP**) and with the requirements of the Financial Markets Conduct Act 2013. The financial statements comply with New Zealand equivalents to International Financial Reporting Standards (**NZ IFRS**) and other applicable Financial Reporting Standards as appropriate for profit-oriented entities, and the Registered Bank Disclosure Statement (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the **Order**). The financial statements also comply with International Financial Reporting Standards (**IFRS**) as issued by the International Accounting Standards Board.

The financial statements are presented in New Zealand dollars which is the Banking Group's functional and presentation currency. Unless otherwise indicated, amounts are rounded to the nearest thousand dollars.

The financial statements have been prepared on a going concern basis after considering the Banking Group's funding and liquidity position.

The accounting policies adopted have been applied consistently throughout the periods presented in these financial statements.

Certain comparative balances have been reclassified to align with the presentation used in the current financial year. These reclassifications have no impact on the overall financial performance or financial position of the comparative year.

Basis of measurement

The financial statements have been prepared on the basis of historical cost, except for certain financial instruments and investment properties, which are measured at their fair values as identified in the accounting policies set out in the accompanying notes to the financial statements.

Principles of consolidation

The consolidated financial statements of the Banking Group incorporate the assets, liabilities and results of all controlled entities. Controlled entities are all entities in which the Bank is exposed to, or has rights to, variable returns from its involvement with the entities and has the ability to affect those returns through its power over the entities. Intercompany transactions, balances and any unrealised income and expense (except for foreign currency transaction gains or losses) between controlled entities are eliminated.

Assets and liabilities in a transactional currency that is not the New Zealand dollar, are translated at the exchange rates ruling at balance date. Revenue and expense items are translated at the average rate at the balance date. Exchange differences are taken to the consolidated statement of comprehensive income.

1 Financial statements preparation (continued)

Changes in accounting standards

Accounting standards issued and effective

There have been no changes to accounting policies or other new or amended standards that are issued and effective that are expected to have a material impact on the Banking Group.

Accounting standards issued but not yet effective

NZ IFRS 17 Insurance Contracts was issued in July 2017 and is applicable to general and life insurance contracts. NZ IFRS 17 will replace NZ IFRS 4 Insurance Contracts. In March 2020, the effective date of NZ IFRS 17 was deferred by one year. As such the standard will be effective for the Banking Group's reporting for the financial year ending 30 June 2024, including 30 June 2023 comparatives.

MARAC Insurance Limited (**MIL**), a subsidiary of HBL, no longer conducts insurance business as HBL entered into a distribution agreement with DPL Insurance Limited (**DPL**) to distribute DPL's insurance products through HBL's network. MIL stopped writing insurance policies in the prior year with the last policies expected to expire in 2025.

Other amendments to existing standards that are not yet effective are not expected to have a material impact on the Banking Group.

Estimates and judgements

The preparation of the Banking Group's consolidated financial statements requires the use of estimates and judgements. This note provides an overview of the areas that involve a higher degree of judgement or complexity. Detailed information about each of these estimates and judgements is included in the relevant notes together with the basis of calculation for each affected item in the financial statements.

- Provisions for impairment - The effect of credit risk is quantified based on the Banking Group's best estimate of future cash repayments and proceeds from any security held or by reference to risk profile groupings, historical loss data and forward-looking information. Refer to Note 8 - Impaired asset expense, and Note 12 - Finance receivables for further details.
- Fair value of reverse mortgages - Fair value is quantified by the transaction price and the Banking Group's subsequent best estimate of the risk profile of the reverse mortgage portfolio. Refer to Note 19 - Fair value for further details.
- Goodwill - Determining the fair value of assets and liabilities of acquired businesses requires the Banking Group to exercise judgement. The carrying value of goodwill is tested annually for impairment, refer to Note 17 - Other balance sheet items.

Assumptions made at each reporting date (e.g. the calculation of the provision for impairment and fair value adjustments) are based on best estimates as at that date. Although the Banking Group has internal controls in place to ensure that estimates can be reliably measured, actual amounts may differ from these estimates. The estimates and judgements used in the preparation of the Banking Group's financial statements are continually evaluated. They are based on historical experience and other factors, including expectations of future events that may have a financial impact on the entity. Revisions to accounting estimates are recognised in the reporting period in which the estimates are revised and in any future periods affected.

1 Financial statements preparation (continued)

COVID-19 pandemic - impact on estimates and judgements

The COVID-19 pandemic resulted in the Banking Group adopting an economic overlay for expected credit losses (**ECL**) to its portfolios as at 30 June 2020 of pre-tax $9.6 million in response to the uncertain but potential economic impact of COVID-19 on HBL's borrowers (**COVID Overlay**). The COVID Overlay was sized based on a range of techniques including stress testing, benchmarking, scenario analysis and expert judgement.

To date, the impact of COVID-19 on HBL's borrowers has been more benign than was initially forecast, and the COVID Overlay has not been utilised. However, the continued prevalence of COVID-19 in other countries (including the emergence of new variants), together with vaccination rates and border closures provides an ongoing risk of further economic disruption in New Zealand. Furthermore, Government stimulus has given rise to the potential for inflationary pressures, a steepening interest rate environment, and a higher cost of labour and inputs in the medium term.

Management notes the uncertainties associated with the ongoing economic impacts of COVID-19 and consequently have decided to retain the COVID Overlay in full at this stage.

The accounting judgement that is most impacted by the COVID Overlay is the ECL on finance receivables at amortised cost. The Banking Group measures the allowance for ECL using an ECL impairment model in compliance with NZ IFRS 9 Financial Instruments.

The estimates and judgements considered to apply the COVID Overlay adequately in the ECL on finance receivables at amortised cost is further discussed in Note 8 Impaired asset expense.

Financial assets and liabilities

Financial assets

Financial assets are classified based on:

- The business model within which the assets are managed; and
- Whether the contractual cash flows of the instrument represent solely payment of principal and interest (**SPPI**).

The Banking Group determines the business model at the level that reflects how groups of financial assets are managed. When assessing the business model, the Banking Group considers factors including how performance and risks are managed, evaluated and reported and the frequency and volume of, and reason for sales in previous periods.

1 Financial statements preparation (continued)

Financial assets (continued)

Financial assets are classified into the following measurement categories:

Financial Assets	Measurement Category	Note
Bank bonds and floating rate notes	Fair value through other comprehensive income (**FVOCI**)	10
Public sector securities and corporate bonds	FVOCI	10
Equity investments	Fair value through profit or loss (**FVTPL**)	10
Finance receivables – reverse mortgages	FVTPL	12
Finance receivables	Amortised cost	12

Financial assets measured at amortised cost
Financial assets are measured at amortised cost if they are held within a business model whose objective is achieved through holding the financial asset to collect contractual cash flows which represent SPPI on the principal balance.

Financial assets at amortised cost are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

Financial assets measured at FVOCI
Financial assets are measured at FVOCI if they are held within a business model whose objective is achieved both through collecting contractual cash flows which represent SPPI on the principal balance or selling the financial asset.

Financial assets at FVOCI are measured at fair value with unrealised gains and losses recognised in other comprehensive income except for interest income, impairment charges and foreign exchange gains and losses, which are recognised in profit or loss.

Financial assets measured at FVTPL
Financial assets are measured at FVTPL if:

- They are held within a business model whose objective is achieved through selling or repurchasing the financial asset in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or
- They are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

Financial assets at FVTPL are measured at fair value with subsequent changes in fair value recognised in profit or loss.

Financial liabilities

Financial liabilities are classified into the following measurement categories:

- Those to be measured at amortised cost;
- Those to be measured at FVTPL.

Financial liabilities measured at amortised cost
Financial liabilities are measured at amortised cost if they are not held for trading or not designated at FVTPL.

Financial liabilities measured at amortised cost are accounted for using the effective interest rate method.

1 Financial statements preparation (continued)

Financial liabilities (continued)

Financial liabilities measured at FVTPL
Financial liabilities are measured at FVTPL if:

- They are held for trading whose principal objective is achieved through selling or repurchasing the financial liability in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or
- They are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

Financial liabilities at FVTPL are measured at fair value with subsequent changes in fair value recognised in profit or loss.

Further details of the accounting policy for each category of financial asset or financial liability mentioned above is set out in the note for the relevant item.

The Banking Group's policies for determining the fair value of financial assets and financial liabilities are set out in Note 19 - Fair value.

Recognition

The Banking Group initially recognises finance receivables and borrowings on the date that they are originated. All other financial assets and liabilities (including assets and liabilities designated at FVTPL) are initially recognised on the trade date at which the Banking Group becomes a party to the contractual provisions of the instrument.

Derecognition

The Banking Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Banking Group is recognised as a separate asset.

The Banking Group enters into transactions whereby it transfers assets recognised on its consolidated statement of financial position, but retains either all risks or rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the consolidated statement of financial position. Transfers of assets with the retention of all or substantially all risks and rewards include, for example, securitised assets and repurchase transactions.

Financial liabilities are derecognised when the obligation is discharged, cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, the exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, with the difference in the respective carrying amounts recognised in profit or loss.

Offsetting financial instruments

The Banking Group offsets financial assets and financial liabilities and reports the net balance in the balance sheet where there is currently a legally enforceable right to set off and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Performance

2 Segmental analysis

Segment information is presented in respect of the Banking Group's operating segments which are those used for the Banking Group's management and internal reporting structure.

Operating segments

The Banking Group operates within New Zealand and comprises the following main operating segments:

Motor	Motor vehicle finance.
Reverse mortgages	Reverse mortgage lending in New Zealand.
Other personal	A range of financial services - including term, transactional and personal loans to individuals.
Business	Term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized businesses.
Rural	Specialist financial services to the farming sector primarily offering livestock finance, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.

Certain operating expenses, such as premises, IT, support centre costs and tax expense are not allocated to operating segments and are included in Other. Finance receivables are allocated across the operating segments as assets and liabilities are managed centrally and therefore are not allocated across the operating segments.

The Banking Group's operating segments are different from the industry categories detailed in Note 21 - Credit risk exposure. The operating segments are primarily categorised by sales channel, whereas Note 21 - Credit risk exposure categorises exposures based on credit risk concentrations.

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Other	Total
June 2021							
Net interest income	65,829	23,098	13,648	66,112	30,579	(457)	198,809
Net other income	3,343	2,369	2,767	2,963	1,581	1,983	15,006
Net operating income	**69,172**	**25,467**	**16,415**	**69,075**	**32,160**	**1,526**	**213,815**
Operating expenses	3,787	4,397	6,241	11,340	2,124	72,963	100,852
Profit/(loss) before impaired asset expense and income tax	**65,385**	**21,070**	**10,174**	**57,735**	**30,036**	**(71,437)**	**112,963**
Fair value gain on investment	-	-	-	-	-	215	215
Impaired asset expense	5,298	-	1,977	5,655	1,649	-	14,579
Profit/(loss) before income tax	**60,087**	**21,070**	**8,197**	**52,080**	**28,387**	**(71,222)**	**98,599**
Income tax expense	-	-	-	-	-	27,090	27,090
Profit/(loss) for the year	**60,087**	**21,070**	**8,197**	**52,080**	**28,387**	**(98,312)**	**71,509**
Total assets	**1,287,978**	**601,505**	**137,910**	**1,225,710**	**586,318**	**580,067**	**4,419,488**
Total liabilities							**3,777,660**

2 Segmental analysis (continued)

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Other	Total
June 2020							
Net interest income	56,957	20,118	18,365	57,950	29,674	5,972	189,036
Net other income	3,622	3,430	3,055	3,465	1,028	1,142	15,742
Net operating income	**60,579**	**23,548**	**21,420**	**61,415**	**30,702**	**7,114**	**204,778**
Operating expenses	3,248	4,804	6,776	11,283	2,648	62,023	90,782
Profit/(loss) before impaired asset expense and income tax	**57,331**	**18,744**	**14,644**	**50,132**	**28,054**	**(54,909)**	**113,996**
Impaired asset expense/(benefit)	10,113	-	11,119	10,110	(1,970)	-	29,372
Profit/(loss) before income tax	**47,218**	**18,744**	**3,525**	**40,022**	**30,024**	**(54,909)**	**84,624**
Income tax expense	-	-	-	-	-	23,924	23,924
Profit/(loss) for the year	**47,218**	**18,744**	**3,525**	**40,022**	**30,024**	**(78,833)**	**60,700**
Total assets	**1,125,295**	**559,934**	**214,759**	**1,126,632**	**604,938**	**683,001**	**4,314,559**
Total liabilities							**3,717,522**

3 Net interest income

Policy

Interest income and expense on financial instruments is measured using the effective interest rate method that discounts the financial instruments' future cash flows to their present value and allocates the interest income or expense over the life of the financial instrument. The effective interest rate is established on initial recognition of the financial assets or liabilities and is not subsequently revised. For financial instruments at amortised cost, the calculation of the effective interest rate includes all yield related fees and commissions paid or received that are an integral part of the underlying financial instrument.

$000's	June 2021	June 2020
Interest income		
Cash and cash equivalents	117	482
Investments	6,979	8,496
Finance receivables	231,659	250,592
Finance receivables - reverse mortgages	33,807	37,942
Total interest income	**272,562**	**297,512**
Interest expense		
Deposits	55,295	90,786
Other borrowings	14,935	14,188
Net interest expense on derivative financial instruments	3,523	3,502
Total interest expense	**73,753**	**108,476**
Net interest income	**198,809**	**189,036**

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4 Net operating lease income

Policy

As a lessor, the Banking Group retains substantially all the risks and rewards incidental to ownership of the assets and therefore classifies the leases as operating leases. Rental income and expense from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term. Profits on the sale of operating lease assets are included as part of operating lease income. Current year depreciation and losses on the sale of operating lease assets are included as part of operating lease expenses. The leased assets are depreciated over their useful lives on a basis consistent with similar assets.

$000's	June 2021	June 2020
Operating lease income		
Lease income	3,908	5,194
Gain on disposal of lease assets	1,096	752
Total operating lease income	**5,004**	**5,946**
Operating lease expense		
Depreciation on lease assets	2,801	3,634
Direct lease costs	348	429
Total operating lease expense	**3,149**	**4,063**
Net operating lease income	**1,855**	**1,883**

5 Other income

Policy

Rental income from investment property

Rental income from investment properties is recognised on a straight-line basis over the term of the relevant lease.

Insurance income

Insurance premium income and commission expense are recognised in profit or loss from the date of attachment of the risk over the period of the insurance contract. Claim expense is recognised in the profit or loss on an accrual basis once our liability to the policyholder has been confirmed under the terms of the contract.

$000's	June 2021	June 2020
Rental income from investment properties	1,055	1,124
Insurance income	1,096	1,610
Gain on sale of investments	157	-
Other income	4,211	2,810
FX gain/(loss)	177	421
Total other income	**6,696**	**5,965**

6 Operating expenses

Policy

Operating expenses are recognised as the underlying service is rendered or over a period in which an asset is consumed or a liability is incurred.

$000's	June 2021	June 2020
Personnel expenses	57,036	45,759
Directors' fees	676	650
Superannuation	979	836
Depreciation - property, plant and equipment	2,883	2,280
Legal and professional fees	2,110	3,049
Advertising and public relations	3,972	4,577
Depreciation - right of use asset	2,123	2,122
Technology services	6,908	6,063
Telecommunications, stationery and postage	1,610	1,651
Customer acquisition costs	2,123	2,919
Amortisation of intangible assets	9,285	4,456
Other operating expenses[1]	11,147	16,420
Total operating expenses	**100,852**	**90,782**

[1]Other operating expenses include compensation of auditor which is further disclosed in Note 7.

7 Compensation of auditor

$000's	June 2021	June 2020
Audit and review of the financial statements[1]	599	559
Other assurance services paid to auditor [2]	20	60
Total compensation of auditor	**619**	**619**

[1] Audit and review of the financial statements includes fees paid for both the audit of the annual financial statements and review of interim financial statements.

[2] Other assurance related services paid to auditor comprise regulatory assurance services, trust deed reporting and registry audits.

8 Impaired asset expense

Policy

Impairment of finance receivables

At each reporting date, the Banking Group applies a three stage approach to measuring ECL to finance receivables not carried at fair value. The ECL model assesses whether there has been a significant increase in credit risk since initial recognition.

The ECL model is a forward looking model where impairment allowances are recognised before losses are actually incurred. On initial recognition, an impairment allowance is required, based on events that are possible in the next 12 months.

Assets may migrate through the following stages based on their change in credit quality:

Stage 1 - 12 months ECL (past due 30 days or less)

Where there has been no evidence of increased credit risk since initial recognition, and finance receivables are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

Stage 2 - Lifetime ECL not credit impaired (greater than 30 but less than 90 days past due)

Where there has been a significant increase in credit risk.

Stage 3 - Lifetime ECL credit impaired (90 days past due or more)

Objective evidence of impairment, so are considered to be in default or otherwise credit impaired.

In determining whether credit risk has increased all available information relevant to the assessment of economic conditions at the reporting date are taken into consideration. To do this the Banking Group considers its historical loss experience and adjusts this for current observable data. In addition to this the Banking Group uses reasonable and supportable forecasts of future economic conditions including experienced judgement to estimate the amount of an expected impairment loss. Future economic conditions consider macroeconomic factors such as unemployment, interest rate, gross domestic product, and inflation, and requires an evaluation of both the current and forecast direction of the economic cycle. The methodology and assumptions including any forecasts of future economic conditions are reviewed regularly as incorporating forward-looking information increases the level of judgement as to how changes in these macroeconomic factors will affect the ECL.

The calculation of ECL is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

For assets that are individually assessed for ECL, the allowance for ECL is calculated directly as the difference between the defaulted assets carrying value and the recoverable amount (being the present value of expected future cash flows, including cash flows from the realisation of collateral or guarantees, where applicable).

$000's	**June 2021**	**June 2020**
Non-securitised		
Individually impaired asset expense	9,131	3,385
Collectively impaired asset expense	5,606	25,590
Total non-securitised impaired asset expense	**14,737**	**28,975**
Securitised		
Collectively impaired asset expense	(158)	397
Total securitised impaired asset expense	**(158)**	**397**
Total		
Individually impaired asset expense	9,131	3,385
Collectively impaired asset expense	5,448	25,987
Total impaired asset expense	**14,579**	**29,3[illegible]**

8 Impaired asset expense (continued)

The Banking Group's models for estimating ECL for each of its portfolios are based on the historic credit experience of those portfolios. The models assume that economic conditions (such as GDP growth, unemployment rates, and house price index forecasts) remain static over time. If the Banking Group forecasts that economic conditions may change in the foreseeable future, the Banking Group applies judgement to determine whether the modelled output should be subject to an economic overlay. Judgment is required because analysis has been unable to establish any clear correlation between key economic indicators and the credit performance of the Banking Group's unique portfolios.

The onset of COVID-19 caused a deterioration in economic conditions, creating uncertainty regarding the impact on HBL's borrowers over and above the modelled ECL. Accordingly, as at 30 June 2020 a COVID Overlay was sized based on a range of techniques (including stress testing, benchmarking, scenario analysis and expert judgement) and adopted by the Banking Group.

The COVID-19 Overlay has not been utilised at this stage. Despite forecasts showing improvements in the economic conditions, new variants of COVID-19 have emerged and vaccination strategies are varied and as yet unproven across a sufficient population. Furthermore, Government stimulus has given rise to the potential for inflationary pressures, a steepening interest rate environment, and a higher cost of labour in the medium term. Management considers that sufficient uncertainty remains such that the COVID Overlay should be retained in full at this stage.

9 Taxation

Policy

Income tax

Income tax expense for the year comprises current tax and movements in deferred tax balances, including any adjustment required for prior years' tax expense. Income tax expense is recognised in profit and loss except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in equity or other comprehensive income.

Current tax

Current tax is the expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to the tax payable or receivable in respect of previous years. Current tax for current and prior years is recognised as a liability (or asset) to the extent that it is unpaid (or refundable).

Deferred tax

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for accounting purposes and the amounts used for taxation purposes. As required by NZ IAS 12 Income Taxes, a deferred tax asset is recognised only to the extent that it is probable that a future taxable profit will be available to realise the asset.

Goods and services tax (GST)

Revenues, expenses and assets are recognised net of GST. As the Banking Group is predominantly involved in providing financial services, only a proportion of GST paid on inputs is recoverable. The non-recoverable proportion of GST is treated as an expense or, if relevant, as part of the cost of acquisition of an asset.

9 Taxation (continued)

Income tax expense

$000's	June 2021	June 2020
Income tax recognised in profit or loss		
Current tax		
Current year	24,823	26,281
Adjustments for prior year	(483)	1,536
Deferred tax		
Current year	2,573	(2,418)
Adjustments for prior year	177	(1,475)
Total income tax expense recognised in profit or loss	**27,090**	**23,924**
Income tax recognised in other comprehensive income		
Current tax		
Derivatives at fair value reserve	(2,197)	768
Fair value movements of cash flow hedge	3,457	(1,477)
Total income tax expense recognised in other comprehensive income	**1,260**	**(709)**

Reconciliation of effective tax rate:

$000's	June 2021	June 2020
Profit before income tax	**98,599**	**84,624**
Prima facie tax @ 28%	27,607	23,695
Adjusted tax effect of items not taxable/deductible	(211)	168
Adjustments for prior year	(306)	61
Total income tax expense	**27,090**	**23,924**

Deferred tax assets comprise the following temporary differences:

$000's	June 2021	June 2020
Employee entitlements	1,009	1,468
Share based payment	202	-
Provision for impairment	14,305	17,547
Intangibles and property, plant and equipment	(3,800)	(4,576)
Deferred acquisition costs	(475)	(936)
Operating lease vehicles	479	731
Other temporary differences	531	1,093
Total deferred tax assets	**12,251**	**15,327**
Opening balance of deferred tax assets	**15,327**	**9,948**
Movement recognised in profit or loss	(3,076)	5,136
Movement recognised in retained earnings	-	243
Closing balance of deferred tax assets	**12,251**	**15,327**

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Financial Position

10 Investments

Policy

Investments are classified into one of the following categories:

Fair value through profit or loss

Investments under this category include equity investments and are measured at fair value plus transaction costs. Changes in fair value of these investments are recognised in profit or loss in the period in which they occur.

Fair value through other comprehensive income

Investments under this category include bank bonds, floating rate notes, local authority stock, public securities and corporate bonds. These are initially measured at fair value, including transaction costs, and subsequently carried at fair value. Changes in fair value of these investments are recognised in other comprehensive income and presented within the fair value reserve.

Amortised cost

Investments under this category include bank deposits and are measured using effective interest rate method. They are held to collect contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

$000's	June 2021	June 2020
Bank deposits, bank bonds and floating rate notes	351,614	366,289
Public sector securities and corporate bonds	5,543	30,716
Equity investments	1,818	2,303
Total investments	**358,975**	**399,308**

Refer to Note 19 - Fair value for details of the split between investments measured at fair value through profit or loss, fair value through other comprehensive income and amortised cost.

11 Derivative financial instruments

Policy

The Banking Group uses derivatives for risk management purposes. Derivatives held for risk management purposes include hedges that either meet the hedge accounting requirements set out in NZ IAS 39, or economic hedges not placed into an accounting hedge relationship.

Derivatives are recognised at their fair value, with the derivatives being carried as assets when their fair value is positive and as liabilities when their fair value is negative.

A hedged item is an asset, liability, firm commitment or highly probable forecast transaction that exposes the Banking Group to risk of changes in fair value or cash flows, and that is designated as being hedged. The Banking Group applies fair value hedge accounting to hedge movements in the value of fixed interest rate assets and liabilities subject to interest rate risk. The Banking Group applies cash flow hedge accounting to hedge the variability in highly probable forecast future cash flows attributable to interest rate risk on variable rate assets and liabilities.

Fair value hedge accounting

The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments or counterparty must be a third party external to the Banking Group.

The Banking Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Banking Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value of hedged items.

Subsequent to initial designation, changes in the fair value of derivatives that are designated and qualify for fair value hedge accounting are recorded through profit or loss alongside any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

Where the hedged item is carried at amortised cost, the movement in fair value of the hedged item attributable to the hedged risk is made as an adjustment to the carrying value of the hedged asset or liability. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, the adjustment to carrying amount of a hedged item carried at amortised cost is amortised to the consolidated statement of comprehensive income on an effective yield basis over the remaining period to maturity of the hedged item. Where a hedged item carried at amortised cost is derecognised from the balance sheet, the adjustment to the carrying amount of the asset or liability is immediately transferred to the consolidated statement of comprehensive income.

Cash flow hedge accounting

The criteria that must be met for a relationship to qualify for hedge accounting include:

- the hedging relationship must be formally designated and documented at inception of the hedge,
- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments or counterparty must be a third party external to the Banking Group.

11 Derivative financial instruments (continued)

The Banking Group documents, at the inception of the transaction, the relationship between hedged items and hedging instruments, as well as its risk management objective and strategy for undertaking various hedge transactions. The Banking Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

A fair value gain or loss associated with the effective portion of a derivative designated as a cash flow hedge is recognised initially in the hedging reserve. The ineffective portion of a fair value gain or loss is recognised immediately in the consolidated statement of comprehensive income.

When a hedging derivative expires or is sold, the hedge no longer meets the criteria for hedge accounting, or the Banking Group elects to revoke the hedge designation, the cumulative gain or loss on the hedging derivative remains in the cash flow hedging reserve until the forecast transaction occurs and affects income, at which point it is transferred to the corresponding income or expense line. If a forecast transaction is no longer expected to occur, the cumulative gain or loss on the hedging derivative previously reported in the cash flow hedging reserve is immediately transferred to the consolidated statement of comprehensive income.

	June 2021			June 2020		
$000's	**Notional Principal**	**Fair Value Assets**	**Fair Value Liabilities**	**Notional Principal**	**Fair Value Assets**	**Fair Value Liabilities**
Held for risk management						
Interest rate related contracts						
Swaps	1,104,012	14,106	4,520	1,140,422	17,238	16,939
Foreign currency related contracts						
Forwards	27,846	5	269	168,100	8	35
Total derivative financial instruments	**1,131,858**	**14,111**	**4,789**	**1,308,522**	**17,246**	**16,974**

The Banking Group has entered into credit support annexes (**CSAs**) which form a part of International Swaps and Derivatives Association (**ISDA**) Master Agreement, in respect of certain exposures relating to derivative transactions. As per these CSAs, the Banking Group or the counterparty needs to collateralise the market value of outstanding derivative transactions. As at 30 June 2021, the Banking Group has received $4.09 million of cash collateral (2020: nil) against derivative assets. The cash collateral received is not netted off against the balance of derivative assets disclosed in the consolidated statement of financial position.

12 Finance receivables

(a) Finance receivables held at amortised cost

Policy

Finance receivables are initially recognised at fair value plus incremental direct transaction costs and are subsequently measured at amortised cost using the effective interest method, less any impairment loss.

Fees and direct costs relating to loan origination, financing and loan commitments are deferred and amortised to interest income over the life of the loan using the effective interest rate method. Lending fees not directly related to the origination of a loan are recognised over the period of service.

Past due but not impaired assets are any assets which have not been operated by the counterparty within their key terms but are not considered to be impaired by the Banking Group.

Individually impaired assets are those loans for which the Banking Group has evidence that it will incur a loss, and will be unable to collect all principal and interest due according to the contractual terms of the loan.

In determining whether credit risk has increased all available information relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date are taken into consideration.

The calculation of ECL is modelled for portfolios of like assets. For portfolios which are either new or too small to model, judgement is used to determine impairment provisions.

$000's	**June 2021**	**June 2020**
Non-securitised		
Neither at least 90 days past due nor impaired	3,063,258	2,945,623
At least 90 days past due	36,602	58,876
Individually impaired	38,143	24,667
Gross finance receivables	**3,138,003**	**3,029,166**
Less provision for impairment	(50,809)	(62,272)
Total non-securitised finance receivables	**3,087,194**	**2,966,894**
Securitised		
Neither at least 90 days past due nor impaired	126,638	78,059
At least 90 days past due	-	404
Individually impaired	-	-
Gross finance receivables	**126,638**	**78,463**
Less provision for impairment	(239)	(397)
Total securitised finance receivables	**126,399**	**78,066**
Total		
Neither at least 90 days past due nor impaired	3,189,896	3,023,682
At least 90 days past due	36,602	59,280
Individually impaired	38,143	24,667
Gross finance receivables	**3,264,641**	**3,107,629**
Less provision for impairment	(51,048)	(62,669)
Total finance receivables	**3,213,593**	**3,044,960**

Refer to Note 22 - Asset quality for further analysis of finance receivables by credit risk concentration.

The impact of COVID-19 on use of judgements and estimates is discussed in Note 8 - Impaired asset expense.

12 Finance receivables (continued)

(a) Finance receivables held at amortised cost (continued)

Movement in provision

The following table details the movement from the opening balance to the closing balance of the provision for impairment losses by class.

$000's	12 - Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2021					
Non-securitised					
Impairment allowance as at 30 June 2020	**32,160**	**2,144**	**22,667**	**5,301**	**62,272**
Changes in loss allowance					
Transfer between stages	(2,466)	(1,081)	(50)	3,597	-
New and increased provision (net of collective provision releases)	(3,495)	1,309	13,295	6,034	17,143
Recovery of amounts written off	-	-	(2,406)	-	(2,406)
Credit impairment charge	**(5,961)**	**228**	**10,839**	**9,631**	**14,737**
Recovery of amounts previously written off	-	-	2,406	-	2,406
Write offs	-	-	(19,291)	(7,303)	(26,594)
Effect of changes in foreign exchange rate	(33)	2	6	-	(25)
Acquisition of portfolio	133	22	188	-	343
Sale of portfolio	(2,083)	(62)	(185)	-	(2,330)
Impairment allowance as at 30 June 2021	**24,216**	**2,334**	**16,630**	**7,629**	**50,809**
Securitised					
Impairment allowance as at 30 June 2020	**260**	**23**	**114**	**-**	**397**
Changes in loss allowance					
Transfer between stages	(4)	(3)	7	-	-
New and increased provision (net of collective provision releases)	(40)	2	(120)	-	(158)
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**(44)**	**(1)**	**(113)**	**-**	**(158)**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Impairment allowance as at 30 June 2021	**216**	**22**	**1**	**-**	**239**
Total					
Impairment allowance as at 30 June 2020	**32,420**	**2,167**	**22,781**	**5,301**	**62,669**
Changes in loss allowance					
Transfer between stages	(2,470)	(1,084)	(43)	3,597	-
New and increased provision (net of collective provision releases)	(3,535)	1,311	13,175	6,034	16,985
Recovery of amounts written off	-	-	(2,406)	-	(2,406)
Credit impairment charge	**(6,005)**	**227**	**10,726**	**9,631**	**14,579**
Recovery of amounts previously written off	-	-	2,406	-	2,406
Write offs	-	-	(19,291)	(7,303)	(26,594)
Effect of changes in foreign exchange rate	(33)	2	6	-	(25)
Acquisition of portfolio	133	22	188	-	343
Sale of portfolio	(2,083)	(62)	(185)	-	(2,330)
Impairment allowance as at 30 June 2021	**24,432**	**2,356**	**16,631**	**7,629**	**51,04[illegible]**

12 Finance receivables (continued)

(a) Finance receivables held at amortised cost (continued)

Movement in provision (continued)

$000's	12 - Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2020					
Non-securitised					
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Changes in loss allowance					
Transfer between stages	(1,190)	(294)	(109)	1,593	-
New and increased provision (net of collective provision releases)	2,901	2,091	24,999	1,792	31,783
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**1,711**	**1,797**	**22,082**	**3,385**	**28,975**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,658)	(5,947)	(28,043)
Effect of changes in foreign exchange rate	27	4	10	-	41
Impairment allowance as at 30 June 2020	**32,160**	**2,144**	**22,667**	**5,301**	**62,272**
Securitised					
Impairment allowance as at 30 June 2019	**-**	**-**	**-**	**-**	**-**
Changes in loss allowance					
Transfer between stages	(19)	11	8	-	-
New and increased provision (net of collective provision releases)	279	12	106	-	397
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**260**	**23**	**114**	**-**	**397**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Impairment allowance as at 30 June 2020	**260**	**23**	**114**	**-**	**397**
Total					
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Changes in loss allowance					
Transfer between stages	(1,209)	(283)	(101)	1,593	-
New and increased provision (net of collective provision releases)	3,180	2,103	25,105	1,792	32,180
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**1,971**	**1,820**	**22,196**	**3,385**	**29,372**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,658)	(5,947)	(28,043)
Effect of changes in foreign exchange rate	27	4	10	-	41
Impairment allowance as at 30 June 2020	**32,420**	**2,167**	**22,781**	**5,301**	**62,669**

12 Finance receivables (continued)

(a) Finance receivables held at amortised cost (continued)

Impact of changes in gross finance receivables held at amortised cost on allowance for ECL

$000's	12 - Month ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2021					
Gross finance receivables as at 30 June 2020	**2,825,973**	**183,260**	**73,729**	**24,667**	**3,107,629**
Transfer between stages	(102,624)	67,219	12,906	22,499	-
Additions	1,421,835	-	-	955	1,422,790
Deletions	(1,128,613)	(85,751)	(20,815)	(466)	(1,235,645)
Write offs	-	-	(20,621)	(9,512)	(30,133)
Gross finance receivables as at 30 June 2021	**3,016,571**	**164,728**	**45,199**	**38,143**	**3,264,641**
June 2020					
Gross finance receivables as at 30 June 2019	**2,799,220**	**206,882**	**57,043**	**26,412**	**3,089,557**
Transfer between stages	(61,191)	12,570	41,245	7,376	-
Additions	1,496,900	87,843	23,610	-	1,608,353
Deletions	(1,402,340)	(118,572)	(37,334)	(3,174)	(1,561,420)
Write offs	(6,616)	(5,463)	(10,835)	(5,947)	(28,861)
Gross finance receivables as at 30 June 2020	**2,825,973**	**183,260**	**73,729**	**24,667**	**3,107,629**

(b) Finance receivables held at fair value

Policy

Finance receivables – reverse mortgages are initially recognised, and subsequently measured, at fair value through profit or loss.

$000's	June 2021	June 2020
Finance receivables - reverse mortgages	601,505	609,346
Total finance receivables - reverse mortgages	601,505	609,346

Note 19 (a) - Financial instruments measured at fair value discloses further information regarding the Banking Group’s valuation policy.

Note 21 - Credit risk exposure discloses further information regarding how reverse mortgages operate.

Credit risk adjustments on financial assets designated at fair value through profit or loss

There were no credit risk adjustments on individual financial assets.

13 Operating lease vehicles

Policy

Operating lease vehicles are stated at cost less accumulated depreciation.

Operating lease vehicles are depreciated on a straight line basis over their expected useful life after allowing for any residual values. The estimated lives of these vehicles vary up to five years. Vehicles held for sale are not depreciated but are tested for impairment.

$000's	**June 2021**	**June 2020**
Cost		
Opening balance	24,098	21,623
Additions	1,788	9,938
Disposals	(9,772)	(7,463)
Closing balance	**16,114**	**24,098**
Accumulated depreciation		
Opening balance	6,495	6,107
Depreciation charge for the year	2,801	3,634
Disposals	(4,047)	(3,246)
Closing balance	**5,249**	**6,495**
Opening net book value	17,603	15,516
Closing net book value	**10,865**	**17,603**

The future minimum lease payments receivable under operating leases not later than one year is $2.141 million (2020: $3.487 million), within one to five years is $1.406 million (2020: $2.053 million) and over five years is nil (2020: nil).

14 Borrowings

Policy

Borrowings and deposits are initially recognised at fair value including incremental direct transaction costs. They are subsequently measured at amortised cost using the effective interest method.

$000's	**June 2021**	**June 2020**
Deposits	3,219,522	3,269,239
Total deposits	**3,219,522**	**3,269,239**
Unsubordinated notes	284,517	293,147
Securitised borrowings	108,150	65,585
Certificate of deposit	69,853	-
Repurchase agreement[1]	40,365	-
Total other borrowings	**502,885**	**358,732**

[1]The amounts disclosed as securities sold under arrangements to repurchase include $40.0 million (face value) of high quality liquid assets. The cash consideration received (recognised as a liability) was $40.4 million.

Deposits and unsubordinated notes rank equally and are unsecured.

14 Borrowings (continued)

The Banking Group has the following unsubordinated notes on issue at reporting date:

Principal	Valuation	Issue Date	Maturity	Frequency of Interest Repayment
$150 million	Amortised cost	21 September 2017	21 September 2022	Semi annually
$125 million	Amortised cost	12 April 2019	12 April 2024	Semi annually

At 30 June 2021 the Banking Group had the following securitised borrowings outstanding:

- Heartland Auto Receivables Warehouse Trust 2018-1 securitisation facility $300 million, drawn $108 million (2020: $300 million, drawn $66 million). Notes issued to investors are secured over the assets of the Heartland Auto Receivables Warehouse Trust 2018-1. The facility has a maturity date of 29 August 2022.

15 Share capital and dividends

Policy

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effect.

000's	June 2021 Number of Shares	June 2020 Number of Shares
Issued shares		
Opening balance	565,430	565,430
Closing balance	**565,430**	**565,430**

There were no new shares issued during the period (2020: nil).

Dividends paid

	June 2021 Date Declared	$000's	June 2020 Date Declared	$000's
Dividend to HGH	18 June 2021	30,000	1 August 2019	35,000
Dividend to HGH	-	-	15 November 2019	20,000
Dividend to HGH	-	-	5 December 2019	10,000
Total dividends paid		**30,000**		**65,000**

The change in Conditions of Registration (**COR**) effective from 2 April 2020 restricted the payment of dividends on ordinary shares, and the redemption on non-CET1 capital instruments as a result of the COVID-19 pandemic. On 29 April 2021, HBL's COR were updated to allow a dividend to be paid up to 50% of the most recently completed financial year's NPAT.

16 Other reserves

$000's	Fair Value Reserve	Defined Benefit Reserve	Cash Flow Hedge Reserve	Total
June 2021				
Balance as at 30 June 2020	5,324	171	(8,022)	(2,527)
Other comprehensive income, net of income tax	(5,646)	-	8,928	3,282
Balance as at 30 June 2021	**(322)**	**171**	**906**	**755**
June 2020				
Balance as at 30 June 2019	4,558	171	(5,843)	(1,114)
Other comprehensive income, net of income tax	766	-	(2,179)	(1,413)
Balance as at 30 June 2020	**5,324**	**171**	**(8,022)**	**(2,527)**

17 Other balance sheet items

Policy

Property, plant and equipment are stated at cost less accumulated depreciation and impairment (if any). Depreciation is calculated on a straight line basis to write off the net cost or revalued amount of each asset over its expected life to its estimated residual value.

$000's	June 2021	June 2020
Other assets		
Trade receivables	635	1,926
GST receivables	1,476	742
Prepayments	2,832	3,269
Property, plant and equipment	8,830	9,839
Other receivables	1,049	1,604
Total other assets	**14,822**	**17,380**

Policy

Intangible assets

Intangible assets with finite useful lives

Software acquired or internally developed by the Banking Group is stated at cost less accumulated amortisation and any accumulated impairment losses. Expenditure on software assets is capitalised only when it increases the future economic value of that asset. Amortisation of software is on a straight line basis, at rates which will write off the cost over the assets' estimated useful lives. The expected useful life of the software varies up to ten years.

Goodwill

Goodwill arising on acquisition represents the excess of the cost of the acquisition over the Banking Group's interest in the fair value of the identifiable net assets acquired. Goodwill that has an indefinite useful life is not subject to amortisation and is tested for impairment annually. Goodwill is carried at cost less accumulated impairment losses.

17 Other balance sheet items (continued)

$000's	June 2021	June 2020
Computer software		
Cost	43,360	42,535
Accumulated amortisation	20,328	14,864
Net carrying value of computer software	**23,032**	**27,671**
Goodwill		
Cost	29,799	29,799
Net carrying value of goodwill	**29,799**	**29,799**
Total intangible assets	**52,831**	**57,470**

For the purposes of impairment testing, goodwill is allocated to cash generating units. A CGU is the smallest identifiable group of assets that generate independent cash inflows. The Banking Group has assessed that goodwill should be allocated to Heartland Bank Limited as the smallest identifiable CGU.

Goodwill is tested for impairment at a cash generating unit (**CGU**) level. The recoverable amounts are determined on a value in use basis using a five-year discounted cash flow methodology based on financial budget and forecasts. Key assumptions used in the models included a discount rate of 10% and a terminal growth rate of 2% which reflect both past experience and external sources of information. The recoverable amounts for each CGU are compared to the respective carrying value of net assets.

There was no indication of impairment and no impairment losses have been recognised against the carrying amount of goodwill for the year ended 30 June 2021 (30 June 2020: nil). Uncertainty associated with the effects from the COVID-19 pandemic were considered in the impairment tests to determine the resilience of the headroom and no impairment was identified from the assessments.

Policy

Employee benefits

Annual leave entitlements are accrued at amounts expected to be paid. Long service leave is accrued by calculating the probable future value of the entitlements and discounting back to present value. Obligations to defined contribution superannuation schemes are recognised as an expense when the contribution is paid.

$000's	June 2021	June 2020
Trade and other payables		
Trade payables	9,218	20,006
Insurance liability	3,354	6,094
Employee benefits	4,625	6,104
Other tax payables	630	1,287
Collateral received on derivatives	4,091	-
Total trade and other payables	**21,918**	**33,491**

17 Other balance sheet items (continued)

Policy

Leases

The Banking Group leases office space, car parks, equipment and cars. Rental contracts are typically made for fixed periods but may have extension options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions.

In determining the lease term, all facts and circumstances that create an economic incentive to exercise an extension option are considered. Extension options are only included in the lease term if the lease is reasonably certain to be extended.

Lease liabilities are measured at the present value of the remaining lease payments and discounted using the Banking Group's incremental borrowing rate (**IBR**). Lease liabilities are measured using the effective interest method. Carrying amounts are remeasured only upon reassessments and lease modifications.

Right of use assets are depreciated at the shorter of lease term or the Banking Group’s depreciation policy for that asset class.

$000's	June 2021	June 2020
Right of use assets		
Balance at beginning of year	17,843	10,002
Depreciation charge for the year, included within depreciation expense in the income statement	(2,123)	(2,122)
(Terminations)/additions to right of use assets	(66)	9,963
Total right of use assets	**15,654**	**17,843**
Lease liability		
Current	2,124	2,021
Non-current	15,656	17,850
Total lease liability	**17,780**	**19,871**
Interest expense relating to lease liability	**555**	**550**

18 Related party transactions and balances

Policy

A person or entity is a related party under the following circumstances:

a) A person or a close member of that person's family if that person:
   i) has control or joint control over the Bank;
   ii) has significant influence over the Bank; or
   iii) is a member of the key management personnel of the Bank.

b) An entity is related to the Bank if any of the following conditions applies:
   i) The entity and the Bank are members of the same group;
   ii) One entity is an associate or joint venture of the other entity;
   iii) Both entities are joint ventures of the same third party;
   iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity;
   v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the Bank;
   vi) The entity is controlled, or jointly controlled by a person identified in (a); and
   vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

18 Related party transactions and balances (continued)

(a) Transactions with key management personnel

Key management personnel (**KMP**), are those who, directly or indirectly, have authority and responsibility for planning, directing and controlling the activities of HGH and HBL. This includes all executive staff, Directors and their close family members.

KMP receive personal banking and financial investment services from the Bank in the ordinary course of business. The terms and conditions, for example interest rates and collateral, and the risks to the Bank are comparable to transactions with other employees and did not involve more than the normal risk of repayment or present other unfavourable features.

All other transactions with KMPs and their related entities are made on terms equivalent to those that prevail in arm's length transactions.

$000's	**June 2021**	**June 2020**
Transactions with key management personnel		
Interest income receivable	39	18
Interest expense payable	(22)	(47)
Key management personnel compensation		
Short-term employee benefits	(2,793)	(3,034)
Short-term employee benefits - HGH parent	(6,591)	(6,240)
Share-based payment expense	(1,797)	(827)
Total transactions with key management personnel	**(11,164)**	**(10,130)**
Due (to)/from key management personnel		
Lending	415	239
Borrowings - deposits	(23,409)	(1,646)
Total due (to)/from key management personnel	**(22,994)**	**(1,407)**

(b) Transactions with related parties

The Banking Group's ultimate parent company is HGH.

The Bank has regular transactions with its ultimate parent company, fellow subsidiaries and subsidiaries (collectively known as the Heartland Group) on agreed terms. The transactions include the provision of administrative services, tax transactions, and customer operations and call centre. Banking facilities are provided by Heartland Bank Limited to other Heartland Group entities on normal commercial terms as with other customers. There is no lending from the Banking Group to HGH.

Related party transactions between the Banking Group eliminate on consolidation. Related party transactions outside of the Banking Group are as follows:

$000's	**June 2021**	**June 2020**
Heartland Group Holdings Limited		
Interest expense	21	47
Deposits/(withdrawals)	31,000	-
Dividends paid to HGH	30,000	65,000
Disposal of investment in Harmoney Corp Limited	-	11,935
Management fees payable to HGH	15,785	4,745
Management fees receivable from HGH	1,149	160
Heartland Australia Group Pty Limited (HAG)		
Interest income	-	678
Funding repaid to the Bank	-	27,225
Sale of Spotcap facility	28,049	-
Sale of Harmoney Australia Fund	40,966	

18 Related party transactions and balances (continued)

(b) Transactions with related parties (continued)

$000's	June 2021	June 2020
Australian Seniors Finance Pty Limited (ASF)		
Management fees payable to ASF	4	9
Management fees receivable from ASF	1,707	1,790
ASF Settlement Trust		
Sale of Australian dollar reverse mortgage loan book	45,971	-
Southern Cross Building Society Staff Superannuation (SCBS)		
Interest expense payable to SCBS	12	33
Management fees receivable from SCBS	10	10

(c) Due from/to related parties

$000's	June 2021	June 2020
Due from		
Australian Seniors Finance Pty Limited	146	1,481
Total due from related parties	**146**	**1,481**
Due to		
Heartland Group Holdings Limited	3,210	5,788
ASF Settlement Trust	-	197
Heartland Australia Group Pty Ltd	-	1,959
Total due to related parties	**3,210**	**7,944**

(d) Other balances with related parties

$000's	June 2021	June 2020
Heartland Group Holdings Limited		
Deposits	36,068	5,047
Southern Cross Building Society Staff Superannuation		
Deposits	1,760	1,934

19 Fair value

Policy

Fair value is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

On initial recognition, the transaction price generally represents the fair value of the financial instrument, unless there is observable information from an active market that provides a more appropriate fair value.

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Banking Group determines fair value using other valuation techniques.

The Banking Group measures fair values using the following fair value hierarchy, which reflects the observability of the inputs used in measuring fair value:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Banking Group recognises transfers between levels of the fair value hierarchy as at the end of the reporting period during which the change has occurred.

(a) Financial instruments measured at fair value

The following methods and assumptions were used to estimate the fair value of each class of financial asset and liability measured at fair value on a recurring basis in the consolidated statement of financial position.

The Banking Group has an established framework in performing valuations required for financial reporting purposes including level 3 fair values. The Banking Group regularly reviews and calibrates significant unobservable inputs and valuation adjustments in accordance with market participants' views. If external valuation specialists are engaged to measure fair values, the Banking Group assesses the evidence obtained from these specialists to support the conclusion of these valuations. All significant valuations are reported to the Banking Group's Board Audit and Risk Committee for approval prior to its adoption in the financial statements.

Investments

Investments in public sector securities and corporate bonds are classified at FVOCI, with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using observable market inputs (Level 2 under the fair value hierarchy). Refer to Note 10 - Investments for more details.

Investments valued under Level 2 of the fair value hierarchy are valued either based on quoted market prices or dealer quotes for similar instruments, or discounted cash flows analysis.

Investments in unlisted equity securities are classified as being fair valued through profit or loss and are valued under Level 3 of the fair value hierarchy, with the fair value being based on unobservable inputs.

Investment properties

Investment properties are initially recorded at their fair value, with subsequent changes in fair value recognised in profit or loss. Fair value are determined by qualified independent valuers or other similar external evidence, adjusted for changes in market conditions.

Investment properties have been acquired through the enforcement of security over finance receivables and are held to earn rental income or for capital appreciation (or both).

Finance receivables - reverse mortgages

Reverse mortgage loans are classified at fair value through profit or loss. On initial recognition the Banking Group considers the transaction price to represent the fair value of the loan.

For subsequent measurement the Banking Group has considered if the fair value can be determined by reference to a relevant active market or observable inputs, but has concluded relevant support is not currently available. In the absence of such market evidence the Banking Group has used valuation techniques (income approach) including actuarial assessments to consider the fair value.

19 Fair value (continued)

(a) Financial instruments measured at fair value (continued)

Finance receivables - reverse mortgages (continued)

When the Banking Group enters into a reverse mortgage loan the Banking Group has set expectations regarding the loan's current and future risk profile and expectation of performance. This expectation references a wide range of assumptions including:

- Mortality and move to care;
- Voluntary exits;
- House price changes;
- No negative equity guarantee; and
- Interest rate margin.

At balance date the Banking Group does not consider any of the above expectations to have moved outside of the original expectation range. Therefore the Banking Group has continued to estimate the fair value of the portfolio at transaction price. There has been no fair value movement recognised in profit or loss during the period. Given the nature of the loan terms and tenor, the fair value as recorded is regarded as not being highly sensitive to the above assumptions, particularly to house prices and interest rates, that would impact the fair value at balance date. While noting the uncertainty around future economic conditions, based on current judgment there is no evidence that COVID-19 has impacted or will have a long-term adverse impact on market conditions, particularly regarding the key elements of house prices or interest rates, that would materially influence the fair value of the reverse mortgage portfolio at balance date.

The Banking Group will continue to reassess the existence of a relevant active market and movements in expectations on an on-going basis.

Derivative financial instruments

Interest rate and foreign currency related contracts are recognised in the financial statements at fair value. Fair values are determined from observable market prices as at the reporting date, discounted cash flow models or option pricing models as appropriate (Level 2 under the fair value hierarchy).

The following table analyses financial instruments measured at fair value at the reporting date by the level in the fair value hierarchy into which each fair value measurement is categorised. The amounts are based on the values recognised in the consolidated statement of financial position.

$000's	**Level 1**	**Level 2**	**Level 3**	**Total**
June 2021				
Assets				
Investments	259,041	92,476	1,818	353,335
Investment properties	-	-	11,832	11,832
Derivative financial instruments	-	14,111	-	14,111
Finance receivables - reverse mortgages	-	-	601,505	601,505
Total financial assets measured at fair value	**259,041**	**106,587**	**615,155**	**980,783**
Liabilities				
Derivative financial instruments	-	4,789	-	4,789
Total financial liabilities measured at fair value	**-**	**4,789**	**-**	**4,789**

19 Fair value (continued)

(a) Financial instruments measured at fair value (continued)

Derivative financial instruments (continued)

$000's	Level 1	Level 2	Level 3	Total
June 2020				
Assets				
Investments	295,300	94,354	2,303	391,957
Investment properties	-	-	11,132	11,132
Derivative financial instruments	-	17,246	-	17,246
Finance receivables - reverse mortgages	-	-	609,346	609,346
Total financial assets measured at fair value	**295,300**	**111,600**	**622,781**	**1,029,681**
Liabilities				
Derivative financial instruments	-	16,974	-	16,974
Total financial liabilities measured at fair value	**-**	**16,974**	**-**	**16,974**

There were no transfers between levels in the fair value hierarchy in the year ended 30 June 2021 (2020: nil).

The movement in Level 3 assets measured at fair value are below:

$000's	Finance Receivables - Reverse Mortgages	Investments	Investment properties	Total
June 2021				
As at 30 June 2020	609,346	2,303	11,132	622,781
New loans	99,510	-	-	99,510
Repayments	(97,577)	-	-	(97,577)
Capitalised Interest and fees	35,775	-	-	35,775
Disposal	(45,650)	-	-	(45,650)
Fair value (loss)/gain on investment	-	(485)	700	215
Other	101	-	-	101
As at 30 June 2021	**601,505**	**1,818**	**11,832**	**615,155**
June 2020				
As at 30 June 2019	561,131	12,435	11,132	584,698
New Loans	76,729	-	-	76,729
Repayments	(69,932)	-	-	(69,932)
Capitalised Interest and fees	39,620	-	-	39,620
Purchase of investments	-	1,803	-	1,803
Disposal	-	(11,935)	-	(11,935)
Other	1,798	-	-	1,798
As at 30 June 2020	**609,346**	**2,303**	**11,132**	**622,781**

(b) Financial instruments not measured at fair value

The following assets and liabilities of the Banking Group are not measured at fair value in the consolidated statement of financial position.

Cash and cash equivalents

Cash and cash equivalents are measured at amortised cost and their carrying value is considered equivalent to their fair value due to their short term nature.

19 Fair value (continued)

(b) Financial instruments not measured at fair value (continued)

Finance receivables

The fair value of the Banking Group's finance receivables is calculated using a valuation technique which assumes the Banking Group's current weighted average lending rates for loans of a similar nature and term.

The current weighted average lending rate used to fair value finance receivables with a fixed interest rate was 7.08% (2020: 8.06%). Finance receivables with a floating interest rate are deemed to be at current market rates. The current amount of credit provisioning has been deducted from the fair value calculation of finance receivables as a proxy for future losses.

Borrowings

The fair value of deposits, bank borrowings and other borrowings is the present value of future cash flows and is based on the current market interest rates payable by the Banking Group for debt of similar maturities. The average current market rate used to fair value borrowings was 1.23% (2020: 2.24%).

Due to and from related parties

The fair value of amounts due to and from related parties is considered equivalent to their carrying value due to their short term nature.

Other financial assets and financial liabilities

The fair value of financial instruments such as short-term trade receivables and payables is considered equivalent to their carrying value due to their short term nature.

The following table sets out financial instruments not measured at fair value, compares their carrying value against their fair value and analyses them by level in the fair value hierarchy.

	June 2021			June 2020		
$000's	**Fair Value Hierarchy**	**Total Fair Value**	**Total Carrying Value**	**Fair Value Hierarchy**	**Total Fair Value**	**Total Carrying Value**
Assets						
Cash and cash equivalents	Level 1	112,903	112,903	Level 1	105,463	105,463
Investments[1]	Level 2	5,640	5,639	Level 2	7,375	7,351
Finance receivables	Level 2	3,283,159	3,213,593	Level 2	3,092,150	3,044,960
Due from related parties	Level 3	146	146	Level 3	1,481	1,481
Other financial assets	Level 3	1,684	1,684	Level 3	3,530	3,530
Total financial assets		**3,403,532**	**3,333,965**		**3,209,999**	**3,162,785**
Liabilities						
Deposits	Level 2	3,228,791	3,219,522	Level 2	3,283,530	3,269,239
Borrowings - securitised	Level 2	108,150	108,150	Level 2	65,585	65,585
Other borrowings	Level 2	394,735	394,735	Level 2	293,147	293,147
Due to related parties	Level 3	3,210	3,210	Level 3	7,944	7,944
Other financial liabilities	Level 3	16,663	16,663	Level 3	26,100	26,100
Total financial liabilities		**3,751,549**	**3,742,280**		**3,676,306**	**3,662,015**

[1]Included within investments are bank deposits which are held to support the Banking Group's contractual cash flows. Such investments are measured at amortised cost.

19 Fair value (continued)

(c) Classification of financial instruments

The following tables summarise the categories of financial instruments and the carrying value and fair value of all financial instruments of the Banking Group:

$000's	FVOCI	FVTPL	Amortised Cost	Total Carrying Value	Total Fair Value
June 2021					
Cash and cash equivalents	-	-	112,903	112,903	112,903
Investments	351,518	1,818	5,639	358,975	358,975
Investment properties	-	11,832	-	11,832	11,832
Finance receivables	-	-	3,213,593	3,213,593	3,283,159
Finance receivables - reverse mortgages	-	601,505	-	601,505	601,505
Derivative financial instruments	3,213	10,898	-	14,111	14,111
Due from related parties	-	-	146	146	146
Other financial assets	-	-	1,684	1,684	1,684
Total financial assets	**354,731**	**626,053**	**3,333,965**	**4,314,749**	**4,384,315**
Deposits	-	-	3,219,522	3,219,522	3,228,791
Other borrowings	-	-	502,885	502,885	502,885
Derivative financial instruments	4,395	394	-	4,789	4,789
Due to related parties	-	-	-	3,210	3,210
Other financial liabilities	-	-	16,663	16,663	16,663
Total financial liabilities	**4,395**	**394**	**3,739,070**	**3,747,069**	**3,756,338**
June 2020					
Cash and cash equivalents	-	-	105,463	105,463	105,463
Investments	389,654	2,303	7,351	399,308	399,332
Investment properties	-	11,132	-	11,132	11,132
Finance receivables	-	-	3,044,960	3,044,960	3,092,150
Finance receivables - reverse mortgages	-	609,346	-	609,346	609,346
Derivative financial instruments	32	17,214	-	17,246	17,246
Due from related parties	-	-	1,481	1,481	1,481
Other financial assets	-	-	3,530	3,530	3,530
Total financial assets	**389,686**	**639,995**	**3,162,785**	**4,192,466**	**4,239,680**
Deposits	-	-	3,269,239	3,269,239	3,283,530
Other borrowings	-	-	358,732	358,732	358,732
Derivative financial instruments	15,409	1,565	-	16,974	16,974
Due to related parties	-	-	7,944	7,944	7,944
Other financial liabilities	-	-	26,100	26,100	26,100
Total financial liabilities	**15,409**	**1,565**	**3,662,015**	**3,678,989**	**3,693,280**

Risk Management

20 Enterprise risk management program

The board of directors (the **Board**) sets and monitors the Banking Group's risk appetite across the primary risk domains of credit, capital, liquidity, market (including interest rate), operational and compliance and general business risk. Management are, in turn, responsible for ensuring appropriate structures, policies, procedures and information systems are in place to actively manage these risk domains, as outlined within the Enterprise Risk Management Framework (**ERMF**). Collectively, these processes are known as the Bank's Enterprise Risk Management Program (**RMP**).

Role of the Board and the Board Risk Committee

The Board, through its Board Risk Committee (**BRC**) is responsible for oversight and governance of the development of the RMP. The role of the BRC is to assist the Board to formulate its risk appetite, and to monitor the effectiveness of the RMP. The BRC has the following specific responsibilities:

- The Board's Risk Appetite Statement.
- Heartland's Internal Capital Adequacy Assessment Program (**ICAAP**) including appropriate stress testing scenarios.
- The effectiveness of the ERMF and internal compliance and risk related policies, including approval or variation of policies, procedures and standards.
- Respond to changes anticipated in the economic, business and regulatory environment.
- Conduct, culture and customer outcomes, including emerging risks and any areas of concern.
- Credit exposures of the Bank, including the Delegated Lending Authority Policy and Framework.
- New products, including the process for approval of new products.

The BRC consists of three non-executive directors. Two members of the BRC sit on the BAC. In addition the CEO Heartland Bank Limited (HBL), CRO, CFO, and Head of Internal Audit (or their nominee, subject to the Chair's prior approval) attend the BRC meetings, and the directors who are not members of the BRC are entitled to attend meetings and to receive copies of the BRC papers.

Board Audit Committee

The Board Audit Committee (**BAC**) focuses on financial reporting and application of accounting policies as part of the internal control and risk assessment framework. The BAC monitors the identification, evaluation and management of all significant risks through the Banking Group. This work is supported by Internal Audit, which provides an independent assessment of the design, adequacy and effectiveness of internal controls. The BAC receives regular reports from Internal Audit.

Charters for both the BRC and the BAC ensure suitable cross representation to allow effective communication pertaining to identified issues with oversight by the Board. The CRO has a direct reporting line to the Chairman of the BRC. The Head of Internal Audit has a direct reporting line to the Chairman of the BAC.

Internal Audit

The Banking Group has an Internal Audit function, the objective of which is to provide independent, objective assurance over the internal control environment. In certain circumstances, Internal Audit will provide risk and control advice to Management provided the work does not impede the independence of the Internal Audit function. The function assists The Banking Group in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal Audit is allowed full, free and unfettered access to any and all of the organisation's records, personnel and physical properties deemed necessary to accomplish its activities.

20 Enterprise risk management program (continued)

Internal Audit (continued)

A regular cycle of review has been implemented to cover all areas of the business, focused on assessment, management and control of risks identified. The audit plan takes into account cyclical review of various business units and operational areas, as well as identified areas of higher identified risk. The audit methodology is designed to meet the International Standards for the Professional Practice of Internal Auditing of The Institute of Internal Auditors.

Each audit has specific audit procedures tailored to the area of business that is being reviewed. The audit procedures are updated during each audit to reflect any process changes. Audit work papers are completed to evidence the testing performed in accordance with the audit procedures.

Audit reports are addressed to the manager of the relevant area that is being audited in addition to other relevant stakeholders within the Bank. Management comments are obtained from the process owner(s) and are included in the report.

The Internal Audit function has a direct reporting line to the BAC of the Bank. A schedule of all outstanding internal control issues is maintained and presented to the BAC to assist the BAC to track the resolution of previously identified issues. Any issues raised that are categorised as high risk are specifically reviewed by Internal Audit during a follow-up review once the issue is considered closed by management. The follow-up review is performed with a view to formally close out the issue.

Asset and Liability Committee (ALCO)

The ALCO comprises the CEO HGH, CEO HBL, CFO HGH, Chief Legal & Bank Risk Officer, Head of Retail, Financial Controller HBL and Chief Distribution Officer. The ALCO has responsibility for overseeing aspects of risk management of the Banking Group's financial position. The ALCO usually meet monthly, and provide reports to the BRC. ALCO's specific responsibilities include decision making and oversight of risk matters in relation to:

- Market risk (including non-traded interest rate risk and the investment of capital).
- Liquidity risk (including funding).
- Foreign exchange rate risk.
- Balance sheet structure.
- Capital management.

Executive Risk Committee (ERC)

The ERC comprises the CEO HBL, CRO, CFO and Head of Internal Audit. The ERC has responsibility for overseeing risk aspects not considered by ALCO, including that the internal control environment is managed so that residual risk is consistent with the Banking Group's risk appetite. The ERC generally meets monthly, and provides minutes to the BRC. ERC’s specific responsibilities include decision making and oversight of operational, compliance risk, and credit risk.

Operational and compliance risk

Operational and compliance risk is the risk arising from day to day operational activities in the execution of the Banking Group's strategy which may result in direct or indirect loss. Operational and compliance risk losses can occur as a result of fraud, human error, missing or inadequately designed processes, failed systems, damage to physical assets, improper behaviour or from external events. The losses range from direct financial losses, to reputational damage, unfavourable media attention, injury to or loss of staff or clients or as a breach of laws or banking regulations. Where appropriate, risks are mitigated by insurance.

To ensure appropriate responsibility is allocated for the management, reporting and escalation of operational and compliance risk, the Banking Group operates a “three lines of defence” model which outlines principles for the roles, responsibilities and accountabilities for operational and compliance risk management:

20 Enterprise risk management program (continued)

Operational and compliance risk (continued)

- The first line of defence is the business line management of the identification, management and mitigation of the risks associated with the products and processes of the business. This accountability includes regular testing and attestation of the adequacy and effectiveness of controls and compliance with the Banking Group's policies.
- The second line of defence is the Risk and Compliance function, responsible for the design and ownership of the Operational Risk Management Framework. It incorporates key processes including Risk and Control Self-Assessment (**RCSA**), incident management, independent evaluation of the adequacy and effectiveness of the internal control framework and the attestation process.
- The third line of defence is Internal Audit which is responsible for independently assessing how effectively the Banking Group is managing its risk according to its stated risk appetite.

The Banking Group's exposure to operational and compliance risk is governed by a risk appetite statement approved by the Board and is used to guide management activities by the ERC. This statement sets out the nature of risk which may be taken and aggregate risk limits, including the requirement for the ERC to monitor adherence to this.

Market risk

Market risk is the possibility of experiencing losses or gains due to factors affecting the overall performance of financial markets in which the Banking Group is exposed. The primary market risk exposures for the Banking Group are interest rate risk and foreign exchange risk. The risk being that market interest rates or foreign exchange rates will change and adversely impact on the Banking Group's earnings due to either adverse moves in foreign exchange market rates or in the case of interest rate risks mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates.

Interest rate risk

Interest rate risk refers to exposure of an entity's earnings and / or capital because of a mismatch between the interest rate exposures of its assets and liabilities. Interest rate risk for the Banking Group arises from the provision of non-traded retail banking products and services and from traded wholesale transactions entered into to reduce aggregate interest rate risk (known as hedges). This risk arises from four key sources:

- Mismatches between the repricing dates of interest bearing assets and liabilities (yield curve and repricing risk);
- Banking products repricing differently to changes in wholesale market rates (basis risk);
- Loan prepayment or deposit early withdrawal behaviour from customers that deviates from the expected or contractually agreed behaviour (optionality risk); and
- The effect of internal or market forces on a bank's net interest margin where, for example, in a low rate environment any fall in rates will further decrease interest income earned on the assets whereas funding cost cannot be reduced as it is already at the minimum level (margin compression risk).

Refer Note 24 - Interest rate risk for further details regarding interest rate risk.

Foreign exchange risk

Foreign exchange risk is the risk that the Banking Group's earnings and shareholder equity position are adversely impacted from changes in foreign exchange rates. The Banking Group has exposure to foreign exchange translation risks through its holding of AUD assets.

20 Enterprise risk management program (continued)

Counterparty Credit Risk

The Banking Group has on-going credit exposure associated with:

- Cash and cash equivalents;
- Finance receivables;
- Holding of investment securities; and
- Payments owed to the Banking Group from risk management instruments.

Counterparty credit risk is managed against limits set in the Market Risk Policy including credit exposure on derivative contracts, bilateral set-off arrangements, cash and cash equivalents and investment securities.

21 Credit risk exposure

Credit risk is the risk that a borrower will default on any type of debt by failing to make payments which it is obligated to make. The risk is primarily that of the lender and includes loss of principal and interest, disruption to cash flows and increased collection costs.

Credit risk is managed to achieve sustainable risk-reward performance whilst maintaining exposures within acceptable risk "appetite" parameters. This is achieved through the combination of governance, policies, systems and controls, underpinned by commercial judgement as described below.

To manage this risk the ERC oversees the formal credit risk management strategy. The ERC reviews the Banking Group's credit risk exposures typically on a monthly basis. The credit risk management strategies aim to ensure that:

- Credit origination meets agreed levels of credit quality at point of approval;
- Sector concentrations are monitored;
- Maximum total exposure to any one debtor is actively managed;
- Changes to credit risk are actively monitored with regular credit reviews.

The BRC also oversees the Banking Group's credit risk exposures to monitor overall risk metrics having regard to risk appetite set by the Board.

The BRC has authority from the Board for approval of all credit exposures. Lending authority has been provided to the Banking Group's Credit Committee, and to the business units under a detailed Delegated Lending Authority framework. Application of credit discretions in the business operation are monitored through a defined review and hindsight structure as outlined in the Credit Risk Oversight Policy. Delegated Lending Authorities are provided to individual officers with due cognisance of their experience and ability. Larger and higher risk exposures require approval of senior management, the Credit Committee and ultimately through to the BRC.

The Banking Group employs a process of hindsighting loans to ensure that credit policies and the quality of credit processes are maintained.

Impact of COVID-19 has been considered by the Banking Group as outlined in Note 8 - Impaired asset expense.

21 Credit risk exposure (continued)

Reverse mortgage loans and negative equity risk

Reverse mortgage loans are a form of mortgage lending designed for the needs of people over 60 years. These loans differ to conventional mortgages in that they typically are not repaid until the borrower ceases to reside in the property. Further, interest is not required to be paid, it is capitalised into the loan balance and is repayable on termination of the loan. As such, there are no incoming cash flows and therefore no default risk to manage during the term of the loan. Negative equity risk arises from the promise by the Banking Group that the maximum repayment amount is limited to the net sale proceeds of the borrowers' property.

The Banking Group’s exposure to negative equity risk is managed by the Credit Risk Oversight Policy in conjunction with associated lending standards specific for this product. In addition to usual criteria regarding the type, and location, of security property that the Banking Group will accept for reverse mortgage lending, a key aspect of the Banking Group's policy is that a borrower’s age on origination of the reverse mortgage loan will dictate the loan-to-value ratio of the reserve mortgage on origination. Both New Zealand and Australia reverse mortgage operations are similarly aligned. The policy is managed and reviewed periodically to ensure appropriate consistency across locations.

Business Finance Guarantee Scheme (BFGS)

The Bank, along with other registered banks in New Zealand, has entered into a Deed of Indemnity with the New Zealand Government to implement the New Zealand Government's Business Finance Guarantee Scheme. The purpose of the scheme is to provide short term credit to eligible small and medium size businesses, who have been impacted by the economic effects of COVID-19. The scheme allows banks to lend to a maximum of $5 million for a maximum of five years. The New Zealand Government will guarantee 80% of any loss incurred (credit risk) with the Bank holding the remaining 20%. As at 30 June 2021 the Bank had a total exposure of $64.3 million (2020: $6.5 million) to its customers under the scheme. BFGS has concluded on 30 June 2021 with scheme loans no longer being available.

Maximum exposure to credit risk at the relevant reporting dates

The following table represents the maximum credit risk exposure, without taking account of any collateral held. The on balance sheet exposures set out below are based on net carrying amounts as reported in the consolidated statement of financial position.

$000's	June 2021	June 2020
On balance sheet:		
Cash and cash equivalents	112,903	105,463
Investments	357,157	397,005
Finance receivables	3,213,593	3,044,960
Finance receivables - reverse mortgages	601,505	609,346
Derivative financial assets	14,111	17,246
Due from related parties	146	1,481
Other financial assets	1,684	3,530
Total on balance sheet credit exposures	**4,301,099**	**4,179,031**
Off balance sheet:		
Letters of credit, guarantee commitments and performance bonds	13,484	6,515
Undrawn facilities available to customers	208,855	177,719
Conditional commitments to fund at future dates	19,083	58,045
Total off balance sheet credit exposures	**241,422**	**242,279**
Total credit exposures	**4,542,521**	**4,421,310**

As at 30 June 2021 there was $0.216 million undrawn lending commitments available to counterparties for whom drawn balances are classified as individually impaired (2020: nil).

21 Credit risk exposure (continued)

Concentration of credit risk by geographic region

$000's	June 2021	June 2020
New Zealand	4,332,737	4,045,917
Australia	753	142,713
Rest of the world [1]	260,079	295,349
Total	**4,593,569**	**4,483,979**
Provision for impairment	(51,048)	(62,669)
Total credit exposures	**4,542,521**	**4,421,310**

[1] These overseas assets are primarily NZD-denominated investments in AA+ and higher rated securities issued by offshore supranational agencies ("Kauri Bonds").

Concentration of credit risk by industry sector

The Australian and New Zealand Standard Industrial Classification (**ANZSIC**) codes have been used as the basis for categorising customer industry sectors.

$000's	June 2021	June 2020
Agriculture	670,428	695,661
Forestry and fishing	153,160	149,871
Mining	12,684	13,425
Manufacturing	76,951	80,776
Finance and insurance	577,486	569,422
Wholesale trade	56,522	48,055
Retail trade and accommodation	279,388	278,768
Households	1,780,799	1,740,788
Other business services	148,011	168,326
Construction	241,668	202,685
Rental, hiring and real estate services	185,320	154,318
Transport and storage	297,920	262,078
Other	113,232	119,806
Total	**4,593,569**	**4,483,979**
Provision for impairment	(51,048)	(62,669)
Total credit exposures	**4,542,521**	**4,421,310**

Credit exposures to connected persons

The Banking Group's methodology for calculating credit exposure concentrations is on the basis of actual credit exposures and calculated on a gross basis (net of individual credit impairment allowances and excluding advances of a capital nature) in accordance with the Bank's conditions of registration and the Reserve Bank's Connected Exposures Policy (**BS8**). Peak end-of-day credit exposures to non-bank connected persons are calculated using the Banking Group’s Tier 1 capital at the end of the reporting period.

In accordance with its conditions of registration, the Banking Group's aggregate credit exposures to all connected persons must not exceed its rating contingent limit of 15% of tier one capital. Within the overall rating contingent limit, there is a sub-limit of 15% of tier one capital which applies to the aggregate credit exposures to non-bank connected persons. There have been no rating-contingent limit changes during the accounting period.

21 Credit risk exposure (continued)

Credit exposures to connected persons (continued)

	As at June 2021	Peak End-of-Day for Year Ended June 2021
Credit exposures to connected persons ($000's)	150	3,070
As a percentage of Tier 1 capital of the Banking Group at end of the year (%)	0.03%	0.56%
Credit exposures to non-bank connected persons ($000's)	150	3,070
As a percentage of Tier 1 capital of the Banking Group at end of the year (%)	0.03%	0.56%

As at 30 June 2021, the Banking Group had no aggregate contingent exposures to connected persons arising from risk lay-off arrangements in respect of credit exposures to counterparties (excluding counterparties that are connected persons). The aggregate amount of the Banking Group's individual credit provisions provided against credit exposure to connected persons was nil at 30 June 2021.

Credit exposure to individual counterparties

The Banking Group's aggregate concentration of credit exposure to individual counterparties is calculated based on the actual credit exposure. Credit exposures to connected persons, the central government or central bank of any country with a long term credit rating of A- or A3 or above, or its equivalent, and any supranational or quasi-sovereign agency with a long-term credit rating of A- or A3 or above, or its equivalent are excluded.

The peak end-of-day aggregate concentration of credit exposure to individual counterparties has been calculated by determining the maximum end-of-day aggregate amount of credit exposure over the relevant six month period and then dividing the amount by the Banking Group's common equity tier one capital as at 30 June 2021.

	Number of Exposures As at June 2021	Number of Exposures Peak End-of-Day over 6 Months to June 2021
Exposures to banks		
With a long-term credit rating of A- or A3 or above, or its equivalent:		
10% to less than 15% of CET1 capital	1	-
15% to less than 20% of CET1 capital	-	1
20% to less than 25% of CET1 capital	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-
Exposures to non-banks		
Total number of exposures to non-banks that are greater than 10% of CET1 capital	-	-
With a long-term credit rating of A- or A3 or above, or its equivalent	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-

22 Asset quality

The disclosures in this note are categorised by the following credit risk concentrations:

Corporate Business lending including rural lending.

Residential Lending secured by a first ranking mortgage over a residential property used primarily for residential purposes either by the mortgagor or a tenant of the mortgagor.

All Other This relates primarily to consumer lending to individuals.

(a) Finance receivables by credit risk concentration

$000's	Corporate	Residential	All Other	Total
June 2021				
Neither at least 90 days past due nor impaired	2,054,020	663,891	1,073,490	3,791,401
At least 90 days past due	13,854	139	22,609	36,602
Individually impaired	37,561	9	573	38,143
Gross finance receivables	**2,105,435**	**664,039**	**1,096,672**	**3,866,146**
Provision for impairment	(30,277)	(88)	(20,683)	(51,048)
Total net finance receivables	**2,075,158**	**663,951**	**1,075,989**	**3,815,098**
June 2020				
Neither at least 90 days past due nor impaired	1,889,231	632,894	1,110,903	3,633,028
At least 90 days past due	27,098	599	31,583	59,280
Individually impaired	22,774	9	1,884	24,667
Gross finance receivables	**1,939,103**	**633,502**	**1,144,370**	**3,716,975**
Provision for impairment	(34,614)	(7)	(28,048)	(62,669)
Total net finance receivables	**1,904,489**	**633,495**	**1,116,322**	**3,654,306**

(b) Past due but not impaired

$000's	Corporate	Residential	All Other	Total
June 2021				
Less than 30 days past due	6,882	357	8,330	15,569
At least 30 but less than 60 days past due	11,950	-	7,829	19,779
At least 60 but less than 90 days past due	4,429	-	3,798	8,227
At least 90 days past due	13,854	139	22,609	36,602
Total past due but not impaired	**37,115**	**496**	**42,566**	**80,177**
June 2020				
Less than 30 days past due	14,301	853	20,965	36,119
At least 30 but less than 60 days past due	9,361	-	10,863	20,224
At least 60 but less than 90 days past due	8,041	47	8,280	16,368
At least 90 days past due	27,098	599	31,583	59,280
Total past due but not impaired	**58,801**	**1,499**	**71,691**	**131,991**

KPMG

22 Asset quality (continued)

(c) Individually impaired assets

$000's	Corporate	Residential	All Other	Total
June 2021				
Opening	22,774	9	1,884	24,667
Additions	23,454	-	-	23,454
Deletions	-	-	(466)	(466)
Write offs	(8,667)	-	(845)	(9,512)
Closing gross individually impaired assets	**37,561**	**9**	**573**	**38,143**
Less: provision for individually impaired assets	7,629	-	-	7,629
Total net individually impaired assets	**29,932**	**9**	**573**	**30,514**
June 2020				
Opening	26,412	-	-	26,412
Additions	5,483	9	1,884	7,376
Deletions	(3,174)	-	-	(3,174)
Write offs	(5,947)	-	-	(5,947)
Closing gross individually impaired assets	**22,774**	**9**	**1,884**	**24,667**
Less: provision for individually impaired assets	5,301	-	-	5,301
Total net individually impaired assets	**17,473**	**9**	**1,884**	**19,366**

(d) Credit risk grading

The Banking Group's finance receivables are monitored either by account behaviour (**Behavioural portfolio**) or a regular assessment of their credit risk grade based on an objective review of defined risk characteristics (**Judgemental portfolio**).

Finance receivables - reverse mortgages have no arrears characteristics and are assessed on origination against a pre-determined criteria.

The Judgemental portfolio consists mainly of business and rural lending where an on-going and detailed working relationship with the customer has been developed while the Behavioural portfolio consists of consumer, retail and smaller business receivables.

Judgemental loans are individually risk graded based on loan status, financial information, security and debt servicing ability. Exposures in the Judgemental portfolio are credit risk graded by an internal risk grading mechanism where grade 1 is the strongest risk. Grade 8 and grade 9 are the weakest risk grades where a loss is probable. Behavioural loans are managed based on their arrears status.

Upon adoption of NZ IFRS 9 all loans past due but not impaired have been categorised into three impairments stages (refer Note 8 Impaired asset expense) which are in most cases based on arrears status. If a Judgemental loan is risk graded 6 or above it will be classified as stage 2 as a minimum and carry a provision based on lifetime ECL.

22 Asset quality (continued)

(d) Credit risk grading (continued)

$000's	12 Months ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specifically Provided	Fair value	Total
June 2021						
Judgemental portfolio						
Grade 1 - Very Strong	34	-	-	-	-	34
Grade 2 - Strong	10,854	64	-	-	-	10,918
Grade 3 - Sound	50,816	163	-	-	-	50,979
Grade 4 - Adequate	580,289	4,675	1,734	-	-	586,698
Grade 5 - Acceptable	849,286	5,658	1,882	-	-	856,826
Grade 6 - Monitor	-	58,178	1,038	-	-	59,216
Grade 7 - Substandard	-	71,718	8,107	-	-	79,825
Grade 8 - Doubtful	-	-	-	33,228	-	33,228
Grade 9 - At risk of loss	-	-	-	4,915	-	4,915
Total Judgemental portfolio	1,491,279	140,456	12,761	38,143	-	1,682,639
Total Behavioural portfolio	1,525,293	24,272	32,437	-	601,505	2,183,507
Gross finance receivables	**3,016,572**	**164,728**	**45,198**	**38,143**	**601,505**	**3,866,146**
Provision for impairment	(24,432)	(2,356)	(16,631)	(7,629)	-	(51,048)
Total finance receivables	**2,992,140**	**162,372**	**28,567**	**30,514**	**601,505**	**3,815,098**

$000's	12 Months ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	Specifically Provided	Fair value	Total
June 2020						
Judgemental portfolio						
Grade 1 - Very Strong	28	-	-	-	-	28
Grade 2 - Strong	9,323	-	-	-	-	9,323
Grade 3 - Sound	65,084	-	189	-	-	65,273
Grade 4 - Adequate	509,154	5,117	4,238	-	-	518,509
Grade 5 - Acceptable	817,190	4,613	1,938	-	-	823,741
Grade 6 - Monitor	-	112,586	2,558	-	-	115,144
Grade 7 - Substandard	-	27,289	17,652	-	-	44,941
Grade 8 - Doubtful	-	-	-	16,025	-	16,025
Grade 9 - At risk of loss	-	-	-	8,642	-	8,642
Total Judgemental portfolio	1,400,779	149,605	26,575	24,667	-	1,601,626
Total Behavioural portfolio	1,425,194	33,655	47,154	-	609,346	2,115,349
Gross finance receivables	**2,825,973**	**183,260**	**73,729**	**24,667**	**609,346**	**3,716,975**
Provision for impairment	(32,420)	(2,167)	(22,781)	(5,301)	-	(62,669)
Total finance receivables	**2,793,553**	**181,093**	**50,948**	**19,366**	**609,346**	**3,654,306**

22 Asset quality (continued)

(e) Provision for impairment

$000's	12 Months ECL	Lifetime Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2021					
Corporate					
Impairment allowance as at 30 June 2020	**18,782**	**829**	**9,702**	**5,301**	**34,614**
Changes in loss allowance					
Transfer between stages	(2,239)	(422)	(936)	3,597	-
New and increased provision (net of collective provision releases)	93	807	1,364	6,034	8,298
Recovery of amounts written off	-	-	(380)	-	(380)
Credit impairment charge	**(2,146)**	**385**	**48**	**9,631**	**7,918**
Recovery of amounts previously written off	-	-	380	-	380
Write offs	-	-	(5,282)	(7,303)	(12,585)
Effect of changes in foreign exchange rate	-	-	-	-	-
Acquisition of portfolio	-	-	-	-	-
Sale of portfolio	(50)	-	-	-	(50)
Impairment allowance as at 30 June 2021	**16,586**	**1,214**	**4,848**	**7,629**	**30,277**
Residential					
Impairment allowance as at 30 June 2020	**10**	**1**	**(4)**	**-**	**7**
Changes in loss allowance					
Transfer between stages	(1)	1	-	-	-
New and increased provision (net of collective provision releases)	79	2	-	-	81
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**78**	**3**	**-**	**-**	**81**
Recovery of amounts previously written off	-				-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Acquisition of portfolio	-	-	-	-	-
Sale of portfolio	-	-	-	-	-
Impairment allowance as at 30 June 2021	**88**	**4**	**(4)**	**-**	**88**
All Other					
Impairment allowance as at 30 June 2020	**13,628**	**1,337**	**13,083**	**-**	**28,048**
Changes in loss allowance					
Transfer between stages	(230)	(663)	893	-	-
New and increased provision (net of collective provision releases)	(3,707)	502	11,811	-	8,606
Recovery of amounts written off	-	-	(2,026)	-	(2,026)
Credit impairment charge	**(3,937)**	**(161)**	**10,678**	**-**	**6,580**
Recovery of amounts previously written off	-	-	2,026	-	2,026
Write offs	-	-	(14,009)	-	(14,009)
Effect of changes in foreign exchange rate	(33)	2	6	-	(25)
Acquisition of portfolio	133	22	188	-	343
Sale of portfolio	(2,033)	(62)	(185)	-	(2,280)
Impairment allowance as at 30 June 2021	**7,758**	**1,138**	**11,787**	**-**	**20,683**

22 Asset quality (continued)

(e) Provision for impairment (continued)

$000's	12 Months ECL	Lifetime Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2021					
Total					
Impairment allowance as at 30 June 2020	**32,420**	**2,167**	**22,781**	**5,301**	**62,669**
Changes in loss allowance					
Transfer between stages	(2,470)	(1,084)	(43)	3,597	-
New and increased provision (net of collective provision releases)	(3,535)	1,311	13,175	6,034	16,985
Recovery of amounts written off	-	-	(2,406)	-	(2,406)
Credit impairment charge	**(6,005)**	**227**	**10,726**	**9,631**	**14,579**
Recovery of amounts previously written off	-	-	2,406	-	2,406
Write offs	-	-	(19,291)	(7,303)	(26,594)
Effect of changes in foreign exchange rate	(33)	2	6	-	(25)
Acquisition of portfolio	133	22	188	-	343
Sale of portfolio	(2,083)	(62)	(185)	-	(2,330)
Impairment allowance as at 30 June 2021	**24,432**	**2,356**	**16,631**	**7,629**	**51,048**

$000's	12 Months ECL	Lifetime Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
June 2020					
Corporate					
Impairment allowance as at 30 June 2019	**21,404**	**670**	**4,532**	**7,863**	**34,469**
Changes in loss allowance					
Transfer between stages	(254)	61	(1,400)	1,593	-
New and increased provision (net of collective provision releases)	(2,368)	97	6,570	1,792	6,091
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**(2,622)**	**158**	**5,170**	**3,385**	**6,091**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	(5,947)	(5,947)
Effect of changes in foreign exchange rate	-	1	-	-	1
Impairment allowance as at 30 June 2020	**18,782**	**829**	**9,702**	**5,301**	**34,614**
Residential					
Impairment allowance as at 30 June 2019	**21**	**3**	**80**	**-**	**104**
Changes in loss allowance					
Transfer between stages	44	(1)	(43)	-	-
New and increased provision (net of collective provision releases)	(55)	(1)	(41)	-	(97)
Recovery of amounts written off	-	-	-	-	-
Credit impairment charge	**(11)**	**(2)**	**(84)**	**-**	**(97)**
Recovery of amounts previously written off	-	-	-	-	-
Write offs	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-
Impairment allowance as at 30 June 2020	**10**	**1**	**(4)**	**-**	**7**

(e) Provision for impairment (continued)

$000's	12 Months ECL	Lifetime Not Credit Impaired	Lifetime ECL Credit Impaired	Specific Provision	Total
All Other					
Impairment allowance as at 30 June 2019	**8,997**	**1,108**	**13,813**	**-**	**23,918**
Changes in loss allowance					
Transfer between stages	(999)	(343)	1,342	-	-
New and increased provision (net of collective provision releases)	5,603	2,007	18,576	-	26,186
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**4,604**	**1,664**	**17,110**	**-**	**23,378**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,658)	-	(22,096)
Effect of changes in foreign exchange rate	27	3	10	-	40
Impairment allowance as at 30 June 2020	**13,628**	**1,337**	**13,083**	**-**	**28,048**
Total					
Impairment allowance as at 30 June 2019	**30,422**	**1,781**	**18,425**	**7,863**	**58,491**
Changes in loss allowance					
Transfer between stages	(1,209)	(283)	(101)	1,593	-
New and increased provision (net of collective provision releases)	3,180	2,103	25,105	1,792	32,180
Recovery of amounts written off	-	-	(2,808)	-	(2,808)
Credit impairment charge	**1,971**	**1,820**	**22,196**	**3,385**	**29,372**
Recovery of amounts previously written off	-	-	2,808	-	2,808
Write offs	-	(1,438)	(20,658)	(5,947)	(28,043)
Effect of changes in foreign exchange rate	27	4	10	-	41
Impairment allowance as at 30 June 2020	**32,420**	**2,167**	**22,781**	**5,301**	**62,669**

(f) Other assets under administration

Other assets under administration are any loans, not being individually impaired or 90 days or more past due, where the customer is in any form of voluntary or involuntary administration, including receivership, liquidation, bankruptcy or statutory management. As at 30 June 2021, the Banking Group had $0.3 million other assets under administration (2020: $0.8 million).

23 Liquidity risk

Liquidity risk is the risk that the Banking Group is unable to meet its payment obligations as they fall due. The timing mismatch of cash flows and the related liquidity risk in all banking operations are closely monitored by the Banking Group.

Measurement of liquidity risk is designed to ensure that the Banking Group has the ability to generate or obtain sufficient cash in a timely manner and at a reasonable price to meet its financial commitments on a daily basis.

The Banking Group's exposure to liquidity risk is governed by the liquidity policy approved by the Board and managed by the ALCO. This policy sets out the nature of the risk which may be taken and aggregate risk limits. The objective of the ALCO is to derive the most appropriate strategy for the Banking Group in terms of a mix of assets and liabilities given its expectations of future cash flows, liquidity constraints and capital adequacy to meet the requirements of the policy. The Banking Group employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies.

RBNZ facilities

In March 2020, the Bank was onboarded by the RBNZ as an approved counterparty and executed a 2011 Global Master Repo Agreement providing an additional source for intra-day liquidity for the Banking Group if required.

On 16 March 2020, as a result of COVID-19, the RBNZ announced that it would provide term funding through a Term Auction Facility (**TAF**) to give banks the ability to access term funding using repurchase agreements with qualifying collateral for a term of up to twelve months. On 10 March 2021, RBNZ announced to remove TAF and the final TAF tenders were held on 16 March 2021.

From 26 May 2020, the RBNZ also made available, for a period of 6 months, a Term Lending Facility (**TLF**) to offer loans for a fixed term of three years at the Official Cash Rate, with access to the funds linked to banks' lending under the Business Finance Guarantee Scheme. On 20 August 2020, RBNZ announced the change of the lending term to five years. The availability of TLF was extended to 1 February 2021, and further extended to 28 July 2021.

Additional stimulus provided through a funding for lending programme also commenced in December 2020 designed to enable banks to provide low-cost lending.

The Banking Group had not utilised any of these facilities as at 30 June 2021.

The Banking Group holds the following liquid assets and committed funding sources for the purpose of managing liquidity risk:

$000's	June 2021	June 2020
Cash and cash equivalents	112,903	105,463
Investments	357,157	397,005
Undrawn committed bank facilities	191,850	234,415
Total liquidity	**661,910**	**736,883**

23 Liquidity risk (continued)

Contractual liquidity profile of financial liabilities

The following tables present the Banking Group's financial liabilities by relevant maturity groupings based upon contractual maturity date. The amounts disclosed in the tables represent undiscounted future principal and interest cash flows. As a result, the amounts in the tables below may differ to the amounts reported on the consolidated statement of financial position.

The contractual cash flows presented below may differ significantly from actual cash flows. This occurs as a result of future actions by the Banking Group and its counterparties, such as early repayments or refinancing of term loans and borrowings. Deposits and other public borrowings include customer savings deposits and transactional accounts, which are at call. These accounts provide a stable source of long term funding for the Banking Group.

$000's	On Demand	0-6 Months	6-12 Months	1-2 Years	2-5 Years	5+ Years	Total
June 2021							
Financial liabilities							
Deposits	974,984	1,324,902	560,232	292,091	91,107	-	3,243,316
Other borrowings	-	116,944	6,468	264,639	128,489	-	516,540
Derivative financial liabilities	-	2,499	1,564	516	4	-	4,583
Due to related parties	-	3,210	-	-	-	-	3,210
Lease liabilities	-	1,308	1,320	2,663	7,605	7,085	19,981
Other financial liabilities	-	16,663	-	-	-	-	16,663
Total financial liabilities	**974,984**	**1,465,526**	**569,584**	**559,909**	**227,205**	**7,085**	**3,804,293**
Undrawn facilities available to customers	208,855	-	-	-	-	-	208,855
Undrawn committed bank facilities	191,850	-	-	-	-	-	191,850
June 2020							
Financial liabilities							
Deposits	813,140	1,418,656	833,440	162,221	86,615	-	3,314,072
Other borrowings	-	6,228	6,126	76,964	284,462	-	373,780
Derivative financial liabilities	-	5,683	4,665	5,297	1,354	-	16,999
Due to related parties	-	7,944	-	-	-	-	7,944
Lease liabilities	-	1,284	1,304	5,335	7,634	7,085	22,642
Other financial liabilities	-	26,100	-	-	-	-	26,100
Total financial liabilities	**813,140**	**1,465,895**	**845,535**	**249,817**	**380,065**	**7,085**	**3,761,537**
Undrawn facilities available to customers	177,719	-	-	-	-	-	177,719
Undrawn committed bank facilities	234,415	-	-	-	-	-	234,415

24 Interest rate risk

The Banking Group's market risk is derived primarily of exposure to interest rate risk, predominantly from raising funds through the retail and wholesale deposit market, the debt capital markets and committed and uncommitted bank funding, securitisation of receivables, and offering loan finance products to the commercial and consumer market in New Zealand and Australia.

The Banking Group's exposure to market risk is governed by a policy approved by the Board and managed by the ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits, and the ALCO must conform to this. The objective of the ALCO is to derive the most appropriate strategy for the Banking Group in terms of the mix of assets and liabilities given its expectations of the future and the potential consequences of interest rate movements, liquidity constraints and capital adequacy.

The objective of the Banking Group's interest rate risk policies is to limit underlying net profit after tax (**NPAT**) volatility. The measurement comprises net interest income the Banking Group generates from its interest earning assets and interest bearing liabilities.

The exposure to net interest income comes from a reduction in margins on interest earning assets or interest bearing liabilities and is managed when setting rates by taking into consideration wholesale rates, liquidity premiums, as well as appropriate lending credit margins.

An analysis of the Banking Group's sensitivity to an increase (+) or decrease (-) in market interest rates by 100 basis points (**BP**) is as follows. An (+)/(-) to market interest rates of 100 BP would result in a $0.2 million (+)/(-) to NPAT (2020: $1.5 million (+)/(-)) with a corresponding impact to equity.

The Banking Group also manages interest rate risk by:

- Monitoring maturity profiles and seeking to match the re-pricing of assets and liabilities;
- Monitoring interest rates daily and regularly (at least monthly) reviewing interest rate exposures; and
- Entering into derivatives to hedge against movements in interest rates.

Contractual repricing analysis

The interest rate risk profile of financial assets and liabilities that follows has been prepared on the basis of maturity or next repricing date, whichever is earlier.

24 Interest rate risk (continued)

Contractual repricing analysis (continued)

$000's	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2+ Years	Non-Interest Bearing	Total
June 2021							
Financial assets							
Cash and cash equivalents	112,893	-	-	-	-	10	112,903
Investments	31,897	8,034	19,669	53,505	244,052	1,818	358,975
Finance receivables	1,554,461	147,303	291,415	450,415	699,967	70,032	3,213,593
Finance receivables - reverse mortgages	601,505	-	-	-	-	-	601,505
Due from related parties	-	-	-	-	-	146	146
Derivative financial assets	-	-	-	-	-	14,111	14,111
Other financial assets	-	-	-	-	-	1,068	1,068
Total financial assets	**2,300,756**	**155,337**	**311,084**	**503,920**	**944,019**	**87,185**	**4,302,301**
Financial liabilities							
Deposits	1,706,735	570,068	554,340	285,025	85,077	18,277	3,219,522
Other borrowings	170,364	50,837	-	153,751	127,933	-	502,885
Derivative financial liabilities	-	-	-	-	-	4,789	4,789
Due to related parties	-	-	-	-	-	3,210	3,210
Lease liabilities	-	-	-	-	-	17,780	17,780
Other financial liabilities	-	-	-	-	-	16,663	16,663
Total financial liabilities	**1,877,099**	**620,905**	**554,340**	**438,776**	**213,010**	**60,719**	**3,764,849**
Effect of derivatives held for risk management	474,010	(9,023)	(146,067)	(85,670)	(233,250)	-	-
Net financial assets/(liabilities)	**897,667**	**(474,591)**	**(389,323)**	**(20,526)**	**497,759**	**26,466**	**537,452**
June 2020							
Financial assets							
Cash and cash equivalents	105,456	-	-	-	-	7	105,463
Investments	43,863	18,425	52,708	59,296	222,713	2,303	399,308
Finance receivables	1,522,602	198,446	352,076	557,569	400,658	13,609	3,044,960
Finance receivables - reverse mortgages	609,346	-	-	-	-	-	609,346
Due from related parties	-	-	-	-	-	1,481	1,481
Derivative financial assets	-	-	-	-	-	17,246	17,246
Other financial assets	-	-	-	-	-	3,530	3,530
Total financial assets	**2,281,267**	**216,871**	**404,784**	**616,865**	**623,371**	**38,176**	**4,181,334**
Financial liabilities							
Deposits	1,621,568	585,482	815,366	155,219	77,655	13,949	3,269,239
Other borrowings	67,439	970	-	-	290,323	-	358,732
Derivative financial liabilities	-	-	-	-	-	16,974	16,974
Due to related parties	-	-	-	-	-	7,944	7,944
Lease liabilities	-	-	-	-	-	19,871	19,871
Other financial liabilities	-	-	-	-	-	26,100	26,100
Total financial liabilities	**1,689,007**	**586,452**	**815,366**	**155,219**	**367,978**	**84,838**	**3,698,860**
Effect of derivatives held for risk management	557,955	(51,349)	(239,137)	(237,213)	(30,256)	-	-
Net financial assets/(liabilities)	**1,150,215**	**(420,930)**	**(649,719)**	**224,433**	**225,137**	**(46,662)**	**482,474**

The tables above illustrate the periods in which the cash flows from interest rate swaps are expected to occur and affect profit or loss.

25 Concentrations of funding

(a) Regulatory liquidity ratios

RBNZ requires banks to hold minimum amounts of liquid assets to help ensure that they are effectively managing their liquidity risks. The mismatch ratio is a measure of a bank's liquid assets, adjusted for contractual cash inflows and outflows during a 1-month or 1-week period of stress. It is expressed as a ratio over the bank's total funding. The Banking Group must maintain its 1-month and 1-week mismatch ratios above zero on a daily basis. The below 1-month and 1-week mismatch ratios are averaged over the quarter.

RBNZ requires banks to get a minimum amount of funding from stable sources called core funding. From 2 April 2020, the minimum amount of core funding was lowered from 75% to 50% of a bank's total loans. The Banking Group must maintain its core funding ratio above the regulatory minimum on a daily basis. The below measure of the core funding ratio is averaged over the quarter. The RBNZ intends to increase the minimum requirement back to 75% on 1 January 2022.

	Average for the 3 Months Ended 30 June 2021	Average for the 3 Months Ended 31 March 2021
One-week mismatch ratio	5.48	6.46
One-month mismatch ratio	6.21	7.84
Core funding ratio	92.64	92.54

The table above has not incorporated any recalculations as detailed on page 80 of this Disclosure Statement.

25 Concentrations of funding (continued)

(b) Concentration of funding by industry

The Australian and New Zealand Standard Industrial Classification codes have been used as the basis for categorising customer industry sectors.

$000's	June 2021	June 2020
Agriculture	102,107	109,268
Forestry and fishing	14,226	14,901
Mining	94	35
Manufacturing	11,592	6,976
Finance and insurance	769,757	682,249
Wholesale trade	11,218	10,855
Retail trade and accommodation	28,521	20,423
Households	2,322,514	2,263,668
Rental, hiring and real estate services	46,245	41,348
Construction	24,231	19,702
Other business services	58,334	63,697
Transport and storage	4,337	4,552
Other	44,714	97,150
Total	**3,437,890**	**3,334,824**
Unsubordinated notes	284,517	293,147
Total borrowings	**3,722,407**	**3,627,971**

(c) Concentration of funding by geographical area

$000's	June 2021	June 2020
New Zealand	3,635,405	3,475,790
Overseas	87,002	152,181
Total borrowings	**3,722,407**	**3,627,971**

Other Disclosures

26 Significant subsidiaries

Significant Subsidiaries	Country of Incorporation and Place of Business	Nature of Business	Proportion of ownership and voting power held June 2021	June 2020
VPS Properties Limited	New Zealand	Investment property holding company	100%	100%
MARAC Insurance Limited	New Zealand	Insurance services	100%	100%

27 Structured entities

A structured entity is one which has been designed such that voting or similar rights are not the dominant factor in deciding who controls the entity. Structured entities are created to accomplish a narrow and well-defined objective such as the securitisation or holding of particular assets, or the execution of a specific borrowing or lending transaction. Structured entities are consolidated where the substance of the relationship is that the Banking Group controls the structured entity.

(a) Heartland Cash and Term PIE Fund (Heartland PIE Fund)

The Banking Group controls the operations of the Heartland PIE Fund which is a portfolio investment entity that invests in the Banking Group's deposits. Investments of Heartland PIE Fund are represented as follows:

$000's	June 2021	June 2020
Deposits	153,244	166,676

(b) Heartland Auto Receivable Warehouse Trust 2018-1 (Auto Warehouse)

The Auto Warehouse securitises motor loan receivables as a source of funding.

The Banking Group continues to recognise the securitised assets and associated borrowings in the consolidated statement of financial position as the Banking Group remains exposed to and has the ability to affect variable returns from those assets and liabilities. Although the Banking Group recognises those interests in Auto Warehouse, the loans sold to the Trust are set aside for the benefit of investors in Auto Warehouse and other depositors and lenders to the Banking Group have no recourse to those assets.

$000's	June 2021	June 2020
Cash and cash equivalents	9,047	5,493
Finance receivables	126,399	78,066
Other borrowings	(128,125)	(79,012)

28 Capital adequacy

The Banking Group is subject to regulation by the Reserve Bank of New Zealand. The RBNZ has set minimum regulatory capital requirements for Banks that are consistent with the internationally agreed framework developed by the Basel Committee on Banking Supervision. The resulting Basel II and III requirements define what is acceptable as capital and provide for methods of measuring the risks incurred by the Banking Group.

The Banking Group's Conditions of Registration prescribes minimum capital adequacy ratios calculated in accordance with the Capital Adequacy Framework (Standardised Approach) BS2A (**BS2A**).

The Banking Group has adopted the Basel II standardised approach per RBNZ BS2A to calculate its regulatory requirements. Basel II is made up of the following three Pillars:

- Pillar 1 sets out the minimum capital requirements for credit, market and operational and compliance risks.
- Pillar 2 is designed to ensure that Banks have adequate capital to support all risks (not just those set out under Pillar 1 above) and is enforced through the requirement for supervisory review.
- Pillar 3 outlines the requirements for adequate and transparent disclosure.

Basel III was developed in order to strengthen the regulation, supervision and risk management of the Banking sector. The measures aim to improve the Banking sector's ability to absorb shocks arising from financial and economic stress; improve risk management and governance; and strengthen Banks' transparency and disclosures. The requirements that impact capital are as follows:

- The level of capital required to be held by Banks increased through the introduction of new minimum capital requirements for CET1 Capital, Additional Tier 1 (**AT1**) Capital and Total Capital as a percentage of risk-weighted-assets (**RWAs**).
- A capital conservation buffer held over and above the minimum capital ratio requirements used to absorb losses during periods of financial and economic stress.
- A counter-cyclical capital buffer held and to be used at the RBNZ's discretion, to assist in attaining the macro-prudential goal of protecting the Banking sector from periods of extraordinary excess aggregate credit growth.
- Strengthen the calculation of RWAs, particularly in respect of counterparty credit risk.

The Basel III requirements have not effected the Banking Group's minimum capital requirements as the Banking Group's Conditions of Registration prescribe minimum capital requirements higher than the Basel III requirements.

The capital adequacy tables set out on the following pages summarise the composition of regulatory capital and the capital adequacy ratios for the Banking Group as at 30 June 2021.

Internal Capital Adequacy Assessment Process (ICAAP)
The Banking Group has an ICAAP which complies with the requirements set out in the "Guidelines on a Bank's Internal Capital Adequacy Assessment Process (**ICAAP**)" BS12 and is in accordance with its Conditions of Registration.

The Board has overall responsibility for ensuring the Banking Group has adequate capital in relation to its risk profile and establishes minimum internal capital levels and limits above the regulatory minimum. The Banking Group has established a Capital Management Policy (**CMP**) to determine minimum capital levels for Tier 1 and Total capital under Basel III and in accordance with its Conditions of Registration. The documented process ensures that the Banking Group has sufficient available capital to meet minimum capital requirements, even in stressed events. It describes the risk profile of the Banking Group and the risk appetite and tolerances under which it operates, and assesses the level of capital held against the material risks of the Banking Group (both Pillar 1 and Pillar 2).

The ICAAP identifies the capital required to be held against other material risks, being strategic / business risk, reputational risk, regulatory risk and additional credit risk.

Compliance with minimum capital levels is monitored by the ALCO and reported to the Board. The ICAAP and CMP is reviewed annually by the Board.

28 Capital adequacy (continued)

RBNZ capital review

The RBNZ released a consultation paper in December 2018 in relation to proposed changes to the Capital Adequacy Framework for Registered Banks in New Zealand (the **Framework**). On 5 December 2019, the RBNZ released its final decision on the revised Framework.

The revised Framework requires the Bank, as a standardised registered bank, to increase its Total Capital ratio to 16% over a seven-year transitional period. The Bank's Total Capital ratio was 12.56% as at 31 December 2019. This means the revised Framework requires the Bank to increase its Total Capital ratio by 3.44% over the transitional period.

The Bank does not expect the revised Framework to result in any changes to the underlying business model or its approach to raising equity, given:

- The quantum of the capital requirement;
- That some of the capital requirement may be satisfied through hybrid capital instruments rather than common equity;
- The length of the transitional period;
- The Bank's existing capital position.

The corporate structure of HGH, the ultimate parent company provides the Banking Group with flexibility to mitigate the impact of the revised Framework. Various capital raising options available include using HGH's dividend reinvestment plan, or raise debt and use the proceeds to subscribe for new capital in the Bank.

The Bank will continue to assess the options available to it to meet the requirements of the revised Framework over the transitional period.

As a result of the impacts of COVID-19 and to support the availability of credit, the RBNZ announced in March 2020 that it has made the decision to delay the start date of increased capital requirements for banks by 12 months to 1 July 2021. Should conditions warrant , the RBNZ will reassess whether further delays are necessary.

New requirements (not yet effective)

Banking Prudential Requirements (**BPRs**) are a replacement of the Banking Supervision Handbook and will take effect from 1 October 2021. The Bank is currently assessing the impact.

(a) Capital

$000's	**June 2021**
Tier 1 Capital	
CET1 capital	
Paid-up ordinary shares issued by the Banking Group plus related share premium	553,239
Retained earnings (net of appropriations)	87,834
Accumulated other comprehensive income and other disclosed reserves	755
Less deductions from CET1 capital	
Intangible assets	(52,786)
Deferred tax assets	(12,251)
Hedging reserve	(906)
Defined benefit superannuation fund assets	(716)
Reverse mortgage loan greater than value of security	(57)
Adjustment under the corresponding deduction approach	(60)
Total CET1 capital	**575,052**
AT1 capital	-
Total Tier 1 capital	**575,052**
Tier 2 capital	-
Total Tier 2 capital	-
Total capital	**575,0[illegible]**

KPMG

28 Capital adequacy (continued)

(b) Capital structure

The following details summarise each instrument included within Total Capital. None of these instruments are subject to phase-out from eligibility as capital under the RBNZ's Basel III transitional arrangements.

Ordinary shares

In accordance with BS2A, ordinary share capital is classified as CET1 capital. The ordinary shares have no par value. Each ordinary share of the Bank carries the right to vote on a poll at meetings of shareholders, the right to an equal share in dividends authorised by the Board and the right to an equal share in the distribution of the surplus assets of the Bank in the event of liquidation.

Retained earnings

Retained earnings is the accumulated profit or loss that has been retained in the Banking Group. Retained earnings is classified as CET1 capital.

Reserves classified as CET1 capital

Fair value reserve	The debt instrument fair value reserve comprises the changes in the fair value of investments, net of tax.
Defined benefit reserve	The defined benefit reserve represents the excess of the fair value of the assets of the defined benefit superannuation plan over the net present value of the defined benefit obligations.
Cash flow hedge reserve	The hedging reserve comprises the fair value gains and losses associated with the effective portion of designated cash flow hedging instruments.

28 Capital adequacy (continued)

(c) Credit risk

On balance sheet exposures

	Total Exposure After Credit Risk Mitigation $000's	Average Risk Weight %	Risk Weighted Exposure $000's	Minimum Pillar 1 Capital Requirement $000's
June 2021				
Cash	-	0%	-	-
Sovereigns and central banks	1,476	0%	-	-
Multilateral development banks	187,917	0%	-	-
Multilateral development banks	71,125	20%	14,225	1,138
Banks - Tier 1	-	20%	-	-
Banks - Tier 2	185,237	50%	92,618	7,409
Banks - Tier 3	13,157	100%	13,157	1,053
Public sector entity (AA- and above)	14,384	20%	2,877	230
Public sector entity (A- and above)	-	50%	-	-
Public sector entity (BBB+, BBB, BBB-)	-	100%	-	-
Corporates (AA- and above)	-	20%	-	-
Corporates (A- and above)	-	50%	-	-
Corporates (BBB- and above)	-	100%	-	-
Corporates other	60,450	20%	12,090	967
Corporates other	1,663,590	100%	1,663,590	133,087
Welcome Home Loans - loan to value ratio (LVR) <= 80%[1]	1,815	35%	635	51
Welcome Home Loans - loan to value ratio (LVR) <= 90%[1]	-	35%	-	-
Welcome Home Loans - LVR 90% >= 100%[1]	-	50%	-	-
Welcome Home Loans - LVR > 100%[1]	-	100%	-	-
Reverse Residential mortgages <= 60% LVR	592,913	50%	296,457	23,717
Reverse Residential mortgages 60 <= 80% LVR	6,726	80%	5,380	430
Reverse Residential mortgages > 80% LVR	1,665	100%	1,665	133
Reverse Residential mortgages > 100% LVR	144	100%	144	12
Non Property Investment Mortgage Loan <=80% LVR	55,455	35%	19,409	1,553
Non Property Investment Mortgage Loan 80 <= 90% LVR	1,656	50%	828	66
Non Property Investment Mortgage Loan 90 <= 100% LVR	-	75%	-	-
Non Property Investment Mortgage Loan > 100% LVR	-	100%	-	-
Property Investment Mortgage Loan <= 80% LVR	3,373	40%	1,349	108
Property Investment Mortgage Loan 80 <= 90% LVR	-	70%	-	-
Property Investment Mortgage Loan 90 <= 100% LVR	-	90%	-	-
Property Investment Mortgage Loan < 100% LVR	-	100%	-	-
Past due residential mortgages	148	100%	148	12
Other past due assets - provision >= 20%	22,292	100%	22,292	1,783
Other past due assets - provision < 20%	33,688	150%	50,532	4,043
Equity holdings	-	300%	-	-
All other equity holdings	1,803	400%	7,212	577
Other assets	1,422,253	100%	1,422,253	113,780
Not risk weighted assets	65,869	0%	-	-
Total on balance sheet exposures	**4,407,136**		**3,626,861**	**290,149**

[1]The LVR classification above is calculated in line with the Bank's Pillar 1 Capital requirement which includes relief for Welcome Home loans that are guaranteed by the Crown.

28 Capital adequacy (continued)

(c) Credit risk (continued)

Off balance sheet exposures

	Total Exposure $000's	Credit Conversion Factor %	Credit Equivalent Amount $000's	Average Risk Weight %	Risk Weighted Exposure $000's	Minimum Pillar 1 Capital Requirement $000's
June 2021						
Direct credit substitute	5,890	100%	5,890	100%	5,890	471
Performance-related contingency	7,594	50%	3,797	100%	3,797	304
Other commitments where original maturity is more than one year	177,975	50%	88,988	100%	88,988	7,119
Other commitments where original maturity is more than one year	24,850	50%	12,425	35%	4,349	348
Other commitments where original maturity is less than or equal to one year	2,461	20%	492	100%	492	39
Other commitments where original maturity is less than or equal to one year	22,652	20%	4,530	50%	2,265	181
Market related contracts[1]						
Interest rate contracts	1,104,012	n/a	13,432	40%	5,338	427
FX forward contracts	28,106	n/a	55	20%	11	1
Credit valuation adjustment	-		-		4,481	358
Total off balance sheet exposures	**1,373,540**		**129,609**		**115,611**	**9,248**

[1]The credit equivalent amount for market related contracts was calculated using the current exposure method.

(d) Additional mortgage information - LVR range

$000's	On Balance Sheet Exposures	Off Balance Sheet Exposures[2]	Total Exposures
June 2021			
Does not exceed 80%	660,280	22,652	682,932
Exceeds 80% and not 90%	2,637	-	2,637
Exceeds 90%	1,034	-	1,034
Total exposures	**663,951**	**22,652**	**686,603**

[2]Off balance sheet exposures means unutilised limits.

At 30 June 2021, there were no Welcome Home loans whose credit risk is mitigated by the Crown included in "Exceeds 90% residential mortgages". Other loans in the exceeds 90% LVR range is primarily business and rural lending where residential mortgage security is only a part of the total security. For capital adequacy calculations only the value of the first mortgages over residential property is included in the LVR calculation, in accordance with BS2A. All new residential mortgages in respect of non-property investments lending have a loan-to-valuation ratio of less than or equal to 80%.

28 Capital adequacy (continued)

(e) Reconciliation of mortgage related amounts

$000's	Note	June 2021
Gross finance receivables - reverse mortgages	12b	601,505
Loans and advances - loans with residential mortgages		62,534
On balance sheet residential mortgage exposures subject to the standardised approach	22a	**664,039**
Less: collective provision for impairment		(88)
Off balance sheet mortgage exposures subject to the standardised approach	28d	22,652
Total residential exposures subject to the standardised approach		**686,603**

(f) Credit risk mitigation

As at 30 June 2021 the Banking Group had $1.8 million of Welcome Home Loans, whose credit risk was mitigated by the Crown. Other than this the Banking Group does not have any exposures covered by eligible collateral, guarantees and credit derivatives.

(g) Operational risk

$000's	Implied Risk Weighted Exposure	Total Operational Risk Capital Requirement
June 2021		
Operational risk	272,080	21,766

Operational risk is calculated based on the previous 12 quarters of the Banking Group.

(h) Market risk

Market risk is the risk that market interest rates or foreign exchange rates will change and impact on the Banking Group's earnings due to either mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates.

$000's		Implied Risk Weighted Exposure	Aggregate Capital Charge
June 2021			
Market risk end-of-period capital charge	Equity rate risk only	1,803	144
Market risk peak end-of-day capital charge	Equity rate risk only	1,803	144
Market risk end-of-period capital charge	Interest rate risk only	125,844	10,068
Market risk peak end-of-day capital charge	Interest rate risk only	130,150	10,412
Market risk end-of-period capital charge	Foreign currency risk only	86	7
Market risk peak end-of-day capital charge	Foreign currency risk only	5,312	425

The Banking Group's aggregate market exposure is derived in accordance with BS2A. Peak end-of-day capital charge disclosure is derived by taking the highest month end market exposure over the six months ended 30 June 2021. Interest rate risk, foreign exchange risk and equity risk are calculated monthly using the month end position. The Banking Group is currently investigating the impact a daily aggregate market risk exposure would have on its ratios for future reporting periods.

28 Capital adequacy (continued)

(i) Total capital requirements

$000's	Total Exposure After Credit Risk Mitigation	Risk Weighted Exposure or Implied Risk Weighted Exposure	Total Capital Requirement
June 2021			
Total credit risk			
On balance sheet	4,407,136	3,626,861	290,149
Off balance sheet	1,373,540	115,611	9,248
Operational risk	n/a	272,080	21,766
Market risk	n/a	127,733	10,219
Total	**5,780,676**	**4,142,285**	**331,382**

(j) Capital ratios

%	June 2021	June 2020
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.88%	12.67%
Minimum Common Equity Tier 1 Capital as per Conditions of Registration	4.50%	4.50%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.88%	12.67%
Minimum Tier 1 Capital as per Conditions of Registration	6.00%	6.00%
Total Capital expressed as a percentage of total risk weighted exposures	13.88%	12.67%
Minimum Total Capital as per Conditions of Registration	8.00%	8.00%
Buffer ratio		
Buffer ratio	5.88%	4.67%
Buffer ratio requirement	2.50%	2.50%

(k) Solo capital adequacy

%	June 2021	June 2020
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	14.24%	12.81%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	14.24%	12.81%
Total Capital expressed as a percentage of total risk weighted exposures	14.24%	12.81%

For the purposes of calculating capital adequacy on a solo basis, subsidiaries which are both wholly owned and wholly funded by the Bank are to be consolidated with the Bank.

(l) Capital for other material risks

In addition to the material risks included in the calculation of the capital ratios, the Banking Group has identified other material risks to be included in the capital allocation (being strategic risk, securitisation risk, liquidity and funding risk, and additional market and operational risk). As at 30 June 2021, the Banking Group has made an internal capital allocation of $8.9 million to cover these risks (2020: $23.2 million).

29 Insurance business, securitisation, funds management, other fiduciary activities

Insurance business

MARAC Insurance Limited (**MIL**), a subsidiary of HBL, no longer conducts insurance business as HBL entered into a distribution agreement with DPL Insurance Limited (**DPL**) to distribute DPL's insurance products through HBL's network. MIL stopped writing insurance policies in the prior year with the last policies expected to expire in 2025.

The Banking Group's aggregate amount of insurance business comprises the total consolidated assets of MIL of $8.5 million (2020: $10.9 million), which represents 0.19% of the total consolidated assets of the Banking Group (2020: 0.25%).

Marketing and distribution of the insurance products

Pre February 2020's distribution agreement with DPL, the Banking Group marketed and distributed term life insurance and general insurance covering risks such as redundancy, bankruptcy or suspension of employment. The insurance products were either underwritten by MIL, a subsidiary of the Banking Group, or sold by MIL on behalf of other parties who underwrite those products themselves.

Securitisation

As at 30 June 2021, the Banking Group had $126.40 million securitised assets (2020: $78.07 million).

There have been no material changes to the Banking Group's involvement in the securitisation activities.

Funds management and other fiduciary activities

The Banking Group, through Heartland PIE Fund Limited, controls, manages and administers the Heartland Cash and Term PIE Fund and its products (Heartland Call PIE and Heartland Term Deposit PIE). Note 27 - Structured entities has further details. The Heartland Cash and Term PIE Fund deals with the Bank in the normal course of business, in the Bank's capacity as Registrar of the Fund and also invests in the Bank's deposits. The Banking Group is considered to control the Heartland Cash and Term PIE Fund, and as such the Heartland Cash and Term PIE Fund is consolidated within the financial statements of the Banking Group.

Heartland NZ Trustee Limited (**HNZT**), a subsidiary of the Bank, acts as manager for a superannuation scheme. The assets and liabilities of this scheme are not included in the financial statements of the Banking Group as the Banking Group does not control the scheme. The Bank provides services to HNZT and its fees for performance of those services are included in other income.

Risk management

The Banking Group has in place policies and procedures to ensure that the fiduciary activities identified above are conducted in an appropriate manner. It is considered that these policies and procedures will ensure that any difficulties arising from these activities will not impact adversely on the Banking Group. The policies and procedures include comprehensive and prominent disclosure of information regarding products, and formal and regular review of operations and policies by management and internal and external auditors. Further information on the Banking Group's risk management policies and practices is included in Note 20 - Enterprise risk management program.

Provision of financial services and asset purchases

Over the accounting period, financial services provided by the Banking Group to entities which were involved in the activities above (including trust, custodial, funds management and other fiduciary activities) were provided on arm's length terms and conditions and at fair value.

Any assets purchased from such entities have been purchased on arm's length terms and conditions and at fair value.

29 Insurance business, securitisation, funds management, other fiduciary activities (continued)

Peak aggregate funding to entities

The Banking Group did not provide any funding to entities conducting funds management and other fiduciary activities, or insurance product or marketing and distribution activities described in this note, during the year (2020: nil).

The Bank provided the following funding in relation to securitisation entities.

	Total Trusts	
	June 2021	**June 2020**
Peak end-of-day aggregate amount of funding provided ($000's)	110,000	76,846
Peak end-of-day aggregate amount of funding provided as a percentage of the Banking Group's Tier 1 Capital as at the end of the year (%)	19.1%	14.5%

For this purpose, peak ratio information was derived by determining the maximum end-of-day aggregate amount of funding over the financial year and then dividing that amount by the amount of the entity's assets or the Banking Group's Tier 1 Capital (as the case required) as at the end of the year.

	Auto Warehouse	
	June 2021	**June 2020**
Peak end-of-day aggregate amount of funding provided ($000's)	110,000	76,846
Peak end-of-day aggregate amount of funding provided as a percentage of the total assets of the individual entity as at the end of the year (%)	86.5%	98.3%

For this purpose, peak ratio information was derived by determining the maximum end-of-day aggregate amount of funding and then dividing that amount by the amount of the entity's assets or the Banking Group's Tier 1 Capital (as the case required) as at the end of the year.

30 Contingent liabilities and commitments

The Banking Group in the ordinary course of business will be subject to claims and proceedings against it whereby the validity of the claim will only be confirmed by uncertain future events. In such circumstances the contingent liabilities are possible obligations, or present obligations if known, where the transfer of economic benefit is uncertain or cannot be reliable measured. Contingent liabilities are not recognised, but are disclosed, unless they are remote. Where some loss is probable, provisions have been made on a case by case basis.

Contingent liabilities and credit related commitments arising in respect of the Banking Group's operations were:

$000's	**June 2021**	**June 2020**
Letters of credit, guarantee commitments and performance bonds	13,484	6,515
Total contingent liabilities	**13,484**	**6,515**
Undrawn facilities available to customers	208,855	177,719
Conditional commitments to fund at future dates	19,083	58,045
Total commitments	**227,939**	**235,764**

31 Events after the reporting date

On Tuesday 17 August 2021 the New Zealand Government, in response to a community outbreak of the Delta COVID variant, placed New Zealand into an immediate Level 4 lockdown. The Directors have considered the impact of this, on the reported performance of the Banking Group, and consider the reported performance has adequately allowed for the potential impact of COVID at this time, and that the current lockdown does not affect the reported result for the 12 months ended 30 June 2021.

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

Historical Summary of Financial Statements

For the year ended 30 June 2021

$000's	Audited June 2021	Audited June 2020	Audited June 2019	Audited June 2018	Audited June 2017
Interest income	272,562	297,512	284,064	272,323	278,279
Interest expense	73,753	108,476	111,665	108,737	115,169
Net interest income	**198,809**	**189,036**	**172,399**	**163,586**	**163,110**
Other net income	15,006	15,742	9,409	12,683	8,142
Net operating income	**213,815**	**204,778**	**181,808**	**176,269**	**171,252**
Employee benefits	-	-	-	-	41,547
Operating expenses	100,852	90,782	76,298	76,291	30,137
Profit before impaired asset expense and income tax	**112,963**	**113,996**	**105,510**	**99,978**	**99,568**
Fair value gain on investments	215	-	1,936	-	-
Impaired asset expense	14,579	29,372	20,554	21,833	15,015
Profit before income tax	**98,599**	**84,624**	**86,892**	**78,145**	**84,553**
Profit before income tax from discontinued operations	-	-	6,169	16,149	-
Income tax expense	27,090	23,924	24,762	26,781	23,745
Profit for the year	**71,509**	**60,700**	**68,299**	**67,513**	**60,808**
Other comprehensive income					
Items that are or may be reclassified subsequently to profit or loss, net of income tax:					
Effective portion of change in fair value of derivative financial instruments	8,928	(2,179)	(4,762)	72	1,108
Movement in fair value reserve	(5,646)	766	2,968	981	(353)
Movement in foreign currency translation reserve	-	-	(4,229)	2,315	761
Items that will not be reclassified to profit or loss, net of income tax:					
Movement in defined benefit reserve	-	-	(86)	340	(84)
Other comprehensive income/(loss) for the year, net of income tax	**3,282**	**(1,413)**	**(6,109)**	**3,708**	**1,432**
Total comprehensive income for the year	**74,791**	**59,287**	**62,190**	**71,221**	**62,240**
Dividends paid to equity holders	30,000	65,000	112,042	47,895	41,977

As at 30 June 2021

$000's	Audited June 2021	Audited June 2020	Audited June 2019	Audited June 2018	Audited June 2017
Total assets	4,419,488	4,314,559	4,143,828	4,496,849	4,034,671
Individually impaired assets	38,143	24,667	26,412	45,186	32,084
Total liabilities	3,777,660	3,717,522	3,540,438	3,832,689	3,465,076
Total equity	641,828	597,037	603,390	664,160	569,595

Amendment to Conditions of Registration

Changes to conditions of registration

- With effect from 1 May 2021, the Reserve Banks Liquidity Policy Annex: Liquid Assets raised residential mortgage securities eligibility to 5% of total assets for lower level asset encumbrance, but constrained eligibility of RMBS at higher levels encumbrance.
- With effect from 1 May 2021, LVR restrictions for owner-occupied remains at a maximum of 20% of new lending at LVRs above 80%(after exemptions); and LVR restrictions for investors were further tightened to 5% of new lending above 60% after exemption.
- With effect from 29 April 2021, the dividend restrictions placed on locally incorporated banks at the height of the COVID-19 pandemic were eased to allow banks to par up to a maximum of 50% of their earnings as dividends to shareholders. The 50% dividend restriction will remain in place until 1 July 2022.
- With effect from 1 March 2021, restrictions on the Banks new residential mortgage lending at high loan -to value (LVR ratios have been reinstated. LVR restrictions for owner -occupiers have been reinstated to a maximum of 20% of new lending at LVRs above 80% (after exemption); and LVR restrictions for investors have been reinstated to a maximum of 5% of new lending at LVRs above 70% (after exemption).

Conditions of Registration

These conditions apply on and after 29 April 2021, except as provided otherwise.

The registration of Heartland Bank Limited ("the bank") as a registered Bank is subject to the following conditions:

1. That—

(a) the Total capital ratio of the banking group is not less than 8%;

(b) the Tier 1 capital ratio of the banking group is not less than 6%;

(c) the Common Equity Tier 1 capital ratio of the banking group is not less than 4.5%;

(d) the Total capital of the Banking Group is not less than $30 million;

(e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and

(f) the bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document "Application requirements for capital recognition or repayment and notification requirements in respect of capital" (BS16) dated November 2015 in respect of regulatory capital instruments.

For the purposes of this condition of registration, -

“Total capital ratio”, “Tier 1 capital ratio”, and “Common Equity Tier 1 capital ratio” have the same meaning as in Part 3 of the Reserve Bank of New Zealand document“Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;

“Total capital” has the same meaning as in Part 2 of the Reserve Bank of New Zealand document “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;

an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8(2)(a) or (c) of the Reserve Bank of New Zealand document “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015;

a Tier 2 capital instrument is an instrument that meets the requirements of subsection 9(2)(a) or (c) of the Reserve Bank of New Zealand document “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated November 2015.

Conditions of Registration (continued)

1A. That—

(a) the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in the document "Guidelines on a bank's internal capital adequacy assessment process ('ICAAP')" (BS12) dated December 2007;

(b) under its ICAAP the bank identifies and measures its "other material risks" defined as all material risks of the banking group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015; and

(c) the bank determines an internal capital allocation for each identified and measured "other material risk".

1B. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:

(a) according to the following table, limit the aggregate distributions of the bank's earnings to the percentage limit on distributions that corresponds to the banking group's buffer ratio:

Banking group's buffer ratio	**Percentage limit to distributions of the banks' earnings**
0% - 0.625%	0%
>0.625% - 1.25%	20%
>1.25% - 1.875%	40%
>1.875% - 2.5%	50%

(b) prepare a capital plan to restore the banking group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and

(c) have the capital plan approved by the Reserve Bank.

For the purposes of this condition of registration, -

"buffer ratio", "distributions", and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

1C. That, if the buffer ratio of the banking group is more than 2.5%, the bank must limit aggregate distributions, other than discretionary payments payable to holders of Additional Tier 1 capital instruments, to no more than 50% of the bank's earnings.

For the purposes of this condition of registration,—

an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 8.2(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015;

"buffer ratio", "distributions" and "earnings" have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: "Capital Adequacy Framework (Standardised Approach)" (BS2A) dated November 2015.

the bank must not make any individual dividend payment contributing to aggregate distributions for a financial year until it has completed its interim financial accounts for the first six months of its financial year or its annual financial accounts for its full financial year, and must not make any such dividend payment less than six months after any previous such dividend payment.

2. That the banking group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

In this condition of registration, the meaning of "material" is based on generally accepted accounting practice.

3. That the banking group's insurance business is not greater than 1% of its total consolidated assets.

For the purposes of this condition of registration, the banking group's insurance business is the sum of the following amounts for entities in the banking group:

Conditions of Registration (continued)

(a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the banking group headed by the entity; and

(b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the banking group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity's insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

In determining the total amount of the banking group's insurance business—

(a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and

(b) if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

For the purposes of this condition of registration,—

"insurance business" means the undertaking or assumption of liability as an insurer under a contract of insurance:

“insurer” and “contract of insurance” have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

4. That aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the banking group to all connected persons do not exceed the rating-contingent limit outlined in the following matrix:

Credit rating of the bank[1]	**Connected exposure limit (% of the banking group's Tier 1 capital)**
AA/Aa2 and above	75
AA-/Aa3	70
A+/A1	60
A/A2	40
A-/A3	30
BBB+/Baa1 and below	15

Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15% of the banking group's Tier 1 capital.

For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank of New Zealand document entitled “Connected exposures policy” (BS8) dated November 2015.

5. That exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.

6. That the bank complies with the following corporate governance requirements:

(a) the board of the bank must have at least five directors;

(b) the majority of the board members must be non-executive directors;

(c) at least half of the board members must be independent directors;

(d) an alternate director,—

(i) for a non-executive director must be non-executive; and

(ii) for an independent director must be independent;

[1] This table uses the rating scales of Standard & Poor's, Fitch Ratings and Moody's Investor Service. (Fitch Ratings' scale is identical to Standard & Poor's.)

Conditions of Registration (continued)

(e) at least half of the independent directors of the bank must be ordinarily resident in New Zealand;

(f) the chairperson of the board of the bank must be independent; and

(g) the bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the bank).

For the purposes of this condition of registration,—

"independent,"—

(a) in relation to a person other than a person to whom paragraph (b) applies, has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014; and

(b) in relation to a person who is the chairperson of the board of the bank, means a person who—

(i) meets the criteria for independence set out in section 10 except for those in paragraph 10(1)(a) in BS14; and

(ii) does not raise any grounds of concern in relation to the person's independence that are communicated in writing to the bank by the Reserve Bank of New Zealand:

"non-executive" has the same meaning as in the Reserve Bank of New Zealand document entitled "Corporate Governance" (BS14) dated July 2014.

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:

(a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

(b) the Reserve Bank has advised that it has no objection to that appointment.

8. That a person must not be appointed as chairperson of the board of the bank unless:

(a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

(b) the Reserve Bank has advised that it has no objection to that appointment.

9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:

(a) the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;

(b) the committee must have at least three members;

(c) every member of the committee must be a non-executive director of the bank;

(d) the majority of the members of the committee must be independent; and

(e) the chairperson of the committee must be independent and must not be the chairperson of the bank.

For the purposes of this condition of registration, "independent" and "non-executive" have the same meanings as in condition of registration 6.

Conditions of Registration (continued)

10. That a substantial proportion of the Bank's business is conducted in and from New Zealand.

11. Before and on 30 April 2021, that the banking group complies with the following quantitative requirements for liquidity-risk management:

    (a) the one-week mismatch ratio of the banking group is not less than zero per cent at the end of each business day;

    (b) the one-month mismatch ratio of the banking group is not less than zero per cent at the end of each business day; and

    (c) the one-year core funding ratio of the banking group is not less than 50 per cent at the end of each business day.

    For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated January 2018 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated October 2018.

11A. On and after 1 May 2021, that the banking group complies with the following quantitative requirements for liquidity-risk management:

    (a) the one-week mismatch ratio of the banking group is not less than zero percent at the end of each business day;

    (b) the one-month mismatch ratio of the banking group is not less than zero percent at the end of each business day; and

    (c) the one-year core funding ratio of the banking group is not less than 50 percent at the end of each business day.

    For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated May 2021 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated May 2021.

12. That the bank has an internal framework for liquidity risk management that is adequate in the bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:

    (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;

    (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;

    (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and

    (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

Conditions of Registration (continued)

13. That no more than 10% of total assets may be beneficially owned by a SPV.

For the purposes of this condition,—

“total assets” means all assets of the banking group plus any assets held by any SPV that are not included in the banking group’s assets:

“SPV” means a person—

(a) to whom any member of the banking group has sold, assigned, or otherwise transferred any asset;

(b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and

(c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the banking group under a covered bond:

“covered bond” means a debt security issued by any member of the banking group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

14. That—

(a) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:

(i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and

(ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document “Significant Acquisitions Policy” (BS15) dated December 2011; and

(b) no member of the banking group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:

(i) the bank has notified the Reserve Bank in writing of the intended acquisition or business combination;

(ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the bank provided the Reserve Bank with the information required under the Reserve Bank of New Zealand Banking Supervision Handbook document “Significant Acquisitions Policy” (BS15) dated December 2011; and

(iii) the Reserve Bank has given the Bank a notice of non-objection to the significant acquisition or business combination.

For the purposes of this condition of registration, “qualifying acquisition or business combination”, “notification threshold” and “non-objection threshold” have the same meaning as in the Reserve Bank of New Zealand Banking Supervision Handbook document “Significant Acquisitions Policy” (BS15) dated December 2011.

15. That the bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the Reserve Bank, the bank can—

(a) close promptly at any time of the day and on any day of the week and that effective upon the appointment of the statutory manager—

(i) all liabilities are frozen in full; and

(ii) no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;

(b) apply a *de minimis* to relevant customer liability accounts;

(c) apply a partial freeze to the customer liability account balances;

(d) reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;

(e) maintain a full freeze on liabilities not pre-positioned for open bank resolution; and

(f) reinstate customers' access to some or all of their residual frozen funds.

For the purposes of this condition of registration, “*de minimis*”, “partial freeze”, “customer liability account”, and “frozen and unfrozen funds” have the same meaning as in the Reserve Bank of New Zealand document “Open Bank Resolution (OBR) Pre-positioning Requirements Policy” (BS17) dated September 2013.

Conditions of Registration (continued)

16. That the bank has an Implementation Plan that—

    (a) is up-to-date; and

    (b) demonstrates that the bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: "Open Bank Resolution Pre-positioning Requirements Policy" (BS17) dated September 2013.

    For the purposes of this condition of registration, “Implementation Plan” has the same meaning as in the Reserve Bank of New Zealand document “Open Bank Resolution (OBR) Pre-positioning Requirements Policy” (BS17) dated September 2013.

17. That the bank has a compendium of liabilities that—

    (a) at the product-class level lists all liabilities, indicating which are—

        (i) pre-positioned for Open Bank Resolution; and

        (ii) not pre-positioned for Open Bank Resolution;

    (b) is agreed to by the Reserve Bank; and

    (c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

    For the purposes of this condition of registration, “compendium of liabilities”, and “pre-positioned and non pre-positioned liabilities” have the same meaning as in the Reserve Bank of New Zealand document “Open Bank Resolution (OBR) Pre-positioning Requirements Policy” (BS17) dated September 2013.

18. That on an annual basis the bank tests all the component parts of its Open Bank Resolution solution that demonstrates the bank’s prepositioning for Open Bank Resolution as specified in the bank’s Implementation Plan.

    For the purposes of this condition of registration, “Implementation Plan” has the same meaning as in the Reserve Bank of New Zealand document “Open Bank Resolution (OBR) Pre-positioning Requirements Policy” (BS17) dated September 2013.

19. That, for a loan-to-valuation measurement period ending on or before 30 September 2021, the total of the bank’s qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 70%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

20. That, for a loan-to-valuation measurement period ending on or after 31 October 2021,the total of the bank’s qualifying new mortgage lending amount in respect of property investment residential mortgage loans with a loan-to-valuation ratio of more than 60%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to valuation measurement period.

21. That, for a loan-to-valuation measurement period, the total of the bank’s qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 20% of the total of the qualifying new mortgage lending amount in respect of no property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

22. That the bank must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank’s agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

In these conditions of registration,—

“banking group” means Heartland Bank Limited (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

"generally accepted accounting practice" has the same meaning as in section 8 of the Financial Reporting Act 2013.

Conditions of Registration (continued)

In conditions of registration 19 to 22,—

“loan-to-valuation ratio”, “non property-investment residential mortgage loan”, “property-investment residential mortgage loan”, “qualifying new mortgage lending amount in respect of property-investment residential mortgage loans”, “qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans”, and “residential mortgage loan” have the same meaning as in the Reserve Bank of New Zealand document entitled “Framework for Restrictions on High-LVR Residential Mortgage Lending” (BS19) dated January 2019:

“loan-to-valuation measurement period” means—

(a) the six calendar month period ending on the last day of August 2021; and

(b) thereafter a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of September 2021.

Conditions of Registration Non-Compliance

Conditions of Registration Non-Compliance

In July 2021 the Bank was made aware of the RBNZ’s Liquidity Thematic review quantitative findings. These identified four issues where the Bank’s calculation of its liquidity ratios was not in compliance with its Condition of Registration 11 (**COR 11**).

All non-compliance issues identified have now been remedied, and the ratios when recalculated remained at all times within the Bank’s Conditions of Registration.

Conditions of Registration Non-Compliance Prior Period

As disclosed in prior reporting periods, the Bank had not been calculating its regulatory capital and liquidity ratios in compliance with the requirements of its Conditions of Registration 1 (**COR 1**), and COR 11.

The Bank completed its remediation programme during the reporting period. The ratios when recalculated correctly have at all times remained above the requirements of the Bank’s Conditions of Registration.

Pending Proceedings

There are no pending legal proceedings or arbitrations concerning any member of the Banking Group at the date of Disclosure Statement that may have a material adverse effect on the Bank or the Banking Group.

Credit Ratings

As at the date of signing this Disclosure Statement, the Bank's credit rating issued by Fitch Australia Pty Ltd (**Fitch Ratings**) was BBB stable. This BBB credit rating was issued on 14 October 2015 and is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars. This BBB stable credit rating was affirmed by Fitch Ratings on 19 October 2020.

The following is a summary of the descriptions of the ratings categories for rating agencies for the rating of long-term senior unsecured obligations:

Fitch Ratings	Standard & Poor's	Moody's Investors Service	Description of Grade
AAA	AAA	Aaa	Ability to repay principal and interest is extremely strong. This is the highest investment category.
AA	AA	Aa	Very strong ability to repay principal and interest in a timely manner.
A	A	A	Strong ability to repay principal and interest although somewhat susceptible to adverse changes in economic, business or financial conditions.
BBB	BBB	Baa	Adequate ability to repay principal and interest. More vulnerable to adverse changes.
BB	BB	Ba	Significant uncertainties exist which could affect the payment of principal and interest on a timely basis.
B	B	B	Greater vulnerability and therefore greater likelihood of default.
CCC	CCC	Caa	Likelihood of default considered high. Timely repayment of principal and interest is dependent on favourable financial conditions.
CC - C	CC - C	Ca - C	Highest risk of default.
RD to D	D	-	Obligations currently in default.

Credit ratings from Fitch Ratings and Standard & Poor’s may be modified by the addition of a plus or minus sign to show relative status within the major rating categories. Moody’s Investors Service apply numerical modifiers 1, 2, and 3 to show relative standing within the major rating categories, with 1 indicating the higher end and 3 the lower end of the rating category.

Other Material Matters

There are no material matters relating to the business or affairs of the Bank or the Banking Group that are not disclosed in these consolidated financial statements which, if disclosed, would materially affect the decision of a person to subscribe for debt or equity instruments of which the Bank or any member of the Banking Group is the issuer.

Independent Auditor's Report

To the shareholder of Heartland Bank Limited

Report on the audit of the consolidated financial statements

Opinion

We have audited the accompanying consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) of Heartland Bank Limited (the "Bank") and its subsidiaries (the "Banking Group") which comprise:

- the consolidated statement of financial position as at 30 June 2021;
- the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended;
- notes, including a summary of significant accounting policies and other explanatory information; and
- the information that is required to be disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order").

In our opinion, the accompanying consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) of the Banking Group on pages 7 to 71:

i. give a true and fair view of the Banking Group's financial position as at 30 June 2021 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand Generally Accepted Accounting Practice, which in this instance means New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS") and International Financial Reporting Standards.

In our opinion, the supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) that is required to be disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order) within the disclosure statement:

i. has been prepared, in all material respects, in accordance with the guidelines issued pursuant to section 78(3) of the Reserve Bank of New Zealand Act 1989 and any conditions of registration;

ii. is in accordance with the books and records of the Banking Group in all material respects; and

iii. fairly states the matters to which it relates in accordance with those Schedules.

Basis for Opinion

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

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

Our responsibilities under ISAs (NZ) are further described in the auditor's responsibilities for the audit of the consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) section of our report.

Our firm has also provided other services to the Banking Group in relation to the review of the Banking Group's half year disclosure statement, regulatory assurance services and supervisor reporting. Subject to certain restrictions, partners and employees of our firm may also deal with the Banking Group on normal terms within the ordinary course of trading activities of the business of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group. The firm has no other relationship with, or interest in, the Banking Group.

Materiality

The scope of our audit was influenced by our application of materiality. Materiality helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the consolidated financial statements as a whole. The materiality for the consolidated financial statements as a whole was set at $5,100,000 determined with reference to a benchmark of the Banking Group's profit before tax. We chose the benchmark because, in our view, this is a key measure of the Banking Group's performance.

We agreed with the Audit Committee that we would report to them, misstatements identified during our audit above $255,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Key audit matters

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

The key audit matter	How the matter was addressed in our audit
Provision for impairment of finance receivables Refer to notes 1, 12 and 22 to the consolidated financial statements.	
The provision for impairment of finance receivables is a key audit matter due to the financial significance and the inherent complexity of the Banking Group's expected credit loss ("ECL") models. Significant judgement and estimates are required to incorporate forward-looking information to reflect future economic conditions. The collective provision is estimated through the ECL models using historical data which is adjusted for forward looking information and the assigned risk grade or arrears status. Additionally, management apply judgement in the determination of provision overlays to adjust for future market conditions. The level of judgement involved in determining the provision for collectively impaired assets requires us to challenge the appropriateness of management's assumptions. The provision for individually impaired assets is based on the application of management judgement regarding expected future cashflows, which are inherently uncertain.	Together with KPMG credit risk specialists we assessed the Banking Group's collective and individual provisions. Our procedures, amongst others, included: — Assessing the Banking Group's governance and oversight, including the continuous reassessment of overall provisioning; — Assessing the Banking Group's significant accounting policies and expected credit loss ("ECL") modelling methodology against the requirements of the standards and underlying accounting records; — Testing key controls including the arrears calculations, customer loan ratings, annual loan reviews, credit risk reviews and data reconciliations between the ECL models and source systems; — Assessing the model output against actual losses incurred by the Banking Group; — Challenging the key assumptions, including forward looking economic assumptions, against external information including benchmarking management's estimates to a range of different market forecasts; — Evaluating individual credit assessments for a sample of 'rural' and other 'corporate' loans on management's credit watchlist. This included inspection of the latest correspondence with the borrower, assessment of the provision estimates prepared by credit risk officers, and consideration of the resolution strategy. We challenged assumptions and assessed collateral values by

KPMG

The key audit matter	How the matter was addressed in our audit
	comparing them to valuations performed by independent valuers; and — Assessing the disclosures in the consolidated financial statements against the requirements of NZ IFRS. From the procedures performed we consider the Banking Group appropriately identified and considered the uncertainties in the provision estimates.
Valuation of finance receivables – reverse mortgages Refer to note 19 of the consolidated financial statements.	
The Banking Group's reverse mortgage portfolio is held at fair value. The fair value calculation is based on the application of management judgement. In assessing the fair value, the Banking Group continuously considers evidence of a relevant active market. In the absence of such a market, in the current period, the Banking Group considered changes since loan origination and expected future cashflows. The inherent uncertainties include estimated exits, interest rates and security property values.	Our procedures over the fair value loan portfolios, amongst others, included: — Testing key controls over the accuracy of data impacting the fair value assessment; — Assessing evidence of a relevant active market or observable inputs; and — Challenging the key assumptions used by the Banking Group in determining the portfolio's fair value. The estimates and assumptions used to determine the valuation of loan portfolio are reasonable, with no evidence of management bias or influence identified from our procedures.
Operation of IT systems and controls	
The Banking Group is reliant on complex IT systems for the processing and recording of significant volumes of transactions and other core banking activity. For significant financial statement balances, such as finance receivables and deposits, where relevant, our audit involves an assessment of the design of the Banking Group's internal control environment. There are some areas of the audit where we seek to test and place reliance on IT systems, automated controls and reporting. The effective operation of these controls is dependent upon the Banking Group's general IT control environment, which incorporates controls relevant to IT system changes and development, IT operations, and developer and user access.	Our audit procedures, amongst others, included: — Gaining an understanding of business processes, key controls and IT systems relevant to significant financial statement balances, including technology services provided by a third party; — Assessing the effectiveness of the IT control environment, including core banking IT systems, key automated controls and reporting; and — Evaluating general IT controls relevant to IT system changes and development, IT operations, and developer and user access. Where we noted design or operating effectiveness matters relating to IT system or application controls relevant to our audit, we performed alternative audit procedures. We also identified and tested mitigating controls in order to respond to the impact on our overall audit approach. We did not identify any material issues or exceptions from those additional procedures.

Other information

The Directors, on behalf of the Banking Group, are responsible for the other information included in the Bank's disclosure statement. Other information comprises the information required to be included in the disclosure statement in accordance with schedule 2 of the Order. Our opinion on the consolidated financial statements does not cover any other information and we do not express any form of assurance conclusion thereon.

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

Report on other legal and regulatory requirements

In accordance with the requirements of clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order, we report that:

— we have obtained all the information and explanations we have required; and

— in our opinion, proper accounting records have been kept by the Banking Group, as far as appears from our examination of those records.

Responsibilities of Directors for the consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements)

The Directors, on behalf of the Banking Group, are responsible for:

— the preparation and fair presentation of the consolidated financial statements in accordance with Clause 24 of the Order, NZ IFRS and International Financial Reporting Standards;

— the preparation and fair presentation of supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements), in accordance with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order;

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

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

Auditor's responsibilities for the audit of the consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements)

Our objective is:

— to obtain reasonable assurance about whether the disclosure statement, including the financial statements prepared in accordance with Clause 24 of the Order, and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements), in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order as a whole is free from material misstatement, whether due to fraud or error; and

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

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

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

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

http://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

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

KPMG

Review conclusion on the supplementary information relating to capital adequacy and regulatory liquidity requirements

We have reviewed the supplementary information relating to capital adequacy and regulatory liquidity requirements, as disclosed in note 25(a) and 28 of the consolidated financial statements for the year ended 30 June 2021. The supplementary information relating to capital adequacy and regulatory liquidity requirements comprises the information that is required to be disclosed in accordance with Schedule 9 of the Order.

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy and regulatory liquidity requirements, disclosed in note 25(a) and 28 to the consolidated financial statements, is not, in all material respects disclosed in accordance with Schedule 9 of the Order.

Basis for conclusion on the supplementary information relating to capital adequacy and regulatory liquidity requirements

A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* ("NZ SRE 2410") is a limited assurance engagement. Our responsibilities under that standard are further described in the Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements section of our report.

As the auditor of Heartland Bank Limited, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual consolidated financial statements.

Responsibilities of Directors for the supplementary information relating to capital adequacy and regulatory liquidity requirements

The directors are responsible for the preparation of supplementary information relating to capital adequacy and regulatory liquidity requirements that is required to be disclosed under Schedule 9 of the Order and prepared in accordance with the Capital Adequacy Framework (Standardised Approach) (BS2A) and described in notes 25(a) and 28 to the consolidated financial statements.

Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements

Our responsibility is to express a conclusion on the supplementary information relating to capital adequacy and regulatory liquidity requirements based on our review. We conducted our review in accordance with NZ SRE 2410. As the auditor of Heartland Bank Limited, NZ SRE 2410 requires that we plan and perform the review to obtain limited assurance about whether the supplementary information relating to capital adequacy and regulatory liquidity requirements is, in all material respects, disclosed in accordance with Schedule 9 of the Order.

A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with ISAs (NZ). Accordingly, we do not express an audit opinion on the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosures.

Use of this independent auditor's report

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

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

For and on behalf of

KPMG

KPMG
Auckland

23 August 2021

HEARTLAND

NZX/ASX release
24 August 2021

ASX Listing Rule 1.15.3 Statement

Heartland Group Holdings Limited (**Heartland**) (**NZX/ASX: HGH**) (an ASX Foreign Exempt Listing) confirms, for the purposes of ASX Listing Rule 1.15.3, that it has complied with and continues to comply with the Listing Rules of NZX Limited, which is its overseas home exchange.

– ENDS –

For further information, please contact the person(s) who authorised this announcement:

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