HEARTLAND

BANK

Disclosure Statement

For the year ended 30 June 2019

Contents

GENERAL INFORMATION

This Disclosure Statement has been issued by Heartland Bank Limited (the **Bank**) and its subsidiaries (the **Banking Group**) for the year ended 30 June 2019 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 2019 form part of, and should be read in conjunction with, this Disclosure Statement.

On 19 September 2018, Heartland Bank shareholders approved a corporate restructure that resulted in Heartland Bank becoming a wholly owned subsidiary of a new company, Heartland Group Holdings Limited (**HGH Ltd**). On 31 October 2018, shares in Heartland Bank Limited were exchanged for shares in Heartland Group Holdings Limited, and Heartland Bank's Australian group of companies transferred to Heartland Group Holdings Limited.

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

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

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 have the ability to appoint 100% of directors, subject to 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.

On 29 August 2018 the assets of the ABCP Trust were purchased by Heartland Bank Limited and the ABCP Trust dissolved. The loans purchased by the Bank where then sold to Heartland Auto Receivables Warehouse Trust 2018-1. See Note 29 - Structured entities for further details.

GUARANTEE ARRANGEMENTS

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

DIRECTORS

All Directors of the Bank reside in New Zealand with the exception of Ellen Comerford who resides in Australia. Communications to the Directors can be sent to Heartland Bank Limited, 35 Teed Street, Newmarket, Auckland.

During the year, Sir Christopher Mace, Gregory Raymond Tomlinson, Graham Russell Kennedy resigned as directors, and Kathryn Morrison was appointed as a director.

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, B R Irvine Limited, Blackbyre Horticulture Limited, Bowdens Mart Limited, Bray Frampton Limited, Britten Motorcycle Company Limited, Chambers @151 Limited, Clipper Investments (2002) Limited, Cockerill and Campbell (2007) Limited, Embassy Hotels Limited, Gough Finance Limited, Gough & Hamer Limited, Gough Group Limited, Gough Holdings Limited, Gough Transport Supplies Limited, Gough Transport NZ Limited, GZ Capital Limited, GZ NZ Limited, GZ RES Limited, Hansons Lane International Holdings Limited, Hawling Holding Limited, House of Travel ESP Trustee Limited, House of Travel Holdings Limited, J.S. Ewers Limited, Kaipaki Berryfruits Limited, Kaipaki Holidings Limited, Kaipaki Properties Limited, Lake Angelus Holdings Limited, Lamanna Bananas (NZ) Limited, Lamanna Limited, Lamanna Premier Group Pty Limited, Limeloader Irrigation 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, Phimai Holdings Limited, Quitachi Limited, Rakon ESOP Trustee Limited, Rakon Limited, Rakon PPS Trustee Limited, Scenic Hotel (Haast) Limited, Scenic Circle Convention Services Limited, Scenic Circle MLC Cafe & Bar Limited, Scenic Circle (Napier) Limited, Scenic Hotels (Ashburton) Limited, Scenic Hotel Group Limited, Scenic Hotels (Hamilton) Limited, Scenic Hotels (International) Limited, Scenic Hotels (Karapiro) Limited, Skope Industries Limited, Southland Produce Markets Limited, USC Investments Limited, Wavell Resources Limited.

Name: Jeffrey Kenneth Greenslade

Qualifications: LLB

Type of Director: Non-Independent Executive Director

Occupation: Chief Executive Officer of Heartland Group Holdings Limited

External Directorships:

Heartland Australia Group Pty Limited, Heartland Australia Holdings Pty Limited, Heartland Group Holdings Limited.

Name: Edward John Harvey

Qualifications: BCom, FCA, CF Inst D

Type of Director: Independent Non-Executive Director

Occupation: Company Director

External Directorships:

Investore Property Limited, Kathmandu Holdings Limited, Pomare Investments Limited, Port of Napier Limited, Napier Port Holdings Limited, Stride Holdings Limited, Stride Investment Management Limited, Stride Property Limited.

Name: Ellen Frances Comerford

Qualifications: BEc

Type of Director: Non-Executive Director

Occupation: Chief Financial Officer of The Hollard Insurance Company Pty Limited

External Directorships:

Comerford Gohl Holdings Pty Limited, Heartland Australia Group Pty Limited, Heartland Australia Holdings Pty Limited, Heartland Group Holding Limited, Hollard Holdings Australia Pty Limited, The Hollard Insurance Company Pty Limited.

Name: Geoffrey Thomas Ricketts CNZM

Qualifications: LLB (Hons), LLD (*honoris causa*), CF Inst D

Type of Director: Non-Executive Director

Occupation: Company Director

External Directorships:

Asteron Life Limited, Janmac Capital Limited, Heartland Australia Group Pty Limited, Heartland Australia Holdings Pty Limited, Heartland Group Holdings Limited, Maisemore Enterprises Limited, MCF 2 FFK-GK Limited, MCF 2 Message4U Limited, MCF 2 Nexus Limited, MCF 3 GP Limited, MCF 3A General Partner Limited, MCF 3B General Partner Limited, MCF 7 Limited, MCF 8 Limited, MCF 9 Limited, MCF 10 Limited, MCF2 (Fund 1) Limited, MCF2A General Partner Limited, MCF2 GP Limited, MC Medical Properties Limited, Mercury Capital No.1 Fund Limited, Mercury Capital No. 1 Trustee Limited, Mercury Pharmacy Holdings 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, Suncorp Group Holdings (NZ) Limited, Suncorp Group New Zealand Limited, Suncorp Group Services NZ Limited, The Centre for Independent Studies Limited, The Todd Corporation Limited, Todd Management Services Limited, Todd Offshore Limited, Vero Insurance New Zealand Limited, Vero Liability Insurance Limited.

Name: Vanessa Cynthia May Stoddart

Qualifications: BCom/ LLB (Hons), PG Dip in Prof Ethics

Type of Director: Independent Non-Executive Director

Occupation: Company Director

External Directorships:

OneFortyOne Plantations Holdings Pty Limited, OneFortyOne Plantations Pty Limited, OneFortyOne Plantation Holdings No 2 Pty Ltd, OneFortyOne Wood Products Pty Limited, OneFortyOne NZ Holdings Limited, Nelson Forests Limited, Nelson Management Limited, New Zealand Global Women Limited, The New Zealand Refinery Company Limited, Stoddart & Co Limited.

Government Appointments: Financial Markets Authority, Tertiary Education Commission, Ministry of Business Inovation and Employment Audit and Risk Committee, Department of Conservation Audit and Risk Committee, Business New Zealand's representative on Defence Force Employer Support Council.

Name: Kathryn Morrison

Qualifications: BA, CM InstD

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, Morrison Horgan Limited, The New Zealand Merino Company Limited.

Conflicts of interest policy

All Directors are required to disclose to the Board any actual or potential conflict 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 on 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-Executive Director
Vanessa Cynthia May Stoddart	Independent Non-Executive Director

AUDITOR

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland

AMENDMENTS TO CONDITIONS OF REGISTRATION

The following amendments have been made to the Bank's condition of registration, and are effective on and after 1 January 2019:

i. Amendment to condition 1 relating to the section headed 'For the purpose of this condition of registration', clarification on the application of 'Capital Adequacy Framework (Standardised Approach)' (BS2A) for condition 1.
ii. Amendment to the conditions 19 and 20, relating to residential mortgage lending loan-to-valuation ratio limits to property investors and non-property investors;
iii. Reference to a revised version of 'Framework of Restrictions on High-LVR Residential Mortgage Lending' (BS19) dated January 2019;

CONDITIONS OF REGISTRATION

These conditions apply on and after 1 January 2019.

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", "Common Equity Tier 1 capital ratio" and "Total capital" 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.

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 to distributions that corresponds to the banking group's buffer ratio:

Banking group's buffer ratio	Percentage limit to distributions of the bank's earnings
0% – 0.625%	0%
>0.625 – 1.25%	20%
>1.25 – 1.875%	40%
>1.875 – 2.5%	60%

(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.

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:

(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 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 exposure 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;

(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:

1 This table uses the rating scales of Standard & Poor's, Fitch Ratings and Moody's Investors Service. (Fitch Ratings' scale is identical to Standard & Poor's.)

"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.

10. That a substantial proportion of the bank's business is conducted in and from New Zealand.

11. 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 75 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.

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.

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.

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" (BS 17) 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, 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, 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 non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

21. 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.

In conditions of registration 19 to 21,—

"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 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 June 2019.

The Bank has complied with the conditions of registration applicable during the period except to the extent noted below.

Condition of registration 1

In July 2019, the Bank identified that from January 2015 it had incorrectly applied "Capital Adequacy Framework (Standardised Approach) (BS2A)" when calculating its risk weighted assets and regulatory capital. When the calculations were re-performed in accordance with BS2A, the Bank's regulatory capital ratios were up to 15 basis points lower than originally reported; however, the Bank was compliant with all of its minimum regulatory capital ratios, and with its additional internal buffers, at all times during the financial year. The incorrect application of BS2A did not result in non-compliance with condition of registration 1 after 31 December 2018, as a new version of that condition took effect from 1 January 2019. The correct application has been applied for the 30 June 2019 capital calculation and the 30 June 2018 comparative information.

The details of the incorrect application are as follows:

1. The Bank had incorrectly included equity investment holdings as part of its risk weighted assets rather than deducting equity investment holdings from total capital, as required by BS2A.

2. The Bank had not consistently deducted from Common Equity Tier 1 capital the amount of reverse residential mortgage loans to the extent the loans exceeded the value of the security for each loan, as required by BS2A.

3. The Bank did not offset its financial assets foreign currency exposure against its financial liabilities foreign currency exposures in relation to its market risk calculation, as required in BS2A.

Condition of registration 11

In July 2019, the Bank identified that from March 2019 it had incorrectly classified certain depositors, resulting in errors in the Bank's reported market funding and non-market funding values. This resulted in the incorrect calculation of the Bank's liquidity ratios. When the calculations were re-performed in accordance with "Liquidity Policy (BS13)" and "Liquidity Policy Annex: Liquid Assets (BS13A)", the Bank's liquidity ratios during the financial year reduced by a maximum of 17 basis points (one-week mismatch ratio), 28 basis points (one-month mismatch ratio) and 54 basis points (one-year core funding ratio); however, the Bank was compliant with all its minimum internal and regulatory liquidity ratios, and with its internal buffers, at all times during the financial year.

External review

The Bank has engaged an external consultant to undertake a broader review of its calculation of its regulatory capital and liquidity ratios. At the time of publication, the external review is still ongoing.

PENDING PROCEEDINGS

There are no pending legal proceedings or arbitrations concerning any member of the Banking Group at the date of this 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 1 November 2018.

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 contained elsewhere in this Disclosure Statement which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which the Bank or any member of the Banking Group is the issuer.

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 2019:
    a. The Bank has complied with the conditions of registration applicable during the period except as noted on page 14;
    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 the 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 businesses risks, and that those systems were being properly applied.

This Disclosure Statement is dated 20 September 2019 and has been signed by all the Directors.

B R Irvine (Chair)

K Morrison

J K Greenslade

G T Ricketts

E J Harvey

V M Stoddart

E F Comerford

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2019

$000's	NOTE	June 2019	Restated June 2018
Interest income	3	288,370	272,323
Interest expense	3	112,678	108,737
Net interest income		**175,692**	**163,586**
Operating lease income	4	5,262	5,675
Operating lease expenses	4	3,427	4,005
Net operating lease income		**1,835**	**1,670**
Lending and credit fee income		2,675	1,837
Other income	5	3,518	9,176
Net operating income		**183,720**	**176,269**
Operating expenses	6	78,210	76,291
Profit before impaired asset expense and income tax		**105,510**	**99,978**
Fair value movement on investment property	12	1,936	-
Impaired asset expense	7	20,554	21,833
Profit before income tax from continuing operations		**86,892**	**78,145**
Profit before income tax from discontinued operations	8	6,169	16,149
Income tax expense	9	24,762	26,781
Profit for the year		**68,299**	**67,513**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss:			
Effective portion of changes in fair value of derivative financial instruments, net of income tax		(4,762)	72
Movement in fair value reserve, net of income tax		2,968	981
Movement in foreign currency translation reserve, net of income tax		(4,229)	2,315
Items that will not be reclassified to profit or loss:			
Movement in defined benefit reserve, net of income tax		(86)	340
Other comprehensive income for the year, net of income tax		**(6,109)**	**3,708**
Total comprehensive income for the year		**62,190**	**71,221**

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

The notes on pages 22 to 77 are an integral part of this consolidated financial statement.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2019

		June 2019				June 2018			
$000's	**Note**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**
Balance at beginning of year		**542,315**	**4,585**	**117,260**	**664,160**	**470,516**	**1,437**	**97,642**	**569,595**
NZ IFRS 9 adjustment	1	-	-	(19,283)	(19,283)	-	-	-	-
Restated balance at beginning of year		**542,315**	**4,585**	**97,977**	**644,877**	**470,516**	**1,437**	**97,642**	**569,595**
Total comprehensive income for the year									
Profit for the year		-	-	68,299	68,299	-	-	67,513	67,513
Sale of discontinued operations		-	-	-	-	-	-	-	-
Other comprehensive income/(loss) net of income tax	18	-	(6,109)	-	(6,109)	-	3,708	-	3,708
Total comprehensive income for the year		**-**	**(6,109)**	**68,299**	**62,190**	**-**	**3,708**	**67,513**	**71,221**
Contributions by and distributions to owners									
Dividends paid	17	-	-	(30,808)	(30,808)	-	-	(47,895)	(47,895)
Dividends to Heartland Group Holdings Limited	17	-	-	(81,234)	(81,234)	-	-	-	-
Transfer of ownership		-	(297)	-	(297)	-	-	-	-
Sale of business		-	2,969	(2,969)	-	-	-	-	-
Dividend reinvestment plan		8,584	-	-	8,584	12,745	-	-	12,745
Issue of share capital		-	-	-	-	59,225	-	-	59,225
Transaction costs associated with capital raising		-	-	-	-	(910)	-	-	(910)
Share based payments		-	78	-	78	-	666	-	666
Shares vested		2,340	(2,340)	-	-	739	(1,226)	-	(487)
Total transactions with owners		**10,924**	**410**	**(115,011)**	**(103,677)**	**71,799**	**(560)**	**(47,895)**	**23,344**
Balance at the end of the year		**553,239**	**(1,114)**	**51,265**	**603,390**	**542,315**	**4,585**	**117,260**	**664,160**

The notes on pages 22 to 77 are an integral part of this consolidated financial statement.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2019

$000's	Note	June 2019	June 2018
Assets			
Cash and cash equivalents		45,228	49,588
Investments	11	354,928	340,546
Investment properties	12	11,132	9,196
Derivative financial instruments	13	12,650	923
Due from related parties	20	21,177	-
Finance receivables	14	3,029,231	3,984,941
Finance receivables - reverse mortgages	14	561,211	-
Operating lease vehicles	15	15,516	17,524
Other assets	19	20,379	14,411
Intangible assets	19	57,335	74,401
Deferred tax asset	9	9,948	5,319
Total assets		**4,138,735**	**4,496,849**
Liabilities			
Retail deposits	16	3,153,681	2,881,805
Other borrowings	16	345,273	914,253
Tax liabilities		5,667	11,459
Derivative financial instruments	13	10,372	2,562
Trade and other payables	19	20,352	22,610
Total liabilities		**3,535,345**	**3,832,689**
Equity			
Share capital	17	553,239	542,315
Retained earnings and other reserves		50,151	121,845
Total equity		**603,390**	**664,160**
Total equity and liabilities		**4,138,735**	**4,496,849**
Total interest earning and discount bearing assets		4,003,982	4,361,937
Total interest and discount bearing liabilities		3,497,499	3,790,067

The notes on pages 22 to 77 are an integral part of this consolidated financial statement.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2019

$000's	Note	June 2019	June 2018
Cash flows from operating activities			
Interest received		292,851	280,471
Lending, credit fees and other income received		2,930	10,398
Operating lease income received		4,761	4,941
Operating inflows		**300,542**	**295,810**
Interest paid		121,748	123,783
Payments to suppliers and employees		84,682	73,672
Taxation paid		21,888	23,818
Operating outflows		**228,318**	**221,273**
Net cash flows from operating activities before changes in operating assets and liabilities		**72,224**	**74,537**
Net movement in deposits		271,876	307,733
Net movement in finance receivables		(368,561)	(431,863)
Proceeds from sale of operating lease vehicles		4,641	5,577
Purchase of operating lease vehicles		(5,495)	(7,163)
Net cash flows applied to operating activities		**(25,315)**	**(51,179)**
Cash flows from investing activities			
Net proceeds from sale of investment properties		-	3,185
Proceeds from equity investments		-	300
Total cash provided from investing activities		**-**	**3,485**
Purchase of property, plant and equipment and intangible assets		4,188	8,837
Net increase in investments		11,468	23,107
Purchase of investment properties		-	7,472
Total cash applied to investing activities		**15,656**	**39,416**
Net cash flows applied to investing activities		**(15,656)**	**(35,931)**
Cash flows from financing activities			
Net increase/(decrease) in wholesale funding		45,236	(93,507)
Proceeds from issue of unsubordinated notes		125,000	150,000
Increase in share capital		-	58,315
Total cash provided from financing activities		**170,236**	**114,808**
Dividends paid	17	42,014	35,150
Repayment of subordinated notes	16	22,846	-
Total cash applied to financing activities		**64,860**	**35,150**
Net cash flows from financing activities		**105,376**	**79,658**
Net increase/(decrease) in cash held		**64,405**	**(7,452)**
Opening cash and cash equivalents		49,588	57,040
Cash transferred on corporate restructure		(68,765)	-
Closing cash and cash equivalents		**45,228**	**49,588**

The notes on pages 22 to 77 are an integral part of this consolidated financial statement.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 30 June 2019

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

$000's	Note	June 2019	June 2018
Profit for the year		**68,299**	**67,513**
Add / (less) non-cash items:			
Depreciation and amortisation expense		5,754	4,638
Depreciation on lease vehicles		3,363	3,771
Capitalised net interest income		(11,886)	(26,373)
Impaired asset expense	7	21,181	22,067
Investment property fair value movement		(1,936)	-
Total non-cash items		**16,476**	**4,103**
Add / (less) movements in operating assets and liabilities:			
Finance receivables		(368,561)	(431,863)
Operating lease vehicles		(1,354)	(2,257)
Other assets		(6,584)	(635)
Current tax		(3,744)	1,603
Derivative financial instruments		(8,676)	(1,638)
Deferred tax		1,547	2,533
Deposits		271,876	307,733
Other liabilities		5,406	1,729
Total movements in operating assets and liabilities		**(110,090)**	**(122,795)**
Net cash flows applied to operating activities		**(25,315)**	**(51,179)**

The notes on pages 22 to 77 are an integral part of this consolidated financial statement.

1 Financial statements preparation

Basis of reporting

Reporting entity

The financial statements presented are the consolidated financial statements comprising Heartland Bank Limited (the **Bank**) and its subsidiaries (the **Banking Group**). Refer to Note 28 – Significant subsidiaries for further details.

On 31 October 2018, the Bank became a wholly owned subsidiary of Heartland Group Holdings Limited (**HGH Ltd**). Shares held in the Bank were exchanged on a one for one basis for shares in HGH Ltd. The Australian group of companies that were previously held by the Bank were transferred to HGH Ltd. The transfer of the Australian group of companies has resulted in the Australian group being classified as a discontinued operation for the year ended 30 June 2019. This is disclosed in more detail in Note 8 - Discontinued operations.

As at 30 June 2019, 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 Bank's functional and the Banking Group's presentation currency. Unless otherwise indicated, amounts are rounded to the nearest thousand.

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

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 information has been restated to comply with the current year presentation.

Discontinued Operations

Discontinued operations
The corporate restructure has led to the Australian group of companies being transferred from the Bank to HGH Ltd. As required by NZ IFRS 5 – Non Current Assets Held for Sale and Discontinued Operations (**NZ IFRS 5**) this has resulted in the reclassification of balances in the Consolidated Statement of Comprehensive Income to net profit before income tax from discontinued operations in both the reporting period and in prior year. NZ IFRS 5 does not require prior year Consolidated Statement of Financial Position to be restated.

1 Financial statements preparation (continued)

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, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. 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 with 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 spot rate at the transaction date or a rate approximating that rate. Exchange differences are taken to the Consolidated Statement of Comprehensive Income.

Changes in accounting policy

The Banking Group adopted NZ IFRS 9 - Financial instruments (**NZ IFRS 9**) and NZ IFRS 15 - Revenue from contracts with customers (**NZ IFRS 15**) from 1 July 2018. There have been no changes in previously reported financials.

NZ IFRS 9 Financial instruments

In accordance with the transition provisions of NZ IFRS 9 the classification and measurement requirements of this standard have been applied retrospectively by adjusting affected opening balances at the date of initial application with no restatement of comparative periods.

The following changes have been made to accounting policies as result of the application of NZ IFRS 9.

Impairment of finance receivables

At each reporting date, the Banking Group applies a three stage approach to measuring "expected credit losses" (**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 made, based on events that are possible in the next 12 months.

After initial recognition, the Bank applies a three stage test to measuring ECL's. 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 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 Bank 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 expected credit loss 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.

Impairment of investments

The requirements of NZ IFRS 9 also apply to the Bank's investments. The impact of which has been assessed as not material.

1 Financial statements preparation (continued)

The table below shows the changes to classification and measurement of the Banking Group's financial assets due to the adoption of NZ IFRS 9. There are no changes in the classification or measurement category of the Banking Group's financial liabilities.

Financial Instruments	NZ IAS 39 Measurement category	NZ IFRS 9 Measurement category	NZ IAS 39 Carrying value June 2018	NZ IFRS 9 Carrying value 1 July 2018
Financial assets				
Bank bonds and floating rate notes	Available for sale (**AFS**)	Fair value through other comprehensive income (**FVOCI**)	230,754	230,754
Public sector securities and corporate bonds	AFS	FVOCI	57,818	57,818
Local authority stock	AFS	FVOCI	42,280	42,280
Equity investments	Fair value through profit or loss (**FVTPL**)	FVOCI	9,694	9,694
Finance receivables – reverse mortgages	Amortised cost	FVTPL	1,129,956	1,132,838
Finance receivables	Amortised cost	Amortised cost	2,854,985	2,824,819
Trade receivables	Amortised cost	Amortised cost	1,613	1,613

The table below is a reconciliation of the balance sheet detailing the changes from NZ IAS 39 to NZ IFRS 9.

$000's	Audited 12 months to June 2018	Impact of NZ IFRS 9 Restatement	Restated 1 July 2018
Assets			
Cash and cash equivalents	49,588	-	49,588
Investments	340,546	-	340,546
Investment properties	9,196	-	9,196
Derivative financial instruments	923	-	923
Finance receivables	3,984,941	(27,284)	3,957,657
Operating lease vehicles	17,524	-	17,524
Other assets	14,411	-	14,411
Intangible assets	74,401	-	74,401
Deferred tax asset	5,319	8,001	13,320
Total assets	**4,496,849**	**(19,283)**	**4,477,566**
Liabilities			
Retail deposits	2,881,805	-	2,881,805
Other borrowings	914,253	-	914,253
Tax liabilities	11,459	-	11,459
Derivative financial instruments	2,562		2,562
Trade and other payables	22,610	-	22,610
Total liabilities	**3,832,689**	**-**	**3,832,689**
Equity			
Share capital	542,315	-	542,315
Retained earnings and reserves	121,845	(19,283)	102,562
Total equity	**664,160**	**(19,283)**	**644,877**
Total equity and liabilities	**4,496,849**	**-**	**4,477,566**

1 Financial statements preparation (continued)

Impact of NZ IFRS 9 adjustment on adoption

Additional provision for impairment recognised at 1 July 2018 on:	
- Finance receivables	28,085
- Finance receivables - reverse mortgages	(2,824)
Provision for impairment at 1 July 2018	25,261
Change in valuation basis - reverse mortgages	2,023
Income tax expense	(8,001)
Net impact on retained earnings	**19,283**

NZ IFRS 15 Revenue from contracts with customers
The Banking Group adopted NZ IFRS 15 on 1 July 2018. This standard provides a principles based approach for revenue recognition and introduces the concept of recognising revenue for performance obligations as they are satisfied.

The Banking Group has adopted this standard retrospectively with the cumulative effect of initial application recognised as an adjustment to opening balances and has applied all practical expedients applicable. There have been no changes to previously reported financials.

Accounting standards issued but not yet effective

Standard and description	Effective for annual years beginning on or after	Expected to be initially applied in year ending
NZ IFRS 16 Leases: contains guidance on identification, recognition, measurement, presentation and disclosure of leases by lessees and lessors.	1 January 2019	30 June 2020
NZ IFRS 9 Financial instruments: contains relaxed requirements for hedge effectiveness, and expanded disclosures.	1 January 2019	To be confirmed
NZ IFRS 17 Insurance contracts: establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts.	1 January 2021	30 June 2022

NZ IFRS 16 Leases

NZ IFRS 16 *Leases* replaces NZ IAS 17 *Leases* and will be adopted by the Banking Group from 1 July 2019. NZ IFRS 16 requires that a right of use asset and lease liability is recognised at lease commencement date. The value of the lease liability is the present value of all future payments arising from a lease contract. The right of use asset will be depreciated over the life of the lease. This could affect the timing on expenses of leased assets. This change will primarily affect leases relating to properties and car leases. Currently the Banking Group accounts for these as operating leases.

The Banking Group intends to apply the simplified transition approach and will not restate comparative amounts for the year prior to first adoption. All practical expedients available to the Banking Group around short term leases, and low value leases will be applied. Right-of-use assets will be measured on transition as if the new rules had always been applied, using the transition discount rate. The cumulative effect of adopting NZ IFRS 16 is estimated at $2 million and will be recognised as an adjustment to the opening balance of retained earnings at 1 July 2019, with no restatement of comparative information.

1 Financial statements preparation (continued)

NZ IFRS 9 Financial instruments

NZ IFRS 9 introduces new hedge accounting requirements which more closely align accounting with risk management activities undertaken when hedging financial and non-financial risks. NZ IFRS 9 provides the Banking Group with an accounting policy choice to continue to apply the NZ IAS 39 hedge accounting requirements until the International Accounting Standards Board's ongoing project on macro hedge accounting is completed. The Banking Group's current expectation is that it will continue to apply the hedge accounting requirements of NZ IAS 39.

Estimates and judgements

The preparation of the Banking Group's financial statements requires the use of estimates and judgement. 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 management's best estimate of future cash repayments and proceeds from any security held or by reference to risk profile groupings and historical loss data. Refer to Note 14 – Finance receivables for further details.

- Fair value of reverse mortgages – Fair value is quantified by the transaction price and management's subsequent best estimate of the risk profile of the reverse mortgage portfolio. Refer to Note 21 – Fair value for further details.

- Goodwill - Determining the fair value of assets and liabilities of acquired businesses requires the exercise of management judgement. The carrying value of goodwill is tested annually for impairment, refer to Note 19 – 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.

Financial assets and liabilities

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 fair value through profit or loss) are initially recognised on the trade date at which the Banking Group becomes a party to the contractual provisions of the instrument.

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 or liability.

The Banking Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expire.

The Banking Group enters into transactions whereby it transfers assets recognised on its 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 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.

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

Motor	Providing motor vehicle finance.
Reverse mortgages	Providing reverse mortgage lending.
Other personal	Providing a comprehensive range of financial services – including term, transactional and savings based deposit accounts and personal loans.
Business	Providing term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium businesses.
Rural	Providing 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	Providing reverse mortgage lending within Australia (Discontinued operation).

Certain operating expenses, such as premises, IT and support centre costs are not allocated to operating segments and are included in Other.

Internal structures have changed during the current year. Previously reported Household segment has been disaggregated to show Motor, Reverse Mortgages and Other Personal. Prior year numbers have been restated accordingly.

The Banking Group's operating segments are different from the industry categories detailed in Note 24 - Asset quality. The operating segments are primarily categorised by sales channel, whereas Note 24 - Asset quality is based on credit risk concentrations.

2 Segmental analysis (continued)

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Australia	Other	Total
June 2019								
Net interest income	54,753	20,673	16,345	54,334	30,865	-	(1,278)	175,692
Net other income	2,313	224	2,563	1,524	816	-	588	8,028
Net operating income	**57,066**	**20,897**	**18,908**	**55,858**	**31,681**	**-**	**(690)**	**183,720**
Operating expenses	2,543	2,279	5,602	9,163	3,263	-	55,360	78,210
Profit/(loss) before impaired asset expense and income tax	**54,523**	**18,618**	**13,306**	**46,695**	**28,418**	**-**	**(56,050)**	**105,510**
Fair value movement on investment property				1,936				1,936
Impaired asset expense	5,009	268	8,307	7,102	(132)	-	-	20,554
Profit/(loss) before income tax from continuing operations	**49,514**	**18,350**	**4,999**	**41,529**	**28,550**	**-**	**(56,050)**	**86,892**
Profit/(loss) before income tax from discontinued operations	-	-	-	-	-	6,169	-	6,169
Income tax expense	-	-	-	-	-	-	24,762	24,762
Profit/(loss) for the year	**49,514**	**18,350**	**4,999**	**41,529**	**28,550**	**6,169**	**(80,812)**	**68,299**
Total assets	1,074,446	561,211	215,253	1,096,253	643,278	-	548,294	**4,138,735**
Total liabilities	-	-	-	-	-	-	3,535,345	**3,535,345**

$000's	Motor	Reverse Mortgages	Other Personal	Business	Rural	Australia	Other	Total
June 2018 (restated)								
Net interest income	50,328	18,189	12,421	51,189	32,122	-	(663)	163,586
Net other income	2,515	262	2,392	1,124	163	-	6,227	12,683
Net operating income	**52,843**	**18,451**	**14,813**	**52,313**	**32,285**	**-**	**5,564**	**176,269**
Operating expenses	2,914	1,670	6,552	8,130	4,351	-	52,674	76,291
Profit/(loss) before impaired asset expense and income tax	**49,929**	**16,781**	**8,261**	**44,183**	**27,934**	**-**	**(47,110)**	**99,978**
Impaired asset expense	7,779	(362)	5,741	6,275	2,400	-	-	21,833
Profit/(loss) before income tax	**42,150**	**17,143**	**2,520**	**37,908**	**25,534**	**-**	**(47,110)**	**78,145**
Discontinued operations	-	-	-	-	-	16,149	-	16,149
Income tax expense	-	-	-	-	-	-	26,781	26,781
Profit/(loss) for the year	**42,150**	**17,143**	**2,520**	**37,908**	**25,534**	**16,149**	**(73,891)**	**67,513**
Total assets	955,088	453,119	178,309	1,048,239	654,935	695,251	511,908	**4,496,849**
Total liabilities	-	-	-	-	-	-	3,832,689	**3,832,689**

3 Net interest income

Policy

Interest income and expense is recognised in profit or loss using the effective interest method. The effective interest rate is established on initial recognition of the financial assets and liabilities and is not revised subsequently. The calculation of the effective interest rate includes all yield related fees and commissions paid or received that are an integral part of the effective interest rate.

Interest on the effective portion of a derivative designated as a cash flow hedge is initially recognised in the hedging reserve. It is released to profit or loss at the same time as the hedged item or when the hedge relationship is subsequently deemed to be ineffective, should this occur.

$000's	June 2019	Restated June 2018
Interest income		
Cash and cash equivalents	717	842
Investments	10,864	9,515
Finance receivables	242,556	231,848
Finance receivables - reverse mortgages	34,233	30,118
Total interest income	**288,370**	**272,323**
Interest expense		
Retail deposits	97,119	90,880
Other borrowings	12,313	15,230
Net interest expense on derivative financial instruments	3,246	2,627
Total interest expense	**112,678**	**108,737**
Net interest income*	**175,692**	**163,586**

*Net interest income from discontinued operations is included in Revenue within Note 8 – Discontinued operations.

4 Net operating lease income

Policy
Leases' where the Banking Group retains substantially all the risks and rewards of ownership of an asset are classified 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 2019	June 2018
Operating lease income		
Lease income	4,761	5,004
Gain on disposal of lease assets	501	671
Total operating lease income	**5,262**	**5,675**
Operating lease expense		
Depreciation on lease assets	3,363	3,771
Direct lease costs	64	234
Total operating lease expenses	**3,427**	**4,005**
Net operating lease income	**1,835**	**1,670**

5 Other income

Policy
Investment property
Rental income from investment properties is recognised on a straight-line basis over the term of the relevant lease.
Other income
Other items of income are recognised at the fair value of the consideration received or receivable.

$000's	June 2019	Restated June 2018
Rental income from investment properties	662	739
Insurance income	2,436	2,238
Gain on sale of investment	173	156
Other income[1]	247	6,043
Total other income	**3,518**	**9,176**

[1] June 2018 Other income includes

- A $0.6 million gain on the sale of the Bank's invoice finance business.
- A $4.8 million gain in relation to the sale of property pertaining to a loan previously written off for which the bank had entered into a profit share arrangement with third parties.

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 once a liability is incurred.

$000's	June 2019	Restated June 2018
Personnel expenses	40,903	43,538
Directors' fees	822	943
Superannuation	827	768
Audit and review of financial statements [1]	472	381
Other assurance services paid to auditor [2]	47	36
Other fees paid to auditor [3]	-	121
Depreciation - property, plant and equipment	1,861	1,386
Amortisation - intangible assets	3,893	3,252
Operating lease expense as a lessee	1,646	1,872
Legal and professional fees	2,278	2,143
Other operating expenses	25,461	21,851
Total operating expenses *	**78,210**	**76,291**

[1] Audit and review of financial statements includes fees paid for both audit of financial statements and review of interim financial statements.
[2] Other assurance services paid to the auditor comprise review of regulatory returns, trust deed reporting, registry audits and other agreed upon procedures engagements.
[3] Other fees paid to the auditor include professional fees in connection with health and safety advisory services, tax, regulatory and accounting advisory services.
* Total operating expenses from discontinued operations is included in Expenses within Note 8 – Discontinued operations.

7 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 made, based on events that are possible in the next 12 months.

After initial recognition, the Bank applies a three stage test to measuring ECL. 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 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 Bank 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 expected credit loss 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 2019	June 2018
Non-securitised		
Individually impaired expense	1,311	5,190
Collectively impaired expense	19,529	16,889
Total non-securitised impaired asset expense	**20,840**	**22,079**
Securitised		
Collectively impaired expense	341	(12)
Total securitised impaired asset expense	**341**	**(12)**
Total		
Individually impaired expense	1,311	5,190
Collectively impaired expense	19,870	16,877
Total impaired asset expense*	**21,181**	**22,067**

*Impaired asset expense from discontinued operations is included in impaired asset expense within Note 8 – Discontinued operations.

7 Impaired asset expense (continued)

Reconciliation of Impaired asset expense

$000's	Note	June 2019	June 2018
Impaired asset expense		20,554	21,833
Impaired asset expense for discontinued operations	8	627	234
Total impaired asset expense		**21,181**	**22,067**

8 Discontinued operations

Policy

Discontinued operations

A discontinued operation is a component of the Banking Group's business, the operations and cash flows of which can be clearly distinguished from the rest of the Banking Group and which:

- represents a separate major line of business or geographic area of operations;
- is part of a single co-ordinated plan to dispose of a separate major line of business or geographic area of operations; or
- is a subsidiary acquired exclusively with a view to resale.

Classification as a discontinued operation occurs at the earlier of disposal or when the operation meets the criteria to be classified as held-for-sale.

Discontinued operations

At the Annual Shareholder Meeting in September 2018, the Bank's shareholders approved a corporate restructure that resulted in the Bank becoming a wholly owned subsidiary of a new company, HGH Ltd. On 31 October 2018, shares in the Bank were exchanged for shares in HGH Ltd, and the Australian group of companies were transferred from the Bank to HGH Ltd.

To reflect this change, the comparative consolidated statements have been restated to remove the Australian group of companies, and show the discontinued operation separately from continuing operations.

Results of discontinued operation

$000's	Note	Unaudited 4 months to October 2018	Unaudited 12 months to June 2018
Net operating income		8,533	20,525
Operating expenses		1,737	4,142
Results from operating activities		**6,796**	**16,383**
Impaired asset expense	7	627	234
Profit before income tax from discontinued operation		**6,169**	**16,149**

The profit before income tax from the discontinued operations of $6.2 million (2018: $16.1 million) is attributable entirely to the Banking Group.

The income tax expense for the discontinued operation was $1.6 million (2018: $4.5 million) and profit after tax for the period was $4.5 million (2018: $11.6 million).

8 Discontinued operations (continued)

Financial position of discontinued operation

$000's	Unaudited October 2018	Unaudited June 2018
Financial position of assets of discontinued operation		
Cash and cash equivalents	68,766	18,943
Finance receivables	725,146	721,236
Other assets	917	80
Deferred tax asset/liability	1,133	(524)
Total discontinued operations assets	**795,962**	**739,735**
Financial position of liabilities of discontinued operation		
Other borrowings	665,950	614,510
Tax liabilities	2,047	2,968
Due to related parties	81,865	75,425
Total discontinued operations liabilities	**749,862**	**692,903**

Cash flow of discontinued operation

$000's	Unaudited October 2018	Unaudited June 2018
Cash flows from (used) in discontinued operations		
Net cash flows applied to operating activities	(8,060)	(107,573)
Net cash flow from investing activities	-	(1,903)
Net cash flows from financing activities	57,883	113,969
Net cash flows for the period / year	**49,823**	**4,493**

Profit on disposal

$000's	Note	Unaudited October 2018
In specie dividend to Heartland Group Holding Limited		61,444
Total consideration received		**61,444**
Net Assets		46,100
Goodwill	19	15,344
Gain/(loss) on disposal		-

9 Taxation

Policy

Income tax

Income tax expense for the year comprises current tax and movements in deferred tax balances. Income tax expense is recognised in profit or loss except to the extent 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 receivable or payable on the taxable income for the year, using the tax rate enacted or substantively enacted at the reporting date, and any adjustment to the tax receivable or payable in respect of previous years. Current tax for current and prior years is recognised as a liability (or asset) to the extent that 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.

Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount 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 part of the cost of assets at the time of acquisition or is expensed.

Income tax expense

$000's	June 2019	June 2018
Income tax recognised in profit and loss		
Current tax		
Current year	22,932	24,861
Adjustments for prior year	(2,037)	(332)
Deferred tax		
Current year	2,830	1,898
Adjustments for prior year	1,037	354
Total income tax expense recognised in profit & loss	**24,762**	**26,781**
Income tax recognised in other comprehensive income		
Current tax		
Derivatives at fair value reserve	(82)	(261)
Deferred tax		
Defined benefit plan	(34)	(132)
Fair value movements of cash flow hedges	(238)	(149)
Total income tax expense recognised in other comprehensive income	**(354)**	**(542)**
Reconciliation of effective tax rate		
Profit before income tax from continuing operations	86,892	78,145
Profit before income tax from discontinued operations	6,169	16,149
Total profit before income tax	**93,061**	**94,294**
Prima facie tax @ 28%	26,057	26,402
Higher tax rate for overseas jurisdiction	112	299
Plus tax effect of items not taxable/deductible	(407)	58
Adjustments for prior year	(1,000)	22
Total income tax expense	**24,762**	**26,781**

9 Taxation (continued)

Deferred tax assets comprise the following temporary differences:

$000's	June 2019	June 2018
Employee expenses	984	1,240
Provision for impairment	14,391	8,427
Investment properties	4	546
Intangibles and property, plant and equipment	(4,182)	(2,100)
Deferred acquisition costs	(1,321)	(1,476)
Operating lease vehicles	(800)	(850)
Other temporary differences	872	(468)
Total deferred tax assets	**9,948**	**5,319**
Opening balance of deferred tax assets	**5,319**	**7,852**
Movement recognised in profit or loss	(4,281)	(2,252)
Movement recognised in other comprehensive income	(272)	(281)
Transfer on demerger	1,442	-
Movement recognised in retained earnings	7,740	-
Closing balance of deferred tax assets	**9,948**	**5,319**

10 Earnings per share

Shares in the Bank were exchanged on a one for one basis for shares in HGH Ltd on 31 October 2018 when the bank became a wholly owned subsidiary of HGH Ltd.

FINANCIAL POSITION

11 Investments

Policy
The Banking Group holds investments in bank deposits, bank bonds and floating rate notes, local authority stock, public securities, corporate bonds and equity investments. The fair values are derived by reference to published price quotations in an active market or modelled using observable market rates. Investments are classified as being fair value through other comprehensive income.

$000's	June 2019	June 2018
Bank deposits, bank bonds and floating rate notes	246,724	230,754
Public sector securities and corporate bonds	82,370	57,818
Local authority stock	13,399	42,280
Equity investments	12,435	9,694
Total investments	**354,928**	**340,546**

12 Investment properties

Policy
Investment properties are initially recorded at fair value, with subsequent changes in fair value recognised in profit or loss. Fair values are determined by qualified independent valuers or other similar external evidence, adjusted for changes in market conditions and the time since last valuation.

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).

$000's	June 2019	June 2018
Opening balance	9,196	4,909
Acquisition	-	7,472
Fair value movement	1,936	-
Disposals	-	(3,185)
Closing balance	**11,132**	**9,196**

A $1.9 million increase in the fair value of non-core legacy property assets has been recognised, reflecting Management's view on the current market value of this portfolio.

13 Derivative financial instruments

Policy

Derivative financial instruments are contracts whose value is derived from changes in one or more underlying financial instruments or indices. They include forward contracts, swaps, options and combinations of these instruments.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently measured at their fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. Fair values include adjustment for counter party credit risk. The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. A hedge instrument is a designated derivative, the changes in fair values or cash flows of which are expected to offset changes in the fair value of cash flows of a designated hedged item.

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 to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments must involve a 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 on 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 in the Consolidated Statement of Comprehensive Income together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. 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 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 the hedged item 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 to ensure the hedge is effective, consistent with the originally documented risk management strategy, and
- the instruments must involve a 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 on offsetting changes in cash flows of hedged items.

13 Derivative financial instruments (continued)

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 19			June 18		
$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	1,958,083	11,232	10,230	744,822	923	2,562
Foreign currency related contracts						
Forwards	157,147	290	142	-	-	-
Options	177,255	1,128	-	-	-	-
Total derivative financial instruments	2,292,485	12,650	10,372	744,822	923	2,562

14 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 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 expected credit loss 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 2019	June 2018
Non-securitised		
Neither at least 90 days past due nor impaired - at amortised cost	3,016,844	3,863,764
At least 90 days past due - at amortised cost	44,466	27,893
Individually impaired - at amortised cost	26,412	45,186
Gross finance receivables	**3,087,722**	**3,936,843**
Less provision for impairment	(58,491)	(29,367)
Less fair value adjustment for present value of future losses over expected life	-	(2,824)
Total non-securitised finance receivables	**3,029,231**	**3,904,652**
Securitised		
Neither at least 90 days past due nor impaired - at amortised cost	-	79,809
At least 90 days past due - at amortised cost	-	784
Individually impaired - at amortised cost	-	-
Gross finance receivables	**-**	**80,593**
Less provision for impairment	-	(304)
Total securitised finance receivables	**-**	**80,289**
Total		
Neither at least 90 days past due nor impaired - at amortised cost	3,016,844	3,943,573
At least 90 days past due - at amortised cost	44,466	28,677
Individually impaired - at amortised cost	26,412	45,186
Gross finance receivables	**3,087,722**	**4,017,436**
Less provision for impairment	(58,491)	(29,671)
Less fair value adjustment for present value of future losses over expected life	-	(2,824)
Total finance receivables	**3,029,231**	**3,984,941**

Refer to Note 24 – Asset quality for further analysis of finance receivables by credit risk concentration.

14 Finance receivables (continued)

$000's	12 month ECL	Lifetime ECL Not credit impaired	Lifetime ECL Credit impaired	Collective provision June 2018	Specific provision	Total
Non-securitised						
Impairment allowance as at 30 June 2018	-	-	-	20,301	9,066	29,367
Restated for adoption of NZ IFRS 9	31,784	1,365	14,945	(20,301)	(169)	27,624
Restated impairment allowance as at 1 July 2018	31,784	1,365	14,945	-	8,897	56,991
Changes in loss allowance						
Transfer to 12 month	1,144	(1,071)	(73)	-	-	-
Transfer to lifetime not credit impaired	(2,134)	2,268	(134)	-	-	-
Transfer to lifetime credit impaired	(29)	(1,399)	1,428	-	-	-
Transfer to specific provision	(1,443)	(36)	(1,169)	-	2,648	-
Effect of changes in foreign exchange rate	(52)	(3)	(1)	-	-	(56)
Impaired asset expense	1,417	607	17,505	-	1,311	20,840
Write offs	-	-	(15,720)	-	(4,993)	(20,713)
Transfer to/from securitised	240	49	817	-	-	1,106
Recovery of amounts written off	-	-	829	-	-	829
Sale of portfolio	(506)	-	-	-	-	(506)
Closing impairment allowance	**30,421**	**1,780**	**18,427**	**-**	**7,863**	**58,491**
Securitised						
Impairment allowance as at 30 June 2018	-	-	-	304	-	304
Restated for adoption of NZ IFRS 9	400	20	345	(304)	-	461
Restated impairment allowance as at 1 July 2018	400	20	345	-	-	765
Changes in loss allowance						
Transfer to 12 month	35	(34)	(1)	-	-	-
Transfer to lifetime not credit impaired	(42)	44	(2)	-	-	-
Transfer to lifetime credit impaired	(1)	(17)	18	-	-	-
Transfer to specific provision	-	-	-	-	-	-
Effect of changes in foreign exchange rate	-	-	-	-	-	-
Impaired asset expense	(152)	36	457	-	-	341
Write offs	-	-	-	-	-	-
Transfer to/from non-securitised	(240)	(49)	(817)	-	-	(1,106)
Recovery of amounts written off	-	-	-	-	-	-
Closing impairment allowance	**-**	**-**	**-**	**-**	**-**	**-**
Total						
Impairment allowance as at 30 June 2018	-	-	-	20,605	9,066	29,671
Restated for adoption of NZ IFRS 9	32,184	1,385	15,290	(20,605)	(169)	28,085
Restated impairment allowance as at 1 July 2018	32,184	1,385	15,290	-	8,897	57,756
Changes in loss allowance						
Transfer to 12 month	1,179	(1,105)	(74)	-	-	-
Transfer to lifetime not credit impaired	(2,176)	2,312	(136)	-	-	-
Transfer to lifetime credit impaired	(30)	(1,416)	1,446	-	-	-
Transfer to specific provision	(1,443)	(36)	(1,169)	-	2,648	-
Effect of changes in foreign exchange rate	(52)	(3)	(1)	-	-	(56)
Impaired asset expense	1,265	643	17,962	-	1,311	21,181
Write offs	-	-	(15,720)	-	(4,993)	(20,713)
Transfers	-	-	-	-	-	-
Recovery of amounts written off	-	-	829	-	-	829
Sale of portfolio	(506)	-	-	-	-	(506)
Closing impairment allowance	**30,421**	**1,780**	**18,427**	**-**	**7,863**	**58,491**

14 Finance receivables (continued)

Summary of impairment allowance

$000's	Non-Securitised June 2019	Total June 2019
Collective allowance measured on a 12 month ECL	30,421	30,421
Collective allowance not credit impaired	1,780	1,780
Collective allowance credit impaired	18,427	18,427
Specific allowance	7,863	7,863
Total impairment allowance	**58,491**	**58,491**

Impact of changes in gross carrying amounts of ECL

The following provides an explanation of how significant change in the gross carrying value of the finance receivables have contributed to the changes in the provision for impairment. The provision for impairment reflects ECL measured using the 3 stage approach under NZ IFRS 9 (refer to Note 1 – Financial statement preparation).

Overall the net increase in the total provision for impairment was $0.7 million which was primarily driven by an increase in stage 2 and 3 collective provisions offset by a reduction in stage 1 provisions and specific provisions.

Collective 12 month ECL provisions (stage 1) decreased $1.8m. Net growth in new stage 1 receivables of $339 million added $3.0m to stage 1 provisions. This was offset by a reduction in provisions of $2.1m as a result of changes to expected loss rates in the Motor book following changes to and investment in collection processes. Stage 1 provisions were further reduced on $289m loans moving from stage 2 to stage 3 or specifically provided, offset by $134m of loans moving from stage 2 and 3 or specifically provided.

Collective lifetime not credit impaired provisions (stage 2) increased $0.4m. $282 million of receivables transferred to stage 2 due to deterioration in credit quality and $8m transferred from stage 3 due to improvement in asset quality. These were offset by $209m which was repaid or transferred to stage 1 due to improvement in credit quality and $90m transferred to stage 3 or specifically provided due to deterioration in credit quality.

Collective lifetime credit impaired provisions (stage 3) increased $3.1m driven primarily by a net increase in receivables of $17 million. This was due to a net increase transferred to stage 3 of $57m offset by $40m of loans that were repaid or written off in the period.

The reduction in specific provisions of $1.0 million was primarily the result of provisions on $24m of loans transferred from collectively provided off set by the release of provisions on $14m of loans that were repaid or written off in the period.

(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.

Advances relating to reverse equity mortgages are recognised in the financial statements at fair value through profit or loss, therefore carrying amount equals fair value. Note 21 (a) Fair Value of the financial statements discloses further information regarding the Banking Group's valuation policy.

Note 23 Credit Risk Exposure of the financial statements discloses further information regarding how reverse mortgages operate.

14 Finance receivables (continued)

$000's	June 2019	June 2018
Finance receivables - reverse mortgages	561,211	-
Total finance receivables - reverse mortgages	**561,211**	**-**

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

There were no credit risk adjustments on individual financial assets.

Credit risk adjustments on financial assets designated at fair value through profit or loss are presented in the following table.

$000's	Non-securitised June 2019	Total June 2019
Opening balance as at 30 June 2018	2,824	2,824
Restated for adoption of NZ IFRS 9	(2,824)	(2,824)
Restated opening balance as at 1 July 2018	-	-
Closing balance as at 30 June 2019	**-**	**-**

15 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 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 2019	June 2018
Cost		
Opening balance	24,703	28,137
Acquisitions	5,495	7,163
Disposals	(8,575)	(10,597)
Closing balance	**21,623**	**24,703**
Accumulated depreciation		
Opening balance	7,179	9,099
Depreciation charge	3,363	3,771
Disposals	(4,435)	(5,691)
Closing balance	**6,107**	**7,179**
Opening net book value	17,524	19,038
Closing net book value	**15,516**	**17,524**

The future minimum lease payments receivable under non-cancellable operating leases not later than one year is $3.952 million (2018: $4.380 million), within one to five years is $3.137 million (2018: $3.897 million) and over five years is nil (2018: nil).

16 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 2019**	**June 2018**
Deposits	3,153,681	2,881,805
Total borrowings related to deposits	**3,153,681**	**2,881,805**
Subordinated bonds	-	3,378
Subordinated notes	-	22,172
Unsubordinated notes	285,435	151,853
Bank borrowings	25,002	35,004
Certificate of deposit	34,836	39,832
Securitised borrowing	-	662,014
Total borrowings other	**345,273**	**914,253**

Deposits and unsubordinated notes rank equally and are unsecured.

The subordinated notes (settled early on 31 October 2018) and subordinated bonds ranked below all other general liabilities of the Bank.

The Bank from time to time issues unsubordinated notes. At 30 June 2019 the Bank had the following unsubordinated notes outstanding:

- $125 million five year unsubordinated notes issued 12 April 2019, interest payable six monthly, maturing 12 April 2024.
- $150 million five year unsubordinated notes issued 21 September 2017, interest payable six monthly, maturing 21 September 2022.

The Bank from time to time securitises loans. At 30 June 2019 the Bank had the following securitised borrowings outstanding:

- Heartland Auto Receivables Warehouse Trust 2018 - 1 securitisation facility $150 million, undrawn. Securitised borrowings held by investors are secured over the securitised assets of the Heartland Auto Receivables Warehouse Trust 2018-1.
- Heartland ABCP Trust 1 (**ABCP Trust**) securitisation facility nil (2018: $100 million, drawn $47 million). Heartland ABCP Trust 1 was dissolved 29 August 2018.
- On 31 October 2018 the assets of Senior Warehouse Trust (**SW Trust**) and Australian Seniors Finance Settlement Trust (**ASF Trust**) were sold to HGH Ltd. During the 2018 financial year SW Trust had securitisation facility AU $600 million, drawn AU $ 562 million. The bank facility is secured over the assets of Australian Seniors Finance Pty Limited (**ASF**) group (comprising ASF, the ASF Trust and the SW Trust).

17 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	Number of shares June 2019	Number of shares June 2018
Issued shares		
Opening balance	560,588	516,236
Shares issued during the year	-	37,224
Dividend reinvestment plan	5,283	7,128
Cancelled shares	(441)	-
Closing balance	**565,430**	**560,588**
Less treasury shares	-	(2,299)
Net closing balance	**565,430**	**558,289**

Under dividend reinvestment plans, the Bank issued 5,282,619 new shares at $1.6250 per share on 21 September 2018 (June 2018: 4,163,008 new shares at $1.8004 per share on 21 September 2017 and 2,965,048 new shares at $1.7707 per share on 3 April 2018).

Dividends paid

	June 2019			June 2018		
	Date declared	Cents per share	$000's	Date declared	Cents per share	$'000's
Final dividend	15 August 2018	5.5	30,808	14 August 2017	5.5	28,393
Interim dividend to HGH	19 February 2019	-	19,790	20 February 2018	3.5	19,502
In specie dividend	31 October 2018	-	61,444	-	-	-
Total dividends paid			**112,042**			**47,895**

18 Other reserves

$000's	Employee benefits reserve	Foreign currency translation reserve (FCTR)	Fair value reserve	Defined benefit reserve	Cash flow hedge reserve	Total
June 2019						
Balance as at 1 July 2018	2,559	1,260	1,590	257	(1,081)	4,585
Other comprehensive income net of tax	-	(4,229)	2,968	(86)	(4,762)	(6,109)
Transfer to Heartland Group Holdings	(297)	-	-	-	-	(297)
Sale of business	-	2,969	-	-	-	2,969
Share based payments	78	-	-	-	-	78
Shares vested	(2,340)	-	-	-	-	(2,340)
Balance as at 30 June 2019	**-**	**-**	**4,558**	**171**	**(5,843)**	**(1,114)**
June 2018						
Balance as at 1 July 2017	3,119	(1,055)	609	(83)	(1,153)	1,437
Other comprehensive income net of tax	-	2,315	981	340	72	3,708
Share based payments	666	-	-	-	-	666
Shares vested	(1,226)	-	-	-	-	(1,226)
Balance as at 30 June 2018	2,559	1,260	1,590	257	(1,081)	4,585

19 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 other revalued amount of each asset over its expected life to its estimated residual value.

$000's	June 2019	June 2018
Other assets		
Trade receivables	3,215	1,613
GST receivable	3,643	1,553
Prepayments	4,381	2,261
Property, plant and equipment	9,140	8,984
Total other assets	**20,379**	**14,411**

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 impairments losses. Subsequent 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 has been determined to be ten years. All other expenditure is expensed immediately as incurred.
Goodwill
Goodwill arising on acquisition represents the excess of cost of the acquisition over the Banking Group's interest in the fair value of the identifiable net assets of a controlled entity. 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 2019	June 2018
Computer software		
Cost	37,965	36,215
Accumulated depreciation	10,429	6,957
Net carrying value of computer software	**27,536**	**29,258**
Goodwill		
Cost	45,143	45,143
Transferred to Heartland Group Holdings Limited	(15,344)	-
Net carrying value of goodwill	**29,799**	**45,143**
Total intangible assets	**57,335**	**74,401**

A significant portion of the computer software costs which the Bank bought into use in May 2017 have an expected useful life determined to be ten years.

Goodwill previously held by the Banking Group was apportioned on the corporate restructure at 31 October 2018 as required by NZ IAS 36 – Impairment of assets. Goodwill of $15.344 million made up part of the in specie dividend paid from the Bank to HGH Ltd.

The remaining goodwill was tested for impairment on 31 May 2019. In assessing impairment, an internal valuation model was developed to indicate the value of the business. This value is compared to the net assets of the Banking Group. 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 2019 (30 June 2018: nil).

For the purposes of impairment testing, goodwill is allocated to cash generation units (**CGU**'s). 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 the Banking Group as the smallest identifiable CGU.

19 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 19**	**June 18**
Trade and other payables		
Trade payables	10,769	10,406
Insurance liability	5,699	6,333
Employee benefits	3,884	5,871
Total trade and other payables	**20,352**	**22,610**

20 Related party transactions and balances

Among the Bank’s deposit holders are the Heartland Cash and Term PIE Fund and some key personnel. The investments of Heartland Cash and Term PIE Fund are detailed in note 28 – Significant subsidiaries.

The Banking Group provides administrative services to members of the Heartland Group, in both New Zealand and Australia. These transactions are at arm’s length and on normal business terms.

Transactions with key management personnel
Key management personnel (**KMP**), being directors of the Bank, the Chief Executive Officer (**CEO**) and those executive staff reporting directly to the CEO. Transactions with immediate family members of KMP are disclosed below.

Loans made to KMP are made in the ordinary course of business on normal commercial terms and conditions no more favourable than those given to other employees or customers, including the term of the loan, security required and the interest rate.

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

$000's	**June 2019**	**June 2018**
Transactions with key personnel		
Interest income	-	5
Interest expense	(76)	(128)
Key personnel compensation		
Short-term employee benefits	(4,839)	(6,194)
Share-based payment expense	(204)	(640)
Total transactions with key personnel	**(4,978)**	**(6,957)**
Due to key personnel		
Borrowings - deposits	(3,019)	(2,412)
Total due(to)/from key personnel	**(3,019)**	**(2,412)**

Sale of Australian entities
On 31 October 2018 the Australian entities owned by the Bank were transferred to HGH Ltd pursuant to a corporate restructure approved by the shareholders of the Bank. The transfer was effected by an in specie dividend of $61.444 million which equalled the net asset value of those entities plus allocated goodwill at the date of the transaction.

Purchase of Australian receivables
On 31 October 2018 the Bank purchased $85.2 million receivables from ASF. These assets were purchased at market value and settled in AUD.

On 1 April 2019, the Bank purchased $22.073 million receivables from ASF. These assets were purchased at market value and settled in AUD.

20 Related party transactions and balances (continued)

Loan to ASF

An AU $75 million loan was advanced to ASF on 31 October 2018, with an interest rate of 6.75% with a term of three years.

Due from/to related parties

$000's	June 2019	June 2018
Due from		
Australian Seniors Finance Pty Limited	24,179	-
Total due from related parties	**24,179**	**-**
Due to		
Heartland Group Holdings Limited	3,002	-
Total due to related parties	**3,002**	**-**
Total due from related parties	**21,177**	**-**

21 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 fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

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 assets and liabilities of the Banking Group are measured at fair value on a recurring basis in the Consolidated Statement of Financial Position.

Investments

Investments in public sector securities and corporate bonds are classified as being FVOCI with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using unobservable market inputs (Level 2 under the fair value hierarchy).

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 flow analysis.

Investments in unlisted equity securities are classified as being FVOCI and are valued under Level 3 of the fair value hierarchy, with the fair value being based on unobservable inputs.

21 Fair value (continued)

Finance receivables – reverse mortgages
Reverse mortgage loans are classified at fair value through profit or loss.

On initial recognition the Bank considers the transaction price to represent the fair value of the loan.

For subsequent measurement the Bank 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 Bank has used valuation techniques including actuarial assessments to consider the fair value.

When the Bank enters into a reverse mortgage loan the Bank 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 Bank does not consider any of the above expectations to have moved outside of the original expectation range. Therefore the Bank 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 loan terms and the current market conditions the fair value as recorded is not considered to be sensitive to changes in house prices or interest rates.

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

There have been no losses on reverse mortgage loans during the current year (2018: Nil).

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 Statement of Financial Position.

$000's	Level 1	Level 2	Level 3	Total
June 2019				
Investments	255,875	86,618	12,435	354,928
Derivative financial instruments	-	12,650	-	12,650
Finance receivables - reverse mortgage	-	-	561,211	561,211
Total assets measured at fair value	**255,875**	**99,268**	**573,646**	**928,789**
Derivative financial instruments	-	10,372	-	10,372
Total liabilities measured at fair value	**-**	**10,372**	**-**	**10,372**
June 2018				
Investments	140,282	190,570	9,694	340,546
Derivative financial instruments	-	923	-	923
Finance receivables - reverse mortgage	-	454	-	454
Total assets measured at fair value	**140,282**	**191,947**	**9,694**	**341,923**
Derivative liabilities held for risk management	-	2,562	-	2,562
Total liabilities measured at fair value	**-**	**2,562**	**-**	**2,562**

21 Fair value (continued)

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

$000's	Finance receivables - reverse mortgages	Investments	Total
June 2019			
As at 1 July 2018	456,844	9,694	466,538
Purchased from ASF	54,711	-	54,711
Loans advanced	82,574	-	82,574
Loans repaid	(42,715)	-	(42,715)
Capitalised Interest	11,886	-	11,886
Purchase of investments	-	2,741	2,741
Other	(2,089)	-	(2,089)
As at 30 June 2019	**561,211**	**12,435**	**573,646**

(b) Financial instruments measured not 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 and other financial assets and liabilities
Cash and cash equivalents and other financial assets and liabilities are considered equivalent to their carrying value due to their short term nature.

Finance receivables
The fair value of 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 8.88% (2018: 8.12%). 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 the debt of similar maturities. The current market rate used to fair value borrowings is 2.59% (2018: 3.09%).

Due from related parties
The fair value of the loan due to related parties is estimated using a discounted cash flow model. The discount rate applied reflects the terms of the loan and the timing of the estimated cash flow.

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.

21 Fair value (continued)

The following table sets financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy.

$000's	Level 1	Level 2	Level 3	Total fair value	Total carrying value
June 2019					
Cash and cash equivalents	45,228	-	-	45,228	45,228
Finance receivables	-	3,017,327	-	3,017,327	3,029,231
Due from related parties	-	27,248	-	27,248	21,177
Other financial assets	-	-	3,215	3,215	3,215
Total financial assets	**45,228**	**3,044,575**	**3,215**	**3,093,018**	**3,098,851**
Retail deposits	-	3,160,426	-	3,160,426	3,153,681
Other borrowings	-	345,273	-	345,273	345,273
Other financial liabilities	-	-	20,352	20,352	20,352
Total financial liabilities	**-**	**3,505,699**	**20,352**	**3,526,051**	**3,519,306**
June 2018					
Cash and cash equivalents	49,588	-	-	49,588	49,588
Finance receivables	-	3,972,072	-	3,972,072	3,984,487
Other financial assets	-	-	1,613	1,613	1,613
Total financial assets	**49,588**	**3,972,072**	**1,613**	**4,023,273**	**4,035,688**
Retail deposits	-	2,877,885	-	2,877,885	2,881,805
Other borrowings	-	914,253	-	914,253	914,253
Other financial liabilities	-	-	22,610	22,610	22,610
Total financial liabilities	**-**	**3,792,138**	**22,610**	**3,814,748**	**3,818,668**

21 Fair value (continued)

(c) Classification of financial instruments

The following table summarise the categories of financial instruments and the carrying and fair value of all financial instruments of the Banking Group.

$000's	FVOCI	FVTPL	Amortised cost	Total carrying Value	Total fair value
June 2019					
Cash and cash equivalents	-	-	45,228	45,228	45,228
Investments	354,928	-	-	354,928	354,928
Finance receivables	-	-	3,029,231	3,029,231	3,017,327
Finance receivables - reverse mortgages	-	561,211	-	561,211	561,211
Derivative financial instruments	2,758	9,892	-	12,650	12,650
Due from related parties	-	-	21,177	21,177	27,248
Other financial assets	-	-	3,215	3,215	3,215
Total financial assets	**357,686**	**571,103**	**3,098,851**	**4,027,640**	**4,021,807**
Retail deposits	-	-	3,153,681	3,153,681	3,160,426
Other borrowings	-	-	345,273	345,273	345,273
Derivative financial instruments	9,159	1,213	-	10,372	10,372
Other financial liabilities	-	-	20,352	20,352	20,352
Total financial liabilities	**9,159**	**1,213**	**3,519,306**	**3,529,678**	**3,536,423**
June 2018					
Cash and cash equivalents	-	-	49,588	49,588	49,588
Investments	330,852	9,694	-	340,546	340,546
Finance receivables	-	-	3,984,487	3,984,487	3,972,072
Finance receivables - reverse mortgages	-	-	454	454	454
Derivative financial instruments	923	-	-	923	923
Other financial assets	-	-	1,613	1,613	1,613
Total financial assets	**331,775**	**9,694**	**4,036,142**	**4,377,611**	**4,365,196**
Retail deposits	-	-	2,881,805	2,881,805	2,877,885
Other borrowings	-	-	914,253	914,253	914,253
Derivative financial instruments	2,562	-	-	2,562	2,562
Other financial liabilities	-	-	22,610	22,610	22,610
Total financial liabilities	**2,562**	**-**	**3,818,668**	**3,821,230**	**3,817,310**

RISK MANAGEMENT

22 Enterprise risk management program

The board of directors (the **Board**) sets and monitors the Bank'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 Programme (**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 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.
- 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 through approval of a Delegated Lending Authority Policy and Framework.
- New products, including the process for approval of new products.

The BRC consists of at least three non-executive directors, of which a majority must be independent. A member of the BRC sits on the Audit Committee. In addition, the Chief Risk Officer (**CRO**), CEO, Chief Financial Officer (**CFO**) or their nominee, subject to the Chair's prior approval attend the BRC meetings. The CEO and the directors who are not members of the BRC are entitled to attend meetings and to receive copies of the BRC papers. The BRC usually meets bi-monthly and reports directly to the Board.

Audit Committee and 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 Bank in accomplishing its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

Internal Audit is allowed full, free and unfettered access to any and all the organisations 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. The audit plan ensures a cyclical review process 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 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, and accountability to the Audit Committee of the Bank and administratively to the CFO. A schedule of all outstanding internal control issues is maintained and presented to the Audit Committee to assist the Audit Committee 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.

22 Enterprise risk management program (continued)

The Audit Committee focuses on financial reporting and the application of accounting policies as part of the internal control and risk assessment framework. The Audit Committee 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 Audit Committee receives regular reports from internal audit.

Charters for both the BRC and Audit Committee 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 Audit Committee.

Asset and Liability Committee (ALCO)

The ALCO comprises the CEO HGH Ltd (Chair),CEO the Banking group, Chief Digital Officer, CFO, CRO, Chief Sales and Distribution Officer, Head of Corporate Finance, Head of Operations, Deputy CFO – Finance, Deputy CFO – Treasury, Treasurer. The ALCO has responsibility for overseeing aspects of the Banking Group's financial position risk management. The ALCO generally meets monthly, and provides 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 of the CEO of HGH Ltd (Chair), CRO (Deputy Chair), CEO, General Counsel, 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 Bank's risk appetite. The ERC generally meets monthly, and provides its minutes to the BRC. ERC's specific responsibilities include decision making and oversight of operational and 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 Bank'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, adverse customer outcomes, 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:

- The first line of defence is the business line management identification, management and mitigation of 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 Bank'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, issue and complaints 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 Bank is managing its risk according to stated risk appetite.

The Banking Group's exposure to operational and compliance risk is governed by the risk appetite statement approved by the Board and used to guide management activities by the ERC. This statement sets out the nature of risk which may be taken and aggregate risk limits, and the ERC monitors adherence to this.

22 Enterprise risk management program (continued)

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 is principally generated through interest rate risk in customer loans and deposits (the bank book). This risk arises from three key sources:

- Mismatches between the repricing dates of interest bearing assets and liabilities;
- Banking products repricing differently to changes in wholesale market rates (basis risk); and
- The investment of capital in interest bearing assets.

Refer Note 26 - 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 risks through its holding of AUD assets and AUD related party lending.

Counterparty credit risk
The Banking Group has on-going credit exposures 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 the derivative contracts, bilateral set-off arrangements, cash and cash equivalents and investment securities.

23 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; and
- 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.

23 Credit risk exposure (continued)

The Banking Group has adopted a detailed credit risk framework. The framework is supported further by lending standards that provide criteria for finance products within each business sector.

The BRC has authority from the Board for approval of all credit exposures. Lending authority has been provided to the Banking Group's Credit Committees, 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 committees and ultimately through to the BRC.

The Banking Group employs a process of hind sighting 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 targeted toward the seniors market. 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 with 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. Credit risk becomes 'negative equity' risk through the promise by the Banking Group to customers that they can reside in their property for 'as long as they wish' and repayment of their loan is limited to the net sale proceeds of their 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 Bank will accept for reverse mortgage lending, a key aspect of the Bank'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.

Maximum exposure to credit risk at the equivalent reporting dates

The following table represents the maximum credit risk exposure, without taking account of any collateral held. The exposures set out below are based on net carrying amounts as reported in the Statement of Financial Position.

$000's	June 2019	June 2018
Cash and cash equivalents	45,228	49,588
Investments	342,493	330,852
Finance receivables	3,029,231	3,984,941
Finance receivables - reverse mortgages	561,211	-
Due from related parties	24,179	-
Derivative financial instruments	12,650	923
Other financial assets	3,215	1,613
Total on balance sheet credit exposures	**4,018,207**	**4,367,917**

23 Credit risk exposure (continued)

Concentration of credit risk by geographic region

$000's	June 2019	June 2018
New Zealand		
Auckland	1,154,853	1,085,421
Wellington	246,028	250,933
Rest of North Island	1,214,744	1,123,324
Canterbury	505,990	484,685
Rest of South Island	587,723	598,933
Australia		
Queensland	10,395	154,145
New South Wales	64,601	322,705
Victoria	22,322	162,214
Western Australia	9,223	35,672
South Australia	3,880	25,356
Rest of Australia	2,788	13,951
Rest of the World [1]	254,151	143,073
	4,076,698	4,400,412
Provision for impairment	(58,491)	(29,671)
Less fair value adjustment	-	(2,824)
Total on balance sheet credit exposures	**4,018,207**	**4,367,917**

[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

$000's	June 2019	June 2018
Agriculture	741,947	741,666
Forestry and Fishing	80,642	87,955
Mining	13,697	19,222
Manufacturing	69,709	71,391
Finance and Insurance	427,059	338,164
Wholesale trade	40,875	33,195
Retail trade	237,427	205,380
Households	1,672,538	2,105,437
Property and business services	406,719	402,169
Transport and storage	237,553	211,005
Other	148,532	184,828
	4,076,698	4,400,412
Provision for impairment	(58,491)	(29,671)
Less fair value adjustment	-	(2,824)
Total on balance sheet credit exposures	**4,018,207**	**4,367,917**

Commitments to extend credit

$000's	June 2019	June 2018
Undrawn facilities available to customers	102,285	180,940
Conditional commitments to fund at a future date	22,921	94,239

As at 30 June 2019 there was nil of undrawn lending commitments available to counterparties for whom drawn balances were classified as individually impaired (2018: $0.196 million).

23 Credit risk exposure (continued)

Credit exposures to connected persons

The Banking Group's methodology for calculating credit exposure concentrations is on the basis of actual credit exposures 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 connected persons are calculated using the Banking Group’s Tier 1 capital at the end of the reporting period.

The Banking Groups rating-contingent limit as defined in its conditions of registration is 15%, which is the same as the overall rating-contingent sub-limit which applies to the aggregate credit exposure to non-bank connected persons. There have been no rating-contingent limit changes during the accounting period.

$000's	As at June 2019	Peak end-of-day for the year ended June 2019
Credit exposures to connected persons	26.9	52.5
As a percentage of Tier 1 capital of the Banking Group at end of the year	5.1%	9.9%
Credit exposures to non-bank connected persons	26.9	52.5
As a percentage of Tier 1 capital of the Banking Group at end of the year	5.1%	9.9%

As at 30 June 2019, the Banking Group had nil of 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 2019.

Credit exposures to individual counterparties

The Banking Group measures its concentration of credit risk to individual counterparties at the reporting date based on actual exposures. Peak aggregate end-of-day credit exposure is determined by taking the maximum end-of-day aggregate amount of credit exposure over the period. The exposure is then divided by the Banking Group's Comment Equity Tier 1 Capital (**CET1**) as at the reporting date.

As at 30 June 2019 the Banking Group had nil period end or peak end-of-day over the relevant six month period credit exposures over 10% of equity to individual counterparties (not being members of groups of closely related counterparties) or groups of closely related counterparties (excluding central government of any country with a long-term credit rating of A- or A3 or above, or its equivalent, or any bank with a long-term credit rating of A- or A3 or above, or its equivalent, and connected persons).

The exposure information in the table below excludes 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.

	As at 30 Jun 2019	Peak end-of-day over 6 months to 30 Jun 2019
Exposures to banks		
Total number of exposures to 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 credit rating of at least BBB- or Baa3, or its equivalent, and at the 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 credit rating of at least BBB- or Baa3, or its equivalent, and at the most BBB+ or Baa1 or its equivalent.	-	-

24 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 2019				
Neither at least 90 days past due nor impaired	1,735,086	592,887	1,250,082	3,578,055
At least 90 days past due	15,256	535	28,675	44,466
Individually impaired	26,412	-	-	26,412
Gross Finance Receivables	1,776,754	593,422	1,278,757	3,648,933
Provision for impairment	(37,938)	(99)	(20,454)	(58,491)
Total net finance receivables	**1,738,816**	**593,323**	**1,258,303**	**3,590,442**
June 2018				
Neither at least 90 days past due nor impaired	1,852,413	1,180,623	910,537	3,943,573
At least 90 days past due	7,261	140	21,276	28,677
Individually impaired	41,237	612	3,337	45,186
Gross Finance Receivables	1,900,911	1,181,375	935,150	4,017,436
Fair value adjustment	-	(2,824)	-	(2,824)
Provision for impairment	(19,517)	(2,114)	(8,040)	(29,671)
Total net finance receivables	**1,881,394**	**1,176,437**	**927,110**	**3,984,941**

24 Asset quality (continued)

(b) Past due not impaired

$000's	Corporate	Residential	All other	Total
June 2019				
Less than 30 days past due	15,297	1,174	41,095	57,566
At least 30 and less than 60 days past due	7,509	472	13,580	21,561
At least 60 and less than 90 days past due	4,671	-	6,920	11,591
At least 90 days past due	15,256	535	28,675	44,466
Total past due but not impaired	**42,733**	**2,181**	**90,270**	**135,184**
June 2018				
Less than 30 days past due	19,702	984	29,370	50,056
At least 30 and less than 60 days past due	5,001	152	12,261	17,414
At least 60 and less than 90 days past due	1,909	-	5,752	7,661
At least 90 days past due	7,261	140	21,276	28,677
Total past due but not impaired	**33,873**	**1,276**	**68,659**	**103,808**

(c) Individually impaired assets

$000's	Corporate	Residential	All other	Total
June 2019				
Opening	41,237	612	3,337	45,186
Reclassified on adoption of IFRS9	-	(612)	-	(612)
Additions	6,479	-	-	6,479
Deletions	(16,311)	-	(3,337)	(19,648)
Write offs	(4,993)	-	-	(4,993)
Closing gross individually impaired assets	**26,412**	**-**	**-**	**26,412**
Less: provision for individually impaired assets	7,863	-	-	7,863
Total net impaired assets	**18,549**	**-**	**-**	**18,549**
June 2018				
Opening	27,070	2,358	2,656	32,084
Additions	26,835	209	3,312	30,356
Deletions	(8,241)	(1,836)	(2,631)	(12,708)
Write offs	(4,427)	(119)	-	(4,546)
Closing gross individually impaired assets	**41,237**	**612**	**3,337**	**45,186**
Less: provision for individually impaired assets	8,672	193	201	9,066
Total net impaired assets	**32,565**	**419**	**3,136**	**36,120**

(d) Credit risk grading

The Banking Group’s receivables are monitored by account behaviour or a regular assessment of their credit risk grade based on an objective review of defined risk characteristics. The portfolio risk is regularly refreshed based on current information.

The Banking Group classifies finance receivables as behavioural or judgemental.

The behavioural portfolio consists of consumer, residential, motor, business international and open for business receivables. Reverse mortgage are receivables at fair value.

Consumer, open for business and retail loans are risk graded based on arrears status.

24 Asset quality (continued)

(d) Credit risk grading (continued)

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 and grade 9 is the weakest risk grade 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 1) 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 expected credit losses.

(d) Credit risk grading (continued)

$000's	12 months ECL	Lifetime ECL Not credit impaired	Lifetime ECL Credit impaired	Specifically provided	Fair value	June 2019 Total	June 2018
Judgemental portfolio							
Grade 1 - Very strong	7	-	-	-	-	7	29
Grade 2 - Strong	8,685	-	-	-	-	8,685	10,172
Grade 3 - Sound	86,109	-	71	-	-	86,180	72,447
Grade 4 - Adequate	478,682	3,707	5,478	-	-	487,867	352,411
Grade 5 - Acceptable	851,307	4,835	4,854	-	-	860,996	687,174
Grade 6 - Monitor	-	142,122	5,031	-	-	147,153	145,706
Grade 7 - Substandard	-	22,913	3,450	-	-	26,363	22,961
Grade 8 - Doubtful	566	-	-	15,391	-	15,957	28,607
Grade 9 - At risk of loss	-	-	-	11,021	-	11,021	10,580
Total judgemental portfolio	**1,425,356**	**173,577**	**18,884**	**26,412**	**-**	**1,644,229**	**1,330,087**
Total behavioural portfolio	1,372,029	33,305	38,159	-	561,211	2,004,704	2,687,349
Gross finance receivables	**2,797,385**	**206,882**	**57,043**	**26,412**	**561,211**	**3,648,933**	**4,017,436**
Provision for impairment	(30,421)	(1,780)	(18,427)	(7,863)	-	(58,491)	(29,671)
FV adjustment for PV of future losses	-	-	-	-	-	-	(2,824)
Total finance receivables	**2,766,964**	**205,102**	**38,616**	**18,549**	**561,211**	**3,590,442**	**3,984,941**

24 Asset quality (continued)

(e) Provision for impairment

$'000	12 month ECL	Lifetime ECL Not credit impaired	Lifetime ECL Credit impaired	Collective provision June 18	Specific provision	Total
Corporate						
Impairment allowance as at 30 June 2018	-	-	-	10,845	8,672	19,517
Restated for adoption of NZ IFRS 9	23,290	697	2,315	(10,845)	-	15,457
Restated impairment allowance as at 1 July 2018	23,290	697	2,315	-	8,672	34,974
Changes in loss allowance						
Transfer to 12 month	191	(180)	(11)	-	-	-
Transfer to lifetime not credit impaired	(397)	410	(13)	-	-	-
Transfer to lifetime credit impaired	-	(179)	179	-	-	-
Transfer to specific provision	(1,443)	(36)	(1,169)	-	2,648	-
Effect of changes in exchange rate	(16)	-	-	-	-	(16)
Impaired asset expense	(221)	(42)	5,696	-	1,536	6,969
Write offs	-	-	(2,464)	-	(4,993)	(7,457)
Recovery of amounts written off	-	-	-	-	-	-
Closing impairment allowance	**21,404**	**670**	**4,533**	**-**	**7,863**	**34,470**
Residential						
Impairment allowance as at 30 June 2018	-	-	-	1,921	193	2,114
Restated for adoption of NZ IFRS 9	44	4	-	(1,921)	(169)	(2,042)
Restated impairment allowance as at 1 July 2018	44	4	-	-	24	72
Changes in loss allowance						
Transfer to 12 month	3	(3)	-	-	-	-
Transfer to lifetime not credit impaired	(1)	64	(63)	-	-	-
Transfer to lifetime credit impaired	-	(3)	3	-	-	-
Transfer to specific provision	-	-	-	-	-	-
Impaired asset expense	(25)	(59)	140	-	(24)	32
Write offs	-	-	-	-	-	-
Recovery of amounts written off	-	-	-	-	-	-
Closing impairment allowance	**21**	**3**	**80**	**-**	**-**	**104**
All other						
Impairment allowance as at 30 June 2018	-	-	-	7,839	201	8,040
Restated for adoption of NZ IFRS 9	8,850	684	12,975	(7,839)	-	14,670
Restated impairment allowance as at 1 July 2018	8,850	684	12,975	-	201	22,710
Changes in loss allowance						
Transfer to 12 month	985	(922)	(63)	-	-	-
Transfer to lifetime not credit impaired	(1,778)	1,838	(60)	-	-	-
Transfer to lifetime credit impaired	(30)	(1,234)	1,264	-	-	-
Transfer to specific provision	-	-	-	-	-	-
Effect of changes in foreign exchange rate	(36)	(3)	(1)	-	-	(40)
Impaired asset expense	1,511	744	12,126	-	(201)	14,180
Write offs	-	-	(13,256)	-	-	(13,256)
Recovery of amounts written off	-	-	829	-	-	829
Sale of portfolio	(506)	-	-	-	- -	506
Closing impairment allowance	**8,996**	**1,107**	**13,814**	**-**	**-**	**23,917**
Total						
Impairment allowance as at 30 June 2018	-	-	-	20,605	9,066	29,671
Restated for adoption of NZ IFRS 9	32,184	1,385	15,290	(20,605)	(169)	28,085
Restated impairment allowance as at 1 July 2018	32,184	1,385	15,290	-	8,897	57,756
Changes in loss allowance						
Transfer to 12 month	1,179	(1,105)	(74)	-	-	-
Transfer to lifetime not credit impaired	(2,176)	2,312	(136)	-	-	-
Transfer to lifetime credit impaired	(30)	(1,416)	1,446	-	-	-
Transfer to specific provision	(1,443)	(36)	(1,169)	-	2,648	-
Effect of changes in foreign exchange rate	(52)	(3)	(1)	-	-	(56)
Impaired asset expense	1,265	643	17,962	-	1,311	21,181
Write offs	-	-	(15,720)	-	(4,993)	(20,713)
Recovery of amounts written off	-	-	829	-	-	829
Sale of portfolio	(506)	-	-	-	-	(506)
Closing impairment allowance	**30,421**	**1,780**	**18,427**	**-**	**7,863**	**58,491**

24 Asset quality (continued)

(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 2019, the Banking Group had $5.791 million assets under administration (June 2018: $1.188 million).

25 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 is inherent in all Banking operations and is 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 a 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, 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 a mix of assets and liabilities given its expectations of future cash flows, liquidity constraints and capital adequacy. The Banking Group employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies.

The Banking Group holds the following financial assets for the purpose of managing liquidity risk:

$000's	June 2019	June 2018
Cash and cash equivalents	45,228	49,588
Investments	342,493	330,852
Undrawn committed bank facilities	150,000	52,500
Total liquidity	**537,721**	**432,940**

Contractual liquidity profile of financial assets and liabilities

The following tables present the Banking Group's financial assets and 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 the actual cash flows. This occurs as a result of future actions by the Banking Group and its counterparties, such as early repayment or refinancing of term loans and borrowings. Deposits and other public borrowings include customer savings deposits and transactional accounts, which are at call. History demonstrates that such accounts provide a stable source of long term funding for the Banking Group.

The Banking Group does not manage its liquidity risk on a contractual liquidity basis.

25 Liquidity risk (continued)

Contractual liquidity profile of financial assets and liabilities (continued)

$000's	On demand	0-6 months	6-12 months	1-2 years	2-5 years	5+ years	Total
June 2019							
Financial Assets							
Cash and cash equivalents	45,228	-	-	-	-	-	45,228
Investments	-	44,979	94,307	56,129	152,870	8,330	356,615
Finance receivables	-	931,670	513,162	799,266	1,168,678	327,719	3,740,495
Finance receivables - reverse mortgages	-	10,395	11,094	23,551	98,236	2,157,295	2,300,571
Derivative financial instruments	-	12,650	-	-	-	-	12,650
Due from related parties	-	410	-	-	27,513	-	27,923
Other financial assets	-	3,215	-	-	-	-	3,215
Total financial assets	**45,228**	**1,003,319**	**618,563**	**878,946**	**1,447,297**	**2,493,344**	**6,486,697**
Financial Liabilities							
Retail deposits	895,290	1,415,994	605,804	224,545	74,714	-	3,216,347
Other borrowings	-	65,640	5,578	11,188	295,649	-	378,055
Derivative financial instruments	-	10,372	-	-	-	-	10,372
Due to related parties	3,002	-	-	-	-	-	3,002
Other financial liabilities	-	20,352	-	-	-	-	20,352
Total financial liabilities	**898,292**	**1,512,358**	**611,382**	**235,733**	**370,363**	**-**	**3,628,128**
Net financial (liabilities)/assets	**(853,064)**	**(509,039)**	**7,181**	**643,213**	**1,076,934**	**2,493,344**	**2,858,569**
Undrawn facilities available to customers	102,285	-	-	-	-	-	102,285
Undrawn committed bank facilities	150,000	-	-	-	-	-	150,000
June 2018							
Financial Assets							
Cash and cash equivalents	49,588	-	-	-	-	-	49,588
Investments	-	53,474	85,376	134,654	71,592	9,694	354,790
Finance receivables	-	554,170	384,245	1,204,534	1,356,798	5,029,371	8,529,118
Finance receivables - reverse mortgages	-	11	11	18	76	2,066	2,182
Derivative financial instruments	-	923	-	-	-	-	923
Other financial assets	-	1,613	-	-	-	-	1,613
Total financial assets	**49,588**	**610,191**	**469,632**	**1,339,206**	**1,428,466**	**5,041,131**	**8,938,214**
Financial Liabilities							
Retail deposits	924,072	1,219,540	559,208	159,765	62,361	-	2,924,946
Other borrowings	-	101,527	13,523	627,070	189,333	-	931,453
Derivative financial instruments	-	2,562	-	-	-	-	2,562
Other financial liabilities	-	22,610	-	-	-	-	22,610
Total financial liabilities	**924,072**	**1,346,239**	**572,731**	**786,835**	**251,694**	**-**	**3,881,571**
Net financial (liabilities)/assets	**(874,484)**	**(736,048)**	**(103,099)**	**552,371**	**1,176,772**	**5,041,131**	**5,056,643**
Undrawn facilities available to customers	180,940	-	-	-	-	-	180,940
Undrawn committed bank facilities	52,500	-	-	-	-	-	52,500

26 Interest rate risk

The Banking Group's market risk is derived primarily of exposure to interest rate risk, predominately 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.

Interest rate risk is the risk that the value of assets or liabilities will change because of changes in interest rates or that market interest rates may change and thus alter the margin between interest-earning assets and interest-bearing liabilities. Interest rate risk for the Banking Group refers to the risk of loss due to holding assets and liabilities that may mature or re-price in different periods.

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 Groups 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.

To manage this market risk, the Banking Group measures sensitivity to interest rate changes by frequently testing its position against various interest rate change scenarios to assess potential risk exposure. The Banking Group also manage interest rate risk by:

- Monitoring maturity profiles and seeking to match the re-pricing of assets and liabilities (physical hedging);
- Monitoring interest rates daily and regularly (at least monthly) reviewing interest rate exposure; and
- Entering into forward rate agreements and interest rate swaps and options 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.

$000's	0-3 months	3-6 months	6-12 months	1-2 years	2+ years	Non-interest bearing	Total
June 2019							
Financial Assets							
Cash and cash equivalents	45,222	-	-	-	-	6	45,228
Investments	24,097	15,368	91,248	62,048	149,732	12,435	354,928
Due from related parties	-	-	-	-	23,769	410	24,179
Finance receivables	1,551,851	206,801	337,236	537,300	386,870	9,173	3,029,231
Finance receivables - reverse mortgages	561,211	-	-	-	-	-	561,211
Derivative financial instruments	11,232	-	-	-	-	-	11,232
Other financial assets	-	-	-	-	-	3,215	3,215
Total financial assets	**2,193,613**	**222,169**	**428,484**	**599,348**	**560,371**	**25,239**	**4,029,224**
Financial Liabilities							
Retail deposits	1,614,124	519,676	729,734	212,575	65,887	11,685	3,153,681
Other borrowings	59,839	-	-	-	285,434	-	345,273
Derivative financial instruments	10,230	-	-	-	-	-	10,230
Due to related parties	-	-	-	-	-	3,002	3,002
Other financial liabilites	-	-	-	-	-	20,352	20,352
Total financial liabilites	**1,684,193**	**519,676**	**729,734**	**212,575**	**351,321**	**35,039**	**3,532,538**
Effect of derivatives held for risk management	(36,789)	162,749	38,975	(313,184)	148,249	-	-
Net financial (liabilities)/assets	**472,631**	**(134,758)**	**(262,275)**	**73,589**	**357,299**	**(9,800)**	**496,686**

26 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 2018							
Financial Assets							
Cash and cash equivalents	49,580	-	-	-	-	8	49,588
Investments	44,483	22,935	82,149	111,355	69,930	9,694	340,546
Finance receivables	2,687,543	165,901	284,847	418,800	423,037	4,359	3,984,487
Finance receivables - reverse mortgages	454	-	-	-	-	-	454
Derivative financial instruments	923	-	-	-	-	-	923
Other financial assets	-	-	-	-	-	1,613	1,613
Total financial assets	**2,782,983**	**188,836**	**366,996**	**530,155**	**492,967**	**15,674**	**4,377,611**
Financial Liabilities							
Retail deposits	1,663,258	482,447	543,746	150,230	33,571	8,553	2,881,805
Other borrowings	736,850	3,378	-	-	174,025	-	914,253
Derivative financial instruments	2,562	-	-	-	-	-	2,562
Other financial liabilities	-	-	-	-	-	22,610	22,610
Total financial liabilities	**2,402,670**	**485,825**	**543,746**	**150,230**	**207,596**	**31,163**	**3,821,230**
Effect of derivatives held for risk management	361,760	(44,735)	(75,365)	(242,090)	430	-	-
Net financial (liabilities)/assets	**742,073**	**(341,724)**	**(252,115)**	**137,835**	**285,801**	**(15,489)**	**556,381**

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

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Banking Groups' financial assets and liabilities to various standard and nonstandard interest rate scenarios. Standard scenarios which are considered on a monthly basis include a 100 basis point parallel fall or rise in the yield curve. There is a no material impact on profit or loss in terms of a fair value change from movement in market interest rates. Furthermore there is no material cash flow impact on the Consolidated Statement of Cash flows from a 100 basis point change in interest rates.

27 Concentrations of funding

(a) Regulatory liquidity ratios

The table below shows the arithmetic 3 month average of the respective daily ratio values in accordance with RBNZ's Liquidity Policy (BS13/BS13A) ("BS13") and the Banks conditions of registration relating to liquidity-risk management.

The one week mismatch ratio is a measure of the Banking Group's one week mismatch amount over its total funding, where the one-week mismatch amount represents the Banking Group's portfolio of primary liquid assets plus expected cash inflows minus expected cash outflows during a one-week period of stress. The Bank is required to maintain this ratio at not less than the minimum level of zero percent on a daily basis. The one-week mismatch ratio = 100 x (one-week mismatch dollar/total funding).

The one-month mismatch ratios is a measure of the Banking Group's one-month mismatch over its total funding, where the one-month mismatch amount represents the Banking Group's portfolio of primary and secondary liquid assets plus expected cash inflows, minus expected cash outflows during a one-month period of stress. The Bank is required to maintain this ratio at not less than the minimum level of zero percent on a daily basis. The one-month mismatch ratio = 100 x (one-month mismatch dollar value/total funding).

The one year core funding ratio measures the extent to which loans and advances are funded by the funding that is considered stable. The one-year core funding ratio = 100 x (one-year core funding dollar amount/BS13 total loans and advances) and must currently remain at not less than 75% on a daily basis.

27 Concentrations of funding (continued)

(a) Regulatory liquidity ratios (continued)

	Average for the 3 months ended 30 June 2019	Average for the 3 months ended 31 March 2019
one-week mismatch ratio	8.74	7.80
one-month mismatch ratio	10.28	9.00
Core funding ratio	97.15	96.94

The table above has not incorporated any recalculations as detailed on page14 of this Disclosure Statement.

(b) Concentrations of funding by industry

$000's	June 2019	June 2018
Agriculture	68,559	69,245
Forestery and Fishing	25,360	23,403
Mining	61	38
Manufacturing	11,233	10,691
Finance and Insurance	488,985	979,871
Wholesale Trade	11,520	9,967
Retail Trade	18,048	14,102
Households	2,340,763	2,260,330
Property and business services	88,744	110,385
Transport and storage	4,416	4,853
Other	155,830	139,148
	3,213,519	3,622,033
Subordinated notes	-	22,172
Unsubordinated notes	285,435	151,853
Total borrowings	**3,498,954**	**3,796,058**

(c) Concentrations of funding by geographical area

$000's	June 2019	June 2018
Auckland	1,094,639	969,518
Wellington	303,595	270,096
Rest of North Island	773,960	686,208
Canterbury	969,778	885,005
Rest of South Island	261,276	245,830
Overseas [1]	95,706	739,401
Total borrowings	**3,498,954**	**3,796,058**

[1] June 2018 included in overseas funding is an AUD bank facility totalling $600 million.

OTHER DISCLOSURES

28 Significant subsidiaries

Significant subsidiaries	Country of incorporation and place of business	Nature of business	Proportion of ownership and voting power held June 2019	June 2018
VPS Properties Limited	New Zealand	Investment property holding company	100%	100%
MARAC Insurance Limited	New Zealand	Insurance services	100%	100%
Heartland Australia Group Pty Limited	Australia	Financial services	-	100%
Australian Seniors Finance Pty Limited	Australia	Management services	-	100%

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

$000's	June 2019	June 2018
Deposits	146,094	115,095

(b) Seniors Warehouse Trust (SW Trust) and ASF Settlement Trust (ASF Trust)
SW Trust and ASF Trust form part of Australian Seniors Finance Pty Limited (**ASF**) reverse mortgage business and were both set up by ASF, as asset holding entities. The Trustee for both Trusts is ASF Custodians Pty Limited and the Trust Manager is ASF. The reverse mortgage loans held by the Trusts were set aside for the benefit of the funder and bank depositors and had no recourse to these assets. On 31 October 2018 the assets of SW Trust and ASF Trust were sold to HGH Ltd.

$000's	June 2019	June 2018
Cash and cash equivalents	-	12,207
Finance receivables - reverse mortgages	-	676,837
Borrowings	-	(614,510)

29 Structured entities (continued)

(c) Heartland ABCP Trust 1 (ABCP Trust)
At 30 June 2018 the Banking Group had securitised a pool of receivables comprising commercial and motor vehicle loans to ABCP Trust.

The Banking Group continued to recognise the securitised assets and associated borrowings in the Consolidated Statement of Financial Position. Although the Banking Group recognised those interests in the ABCP Trust, the loans sold to the Trust were set aside for the benefit of investors in the ABCP Trust and other depositors and lenders to the Banking Group had no recourse to those assets.

On 29 August 2018 the assets of the ABCP Trust were purchased by the Bank and the ABCP Trust dissolved.

$000's	June 2019	June 2018
Cash and cash equivalents	-	3,625
Finance receivables - securitised	-	80,289
Borrowings - securitised	-	(47,504)
Derivative financial liabilities - securitised	-	(496)

(d) Heartland Auto Receivables Warehouse Trust (Auto Warehouse)
The Banking Group had securitised a pool of receivables comprising commercial and motor vehicle loans sold to Auto Warehouse.

The Banking Group continues to recognise the securitised assets and associated borrowings in the Consolidated Statement of Financial Position. 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 2019	June 2018
Cash and cash equivalents	555	-
Liabilities	(559)	-

30 Staff share ownership arrangements

In the prior period the Bank operated a number of share-based compensation plans that were equity settled. The fair value was determined at the grant date and was expensed on a straight line basis over the vesting period. This was based on the Bank's estimate of equity instruments that would eventually vest, with a corresponding increase in equity. The corporate restructure on 31 October 2018 with the Bank becoming a wholly owned subsidiary of HGH Ltd transferred staff share ownership arrangements to HGH Ltd.

31 Capital adequacy

The Banking Group is subject to regulation by the Reserve Bank of New Zealand (**RBNZ**). 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 risk.
- Pillar 2 is designed to ensure that banks have adequate capital to support all risk (not just those set under Pillar 1 above) and is enforced through the requirements of 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 Common Equity Tier 1 (**CET1**) capital, Additional Tier 1 (**AT1**) capital and Total capital as a percentage of risk weighted assets (**RWA**).
- 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 be 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 affected 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 2019.

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.

31 Capital adequacy (continued)

(a) Capital

$000's	June 2019
Tier 1 capital	
CET1 capital	
Paid-up ordinary shares, issued by the Banking Group plus related share premium	553,239
Retained earnings (net of appropriation)	51,265
Accumulated other comprehensive income and other disclosed reserves	(1,114)
Less deductions from CET1 capital	
Intangible assets	(57,335)
Deferred tax assets	(9,948)
Cash flow hedge reserve	5,843
Excess of loan value over the security value on reverse residential mortgage loans	(41)
Defined benefit superannuation fund assets	(715)
Adjustment under the corresponding deductions approach	(12,435)
Total CET1 capital	**528,759**
Additional Tier 1 capital	-
Tier 2 capital	-
Total Capital	**528,759**

(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 of 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.

31 Capital adequacy (continued)

(c) Credit risk

On balance sheet exposures

$000's	Total exposure after credit risk mitigation	Average risk weighting	Risk weighted exposure	Minimum Pillar 1 capital requirement
Cash and gold bullion	6	0%	-	-
Multilateral development banks	126,015	0%	-	-
Multilateral development banks	127,824	20%	25,565	2,045
Public sector entities	16,567	20%	3,313	265
Public sector entities	-	50%	-	-
Banks	58,003	20%	11,601	928
Banks	11,537	50%	5,768	461
Banks	16,221	100%	16,221	1,298
Corporates	15,981	20%	3,196	256
Corporates	6,232	50%	3,117	249
Corporates	1,616,965	100%	1,616,965	129,357
Welcome Home Loans - loan to value ratio (LVR) ≤ 80%[1]	2,035	35%	712	56
Welcome Home Loans - loan to value ratio (LVR) ≤ 90%[1]	1,282	35%	449	36
Welcome Home Loans - LVR > 90% and ≤ 100%[1]	-	50%	-	-
Welcome Home Loans - LVR > 100%[1]	-	100%	-	-
Reverse Residential mortgages ≤ 60% LVR	545,086	50%	272,543	21,803
Reverse Residential mortgages >60 and ≤ 80% LVR	13,076	80%	10,461	837
Reverse Residential mortgages > 80% LVR	3,008	100%	3,008	241
Past due residential mortgages	455	100%	455	36
Other past due assets - provision ≥ 20%	25,788	100%	25,788	2,063
Other past due assets - provision < 20%	22,225	150%	33,338	2,667
Non property investment mortgage loan < 80% LVR	16,045	35%	5,616	449
Non property investment mortgage loan > 80 and ≤ 90% LVR	1,391	50%	697	56
Non property investment mortgage loan > 90 and ≤ 100% LVR	441	75%	331	26
Non property investment mortgage loan > 100% LVR	1,344	100%	1,344	108
Property Investment Mortgage Loan ≤ 80% LVR	8,133	40%	3,253	260
Property Investment Mortgage Loan > 80 and ≤ 90% LVR	1,004	70%	703	56
Property Investment Mortgage Loan > 90 and ≤ 100% LVR	-	90%	-	-
Property Investment Mortgage Loan > 100% LVR	-	100%	-	-
Equity holdings	-	300%	-	-
All other equity holdings	-	400%	-	-
Other assets	1,421,597	100%	1,421,597	113,728
Not risk weighted assets	80,474	0%	-	-
Total on balance sheet exposures	**4,138,735**		**3,466,041**	**277,281**

[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.

31 Capital adequacy (continued)

(c) Credit Risk (continued)

Off balance sheet exposures

$000's	Total exposure	Average credit conversion factor	Credit equivalent amount	Average risk weight	Risk weighted exposure	Minimum Pillar 1 requirement
Direct credit substitute	4,183	100%	4,183	100%	4,183	335
Performance-related contingency	2,574	50%	1,287	100%	1,287	103
Other commitments where original maturity is more than one year	112,552	50%	56,276	100%	56,276	4,502
Other commitments where original maturity is more than one year	8,636	50%	4,318	50%	2,159	173
Other commitments where original maturity is less than or equal to one year	4,018	20%	804	100%	804	64
Market related contracts						
Foreign currency contracts (<1 year)	157,147	1%	1,571	20%	314	25
Interest rate contracts (<1 year)	1,359,782	0%	-	20%	-	-
Interest rate contracts (>1 year)	598,301	0.5%	2,992	20%	598	48
Total off balance sheet exposures	**2,247,193**		**71,431**		**65,621**	**5,250**

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[1]	Total exposures
Does not exceed 80%	584,375	3,674	**588,049**
Exceeds 80% and not 90%	6,186	-	**6,186**
Exceeds 90%	2,780	-	**2,780**
Total exposures	**593,341**	**3,674**	**597,015**

[1] Off balance sheet exposures means unutilised limits

At 30 June 2019 nil Welcome Home loans whose credit risk is mitigated by the Crown is 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 and have a loan-to-valuation ratio of less than or equal to 80%.

(e) Reconciliations of mortgage related amounts

$000's	Note	June 2019
Recognised at fair value finance receivables - reverse mortgages recognised	14b	561,211
Recognised at amortised cost finance receivable - residential mortgages		32,211
Total gross on balance sheet residential mortgage exposures	24a	**593,422**
Less: collective provision for impairment		(81)
Off Balance sheet mortgage exposures		3,674
Total residential mortgage exposures		**597,015**

(f) Credit risk mitigation

As at 30 June 2019 the Banking Group had $3.32 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.

31 Capital adequacy (continued)

(g) Operational risk

$000's	Implied risk weighted exposure	Aggregate capital charge
Operational risk	244,455	19,556

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
Market risk end-of-period capital charge	Interest rate risk only	133,861	10,709
Market risk peak end-of-day capital charge	Interest rate risk only	149,469	11,958
Market risk end-of-period capital charge	Foreign currency risk only	11,094	888
Market risk peak end-of-day capital charge	Foreign currency risk only	168,038	13,443

Peak end of day aggregate capital charge at the end of the period is derived by following the risk methodology for measuring capital requirements within Part 10 of the standardised approach. Peak-end-of-day aggregate capital charge is derived by determining the maximum end of month capital charge over the reporting period. Based on the portfolio of the Banking Group's risk exposures, it is considered by management that the difference between end of month aggregate capital charge and end-of-day aggregate capital charge is insignificant.

(i) Total capital requirements

$000's	Total exposure after credit risk mitigation	Risk weighted exposure or implied risk weighted exposure	Total capital requirement
Total credit risk and equity			
On balance sheet	4,138,735	3,466,041	277,281
Off balance sheet	2,247,193	65,621	5,250
Operational risk	n/a	244,455	19,556
Market risk	n/a	144,955	11,597
Total	**n/a**	**3,921,072**	**313,684**

31 Capital adequacy (continued)

(j) Capital ratios

	June 2019	June 2018[1]
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.49%	13.61%
Minimum Common Equity Tier 1 Capital as per Conditions of Registration	4.5%	4.5%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.49%	13.61%
Minimum Tier 1 Capital as per Conditions of Registration	6.0%	6.0%
Total Capital expressed as a percentage of total risk weighted exposures	13.49%	14.02%
Minimum Total Capital as per Conditions of Registration	8.0%	8.0%
Buffer ratio		
Buffer ratio	5.49%	6.02%
Buffer ratio requirement	2.5%	2.5%

[1]Comparative ratios has been restated, refer to page 14 for further details.

(k) Solo capital adequacy

	June 2019	June 2018[1]
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.46%	15.24%
Tier 1 Capital expressed as a percentage of total risk weighted exposures	13.46%	15.24%
Total Capital expressed as a percentage of total risk weighted exposures	13.46%	15.69%

[1]Comparative ratios has been restated, refer to page 14 for further details.

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. Therefore, capital adequacy on a solo basis is calculated based on the Bank and its subsidiaries excluding Auto Receivables Warehouse Trust.

(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/business risk, regulatory and additional credit risk). As at 30 June 2019, the Banking Group has made an internal capital allocation of $7.0 million to cover these risks (2018: $48.2 million)

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

Insurance business

The Banking Group conducts insurance business through its subsidiary MIL.

The Banking Group's aggregate amount of insurance business comprises the total consolidated assets of MIL of $12.9 million (2018: $13.2 million).

The Banking Group's objective is to minimise the insurance risk to within acceptable levels through policies and procedures implemented by management. Should adverse conditions arise, these policies and procedures are expected to mitigate the impact of the conditions on the Banking Group.

Marketing and distribution of insurance products

The Banking Group markets and distributes term life insurance and general insurance covering risks such as redundancy, bankruptcy or suspension of employment. The insurance products are either underwritten by MIL, a subsidiary of the Banking Group, or sold by MIL on behalf of other parties who underwrite those products themselves. There have been no material changes in the Banking Group's marketing and distribution of insurance products since the reporting date of the previous disclosure statement.

32 Insurance business, securitisation, funds management, other fiduciary activities (continued)

Securitisation

As at 30 June 2019, the Banking Group had no securitised assets (2018: $80 million). These assets were sold to Heartland Auto Receivables Warehouse Trust, formerly ABCP Trust (a special purpose vehicle investing in motor vehicle, truck and trailer and commercial loans originated by the Banking Group and funded through the issuance of commercial paper and also through liquidity facilities). Note 29 - Structured entities provides further information on the securitised assets.

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). Further details are provided in Note 29 - Structured entities. 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 22 - 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.

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 (2018: nil).

32 Insurance business, securitisation, funds management, other fiduciary activities (continued)

The Banking Group provided the following funding in relation to securitisation entities.

	Total Trusts	
	June 2019	June 2018
Peak end-of-day aggregate amount of funding provided ($000's)	165,189	90,439
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	31.3%	15.5%

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.

	SW Trust		ASF Settlement Trust		ABCP Trust		Auto Warehouse	
	June 2019	June 2018	June 2019	June 2018	June 2019	June 2018	June 2019	June 2018
Peak end-of-day aggregate amount of funding provided ($000's)[1]	**50,026**	51,875	**3,974**	4,077	**15,266**	38,219	**165,189**	-
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[2]	-	7.6%	-	71.8%	-	45.6%	**16838.9%**	0.0%

[1]Peak end-of-day aggregate amount of funding provided for the financial year.

[2]On 31 October 2018 SW Trust and ASF Settlement Trust were sold to HGH Ltd. On 29 August 2018 the assets of the ABCP Trust were purchased by the Bank and the ABCP Trust dissolved.

33 Contingent liabilities and commitments

Contingent liabilities are possible obligations, whose existence will be confirmed only by uncertain future events, or present obligations where the transfer of economic benefit is uncertain or cannot be reliably measured. Contingent liabilities are not recognised, but are disclosed, unless they are remote. Where some loss is probable, provisions have been made.

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

$000's	June 2019	June 2018
Letters of credit, guarantee commitments and performance bonds	6,757	6,847
Total contingent liabilities	**6,757**	**6,847**
Undrawn facilities available to customers	102,285	180,940
Conditional commitments to fund at future dates	22,921	94,239
Total commitments	**125,206**	**275,179**

34 Events after the reporting date

The Bank resolved to and paid a cash dividend to its parent company HGH Ltd of $35 million on its ordinary shares on 01 August 2019.

HISTORICAL SUMMARY OF FINANCIAL STATEMENTS

For the year ended 30 June 2019

$000's	Audited June 2019	Restated June 2018	Audited June 2017	Audited June 2016	Audited June 2015
Interest income	288,370	272,323	278,279	265,475	260,468
Interest expense	112,678	108,737	115,169	118,815	126,041
Net interest income	**175,692**	**163,586**	**163,110**	**146,660**	**134,427**
Other net income	8,028	12,683	8,142	10,901	10,280
Net operating income	**183,720**	**176,269**	**171,252**	**157,561**	**144,707**
Employee benefits			41,547	39,799	40,401
Operating expenses	78,210	76,291	30,137	30,073	28,002
Profit before impaired asset expense and income tax	**105,510**	**99,978**	**99,568**	**87,689**	**76,304**
Fair value movement on investment property	1,936	-	-	-	-
Impaired asset expense	20,554	21,833	15,015	13,501	12,105
Profit before income tax from continuing operations	**86,892**	**78,145**	**84,553**	**74,188**	**64,199**
Share of joint arrangement profit	-	-	-	-	137
Profit before income tax from discontinued operations	6,169	16,149	-	-	-
Income tax expense	24,762	26,781	23,745	20,024	16,173
Profit for the year	**68,299**	**67,513**	**60,808**	**54,164**	**48,163**
Other comprehensive income					
Items that are or may be reclassified subsequently to profit or loss:					
Effective portion of changes in fair value of cash flow hedges, net of income tax	(4,762)	72	1,108	(708)	(2,709)
Movement in debt instrument fair value reserve, net of income tax	2,968	981	(353)	(208)	898
Movement in foreign currency translation reserve, net of income tax	(4,229)	2,315	761	(4,047)	2,136
Items that will not be reclassified to profit or loss:					
Movement in defined benefit reserve, net of income tax	(86)	340	(84)	(93)	50
Other comprehensive income / (loss) for the year, net of income tax	**(6,109)**	**3,708**	**1,432**	**(5,056)**	**375**
Total comprehensive income for the year	**62,190**	**71,221**	**62,240**	**49,108**	**48,538**
Dividends paid to equity holders*	112,042	47,895	41,977	37,690	30,188

* 2019 Dividends paid to sharholders is comprised of $30.808 million of dividends paid and $81.234 million in specie dividends arising on restructuring.

HISTORICAL SUMMARY OF FINANCIAL STATEMENTS (continued)

For the year ended 30 June 2019

$000's	Audited June 2019	Audited June 2018	Audited June 2017	Audited June 2016	Audited June 2015
Total assets	4,138,735	4,496,849	4,034,671	3,547,181	3,359,259
Individually impaired assets	26,412	45,186	32,084	33,764	25,622
Total liabilities	3,535,345	3,832,689	3,465,076	3,048,840	2,879,134
Total equity	603,390	664,160	569,595	498,341	480,125

KPMG

Independent Auditor's Report

To the shareholder of Heartland Bank Limited

Report on the consolidated financial statements

Opinion

In our opinion, the accompanying consolidated financial statements (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) of Heartland Bank Limited (the "Bank") and its subsidiaries (the "Banking Group") on pages 17 to 77:

i. give a true and fair view of the Banking Group's financial position as at 30 June 2019 and its financial performance and cash flows for the year ended on that date; and

ii. comply with New Zealand 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 Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order"):

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 Bank and Banking Group in all material respects; and

iii. fairly states the matters to which it relates in accordance with those schedules.

We have audited the accompanying consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements) which comprise:

— the consolidated statement of financial position as at 30 June 2019;

— 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 Order.

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

Our responsibilities under ISAs (NZ) are further described in the 'Auditor's responsibilities for the audit of the 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 Bank and Banking Group in relation to the review of the Banking Group's consolidated interim financial statements, regulatory returns, trust deed reporting, registry audits and other agreed upon procedures engagements. 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 $4,300,000 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 misstatements identified during our audit, to them, above $210,000 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, and our findings, in order that the shareholder 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 and our findings

Provision for impairment of finance receivables

Refer to notes 14 and 24 to the consolidated financial statements.

The provision for impairment of finance receivables is a key audit matter owing to their financial significance and the high degree of complexity and judgement applied by management in determining the value.

NZ IFRS 9 *Financial Instruments* was adopted for the first time on 1 July 2018. This added effort to our audit due to the complexity of the accounting standard and its expected pervasive impact on the industry.

The provision for individually impaired assets is based on the application of management judgement, with the assessment of expected future cash flows being inherently uncertain. The provision for individually impaired assets for 'rural' and other 'corporate' loans is of particular audit focus, owing to its financial significance and inherent uncertainties of expected future cash flows, which may include estimated timing and proceeds from the future sale of assets securing the debt, in addition to repayments from borrowers.

Based on the assigned risk grading or arrears status, an estimate of ECL will be applied to determine the collective provision based on historical data, adjusted for forward looking information.

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.

Together with KPMG credit risk specialists we assessed the Bank's adoption of NZ IFRS 9, individual provisions and collective provisions. Our procedures included:

- Assessing the Bank's governance and oversight, including the continuous reassessment of overall provisioning;
- Assessing the Bank's significant accounting policies and expected credit loss ("ECL") modelling methodology against the requirements of the standards and underlying accounting records;
- Assessing the disclosures in the consolidated financial statements against the requirements of NZ IFRS;
- Testing key controls over arrears calculations, customer loan ratings, annual loan reviews, credit risk reviews and model validations;
- Evaluating credit assessments for a sample of 'rural' and other 'corporate' loans that are either individually above $10 million or 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; including challenging assumptions based on our experience and industry knowledge, and assessing collateral values by comparing them to valuations performed by independent valuers;
- Assessing individually significant loans in arrears not specifically provided for, to determine whether they were being appropriately monitored and incorporated into the provision for collectively impaired assets;
- Testing key inputs used in the ECL calculation for significant portfolios. This included testing data reconciliation controls between the ECL models and source systems;
- Challenging the key assumptions in the models such as probability of default loss given default and forward-looking assumptions for a sample of models. We compared modelled estimates against actual losses incurred by the Bank and forward-looking assumptions against external economic information; and
- Assessing management's judgement in the application of overlays by applying sensitivities to assumptions underlying the overlays, and evaluating current economic and climatic conditions linked to the overlays, not captured in the Bank's models.

The key audit matter	How the matter was addressed in our audit and our findings
Valuation of finance receivables – reverse mortgages	
Refer to notes 14, 21 and 24 to the consolidated financial statements.	
The Bank'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 Bank continuously considers evidence of a relevant active market. In the absence of such a market, in the current period, the Bank considered changes since the original lending and an independent actuarial assessment of future cash flows. The inherent uncertainties include estimated future mortality and move to care rates, voluntary exits, house price changes and interest rate margin.	Together with KPMG valuation specialists, our procedures over the fair value loan portfolios included: — Testing key controls over the accuracy of historic data impacting the fair value assessment; — Assessing evidence of a relevant active market or observable inputs; and — Challenging the key assumptions used by the Bank 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. We did not identify any material issues or exceptions from our procedures.
Operation of IT systems and controls	
The Banking Group is heavily dependent 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, our audit involves an assessment of the design of the Banking Group's internal control environment relevant to the preparation of these consolidated financial statements. 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, developer and user access controls.	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, developer and user access controls. In performing our work, we identified design and operating effectiveness control observations that impacted the level of reliance we could place on IT systems, automated controls and reports. In response, we performed additional compensating control tests and substantive audit procedures: — We carried out substantive testing on IT systems and controls to assess: (i) the accuracy of automated controls and IT system calculated transactions and balances, such as interest income and expense; (ii) the reliability of automated reporting, such as IT system generated arrears reporting; and (iii) the operation of technology dependent manual controls; — We performed additional control testing on compensating controls, including management and governance review controls; and — We completed further substantive audit procedures over significant financial statement balances, where required to support our audit. 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 received the Bank's disclosure statement and 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 a consolidated set of financial statements that is fairly presented and free from material misstatement, whether due to fraud or error; and

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

Auditor's responsibilities for the audit of the 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 consolidated 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 (the "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.

Report on the supplementary information relating to capital adequacy and regulatory liquidity requirements

Review conclusion

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 notes 27(a) and 31 to the consolidated financial statements, is not, in all material respects:

i. prepared in accordance with the Banking Group's conditions of registration; and

ii. disclosed in accordance with Schedule 9 of the Order.

We have reviewed the supplementary information relating to capital adequacy and regulatory liquidity requirements, as disclosed in notes 27(a) and 31 to the consolidated financial statements for the year ended 30 June 2019. 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.

Emphasis of matter

We draw attention to note 27(a) of the consolidated financial statements, and the conditions of registration on page 14 which references the Banking Group's identification of adjustments to the liquidity ratios, as required under condition of registration 11. Our opinion is not modified in respect of this matter.

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. 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. 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.

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 described in notes 27(a) and 31 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 the Bank, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements, and 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:

- prepared in accordance with the Banking Group’s conditions of registration; and
- 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

20 September 2019