Disclosure Statement

For the year ended 30 June 2023

HEARTLAND BANK

Contents

General Information

This Disclosure Statement has been issued by Heartland Bank Limited (**HBL** or the **Bank**) and its subsidiaries (the **Banking Group**) for the year ended 30 June 2023 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the **Order**). The financial statements of the Banking Group for the year ended 30 June 2023 form part of, and should be read in conjunction with, this Disclosure Statement.

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

Name and address for service

The name of the Registered Bank is Heartland Bank Limited.

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

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

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

Details of incorporation

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

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

Name	**Percentage held**
Heartland Group Holdings Limited	100%

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

Priority of Creditors' Claims

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

Guarantee Arrangements

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

Auditor

PricewaterhouseCoopers
PwC Tower, Level 27
15 Customs Street West
Auckland 1010

Directors

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

On 8 November 2022, Simon Tyler was appointed as Director. Geoffrey Ricketts ceased directorship on 13 March 2023.

There have been no other changes in the composition of the Board of Directors of the Bank for the year ended 30 June 2023.

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, CFInstD
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, MG Sustainable Operations Limited, Chambers @151 Limited, Clipper Investments (2002) Limited, Cockerill and Campbell (2007) Limited, Embassy Hotels Limited, GZ Capital Limited, GZ NZ Limited, GZ RES Limited, Hansons Lane International Holdings Limited, Hawling Holdings Limited, House of Travel Holdings Limited, J.S. Ewers Limited, Kaipaki Holdings Limited, Kaipaki Properties Limited, Lake Angelus Holdings Limited, Lamanna Bananas (NZ) Limited, Lamanna Premier Group Pty Limited, Lamanna Limited, Market Fresh Wholesale Limited, Market Gardeners Limited, MG Group Holdings Limited, MG Marketing Limited, MG New Zealand Limited, Monarch Hotels Limited, Noblesse Oblige Limited, Paradise Islands Limited, Phimai Holdings Limited, Quitachi Limited, Scenic Hotels (Karapiro) Limited, Scenic Hotels (Hamilton) Limited, Scenic Circle Convention Services Limited, Scenic Hotel (Haast) Limited, Scenic Circle (Napier) Limited, Scenic Hotel Group Limited, Scenic Hotels (Ashburton) Limited, Scenic Hotels (International) Limited, Scenic Circle MLC Café & Bar Limited, Skope Industries Limited, Southland Produce Markets Limited, Stark Holdings (NZ) Limited, Wavell Resources Limited, Scenic Circle (Rotorua) Limited, Scenic Circle (Queenstown) Limited, Scenic Hotels Limited, Abalon Investments Limited, Airedale Developments (Auckland) Limited, Scenic Hotels (Tonga) Limited, Waiho Investments Limited, Scenic Circle Hotels Management Services Limited, Scenic Hotel Collection New Zealand Limited, Scenic Hotels (Auckland) Limited, Scenic Hotels (Niue) Limited, Scenic Hotels (Kaikoura) Limited, Heartland Hotels Limited, Scenic (Franz Josef) Limited, Scenic Circle (Airedale) Limited, Scenic Circle (Bay Of Islands) Limited, Platinum Hotels Limited, Scenic Aviation Limited, Scenic Circle (Bay Of Plenty) Limited, Scenic Circle (Blenheim) Limited, Karma Finance Limited, Scenic Circle Hotels (Dunedin) Limited, Refined Hotels Limited, Scenic Hospitality Services Limited, Scenic Circle Glacier Country Hotel Limited, Scenic Circle (North Island) Limited, Scenic Hotels Technology Limited, Scenic Circle (Rotorua Lakes) Limited, Ezibed (2022) Limited, Mainstay International Hotels (NZ)(2022) Limited, Mainstay International Hotels (2022) Limited, Mitchell Corp New Zealand (2022) Limited, Te Kaikoura Investments Limited, MLC Scenic Limited, Wagstaff Holdings Limited, Heartland PIE Fund Limited, Scenic Hotel Punakaiki Limited, Golden Chain (NZ) (2022) Limited, Sproule Ft Leinster Limited, Sproule Ft Prestons Limited, Southern Paprika Limited, Premier Fresh Australia Pty Ltd.

Name: Jeffrey Kenneth Greenslade
Qualifications: LLB
Type of Director: Non-Independent Non-Executive Director
Occupation: Chief Executive Officer of Heartland Group Holdings
External Directorships:
Heartland Australia Group Pty Limited, Heartland Australia Holdings Pty Limited, Australian Seniors Finance Pty Limited, ASF Custodians Pty Limited, Heartland Group Holdings Limited, Henley Family Investments Limited, StockCo Holdings 2 Pty Limited, StockCo Australia Management Pty Limited.

Name: Edward John Harvey
Qualifications: BCom, CA, CFInstD
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Napier Port Holdings Limited, Pomare Investments Limited, Port of Napier Limited.

Name: Kathryn Mitchell
Qualifications: BA, CMInstD
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Chambers@151 Limited, Christchurch International Airport Limited, Farmright Limited, Firsttrax Limited, Helpings Hands Holdings Limited, Link Engine Management Limited, Morrison Horgan Limited, The New Zealand Merino Company Limited, Heartland Group Holdings Limited, The A2 Milk Company Limited.

Directors (continued)

Name: Shelley Maree Ruha
Qualifications: BCom, DipBank
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Analey Holdings Limited, Analey Investments Limited, IT & Business Consulting Limited, New Zealand Rural Land Management GP Limited, Partners Group Holdings Limited, Partners Life Limited, 9 Spokes International Limited, Taxgift Limited, Hobson Wealth Holdings Limited, Hobson Wealth Partner's Limited, Paysauce Limited, 9 Spokes Knowledge Limited, 9 Spokes Operations Limited, 9 Spokes Trustee Limited, 9 Spokes US Holdings Limited, Allied Farmers Limited, Iris Group Holdings Limited, Iris Life Limited, Iris Services Limtied, 5M No.2 Limited, Alf Nominees Limited, Allied Farmers Rural Limited, Clearwater Hotel 2004 Limited, Lifestyles of New Zealand Queenstown Limited, Lonz 2008 Holdings Limited, Lonz 2008 Limited, NZ Farmers Livestock Finance Limited, QWF Holdings Limited, Rural Funding Solutionz Limited, UFL Lakeview Limited.

Name: Simon Ross Tyler
Qualifications: MSc, BSc (hons)
Type of Director: Independent Non-Executive Director
Occupation: Company Director
External Directorships:
Nutrition for Health Limited, Global Horticulture Limited, Palliser Estate Wines of Martinborough Limited.

Conflicts of interest policy

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

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

Interested transactions

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

Audit committee composition

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

Edward John Harvey (Chairperson)	Independent Non-Executive Director
Bruce Robertson Irvine	Independent Non-Executive Director
Shelley Maree Ruha	Independent Non-Executive Director
Simon Ross Tyler	Independent Non-Executive Director

Directors' Statements

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

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

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

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

2. During the year ended 30 June 2023:

   (a) the Bank complied in all material respects with each Condition of Registration that applied during the period;

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

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

This Disclosure Statement is dated 28 August 2023 and has been signed by all the Directors.

B. R. Irvine (Chair)

K. Mitchell

J. K. Greenslade

S. M. Ruha

E. J. Harvey

S. Tyler

Consolidated Statement of Comprehensive Income

For the year ended 30 June 2023

$000's	Note	June 2023	June 2022
Interest income	3	372,688	275,770
Interest expense	3	158,027	66,205
Net interest income		**214,661**	**209,565**
Operating lease income	4	5,631	5,284
Operating lease expense	4	3,827	3,383
Net operating lease income		**1,804**	**1,901**
Lending and credit fee income		7,722	6,943
Other income	5	2,932	24,860
Net operating income		**227,119**	**243,269**
Operating expenses	6	101,337	96,203
Profit before impaired asset expense and income tax		**125,782**	**147,066**
Fair value (loss) on investments		-	(315)
Impaired asset expense	8	22,891	14,692
Profit before income tax		**102,891**	**132,059**
Income tax expense	9	28,389	36,068
Profit for the year		**74,502**	**95,991**
Other comprehensive income			
Items that are or may be reclassified subsequently to profit or loss, net of income tax:			
Effective portion of change in fair value of derivative financial instruments		7,264	6,540
Movement in fair value reserve		(533)	(712)
Items that will not be reclassified to profit or loss, net of income tax:			
Movement in defined benefit reserve		-	(171)
Net loss due to wind-up of superannuation scheme		-	(473)
Other comprehensive income for the year, net of income tax		**6,731**	**5,184**
Total comprehensive income for the year		**81,233**	**101,175**

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

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

Consolidated Statement of Changes in Equity

For the year ended 30 June 2023

		June 2023				June 2022			
$000's	**Note**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**	**Share Capital**	**Reserves**	**Retained Earnings**	**Total Equity**
Balance at beginning of year		**553,239**	**6,412**	**147,852**	**707,503**	**553,239**	**755**	**87,834**	**641,828**
Total comprehensive income for the year									
Profit for the year		-	-	74,502	74,502	-	-	95,991	95,991
Other comprehensive income, net of income tax	16	-	6,731		6,731	-	5,657	(473)	5,184
Total comprehensive income for the year		**-**	**6,731**	**74,502**	**81,233**	**-**	**5,657**	**95,518**	**101,175**
Contributions by and distributions to owner									
Dividend to Heartland Group Holdings Limited	15	-	-	(60,000)	(60,000)	-	-	(35,500)	(35,500)
Total transactions with owner		**-**	**-**	**(60,000)**	**(60,000)**	**-**	**-**	**(35,500)**	**(35,500)**
Balance at end of the year		**553,239**	**13,143**	**162,354**	**728,736**	**553,239**	**6,412**	**147,852**	**707,503**

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

Consolidated Statement of Financial Position

As at 30 June 2023

$000's	Note	June 2023	June 2022
Assets			
Cash and cash equivalents		216,044	221,469
Investments	10	317,011	275,714
Derivative financial instruments	11	36,982	44,487
Due from related parties	18	-	1,540
Finance receivables	12	3,954,800	3,762,231
Finance receivables - reverse mortgages	19	888,600	721,264
Investment properties		11,903	11,832
Operating lease vehicles	13	16,966	15,161
Right of use assets	17	11,510	13,660
Other assets	17	19,597	13,338
Intangible assets	17	71,635	58,418
Deferred tax asset	9	16,760	15,538
Total assets		**5,561,808**	**5,154,652**
Liabilities			
Deposits	14	4,131,029	3,597,144
Other borrowings	14	615,126	749,478
Derivative financial instruments	11	7,624	6,335
Due to related parties	18	7,173	1,535
Lease liabilities	17	13,478	15,726
Tax liabilities		7,692	22,479
Trade and other payables	17	50,950	54,452
Total liabilities		**4,833,072**	**4,447,149**
Net assets		**728,736**	**707,503**
Equity			
Share capital	15	553,239	553,239
Retained earnings and other reserves	16	175,497	154,264
Total equity		**728,736**	**707,503**
Total interest earning and discount bearing assets		5,374,632	4,979,167
Total interest and discount bearing liabilities		4,726,367	4,318,947

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

Consolidated Statement of Cash Flows

For the year ended 30 June 2023

$000's	Note	June 2023	June 2022
Cash flows from operating activities			
Interest received		293,872	232,601
Operating lease income received		4,571	3,913
Lending, credit fees and other income received		12,236	11,740
Operating inflows		**310,679**	**248,254**
Interest paid		(138,332)	(87,131)
Payments to suppliers and employees		(93,333)	(47,169)
Taxation paid		(44,055)	(26,616)
Operating outflows		**(275,720)**	**(160,916)**
Net cash flows from operating activities before changes in operating assets and liabilities		**34,959**	**87,338**
Proceeds from sale of operating lease vehicles		4,492	4,482
Purchase of operating lease vehicles		(8,766)	(10,758)
Net movement in finance receivables		(301,687)	(636,981)
Net movement in deposits		522,307	376,052
Net movement in related party balances		3,202	(3,069)
Net cash flows from/(applied to) operating activities[1]		**254,507**	**(182,936)**
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets		(23,423)	(11,889)
Proceeds from investment securities		55,443	82,946
Purchase of investment securities		(95,000)	-
Purchase of investment property		(71)	-
Net cash flows (applied to)/from investing activities		**(63,051)**	**71,057**
Cash flows from financing activities			
Proceeds from wholesale funding		671,271	779,668
Repayment of wholesale borrowings		(753,838)	(521,541)
Repayment of unsubordinated notes		(150,000)	-
Proceeds from issue of subordinated debt		97,934	-
Dividends paid	15	(60,000)	(35,500)
Payment of lease liabilities		(2,248)	(2,182)
Net cashflows (applied to)/from financing activities		**(196,881)**	**220,445**
Net (decrease)/increase in cash held		**(5,425)**	**108,566**
Opening cash and cash equivalents		221,469	112,903
Closing cash and cash equivalents[2]		**216,044**	**221,469**

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

[2]At 30 June 2023, the Banking Group has $16.9 million (2022: $20.2 million) of cash held by the Trust which may only be used for the purposes defined in the underlying Trust documents. Refer to Note 27 - Structured entities for definition of the Trust and further details.

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

Consolidated Statement of Cash Flows (continued)

For the year ended 30 June 2023

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

$000's	Note	June 2023	June 2022
Profit for the year		**74,502**	**95,991**
Add/(less) non-cash items:			
Depreciation and amortisation expense		9,299	10,294
Depreciation on lease vehicles	13	3,461	3,103
Capitalised net interest income and fee income		(69,249)	(46,108)
Impaired asset expense	8	22,891	14,692
Investment fair value movement		-	315
Deferred tax		(1,222)	(3,287)
Other non-cash items		1,015	(13,245)
Total non-cash items		**(33,805)**	**(34,236)**
Add/(less) movements in operating assets and liabilities:			
Finance receivables		(301,687)	(636,981)
Operating lease vehicles		(5,266)	(6,276)
Other assets		2,313	(1,780)
Current tax		(14,787)	14,923
Derivative financial instruments		8,794	(23,002)
Deposits		522,307	376,052
Other liabilities		2,136	32,373
Total movements in operating assets and liabilities		**213,810**	**(244,691)**
Net cash flows from/(applied to) operating activities[1]		**254,507**	**(182,936)**

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

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

Consolidated Statement of Cash Flows (continued)

For the year ended 30 June 2023

Net debt reconciliation

The below table sets out net cash flow and non-cash changes in liabilities arising from financing activities.

$000's	Note	June 2023	June 2022
Balance as at beginning of year[1]		**765,204**	**520,665**
Proceeds from wholesale funding		671,271	779,668
Repayment of wholesale borrowings		(753,838)	(521,541)
Repayment of unsubordinated notes		(150,000)	-
Proceeds from issue of subordinated debt		97,934	-
Payment of lease liabilities		(2,248)	(2,182)
Total cash movements		**(136,881)**	**255,945**
Capitalised interest and fee expense		755	-
Fair value movements		(473)	(11,534)
Other movements		-	128
Total non-cash movements		**282**	**(11,406)**
Balances as at end of year		**628,605**	**765,204**

[1]Includes lease liabilities and other borrowings.

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

Notes to the Financial Statements

For the year ended 30 June 2023

1 Financial statements preparation

Reporting entity

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

The Bank is a company incorporated in New Zealand under the Companies Act 1993, a registered bank under the Banking (Prudential Supervision) Act 1989 and a Financial Market Conduct (**FMC**) reporting entity for the purposes of the Financial Markets Conduct Act 2013.

Basis of preparation

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

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

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

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

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

Basis of measurement

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

Principles of consolidation

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

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

1 Financial statements preparation (continued)

Changes in accounting standards

Accounting standards issued and effective

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

Accounting standards issued not yet effective

Disclosure of fees for audit firms' services (Amendments to FRS-44)

Amendments were issued to FRS-44 New Zealand Additional Disclosures (Amendments to FRS-44) that require an entity to describe the services provided by its audit or review firm and to disclose the fees incurred by the entity for those services using prescribed categories. These amendments apply to accounting periods beginning on or after 1 January 2024. Earlier application is permitted for accounting periods that begin before 1 January 2024 but have not ended or do not end before 15 June 2023.

The Banking Group has early adopted the Amendments to FRS-44 from 1 July 2022. Refer to Note 7 - Compensation of auditor for further details.

Climate-related standards

Climate-related disclosure standards were issued in December 2022, and took effect on 1 January 2023. These include the Climate-related Disclosures (CS 1), Adoption of Aotearoa New Zealand Climate Standards (CS 2) and General Requirements for Climate-related Disclosures (CS 3). The Banking Group is a designated climate reporting entity under the climate related disclosure regime and is required to meet its requirements effective from the financial reporting period commencing 1 July 2023.

Other new accounting standards, amendments to accounting standards and interpretations have been published that are not mandatory for the 30 June 2023 reporting periods and have not been early adopted by the Banking Group. These standards, amendments or interpretations are not expected to have a material impact on the current or future reporting periods.

Critical accounting estimates and judgements

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

- Provisions for impairment - The effect of credit risk is quantified based on the Banking Group's best estimate of future cash repayments and proceeds from any security held or by reference to risk profile groupings, historical loss data and forward-looking information. Refer to Note 8 - Impaired asset expense and Note 12 - Finance receivables for further details.

- Fair value of reverse mortgages - Fair value is quantified by the transaction price. Management judgement is applied in determining the appropriateness of the transaction price as fair value. Refer to Note 19 - Fair value for further details.

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

1 Financial statements preparation (continued)

Financial assets and liabilities

Financial Assets

Financial assets are classified based on:

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

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

Financial assets are classified into the following measurement categories:

Financial Assets	Measurement Category	Note
Bank bonds and floating rate notes	Fair value through other comprehensive income (**FVOCI**)	10
Public sector securities and corporate bonds	FVOCI	10
Equity investments	Fair value through profit or loss (**FVTPL**)	10
Finance receivables – reverse mortgages	FVTPL	19
Finance receivables	Amortised cost	12
Derivative financial instruments	FVTPL	11

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

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

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

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

1 Financial statements preparation (continued)

Financial assets and liabilities (continued)

Financial Assets (continued)

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

- they are held within a business model whose objective is achieved through selling or repurchasing the financial asset in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or

- the contractual cash flows of the financial asset do not represent SPPI on the principal balance outstanding; or

- they are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

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

Financial Liabilities

Financial liabilities are classified into the following measurement categories:

- Those to be measured at amortised cost;

- Those to be measured at FVTPL.

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

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

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

- They are held for trading whose principal objective is achieved through selling or repurchasing the financial liability in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking; or

- They are designated at FVTPL upon initial recognition to eliminate or reduce an accounting mismatch.

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

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

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

Recognition

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

1 Financial statements preparation (continued)

Derecognition

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

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

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

Performance

2 Segmental analysis

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

An operating segment is a component of an entity engaging in business activities and whose operating results are regularly reviewed by the Banking Group's chief operating decision maker (**CODM**). The CODM, who is responsible for allocating resources and assessing business performance of the Banking Group, has been identified as the Bank's Chief Executive Officer (**CEO**) and direct reports.

Operating segments

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

Motor	Motor vehicle finance.
Reverse mortgages	Reverse mortgage lending.
Personal lending	Transactional, home loans and personal loans to individuals.
Business	Term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized businesses.
Rural	Specialist financial services to the farming sector primarily offering livestock finance, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.

Certain operating expenses, such as premises, IT and support centre costs are not allocated to operating segments and are included in Other. Finance receivables are allocated across the operating segments as assets. Liabilities are managed centrally and therefore are not allocated across the operating segments. The Banking Group does not rely on any single major customer for its revenue base.

$000's	Motor	Reverse Mortgages	Personal Lending	Business	Rural	Other	Total
June 2023							
Net interest income	60,681	39,696	9,426	71,630	33,522	(294)	214,661
Lending and credit fee income	2,034	2,671	447	2,278	292	-	7,722
Net other income	1,485	-	935	991	398	927	4,736
Net operating income	**64,200**	**42,367**	**10,808**	**74,899**	**34,212**	**633**	**227,119**
Operating expenses	4,140	4,928	6,459	9,387	3,068	73,355	101,337
Profit/(loss) before impaired asset expense and income tax	**60,060**	**37,439**	**4,349**	**65,512**	**31,144**	**(72,722)**	**125,782**
Impaired asset expense	10,911	-	3,195	8,155	630	-	22,891
Profit before income tax	**49,149**	**37,439**	**1,154**	**57,357**	**30,514**	**(72,722)**	**102,891**
Income tax expense	-	-	-	-	-	28,389	28,389
Profit/(loss) for the year	**49,149**	**37,439**	**1,154**	**57,357**	**30,514**	**(101,111)**	**74,502**
Total assets	**1,563,939**	**888,600**	**358,572**	**1,356,913**	**712,596**	**681,188**	**5,561,808**
Total liabilities							**4,833,072**

2 Segmental analysis (continued)

$000's	Motor	Reverse Mortgages	Personal Lending	Business	Rural	Other	Total
June 2022							
Net interest income	69,730	29,957	10,218	70,602	29,460	(402)	209,565
Lending and credit fee income	1,582	2,583	364	2,145	269	-	6,943
Net other income	1,744	-	1,198	534	470	22,815	26,761
Net operating income	**73,056**	**32,540**	**11,780**	**73,281**	**30,199**	**22,413**	**243,269**
Operating expenses	3,792	4,485	6,417	9,358	3,038	69,113	96,203
Profit/(loss) before impaired asset expense and income tax	**69,264**	**28,055**	**5,363**	**63,923**	**27,161**	**(46,700)**	**147,066**
Fair value (loss) on investments	-	-	-	-	-	(315)	(315)
Impaired asset expense/(benefit)	1,481	-	(877)	11,831	2,257	-	14,692
Profit/(loss) before income tax	**67,783**	**28,055**	**6,240**	**52,092**	**24,904**	**(47,015)**	**132,059**
Income tax expense	-	-	-	-	-	36,068	36,068
Profit/(loss) for the year	**67,783**	**28,055**	**6,240**	**52,092**	**24,904**	**(83,083)**	**95,991**
Total assets	**1,382,367**	**721,264**	**332,783**	**1,387,352**	**687,232**	**643,654**	**5,154,652**
Total liabilities							**4,447,149**

3 Net interest income

Policy

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

Interest income is calculated based on the gross carrying amount of financial assets in stages 1 and 2 of the Banking Group’s expected credit losses (**ECL**) model and on the carrying amount net of the provision for ECL for financial assets in stage 3. For financial instruments measured at FVTPL, interest is not calculated under the effective interest rate method.

$000's	June 2023	June 2022
Interest income		
Cash and cash equivalents	9,585	805
Investments	5,081	5,156
Finance receivables	290,487	230,514
Finance receivables - reverse mortgages	67,535	39,295
Total interest income [1]	**372,688**	**275,770**

3 Net interest income (continued)

$000's	June 2023	June 2022
Interest expense		
Retail deposits	146,301	45,387
Other borrowings	31,490	20,727
Net interest (income)/expense on derivative financial instruments	(19,764)	91
Total interest expense [2]	**158,027**	**66,205**
Net interest income	**214,661**	**209,565**

[1] Cash and cash equivalents and Finance receivables are measured at amortised cost. Investments are measured at FVOCI. Total interest income derived from these financial assets is calculated using the effective interest rate method. Finance receivables - reverse mortgages are measured at FVTPL.

[2] Deposits and Other borrowings are measured at amortised cost, therefore interest expense incurred on these financial liabilities is calculated using the effective interest rate method. Net interest expense on derivative financial instruments is not calculated using the effective interest rate method as they are measured at FVTPL.

4 Net operating lease income

Policy

As a lessor, the Banking Group retains substantially all the risks and rewards incidental to ownership of the assets and therefore classifies the leases as operating leases. Rental income and expense from operating leases are 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 2023	June 2022
Operating lease income		
Lease income	4,639	4,161
Gain on disposal of lease assets	992	1,123
Total operating lease income	**5,631**	**5,284**
Operating lease expense		
Depreciation on lease assets	3,461	3,103
Direct lease costs	366	280
Total operating lease expense	**3,827**	**3,383**
Net operating lease income	**1,804**	**1,901**

5 Other income

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

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

Fair value gain or loss on derivative financial instruments
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 and changes in the fair value of any derivatives not designated in a hedge relationship are recognised immediately in the consolidated statement of comprehensive income and disclosed within Other income. Refer to Note 11 - Derivative financial instruments for further details.

$000's	**June 2023**	**June 2022**
Rental income from investment properties	1,063	833
Insurance income[1]	756	664
Management fee income[2]	9,113	5,918
Other income	243	706
Fair value (loss)/gain on derivative financial instruments	(8,237)	16,723
Foreign exchange (loss)/gain	(6)	16
Total other income	**2,932**	**24,860**

[1] Insurance income includes net income from Marac Insurance Limited (**MIL**), a subsidiary of HBL. MIL ceased writing insurance policies in 2020 with the periodic policies expected to expire in 2025.

[2] Refer to Note 18 - Related party transactions and balances for further details.

6 Operating expenses

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

$000's	June 2023	June 2022
Personnel expenses[1]	60,213	53,826
Directors' fees	574	542
Superannuation	1,171	1,045
Depreciation - property, plant and equipment	1,756	2,342
Legal and professional fees[2]	2,838	2,310
Advertising and public relations	1,803	2,814
Depreciation - right of use asset	2,150	2,122
Technology services	9,720	9,014
Telecommunications, stationery and postage	1,694	1,492
Customer administration costs	2,497	2,419
Customer onboarding costs	2,469	2,341
Occupancy costs	1,408	1,345
Amortisation of intangible assets	5,393	5,830
Other operating expenses	7,651	8,761
Total operating expenses	**101,337**	**96,203**

[1] Excludes certain personnel expenses directly incurred in acquiring and developing software and capitalised as part of specific application software.

[2] Legal and professional fees include compensation of auditor which is disclosed in Note 7 - Compensation of auditor.

7 Compensation of auditor

In accordance with the Amendments to FRS-44, adopted by the Banking Group from 1 July 2022, the Banking Group is required to disclose the fees incurred for services received from its audit or review firm, with a description of each service, including audit or review of the financial statements. Other services performed during the reporting period are required to be disclosed using the following categories:

- audit or review related services;
- other assurance services and other agreed-upon procedures engagements;
- taxation services and;
- other services.

In accordance with HGH's external auditor independence policy, it is prohibited for the external auditor's firm to perform tax compliance work. It is also the Banking Group's policy to engage the external auditor's firm on assignments additional to its statutory audit duties only if they are not perceived to be in conflict with the role of external auditor. All services are approved by the Board Audit and Risk Committee.

The fees payable to the current auditor, PricewaterhouseCoopers New Zealand (**PwC**) and to the predecessor auditor, KPMG are outlined in the below table:

$000's	June 2023	June 2022
Fees paid to current auditor - PwC		
Audit and review of financial statements[1]	660	-
Other assurance and agreed-upon procedure services paid to auditor[2]	17	
Other services paid to auditor[3]	17	-
Total compensation to PwC	**694**	**-**
Fees paid to predecessor auditor - KPMG		
Audit and review of financial statements[1]	-	593
Other assurance and agreed-upon procedure services paid to auditor[2]	-	20
Total compensation to KPMG	-	**613**
Total compensation of auditor	**694**	**613**

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

[2]Other assurance related services paid to the auditor comprise reasonable assurance engagement services for insurance solvency return, trust deed reporting, supervisor and registry audits.

[3]Other non-assurance services paid to PwC relates to actuarial services for reverse mortgages for the Banking Group carried out by PwC prior to the appointment as external auditors and fees for executive reward survey report.

8 Impaired asset expense

$000's	June 2023	June 2022
Individually impaired asset expense	13,033	10,782
Collectively impaired asset expense	11,757	6,665
Total impaired asset expense excluding recovery of amounts previously written off	**24,790**	**17,447**
Recovery of amounts previously written off to the income statement	(1,899)	(2,755)
Total impaired asset expense	**22,891**	**14,692**

Refer to Note 22 – Asset quality for provision for impairment details.

9 Taxation

Policy

Income tax

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

Current tax

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

Deferred tax

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

Goods and services tax (GST)

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

9 Taxation (continued)

Income tax expense

$000's	June 2023	June 2022
Income tax recognised in profit or loss		
Current tax		
Current year	30,353	40,104
Adjustments for prior year	(742)	(748)
Deferred tax		
Current year	(1,447)	(2,895)
Adjustments for prior year	225	(393)
Total income tax expense recognised in profit or loss	**28,389**	**36,068**
Income tax recognised in other comprehensive income		
Current tax		
Investment securities at fair value in fair value reserve	(246)	(5,271)
Fair value movements in derivatives held in cash flow hedge reserve	2,418	7,537
Total income tax expense recognised in other comprehensive income	**2,172**	**2,266**

Reconciliation of effective tax rate

Profit before income tax	**102,891**	**132,059**
Prima facie tax @ 28%	28,810	36,976
Adjusted tax effect of items not deductible	97	232
Adjustments for prior year	(518)	(1,140)
Total income tax expense	**28,389**	**36,068**

Deferred tax assets comprise the following temporary differences:

$000's	June 2023	June 2022
Employee entitlements	1,370	1,234
Share based payment	616	501
Provision for impairment	14,622	14,176
Intangibles and property, plant and equipment	(1,530)	(2,972)
Deferred acquisition costs	(55)	(196)
Operating lease vehicles	451	680
Other temporary differences	1,286	2,116
Total deferred tax assets	**16,760**	**15,538**
Opening balance of deferred tax assets	**15,538**	**12,251**
Movement recognised in profit or loss	1,222	3,287
Closing balance of deferred tax assets	**16,760**	**15,538**

Financial Position

10 Investments

Policy
Investments are classified into one of the following categories:

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

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

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

$000's	June 2023	June 2022
Bank deposits, bank bonds and floating rate notes	305,310	261,258
Public sector securities and corporate bonds	9,882	12,953
Equity investments	1,819	1,503
Total investments	**317,011**	**275,714**

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

11 Derivative financial instruments

Policy
The Banking Group uses derivatives for risk management purposes. Derivatives held for risk management purposes are placed into hedges that either meet hedge accounting requirements, or economic hedges not placed into an accounting hedge relationship.

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

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

Derivative instruments that do not qualify for hedge accounting are held as economic hedges. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the consolidated statement of comprehensive income and disclosed within Other income.

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

- the hedging relationship must be formally designated and documented at inception of the hedge,

- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and

- the instruments or counterparty must be a third party external to the Banking Group.

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

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

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

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

- the hedging relationship must be formally designated and documented at inception of the hedge,

- effectiveness testing must be carried out on an on-going basis to ensure the hedge is effective, consistent with the originally documented risk management strategy, and

- the instruments or counterparty must be a third party external to the Banking Group.

11 Derivative financial instruments (continued)

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

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

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

The Banking Group actively manages interest rate risk by entering into derivative contracts to hedge against movements in interest rates. As permitted by NZ IFRS 9, the Banking Group has elected to continue to apply the hedge accounting requirements of NZ IAS 39.

The Banking Group's approach to managing market risk, including interest rate risk, is disclosed in Note 24 – Interest rate risk. The Banking Group actively manages residual interest rate risk from the net exposure of its underlying assets and liabilities, associated with the mismatch of the interest rate repricing profiles of its interest earning assets and interest bearing liabilities, by entering into interest rate swaps to hedge against movements in interest rates.

Interest rate swaps are bilateral derivative contracts with commitments to exchange one set of cash flows for another resulting in an economic exchange of interest rates (for example, fixed rate for floating rate) without exchange of principal. Interest rate swap notional values indicate the volume of transactions outstanding at the end of the financial year and provide basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved, therefore don't indicate the Banking Group's exposure to credit or market risks. The fair values of derivative instruments and their notional values are set out in the below table.

	June 2023			June 2022		
$000's	**Notional Principal**	**Fair Value Assets**	**Fair Value Liabilities**	**Notional Principal**	**Fair Value Assets**	**Fair Value Liabilities**
Interest rate related contracts						
Held as economic hedges	260,650	6,539	-	619,005	17,842	1,537
Designated as cash flow hedges	850,068	15,398	941	309,946	7,949	-
Designated as fair value hedges	543,200	15,045	6,683	549,200	18,696	4,798
Interest rate swaps	**1,653,918**	**36,982**	**7,624**	**1,478,151**	**44,487**	**6,335**
Total derivative financial instruments	**1,653,918**	**36,982**	**7,624**	**1,478,151**	**44,487**	**6,335**

11 Derivative financial instruments (continued)

Micro cash flow hedge accounting is applied to interest rate swaps designated as hedges of the Banking Group's floating rate domestic borrowings and deposits by using 'receive floating / pay fixed' interest rate swaps to fix the cost of floating interest rate loans and deposits.

Micro fair value hedge accounting is applied to receive fixed interest rate swaps designated as hedges of interest rate risk arising from fixed-rate subordinated notes and retail bond, and to pay fixed interest rate swaps designated as hedges of interest rate risk arising from fixed-rate investment securities.

The Banking Group determines whether an economic relationship between the hedged item and the hedging instrument exists based on an assessment of the qualitative characteristics of this hedged item and the hedged risk, supported by quantitative analysis. Close alignment of the critical terms of the hedged item and hedging instrument is also considered a strong indication of the presence of an economic relationship by the Banking Group.

The Banking Group establishes a hedge ratio by aligning the par amount of the exposure to be hedged and the notional amount of the interest rate swap designated as a hedging instrument.

Retrospective testing for each reporting period uses a regression model, which compares the change in the fair value of the hedged item and the change in the fair value of the hedging instrument. For a hedge to be deemed effective, the change in fair values should be within 80% and 125% of each other. Should the result fall outside this range the hedge would be deemed ineffective and recognised immediately through the income statement in line with each hedge relationship policy above.

The hedge relationship is reviewed on a monthly basis and the hedging instruments and hedged items are de-designated and re-designated, if necessary, based on the effectiveness test results and changes in the hedged exposure.

Hedge ineffectiveness may arise from timing difference on repricing between the hedged item and the hedging instrument, difference in timing of their cash flows, or due to changes in the counterparties' credit risk affecting the fair value of hedging instruments.

The following table shows the maturity and interest rate risk profiles of the interest rate swaps as hedging instruments in continuing fair value and cash flow hedge relationships.

$000's	0-6 Months	6-12 Months	1-2 Years	2-5 Years	5+ Years	Total
June 2023						
Interest rate risk						
Cash flow hedge relationships						
Pay fixed						
Nominal amounts	-	20,000	295,000	535,068	-	850,068
Average interest rate	-	4.22%	3.78%	4.00%	-	
Fair value hedge relationships						
Pay fixed						
Nominal amounts	54,700	38,000	60,000	160,400	5,100	318,200
Average interest rate	1.17%	0.77%	0.88%	3.06%	1.51%	
Receive fixed						
Nominal amounts	-	125,000	-	100,000	-	225,000
Average interest rate	-	1.78%	-	4.30%	-	
Total interest rate risk nominal amount	**54,700**	**183,000**	**355,000**	**795,468**	**5,100**	**1,393,268**

11 Derivative financial instruments (continued)

$000's	0-6 Months	6-12 Months	1-2 Years	2-5 Years	5+ Years	Total
June 2022						
Interest rate risk						
Cash flow hedge relationships						
Pay fixed						
Nominal amounts	-	-	-	309,946	-	309,946
Average interest rate	-	-	-	2.49%	-	
Fair value hedge relationships						
Pay fixed						
Nominal amounts	20,000	31,000	92,700	115,400	15,100	274,200
Average interest rate	1.20%	0.81%	1.00%	0.84%	1.45%	
Receive fixed						
Nominal amounts	150,000	-	125,000	-	-	275,000
Average interest rate	4.50%	-	1.78%	-	-	
Total interest rate risk nominal amount	**170,000**	**31,000**	**217,700**	**425,346**	**15,100**	**859,146**

The following table sets out the accumulated fair value adjustments arising from the corresponding fair value hedge relationships and the outcome of the changes in fair value of the hedged item as well as the hedging instruments used as the basis for recognising effectiveness.

	As at 30 June 2023		For the year ended 30 June 2023
$000's	Carrying value	Accumulated amount of fair value hedge adjustment	Hedge ineffectiveness gain/(loss) recognised in income statement
Interest rate risk			
Investments	290,723	(14,893)	2,620
Other borrowings	(219,959)	5,331	473
Total	**70,764**	**(9,562)**	**3,093**
Interest rate swaps	**8,362**	**8,362**	**(3,133)**
Hedge ineffectiveness of financial instruments recognised in other income			**(40)**

11 Derivative financial instruments (continued)

$000's	As at 30 June 2022 Carrying value	Accumulated amount of fair value hedge adjustment	For the year ended 30 June 2022 Hedge ineffectiveness gain/(loss) recognised in income statement
Interest rate risk			
Investments	262,314	(16,914)	(14,793)
Other borrowings	(272,983)	4,858	11,543
Total	**(10,669)**	**(12,056)**	**(3,250)**
Interest rate swaps	**13,898**	**13,898**	**3,295**
Hedge ineffectiveness of financial instruments recognised in other income			**45**

The accumulated amount of fair value hedge adjustments included in the carrying amount of hedged items that have ceased to be adjusted for hedging gains and losses is nil (2022: nil).

The balance of the cash flow hedge reserve, amounts recognised in the reserve, and amounts transferred out of the reserve are shown in the following table.

$000's	June 2023	June 2022
Cash flow hedge reserve		
Balance at beginning of year	7,446	906
Transferred to the income statement	(1,771)	(641)
Net gains from change in fair value	11,453	10,036
Net movement before tax	**9,682**	**9,395**
Tax on net movement in cash flow hedge reserve	(2,418)	(2,855)
Balance at end of year	**14,710**	**7,446**

During the year ended 30 June 2023, a gain of $0.7 million was recognised in fair value gain on derivative financial instruments in the consolidated statement of comprehensive income related to hedge ineffectiveness from cash flow hedge relationships (2022: nil).

There were no transactions for which cash flow hedge accounting had to be ceased as a result of the highly probable cash flows no longer being expected to occur (2022: nil).

There are $10.1 million (2022: $1.6 million) of balances recognised in the cash flow hedge reserve for which hedge accounting is no longer applied on the basis that the associated variable cash flows are still expected to occur over the lifetime of the original hedge relationships. The associated cash flow hedge reserve is being released over the period of the original hedge relationship which has since been de-designated.

12 Finance receivables

Policy

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

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

$000's	June 2023	June 2022
Gross finance receivables at amortised cost	4,006,945	3,812,658
Less provision for impairment[1]	(52,145)	(50,427)
Net finance receivables at amortised cost	**3,954,800**	**3,762,231**

[1] Refer to Note 22 - Asset quality for further details.

13 Operating lease vehicles

Policy
Operating lease vehicles are stated at cost less accumulated depreciation.

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

$000's	**June 2023**	**June 2022**
Cost		
Opening balance	20,450	16,114
Additions	8,766	10,758
Disposals	(6,303)	(6,422)
Closing balance	**22,913**	**20,450**
Accumulated depreciation		
Opening balance	5,289	5,249
Depreciation charge for the year	3,461	3,103
Disposals	(2,803)	(3,063)
Closing balance	**5,947**	**5,289**
Opening net book value	15,161	10,865
Closing net book value	**16,966**	**15,161**

The future minimum lease payments receivable under operating leases not later than one year is $4.086 million (2022: $3.057 million), within one to five years is $7.598 million (2022: $6.465 million) and over five years is nil (2022: nil).

14 Borrowings

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

The Banking Group hedges interest rate risk on certain debt issues. When fair value hedge accounting is applied to fixed rate debt issues, the carrying values are adjusted for changes in fair value related to the hedged risks.

$000's	**June 2023**	**June 2022**
Deposits	4,131,029	3,597,144
Total borrowings related to deposits	**4,131,029**	**3,597,144**
Unsubordinated notes	122,165	272,983
Subordinated notes[1]	97,793	-
Securitised borrowings	227,054	267,779
Certificate of deposit	148,110	198,715
Money market borrowings	20,004	10,001
Total other borrowings	**615,126**	**749,478**
Total deposits and other borrowings	**4,746,155**	**4,346,622**
Due within one year	4,328,399	3,509,295
Due more than one year	417,756	837,327
Total deposits and other borrowings	**4,746,155**	**4,346,622**

[1]Refer to Note 28 - Capital adequacy for further details.

Deposits and unsubordinated notes rank equally and are unsecured.

14 Borrowings (continued)

The Banking Group has the following retail bonds on issue at balance sheet date:

Retail Bonds $000's	Frequency of interest repayments	June 2023	June 2022	Maturity
$150 million	Semi-annually	-	145,142	21 September 2022
$125 million	Semi-annually	122,165	127,841	12 April 2024
Total retail bonds		**122,165**	**272,983**	

The Banking Group had the following securitised borrowings outstanding at balance sheet date:

Securitisation facility	June 2023		June 2022		
$000's	Limit	Drawn	Limit	Drawn	Maturity
Heartland Auto Receivable Warehouse (**HARWT**)	400,000	227,054	400,000	267,779	26 August 2024
Total securitisation borrowings		**227,054**		**267,779**	

HARWT notes issued to investors are secured over motor vehicle loans.

The Banking Group actively engages facility providers in commercial negotiations including tenor extensions, increase in facility limits, refinancing arrangements, and other commercial terms. The Banking Group has a track record of extending or refinancing funding arrangements as they fall due and does not anticipate any difficultly in doing so when the facilities above expire.

15 Share capital and dividends

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

000's	June 2023 Number of Shares	June 2022 Number of Shares
Issued shares		
Opening balance	565,430	565,430
Closing balance	**565,430**	**565,430**

There were nil new shares issued during the period (2022:nil).

The issued and fully paid ordinary share capital is included in Tier 1 capital of the Banking Group. Refer to Note 28 - Capital adequacy for further details.

Dividends paid

	June 2023 Date Declared	$000's	June 2022 Date Declared	$000's
Dividend to HGH	22 August 2022	30,000	21 February 2022	35,500
Dividend to HGH	28 February 2023	30,000		
Total dividends paid		**60,000**		**35,500**

16 Other reserves

$000's	Fair Value Reserve	Defined Benefit Reserve	Cash flow Hedge Reserve	Total
June 2023				
Balance as at 30 June 2022	(1,034)	-	7,446	6,412
Movements attributable to fair value hedges	(779)	-	-	(779)
Movements attributable to cash flow hedges	-	-	9,682	9,682
Income tax effect	246	-	(2,418)	(2,172)
Balance as at 30 June 2023	**(1,567)**	**-**	**14,710**	**13,143**
June 2022				
Balance as at 30 June 2021	(322)	171	906	755
Movements attributable to fair value hedges	(1,301)	-	-	(1,301)
Movements attributable to cash flow hedges	-	-	9,395	9,395
Movement in defined benefit reserve	-	(171)	-	(171)
Income tax effect	589	-	(2,855)	(2,266)
Balance as at 30 June 2022	**(1,034)**	**-**	**7,446**	**6,412**

Fair value reserve
Includes changes in the fair value of investment securities measured at fair value through other comprehensive income, net of tax. For debt securities, these changes are reclassified to the profit or loss when the asset is disposed.

Defined benefit reserve
Includes predetermined retirement benefits calculated for employees of a historical amalgamated entity which was wound up during the prior financial year.

Cash flow hedge reserve
This includes fair value gains and losses associated with the effective portion of the designated cash flow hedging instruments, net of tax.

17 Other balance sheet items

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

$000's	June 2023	June 2022
Other assets		
Trade receivables	381	-
GST receivables	275	1,506
Prepayments	4,280	4,697
Property, plant and equipment[1]	13,993	6,960
Other receivables	668	175
Total other assets	**19,597**	**13,338**

[1]Property, plant and equipment include rural property worth $7.8 million acquired during the year.

17 Other balance sheet items (continued)

Policy

Intangible assets

Intangible assets with finite useful lives

Software acquired or internally developed by the Banking Group is stated at cost less accumulated amortisation and any accumulated impairment losses. Expenditure on software assets is capitalised only when it increases the future economic value of that asset. Certain internal and external costs directly incurred in acquiring and developing software are capitalised when specific criteria are met. Costs incurred on planning or evaluating software proposals during the research phase or on maintaining systems after implementation are not capitalised. Amortisation of software is on a straight line basis, at rates which will write off the cost over the assets' estimated useful lives. The expected useful life of the software varies up to ten years.

Software-as-a-Service (SaaS) arrangements

SaaS arrangements are service agreements that grant the Banking Group the right to access the cloud provider's application software over the contract period. Costs associated with configuring or customising the software, along with ongoing fees for accessing the cloud provider's application, are recognised as operating expenses when the services are received.

Some of these costs pertain to developing software code that enhances or modifies, or creates additional capability to, existing on-premise systems and qualifies as an intangible asset based on its definition and recognition criteria.

The Banking Group capitalises costs incurred in configuring or customising certain suppliers' application software within specific cloud computing arrangements as intangible assets as the Banking Group considers that it would benefit from those costs to implement the cloud-based software over the expected terms of the cloud computing arrangements. However, such capitalisation occurs only if the activities result in creating an intangible asset that the Banking Group has control over and meets the necessary recognition criteria. Costs that do not meet the criteria for capitalisation as intangible assets are expensed as incurred unless they are paid to the suppliers (or subcontractors of the supplier) of the cloud-based software to significantly customise the cloud-based software for the Banking Group (i.e., such services are not distinct from the Banking Group's right to receive access to the supplier's cloud-based software). In the latter case, the upfront costs are recorded as prepayments for services and amortised over the expected terms of the cloud computing arrangements.

Goodwill

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

$000's	June 2023	June 2022
Computer software		
Software - cost	46,714	43,482
Software under development	26,664	11,295
Accumulated amortisation	31,542	26,158
Net carrying value of computer software	**41,836**	**28,619**
Goodwill		
Cost	29,799	29,799
Net carrying value of goodwill	**29,799**	**29,799**
Total intangible assets	**71,635**	**58,418**

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

17 Other balance sheet items (continued)

The recoverable amount of the business was determined on a value in use basis using a discounted cash flow methodology. The model uses a five-year cash flow forecast based on the latest budget approved by the board and extended out based on long term growth rates. The long-term growth rate applied to the future cash flows after year five of the forecast was 2.0% (2022: 2.0%) and a discount rate of 10.0% (2022: 10.0%) was applied which reflect both past experience and external sources of information. The goodwill impairment assessment indicates significant headroom, and that no foreseeable adjustments to key assumptions such as growth rate or discount rate would lead to impairment.

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 2023 (2022: nil).

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 2023	June 2022
Trade and other payables		
Trade payables	12,439	13,329
Insurance liability	915	1,840
Employee benefits	6,158	5,810
Other tax payables	3,829	1,132
Collateral received on derivatives[1]	27,609	32,341
Total trade and other payables	**50,950**	**54,452**

[1]The Banking Group has accepted collateral arising from derivative transactions, included in Cash and cash equivalents.

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

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

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

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

$000's	June 2023	June 2022
Right of use assets		
Balance at beginning of year	13,660	15,654
Depreciation charge for the year, included within depreciation expense in the income statement	(2,150)	(2,122)
Additions to right of use assets	-	128
Total right of use assets	**11,510**	**13,660**
Lease liability		
Current	2,357	3,181
Non-current	11,121	12,545
Total lease liability	**13,478**	**15,726**
Interest expense relating to lease liability	**434**	**470**

18 Related party transactions and balances

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

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

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

(a) Transactions with key management personnel

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

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

All other transactions with KMPs and their related parties are conducted in the ordinary course of business on commercial terms and conditions.

$000's	**June 2023**	**June 2022**
Transactions with key management personnel		
Interest income	123	26
Interest expense	(43)	(24)
Key management personnel compensation		
Short-term employee benefits	(1,441)	(2,373)
Short-term employee benefits - HGH parent	(6,642)	(6,417)
Share-based plan benefit/(expense)	14	(1,915)
Total transactions with key management personnel	**(7,989)**	**(10,703)**
Due from/(to) key management personnel		
Lending	4,428	229
Borrowings - deposits	(855)	(508)
Total due from/(to) key management personnel	**3,573**	**(279)**

18 Related party transactions and balances (continued)

(b) Transactions with related parties

The Banking Group's ultimate parent company is HGH.

The Bank has regular transactions with its ultimate parent company, fellow subsidiaries and subsidiaries (collectively known as the Heartland Group) on agreed terms. The transactions include the provision of tax and administrative services and customer operations. Banking facilities are provided by HBL to other Banking Group entities on normal commercial terms as with other customers. There is no lending from the Banking Group to HGH.

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

$000's	June 2023	June 2022
Heartland Group Holdings Limited (HGH)		
Interest expense	122	68
Deposits/(withdrawals)	(4,754)	(31,500)
Dividends paid to HGH	60,000	35,500
Management fees paid to HGH	11,013	8,327
Management fees received from HGH	4,596	2,164

$000's	June 2023	June 2022
Australian Seniors Finance Pty Limited (ASF)		
Management fees paid to ASF	5	-
Management fees received from ASF	4,517	2,752
Heartland Trust (HT)		
Unclaimed monies paid to HT	20	-
Payment to HT for providing goods and services	10	-

(c) Due from/to related parties

$000's	June 2023	June 2022
Due from		
Australian Seniors Finance Pty Limited	-	1,540
Total due from related parties	**-**	**1,540**
Due to		
Heartland Group Holdings Limited	6,956	1,535
Australian Seniors Finance Pty Limited	217	-
Total due to related parties	**7,173**	**1,535**

(d) Other balances with related parties

$000's	June 2023	June 2022
Heartland Group Holdings Limited		
Retail deposits owing to HGH	4	4,636

19 Fair value

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

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

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

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

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

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

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

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

(a) Financial instruments measured at fair value

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

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

Investments in debt securities

Investments in public sector securities and corporate bonds are stated at FVOCI with the fair value being based on quoted market prices (Level 1 under the fair value hierarchy) or modelled using observable market inputs (Level 2 under the fair value hierarchy). Refer to Note - 10 Investments for more details.

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

Investments in equity securities

Investments in equity securities are classified at FVTPL unless an irrevocable election is made by the Banking Group to measure at FVOCI. Investment in listed securities traded in liquid, active markets where prices are readily observable are measured under Level 1 of the fair value hierarchy with no modelling or assumptions used in the valuation. Investments in unlisted equity securities are measured under Level 3 of the fair value hierarchy with the fair value being based on unobservable inputs using market accepted valuation techniques. Where appropriate, the Banking Group may apply adjustments to the above-mentioned techniques to determine fair value of an equity security to reflect the underlying characteristics. These adjustments are reflective of market participant considerations in valuing the said security.

19 Fair value (continued)

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

Finance receivables - reverse mortgages

The reverse mortgage portfolio is classified and measured at FVTPL under NZ IFRS 9 Financial instruments (**NZ IFRS 9**). NZ IFRS 4 Insurance contracts (**NZ IFRS 4**) requires entities to account for insurance components of lifetime mortgage contracts. The review of the reverse mortgage portfolio valuation determined that the terms and conditions of these loan contracts do not contain a component of significant insurance risk, therefore they continue to be treated under NZ IFRS 9 Financial Instruments classified at FVTPL under NZ IFRS. Application of NZ IFRS 17 going forward will have a policy choice to continue applying NZ IFRS 9 for these instruments.

On initial recognition the Banking Group considers the transaction price to represent the fair value of the loan, on the basis that no reliable fair value can be estimated as there is no relevant active market and fair value cannot be reliably measured using other valuation techniques under NZ IFRS 13 Fair value measurement.

For subsequent measurement, and at balance date, the Banking Group considered whether the fair value can be determined by reference to a relevant active market or using a valuation technique that incorporates observable inputs but has concluded relevant support is not currently available. In the absence of such market evidence the Banking Group has used an actuarial valuation to determine a proxy for the fair value that incorporates changes in the portfolio risk and expectations of the portfolio performance. The actuarial valuation includes inputs such as mortality and potential move into care, voluntary exits, house price changes, interest rate margin and the no equity guarantee. This estimate is highly subjective and a wide range of plausible values are possible. The estimate provides an indication of whether the transaction value is overstated.

The Banking Group does not consider that the actuarial estimate has moved outside of the original expectation range on initial recognition. There has been no fair value movement recognised in profit or loss during the period (2022: nil). Fair value is not sensitive to the above assumptions due to the nature of reverse mortgage loans. In particular, given conservative origination loan-to-value ratio and security criteria, a material deterioration in house prices combined with a material increase in interest rates over a sustained period of time would likely need to occur before any potential impact to fair value.

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

Derivative financial instruments

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

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

19 Fair value (continued)

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

$000's	Level 1	Level 2	Level 3	Total
June 2023				
Assets				
Investments	315,192	-	1,819	317,011
Derivative financial instruments	-	36,982	-	36,982
Finance receivables - reverse mortgages	-	-	888,600	888,600
Total financial assets measured at fair value	**315,192**	**36,982**	**890,419**	**1,242,593**
Liabilities				
Derivative financial instruments	-	7,624	-	7,624
Total financial liabilities measured at fair value	**-**	**7,624**	**-**	**7,624**
June 2022				
Assets				
Investments	271,790	-	1,503	273,293
Derivative financial instruments	-	44,487	-	44,487
Finance receivables - reverse mortgages	-	-	721,264	721,264
Total financial assets measured at fair value	**271,790**	**44,487**	**722,767**	**1,039,044**
Liabilities				
Derivative financial instruments	-	6,335	-	6,335
Total financial liabilities measured at fair value	**-**	**6,335**	**-**	**6,335**

There were no transfers between levels in the fair value hierarchy in the year ended 30 June 2023 (2022: nil).

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

$000's	Finance Receivables - Reverse Mortgage	Investments	Total
June 2023			
As at 30 June 2022	721,264	1,503	722,767
New loans	193,845	-	193,845
Repayments	(96,753)	-	(96,753)
Capitalised Interest and fees	70,168	-	70,168
Purchase of investments	-	316	316
Other	76	-	76
As at 30 June 2023	**888,600**	**1,819**	**890,419**
June 2022			
As at 30 June 2021	601,505	1,818	603,323
New loans	162,166	-	162,166
Repayments	(83,629)	-	(83,629)
Capitalised Interest and fees	41,864	-	41,864
Fair value (loss) on investment	-	(315)	(315)
Other	(642)	-	(642)
As at 30 June 2022	**721,264**	**1,503**	**722,767**

19 Fair value (continued)

(b) Financial instruments not measured at fair value

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

Cash and cash equivalents

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

Investments

Investments not measured at fair value include bank deposits and are measured using the effective interest rate method. They are held to support the Banking Group's contractual cash flows rather than selling prior to contractual maturity to realise changes in fair value.

Finance receivables

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

The current weighted average lending rate used to fair value finance receivables with a fixed interest rate was 10.25% (2022: 7.77%). Finance receivables with a floating interest rate are deemed to be at current market rates. The current amount of credit provisioning has been deducted from the fair value calculation of finance receivables as a proxy for future losses.

Borrowings

The fair value of deposits, bank borrowings and other borrowings is the present value of future cash flows and is based on the current market interest rates payable by the Banking Group for debt of similar maturities. The average current market rate used to fair value other borrowings was 6.66% (2022: 3.57%).

Due to and from related parties

The fair value of amounts due to and from related parties is considered equivalent to their carrying value due to their short term nature.

19 Fair value (continued)

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

Other financial assets and financial liabilities

The fair value of financial instruments such as short-term trade receivables and payables is considered equivalent to their carrying value due to their short-term nature.

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

	June 2023			June 2022		
$000's	**Fair Value Hierarchy**	**Total Fair Value**	**Total Carrying Value**	**Fair Value Hierarchy**	**Total Fair Value**	**Total Carrying Value**
Assets						
Investments	Level 2	-	-	Level 2	2,418	2,421
Finance receivables	Level 3	3,700,196	3,954,800	Level 3	3,701,694	3,762,231
Total financial assets		**3,700,196**	**3,954,800**		**3,704,112**	**3,764,652**
Liabilities						
Deposits	Level 2	4,130,330	4,131,029	Level 2	3,595,554	3,597,144
Other borrowings	Level 2	615,061	615,126	Level 2	749,478	749,478
Total financial liabilities		**4,745,391**	**4,746,155**		**4,345,032**	**4,346,622**

19 Fair value (continued)

(c) Classification of financial instruments

The following tables summarise the categories of financial instruments and the carrying value of all financial instruments of the Banking Group:

$000's	FVOCI Debt Securities	FVTPL	Amortised Cost	Total Carrying Value
June 2023				
Assets				
Cash and cash equivalents	-	-	216,044	216,044
Investments	315,192	1,819	-	317,011
Finance receivables	-	-	3,954,800	3,954,800
Finance receivables - reverse mortgages	-	888,600	-	888,600
Derivative financial instruments	-	36,982	-	36,982
Other financial assets	-	-	1,050	1,050
Total financial assets	**315,192**	**927,401**	**4,171,894**	**5,414,487**
Liabilities				
Deposits	-	-	4,131,029	4,131,029
Other borrowings	-	-	615,126	615,126
Derivative financial instruments	-	7,624	-	7,624
Due to related parties	-	-	7,173	7,173
Other financial liabilities	-	-	40,963	40,963
Total financial liabilities	**-**	**7,624**	**4,794,291**	**4,801,915**
June 2022				
Assets				
Cash and cash equivalents	-	-	221,469	221,469
Investments	271,790	1,503	2,421	275,714
Finance receivables	-	-	3,762,231	3,762,231
Finance receivables - reverse mortgages	-	721,264	-	721,264
Derivative financial instruments	-	44,487	-	44,487
Due from related parties	-	-	1,540	1,540
Other financial assets	-	-	175	175
Total financial assets	**271,790**	**767,254**	**3,987,836**	**5,026,880**
Liabilities				
Deposits	-	-	3,597,144	3,597,144
Other borrowings	-	-	749,478	749,478
Derivative financial instruments	-	6,335	-	6,335
Due to related parties	-	-	1,535	1,535
Other financial liabilities	-	-	47,510	47,510
Total financial liabilities	**-**	**6,335**	**4,395,667**	**4,402,002**

Risk Management

20 Enterprise risk management program

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

Role of the Board and the Board Risk Committee

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

- The Board's Risk Appetite Statement.
- Heartland's Internal Capital Adequacy Assessment Program (**ICAAP**) including appropriate stress testing scenarios.
- The effectiveness of the ERMF and internal compliance and risk related policies, including approval or variation of policies, procedures and standards.
- Respond to changes anticipated in the economic, business and regulatory environment.
- Conduct, culture and customer outcomes, including emerging risks and any areas of concern.
- Credit exposures of the Bank, including the Delegated Lending Authority Policy and Framework.
- New products, including the process for approval of new products.

The BRC consists of three non-executive directors. Two members of the BRC sit on the Board Audit Committee (**BAC**). In addition, the HBL CEO, CRO, Head of Internal Audit and the CFO of Heartland Group Holdings Limited (or their nominee, subject to the Chair's prior approval) attend the BRC meetings, and the directors who are not members of the BRC are entitled to attend meetings and to receive copies of the BRC papers.

Board Audit Committee

The BAC focuses on financial reporting and application of accounting policies as part of the internal control and risk assessment framework. The BAC monitors the identification, evaluation and management of all significant risks through the Banking Group. This work is supported by Internal Audit, which provides an independent assessment of the design, adequacy and effectiveness of internal controls. The BAC receives regular reports from Internal Audit.

Charters for both the BRC and the BAC ensure suitable cross representation to allow effective communication pertaining to identified issues with oversight by the Board. The CRO has a direct reporting line to the Chair of the BRC. The Head of Internal Audit has a direct reporting line to the Chair of the BAC.

Internal Audit

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

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

20 Enterprise risk management program (continued)

Internal Audit (continued)

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

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

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

Asset and Liability Committee (ALCO)

The ALCO is a group management committee comprising the CEO of HBL, CFO of HGH, CRO of HBL, Head of Retail and Financial Controller of HBL. The ALCO has responsibility for overseeing aspects of risk management of the Banking Group's financial position. The ALCO usually meets monthly, and provides reports to HBL Audit and Risk Committees. ALCO's specific responsibilities include decision making and oversight of risk matters in relation to:

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

Executive Risk Committee (ERC)

The ERC comprises the CEO of HBL, CRO of HBL, CFO of HGH, Financial Controller of HBL and Head of Internal Audit. The ERC has responsibility for overseeing risk aspects including internal control environment to ensure that residual risk is consistent with the Banking Group’s risk appetite. The ERC generally meets monthly and minutes are made available to the BRC. ERC’s specific responsibilities include decision making and oversight of operational risk, compliance risk and credit risk.

Climate-related risks

Climate change risks are managed in accordance with the Banking Group’s RMP and supported by the environmental sustainability framework.

The Banking Group considers the impact of climate-related risks on its financial position and performance (and in this regard, the Board is currently in the process of establishing a new Board Committee to assist it in managing its climate related risks). While the effects of climate change represent a source of uncertainty, the Banking Group has concluded that climate-related risks do not have a material impact on the judgements, assumptions and estimates for the year ended 30 June 2023.

20 Enterprise risk management program (continued)

Operational and compliance risk

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

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

- The first line of defence is the business line management of the identification, management and mitigation of the risks associated with the products and processes of the business. This accountability includes regular testing and attestation of the adequacy and effectiveness of controls and compliance with the Banking Group's policies.

- The second line of defence is the Risk and Compliance function, responsible for the design and ownership of the Operational Risk Management Framework. It incorporates key processes including Risk and Control Self-Assessment (**RCSA**), incident management, independent evaluation of the adequacy and effectiveness of the internal control framework and the attestation process.

- The third line of defence is Internal Audit which is responsible for independently assessing how effectively the Banking Group is managing its risk according to its stated risk appetite.

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

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.

20 Enterprise risk management program (continued)

Interest rate risk

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

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

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

Counterparty Credit Risk

The Banking Group has on-going credit exposure associated with:

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

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

21 Credit risk exposure

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

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

To manage this risk the ERC oversees the formal credit risk management strategy. The ERC reviews the Banking Group's credit risk exposures typically on a monthly basis. The credit risk management strategies aim to ensure that:

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

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

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

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

21 Credit risk exposure (continued)

Reverse mortgage loans and negative equity risk

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

The Banking Group's exposure to negative equity risk is managed via lending standards specific for this product. In addition to usual criteria regarding the type, and location, of security property that the Banking Group will accept for reverse mortgage lending, a key aspect of the Banking Group's policy is that a borrower's age on origination of the reverse mortgage loan will dictate the loan-to-value ratio of the reverse mortgage on origination.

Business Finance Guarantee Scheme (BFGS)

In April 2020, the Bank along with other registered banks in New Zealand, entered into a Deed of Indemnity with the New Zealand Government to implement the New Zealand Government's Business Finance Guarantee Scheme (the **Scheme**). The purpose of the Scheme was to provide short term credit to eligible small and medium size businesses, who had been impacted by the economic effects of COVID-19. The Scheme allowed banks to lend to a maximum of $5 million for a five-year term. The New Zealand Government guaranteed 80% of any loss incurred (credit risk) with the Bank holding the remaining 20%. The Scheme concluded on 30 June 2021. As at 30 June 2023 the Bank had a total exposure of $54.8 million (2022: $64.8 million) to its customers under this Scheme.

Maximum exposure to credit risk at the relevant reporting dates

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

$000's	**June 2023**	**June 2022**
On balance sheet:		
Cash and cash equivalents	216,044	221,469
Investments	315,192	274,211
Finance receivables	3,954,800	3,762,231
Finance receivables - reverse mortgages	888,600	721,264
Derivative financial assets	36,982	44,487
Due from related parties	-	1,540
Other financial assets	1,050	175
Total on balance sheet credit exposures	**5,412,668**	**5,025,377**
Off balance sheet:		
Letters of credit, guarantee commitments and performance bonds	7,378	8,969
Undrawn facilities available to customers	310,423	272,735
Conditional commitments to fund at future dates	24,873	34,791
Total off balance sheet credit exposures	**342,674**	**316,495**
Total credit exposures	**5,755,342**	**5,341,872**

21 Credit risk exposure (continued)

Concentration of credit risk by geographic region

$000's	June 2023	June 2022
New Zealand	5,538,346	5,176,026
Australia	1,137	3,520
Rest of the world [1]	268,004	212,753
	5,807,487	**5,392,299**
Provision for impairment	(52,145)	(50,427)
Total credit exposures	**5,755,342**	**5,341,872**

[1] These overseas assets are primarily NZD-denominated investments in AA+ (Standard & Poor's) and high quality investment grade securities issued by offshore supranational agencies ("Kauri Bonds").

Concentration of credit risk by industry sector

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

$000's	June 2023	June 2022
Agriculture	781,065	747,618
Forestry and fishing	130,055	148,797
Mining	8,266	12,524
Manufacturing	80,729	78,432
Finance and insurance	722,404	685,938
Wholesale trade	46,053	41,986
Retail trade and accommodation	402,146	423,975
Households	2,432,860	2,134,097
Other business services	198,377	189,860
Construction	336,333	291,971
Rental, hiring and real estate services	205,079	199,388
Transport and storage	359,865	323,732
Other	104,255	113,981
	5,807,487	**5,392,299**
Provision for impairment	(52,145)	(50,427)
Total credit exposures	**5,755,342**	**5,341,872**

Credit exposures to connected persons

The Banking Group's methodology for calculating credit exposure concentrations is on the basis of actual credit exposures and calculated on a gross basis (net of individual credit impairment allowances and excluding advances of a capital nature) in accordance with the Bank's conditions of registration and the Reserve Bank's Connected Exposures Policy (**BS8**). Peak end-of-day credit exposures to non-bank connected persons are calculated using the Banking Group’s Tier 1 capital at the end of the reporting period.

21 Credit risk exposure (continued)

Credit exposures to connected persons (continued)

In accordance with its conditions of registration, the Banking Group's aggregate credit exposures to all connected persons must not exceed its rating contingent limit of 15% of tier one capital. Within the overall rating contingent limit, there is a sub-limit of 15% of tier one capital which applies to the aggregate credit exposures to non-bank connected persons. There have been no rating-contingent limit changes during the accounting period.

	As at June 2023	Peak End-of-Day for Year Ended June 2023
Credit exposures to connected persons ($000's)	-	2,660
As a percentage of Tier 1 capital of the Banking Group at end of the year (%)	0.00%	0.44%
Credit exposures to non-bank connected persons ($000's)	-	2,660
As a percentage of Tier 1 capital of the Banking Group at end of the year (%)	0.00%	0.44%

As at 30 June 2023, the Banking Group had no aggregate contingent exposures to connected persons arising from risk lay-off arrangements in respect of credit exposures to counterparties (excluding counterparties that are connected persons). The aggregate amount of the Banking Group's individual credit provisions provided against credit exposure to connected persons was nil at 30 June 2023.

Credit exposure to individual counterparties

The Banking Group's aggregate concentration of credit exposure to individual counterparties is calculated based on the actual credit exposure. Credit exposures to connected persons, the central government or central bank of any country with a long term credit rating of A- or A3 or above, or its equivalent, and any supranational or quasi-sovereign agency with a long-term credit rating of A- or A3 or above, or its equivalent are excluded.

The peak end-of-day aggregate concentration of credit exposure to individual counterparties has been calculated by determining the maximum end-of-day aggregate amount of credit exposure over the relevant six-month period and then dividing the amount by the Banking Group's common equity tier one capital as 30 June 2023.

	Number of Exposures As at June 2023	Number of Exposures Peak End-of-Day over 6 Months to June 2023
Exposures to banks		
With a long-term credit rating of A- or A3 or above, or its equivalent:		
10% to less than 15% of CET1 capital	-	-
15% to less than 20% of CET1 capital	1	2
20% to less than 25% of CET1 capital	1	1
25% to less than 30% of CET1 capital	-	-
With a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent	-	-
Exposures to non-banks		
Total number of exposures to non-banks that are greater than 10% to less than 15% of CET1 capital that do not have a long-term credit rating.	1	1

21 Credit risk exposure (continued)

Collateral held

The Banking Group employs a range of policies and practices to mitigate credit risk and has internal policies on the acceptability of specific classes of collateral. Collateral is held as security to support credit risk on finance receivables and enforced in satisfying the debt in the event contractual repayment obligations are not met. The collateral held for mitigating credit risk for the Banking Group's lending portfolios is outlined below.

Reverse mortgage and Residential mortgage loans
Reverse mortgage loans are secured by a first mortgage over a residential property which is typically a customer's primary residential dwelling, residential investment property or holiday home. Residential mortgage loans are secured by a residential mortgage over an owner-occupied property located in an approved urban area.

Corporate lending
Business lending including rural lending is typically secured by way of a charge over property and/or specific security agreement over relevant business assets, and, where considered appropriate, a general security agreement to provide the ability to control cash flows.

Other lending
Other lending comprises personal loans, primarily motor loans, which are secured by a motor vehicle or a boat; and other shorter term smaller personal loans which are predominantly unsecured.

The Banking Group analyses the coverage of the loan portfolio which is secured by the collateral it holds.

Coverage is measured by the value of security as a proportion of loan balance outstanding and classified as follows:

Fully secured	Greater or equal to 100%
Partially secured	1% - 99.9%
Unsecured	No security held

The Banking Group's loan portfolio have the following coverage from collateral held:

	Corporate	Residential	All Other
June 2023			
Fully Secured	91%	100%	73%
Partially Secured	4%	-	12%
Unsecured	5%	-	15%
Total	**100%**	**100%**	**100%**
June 2022			
Fully Secured	92%	100%	71%
Partially Secured	6%	-	14%
Unsecured	2%	-	15%
Total	**100%**	**100%**	**100%**

22 Asset quality

The disclosures in this note are categorised by the following credit risk concentrations:

Corporate Business lending including rural lending.

Residential Lending secured by a first ranking mortgage over a residential property used primarily for residential purposes either by the mortgagor or a tenant of the mortgagor.

All Other This relates primarily to consumer lending to individuals.

Information is not presented in respect of other financial assets or credit related contingent liabilities as the related allowances for ECL are not material to the Banking Group.

(a) Past due but not individually impaired

$000's	Corporate	Residential	All Other	Total
June 2023				
Less than 30 days past due	4,515	151	4,685	9,351
At least 30 but less than 60 days past due	31,739	-	12,358	44,097
At least 60 but less than 90 days past due	6,514	300	4,543	11,357
At least 90 days past due	35,775	401	36,162	72,338
Total past due but not individually impaired	**78,543**	**852**	**57,748**	**137,143**
June 2022				
Less than 30 days past due	4,147	171	3,249	7,567
At least 30 but less than 60 days past due	15,320	263	10,751	26,334
At least 60 but less than 90 days past due	4,621	85	5,071	9,777
At least 90 days past due	15,276	131	25,872	41,279
Total past due but not individually impaired	**39,364**	**650**	**44,943**	**84,957**

(b) Credit risk grading

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

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

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

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

22 Asset quality (continued)

(b) Credit risk grading (continued)

All loans past due but not impaired have been categorised into three impairments stages (refer to Note 22 – Asset quality (c)) 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.

	Collectively Assessed			Individually	
$000's	**Stage 1**	**Stage 2**	**Stage 3**	**Assessed**	**Total**
June 2023					
Judgemental portfolio					
Grade 1 - Very Strong	25	-	-	-	25
Grade 2 - Strong	3,658	-	-	-	3,658
Grade 3 - Sound	41,887	477	-	-	42,364
Grade 4 - Adequate	637,993	9,975	3,477	-	651,445
Grade 5 - Acceptable	1,016,113	5,492	602	-	1,022,207
Grade 6 - Monitor	-	64,946	6,763	-	71,709
Grade 7 - Substandard	-	76,955	13,725	-	90,680
Grade 8 - Doubtful	-	-	-	51,284	51,284
Grade 9 - At risk of loss	-	-	-	1,671	1,671
Total Judgemental portfolio	1,699,676	157,845	24,567	52,955	1,935,043
Total Behavioural portfolio	1,990,888	24,335	56,679	-	2,071,902
Gross finance receivables	**3,690,564**	**182,180**	**81,246**	**52,955**	**4,006,945**
Provision for impairment	(12,250)	(2,444)	(21,320)	(16,131)	(52,145)
Total finance receivables	**3,678,314**	**179,736**	**59,926**	**36,824**	**3,954,800**
Undrawn facilities available to customers	57,471	77,150	123,248	-	257,869
June 2022					
Judgemental portfolio					
Grade 1 - Very Strong	26	-	-	-	26
Grade 2 - Strong	10,859	-	-	-	10,859
Grade 3 - Sound	53,756	-	-	-	53,756
Grade 4 - Adequate	697,590	5,382	1,052	-	704,024
Grade 5 - Acceptable	994,079	1,823	53	-	995,955
Grade 6 - Monitor	-	25,106	2,308	-	27,414
Grade 7 - Substandard	-	64,203	4,727	-	68,930
Grade 8 - Doubtful	-	-	-	62,672	62,672
Grade 9 - At risk of loss	-	-	-	3,511	3,511
Total Judgemental portfolio	1,756,310	96,514	8,140	66,183	1,927,147
Total Behavioural portfolio	1,827,025	21,001	37,485	-	1,885,511
Gross finance receivables	**3,583,335**	**117,515**	**45,625**	**66,183**	**3,812,658**
Provision for impairment	(19,201)	(1,863)	(14,362)	(15,001)	(50,427)
Total finance receivables	**3,564,134**	**115,652**	**31,263**	**51,182**	**3,762,231**
Undrawn facilities available to customers	52,949	73,175	110,495	-	236,619

22 Asset quality (continued)

(c) Provision for impairment

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.

Exposures are assessed on a collective basis in each stage unless there is sufficient evidence that one or more events associated with an exposure could have a detrimental impact on estimated future cash flows. Where such evidence exists, the exposure is assessed on an individual basis.

For the purposes of a collective evaluation of impairment, finance receivables are grouped based on shared credit risk characteristics, credit risk ratings, contractual term, date of initial recognition, remaining term to maturity, customer type and other relevant factors.

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

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

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

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

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

Where there has been a significant increase in credit risk.

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

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

Credit quality of financial assets

The Banking Group internally computes probability of default using historical default data, to assess the potential risk of default of the lending, or other financial services products, provided to counterparties or customers. The Banking Group has defined counterparty probabilities of default across consumer, retail, business and rural portfolios.

The Banking Group considers a receivable to be in default when contractual payments are 90 days or more past due, or when it is considered unlikely that the credit obligation to the Banking Group will be paid in full without recourse to actions, such as realisation of security.

Finance receivables are written off against the related impairment allowance when there is no reasonable expectation of recovery. Any recoveries of amounts previously written off are credited to credit impairment expense in profit or loss.

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

The calculation of 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.

22 Asset quality (continued)

Policy (continued)

Credit quality of financial assets (continued)

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

Modification of contractual cash flows

The Banking Group sometimes modifies the terms of loans provided to customers due to commercial re-negotiations, or for distressed loans, with a view to maximising recovery.

Such restructuring activities include extended payment term arrangements, payment holidays and payment forgiveness. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue.

These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

The Banking Group's models for estimating ECL for each of its portfolios are based on the historic credit experience of those portfolios. The models assume that economic conditions remain static over time. If the Banking Group forecasts that economic conditions may change in the foreseeable future, the Banking Group applies judgement to determine whether the modelled output should be subject to an economic overlay. Judgement is required to establish clear correlation between key economic indicators and the credit performance of the Banking Group's unique portfolios.

The most significant and judgemental provision for impairment is on motor vehicle lending with a collective ECL of $15.1 million at 30 June 2023 (2022: $9.5 million). There are fewer judgements on the other remaining lending portfolios.

The motor vehicle lending impairment allowance is sensitive to changes in the level of unemployment. The modelled provision for motor vehicle lending is a probability weighted estimate based on three scenarios. The forecast of unemployment across all three scenarios uses consensus external data obtained from external economic experts.

The forecast assumes the following for unemployment for all three scenarios:

	2024	2025	2026
Upside	4.00%	4.80%	4.40%
Central	4.60%	5.20%	5.00%
Downside	5.96%	6.13%	5.70%

The probability weights assigned to each scenario are based on management's estimate of their relative likelihood. The following table indicates the weightings applied by the Banking Group as at 30 June 2023:

Upside	15%
Central	50%
Downside	35%

The following sensitivity table shows the provision for impairment based on the probability weighted scenarios and what the impairment allowance for motor vehicle lending would be assuming a 100% weighting is applied to the three scenarios with all other assumptions held constant.

Reported probability weighted impairment allowance	$15.1 million
100% Upside	$9.7 million
100% Central	$12.4 million
100% Downside	$21.2 million

22 Asset quality (continued)

(c) Provision for impairment (continued)

$000's	Collectively Assessed Stage 1	Collectively Assessed Stage 2	Stage 3	Individually Assessed	Total
June 2023					
Corporate					
Impairment allowance as at 30 June 2022	**19,353**	**901**	**4,941**	**15,001**	**40,196**
Changes in loss allowance					
Transfer between stages[1]	(7,738)	(1,940)	1,346	8,332	-
New and increased provision (net of provision releases)[1]	(526)	2,376	4,653	4,701	11,204
Credit impairment charge	**(8,264)**	**436**	**5,999**	**13,033**	**11,204**
Write-offs	-	-	(2,410)	(11,903)	(14,313)
Impairment allowance as at 30 June 2023	**11,089**	**1,337**	**8,530**	**16,131**	**37,087**
Residential					
Impairment allowance as at 30 June 2022	**115**	**-**	**-**	**-**	**115**
Changes in loss allowance					
Transfer between stages[1]	-	-	-	-	-
New and increased provision (net of provision releases)[1]	12	-	-	-	12
Credit impairment charge	**12**	**-**	**-**	**-**	**12**
Write-offs	-	-	-	-	-
Impairment allowance as at 30 June 2023	**127**	**-**	**-**	**-**	**127**
All Other					
Impairment allowance as at 30 June 2022	**(267)**	**966**	**9,417**	**-**	**10,116**
Changes in loss allowance					
Transfer between stages[1]	(459)	(1,883)	2,342	-	-
New and increased provision (net of provision releases)[1]	1,760	2,028	9,786	-	13,574
Credit impairment charge	**1,301**	**145**	**12,128**	**-**	**13,574**
Write-offs	-	-	(8,759)	-	(8,759)
Impairment allowance as at 30 June 2023	**1,034**	**1,111**	**12,786**	**-**	**14,931**
Total					
Impairment allowance as at 30 June 2022	**19,201**	**1,863**	**14,362**	**15,001**	**50,427**
Changes in loss allowance					
Transfer between stages[1]	(8,197)	(3,823)	3,688	8,332	-
New and increased provision (net of provision releases)[1]	1,246	4,404	14,439	4,701	24,790
Credit impairment charge	**(6,951)**	**581**	**18,127**	**13,033**	**24,790**
Write-offs	-	-	(11,169)	(11,903)	(23,072)
Impairment allowance as at 30 June 2023	**12,250**	**2,444**	**21,320**	**16,131**	**52,145**

[1] The increase in provision when a loan moves to a higher stage is included in New and increased provision (net of provision releases) in the higher stage to which the loan moved. The decrease in provision when a loan moves to a lower stage is included in New and increased provision (net of provision releases) in the higher stage from which the loan moved.

22 Asset quality (continued)

(c) Provision for impairment (continued)

$000's	Collectively Assessed Stage 1	Stage 2	Stage 3	Individually Assessed	Total
June 2022					
Corporate					
Impairment allowance as at 30 June 2021	**16,586**	**1,218**	**4,844**	**7,629**	**30,277**
Changes in loss allowance					
Transfer between stages[1]	(3,614)	(1,060)	(601)	5,275	-
New and increased provision (net of provision releases)[1]	6,381	739	4,164	5,507	16,791
Credit impairment charge	**2,767**	**(321)**	**3,563**	**10,782**	**16,791**
Write-offs	-	-	(3,462)	(3,410)	(6,872)
Impairment allowance as at 30 June 2022	**19,353**	**897**	**4,945**	**15,001**	**40,196**
Residential					
Impairment allowance as at 30 June 2021	**88**	**-**	**-**	**-**	**88**
Changes in loss allowance					
Transfer between stages	-	-	-	-	-
New and increased provision (net of provision releases)[1]	27	-	-	-	27
Credit impairment charge	**27**	**-**	**-**	**-**	**27**
Write-offs	-	-	-	-	-
Impairment allowance as at 30 June 2022	**115**	**-**	**-**	**-**	**115**
All Other					
Impairment allowance as at 30 June 2021	**7,758**	**1,138**	**11,787**	**-**	**20,683**
Changes in loss allowance					
Transfer between stages[1]	(192)	(1,440)	1,632	-	-
New and increased provision (net of provision releases)[1]	(7,833)	1,268	7,194	-	629
Credit impairment charge	**(8,025)**	**(172)**	**8,826**	**-**	**629**
Write-offs	-	-	(11,196)	-	(11,196)
Impairment allowance as at 30 June 2022	**(267)**	**966**	**9,417**	**-**	**10,116**
Total					
Impairment allowance as at 30 June 2021	**24,432**	**2,356**	**16,631**	**7,629**	**51,048**
Changes in loss allowance					
Transfer between stages[1]	(3,806)	(2,500)	1,031	5,275	-
New and increased provision (net of provision releases)[1]	(1,425)	2,007	11,358	5,507	17,447
Credit impairment charge	**(5,231)**	**(493)**	**12,389**	**10,782**	**17,447**
Write-offs	-	-	(14,658)	(3,410)	(18,068)
Impairment allowance as at 30 June 2022	**19,201**	**1,863**	**14,362**	**15,001**	**50,427**

[1] The increase in provision when a loan moves to a higher stage is included in New and increased provision (net of provision releases) in the higher stage to which the loan moved. The decrease in provision when a loan moves to a lower stage is included in New and increased provision (net of provision releases) in the higher stage from which the loan moved.

22 Asset quality (continued)

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

$000's	Collectively Assessed Stage 1	 Stage 2	 Stage 3	Individually Assessed	 Total
June 2023					
Corporate					
Gross finance receivables as at 30 June 2022	**2,289,350**	**99,514**	**21,306**	**66,183**	**2,476,353**
Transfer between stages	(180,762)	139,860	29,179	11,723	-
Additions	711,378	-	-	9,326	720,704
Deletions	(509,932)	(80,418)	(2,685)	(15,194)	(608,229)
Write-offs	-	-	(3,091)	(19,083)	(22,174)
Gross finance receivables as at 30 June 2023	**2,310,034**	**158,956**	**44,709**	**52,955**	**2,566,654**
Residential					
Gross finance receivables as at 30 June 2022	**285,844**	-	-	-	**285,844**
Transfer between stages	-	-	-	-	-
Additions	42,721	-	-	-	42,721
Deletions	(6,079)	-	-	-	(6,079)
Write-offs	-	-	-	-	-
Gross finance receivables as at 30 June 2023	**322,486**	**-**	**-**	**-**	**322,486**
All Other					
Gross finance receivables as at 30 June 2022	**1,008,141**	**18,001**	**24,319**	**-**	**1,050,461**
Transfer between stages	(56,358)	21,943	34,415	-	-
Additions	642,266	-	-	-	642,266
Deletions	(536,005)	(16,720)	(14,046)	-	(566,771)
Write-offs	-	-	(8,151)	-	(8,151)
Gross finance receivables as at 30 June 2023	**1,058,044**	**23,224**	**36,537**	**-**	**1,117,805**
Total					
Gross finance receivables as at 30 June 2022	**3,583,335**	**117,515**	**45,625**	**66,183**	**3,812,658**
Transfer between stages	(237,120)	161,803	63,594	11,723	-
Additions	1,396,365	-	-	9,326	1,405,691
Deletions	(1,052,016)	(97,138)	(16,731)	(15,194)	(1,181,079)
Write-offs	-	-	(11,242)	(19,083)	(30,325)
Gross finance receivables as at 30 June 2023	**3,690,564**	**182,180**	**81,246**	**52,955**	**4,006,945**

22 Asset quality (continued)

(d) Impact of changes in gross finance receivables held at amortised cost on allowance for ECL (continued)

	Collectively Assessed			Individually	
$000's	**Stage 1**	**Stage 2**	**Stage 3**	**Assessed**	**Total**
June 2022					
Corporate					
Gross finance receivables as at 30 June 2021	**1,897,900**	**158,218**	**27,565**	**38,143**	**2,121,826**
Transfer between stages	(72,300)	13,380	3,526	55,394	-
Additions	1,326,598	-	-	3,002	1,329,600
Deletions	(862,848)	(72,084)	(7,191)	(26,946)	(969,069)
Write-offs	-	-	(2,594)	(3,410)	(6,004)
Gross finance receivables as at 30 June 2022	**2,289,350**	**99,514**	**21,306**	**66,183**	**2,476,353**
Residential					
Gross finance receivables as at 30 June 2021	**62,534**	**-**	**-**	**-**	**62,534**
Transfer between stages	-	-	-	-	-
Additions	242,672	-	-	-	242,672
Deletions	(19,362)	-	-	-	(19,362)
Write-offs	-	-	-	-	-
Gross finance receivables as at 30 June 2022	**285,844**	**-**	**-**	**-**	**285,844**
All Other					
Gross finance receivables as at 30 June 2021	**1,056,137**	**6,510**	**17,634**	**-**	**1,080,281**
Transfer between stages	(36,751)	11,491	25,260	-	-
Additions	489,911	-	-	-	489,911
Deletions	(501,156)	-	(6,150)	-	(507,306)
Write-offs	-	-	(12,425)	-	(12,425)
Gross finance receivables as at 30 June 2022	**1,008,141**	**18,001**	**24,319**	**-**	**1,050,461**
Total					
Gross finance receivables as at 30 June 2021	**3,016,571**	**164,728**	**45,199**	**38,143**	**3,264,641**
Transfer between stages	(109,051)	24,871	28,786	55,394	-
Additions	2,059,181	-	-	3,002	2,062,183
Deletions	(1,383,366)	(72,084)	(13,341)	(26,946)	(1,495,737)
Write-offs	-	-	(15,019)	(3,410)	(18,429)
Gross finance receivables as at 30 June 2022	**3,583,335**	**117,515**	**45,625**	**66,183**	**3,812,658**

Impact of changes in gross exposures on loss allowances - Corporate exposures
Overall credit impairment provisions for corporate exposures decreased by $3.1 million (7.7%) for the year ended 30 June 2023, mainly due to increase in the corporate exposure portfolio of $90.3 million (3.6%) which was partially offset by the release of provisions previously held against assets written off during the year.

Impact of changes in gross exposures on loss allowances – All other exposures
Overall credit impairment provisions for All other exposures increased by $4.8 million (47.6%) for the year ended 30 June 2023, mainly due to increase in the All other portfolio of $67.4 million (6.4%) and movement of exposures into more advanced stages. This is offset by reduction in loss given default from more effective arrears management.

(e) Other asset quality information

As at 30 June 2023 there were nil undrawn lending commitments available to counterparties for whom drawn balances are classified as individually impaired (2022: $0.003 million). As at 30 June 2023, the Banking Group had $0.349 million assets under administration (2022: $1.015 million).

As at 30 June 2023, the contractual amount outstanding on loans to customers written off during the year and are still subject to enforcement activity was nil (2022:nil).

23 Liquidity risk

Liquidity risk is the risk that the Banking Group is unable to meet its payment obligations as they fall due. The timing mismatch of cash flows and the related liquidity risk in all banking operations 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 observe. Within 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 ALCO employs asset and liability cash flow modelling to determine appropriate liquidity and funding strategies.

Reserve Bank of New Zealand facilities

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

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

$000's	June 2023	June 2022
Cash and cash equivalents	216,044	221,469
Investments	315,192	274,211
Total liquid assets	**531,236**	**495,680**
Undrawn committed bank facilities	172,946	132,221
Total liquid assets and committed undrawn funding	**704,182**	**627,901**

23 Liquidity risk (continued)

Contractual liquidity profile of financial liabilities

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

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

$000's	On Demand	0-6 Months	6-12 Months	1-2 Years	2-5 Years	5+ Years	Total
June 2023							
Non-derivative financial liabilities							
Deposits	782,775	2,313,983	1,015,525	62,618	42,186	-	4,217,087
Other borrowings	-	184,397	138,217	237,138	22,551	136,274	718,577
Due to related parties	-	7,173	-	-	-	-	7,173
Lease liabilities	-	1,356	1,368	2,643	6,615	2,731	14,713
Other financial liabilities	-	40,963	-	-	-	-	40,963
Total non-derivative financial liabilities	**782,775**	**2,547,872**	**1,155,110**	**302,399**	**71,352**	**139,005**	**4,998,513**
Derivative financial liabilities							
Inflows from derivatives	-	3,583	3,552	4,799	13,469	-	25,403
Outflows from derivatives	-	6,644	6,796	5,773	13,125	-	32,338
Total derivative financial liabilities	**-**	**3,061**	**3,244**	**974**	**(344)**	**-**	**6,935**
Undrawn facilities available to customers	310,423	-	-	-	-	-	310,423
June 2022							
Non-derivative financial liabilities							
Deposits	892,612	2,028,225	561,468	103,192	41,655	-	3,627,152
Other borrowings	-	368,926	7,251	397,859	-	-	774,036
Due to related parties	-	1,535	-	-	-	-	1,535
Lease liabilities	-	1,282	1,292	2,615	6,985	4,911	17,085
Other financial liabilities	-	47,510	-	-	-	-	47,510
Total non-derivative financial liabilities	**892,612**	**2,447,478**	**570,011**	**503,666**	**48,640**	**4,911**	**4,467,318**
Derivative financial liabilities							
Inflows from derivatives	-	5,007	1,759	3,505	813	-	11,084
Outflows from derivatives	-	3,893	3,227	6,621	839	-	14,580
Total derivative financial liabilities	**-**	**(1,114)**	**1,468**	**3,116**	**26**	**-**	**3,496**
Undrawn facilities available to customers	272,735	-	-	-	-	-	272,735

24 Interest rate risk

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

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

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

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

An analysis of the Banking Group’s sensitivity to an increase (+) or decrease (-) in market interest rates by 100 basis points (**BP**) is as follows. An (+)/(-) to market interest rates of 100 BP would result in a $0.2 million (+)/(-) to NPAT (2022: $0.7 million (+)/(-)) with a corresponding impact to equity.

The Banking Group also manages interest rate risk by:

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

24 Interest rate risk (continued)

Contractual repricing analysis

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

$000's	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2+ Years	Non-Interest Bearing	Total
June 2023							
Financial assets							
Cash and cash equivalents	216,040	-	-	-	-	4	216,044
Investments	29,828	24,963	37,767	55,460	167,174	1,819	317,011
Derivative financial assets	-	-	-	-	-	36,982	36,982
Finance receivables	1,675,775	302,005	520,923	766,532	689,565	-	3,954,800
Finance receivables - reverse mortgages	888,600	-	-	-	-	-	888,600
Other financial assets	-	-	-	-	-	1,050	1,050
Total financial assets	**2,810,243**	**326,968**	**558,690**	**821,992**	**856,739**	**39,855**	**5,414,487**
Financial liabilities							
Deposits	2,259,258	795,536	962,205	59,026	35,216	19,788	4,131,029
Other borrowings	345,859	49,598	121,195	-	98,474	-	615,126
Derivative financial liabilities	-	-	-	-	-	7,624	7,624
Due to related parties	-	-	-	-	-	7,173	7,173
Lease liabilities	-	-	-	-	-	13,478	13,478
Other financial liabilities	-	-	-	-	-	40,963	40,963
Total financial liabilities	**2,605,117**	**845,134**	**1,083,400**	**59,026**	**133,690**	**89,026**	**4,815,393**
Effect of derivatives held for risk management	1,084,971	(66,798)	(41,181)	(556,676)	(420,316)	-	-
Net financial assets/(liabilities)	**1,290,097**	**(584,964)**	**(565,891)**	**206,290**	**302,733**	**(49,171)**	**599,094**

24 Interest rate risk (continued)

Contractual repricing analysis (continued)

$000's	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2+ Years	Non-Interest Bearing	Total
June 2022							
Financial assets							
Cash and cash equivalents	221,460	-	-	-	-	9	221,469
Investments	1,568	854	51,144	91,974	128,672	1,502	275,714
Derivative financial assets	-	-	-	-	-	44,487	44,487
Finance receivables	1,736,646	185,858	334,715	576,037	928,975	-	3,762,231
Finance receivables - reverse mortgages	721,264	-	-	-	-	-	721,264
Due from related parties	-	-	-	-	-	1,540	1,540
Other financial assets	-	-	-	-	-	175	175
Total financial assets	**2,680,938**	**186,712**	**385,859**	**668,011**	**1,057,647**	**47,713**	**5,026,880**
Financial liabilities							
Deposits	2,201,740	684,378	546,718	99,196	38,325	26,787	3,597,144
Other borrowings	548,488	78,911	-	121,191	-	888	749,478
Derivative financial liabilities	-	-	-	-	-	6,335	6,335
Due to related parties	-	-	-	-	-	1,535	1,535
Lease liabilities	-	-	-	-	-	15,726	15,726
Other financial liabilities	-	-	-	-	-	47,510	47,510
Total financial liabilities	**2,750,228**	**763,289**	**546,718**	**220,387**	**38,325**	**98,781**	**4,417,728**
Effect of derivatives held for risk management	986,194	(76,349)	(127,004)	(309,781)	(473,060)	-	-
Net financial assets/(liabilities)	**916,904**	**(652,926)**	**(287,863)**	**137,843**	**546,262**	**(51,068)**	**609,152**

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

25 Concentrations of funding

(a) Regulatory liquidity ratios (unaudited)

RBNZ requires banks to hold minimum amounts of liquid assets to help ensure that they are effectively managing their liquidity risks. The mismatch ratio is a measure of a bank's liquid assets, adjusted for contractual cash inflows and outflows during a one-month or one-week period of stress. It is expressed as a ratio over the bank's total funding. The Banking Group must maintain its one-month and one-week mismatch ratios above zero on a daily basis. The below one-month and one-week mismatch ratios are averaged over the quarter.

RBNZ requires banks to hold a minimum amount of funding from stable sources called core funding. The minimum amount of core funding is 75% of a bank's total loans. The Banking Group must maintain its core funding ratio above the regulatory minimum on a daily basis. The below measure of the core funding ratio is averaged over the quarter.

	Average for the 3 Months Ended 30 June 2023	Average for the 3 Months Ended 31 March 2023
One-week mismatch ratio	8.29	8.69
One-month mismatch ratio	7.96	8.42
Core funding ratio	90.32	90.17

25 Concentrations of funding (continued)

(b) Concentration of funding by industry

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

$000's	June 2023	June 2022
Agriculture	113,341	113,848
Forestry and fishing	21,944	14,391
Mining	291	1,524
Manufacturing	19,185	18,643
Finance and insurance	1,009,291	960,175
Wholesale trade	7,634	5,854
Retail trade and accommodation	25,136	19,491
Households	3,215,828	2,754,452
Rental, hiring and real estate services	59,720	43,797
Construction	36,868	28,449
Other business services	66,763	66,731
Transport and storage	7,807	4,598
Other	40,182	41,686
Total	**4,623,990**	**4,073,639**
Unsubordinated notes	122,165	272,983
Total borrowings	**4,746,155**	**4,346,622**

(c) Concentration of funding by geographical area

$000's	June 2023	June 2022
New Zealand	4,634,937	4,241,026
Overseas	111,218	105,596
Total borrowings	**4,746,155**	**4,346,622**

Other Disclosures

26 Significant subsidiaries

Significant Subsidiaries	Country of Incorporation and Place of business	Nature of business	Proportion of ownership and voting power held June 2023	June 2022
VPS Properties Limited	New Zealand	Investment property holding company	100%	100%
Marac Insurance Limited	New Zealand	Insurance services	100%	100%

27 Structured entities

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

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

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

$000's	June 2023	June 2022
Deposits	244,258	149,824

(b) Heartland Auto Receivable Warehouse Trust 2018-1 (HARWT)

HARWT securitises motor vehicle loan receivables as a source of funding.

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

$000's	June 2023	June 2022
Cash and cash equivalents	16,874	20,197
Finance receivables	254,735	312,239
Other borrowings	(258,256)	(315,308)

28 Capital adequacy - unaudited

The Reserve Bank of New Zealand (**RBNZ**) minimum regulatory capital requirements for banks have been established under the RBNZ Capital Adequacy Framework, outlined in the "Banking Prudential Requirements" (**BPRs**) documents. These documents are based on the international framework developed by the Bank for Internal Settlements Committee on Banking Supervision, commonly known as Basel III. These requirements define what is acceptable as capital and provide methods for measuring risks incurred by the banks in New Zealand. Basel III consists of three pillars:

- Pillar One covers the capital requirements for banks for credit, operational, and market risks;
- Pillar Two covers all other material risks not already included in Pillar One; and
- Pillar Three relates to market disclosure.

RBNZ Capital Adequacy Framework

The Banking Group has calculated its Risk Weighted Exposures (**RWEs**) and minimum regulatory capital requirements in accordance with the BPR documents. In doing so, the Banking Group has applied the standardised methodology to Risk Weighted Assets (**RWAs**) as per BPR 131: Standardised credit RWA's, standardised operational risk as per BPR150: Standardised Operational risk, and market risk as per BPR140: Market Risk.

Total regulatory capital is divided into Tier 1 and Tier 2 capital. Tier 1 capital comprises Common Equity Tier 1 (**CET1**) capital and Additional Tier 1 (**AT1**) capital. Tier 1 capital primarily consists of shareholder's equity and other capital instruments acceptable to the RBNZ as per BPR110: Capital Definitions, less intangible assets, cash flow hedge reserves, deferred tax assets, and other prescribed deductions. Tier 2 as per BPR110: Capital Definitions comprises eligible subordinated debt securities.

Regulatory capital adequacy ratios are calculated by expressing capital as a percentage of risk weighted exposures. As a Condition of Registration, the Bank must comply with the following minimum requirements set by the RBNZ:

- Total capital must not be less than 8% of RWE
- Tier 1 capital must not be less than 6% of RWE
- CET1 capital must not be less than 4.5% of RWE
- Capital must not be less than NZ$30m

In addition, if the Prudential Buffer Ratio (**PCR**) is less than 2.5%, the Bank must limit aggregate distributions, other than discretionary payments payable to holders of AT1 capital instruments, to the limits set out within the Banks Conditions of Registration.

Including the PCR, the Banking Group's minimum total capital requirement is 10.5%. On 5 December 2019 the RBNZ finalised their revised Capital Framework for banks which were not domestic systematically important banks (**non D-SIB**). This requires non D-SIB banks in New Zealand to gradually increase their Total Capital ratio to 16% by July 2028. The Banking Group's Total Capital ratio is 14.69% as at 30 June 2023. This means the revised Framework requires the Banking Group to increase its Total Capital ratio by 1.31% over the transitional period.

Capital management

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's objectives for the management of capital are to:

- Comply at all times with the regulatory capital requirements set by the RBNZ;
- Maintain a strong capital base to cover the inherent risks of the business in excess of that required by credit ratings agencies to maintain a strong credit rating; and
- Support the future development and growth of the business.

The Bank's Capital Management Framework includes its:

- Internal Capital Adequacy Assessment Process (**ICAAP**);
- Capital Stress Testing Policy; and
- Capital Management Plan (**CMP**)

28 Capital adequacy (continued) - unaudited

Capital management (continued)

The Banking Group has an ICAAP which complies with the requirements set out in BPR100 and is in accordance with its Conditions of Registration. 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 which is assisted through stress testing conducted in accordance with the Capital Stress Testing policy.

The Banking Group actively monitors its capital adequacy through ALCO and reports this on a regular basis to the Board. This includes forecasting capital requirements to ensure any future capital requirements can be executed in a timely manner. The Banking Group uses a mix of capital instruments to reduce single source reliance and to optimise the Banking Group's mix of capital. ICAAP, CMP and Capital Stress Testing Policy are reviewed annually by the Board.

The capital adequacy tables set out below summarise the composition of regulatory capital and the capital adequacy ratios for the Banking group for the year ended 30 June 2023.

(a) Capital

$000's	June 2023
Tier 1 Capital	
CET1 capital	
Paid-up ordinary shares issued by the Banking Group plus related share premium	553,239
Retained earnings (net of appropriations)	162,354
Accumulated other comprehensive income and other disclosed reserves	13,143
Less deductions from CET1 capital	
Intangible assets	(71,650)
Deferred tax assets	(16,760)
Cash flow hedge reserve	(14,710)
Total CET1 capital	**625,616**
AT1 capital	-
Total Tier 1 capital	**625,616**
Tier 2 Capital	
Tier 2 capital instrument[1]	100,000
Total Tier 2 capital	**100,000**
Total capital	**725,616**

[1] Classified as a liability under NZ GAAP and excludes capitalised transaction costs.

(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 BPR110, ordinary share capital is classified as CET1 capital. The ordinary shares have no par value. Each ordinary share of the Bank carries the right to vote on a poll at meetings of shareholders, the right to an equal share in dividends authorised by the Board and the right to an equal share in the distribution of the surplus assets of the Bank in the event of liquidation.

28 Capital adequacy (continued) - unaudited

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 fair value reserve comprises the changes in the fair value of investments, net of tax.
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.

Tier 2 capital

Subordinated notes

A summary of the key terms and features of the subordinated notes is provided below:

Issuer	The Bank
Face value	$100 million
Issue date	28 April 2023
Maturity date	28 April 2033
Optional redemption	28 April 2028 and every quarterly interest payment date thereafter
Interest rate	Fixed at 7.51% for the first five years, thereafter, resets to quarterly floating rate equal to the sum of the applicable 3-month Bank Bill Rate plus 3.2% per annum.

Interest payable
The quarterly payment of interest in respect of the subordinated notes of the Bank are subject to the Bank being solvent at the time of, and immediately following the interest payment.

Early redemption
The Bank may choose to repay all or some of the subordinated notes for their face value together with accrued interest (if any) on 28 April 2028 or any interest payment date thereafter. Early redemption of all the subordinated notes for certain tax or regulatory events is permitted on an interest payment date. Early redemption is subject to certain conditions, including the Bank obtaining the RBNZ prior written approval and the Bank being solvent at the time.

Ranking
In a liquidation of the Bank, the claims of the holders of the subordinated notes will rank:

- Behind the claims of all depositors and other creditors of the Bank;
- equally with the claims of other holders of any other securities and obligations that rank equally with the subordinated notes; and
- ahead of the rights of the Bank's shareholders and holders of any other securities and obligations of the Bank that rank behind the subordinated notes.

28 Capital adequacy (continued) - unaudited

(c) Credit risk

On balance sheet exposures

	Total Exposure After Credit Risk Mitigation $000's	Average Risk Weight %	Risk Weighted Exposure $000's	Minimum Pillar 1 Capital Requirement $000's
June 2023				
Cash	-	0%	-	-
Sovereigns and central banks	275	0%	-	-
Multilateral development banks	174,274	0%	-	-
Multilateral development banks	89,834	20%	17,967	1,437
Banks - Short term - Tier 1	-	20%	-	-
Banks - Short term - Tier 2	216,044	20%	43,209	3,457
Banks - Short term - Tier 3	-	20%	-	-
Banks - Long term - Tier 1	-	20%	-	-
Banks - Long term - Tier 2	41,203	50%	20,601	1,648
Banks - Long term - Tier 3	-	50%	-	-
Public sector entity (AA- and above)	9,882	20%	1,976	158
Public sector entity (A- and above)	-	50%	-	-
Public sector entity (BBB+, BBB, BBB-)	-	100%	-	-
Corporates (AA- and above)	-	20%	-	-
Corporates (A- and above)	-	50%	-	-
Corporates (BBB- and above)	-	100%	-	-
Corporate Exposures - BFGS	41,022	20%	8,204	656
Corporate Exposures- unrated	2,082,338	100%	2,082,338	166,587
Welcome Home Loans - loan to value ratio (LVR) <= 80%[1]	1,265	35%	443	35
Welcome Home Loans - loan to value ratio (LVR) <= 90%[1]	-	35%	-	-
Welcome Home Loans - LVR 90% <= 100%[1]	-	50%	-	-
Welcome Home Loans - LVR > 100%[1]	-	100%	-	-
Reverse Residential mortgages <= 60% LVR	879,382	50%	439,691	35,175
Reverse Residential mortgages 60 <= 80% LVR	9,218	80%	7,374	590
Reverse Residential mortgages > 80% LVR	-	100%	-	-
Reverse Residential mortgages > 100% LVR	-	100%	-	-
Non Property Investment Mortgage Loan <=80% LVR	318,450	35%	111,458	8,917
Non Property Investment Mortgage Loan 80 <= 90% LVR	-	50%	-	-
Non Property Investment Mortgage Loan 90 <= 100% LVR	727	75%	545	44
Non Property Investment Mortgage Loan > 100% LVR	-	100%	-	-
Property Investment Mortgage Loan <= 80% LVR	1,639	40%	655	52
Property Investment Mortgage Loan 80 <= 90% LVR	-	70%	-	-
Property Investment Mortgage Loan 90 <= 100% LVR	-	90%	-	-
Property Investment Mortgage Loan > 100% LVR	-	100%	-	-
Past due residential mortgages	278	100%	278	22
Other past due assets - provision >= 20%	42,398	100%	42,398	3,392
Other past due assets - provision < 20%	37,562	150%	56,344	4,508
Equity holdings	-	300%	-	-
All other equity holdings	1,804	400%	7,215	577
Fixed Assets	13,027	100%	13,027	1,042
Leased Assets	11,510	100%	11,510	921
Other assets	1,464,284	100%	1,464,284	117,143
Not risk weighted assets	88,410	0%	-	-
Total on balance sheet exposures	**5,524,826**		**4,329,517**	**346,361**

[1] The LVR classification above is calculated in line with the Bank's Pillar 1 Capital requirement which includes relief for Welcome Home loans that are guaranteed by the Crown.

28 Capital adequacy (continued) - unaudited

(c) Credit risk (continued)

Off balance sheet exposures

	Total Exposure $000's	Credit Conversion Factor %	Credit Equivalent Amount $000's	Risk Weight %	Risk Weighted Exposure $000's	Minimum Pillar 1 Capital Requirement $000's
June 2023						
Direct credit substitute	3,897	100%	3,897	100%	3,897	312
Performance-related contingency	3,480	50%	1,740	100%	1,740	139
Other commitments where original maturity is more than one year	165,874	50%	82,937	100%	82,937	6,635
Other commitments where original maturity is more than one year	42,393	50%	21,197	35%	7,419	594
Other commitments where original maturity is less than or equal to one year	73,237	20%	14,647	100%	14,647	1,172
Other commitments where original maturity is less than or equal to one year	52,554	20%	10,511	50%	5,256	420
Other commitments where original maturity is less than or equal to one year	1,238	20%	248	35%	87	7
Counterparty credit risk[1]						
Interest rate contracts	1,653,918	N/A	35,198	34%	11,965	957
FX forward contracts	-	N/A	-	0%	-	-
Total off balance sheet exposures	**1,996,591**		**170,375**		**127,948**	**10,236**
Credit valuation adjustment	-		-		13,969	1,118
Total off balance sheet exposures	**1,996,591**		**170,375**		**141,917**	**11,354**

[1] The credit equivalent amount was calculated using the current exposure method.

(d) Additional mortgage information – LVR range

$000's	On Balance Sheet Exposures	Off Balance Sheet Exposures[2]	Total Exposures
June 2023			
Does not exceed 80%	1,209,954	94,848	1,304,802
Exceeds 80% and not 90%	-	-	-
Exceeds 90%	1,005	-	1,005
Total exposures	**1,210,959**	**94,848**	**1,305,807**

[2] Off balance sheet exposures means unutilised limits.

At 30 June 2023, there were no Welcome Home loans whose credit risk is mitigated by the Crown included in “Exceeds 90% residential mortgages”. Other loans in the exceeds 90% LVR range is primarily business and rural lending where residential mortgage security is only a part of the total security. For capital adequacy calculations only the value of the first mortgages over residential property is included in the LVR calculation, in accordance with BPR131. All new residential mortgages in respect of non-property investments lending have a loan-to-valuation ratio of less than or equal to 80%.

28 Capital adequacy (continued) - unaudited

(e) Reconciliation of mortgage related amounts

$000's	Note	June 2023
Gross finance receivables - reverse mortgages	19	888,600
Loans and advances - loans with residential mortgages	22d	322,486
On balance sheet residential mortgage exposures subject to the standardised approach		**1,211,086**
Less: collective provision for impairment	22c	(127)
On balance sheet residential mortgage exposures after collective provision	28d	**1,210,959**
Off balance sheet mortgage exposures subject to the standardised approach	28d	94,848
Total residential exposures subject to the standardised approach		**1,305,807**

(f) Credit risk mitigation

As at 30 June 2023 the Banking Group had $1.3 million of Welcome Home Loans (2022: $1.6 million), whose credit risk was mitigated by the Crown. Other than this the Banking Group does not have any exposures covered by eligible collateral, guarantees and credit derivatives.

(g) Operational risk

$000's	Implied Risk Weighted Exposure	Total Operational Risk Capital Requirement
June 2023		
Operational risk	300,483	24,039

Operational risk is calculated based on the previous 12 quarters of the Banking Group.

(h) Market risk

Market risk is the risk that market interest rates or foreign exchange rates will change and impact on the Banking Group's earnings due to either mismatches between repricing dates of interest bearing assets and liabilities and/or differences between customer pricing and wholesale rates.

$000's	Implied Risk Weighted Exposure	Aggregate Capital Charge
June 2023		
Market risk end-of-period capital charge		
Equity risk	1,804	144
Interest rate risk	159,466	12,757
Foreign currency risk	48	4
Market risk peak end-of-period capital charge		
Equity risk	1,804	144
Interest rate risk	159,466	12,757
Foreign currency risk	223	18

The Banking Group's aggregate market exposure is derived in accordance with BPR140. Peak end-of-day capital charge disclosure is derived by taking the highest month end market exposure over the six months ended 30 June 2023. Interest rate risk, foreign exchange risk and equity risk are calculated monthly using the month end position. The Banking Group has investigated the impact of daily aggregate market risk exposure. Certain identified system limitations that cause anomalous results are being addressed so that a satisfactory future daily peak period exposure can be obtained.

28 Capital adequacy (continued) - unaudited

(i) Total capital requirement

$000's	Total Exposure After Credit Risk Mitigation	Risk Weighted Exposure or Implied Risk Weighted Exposure	Total Capital Requirement
June 2023			
Total credit risk			
On balance sheet	5,524,826	4,329,517	346,361
Off balance sheet	1,996,591	141,917	11,354
Operational risk	n/a	300,483	24,039
Market risk	n/a	161,318	12,901
Total	**7,521,417**	**4,933,235**	**394,655**

(j) Capital ratios

%	June 2023	June 2022
Capital ratios compared to minimum ratio requirements		
Common Equity Tier 1 capital ratio	12.68%	13.49%
Minimum Common Equity Tier 1 Capital as per Conditions of Registration	4.50%	4.50%
Tier 1 capital ratio	12.68%	13.49%
Minimum Tier 1 Capital as per Conditions of Registration	6.00%	6.00%
Total capital ratio	14.71%	13.49%
Minimum Total Capital as per Conditions of Registration	8.00%	8.00%
Buffer ratio	6.68%	5.49%
Buffer trigger ratio	2.50%	2.50%

(k) Solo capital adequacy

%	June 2023	June 2022
Capital ratios		
Common Equity Tier 1 capital ratio	12.77%	14.37%
Tier 1 capital ratio	12.77%	14.37%
Total capital ratio	14.93%	14.37%

For the purposes of calculating capital adequacy on a solo basis, subsidiaries which are both wholly owned and wholly funded by the Bank are to be consolidated with the Bank.

(l) Capital for other material risks

In addition to the material risks included in the calculation of the capital ratios, the Banking Group has identified other material risks to be included in the capital allocation (being strategic risk, business risk, regulatory and additional credit risk). As at 30 June 2023, the Banking Group has made an internal capital allocation of $20.01 million to cover these risks (2022: $8.4 million).

29 Securitisation, funds management and other fiduciary activities

Securitisation

As at 30 June 2023, the Banking Group had $254.74 million securitised assets (2022: $312.24 million).

There have been no material changes to the Banking Group's involvement in the securitisation activities.

Funds management and other fiduciary activities

The Banking Group, through Heartland PIE Fund Limited, controls, manages and administers the Heartland Cash and Term PIE Fund and its products (Heartland Call PIE and Heartland Term Deposit PIE). Note 27 - Structured entities has further details. The Heartland Cash and Term PIE Fund deals with the Bank in the normal course of business, in the Bank's capacity as Registrar of the Fund and also invests in the Bank's deposits. The Banking Group is considered to control the Heartland Cash and Term PIE Fund, and as such the Heartland Cash and Term PIE Fund is consolidated within the financial statements of the Banking Group.

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 auditors. Further information on the Banking Group's risk management policies and practices is included in Note 20 - Enterprise risk management.

Provision of financial services and asset purchases

Over the accounting period, financial services provided by the Banking Group to entities which were involved in the activities above (including trust, custodial, funds management and other fiduciary activities) were provided on arm's length terms and conditions and at fair value.

Any assets purchased from such entities have been purchased on arm's length terms and conditions and at fair value.

29 Securitisation, funds management and other fiduciary activities (continued)

Peak aggregate funding to entities

The Banking Group did not provide any funding to entities conducting funds management and other fiduciary activities, or insurance product or marketing and distribution activities described in this note, during the year (2022: nil).

The Bank provided the following funding in relation to securitisation entities.

	Total Trusts	
	June 2023	**June 2022**
Peak end-of-day aggregate amount of funding provided ($000's)	308,755	305,038
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 (%)	49.4%	49.0%

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.

	HARWT	
	June 2023	**June 2022**
Peak end-of-day aggregate amount of funding provided ($000's)	308,755	305,038
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 [1]	114.8%	93.5%

[1] Total assets as at the end of the year in June 2023 are lower compared to the timing of the peak end-of-day aggregate amount of funding provided due to a repurchase.

For this purpose, peak ratio information was derived by determining the maximum end-of-day aggregate amount of funding and then dividing that amount by the amount of the entity's assets or the Banking Group's Tier 1 Capital (as the case required) as at the end of the year.

30 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.

The Banking Group enters into contractual arrangements with counterparties to manage the credit risks associated primarily with over-the-counter derivatives. The Banking Group has entered into credit support annexes (**CSAs**) which form a part of International Swaps and Derivatives Association (**ISDA**) Master Agreement, in respect of certain exposures relating to derivative transactions. As per these CSAs, the Banking Group or the counterparty needs to collateralise the market value of outstanding derivative transactions. As at 30 June 2023, the Banking Group has received $27.61 million of cash collateral (2022: $32.34 million) against derivative assets. Cash collateral includes amounts of cash obtained to cover the net exposure between the counterparty in the event of default or insolvency. The cash collateral received is not netted off against the balance of derivative assets disclosed in the consolidated statement of financial position and is disclosed within trade and other payables.

The following table sets out financial assets and financial liabilities which have not been offset but are subject to enforceable master netting agreements (or similar arrangements) and the related amounts not offset in the balance sheet. Financial instruments refer to amounts that are subject to relevant close out netting arrangements under a relevant ISDA agreement. ISDA and similar master netting arrangements do not meet the criteria for offsetting in the statement of financial position because under such agreements the counterparties typically have the right to offset only following an event of default, insolvency or bankruptcy or following other predetermined events.

	Effects of offsetting on the balance sheet			**Related amounts not offset**		
$000's	**Gross Amount**	**Gross amounts set off in the balance sheet**	**Net amounts reported in the balance sheet**	**Financial Instruments**	**Cash collateral received**	**Net amount**
June 2023						
Derivative financial assets	36,982	-	36,982	(7,624)	(27,609)	1,749
Total financial assets	**36,982**	**-**	**36,982**	**(7,624)**	**(27,609)**	**1,749**
Derivative financial liabilities	7,624	-	7,624	(7,624)	-	-
Total financial liabilities	**7,624**	**-**	**7,624**	**(7,624)**	**-**	**-**
June 2022						
Derivative financial assets	44,487	-	44,487	(6,335)	(32,341)	5,811
Total financial assets	**44,487**	**-**	**44,487**	**(6,335)**	**(32,341)**	**5,811**
Derivative financial liabilities	6,335	-	6,335	(6,335)	-	-
Total financial liabilities	**6,335**	**-**	**6,335**	**(6,335)**	**-**	**-**

31 Contingent liabilities and commitments

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

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

$000's	**June 2023**	**June 2022**
Letters of credit, guarantee commitments and performance bonds	7,378	8,969
Total contingent liabilities	**7,378**	**8,969**
Undrawn facilities available to customers	310,423	272,735
Conditional commitments to fund at future dates	24,873	34,791
Total commitments	**335,296**	**307,526**

32 Events after reporting date

In July 2023, Heartland Bank Limited purchased AU$30 million reverse mortgage loans from Senior Warehouse Trust.

The Bank resolved to pay a cash dividend to its parent company HGH of $43 million on its ordinary shares on 28 August 2023.

There were no other events subsequent to the reporting period which would materially affect the consolidated financial statements.

Independent auditor's report

To the shareholder of Heartland Bank Limited

Our opinion

In our opinion, the accompanying:

- financial statements, excluding the information disclosed in accordance with Schedules 4, 7, 9, 13, 14, 15 and 17 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order"), of Heartland Bank Limited (the "Bank"), including the entities it controlled as at 30 June 2023 or from time to time during the financial year (the "Banking Group"), present fairly, in all material respects, the financial position of the Banking Group as at 30 June 2023, its financial performance and its cash flows for the year then ended in accordance with New Zealand Equivalents to International Financial Reporting Standards ("NZ IFRS") and International Financial Reporting Standards ("IFRS"); and
- information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order (the "Supplementary Information"), in all material respects:
  - presents fairly the matters to which it relates; and
  - is disclosed in accordance with those schedules; and
  - has been prepared in accordance with any conditions of registration relating to disclosure requirements imposed under section 74(4)(c) of the Banking (Prudential Supervision) Act 1989.

What we have audited

- The Banking Group's financial statements (the "Financial Statements") required by clause 24 of the Order, comprising:
  - the consolidated statement of financial position as at 30 June 2023;
  - the consolidated statement of comprehensive income for the year then ended;
  - the consolidated statement of changes in equity for the year then ended;
  - the consolidated statement of cash flows for the year then ended; and
  - the notes to the Financial Statements, excluding the information disclosed in accordance with Schedules 4, 7, 9, 13, 14, 15 and 17 of the Order within notes 20, 21, 22, 23, 24, 25, 28 and 29, which includes significant accounting policies and other explanatory information.
- The Supplementary Information within the consolidated statement of financial position and notes 20, 21, 22, 23, 24, 25, 28 and 29 of the Financial Statements for the year ended 30 June 2023 of the Banking Group.

  We have not audited the information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 9 of the Order within notes 25 and 28 of the Financial Statements and our opinion does not extend to this information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Statements and the Supplementary Information* section of our report.

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

Independence

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

Our firm carries out other services for the Banking Group. These services are audit and assurance related services comprising: insurance solvency, trust deed reporting, supervisor reporting and registry audits and other services. Other services are actuarial services in respect of reverse mortgages for the Banking Group prior to our appointment as auditor and the provision of an executive reward survey report. In addition, certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities. The provision of these other services and these relationships have not impaired our independence as auditor of the Banking Group.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Statements and the Supplementary Information of the current year. These matters were addressed in the context of our audit of the Financial Statements and the Supplementary Information as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Description of the key audit matter	How our audit addressed the key audit matter
Provision for impairment of finance receivables As disclosed in note 22 of the Financial Statements, the impairment allowance totalled $52.1 million at 30 June 2023. For the determination of the collectively assessed impairment allowance, this requires the use of credit risk methodologies that are applied in models using the Banking Group's historical experience of the correlations between defaults and losses, borrower creditworthiness, segmentation of customers or portfolios and economic	We obtained an understanding of control activities over the Banking Group's impairment allowance, and for relevant control activities assessed whether they are appropriately designed. For controls relevant to our planned audit approach we tested, on a sample basis, whether they operated effectively, throughout the financial year. In addition, we, along with our credit risk modelling expert, performed the following procedures, amongst others, on a targeted or sample basis, to assess the reasonableness of the Banking Group's collective allowance for impairment:

Description of the key audit matter	How our audit addressed the key audit matter
conditions. The assumptions we focused our audit on included those with greater levels of management judgement and for which variations have the most significant impact on the impairment allowance. For finance receivables that meet specific risk based criteria, the impairment allowance is individually assessed by the Banking Group. These allowances are measured using probability weighted scenarios which are intended to reflect a range of reasonably possible outcomes, and incorporate assumptions such as estimated future cash proceeds expected to be recovered from the realisation of security held as collateral by the Banking Group. We considered this a key audit matter due to the significant audit effort required and the inherent estimation uncertainty present in its determination, which is due to the subjectivity and extent of judgement used by the Banking Group in the impairment allowance recognition and measurement.	● Assessed the appropriateness of the methodology inherent in the models used against the requirements of NZ IFRS 9 *Financial Instruments*; ● Challenged and assessed the appropriateness of the collective allowance for impairment inclusive of the impacts of any post model adjustments; ● We challenged management's modelling outcomes using a range of what we consider reasonably possible assumptions to assess the collective impairment allowance; and ● Tested the completeness and accuracy of critical data elements used in the calculations. With respect to individually assessed allowances we: ● For a sample of business and rural loans not identified as impaired, considered the borrowers latest financial information provided to the Banking Group to assess the credit risk grade rating allocated to the borrower to assess whether the borrower has had a significant increase in credit risk, a critical data element which involves significant management judgement; ● For loans where an impairment was individually assessed, we considered the borrower's latest financial information, value of security held as collateral and probability weighted scenario outcomes (where applicable) to test the basis of measuring the impairment allowance. We also considered the impacts of events occurring subsequent to balance date on the impairment allowances. Where applicable, we considered the competency, capabilities, objectivity and nature of the work of certain experts used by the Banking Group to assist in determining the individual impairment allowance. We also assessed the reasonableness of the disclosures against the requirements of the accounting standards.

Description of the key audit matter	How our audit addressed the key audit matter
Fair value of reverse mortgages The Banking Group's fair value of finance receivables – reverse mortgages ("Reverse mortgages") totalled $888.6 million at 30 June 2023 as disclosed in note 19 of the Financial Statements. Reverse mortgages are held at fair value through profit or loss. The fair value of reverse mortgages is subject to significant judgement and is highly complex. In addition, the current impacts of rising interest rates and declining house prices, combined with the economic outlook, increases the possibility of increasing outflows under the no negative equity guarantee provided by the Banking Group to the borrower. Accordingly, we consider this to be a key audit matter. The Banking Group records the estimated fair value of the reverse mortgages at transaction price on the basis no reliable fair value can be estimated as there is no relevant active market and fair value cannot be reliably estimated using other valuation techniques under NZ IFRS 13 *Fair Value Measurement (NZ IFRS 13)*. To assess whether the transaction price remains an appropriate proxy for fair value, the Banking Group considers the impact on future discounted cash flows of changes in the risk profile and expectations of performance since loan origination. Specifically considering changes in mortality and potential move into care, voluntary exits, house prices, likelihood of cash outflows under the no negative equity guarantee and interest rate margins.	Our audit procedures included assessing the design and implementation of controls relating to the Banking Group's assessment of the fair value of reverse mortgages. In addition, our audit procedures included: • Assessing the reasonableness of the Banking Group's approach to estimating the fair value based on the transaction cost against the requirements of NZ IFRS 13; • Assessing whether there was evidence of a relevant active market or observable inputs in which to establish fair value using a market approach; • Engaging our internal actuarial experts to independently estimate the value of discounted future cash flows from the reverse mortgages, including any expected outflows under the no negative equity guarantee and comparing this to the transaction cost of reverse mortgages (carrying value) to assess any potential shortfall (a shortfall would indicate the transaction value was overstated); • Tested the completeness and accuracy of a sample of critical data elements used as inputs to our internal actuarial expert assessment of the value of discounted future cash flows; • Assessed the reasonableness of key assumptions (such as future house prices, voluntary exits, interest rate margins, future interest rates) used by our internal actuarial expert in their assessment of the value of discounted future cash flows; and • Considered the appropriateness of the disclosures in note 19 of the Financial Statements against the requirements of the accounting standards.

Description of the key audit matter	How our audit addressed the key audit matter
Operation of financial reporting information technology (IT) systems and controls The Banking Group's operations and financial reporting processes are heavily dependent on IT systems for the capture, processing, storage and extraction of significant volumes of transactions which is critical to the recording of financial information and the preparation of the Banking Group's Financial Statements. Accordingly, we consider this to be a key audit matter. In common with other banking entities, access management controls are important to ensure both access and changes made to applications and data are appropriate. Ensuring that only appropriate staff have access to IT systems, that the level of access itself is appropriate, and that access is periodically monitored, are key controls in mitigating the potential for fraud or error as a result of a change to an application or underlying data. The Banking Group's controls over IT systems are intended to ensure that: ● changes to existing systems operate as intended and are authorised; ● access to process transactions or change data is appropriate and maintains an intended segregation of duties; ● the use of privileged access to systems and data is restricted and monitored; and ● IT processing is approved and where issues arise they are resolved	For material financial statement transactions and balances, our procedures included obtaining an understanding of the business processes, IT systems used to generate and support those transactions and balances, associated IT application controls, and IT dependencies in manual controls. This involved assessing, where relevant to the audit: ● change management: the processes and controls used to develop, test and authorise changes to the functionality and configurations within systems; ● security: the access controls designed to enforce segregation of duties, govern the use of generic and privileged accounts, or ensure that data is only changed through authorised means; and ● IT operations: the controls over certain IT batch processes used to ensure that any issues that arise are managed appropriately. Where relevant to our planned audit approach, we, along with our IT specialists, evaluated and tested the design and operating effectiveness of certain controls over the continued integrity of IT systems that are relevant to financial reporting. We also carried out tests, on a sample basis, of IT application controls that were key to our audit testing strategy in order to assess the accuracy of relevant system calculations, automated controls and the operation of certain system enforced access controls. Where we identified design or operating effectiveness matters relating to IT systems and application controls relevant to our audit, we performed alternative or additional audit procedures.

Our audit approach

Overview

Overall Banking Group materiality: $5.0 million, which represents approximately 5% of profit before tax.

We chose profit before tax because, in our view, it is the benchmark against which the performance of the Banking Group is most commonly measured by users, and is a generally accepted benchmark.

Following our assessment of the risk of material misstatement, we performed a full scope audit over the consolidated financial information of the Banking Group.

As reported above, we have three key audit matters, being:

- Provision for impairment of finance receivables
- Fair value of reverse mortgages
- Operation of financial reporting information technology (IT) systems and controls

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the Financial Statements and the Supplementary Information. In particular, we considered where management made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance about whether the Financial Statements and the Supplementary Information are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Statements and the Supplementary Information.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall Banking Group materiality for the Financial Statements and the Supplementary Information, as a whole, as set out above. These, together with qualitative considerations, helped us to determine the scope of our audit, the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate, on the Financial Statements and the Supplementary Information, as a whole.

How we tailored our group audit scope

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the Financial Statements and the Supplementary Information, as a whole, taking into account the structure of the Banking Group, the financial reporting processes and controls, and the industry in which the Banking Group operates.

The scope of our audit and the nature, timing and extent of audit procedures performed were determined by our risk assessment, the financial significance of components and other qualitative factors (including history of misstatement through fraud or error).

Other information

The Directors are responsible for the other information. The other information comprises the information included in the Disclosure Statement presented in accordance with Schedule 2 of the Order on pages 1 to 4 and 90 to 99, and the information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 9 of the Order within notes 25 and 28, but does not include the Financial Statements, the Supplementary Information and our auditor's report thereon.

Our opinion on the Financial Statements and the Supplementary Information does not cover the other information and we do not express any form of audit opinion or assurance conclusion thereon. We issue a separate limited assurance report on the information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 9 of the Order.

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

Responsibilities of the Directors for the Disclosure Statement

The Directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the Financial Statements in accordance with clause 24 of the Order, NZ IFRS and IFRS, and for such internal control as the Directors determine is necessary to enable the preparation of Financial Statements and Supplementary Information that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the Disclosure Statement which includes:

- all of the information prescribed in Schedule 2 of the Order; and
- the information prescribed in Schedules 4, 7, 9, 13, 14, 15 and 17 of the Order.

In preparing the Financial Statements, the Directors are responsible for assessing the Banking Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Banking Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Statements and the Supplementary Information

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

A further description of our responsibilities for the audit of the Financial Statements and the Supplementary Information is located at the External Reporting Board's website at:

https://www.xrb.govt.nz/assurance-standards/auditors-responsibilities/audit-report-1/

This description forms part of our auditor's report.

Who we report to

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

The engagement partner on the engagement resulting in this independent auditor's report is Karen Shires.

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants | Auckland
28 August 2023

Independent Assurance Report

To the shareholder of Heartland Bank Limited

Limited assurance report on compliance with the information required on capital adequacy and regulatory liquidity requirements

Our conclusion

We have undertaken a limited assurance engagement on Heartland Bank Limited's (the "Bank") compliance, in all material respects, with clause 21 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order") which requires information prescribed in Schedule 9 of the Order relating to capital adequacy and regulatory liquidity requirements to be disclosed in its full year Disclosure Statement for the year ended 30 June 2023 (the "Disclosure Statement").

Based on the procedures we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that the Bank's information relating to capital adequacy and regulatory liquidity requirements, included in the Disclosure Statement in compliance with clause 21 of the Order and disclosed in notes 25 and 28, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

Basis for conclusion

We have conducted our engagement in accordance with Standard on Assurance Engagements 3100 (Revised) *Compliance Engagements* ("SAE 3100 (Revised)") issued by the New Zealand Auditing and Assurance Standards Board.

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

Directors' responsibilities

The Directors are responsible on behalf of the Bank for compliance with the Order, including clause 21 of the Order which requires information relating to capital adequacy and regulatory liquidity requirements prescribed in Schedule 9 of the Order to be included in the Disclosure Statement, for the identification of risks that may threaten compliance with that clause, controls that would mitigate those risks and monitoring ongoing compliance.

Our independence and quality management

We have complied with the independence and other ethical requirements of Professional and Ethical Standard 1 *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)* issued by the New Zealand Auditing and Assurance Standards Board, which is founded on the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

We apply Professional and Ethical Standard 3 *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*, which requires our firm to design, implement and operate a system of quality management including policies or procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

We are independent of the Bank and the entities it controlled at 30 June 2023 or from time to time during the period (together, the “Banking Group”). In our role as auditor, we provided other audit and assurance related services comprising: insurance solvency, trust deed reporting, supervisor reporting and registry audits and other services. Other services are actuarial services in respect of reverse mortgages for the Banking Group (prior to our appointment as assurance practitioner) and the provision of an executive reward survey report. In addition, certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the Banking Group. The provision of these other services and these relationships have not impaired our independence.

Assurance practitioner’s responsibilities

Our responsibility is to express a limited assurance conclusion on whether the Bank’s information relating to capital adequacy and regulatory liquidity requirements, included in the Disclosure Statement in compliance with clause 21 of the Order is not, in all material respects, disclosed in accordance with Schedule 9 of the Order. SAE 3100 (Revised) requires that we plan and perform our procedures to obtain limited assurance about whether anything has come to our attention that causes us to believe that the Bank’s information relating to capital adequacy and regulatory liquidity requirements, included in the Disclosure Statement in compliance with clause 21 of the Order, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

In a limited assurance engagement, the assurance practitioner performs procedures, primarily consisting of discussion and enquiries of management and others within the entity, as appropriate, and observation and walk-throughs, and evaluates the evidence obtained. The procedures selected depend on our judgement, including identifying areas where the risk of material non-compliance with clause 21 of the Order in respect of the information relating to capital adequacy and regulatory liquidity requirements is likely to arise.

Given the circumstances of the engagement we:

- obtained an understanding of the process, models, data and internal controls implemented over the preparation of the information relating to capital adequacy and regulatory liquidity requirements;
- obtained an understanding of the Bank’s compliance framework and internal control environment to ensure the information relating to capital adequacy and regulatory liquidity requirements is in compliance with the Reserve Bank of New Zealand’s (the “RBNZ”) prudential requirements for banks;
- obtained an understanding and assessed the impact of any matters of non-compliance with the RBNZ’s prudential requirements for banks that relate to capital adequacy and regulatory liquidity requirements and inspected relevant correspondence with the RBNZ;
- performed analytical and other procedures on the information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 9 of the Order, and considered its consistency with the annual financial statements; and
- agreed the information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 9 of the Order to information extracted from the Bank’s models, accounting records or other supporting documentation.

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement and consequently the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed. Accordingly, we do not express a reasonable assurance opinion on compliance with the compliance requirements.

Inherent limitations
Because of the inherent limitations of an assurance engagement, together with the internal control structure, it is possible that fraud, error or non-compliance with the compliance requirements may occur and not be detected.

A limited assurance engagement on the Bank's information relating to capital adequacy and regulatory liquidity requirements prescribed in Schedule 9 of the Order to be included in the Disclosure Statement in compliance with clause 21 of the Order does not provide assurance on whether compliance will continue in the future.

Use of report
This report has been prepared for use by the Bank's shareholder for the purpose of establishing that these compliance requirements have been met.

Our report should not be used for any other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility for any reliance on this report to anyone other than the Bank and the Bank's shareholder, or for any purpose other than that for which it was prepared.

The engagement partner on the engagement resulting in this independent assurance report is Karen Shires.

PricewaterhouseCoopers

Chartered Accountants
28 August 2023

Auckland

Historical Summary of Financial Statements

For the year ended 30 June 2023

$000's	June 2023	June 2022	June 2021	June 2020	June 2019
Interest income	372,688	275,770	272,562	297,512	284,064
Interest expense	158,027	66,205	73,753	108,476	111,665
Net interest income	**214,661**	**209,565**	**198,809**	**189,036**	**172,399**
Other net income	12,458	33,704	15,006	15,742	9,409
Net operating income	**227,119**	**243,269**	**213,815**	**204,778**	**181,808**
Operating expenses	101,337	96,203	100,852	90,782	76,298
Profit before impaired asset expense and income tax	**125,782**	**147,066**	**112,963**	**113,996**	**105,510**
Fair value (loss)/gain on investments	-	(315)	215	-	1,936
Impaired asset expense	22,891	14,692	14,579	29,372	20,554
Profit before income tax	**102,891**	**132,059**	**98,599**	**84,624**	**86,892**
Profit before income tax from discontinued operations	-	-	-	-	6,169
Income tax expense	28,389	36,068	27,090	23,924	24,762
Profit for the year	**74,502**	**95,991**	**71,509**	**60,700**	**68,299**
Dividends paid to equity holders	60,000	35,500	30,000	65,000	112,042

As at 30 June 2023

$000's	June 2023	June 2022	June 2021	June 2020	June 2019
Total assets	5,561,808	5,154,652	4,419,488	4,314,559	4,143,828
Individually impaired assets	52,955	66,183	38,143	24,667	26,412
Total liabilities	4,833,072	4,447,149	3,777,660	3,717,522	3,540,438
Total equity	728,736	707,503	641,828	597,037	603,390

The amounts above have been extracted from the audited financial statements of the Banking Group.

Amendments to Conditions of Registration

Changes in Conditions of Registration

With effect from 1 June 2023 LVR restrictions were eased from:

- 10% limit for loans with LVR above 80% for owner occupiers, and
- 5% limit for loans with LVR above 60% for investors

To:

- 15% limit for loans with LVR above 80% for owner occupiers, and
- 5% limit for loans with LVR above 65% for investors

The previous LVR settings were put in place November 2021 when risks were elevated. The restrictions built resilience in the financial system, which has been evident in the past year as house prices have fallen without widespread impacts to financial stability.

With effect on or after 1 July 2022:

The Bank's implicit risk capital requirement (formerly referenced in conditions 1C) has been removed.

As at 30 June 2023, there have been no other changes to the Conditions of Registration.

Conditions of Registration

These conditions apply on and after 1 June 2023.

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.

For the purposes of this condition of registration,—

"Total capital ratio", "Tier 1 capital ratio", and "Common Equity Tier 1 capital ratio" have the same meaning as in Subpart B2 of BPR100: Capital Adequacy;

"Total capital" has the same meaning as in BPR110: Capital Definitions.

1A. That—

(a) the bank has an internal capital adequacy assessment process ("ICAAP") that accords with the requirements set out in Part D of BPR100: Capital Adequacy;
(b) under its ICAAP the bank identifies and measures its "other material risks" defined in Part D of BPR100: Capital Adequacy; and
(c) the bank determines an internal capital allocation for each identified and measured "other material risk".

1B. That, if the Prudential Capital Buffer (PCB) 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, other than discretionary payments payable to holders of Additional Tier 1 capital instruments, to the percentage limit on distributions that corresponds to the banking group's PCB ratio; and

Banking group's PCB ratio	**Percentage limit on distributions of the bank's earnings**	**Capital Buffer Response Framework stage**
0% – 0.5%	0%	Stage 3
>0.5 – 1%	30%	Stage 2
>1 – 2%	60%	Stage 1
>2 – 2.5%	100%	None

(b) comply with the Capital Buffer Response Framework requirements as set out in Part D of BPR120: Capital Adequacy Process Requirements.

For the purposes of this condition of registration,—

"prudential capital buffer ratio", "distributions", and "earnings" have the same meaning as in Subpart B2 of BPR100: Capital Adequacy;

an Additional Tier 1 capital instrument is an instrument that meets the requirements of B2.2(2)(a), (c) or (d) of BPR110: Capital Definitions.

1BA. That the bank must not make any distribution on a transitional AT1 capital instrument on or after the date on which on any conversion or write-off provision in the terms and conditions of the instrument is triggered due to either a loss absorption trigger event or a non-viability trigger event.

Conditions of Registration (continued)

For the purposes of this condition of registration, “transitional AT1 capital instrument” has the meaning given in section A2.3 of BPR110: Capital Definitions and “loss absorption trigger event” and “non-viability trigger event” have the meanings given in sub-section C2.2(3) of BPR120: Capital Adequacy Requirements.

1C. That:

(a) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued on or after 1 July 2021 in the calculation of its capital ratios unless it has completed the notification requirements in Part B of BPR120: Capital Adequacy Process Requirements in respect of the instrument; and
(b) the bank meets the requirements of Part C of BPR120: Capital Adequacy Process Requirements in respect of regulatory capital instruments.

For the purposes of this condition of registration, —

an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection B2.2(2)(a) or (c) of BPR110: Capital Definitions;
a Tier 2 capital instrument is an instrument that meets the requirements of subsection B3.2(2)(a) or (c) of BPR110: Capital Definitions.

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.

Conditions of Registration (continued)

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 October 2021.

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 percent at the end of each business day;
   (b) the one-month mismatch ratio of the Banking Group is not less than zero percent at the end of each business day; and
   (c) the one-year core funding ratio of the Banking Group is not less than 75 percent at the end of each business day.

   For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled "Liquidity Policy" (BS13) dated July 2022 and "Liquidity Policy Annex: Liquid Assets" (BS13A) dated July 2022.

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.

Conditions of Registration (continued)

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 June 2022.

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 June 2022.

    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 June 2022.

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 June 2022.

Conditions of Registration (continued)

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 June 2022.

19. That, for a loan-to-valuation measurement period ending on or after 30 November 2023, 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 65%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

20. That, for a loan-to-valuation measurement period ending on or after 30 November 2023, 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 15% 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 these conditions of registration, the version dates of the Reserve Bank of New Zealand Banking Prudential Requirement (BPR) documents that are referred to in the capital adequacy conditions 1 to 1C, or are referred to in turn by those documents or by Banking Supervision Handbook (BS) documents, are—

BPR document	Version date
BPR100: Capital adequacy	1 October 2021
BPR110: Capital definitions	1 October 2021
BPR120: Capital adequacy process requirements	1 July 2021
BPR130: Credit risk RWAs overview	1 July 2021
BPR131: Standardised credit risk RWAs	1 October 2021
BPR132: Credit risk mitigation	1 October 2021
BPR133: IRB credit risk RWAs	1 October 2021
BPR134: IRB minimum system requirements	1 July 2021
BPR140: Market risk exposure	1 October 2021
BPR150: Standardised operational risk	1 July 2021
BPR151: AMA operational risk	1 July 2021
BPR160: Insurance, securitisation, and loan transfers	1 July 2021
BPR001: Glossary	1 July 2021

Conditions of Registration (continued)

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 October 2021:
>
> "loan-to-valuation measurement period" means a period of six calendar months ending on the last day of the sixth calendar month.

Conditions of Registration – Non Compliance

Conditions of Registration Non-Compliance

The Bank has complied with the conditions of registrations since its last disclosure statement.

Pending Proceedings or Arbitration

There are no pending legal proceedings or arbitrations concerning any member of the Banking Group at the date of Disclosure Statement that may have a material adverse effect on the Bank or the Banking Group.

Credit Ratings

As at the date of signing this Disclosure Statement, the Bank's credit rating issued by Fitch Australia Pty Ltd (**Fitch Ratings**) was BBB stable. This BBB credit rating was issued on 14 October 2015 and is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars. This BBB stable credit rating was affirmed by Fitch Ratings on 7 April 2022.

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 already 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.