# Latitude Financial Services Group

# COMBINED FINANCIAL REPORT 2019

# Latitude Financial Services Group

## Combined financial report for the year ended 31 December 2019

### Contents

# Management's Declaration

In the opinion of the Management of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited (the "Group"), we report that:

(a) the Group is not a reporting entity

(b) the combined financial statements and notes set out on pages 8 to 75:

(i) present fairly the financial position of the Group as at 31 December 2019 and of its performance, as represented by the results of its operations and its cash flows, for the year ended 31 December 2019 in accordance with the basis of accounting described in Section 1.1;

(ii) complies with International Financial Reporting Standards to the extent described in Section 1.1; and

(c) there are reasonable grounds to believe that the Group will be able to pay its debts as and when they become due and payable.

Signed by Management on behalf of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited.

Ahmed Fahour
Chief Executive Officer
Melbourne
25 February 2021

Adrienne Duarte
Chief Financial Officer
Melbourne
25 February 2021

# Independent Auditor's Report

## To the Directors of KVD Australia Holdco Pty Ltd and the Directors of Latitude Financial Services Limited (the Directors)

### Opinion

We have audited the ***Combined Financial Report*** of the Latitude Financial Services Group (the ***Combined Group***).

In our opinion, the accompanying Combined Financial Report presents fairly, in all material respects, the financial position of the Latitude Financial Services Group as at 31 December 2019, and of its financial performance and its cash flows for each of the years then ended, in accordance with the combination basis of preparation described in Note 1.1 and *International Financial Reporting Standards (IFRS)* as issued by the International Accounting Standards Board.

The ***Combined Financial Report*** comprises:

- Combined balance sheets as at 31 December 2019
- Combined income statements, Combined statements of changes in net investment, and Combined statements of cash flows for the year then ended
- Notes including a summary of significant accounting policies
- Management's Declaration

The ***Combined Group*** consists of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited, and their respective subsidiaries that have been combined to form the Latitude Financial Services Group.

### Basis for opinion

We conducted our audit in accordance with *Australian Auditing Standards*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Combined Financial Report* section of our report.

We are independent of the Combined Group in accordance with the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the Combined Financial Report in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

## Emphasis of matter – Basis of preparation

We draw attention to Note 1.1 of the Combined Financial Report, which describes its combination basis of preparation, including the approach taken to and the purpose of preparing it.

The Combined Financial Report has been prepared to assist the Directors for the purpose of providing historical financial information of the Latitude Financial Services Group relating to a potential transaction. As a result, the Combined Financial Report and this Auditor's Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Our report is intended solely for the Directors of KVD Australia Holdco Pty Ltd and the Directors of Latitude Financial Services Limited in accordance with the agreed terms of engagement, and for no other purpose. We disclaim any assumption of responsibility for any reliance on this report, or on the Combined Financial Report to which it relates, to any person other than the Directors of KVD Australia Holdco Pty Ltd and the Directors of Latitude Financial Services Limited or for any other purpose than that for which it was prepared.

## Responsibilities of Management for the Combined Financial Report

Management are responsible for:

- the preparation and fair presentation of the Combined Financial Report in accordance with *International Financial Reporting Standards* and the combination basis of preparation described in Note 1.1 of the Combined Financial Report and have determined that the financial reporting framework is appropriate to meet the needs of the Directors for the purpose of providing historical financial information of the Latitude Financial Services Group relating to a potential transaction.
- implementing necessary internal control to enable the preparation of a Combined Financial Report that is free from material misstatement, whether due to fraud or error
- assessing the Combined Group's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Combined Group or to cease operations, or have no realistic alternative but to do so.

## Auditor's responsibilities for the audit of the Combined Financial Report

Our objective is:

- to obtain reasonable assurance about whether the Combined Financial Report as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an Auditor's Report that includes our opinion.

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

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

A further description of our responsibilities for the audit of the Combined Financial Report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_responsibilities/ar3.pdf. This description forms part of our Auditor's Report.

KPMG

KPMG

Melbourne

25 February 2021

# Combined Income Statement

## For the year ended 31 December 2019

| | Notes | 2019 $'000 | 2018 $'000 |
|---|---|---|---|
| Interest income | 2.2(a) | **1,209,048** | 1,135,651 |
| Interest expense | 2.2(a) | **(362,502)** | (365,327) |
| **Net interest income** | | **846,546** | 770,324 |
| Other operating income | 2.2(b) | **36,575** | 44,995 |
| Net insurance income | 2.2(c) | **51,029** | 60,212 |
| **Total other operating income** | | **87,604** | 105,207 |
| **Total operating income** | | **934,150** | 875,531 |
| | | | |
| Loan impairment expense | 3.2(g) | **(248,827)** | (253,377) |
| | | | |
| **Operating expenses** | | | |
| Depreciation and amortisation expense | | **(82,751)** | (68,838) |
| Employee benefit expense | | **(190,571)** | (173,030) |
| Other expenses | 2.2(d) | **(282,989)** | (248,291) |
| **Total operating expenses** | | **(556,311)** | (490,159) |
| | | | |
| Distribution to trust beneficiaries | | **(103,595)** | (74,487) |
| **Profit before income tax** | | **25,417** | 57,508 |
| | | | |
| Income tax expense | 2.3(a) | **(5,972)** | (13,231) |
| **Profit from continuing operations** | | **19,445** | 44,277 |
| | | | |
| Profit is attributable to: | | | |
| Owners of Latitude Financial Services Group | | **28,938** | 51,354 |
| Non-controlling interests | | **(9,493)** | (7,077) |
| **Profit for the year** | | **19,445** | 44,277 |

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

# Combined Statement of Comprehensive Income

## For the year ended 31 December 2019

| | Notes | 2019 $'000 | 2018 $'000 |
|---|---|---|---|
| **Net profit for the period from continuing operations** | | **19,445** | 44,277 |
| **Other comprehensive income** | | | |
| **Item that may be reclassified to income statement** | | | |
| Cash flow hedges | 3.2(q) | **(19,255)** | (3,461) |
| Currency translation differences arising during the year | | **739** | 1,566 |
| | | **(18,516)** | (1,895) |
| **Item that will not be reclassified to income statement** | | | |
| Equity investment at FVOCI - net change in fair value | | **-** | (2,400) |
| | | **-** | (2,400) |
| **Other comprehensive loss for the year, net of tax** | | **(18,516)** | (4,295) |
| **Total comprehensive income for the year from continuing operations** | | **929** | 39,982 |
| Total comprehensive income for the year is attributable to: | | | |
| Owners of Latitude Financial Services Group | | **10,422** | 47,059 |
| Non-controlling interests | | **(9,493)** | (7,077) |
| **Total comprehensive income for the year** | | **929** | 39,982 |

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

# Combined Balance Sheet

## As at 31 December 2019

| | Notes | 2019 $'000 | 2018 $'000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 3.1(b) | **411,968** | 518,604 |
| Assets classified as held for sale | | **328** | 553 |
| Derivative financial instruments | 3.1(d) | **3,896** | 376 |
| Loans and other receivables | 3.1(c) | **7,217,139** | 7,095,709 |
| Other assets | | **8,739** | 3,559 |
| Current tax assets | | **11,363** | - |
| Deferred tax assets | 2.3(d) | **211,094** | 178,441 |
| Property, plant and equipment | | **91,338** | 7,268 |
| Intangible assets | 5.1(a) | **858,168** | 894,530 |
| **Total assets** | | **8,814,033** | 8,699,040 |
| | | | |
| **Liabilities** | | | |
| Trade and other liabilities | 3.1(e) | **338,428** | 247,535 |
| Current tax liabilities | | **-** | 14,804 |
| Derivative financial instruments | 3.1(d) | **74** | 4,426 |
| Provisions | 5.1(d) | **73,969** | 60,293 |
| Gross insurance policy liabilities | 5.1(e) | **65,234** | 82,970 |
| Deferred tax liabilities | 2.3(d) | **101,558** | 89,197 |
| Borrowings | 3.1(f) | **7,830,922** | 7,820,091 |
| **Total liabilities** | | **8,410,185** | 8,319,316 |
| **Net assets** | | **403,848** | 379,724 |
| | | | |
| **Net investment** | | | |
| Parent investment | | **496,987** | 496,987 |
| Reserves | | **24,367** | 17,418 |
| Retained earnings/(losses) | | **(100,821)** | (127,489) |
| | | | |
| Net parent investment | | **420,533** | 386,916 |
| Non-controlling interests | | **(16,685)** | (7,192) |
| **Total net investment** | | **403,848** | 379,724 |

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

# Combined Statement of Changes in Net Investment

## For the year ended 31 December 2019

| | Attributable to owners of Latitude Financial Services Group | | | | | |
|---|---|---|---|---|---|---|
| | **Parent investment** | **Reserves** | **Retained earnings** | **Net parent investment** | **Non-controlling Interests** | **Total net investment** |
| | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** | **$'000** |
| At 1 January 2018 | 496,987 | 22,122 | (160,968) | 358,141 | (115) | **358,026** |
| Adjustment on initial adoption of new accounting standards (1) | - | - | (17,875) | (17,875) | - | **(17,875)** |
| At 1 January 2018 AASB 9 and 15 adjusted balance | 496,987 | 22,122 | (178,843) | 340,266 | (115) | **340,151** |
| Profit/(Loss) for the year | - | - | 51,354 | 51,354 | (7,077) | **44,277** |
| Other comprehensive loss | - | (4,295) | - | (4,295) | - | **(4,295)** |
| Total comprehensive income/(loss) for the year | - | (4,295) | 51,354 | 47,059 | (7,077) | **39,982** |
| Transactions with owners in their capacity as owners: | | | | | | |
| Share-based payments | - | (409) | - | (409) | - | **(409)** |
| **At 31 December 2018** | **496,987** | **17,418** | **(127,489)** | **386,916** | **(7,192)** | **379,724** |
| At 1 January 2019 | 496,987 | 17,418 | (127,489) | 386,916 | (7,192) | **379,724** |
| Adjustment on initial adoption of new accounting standards (1) | - | - | (2,270) | (2,270) | - | **(2,270)** |
| At 1 January 2019 AASB 16 adjusted balance | 496,987 | 17,418 | (129,759) | 384,646 | (7,192) | **377,454** |
| Profit/(Loss) for the year | - | - | 28,938 | 28,938 | (9,493) | **19,445** |
| Amounts transferred to Profit or loss | - | 8,609 | - | 8,609 | - | **8,609** |
| Other comprehensive loss | - | (18,516) | - | (18,516) | - | **(18,516)** |
| Total comprehensive income/(loss) for the year | - | (9,907) | 28,938 | 19,031 | (9,493) | **9,538** |
| Transactions with owners in their capacity as owners: | | | | | | |
| Share-based payments | - | 16,856 | - | 16,856 | - | **16,856** |
| **At 31 December 2019** | **496,987** | **24,367** | **(100,821)** | **420,533** | **(16,685)** | **403,848** |

(1) The adjustment is as a result of the change in accounting policies as described in Section 1.3
The above statement should be read in conjunction with the accompanying notes.

# Combined Statement of Cash Flows

## For the year ended 31 December 2019

| | Notes | 2019 $'000 | 2018 $'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest received | | **1,220,036** | 1,145,195 |
| Interest paid | | **(332,892)** | (350,037) |
| Other operating income received | | **36,419** | 44,974 |
| Net insurance income | | | |
| Premiums received | | **48,119** | 65,022 |
| Claims paid | | **(19,422)** | (17,020) |
| Other | | **(29)** | 333 |
| Investment income | | **4,509** | 5,190 |
| Operating expenses paid | | **(332,549)** | (287,265) |
| Distributions paid to trust beneficiaries | | **(54,735)** | (67,865) |
| Income taxes paid | | **(45,655)** | (54,816) |
| **Cash flow from operating activities before changes in operating assets and liabilities** | | **523,801** | 483,711 |
| **Changes in operating assets and liabilities arising from cash flow movements** | | | |
| Net increase in loans and other receivables | | **(462,501)** | (878,574) |
| Net increase/(decrease) in provisions | | **2,573** | (861) |
| Net (decrease)/increase in trade and other liabilities | | **(47,493)** | 16,704 |
| Net increase/(decrease) in gross insurance policy liabilities | | **1,096** | 97 |
| Net (increase)/decrease in other assets | | **(5,181)** | 855 |
| **Changes in operating assets and liabilities arising from cash flow movements** | | **(511,506)** | (861,779) |
| **Net cash (used in)/provided by operating activities** | **2.2(e)** | **12,295** | (378,068) |
| **Cash flows from investing activities** | | | |
| Net purchases of intangible assets and property plant & equipment | | **(55,487)** | (61,295) |
| **Net cash (used in)/provided by investing activities** | | **(55,487)** | (61,295) |
| **Cash flows from financing activities** | | | |
| Proceeds from borrowing issuances and drawdowns | | **2,450,529** | 1,865,888 |
| Repayment of borrowings | | **(2,455,194)** | (1,341,503) |
| Payment of interest rate swap break costs | | **(31,168)** | - |
| Repayment of related party loans | | **(19,209)** | - |
| Net inflow/(outflow) from share based payments | | **4,514** | (2,080) |
| Payment of lease liabilities [1] | | **(10,281)** | - |
| Payments of transaction costs from financing activities | | **(3,308)** | (4,949) |
| **Net cash provided by/(used in) financing activities** | | **(64,117)** | 517,356 |
| **Net (decrease)/increase in cash and cash equivalents** | | **(107,309)** | 77,993 |
| Cash and cash equivalents at beginning of financial year | | **518,604** | 439,690 |
| Effects of exchange rate changes on cash and cash equivalents | | **673** | 921 |
| **Cash and cash equivalents at end of financial year** | **3.1(b)** | **411,968** | 518,604 |

[1] New disclosure as a result of the change in accounting policy as described in Section 1.3

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

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## Section 1 - Basis of preparation

### 1.1 Basis of preparation

#### (a) Combined report

The Combined financial report is for the Latitude Financial Services Group (the "Group") which consists of KVD Australia Holdco Pty Ltd, Latitude Financial Services Limited, and their respective controlled and related entities.

KVD Australia Holdco Pty Ltd is a company limited by shares, incorporated and domiciled in Australia. Its registered office and principal place of business is 800 Collins Street, Docklands, Melbourne, Victoria, 3008.

Latitude Financial Services Limited is a company limited by shares, incorporated and domiciled in New Zealand. Its registered office and principal place of business is 8 Tangihua Street, Auckland Central, Auckland, 1010, New Zealand.

This note provides a list of all significant accounting policies adopted in the preparation of these combined financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated. The combined financial statements are for the Group, consisting of KVD Australia Holdco Pty Ltd, Latitude Financial Services Limited, and their respective controlled and related entities.

The financial statements were authorised for issue on 25 February 2021.

#### (b) Basis of preparation

The Group does not have a separate single parent entity, however, both KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited are under the ultimate control of KVD Singapore Pte. Ltd. As a result of there being no parent entity, the combined financial statements have not been prepared on a consolidation basis, but rather, represent a combination of individual consolidated financial statements of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited, and their respective controlled and related entities. In all other respects, the combined financial statements have been prepared in accordance with the recognition, measurement and classification requirements of all applicable International Financial Reporting Standards issued by the International Accounting Standards Board (IFRS).

In preparing these combined financial statements, the financial information of the Group has been extracted from the reporting records of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited, and their respective controlled and related entities. The combined financial statements have been prepared on a 'carve-out' basis from KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited consolidated financial statements for the purposes of presenting the financial position, results of operations and cash flows of the Group on a stand-alone basis. The combined financial statements of the Group reflect assets, liabilities, revenues and expenses directly attributable to the Group, as well as allocations deemed reasonable by the Directors of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited.

The financial information included herein may not reflect the combined financial position, results of operations, changes in net investment and cash flows of the Group in the future or what they may have been had the Group been a separate, stand-alone entity during the

## 1.1 Basis of preparation (continued)

periods presented. All intragroup (between the combining entities) balances, and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the combined financial statements.

### (c) Basis of measurement

These financial statements have been prepared under the historical cost basis, except for the following:

- Financial instruments measured at fair value, including financial assets backing insurance policies designated at fair value through profit or loss, equity investments designated at fair value though other comprehensive income and derivatives
- Assets held for sale - measured at fair value less cost of disposal in accordance with IFRS 5 Non-current Assets held for Sale and Discontinued Operations

### (d) Functional and presentation currency

These Financial statements are presented in Australian Dollars, which is Latitude Financial Services Group's deemed functional and presentation currency.

### (e) Rounding of amounts

Amounts in the financial statements have been rounded off to the nearest thousand dollars, or in certain cases, the nearest dollar.

### (f) Significant estimates and judgements

The preparation of financial statements that conform to accounting standards requires Management to exercise judgement in applying the Group's accounting policies and to make estimates and assumptions. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that may have a financial impact on the Group and that are believed to be reasonable under the circumstances.

Areas involving assumptions and estimates that are significant to the financial statements or areas requiring a higher degree of judgement, are disclosed in the following notes:

- Section 3.1: Recoverability of loans and other receivables
- Section 5: Estimation of insurance claims liability
- Section 5: Recoverability of goodwill and other intangible assets and estimated useful life (other than goodwill)

## 1.2 Other significant accounting policies

Significant accounting policies adopted in the preparation of these combined financial statements have been included in the relevant notes to which the policies relate. Other significant accounting policies are listed below. These policies have been consistently applied to all the years presented, unless otherwise stated.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 1.2 Other significant accounting policies (continued)

### (a) Foreign currency translation

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency').

*Transactions and balances*
Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the combined income statement. Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction. Foreign exchange gains and losses are presented in the combined income statement on a net basis within other operating income or other expenses.

*Group companies*
The results and financial position of foreign operations that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each combined balance sheet presented are translated at the closing rate at the date of that balance sheet,
- Income and expenses for each combined income statement are translated at average exchange rates (unless this is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- All resulting exchange differences are recognised in other comprehensive income.

### (b) Principles of consolidation

*Subsidiaries*
Subsidiaries are all entities (including structured entities) over which the Group has control. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases. The acquisition method of accounting is used to account for business combinations by the Group. Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Non-controlling interests in the results and net investment of subsidiaries are shown separately in the combined income statement, combined statement of changes in net investment and combined balance sheet respectively.

## 1.3 New and amended standards

### (a) New and amended standards adopted

*AASB 16 Leases* – The Group applied AASB 16 with a date of initial application of 1 January 2019.

The Group's lease portfolio mainly comprises property leases in relation to office space in Australia and New Zealand, where it principally acts as lessee and it earns a nominal amount of lease income from sub-leasing office space. The Group also leases a small value of fleet cars and equipment such as printers. The leases have varying terms, escalation clauses and renewal rights. On renewal, the lease terms of the leases are renegotiated.

The Group has applied AASB 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS 17 and IFRIC 4. The Group recognised the cumulative effect of adopting IFRS 16 at 1 January 2019 to equity. For the purpose of applying the modified retrospective approach to these leases, the Group elected to:

- measure the right-of-use assets as if it had applied IFRS 16 since the commencement date using its incremental borrowing rate at the date of initial application;
- apply the practical expedient not to recognise a right-of-use asset or lease liability to leases for which the lease term ends within 12 months of the date of initial application; and
- apply the practical expedient to recognise onerous lease provisions on transition.

The Group applied IFRS 16 only to contracts that were previously identified as a lease. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed for whether there is a lease.

The main impact of adopting AASB 16 has been the requirement, as a lessee, to recognise a lease liability and corresponding right of use asset on balance sheet for all leases with a term of more than twelve months, unless the underlying asset is of low value. On transition, retained earnings reduced by $2.3 million as a result of the additional recognition of $74.0 million of right of use assets, $80.5 million of lease liabilities, $23.2 million of deferred tax assets, $22.2 million of deferred tax liabilities and other adjustments of $3.2 million for the pre-existing lease liability and onerous lease provision.

The Group has presented right-of-use assets within property, plant and equipment and presented the lease liability as an other liability within trade and other liabilities in the combined balance sheet. Depreciation charge for the right-of-use asset is included as a sub-component within depreciation charge and the lease liability interest expense is presented as interest expense in the combined income statement. The Group has classified the principal portion of lease payments within financing activities and the interest portion within operating activities within the combined Statement of cashflows. As at 31 December 2019, the right-of-use asset net book value disclosed within property, plant and equipment is $84.9 million.

When measuring lease liabilities, the Group discounted lease payments using its incremental borrowing rate at 1 January 2019. The weighted-average discount rate applied is 3.9% as at 1 January 2019.

## 1.3 New and amended standards (continued)

The lease commitment at 31 December 2018 as disclosed in the Group's combined financial statements is reconciled to the lease liability at 1 January 2019 as follows:

| | **1 January 2019** **$'000** |
|---|---|
| Operating lease commitment at 31 December 2018 as disclosed in the Group's combined financial statements | 70,207 |
| Discounted using the incremental borrowing rate at 1 January 2019 | 56,270 |
| Recognition exemption for: | |
| Short term leases | (380) |
| Adjustment for recognition of sub-lease income | 4,222 |
| Adjustment for recognition of property outgoings under AASB 16 | 20,424 |
| **Lease liabilities recognised at 1 January 2019** | **80,536** |

*AASB Interpretation 23 Uncertainty over Income Tax Treatments* - AASB Interpretation 23 became effective to the Group at 1 January 2019. The new interpretation clarifies the accounting for uncertainties in income taxes in relation to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. This has had an immaterial impact on the Group.

*Other amended standards*

Other amended Standards that became effective for the financial year ended 31 December 2019 did not have a material impact on the Group.

### (b) New standards and interpretations not yet adopted

The following standards have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Group. The Group expects to adopt these on their effective dates.

*AASB 17 Insurance Contracts* - AASB 17 is effective for financial years commencing on or after 1 January 2023. The new standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts. The objective of AASB 17 is to ensure that an entity provides relevant information that faithfully represents those contracts. This information gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. The Group is currently assessing the impact of the new requirements on the Group's Insurance business.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## Section 2 - Results

## 2.1 Segment information

### (a) Description of segments

The Group's Chief Executive Officer (CEO) and Executive Committee (EC) are responsible for the overall performance of the Group and take accountability for monitoring the Group's business affairs and setting its strategic direction, establishing policies and overseeing the Group's financial position. The CEO and EC assess the business on a Risk Adjusted Income basis (RAI), where RAI is total revenue, being interest income and other operating income, net of interest expense, loan impairment expense and insurance claims and expenses. Operating expenditure is not allocated to any segments or business units, but rather managed at a Group level.

The CEO and EC have identified three reportable segments of its business:

- **Australia:** LatitudePay and other payments and instalments products, LMoney including credit cards, personal loans and motor loans
- **New Zealand:** Genoapay and other payments and instalments products, credit cards and personal loans
- **Other/unallocated:** Consumer credit insurance (Hallmark life and general companies), other statutory adjustments not directly attributable to segments for management decision making purposes and unallocated operating expenses.

The Group's business segments operate principally in Australia and New Zealand. The Hallmark Insurance business also operates in New Zealand, which is not material for geographic segment information disclosure purposes.

A segment overview is presented below. During the year, $1,031.4 million of external revenue was generated within the country of Australia (2018: $1,011.2 million) and $279.3 million of external revenue was generated within the country of New Zealand (2018: $261.1 million). At 31 December 2019 there were $3,518.4 million non-current assets in the country of Australia (2018: $3,203.6 million) and $1,494.9 million non-current assets in the country of New Zealand (2018: $1,361.6 million).

Australia charges Hallmark insurance and New Zealand a management fee and Hallmark insurance pays commission to other segments. Sales between segments are carried out at arm's length and are eliminated on combination when they arise within the Group.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 2.1 Segment information (continued)

### (b) Segment overview

| **Year ended 2019** | **Australia $'000** | **New Zealand $'000** | **Other/ Unallocated $'000** | **Total $'000** |
|---|---|---|---|---|
| Interest income | 949,279 | 259,769 | - | **1,209,048** |
| Interest expense | (197,479) | (55,233) | (109,790) | **(362,502)** |
| Other operating income | 41,112 | 5,957 | 1,147 | **48,216** |
| Net insurance income | - | - | 39,388 | **39,388** |
| Loan impairment expense | (212,795) | (36,032) | - | **(248,827)** |
| **RAI before inter-segment adjustment** | **580,117** | **174,461** | **(69,255)** | **685,323** |
| Inter-segment risk adjusted income | (7,794) | (3,847) | 11,641 | **0** |
| **RAI as reported by the combined Group** | **572,323** | **170,614** | **(57,614)** | **685,323** |
| Operating expenses | - | - | (556,311) | **(556,311)** |
| Distribution to Trust beneficiaries | - | - | (103,595) | **(103,595)** |
| Income tax expense | - | - | (5,972) | **(5,972)** |
| **Profit/(loss) from continuing operations** | **572,323** | **170,614** | **(723,492)** | **19,445** |
| **Segment balance sheet information** | | | | |
| **Total segment assets** | 5,941,675 | 1,802,157 | 1,084,188 | **8,828,020** |
| Inter-seg. assets eliminated on consolidation | (302) | (523) | (13,162) | **(13,987)** |
| Total assets reported by the Combined Group | **5,941,373** | **1,801,634** | **1,071,026** | **8,814,033** |
| **Total segment liabilities** | 5,354,902 | 1,740,895 | 1,328,375 | **8,424,172** |
| Inter-seg. liabilities eliminated on consolidation | (1,491) | (8,486) | (4,010) | **(13,987)** |
| Total liabilities reported by the Combined Group | 5,353,411 | 1,732,409 | 1,324,365 | **8,410,185** |

| **Year ended 2018** | **Australia $'000** | **New Zealand $'000** | **Other/ Unallocated $'000** | **Total $'000** |
|---|---|---|---|---|
| Interest income | 914,896 | 240,745 | (19,990) | 1,135,651 |
| Interest expense | (217,328) | (54,703) | (93,296) | (365,327) |
| Other operating income | 47,636 | 7,576 | 1,057 | 56,269 |
| Net insurance income | - | - | 48,938 | 48,938 |
| Loan impairment expense | (208,979) | (44,398) | - | (253,377) |
| **RAI before inter-segment adjustment** | **536,225** | **149,220** | **(63,291)** | **622,154** |
| Inter-segment risk adjusted income | (6,743) | (4,532) | 11,275 | - |
| **RAI as reported by the combined Group** | **529,482** | **144,688** | **(52,016)** | **622,154** |
| Operating expenses | - | - | (490,159) | (490,159) |
| Distribution to Trust beneficiaries | - | - | (74,487) | (74,487) |
| Income tax expense | - | - | (13,231) | (13,231) |
| **Profit/(loss) from continuing operations** | **529,482** | **144,688** | **(629,893)** | **44,277** |
| **Segment balance sheet information** | | | | |
| **Total segment assets** | **5,901,076** | **1,563,819** | **1,239,726** | **8,704,621** |
| Inter-seg. assets eliminated on consolidation | (4,512) | - | (1,069) | (5,581) |
| Total assets reported by the Combined Group | 5,896,564 | 1,563,819 | 1,238,657 | 8,699,040 |
| **Total segment liabilities** | **5,481,306** | **1,555,666** | **1,287,925** | **8,324,897** |
| Inter-seg. liabilities eliminated on consolidation | - | (5,581) | - | (5,581) |
| Total liabilities reported by the Combined Group | 5,481,306 | 1,550,085 | 1,287,925 | 8,319,316 |

## 2.2 Revenue and expenses

### Accounting Policy

#### Revenue Recognition

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities below. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement. Interest is applied to the gross carrying value of a financial asset unless the asset is credit impaired, in which case it is applied to the net carrying value.

#### Revenue from customer loans

Interest income on loans is recognised using the effective interest method. The effective interest method is a way of calculating the amortised cost using the effective interest rate (EIR) of the financial asset or financial liability. The EIR is a rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument, or when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. Loan origination fees and costs are deferred over the life of the loan and are recognised as an adjustment of the yield. Unless included in the EIR calculation, fees and commissions are recognised on an accruals basis when the service has been provided and all other loan-related costs are expensed as occurred.

Fair value adjustments in relation to acquisition date fair value measurement of loan receivables recorded as a result of business combinations are amortised and included as part of interest income over the estimated customer repayment period. The amortisation period is accelerated when the remaining fair value adjustment is determined to be less than 10% of the original amount.

#### Insurance premium revenue

Premium revenue comprises amounts charged to policyholders (direct premium) for insurance contracts, excluding stamp duties and taxes collected on behalf of third parties, including GST. Premium revenue is recognised in the profit or loss with the incidence of the pattern of risk. Generally, the premium is earned according to the passing of time, but where time does not approximate the pattern of risk, previous claims experience is used to derive the incidence of risk. Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought to account based on previous experience with due allowance for any changes in the pattern of new business and renewals. The unearned portion of premium is recognised within unearned premium liability in the combined balance sheet.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 2.2 Revenue and expenses (continued)

### Goods and Services Tax (GST)

Revenues, expenses and assets are recognised net of the amount of associated GST, unless the GST incurred is not recoverable from the taxation authority. In this case, it is recognised as part of the cost of acquisition of the asset or as part of the expense. Receivables and payables are stated inclusive of the amount of GST receivable or payable. The net GST recoverable from, or payable to, the taxation authority is included with other receivables or payables in the combined balance sheet. Cash flows are presented on a gross basis. The GST components of cash flows arising from investing or financing activities which are recoverable from, or payable to the taxation authority, are presented as operating cash flows.

### (a) Net interest income

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| **Interest income** | | |
| Interest income | **1,209,048** | 1,135,651 |
| **Total interest income** | **1,209,048** | 1,135,651 |
| | | |
| **Interest expense** | | |
| Finance costs on borrowings | **(362,502)** | (365,327) |
| **Net interest income** | **846,546** | 770,324 |

Interest income include an adjustment in relation to acquisition date fair value measurement of loan receivables of $20.0 million at 31 December 2018. The fair value adjustment was fully amortised by 31 December 2018.

### (b) Other operating income

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Interchange and operating fees | **32,375** | 40,574 |
| Other | **4,200** | 4,421 |
| **Total other operating income** | **36,575** | 44,995 |

### (c) Net insurance income

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Insurance premium revenue | **66,104** | 74,112 |
| Insurance claims and expenses | **(19,584)** | (19,090) |
| Investment income | **4,509** | 5,190 |
| **Total net insurance income** | **51,029** | 60,212 |

## 2.2 Revenue and expenses (continued)

### (d) Other operating expenses

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Administrative and professional expenses | **(61,978)** | (78,245) |
| IT and data processing expenses | **(43,346)** | (42,327) |
| Marketing expenses | **(41,836)** | (40,661) |
| Occupancy and operating expenses | **(28,652)** | (40,745) |
| Other expenses | **(16,246)** | (21,865) |
| Transition and Replatforming costs | **(3,085)** | (5,697) |
| Latitude 2.0 - Strategy reset | **(551)** | (462) |
| Latitude 2.0 - Technology investment | **(16,330)** | - |
| Latitude 2.0 - Strategy execution | **(14,988)** | - |
| Restructuring costs | **(6,179)** | - |
| Remediation and other provisions | **(28,296)** | (11,027) |
| Impairment loss on non-financial instruments | **(21,502)** | (7,262) |
| **Total other operating expenses** | **(282,989)** | (248,291) |

### (e) Reconciliation of profit after income tax to net cash inflow from operating activities

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Net profit after income tax | 19,445 | 44,277 |
| Decrease in interest receivable | 11,917 | 10,823 |
| Increase in interest payable | 29,610 | 13,120 |
| Depreciation and amortisation | 82,751 | 68,838 |
| Loan impairment expense | 349,668 | 350,963 |
| Other (income)/expenses and write downs | 30,412 | (4,312) |
| Increase in loans and other receivables | (462,502) | (878,574) |
| Net (increase)/decrease in other assets | (5,181) | 855 |
| Increase in deferred tax assets | (32,653) | (11,943) |
| Increase in provisions | 2,573 | 47,188 |
| Net increase/(decrease) in gross insurance policy liabilities | 1,096 | (861) |
| Net (decrease)/increase in trade and other liabilities | (27,202) | 98 |
| Increase/(decrease) in deferred tax liabilities | 12,361 | (18,540) |
| **Net cash (used in)/provided by operating activities** | 12,295 | (378,068) |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 2.3 Income tax expense and deferred tax

### Accounting Policy

**Taxation**

For the purposes of the Combined Financial Statements, income tax is accounted as follows:
-For the Australian tax consolidation group, being KVD Australia Holdco Pty Ltd and its Australian subsidiaries, on the basis as detailed in the tax consolidation legislation policy below; and
-The Australian tax consolidation Group is aggregated with Latitude Financial Services Limited and its New Zealand subsidiaries in accordance with the principles as described in the Basis of Preparation.

**Income tax**

The income tax expense or revenue for the period is the tax payable on the current period's taxable income based on the applicable income tax rate for each jurisdiction adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses. The current income tax charge is calculated based on the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Company's subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate, based on amounts expected to be paid to the tax authorities.

**Deferred tax**

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. Deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination, that, at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses. Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and liabilities are offset when there is a legally enforceable right to offset and an intention to settle the liability simultaneously. Current and deferred tax is recognised in the combined income statement except to the extent that it relates to items recognised in other comprehensive income or directly in net investment. In this case, the tax is also recognised in other comprehensive income or directly in net investment respectively.

**Tax consolidation legislation (Australian Parent and Group only)**

KVD Australia Holdco Pty Ltd, which is the parent of the Australian Group and its wholly-owned controlled entities have implemented the tax consolidation legislation from December 2015. On adoption of the tax consolidation legislation, the entities in the tax consolidated group entered into a tax sharing agreement which limits the joint and several liability of the wholly-

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 2.3 Income tax expense and deferred tax (continued)

owned entities in the case of a default by the head entity, KVD Australia Holdco Pty Ltd. The entities are taxed as a single entity and the deferred tax assets and liabilities of these entities are set-off in the consolidated financial statements. The head and controlled entities in the tax consolidated group account for their own current and deferred tax accounts. These tax amounts are measured as if each entity in the tax consolidation group was a separate taxpayer with the group. In addition to its own current and deferred tax amounts, the Australian parent company also recognises the current tax liabilities (assets) and the deferred tax assets arising from unused tax losses and unused tax credits assumed from controlled entities in the tax consolidation group.

The entities have also entered into a tax funding agreement under which the wholly-owned entities fully compensate the Australian parent company for any current tax payable assumed. The funding amounts are determined by reference to the amounts recognised in the wholly-owned entities' financial statements. The amounts receivable or payable under the tax funding agreement are due upon receipt of the funding advice from the head entity, which is issued as soon as practicable after the end of the financial year. The funding amounts are recognised as intercompany receivables. Where a member of the income tax consolidated group recognises a taxable loss, the funding amount is nil with no compensation for the tax losses, unless the member is subject to prudential regulation by the Australian Prudential Regulation Authority, in which case the regulated entity will be compensated for its tax losses. Assets or liabilities arising under tax funding agreements with the tax consolidated entities are recognised as amounts receivable from or payable to other entities in the Group. Any difference between the amounts assumed and amounts receivable or payable under the agreement are recognised as an equity contribution to (or distribution from) wholly-owned tax consolidation entities.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 2.3 Income tax expense and deferred tax (continued)

### (a) Income tax expense

| | 2019<br>$'000 | 2018<br>$'000 |
|---|---|---|
| Current tax on profits for the year | **19,816** | 39,253 |
| Deferred tax expenses | **(9,786)** | (20,293) |
| (Over)/under provision in prior year | **(4,053)** | (5,541) |
| Foreign exchange differences arising on translation | **(5)** | (188) |
| **Income tax expense** | **5,972** | 13,231 |

### (b) Numerical reconciliation of income tax expense to prima facie tax payable

| | 2019<br>$'000 | 2018<br>$'000 |
|---|---|---|
| Profit from continuing operations before income tax expense | **25,417** | 57,508 |
| Tax at the Australian tax rate of 30% | **7,625** | 17,253 |
| Tax effect of amounts which are not deductible (taxable) in calculating taxable income: | | |
| Permanent differences (^) | **2,931** | 2,036 |
| Effect of differences in tax rates in foreign jurisdictions | **(526)** | (517) |
| Other | **(5)** | - |
| Adjustments of prior periods | **(4,053)** | (5,541) |
| **Income tax expense** | **5,972** | 13,231 |

(^) Includes monitoring & advisory fees, income from trust operations, amortisation of acquisition costs and other items.

### (c) Deferred tax expense represents movements in deferred tax assets/liabilities

| | 2019<br>$'000 | 2018<br>$'000 |
|---|---|---|
| Provisions and other liabilities | **(4,821)** | (9,359) |
| Deferred income | **5,605** | 2,336 |
| Acquisition transaction costs | **3,547** | 3,435 |
| Property, plant and equipment | **(495)** | 6,744 |
| Intangible assets | **(14,521)** | (14,687) |
| Deferred expenses and prepayments | **2,060** | 1,189 |
| Others | **(1,161)** | (9,951) |
| **Deferred tax expense/(benefit)** | **(9,786)** | (20,293) |

## 2.3 Income tax expense and deferred tax (continued)

### (d) Deferred tax assets and liabilities

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| **Deferred tax assets** | | |
| Provisions and other liabilities | **122,841** | 119,248 |
| Carry forward tax losses | **62** | |
| Deferred income | **41,431** | 47,068 |
| Acquisition transaction costs | **22** | 3,568 |
| Lease liability | **27,260** | - |
| Property, plant and equipment | **9,135** | 2,496 |
| Others | **10,343** | 6,061 |
| **Deferred tax assets** | **211,094** | 178,441 |
| | | |
| **Deferred tax liabilities** | | |
| Intangible assets | **66,856** | 81,378 |
| Deferred expenses & prepayments | **9,329** | 7,295 |
| Right-of-use assets | **24,997** | - |
| Other | **376** | 524 |
| **Deferred tax liabilities** | **101,558** | 89,197 |
| | | |
| **Net deferred tax assets/ (liabilities)** | **109,536** | 89,244 |
| Amounts expected to be settled within 12 months | **79,787** | 85,272 |
| Amounts expected to be settled after more than 12 months | **29,749** | 3,972 |
| **Net deferred tax assets/ (liabilities)** | **109,536** | 89,244 |

## 2.4 Shareholder returns

### Accounting Policy

**Dividends**
Provision is made for the amount of any dividend declared, being appropriately authorised and no longer at the discretion of the Group, on or before the end of the reporting period but not distributed at the end of the reporting period.

**Distributions**
In accordance with the relevant Trust Constitution, the Trustee distributes income from structured trusts of the Group to a unit holder which is a non-controlled related party of the Group. These distributions have been treated as distributions to a non-controlling interest.

### (a) Dividends

No ordinary share dividends were declared or paid during the year (2018: $nil).

## Section 3 - Financial Instruments and Risk Management

### 3.1 Financial assets and liabilities

#### Accounting Policy

**Classification - Financial assets and liabilities**
**Amortised cost**
Debt instruments are measured at amortised cost if both the following conditions apply:
(a) the instrument is held to collect contractual cash flows, rather than being sold prior to contractual maturity to realise fair value changes; and
(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

**Cash and cash equivalents**
Cash and cash equivalents include cash on hand, deposits held at call with financial institutions, restricted cash and other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash.

**Loans and other receivables**
Loan receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group did not intend to sell immediately or in the near term. Loans and advances are amounts due from customers in the ordinary course of business. They are initially recognised at fair value plus directly attributable transaction costs and subsequently measured at amortised cost, using the effective interest method, net of any provision for doubtful debts.

**Trade and other liabilities**
These amounts represent liabilities for goods and services provided to the Group prior to the end of the financial year which are unpaid. The amounts are unsecured and are usually paid within 60 days of recognition.

**Borrowings**
Borrowings are initially recognised at fair value, net of directly attributable transaction costs and subsequently measured at amortised cost, using the effective interest method. Any difference between the proceeds (net of transaction costs) and the redemption amount is recognised in profit or loss over the period of the borrowings using the effective interest method. Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. Borrowings are removed from the balance sheet when the obligation specified in the contract is discharged, cancelled or expired.

**Fair value through profit or loss (FVPL)**
The Group may choose to designate, at initial recognition, a financial asset or a financial liability at FVPL if it eliminates or reduces an accounting mismatch. Equity investments are measured at FVPL unless the Group has elected to measure them as FVOCI below.

## 3.1 Financial assets and liabilities (continued)

**Financial assets backing insurance liabilities**

Financial assets backing insurance policies are measured at fair value through profit or loss, with gains and losses being recognised through profit or loss.

### Fair value through other comprehensive income (FVOCI)

**Other financial assets**

The Group may elect to measure its non-traded equity instruments at fair value through other comprehensive income, with only dividend income being recognised in profit or loss.

### Loss provisioning

**Provision for losses on loans and advances**

Loss provisioning is based on a three-stage approach to measuring expected credit losses (ECLs) for loans and advances which is based on the change in credit quality of financial assets since initial recognition:

**Stage 1**: Where there has been no significant increase in the risk of default since origination, reserves reflect the portion of the lifetime ECL from expected defaults in the following twelve months.
**Stage 2**: For assets where there has been a significant increase in risk since origination but are not credit impaired, a lifetime ECL is recognised.
**Stage 3**: For assets deemed as credit impaired, a lifetime ECL is recognised.

The Group determines that a significant increase in risk occurs when an account is more than 30 days delinquent since origination. Exposures are assessed as credit impaired where the Group determines that an account is in default, being an account that is either 90 days or more past due or it is an account identified as bankrupt, deceased or fraudulent or any account in litigation or in hardship. ECLs are derived from probability-weighted estimated loss measures taking account of possible outcomes, the time value of money and current and future economic conditions. Customer loans are grouped on the basis of shared credit risk characteristics and lending type, by product category. As asset quality deteriorates an exposure will move through ECL stages. As asset quality improves, an asset that was previously assessed as a significant increase in credit risk that had lifetime ECL, may in subsequent periods revert back to Stage 1.

Modified loans comprise financial assets under a hardship arrangement or those in the process of litigation. When a flag indicator is removed from the account of a modified financial asset, signalling the end of the modification arrangement, then the loss allowance for the financial asset will revert to being measured at an amount equal to Stage 1 12-month ECL if the financial asset is less than 30 days past due and is not flagged as bankrupt, deceased, fraud, hardship or litigation status. ECL for a previously modified financial asset can subsequently be remeasured at an amount equal to lifetime ECL when the delinquency is between 30 and 89 days past due (Stage 2), or when the delinquency is greater than or equal to 90 days past due, or is flagged as bankrupt, deceased, fraud, hardship or litigation status (Stage 3).

Loans and advances from customers are written off when they are deemed non-collectable at a portfolio level, or at an earlier date depending on customer status. Subsequent recoveries of loans from legal enforcement relating to an amount previously charged off are set off against loan impairment expenses in the combined statement of profit or loss and other comprehensive

## 3.1 Financial assets and liabilities (continued)

income.

**Derivative Financial Instruments**
**(The Group continues to apply hedge accounting under AASB 139).**
Derivatives are classified as FVPL unless they are designated hedging instruments. They are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured to their fair value at the end of each reporting period. The accounting for subsequent changes in fair value depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates derivatives as hedges of a particular risk associated with the cash flows of recognised assets and liabilities and highly probable forecast transactions (cash flow hedges). The Group documents at the inception of the hedging transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. It also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions have been and will continue to be highly effective in offsetting changes in fair values of cash flows on hedged items.

*Cash flow hedge*
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income and accumulated in reserves in net investment. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss within other income. When a hedging instrument expires or is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in net investment at that time remains in net investment and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in net investment is immediately reclassified to profit or loss.

*Derivatives that do not qualify for hedge accounting*
Changes in the fair value of any derivative instrument that does not quality for hedge accounting are recognised immediately in profit or loss within other operating income.

**Offsetting**
Financial assets and liabilities are offset and the net amount is presented in the balance sheet when the Group has a legal right to offset the amounts and intends to settle on a net basis or to realise the asset and settle the liability simultaneously.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.1 Financial assets and liabilities (continued)

### (a) Financial assets and financial liabilities

| **Financial assets** | **Notes** | **Assets designated FVPL $'000** | **Derivatives used for hedging $'000** | **Assets at amortised cost $'000** | **Total $'000** |
|---|---|---|---|---|---|
| **2019** | | | | | |
| Cash and cash equivalents | 3.1(b) | **184,503** | **-** | **227,465** | **411,968** |
| Loans and other receivables | 3.1(c) | **2,195** | **-** | **7,214,944** | **7,217,139** |
| Derivative financial instruments | 3.1(d) | **-** | **3,896** | **-** | **3,896** |
| **Financial assets** | | **186,698** | **3,896** | **7,442,409** | **7,633,003** |
| **2018** | | | | | |
| Cash and cash equivalents | 3.1(b) | 206,120 | - | 312,484 | 518,604 |
| Loans and other receivables | 3.1(c) | 2,923 | - | 7,092,786 | 7,095,709 |
| Derivative financial instruments | 3.1(d) | - | 376 | - | 376 |
| Financial assets | | 209,043 | 376 | 7,405,270 | 7,614,689 |

| **Financial liabilities** | **Notes** | **Derivatives used for hedging $'000** | **Liabilities at amortised cost $'000** | **Total $'000** |
|---|---|---|---|---|
| **2019** | | | | |
| Trade and other liabilities | 3.1(e) | **-** | **338,428** | **338,428** |
| Derivative financial instruments | 3.1(d) | **74** | **-** | **74** |
| Borrowings | 3.1(f) | **-** | **7,830,922** | **7,830,922** |
| **Financial liabilities** | | **74** | **8,169,350** | **8,169,424** |
| **2018** | | | | |
| Trade and other liabilities | 3.1(e) | - | 247,535 | 247,535 |
| Derivative financial instruments | 3.1(d) | 4,426 | - | 4,426 |
| Borrowings | 3.1(f) | - | 7,820,091 | 7,820,091 |
| Financial liabilities | | 4,426 | 8,067,626 | 8,072,052 |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.1 Financial assets and liabilities (continued)

### (b) Cash and cash equivalents

| | 2019<br>$'000 | 2018<br>$'000 |
|---|---|---|
| **Current assets** | | |
| Cash and cash equivalents | **224,305** | 311,439 |
| Short term deposits | **179,617** | 199,789 |
| Restricted cash | **8,046** | 7,376 |
| **Cash and cash equivalents** | **411,968** | 518,604 |

### (c) Loans and other receivables

| | 2019<br>$'000 | 2018<br>$'000 |
|---|---|---|
| **Loans and advances** | | |
| Loans and advances | **7,672,440** | 7,575,455 |
| Unearned income | **(151,294)** | (175,439) |
| Provision for impairment losses | **(322,440)** | (324,867) |
| **Total loans and advances** | **7,198,706** | 7,075,149 |
| | | |
| **Other receivables** | | |
| Trade receivables | **10,577** | 12,398 |
| Other receivables | **7,856** | 8,162 |
| **Total other receivables** | **18,433** | 20,560 |
| | | |
| **Total loans and other receivables** | **7,217,139** | 7,095,709 |
| | | |
| Current | **3,895,438** | 3,510,264 |
| Non-current | **3,321,701** | 3,585,445 |
| **Total loans and other receivables** | **7,217,139** | 7,095,709 |

Due to the short-term nature of the current receivables, their fair value is assumed to be the same as their carrying value. For the majority of the non-current receivables, using discounted cash flows to calculate fair values would not result in significantly different amounts to their carrying amounts values.

Information about the impairment of loans and other receivables, their credit quality and the group's exposure to credit risk and other risks can be found in section 3.2.

## 3.1 Financial assets and liabilities (continued)

### (d) Derivatives

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Current derivative assets | | |
| Interest rate swap contracts - cash flow hedges | **-** | 19 |
| Forward foreign exchange contracts | **34** | 350 |
| Total current derivative financial instrument assets | **34** | 369 |
| | | |
| Non-current derivative assets | | |
| Interest rate swap contracts - cash flow hedges | **3,862** | 7 |
| Total non-current derivative financial instruments | **3,862** | 7 |
| | | |
| **Total derivative assets** | **3,896** | 376 |
| | | |
| Current derivative liabilities | | |
| Interest rate swap contracts - cash flow hedges | **-** | 151 |
| Total current derivative financial instrument liabilities | **-** | 151 |
| | | |
| Non-current derivative liabilities | | |
| Interest rate swap contracts - cash flow hedges | **74** | 4,275 |
| Total non-current derivative financial instrument liabilities | **74** | 4,275 |
| | | |
| **Total derivative liabilities** | **74** | 4,426 |

The Group enters into derivative transactions for economic hedging purposes under International Swaps and Derivatives Association ('ISDA') master agreements. The agreements generally allow for simultaneous netting of payments in relation to each party's obligations for derivative assets and liabilities. Therefore, although the Group does not have a current legal enforceable right of set off and does not offset the assets and liabilities on the balance sheet, it will settle the derivative on a net basis simultaneously when the amounts due or owed are with the same counterparty.

## 3.1 Financial assets and liabilities (continued)

### (e) Trade and other liabilities

| | Notes | 2019 $'000 | 2018 $'000 |
|---|---|---|---|
| **Current** | | | |
| Trade and other payables | | **50,285** | 86,835 |
| Accrued expenses | | **51,524** | 58,956 |
| Payables to related parties | 6.4(e) | **79,889** | 37,225 |
| Customer credit balances | | **42,600** | 40,361 |
| Outstanding Insurance claims liability | | **9,360** | 10,863 |
| Lease liability | | **9,692** | - |
| **Total current trade and other liabilities** | | **243,350** | 234,240 |
| | | | |
| **Non-Current** | | | |
| Trade and other payables | | **6,295** | 7,240 |
| Outstanding Insurance claims liability | | **6,027** | 6,055 |
| Lease liability | | **82,756** | - |
| **Total non-current trade and other liabilities** | | **95,078** | 13,295 |
| | | | |
| **Total trade and other liabilities** | | **338,428** | 247,535 |

The carrying amounts of trade and other liabilities approximates fair value. When measuring lease liabilities, the Group discounts lease payments using its incremental borrowing rate. The weighted-average discount rate applied is 3.9% as at 31 December 2019.

## 3.1 Financial assets and liabilities (continued)

### (f) Borrowings

| | Current | Non-current | 2019 Total | Current | Non-current | 2018 Total |
|---|---|---|---|---|---|---|
| | $'000 | $'000 | $'000 | $'000 | $'000 | $'000 |
| **Secured** | | | | | | |
| Securitisation liabilities | **1,443,135** | **5,496,644** | **6,939,779** | 231,132 | 6,681,042 | 6,912,174 |
| Total secured borrowings | **1,443,135** | **5,496,644** | **6,939,779** | 231,132 | 6,681,042 | 6,912,174 |
| **Unsecured** | | | | | | |
| Shareholder loan | **1,923** | **889,220** | **891,143** | 1,736 | 906,181 | 907,917 |
| Total unsecured borrowings | **1,923** | **889,220** | **891,143** | 1,736 | 906,181 | 907,917 |
| **Total borrowings** | **1,445,058** | **6,385,864** | **7,830,922** | 232,868 | 7,587,223 | 7,820,091 |

Borrowings are shown net of capitalised transaction costs, where unamortised transaction costs of $24.1 million are set off against borrowings at 31 December 2019 (2018: $43.6 million). During the year $3.3 million (2018: $4.9 million) of borrowing costs were capitalised.

Customer loans and advances have been securitised, providing security for amounts owing on notes issued by structured entities. The note holders have full recourse to the pool of loans and advances which have been securitised.

In 2019 the Group continued to develop its funding capacity via securitisation vehicles. On 21 January 2019 the increased Australian Auto Loans Trust committed facility became effective. On 7 February 2019 the Australian Secured Personal Loan trust maturity was extended until 19 August 2019. This trust was subsequently repurchased by Latitude in August 2019 from the sole financier. On 13 September 2019, the Group issued Series 2019-1 under the Latitude Australian Master Trust program for an amount of $750 million. On 22 September 2019 the New Zealand Sales Finance and Credit Cards Trust was refinanced until 22 September 2022.

The contractual maturities attached to the securitisation liabilities range between 2-6 years. Actual securitisation liability repayments occur once the trust reaches contractual amortisation periods (commencing in 0-5 years) based on assumed repayment patterns in the underlying receivables. Refer to Note 3.2(t) for further details relating to liquidity management.

During the year, the terms of the shareholder loan were amended, and the repayment dates were extended from 24 November 2020 to 24 May 2022. The decrease in the shareholder loan of $16.8 million (2018: $11.7million increase) resulted from a repayment of the loan of $19.2 million (2018: nil), offset by a non-cash increase of $2.4 million (2018: $11.7 million) from movements in accrued interest and the effects of exchange rate differences on translation of foreign operations. The increase in securitisation liabilities of $27.6 million (2018: $520.9 million) includes proceeds from issuances and drawdowns of $2,450.5 million (2018: $1,892.7 million), net of repayments of borrowings of $2,455.2 million (2018: $1,436.0 million) and transaction costs paid of $3.3 million (2018: $4.9 million). In addition, there was a non-cash net increase of $35.6 million (2018: $69.1 million) resulting from movements in accrued interest, the effects of exchange rate differences on translation of foreign operations and amortisation of transaction costs.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.1 Financial assets and liabilities (continued)

KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited each have a committed facility that can provide funding for the business. At 31 December 2019, the facilities remained unutilised (2018: $nil). The facilities are secured by a fixed charge over the Group's assets (excluding customer receivables sold into the securitisation trusts above, all collections related to these assets and Insurance assets) and secured by a pledge that imposes certain covenants on the subsidiary that has received those loans. The pledge states that (subject to certain exceptions) the Group will not, unless required by law, under a Trust Document or expressly part of a retailer agreement; provide any other security over the pledged assets; sell or dispose of any assets subject to the pledge, or commingle any pledged assets with non-pledged assets.

Under the terms of the major borrowing facilities, the Group is required to comply with financial covenants. The Group has complied with these covenants during the 2019 financial year.

For the Group's borrowings, the fair values are not materially different to their carrying amounts, since the interest payable on those borrowings is either close to current market rates or the borrowings are of a short-term nature.

## 3.1 Financial assets and liabilities (continued)

### (g) Recognised fair value measurements

The Group uses valuation techniques and hierarchy levels to determine the value of its financial instruments measured at fair value. Three classification levels are used. There were no transfers between levels for recurring fair value measurements during the year.

Level 1**:** This includes instruments for which the valuation is based on quoted market prices.

Level 2**:** This includes instruments that do not have quoted market prices, where observable market data is used to determine fair value.

Forward exchange contracts are valued using forward pricing valuation techniques. The fair value is determined using quoted forward exchange rates at the reporting date and present value calculations based on high credit quality yield curves in the respective currencies.

Interest rate swaps are valued using swap models. The fair value is calculated as the present value of the estimated future cash flows. Estimates of future floating-rate cash flows are based on quoted swap rates, future prices and interbank borrowing rates. Estimated cash flows are discounted using a yield curve constructed from similar sources and which reflects the relevant benchmark interbank rate used by market participants for this purpose when pricing interest rate swaps. The fair value estimate is subject to a credit risk adjustment that reflects the credit risk of the Group and of the counterparty; this is calculated based on credit spreads derived from current credit default swap or bond prices.

Level 3: This category level has no observable market data inputs.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.1 Financial assets and liabilities (continued)

### (h) Recurring fair values

| At 31 December 2019 | Notes | Level 1 $'000 | Level 2 $'000 | Level 3 $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Investments relating to Insurance business | | - | **186,698** | - | **186,698** |
| Derivative financial assets: | | | | | |
| Derivatives used for hedging - interest rate swaps | 3.1(d) | - | **3,862** | - | **3,862** |
| Derivatives used for hedging - foreign exchange contracts | 3.1(d) | - | **34** | - | **34** |
| **Total financial assets** | | - | **190,594** | - | **190,594** |
| **Financial Liabilities** | | | | | |
| Derivatives used for hedging - interest rate swaps | 3.1(d) | - | **74** | - | **74** |
| **Total financial liabilities** | | - | **74** | - | **74** |
| **At 31 December 2018** | | | | | |
| **Financial assets** | | | | | |
| Investments relating to Insurance business | | - | 209,043 | - | 209,043 |
| Derivative financial assets: | | | | | |
| Derivatives used for hedging - interest rate swaps | 3.1(d) | - | 26 | - | 26 |
| Derivatives used for hedging - foreign exchange contracts | 3.1(d) | - | 350 | - | 350 |
| **Total financial assets** | | - | 209,419 | - | 209,419 |
| **Financial Liabilities** | | | | | |
| Derivative financial liabilities | | | | | |
| Derivatives used for hedging - interest rate swaps | 3.1(d) | - | 4,426 | - | 4,426 |
| **Total financial liabilities** | | - | 4,426 | - | 4,426 |

The table shows the fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

### (i) Level 3 fair values

Reconciliation from the opening balance to the closing balance for level 3 fair values:

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| **Other financial assets:** | | |
| Balance 1 January | - | 2,400 |
| **Loss included in OCI** | | |
| Net change in fair value - unrealised | - | (2,400) |
| Balance 31 December | - | - |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.2 Financial risk management

The main risks arising from the Group's financial instruments are credit risk, liquidity risk, interest rate risk and foreign currency risk.

The Group has established risk management processes and has an enterprise risk management framework in place that aims to ensure enterprise risks are effectively identified, measured, monitored and managed. The Group operates under a governance and risk management culture, managed ultimately by a Board Risk Committee, responsible for all enterprise risk. Risk management is cascaded to the business through approved strategies and policies, risk appetite statements and operating procedures that establish appropriate limits and controls to monitor and manage the level of risk exposure. The management committees supporting risk governance include the Asset and Liability Committee, who manage funding, liquidity and market risks, and the Risk Management Committee who manage strategic, credit, operational and financial risks. A 'three-line' of defence model is operated to comply with the risk management framework. Separate Committees govern the Hallmark Insurance business, including for risk and compliance.

Latitude and its subsidiaries may, from time to time, be involved in legal proceedings (including class actions), regulatory actions or arbitration. Such litigation could be commenced by a range of plaintiffs, such as customers, shareholders, suppliers, counterparties and regulators.

In recent years there has been an increase in regulatory action and class action proceedings, many of which have resulted in significant monetary settlements. The risk of regulatory and class actions has been heightened by a number of factors, including regulatory enforcement actions (such as the civil penalty proceedings brought by AUSTRAC), an increase in the number of regulatory investigations and inquiries (such as the Royal Commission), a greater willingness on the part of regulators to commence court proceedings, more intense media scrutiny and the growth of third party litigation funding. Regulatory investigations and class actions commenced against a competitor could also lead to similar proceedings against the Group.

Litigation (including class actions) may, either individually or in aggregate, adversely affect the Group's business, operations, prospects, reputation or financial condition. This risk is heightened by increases in the severity of penalties for certain breaches of the law. Such matters are subject to many uncertainties and the outcome may not be predicted accurately. Furthermore, the Group's ability to respond to and defend litigation may be adversely affected by inadequate record keeping.

Depending on the outcome of any litigation, the Group may be required to comply with broad court orders, including compliance orders, enforcement orders or otherwise pay significant damages, fines, penalties or legal costs.

## Credit risk

Credit risk is the risk of financial loss to the Group if a customer fails to meet their contractual obligations, arising principally from the Group's loans to customers. The maximum exposure of the Group is represented by the carrying amount of loans and advances in the combined balance sheet.

## 3.2 Financial risk management (continued)

*Risk management*
The Group has strategies in place to minimise future losses including the assessment of acceptable concentration of risk. New strategies are implemented to take appropriate action if adverse trends occur.

## 3.2 Financial risk management (continued)

*Exposure*

### (a) Total undrawn exposure of loans and advances to credit risk by credit risk rating grades

| **2019**<br>**Loans and advances undrawn** | **12-month ECL $'000** | **Lifetime ECL not credit impaired $'000** | **Lifetime ECL credit impaired, not POCI^ $'000** | **Lifetime ECL credit impaired, POCI^ $'000** | **Total $'000** |
|---|---|---|---|---|---|
| Very low risk | 8,158,026 | - | - | 2,228 | 8,160,254 |
| Low risk | 797,310 | - | - | 949 | 798,259 |
| Medium risk | 287,185 | - | - | 473 | 287,658 |
| Moderate risk | 53,401 | - | - | 123 | 53,524 |
| High risk | 14,879 | - | - | 48 | 14,927 |
| **Total** | 9,310,801 | - | - | 3,821 | 9,314,622 |

| **2018**<br>**Loans and advances undrawn** | **12-month ECL $'000** | **Lifetime ECL not credit impaired $'000** | **Lifetime ECL credit impaired, not POCI^ $'000** | **Lifetime ECL credit impaired, POCI^ $'000** | **Total $'000** |
|---|---|---|---|---|---|
| Very low risk | 8,015,719 | - | - | 2,307 | 8,018,026 |
| Low risk | 875,446 | - | - | 1,041 | 876,487 |
| Medium risk | 330,093 | - | - | 598 | 330,691 |
| Moderate risk | 63,028 | - | - | 132 | 63,160 |
| High risk | 59,071 | - | - | 30 | 59,101 |
| Unrated | - | - | - | - | - |
| **Total** | 9,343,357 | - | - | 4,108 | 9,347,465 |

^POCI: Purchased or Originated Credit Impaired

## 3.2 Financial risk management (continued)

*Credit risk rating*

### (b) Loans and advances by credit risk rating grades

**2019**

| Gross loans and advances | 12-month ECL $'000 | Lifetime ECL not credit impaired $'000 | Lifetime ECL credit impaired, not POCI^ $'000 | Lifetime ECL credit impaired, POCI^ $'000 | Total $'000 |
|---|---|---|---|---|---|
| Very low risk | 2,443,522 | 1,817 | - | 1,665 | 2,447,004 |
| Low risk | 2,050,397 | 5,598 | - | 3,786 | 2,059,781 |
| Medium risk | 1,571,620 | 8,010 | - | 7,187 | 1,586,817 |
| Moderate risk | 550,731 | 8,197 | - | 4,353 | 563,281 |
| High risk | 482,509 | 156,778 | 311,541 | 16,507 | 967,335 |
| Unrated | 42,406 | 4,695 | 1,121 | - | 48,222 |
| **Total** | 7,141,185 | 185,095 | 312,662 | 33,498 | 7,672,440 |

**2018**

| Gross loans and advances | 12-month ECL $'000 | Lifetime ECL not credit impaired $'000 | Lifetime ECL credit impaired, not POCI^ $'000 | Lifetime ECL credit impaired, POCI^ $'000 | Total $'000 |
|---|---|---|---|---|---|
| Very low risk | 2,335,814 | 1,270 | - | 2,342 | 2,339,426 |
| Low risk | 2,026,569 | 4,772 | - | 6,228 | 2,037,569 |
| Medium risk | 1,560,285 | 6,702 | - | 10,719 | 1,577,706 |
| Moderate risk | 583,960 | 5,329 | - | 6,215 | 595,504 |
| High risk | 561,144 | 153,807 | 241,395 | 26,465 | 982,811 |
| Unrated | 35,426 | 6,016 | 997 | - | 42,439 |
| **Total** | 7,103,198 | 177,896 | 242,392 | 51,969 | 7,575,455 |

^POCI: Purchased or Originated Credit Impaired

The credit risk grade scale is used to summarise the risk distribution of the portfolio, based on the probability of an account going to default as determined by behavioural scorecards.

# Notes to the Combined Financial Statements
**For the year ended 31 December 2019**

## 3.2 Financial risk management (continued)

*Credit quality*
The ageing of loans and advances is shown below:

### (c) Loans and advances by credit quality

| | 2019 | 2018 |
|---|---|---|
| **Gross loans and advances** | **$'000** | **$'000** |
| Neither past due or impaired (not POCI^) | **6,450,468** | 6,267,530 |
| Past due but not impaired (not POCI^) | **875,812** | 1,013,564 |
| Impaired (not POCI^) | **312,662** | 242,392 |
| POCI^ | **33,498** | 51,969 |
| **Total** | **7,672,440** | 7,575,455 |

^POCI: Purchased or Originated Credit Impaired

### (d) Loans and advances past due

| | 2019 | 2018 |
|---|---|---|
| **Gross loans and advances** | **$'000** | **$'000** |
| Current | **6,626,044** | 6,419,235 |
| Past due 1-29 days | **767,336** | 874,307 |
| Past due 30-89 days | **199,959** | 200,953 |
| Past due > 90 days | **79,101** | 80,960 |
| **Total** | **7,672,440** | 7,575,455 |

*Counterparty risk*

The Group is exposed to counterparty risk by holding cash and cash equivalents, and entering into derivatives with financial institutions. Their credit quality can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates:

### (e) Counterparty risk

| | 2019 | 2018 |
|---|---|---|
| | **$'000** | **$'000** |
| **Cash and cash equivalents** | | |
| *Investment grade* | **411,968** | 518,604 |
| **Derivative financial assets** | | |
| *Investment grade* | **3,896** | 376 |

Other financial assets held by the Group are with counterparties with no external credit rating.

## 3.2 Financial risk management (continued)

*Provision for impairment losses*

### (f) Movements in the provision for impairment of loans and advances

Movements in the provision for impairment of loans and advances that are assessed for impairment collectively under AASB 9 are shown below. This includes transition between stages of loans considered modified.

| | Collective provision 12-month ECL | Collective provision lifetime ECL not credit impaired | Collective provision lifetime ECL credit impaired, not POCI^ | Collective provision lifetime ECL credit impaired, POCI^ | Collective provision Total |
|---|---|---|---|---|---|
| | $'000 | $'000 | $'000 | $'000 | $'000 |
| **At 1 January 2018 AASB 139** | | | | | **286,742** |
| Transitional adjustment on adoption of AASB 9 | | | | | 24,253 |
| **At 1 January 2018 remeasured** | **222,982** | **12,664** | **66,020** | **9,329** | **310,995** |
| Effects of exchange rate on translation | 1,548 | 88 | 458 | 65 | 2,159 |
| *Changes in the loss allowance contributed to by changes in the gross carrying amount of financial instruments, due to:* | | | | | |
| i) financial instruments originated during the reporting period | 71,360 | 1,077 | 5,074 | - | 77,511 |
| ii) derecognition of financial instruments during the reporting period | (34,346) | (2,562) | (23,798) | (1,365) | (62,071) |
| iii) change in balance during reporting period | (18,359) | (68) | (2,129) | (1,366) | (21,922) |
| iv) transfers between stages | (6,215) | 864 | 30,100 | 251 | 25,000 |
| ECL calculation impact | (896) | 245 | (5,770) | (454) | (6,875) |
| Other | (149) | (320) | 1,244 | (705) | 70 |
| **At 31 December 2018** | **235,925** | **11,988** | **71,199** | **5,755** | **324,867** |
| **At 1 January 2019** | **235,925** | **11,988** | **71,199** | **5,755** | **324,867** |
| Effects of exchange rate on translation | 435 | 22 | 113 | 4 | 574 |
| *Changes in the loss allowance contributed to by changes in the gross carrying amount of financial instruments, due to:* | | | | | |
| i) financial instruments originated during the reporting period | 70,461 | 1,894 | 4,854 | - | 77,209 |
| ii) derecognition of financial instruments during the reporting period | (24,922) | (3,349) | (25,345) | (907) | (54,523) |
| iii) change in balance during reporting period | (29,750) | (218) | (2,751) | (910) | (33,629) |
| iv) transfers between stages | (18,155) | 7,872 | 31,927 | 119 | 21,763 |
| ECL calculation impact | 8,249 | (135) | 9,923 | 831 | 18,868 |
| Other | (25,426) | (558) | (5,942) | (763) | (32,689) |
| **At 31 December 2019** | **216,817** | **17,516** | **83,978** | **4,129** | **322,440** |

^POCI: Purchased or Originated Credit Impaired

## 3.2 Financial risk management (continued)

*Impairment losses*

### (g) Losses recognised in relation to loans and advances

During the year, the following losses were recognised:

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| **Recognised in profit or loss** | | |
| Movement in provision on loans and advances | **(250,670)** | (11,418) |
| Net impairment loss on loans and advances | **1,843** | (241,959) |
| **Losses recognised in relation to loans and advances** | **(248,827)** | (253,377) |

*Collateral*

### (h) Collateral held

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| **Maximum exposure** | **7,672,440** | 7,575,455 |
| **Collateral classification:** | | |
| Secured (%) | **15.1** | 12.5 |
| Unsecured (%) | **84.9** | 87.5 |

*Guarantees*

The Group does not have any guarantees at 31 December 2019 (2018: $nil).

## 3.2 Financial risk management (continued)

## Foreign exchange risk

The Group has exposures primarily due to the changes in value of non-functional currency assets and liabilities and non-functional forecasted transactions. Material currency exposures are hedged where they are highly probable.

*Risk management*
The Group uses forward foreign exchange contracts to manage its foreign exchange risk. These contracts are not designated as hedging instruments.

*Exposure*

### (i) Exposure to foreign currency risk, expressed in Australian Dollars

| | 31 December 2019 currency risk $'000 | 31 December 2018 currency risk $'000 |
|---|---|---|
| Net open position - US Dollar | **6,775** | (191) |
| Net open position - NZ Dollar | **(49)** | 409 |

*Foreign exchange gains or losses*

### (j) Gains/(losses) recognised in relation to changes in foreign exchange rates

During the year, the following gains/(losses) were recognised:

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| **Recognised in profit or loss** | | |
| Net foreign exchange gains included in other operating income | **53** | 669 |
| **Recognised in other comprehensive income** | | |
| Translation of entities with a non-Australian denominated functional currency recognised in foreign currency translation reserve | **739** | 1,566 |

*Sensitivity*

### (k) Sensitivity to changes in exchange rates to financial instruments denominated in foreign currency

| | Impact on post-tax profit | | Impact on other components of net investment | |
|---|---|---|---|---|
| **Index** | **2019 $'000** | **2018 $'000** | **2019 $'000** | **2018 $'000** |
| USD/AUD exchange rate-increase 10% | **474** | (13) | **-** | - |
| USD/AUD exchange rate-decrease 10% | **(474)** | 13 | **-** | - |
| NZD/AUD exchange rate-increase 10% | **(49)** | 29 | **2,652** | 1,432 |
| NZD/AUD exchange rate-decrease 10% | **49** | (29) | **(2,652)** | (1,432) |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.2 Financial risk management (continued)

## Interest rate risk

The Group's main interest rate risk arises from mismatches in the interest rate characteristics of the receivable assets that yield a fixed rate return and funding that is primarily through floating rate instruments.

*Risk management*
The Group manages its interest rate risk based on the characteristics of the underlying receivables portfolio. Hedging is undertaken for customer receivable products that yield a fixed rate return based on the expected prepayment profiles. Interest rate swaps are used where the Group agrees with other parties to exchange, at specified intervals (mainly monthly), the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts. Swaps currently in place cover floating rate securitisation liabilities relating to fixed rate auto loans and personal loans sold into securitisation trusts. These derivatives are designated in hedging relationships to minimise profit or loss volatility.

The Group determines the existence of an economic relationship between the hedging instrument and hedged item based on the reference interest rates, tenors, repricing dates and the maturities and the notional or par amounts. The Group assesses whether the derivative designated in each hedging relationship is expected to be effective in offsetting changes in cash flows of the hedged item using the hypothetical derivative method.

In these hedge relationships the main source of ineffectiveness are differences in repricing dates between the swaps and the borrowings.

*Exposure*

### (I) Interest rate profile

The exposure of the Group's borrowing to interest rate changes and the contractual re-pricing dates of the interest rate borrowings at the end of the reporting period are as follows:

| | 2019<br>$'000 | 2018<br>$'000 |
|---|---|---|
| Variable rate borrowings | **6,939,779** | 6,912,174 |
| Fixed interest rate - repricing dates: | | |
| 1 – 5 years | **891,143** | 907,917 |
| | **7,830,922** | 7,820,091 |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.2 Financial risk management (continued)

### (m) Interest rate swaps

As at the end of the reporting period, the Group had the following interest rate swap contracts outstanding:

| | 31 December 2019 | | 31 December 2018 | |
|---|---|---|---|---|
| | Weighted average interest rate % | Balance $'000 | Weighted average interest rate % | Balance $'000 |
| Interest rate swaps (nominal amount) | **0.79%** | **2,456,815** | 2.01% | 2,264,288 |

### (n) Amounts relating to items designated as hedged items

| | Change in value used for calculating hedge ineffectiveness $'000 | Cash flow hedge reserve $'000 | Balances remaining in the cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied $'000 |
|---|---|---|---|
| **31 December 2019** | | | |
| **Interest rate risk** | | | |
| Variable rate borrowings | **3,785** | **2,842** | |
| Discontinued hedges [1] | | | **(16,733)** |
| 31 December 2018 | | | |
| **Interest rate risk** | | | |
| Variable rate borrowings | (4,692) | (3,245) | - |

[1] Balance in Cash flow hedge reserve relates to discontinued hedges - Refer to note 3.2(o)

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.2 Financial risk management (continued)

### (o) Amounts relating to items designated as hedging instruments and hedge ineffectiveness

| | Nominal amount $'000 | Carrying amount Assets $'000 | Carrying amount Liabilities $'000 | Changes in the value of the hedging instrument recognised in OCI $'000 | Hedge ineffective-ness recognised in profit or loss $'000 | Amount reclassified from hedge cash flow reserve to profit or loss $'000 |
|---|---|---|---|---|---|---|
| **2019** | | | | | | |
| **Interest rate risk** | | | | | | |
| Interest rate swaps | **2,456,815** | **3,862** | **74** | **3,661** | **124** | **-** |
| Discontinued hedges (1) | | | | **(27,054)** | **175** | **8,609** |
| 2018 | | | | | | |
| **Interest rate risk** | | | | | | |
| Interest rate swaps | 2,264,288 | 26 | 4,426 | (4,714) | 21 | - |

(1) A number of hedge relationships were discontinued in 2019 in order to rebase the economics of fixed rate portfolios of the Group. Gain or losses on discontinued hedges that were in cash flow hedge relationships remain in the reserves until the underlying transactions occur. Any changes in the market value of the discontinued hedges are recognised in the profit or loss from discontinuation.

### (p) Amounts relating to hedged items as continuing hedges and discontinued hedges

| | | Cash flow hedge reserve | | |
|---|---|---|---|---|
| | Hedged risk | Continuing hedges $'000 | Discontinued hedges $'000 | Total $'000 |
| **2019** | | | | |
| **Cash flow hedges** | | | | |
| Variable rate borrowings | Interest rate | **2,842** | **(16,733)** | **(13,891)** |
| 2018 | | | | |
| **Cash flow hedges** | | | | |
| Variable rate borrowings | Interest rate | (3,245) | - | (3,245) |

## 3.2 Financial risk management (continued)

*Fair value gains or losses*

### (q) Gains/(losses) recognised in relation to derivatives designated as cash flow hedges

During the year, the following gains/(losses) were recognised:

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| **Recognised in profit or loss** | | |
| Net gain for ineffective portion of derivatives designated as cash flow hedges | **299** | 21 |
| **Recognised in other comprehensive income** | | |
| (Loss) recognised in other comprehensive income | **(19,255)** | (3,461) |

*Sensitivity*

### (r) Sensitivity to changes in interest rates

| | Impact on post-tax profit | | Impact on other components of net investment | |
|---|---|---|---|---|
| | 2019 $'000 | 2018 $'000 | 2019 $'000 | 2018 $'000 |
| Interest rates - increase by 100 basis points - Increase in profit | **8** | 52 | **29,237** | 26,605 |
| Interest rates - decrease by 100 basis points - Decrease in profit | **(8)** | (52) | **(29,951)** | (27,273) |

The analysis above includes the assessment of cash and derivatives, excluding those within securitisation trusts. Movements in the cash rate would increase or decrease the interest income receivable on cash and receivables and increase or decrease the interest payable on borrowings within the Trusts. However, as these movements would ultimately be reflected in the distribution payable to the Trust beneficiaries, there will be no net impact on the profit or loss attributable to the owners of the Group.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 3.2 Financial risk management (continued)

## Liquidity risk

The Group ensures it has access to liquidity and has the resources to meet its contractual financial obligations during the normal course of business and in periods of stress. This includes maintaining sufficient cash and other liquid assets and flexibility in funding through committed credit lines.

*Risk management*
Funding is monitored on a regular basis and risk management includes forecasts and modelling including stress testing scenarios.

*Financing arrangements*
KVD Australia Holdco Pty Ltd has access to a $15 million (2018: $15 million) bank overdraft facility and Latitude Financial Services Limited has access to a $4.8 million (2018: $4.7 million) bank overdraft facility, that may be drawn at any time and may be terminated by the bank without notice. The facilities are fixed rate facilities that expire within one year, repayable within 90 days of being drawn. As at 31 December 2019 the overdrafts had not been utilised (2018: $nil).

In addition, the Group had access to the following undrawn borrowing facilities at the end of the reporting period, relating to securitisation borrowings disclosed (refer section 3.1 as follows):

### (s) Undrawn facilities

| **Floating rate** | **2019 $'000** | **2018 $'000** |
|---|---|---|
| Borrowing facilities available | **8,906,088** | 8,251,940 |
| Drawn facilities | **(6,958,179)** | (6,948,231) |
| Undrawn facilities | **1,947,909** | 1,303,709 |

*Maturities of financial liabilities*
The tables below analyse the Group's financial liabilities into relevant maturity groupings based on their contractual maturities. The amounts disclosed are the undiscounted cash flows, including both principal and associated future interest payments, but exclude transaction costs that have been set off and therefore will not agree to the carrying amounts on the balance sheet.

## 3.2 Financial risk management (continued)

### (t) Contractual maturities of financial liabilities

| At 31 December 2019 | Less than 6 months $'000 | 6 - 12 months $'000 | Between 1-2 years $'000 | Between 2-5 years $'000 | Over 5 years $'000 | Total contractual cash flows $'000 | Carrying amount (assets)/ liabilities $'000 |
|---|---|---|---|---|---|---|---|
| **Non-derivatives** | | | | | | | |
| Borrowings – Securitisation liabilities | 406,302 | 689,352 | 1,572,186 | 4,249,280 | 568,316 | 7,485,436 | 6,963,924 |
| Borrowings – Shareholder loans | 38,801 | 36,750 | 52,998 | 911,303 | - | 1,039,852 | 891,143 |
| Trade and other liabilities | 338,428 | | | | | 338,428 | 338,428 |
| **Total non-derivatives** | 783,531 | 726,102 | 1,625,184 | 5,160,583 | 568,316 | 8,863,716 | 8,193,495 |
| | | | | | | | |
| **Derivatives** | | | | | | | |
| Derivatives - interest rate swaps | (823) | (181) | (1,244) | (356) | - | (2,604) | 74 |
| **Total derivatives** | (823) | (181) | (1,244) | (356) | - | (2,604) | 74 |
| | | | | | | | |
| At 31 December 2018 | | | | | | | |
| **Non-derivatives** | | | | | | | |
| Borrowings – Securitisation liabilities | 252,999 | 252,639 | 1,432,962 | 5,666,621 | 155,677 | 7,760,898 | 6,955,782 |
| Borrowings – Shareholder loans | 39,607 | 39,607 | 981,523 | - | - | 1,060,737 | 907,917 |
| Trade and other liabilities | 247,535 | - | - | - | - | 247,535 | 247,535 |
| **Total non-derivatives** | 540,141 | 292,246 | 2,414,485 | 5,666,621 | 155,677 | 9,069,170 | 8,111,234 |
| | | | | | | | |
| **Derivatives** | | | | | | | |
| Derivatives - interest rate swaps | 1,760 | 2,375 | 3,375 | 1,385 | - | 8,895 | 4,426 |
| **Total derivatives** | 1,760 | 2,375 | 3,375 | 1,385 | - | 8,895 | 4,426 |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## Section 4 - Capital Management

### 4.1 Commitments

#### (a) Non-cancellable operating leases

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows: | | |
| Within one year | **13,236** | 10,038 |
| Later than one year but not later than five years | **52,998** | 31,505 |
| Later than five years | **43,338** | 28,664 |
| **Commitments for minimum lease payments in relation to non-cancellable operating leases** | **109,572** | 70,207 |

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Rental expense relating to operating leases: | | |
| Minimum lease payments | **13,246** | 13,898 |

The Group leases operational sites and equipment under non-cancellable operating leases within one year to later than five years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated.

From 1 January 2019, the Group has recognised right-of-use assets and a corresponding lease liability for these leases, with the exception of short-term leases and one property lease agreement committed to, but not yet recognised on balance sheet as a lease. This relates to the commencement of a new ten year lease for the premises at 8 Tangihua Street, Auckland from 1 April 2020.

#### (b) Other commitments

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Commitment to extend credit | **9,314,622** | 9,347,465 |
| Capital expenditure | **5,986** | 6,744 |
| **Other commitments** | **9,320,608** | 9,354,209 |

The Group makes commitments to extend credit facilities to its customers in the normal course of business.

The Group is investing significantly in technology developments as it transitions to a more digital business model. At the reporting date, the Group has committed expenditure in relation to a number of technology investment programs.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## Section 5 - Other Assets and Liabilities

### Accounting Policy

**Goodwill**

Goodwill on acquisitions of subsidiaries is included in intangible assets and represents the excess of the cost paid over the fair value of the net identifiable assets acquired at the date of acquisition.

**Customer relationships and distribution agreements**

Separately acquired customer contracts and distribution agreements are shown at historical cost. Those acquired in a business combination are recognised at fair value at the acquisition date. They have a finite useful life and are subsequently carried at cost less accumulated amortisation and impairment losses. Customer contracts are amortised on a straight-line basis over 5-9 years and distribution agreements are amortised on a straight-line basis over 1-9 years.

**Software**

Software relates to IT projects and associated system expenditure that does not result in the acquisition of physical hardware, including software licence acquisitions, upgrades to software platforms, applications and internal functions and network configuration, including internally generated development costs. Software is amortised on a straight-line basis over 1-5 years, or in the case of a licenced intangible, straight line over the licence period.

An intangible asset is recognised if it is probable that the associated future economic benefits will flow to the Group and the cost can be measured reliably where the following criteria are met: it is technically feasible to complete the software so that it will be available for use; it can be demonstrated how the software will generate probable future economic benefits; adequate technical, financial and other resources to complete the development and to use or sell the software are available, and the expenditure attributable to the software during its development can be reliably measured. Any other costs associated with maintaining software are recognised as an expense as incurred.

**Development Activities**

Capitalised development costs are recorded as software intangible assets and amortised on a straight-line basis from the point at which the asset is ready for use, over the useful life of the intangible. Each phase of a project is considered separately to determine the useful life of the project. Development expenses that do not meet the criteria as software above is recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

**Impairment of assets**

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value-in-use. For the purposes of assessing impairment, assets are

## Section 5 - Other Assets and Liabilities (continued)

grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

### Leases
**(AASB 16 - applied from 1 January 2019)**

At inception of a contract, the Group assesses whether a contract is, or contains, a lease and recognises a right-of-use asset and a lease liability at the commencement date.

The Group recognises a right-of-use asset initially at cost, comprising the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle or restore the underlying asset, or restore the site on which it is located. The asset is subsequently depreciated using the straight line method and reduced by impairment losses.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or at the Group's incremental borrowing rate if this is not readily determined. Lease payments included in the measurement of the lease liability comprise:
- fixed payments less any lease incentives receivable
- variable lease payments that depend on an index or rate, initially measured using the rate at commencement date
- amounts expected to be payable by the Group under residual value guarantees
- the exercise price of a purchase option if the Group is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the Group exercising an option to terminate the lease

The lease liability is subsequently adjusted for interest and lease payments made.

The Group's policy is to apply lease accounting to all non low-value leases that are for greater than a 12-month period. For short term or low-value items to which this exemption is applied, lease payments are recognised as an expense over the lease term.

**(AASB 117 - 2018 comparative year)**

Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Group as lessee are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to profit or loss on a straight-line basis over the period of the lease

### Provisions
Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognised for future operating losses. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## Section 5 - Other Assets and Liabilities (continued)

included in the same class of obligations may be small. Provisions are measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The discount rate used to determine the present value is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The increase in the provision due to the passage of time is recognised as interest expense.

### Employee benefit obligations

Short-term obligations: Liabilities for wages and salaries, including non-monetary benefits that are expected to be settled wholly within 12 months after the end of the period in which the employees render the related service are recognised in respect of employees' services up to the end of the reporting period and are measured at the amounts expected to be paid when the liabilities are settled. The liabilities are presented as current employee benefit obligations in the balance sheet.

Other long-term employee benefit obligations - Long service leave: These are measured as the present value of expected future payments to be made in respect of services provided by employees up to the end of the reporting period using the projected unit credit method. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service.

Expected future payments are discounted using market yields at the end of the reporting period of government bonds with terms and currencies that match, as closely as possible, the estimated future cash outflows. Remeasurements as a result of experience adjustments and changes in actuarial assumptions are recognised in profit or loss. The obligations are presented as current liabilities in the combined balance sheet if the entity does not have an unconditional right to defer settlement for at least 12 months after the reporting date, regardless of when the actual settlement is expected to occur.

## Section 5 - Other Assets and Liabilities (continued)

### Equity-based payments

The fair value of units granted under equity based compensation benefits is recognised as employment expenses in the combined income statement with a corresponding increase in net investment. The fair value is recognised at grant date and recognised over the period during which the party becomes unconditionally entitled to the instruments. The fair value is independently determined using an option-granting model as measured at the grant date which includes the terms and conditions of the instruments. The fair value of the instruments granted is adjusted to reflect market vesting conditions, but excludes the impact of any non-market vesting conditions. Non-market vesting conditions are included in assumptions about the number and value of instruments that are expected to become exercisable. The equity-based payment expense recognised each year takes into account the most recent estimate.

### Insurance liabilities

Profits of the Insurance business are brought to account on a margin on services ('MoS') basis. Under MoS, profit (the excess of premium received and investment earnings over claims and expenses including amortised acquisition costs) is recognised as fees are received and services are provided to policyholders. Profit is deferred to the balance sheet when fees have been received but the service has not been provided. Costs associated with the acquisition of policies are deferred on the balance sheet and charged to the profit or loss over the period that the policy will generate profits. Insurance contract liabilities are valued using a method that approximates to the projection method and the liability for outstanding claims is subject to an annual actuarial review.

### Insurance claims

Claims incurred relate to the provision of services and bearing of risks and is treated as an expense. The liability for outstanding claims covers the expected future payments for claims including IBNR and IBNER claims and the anticipated direct and indirect costs of settling these claims. Actuarial methods are used by a qualified person to estimate the value of outstanding claims where generally, this involves analysing available past experience to determine expected future payments. The provision for the outstanding claims liability also contains a risk margin to reflect the inherent uncertainty in the central estimate. The risk margin increases the probability that the net liability is adequately provided for, to a 90% confidence level.

### Outward reinsurance and reinsurance recoveries

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of outwards reinsurance premium is treated at the reporting date as deferred reinsurance expense. Reinsurance recoveries and other recoveries receivable on paid claims, reported claims not yet paid and IBNR's are recognised as revenue.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## Section 5 - Other Assets and Liabilities (continued)

### Assets backing insurance liabilities

The Insurance business has established a target capital to ensure assets are available to meet insurance liabilities. Financial assets designated at fair value through profit or loss are initially recognised at fair value, excluding transaction costs, which are expensed in the combined income statement in the period in which they arise. Financial assets are subsequently measured at fair value at each reporting date with realised and unrealised gains and losses arising from changes in the fair value recognised in the combined income statement in the period in which they arise. Short term deposits are carried at the face value of the amounts deposited as their carrying amounts approximate their fair value. Unlisted fixed interest securities are recorded at amounts based on valuations using rates of interest equivalent to the yields obtainable on comparable investments at the end of the reporting period.

### Unexpired risk liability

Provision is made for unexpired risks arising from general insurance business where the expected value of claims and expenses attributed to the unexpired periods of policies in force at the end of the reporting period exceeds the unearned premiums provision in relation to such policies after the deduction of any deferred acquisition costs. The provision for unexpired risk is calculated separately by reference to separate classes of business, which are managed together, after taking into account the relevant investment return. Unexpired risk liability, if any, remaining after writing off deferred acquisition costs is recognised immediately in the combined income statement.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 5.1 Other Assets and Liabilities

### (a) Intangible assets

| | Goodwill $'000 | Distribution agreements $'000 | Customer contracts $'000 | Software $'000 | Capital works in progress $'000 | Trade-mark $'000 | Total $'000 |
|---|---|---|---|---|---|---|---|
| **At 1 January 2019** | | | | | | | |
| Cost | 522,812 | 161,807 | 267,812 | 116,852 | 50,038 | 166 | 1,119,487 |
| Accumulation amortisation | - | (57,165) | (98,978) | (68,811) | - | (3) | (224,957) |
| Net book amount | 522,812 | 104,642 | 168,834 | 48,041 | 50,038 | 163 | 894,530 |
| **Year ended 31 December 2019** | | | | | | | |
| Opening net book amount | 522,812 | 104,642 | 168,834 | 48,041 | 50,038 | 163 | 894,530 |
| Effects of exchange rate differences on translation of foreign operations | 1,163 | 82 | 236 | 116 | - | 1 | 1,598 |
| Additions | - | - | 1,376 | - | 55,173 | - | 56,549 |
| Amortisation charge | - | (18,454) | (32,240) | (21,704) | - | (33) | (72,431) |
| Impairment loss | - | - | - | (9,309) | (11,206) | - | (20,515) |
| Transfers | - | - | - | 62,109 | (63,672) | - | (1,563) |
| Closing net book amount | 523,975 | 86,270 | 138,206 | 79,253 | 30,333 | 131 | 858,168 |
| **At 31 December 2019** | | | | | | | |
| Cost | 523,975 | 161,889 | 269,424 | 169,768 | 30,333 | 168 | 1,155,557 |
| Accumulation amortisation | - | (75,619) | (131,218) | (90,515) | - | (37) | (297,389) |
| Net book amount | 523,975 | 86,270 | 138,206 | 79,253 | 30,333 | 131 | 858,168 |
| **Year ended 31 December 2018** | | | | | | | |
| Opening net book amount | 517,954 | 122,645 | 197,786 | 43,292 | 32,840 | - | 914,517 |
| Effects of exchange rate differences on translation of foreign operations | 4,858 | 429 | 1,251 | 68 | - | - | 6,606 |
| Additions | - | - | 1,595 | 5,489 | 51,946 | 166 | 59,196 |
| Disposals | - | - | - | (457) | - | - | (457) |
| Amortisation charge | - | (18,432) | (31,798) | (18,904) | - | (3) | (69,137) |
| Impairment loss | - | - | - | - | (14,326) | - | (14,326) |
| Amortisation on disposals | - | - | - | 321 | - | - | 321 |
| Transfers | - | - | - | 18,232 | (20,422) | | (2,190) |
| Closing net book amount | 522,812 | 104,642 | 168,834 | 48,041 | 50,038 | 163 | 894,530 |
| **At 31 December 2018** | | | | | | | |
| Cost | 522,812 | 161,807 | 267,812 | 116,852 | 50,038 | 166 | 1,119,487 |
| Accumulation amortisation | - | (57,165) | (98,978) | (68,811) | - | (3) | (224,957) |
| Net book amount | 522,812 | 104,642 | 168,834 | 48,041 | 50,038 | 163 | 894,530 |

As a result of the investment in digital capability as described a number of legacy assets classified as Capital works in progress have had their useful life reduced, leading to impairment charges in 2019 and 2018. Capital works in progress are impaired when they no longer meet capitalisation criteria. Distribution agreements and customer contracts recognised as part of a business combination in 2015 have remaining amortisation periods of 5 years in Australia and 3 years in New Zealand at 31 December 2019 (2018: 6 years in Australia and 4 years in New Zealand).

## 5.1 Other Assets and Liabilities (continued)

*Impairment testing for cash-generating units containing goodwill*

### (b) Goodwill allocation

Goodwill arises on the acquisition of entities and is allocated to the Group's cash-generating units (CGU's). Goodwill is subject to impairment testing on an annual basis.

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Australia | **396,071** | 396,071 |
| New Zealand | **114,300** | 113,137 |
| Insurance | **13,604** | 13,604 |
| **Total goodwill** | **523,975** | 522,812 |

### (c) Significant estimates: key assumptions used for value-in-use calculations

The recoverable amount of a cash generating unit (CGU) is determined based on value-in-use calculations which require the use of assumptions. The calculations use discounted cash flow projections based on financial forecasts covering a five-year period. Cash flows are extrapolated using a growth rate and a terminal value to yield value appropriate to each CGU. The following table sets out the key assumptions for those CGUs:

| | Australia | | New Zealand | | Insurance | |
|---|---|---|---|---|---|---|
| | 2019 % | 2018 % | 2019 % | 2018 % | 2019 % | 2018 % |
| Pre-tax discount rate | **16.0** | 17.5 | **15.5** | 16.7 | **16.0** | 17.5 |
| Terminal growth rate | **2.7** | 3.0 | **2.4** | 3.0 | **2.7** | 3.0 |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 5.1 Other Assets and Liabilities (continued)

### (d) Provisions

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Current $'000 | Non-Current $'000 | Total $'000 | Current $'000 | Non-current $'000 | Total $'000 |
| Leave obligations | **17,191** | **1,230** | **18,421** | 17,425 | 762 | 18,187 |
| Other employee benefit obligations | **14,345** | **-** | **14,345** | 18,373 | - | 18,373 |
| **Total employee benefit obligations** | **31,536** | **1,230** | **32,766** | 35,798 | 762 | 36,560 |
| **Customer remediation provisions** | **39,251** | **1,952** | **41,203** | 21,676 | 2,057 | 23,733 |
| **Total provisions** | **70,787** | **3,182** | **73,969** | 57,474 | 2,819 | 60,293 |

Leave obligations represent the Group's liability for long service leave and annual leave. The current portion of this liability includes all of the accrued annual leave, the unconditional entitlements to long service leave where employees have completed the required period of service and also those where employees are entitled to pro-rata payments in certain circumstances. Other employee benefit obligations cover the Group's liability for other employee benefit obligations such as bonus payments.

Customer remediation includes provisions for expected refunds to customers, related customer claims and remediation project costs.

### (e) Gross insurance policy liabilities

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Current | **35,902** | 45,583 |
| Non-current | **29,332** | 37,387 |
| Total gross insurance policy liabilities | **65,234** | 82,970 |

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods

Contracts under which the Insurance group accepts significant insurance risk from the policyholder, or another party, by agreeing to compensate the policyholder, or other beneficiary, if a specified uncertain future event adversely affects the policyholder or other beneficiary, are classified as insurance contracts. Any products sold that do not meet the definitions of a life insurance contract are classified as life investment contracts. The Insurance business has no life investment contracts.

Insurance risk is defined as significant if and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (i.e. have no discernible effect on the economics of the transaction). Insurance contracts include those where the insured benefit is payable on the occurrence of a specified event such as death, injury or disability caused by accident or illness. The insured benefit is either not linked or only partly linked to the market value of the investments held by the Insurance group, and the financial risks are substantially borne by the Insurance group.

The life insurance operations of the Insurance group are conducted within separate Statutory funds as required by the *Life Insurance Act 1995* and are reported in aggregate with the Shareholders' fund in the statement of profit or loss and other comprehensive income, balance sheet and statement of cash flows of the Group. Monies held in the Statutory funds are subject to the distribution and transfer restrictions and other requirements of the *Life Insurance Act 1995*.

## Life insurance actuarial assumptions and methods

The following section describes the process surrounding, and key factors used to estimate the policy liabilities in the actuarial report:

### (a) Basis of preparation

The effective date of the actuarial report on policy liabilities and capital requirements is 31 December 2019. The actuarial report was prepared by Mr. Thomas David Millar, FIAA, FNSZA. The actuarial report indicates that Mr. Millar is satisfied as to the accuracy of the data upon which policy liabilities have been determined.

The amount of policy liabilities has been determined in accordance with methods and assumptions disclosed in these financial statements and the requirements of the relevant accounting standards (which may differ from the requirements of the Life Insurance Act 1995).

**Policy Liabilities for Insurance Contracts**
Policy liabilities for insurance contracts have been determined in accordance with AASB 1038 Life Insurance Contracts and have been calculated in accordance with Prudential Standard LPS 340 Valuation of Policy Liabilities issued by the Australian Prudential Regulation Authority (APRA). These require policy liabilities to be calculated in a way which allows for the systematic release of planned margins as services are provided to policy owners.

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

The profit carriers used for the major product groups in order to achieve the systematic release of planned margins are as follows:

| Product group | Method (projection or other) | Profit carrier |
|---|---|---|
| Lump sum risk | Accumulation (2018: Accumulation) | Claims (implied) |
| Disability and involuntary unemployment income | Accumulation (2018: Accumulation) | Claims (implied) |

Policy liabilities have been calculated as the provision for unearned premium, less a deferred acquisition cost item. The recognition rate of premium has been chosen to approximate the planned margin release that would be achieved through use of the projection method.

### (b) Disclosure of assumptions

Assumptions are required to establish recoverability of acquisition costs:

(i) Discount rates

The gross interest rates used are the gross yield to redemption of benchmark government securities. For the current valuation, these are:
90 days: Australia 0.93% (2018: 2.09%), New Zealand 1.29% (2018: 1.97%)
5 years: Australia 1.04% (2018: 1.99%), New Zealand 1.36% (2018: 1.85%)

(ii) Inflation rates

Allowance for future inflation:
Australia 2.5%. (2018: 2.5% p.a.) where future inflation assumption is based on the long-term target range of the Reserve Bank of Australia of 2% - 3%.
New Zealand 2.0% (2018: 2.0% p.a.) where future inflation assumption is based on the medium-term target range of the Reserve Bank of New Zealand of 1% - 3%.

(iii) Future expenses and indexation

Maintenance expense assumptions have been based on the experience in the current year and budgeted expenses for the 2020 year. Inflation adjustments are consistent with the inflation assumption.

(iv) Mortality and morbidity

Mortality rates for risk products have been based on experience over recent years. A loss ratio approach (applied to earned premium) was adopted. The loss ratios used have not varied significantly from those used in 2018.

(v) Disability and involuntary unemployment

The general approach to actuarial estimation of disability and involuntary unemployment liabilities (in the New Zealand statutory fund) is to analyse all available past experience. This analysis allows patterns to be identified in the past experience. Based on this, development patterns associated with the run-off of outstanding claims at the balance date can be estimated. The estimate of the outstanding claims includes an allowance for claims incurred but not reported ("IBNR") and the further development of reported claims, a risk margin and

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

claims handling expense provision. Actuarial methods such as payment per claim incurred (PPCI), Payment Chain Ladder ("PCL") and Bornheutter Ferguson ("BF") are adopted to estimate the outstanding claims.

The key actuarial assumptions for the determination of the outstanding claims liabilities are average claim size (Disability = NZ$1,220, Unemployment = NZ$661), a claims handling expense rate of 15.5% of the projected gross claim payments (based on expense investigation) and a discount rate of 1.12% (based on the yield of 1 year and 2 year New Zealand Government bond yield as at 31 December 2019). Across all classes, changes to the claim termination and average claim size assumptions would cause the most significant change to the liability estimate.

(vi) Voluntary discontinuance

Voluntary discontinuance rates vary by product and have been based on the Group's recent discontinuance experience.

For the major classes of Australian business, the assumed aggregate rates of discontinuance are:
Consumer credit insurances - 31% p.a.(2018: 35% p.a.)
Regular premium term life insurances - 17% p.a.( 2018: 18% p.a.)

For the major classes of New Zealand business, the assumed aggregate rates of discontinuance are:
Consumer credit insurances - 39% p.a.(2018: 40% p.a.)

(vii) Capital requirements

The Group is required to hold prudential reserves, over and above the policy liabilities, as a buffer against adverse future experience and poor investment returns. The methods and bases used for determining the capital requirements were in accordance with the requirements of Prudential Standard *LPS 110: Capital Adequacy* as issued by APRA.

### (c) Impact of changes in assumptions

The policy liabilities for insurance contracts have been calculated using the accumulation method. Under this method, changes in assumptions do not have any impact on policy liabilities in the current period, unless a product enters loss recognition. As at 31 December 2019, the assumption changes have not resulted in any of the related product groups entering loss recognition, and hence the policy liability has not been impacted by changes in assumptions.

The value of future profit margins is not explicitly calculated under the accumulation method and hence the impact of any change in assumptions on the value of future profit margins is not determined.

### (d) Sensitivity analysis

Movements in key variables such as mortality experience, lapse rates and expenses will have an impact on the future cash flows, performance and net assets of the business.

As the accumulation method is used to determine policy liabilities for insurance contracts, changes in the assumptions around these key variables do not have any impact on the policy

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

liability or retained profits at the current balance date, unless a product group enters loss recognition. An alternate approach to demonstrating the sensitivity to changes in variables is to consider the impact on profit and net investment at the current balance date if the experience over the current financial period varied under certain scenarios. The table below considers a number of changes in variables, and shows the impact on the profit and net investment if that change had been experienced during the financial reporting period.

| 31/12/2019 ($'000) Australia | Percentage change in Assumptions | Impact on 2019 income statement | | Impact on 2019 net investment | |
|---|---|---|---|---|---|
| | | Gross of Reinsurance | Net of Reinsurance | Gross of Reinsurance | Net of Reinsurance |
| Mortality/morbidity | Worsening by 5% | (90) | (85) | (90) | (85) |
| | Improving by 5% | 90 | 85 | 90 | 85 |
| Lapse rates | Worsening by 5% | 20 | 20 | 20 | 20 |
| | Improving by 5% | (20) | (20) | (20) | (20) |
| Expenses | Worsening by 5% | (158) | (158) | (158) | (158) |
| | Improving by 5% | 158 | 158 | 158 | 158 |

| 31/12/2018 ($'000) Australia | Percentage change in Assumptions | Impact on 2018 income statement | | Impact on 2018 net investment | |
|---|---|---|---|---|---|
| | | Gross of Reinsurance | Net of Reinsurance | Gross of Reinsurance | Net of Reinsurance |
| Mortality/morbidity | Worsening by 5% | (144) | (119) | (144) | (119) |
| | Improving by 5% | 144 | 119 | 144 | 119 |
| Lapse rates | Worsening by 5% | 32 | 32 | 32 | 32 |
| | Improving by 5% | (32) | (32) | (32) | (32) |
| Expenses | Worsening by 5% | (169) | (169) | (169) | (169) |
| | Improving by 5% | 169 | 169 | 169 | 169 |

| 31/12/2019 ($'000) New Zealand | Percentage change in variables | Impact on 2019 income statement | | Impact on 2019 net investment | |
|---|---|---|---|---|---|
| | | Gross of Reinsurance | Net of Reinsurance | Gross of Reinsurance | Net of Reinsurance |
| Mortality/morbidity | Worsening by 5% | (34) | (34) | (34) | (34) |
| | Improving by 5% | 34 | 34 | 34 | 34 |
| Lapse rates | Worsening by 5% | 12 | 12 | 12 | 12 |
| | Improving by 5% | (12) | (12) | (12) | (12) |
| Expenses | Worsening by 5% | (41) | (41) | (41) | (41) |
| | Improving by 5% | 41 | 41 | 41 | 41 |

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

| 31/12/2018 ($'000) New Zealand | Percentage change in variables | Impact on 2018 income statement | | Impact on 2018 net investment | |
|---|---|---|---|---|---|
| | | Gross of Reinsurance | Net of Reinsurance | Gross of Reinsurance | Net of Reinsurance |
| Mortality/morbidity | Worsening by 5% | (41) | (41) | (41) | (41) |
| | Improving by 5% | 41 | 41 | 41 | 41 |
| Lapse rates | Worsening by 5% | 11 | 11 | 11 | 11 |
| | Improving by 5% | (11) | (11) | (11) | (11) |
| Expenses | Worsening by 5% | (43) | (43) | (43) | (43) |
| | Improving by 5% | 43 | 43 | 43 | 43 |

## General insurance actuarial assumptions and methods

The Group writes consumer credit insurances across Australia and New Zealand, including involuntary unemployment, disability, merchandise and price protection and stolen card cover.

### (e) Process used to determine outstanding claims liabilities (actuarial methods)

The general approach to the estimation of Outstanding Claims Liabilities is to analyse all available past experience, including the number of reported and finalised claims, timing and amounts of claim payments. This analysis allows patterns to be identified in the past experience. Based on this, development patterns associated with the run-off of outstanding claims and premium liabilities at the balance date can be estimated. Claims incurred all relate to providing services, including the bearing of risk, and are accordingly treated as expenses in the income statement. Claims expenses represent total claim payments made during the year adjusted for the movement in the outstanding claims liability. The determination of the outstanding claims liabilities involves two steps:

1. The determination of the central estimate of outstanding claims at the balance date. The central estimate of outstanding claims includes an allowance for claims incurred but not reported ("IBNR") and the further development of reported claims, also known as incurred but not enough reported ("IBNER"). The central estimate has no deliberate bias towards either over or under estimation. This means that the central estimate is assessed to have approximately 50% probability of adequacy.

2. The determination of a risk margin and claims handling expense provision to be added to the central estimates of outstanding claims. The risk margin is intended to achieve a 90% probability of adequacy at an aggregate level. The estimation of the outstanding claims liabilities involves the use of the following standard aggregate projection methods: Payment Chain Ladder ("PCL"); Payment Per Claim Incurred ("PPCI"); Payment Per Claim Finalised ("PPCF"); Payment Per Claim Handled ("PPCH") and Bornheutter Ferguson ("BF"). A blend of the projection methods is adopted based on the nature of the claims within each portfolio to estimate the appropriate outstanding claims.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

### (f) Actuarial assumptions

The key actuarial assumptions for the determination of the outstanding claims liabilities of the consumer credit insurance portfolios are as follows:

| **2019** | **Disability (Personal Loans)** | **Unemployment (Personal Loans)** | **Disability (Credit Cards)** | **Unemployment (Credit Cards)** | **Protection^** |
|---|---|---|---|---|---|
| **Australia:** | | | | | |
| Number of future finalisations | 641 | 263 | 443 | 483 | 938 |
| Discounted loss ratio | 35% | 22% | 17% | 21% | 23% |
| Expense rate | 15.5% | 15.5% | 15.5% | 15.5% | 15.5% |
| Discount rate | 0.9%pa-2.7%pa | 0.9%pa-2.7%pa | 0.9%pa-2.7%pa | 0.9%pa-2.7%pa | 0.9%pa-2.7%pa |
| **New Zealand:** | | | | | |
| Number of future finalisations | 251 | 121 | 106 | 69 | 37 |
| Discounted loss ratio | 26% | 8% | 26% | 12% | 7% |
| Expense rate | 15.5% | 15.5% | 15.5% | 15.5% | 15.5% |
| Discount rate | 1.12% | | | | |

| **2018** | **Disability (Personal Loans)** | **Unemployment (Personal Loans)** | **Disability (Credit Cards)** | **Unemployment (Credit Cards)** | **Protection^** |
|---|---|---|---|---|---|
| **Australia:** | | | | | |
| Number of future finalisations | 688 | 238 | 388 | 363 | 733 |
| Discounted loss ratio | 36% | 18% | 12% | 17% | 13% |
| Expense rate | 13.5% | 13.5% | 13.5% | 13.5% | 13.5% |
| Discount rate | 1.8%pa-3.2%pa | 1.8%pa-3.2%pa | 1.8%pa-3.2%pa | 1.8%pa-3.2%pa | 1.8%pa-3.2%pa |
| **New Zealand:** | | | | | |
| Number of future finalisations | 211 | 89 | 79 | 47 | 58 |
| Discounted loss ratio | 27% | 7% | 18% | 10% | 6% |
| Expense rate | 13.5% | 13.5% | 13.5% | 13.5% | 13.5% |
| Discount rate | 1.71% | 1.71% | | | |

^ Merchandise protection, price protection and stolen cards (credit cards)

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

The above key actuarial assumptions were based on the following:

- Future finalisations - based on an analysis of historical claim reports and finalisation rates, enabling the future numbers of reports, handled claims and finalisations to be projected.
- Adopted average claim size - based on historic ratios of claim payments to factors such as number of claims reported, handled or finalised.
- Adopted claims handling expense rate – determined based on the results of an expense investigation.
- Central estimates of the outstanding claims liabilities - discounted to allow for future investment income attributable to the liabilities during the run off period. The discount factor is based on annual risk-free rates of return, derived from Government bond yield curves.
- Other assumptions - the outstanding claims provision for disability (Personal Loans) includes an additional 1.3% for medical expenses, with a prudential margin calculated at a 90% probability of adequacy.

### (g) Sensitivity analysis

The outstanding claims liabilities included in the reported results are calculated based on the key actuarial assumptions as disclosed above. The movements in any of the above key actuarial assumptions will impact the performance and net investment of the Group. The table below describes how a change in each of the assumptions will affect the outstanding claims liabilities.

| Key actuarial assumptions 2019 | Changes | Impact on net outstanding claims liabilities ($'000's) | Impact on total outstanding claims liabilities (%) |
|---|---|---|---|
| **Australia:** | | | |
| Reported claims chain ladder factor | Increase the chain ladder factor by 10% | +230 | +2.1 |
| Discount rate | Decrease discount rate by 1% | +116 | +1.1 |
| Claims handling expense rate | Increase claims handling expense rate by 4% | +412 | +3.8 |
| **New Zealand:** | | | |
| Chain ladder factor | Increase the chain ladder factor by 10% | +34 | +1.14 |
| Discount rate | Decrease discount rate by 1% | +26 | +0.86 |
| Claims handling expense rate | Increase claims handling expense rate by 4% | +117 | +3.9 |

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 5.2 Summary of Hallmark life and general actuarial assumptions and methods (continued)

| **Key actuarial assumptions 2018** | **Changes** | **Impact on net outstanding claims liabilities ($'000's)** | **Impact on total outstanding claims liabilities (%)** |
|---|---|---|---|
| **Australia:** | | | |
| Reported claims chain ladder factor | Increase the chain ladder factor by 10% | +249 | +2.0 |
| Discount rate | Decrease discount rate by 1% | +136 | +1.1 |
| Claims handling expense rate | Increase from claims handling expense rate by 4% | +477 | +3.8 |
| **New Zealand:** | | | |
| Chain ladder factor | Increase the chain ladder factor by 10% | +30 | +1.12 |
| Discount rate | Decrease discount rate by 1% | +23 | +0.87 |
| Claims handling expense rate | Increase from claims handling expense rate by 4% | +107 | +3.98 |

# Notes to the Combined Financial Statements
**For the year ended 31 December 2019**

## Section 6 - Other Disclosures

## 6.1 Interests in other entities

### (a) Material subsidiaries

The Group's principal subsidiaries at 31 December 2019 are set out below. Unless otherwise stated, they have share capital consisting solely of ordinary shares that are held directly by the Group, and the proportion of ownership interests held equals the voting rights held by the Group. The country of incorporation or registration for all entities is Australia or New Zealand, which is also their principal place of business.

| Name of entity | Ownership held by Group | | Ownership held by NCI | | Principal activities |
|---|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 | |
| | % | % | % | % | |
| **Country of incorporation - Australia:** | | | | | |
| KVD Australia Pty Ltd* | **100** | 100 | **-** | - | Group financier |
| Latitude Financial Services Australia Holdings Pty Ltd* | **100** | 100 | **-** | - | Employer/servicer |
| Latitude Finance Australia* | **100** | 100 | **-** | - | Sales finance/credit cards |
| Latitude Automotive Financial Services* | **100** | 100 | **-** | - | Automotive lending |
| Latitude Personal Finance Pty Ltd* | **100** | 100 | **-** | - | Personal lending |
| LatitudePay Pty Ltd* | **100** | - | **-** | - | Buy now pay later |
| Latitude Finance JV HoldCo Pty Ltd* | **100** | 100 | **-** | - | Dormant |
| Hallmark Life Insurance Company Ltd | **100** | 100 | **-** | - | Life insurer |
| Hallmark General Insurance Company Ltd | **100** | 100 | **-** | - | General insurer |
| KVD TM Pty Ltd | **100** | 100 | **-** | - | Trust manager |
| Latitude Insurance Holdings Pty Ltd | **100** | 100 | **-** | - | Holding company |
| Australian Sales Finance and Credit Cards Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Australian Personal Loans Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Australian Auto Loans Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Australian Secured Personal Loans Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Australian Sales Finance and Credit Cards Trust No.2 | **-** | - | **100** | 100 | Securitisation of receivables |
| Latitude Australia Credit Card Master Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Latitude Australia Credit Card Loan Note Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Latitude Australia Personal Loans Series 2017-1 Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Latitude Investment Holdings Pty Ltd | **100** | 100 | **-** | - | Trust management |
| Latitude Investment Holdings No.1 Pty Ltd | **100** | 100 | **-** | - | Trust management |
| Latitude Investment Trust | **-** | - | **100** | 100 | Investment Trust |
| Latitude Investment Sub-Trust 1 | **-** | - | **100** | 100 | Investment Trust |
| Latitude Investment Sub-Trust 2 | **-** | - | **100** | 100 | Investment Trust |
| Latitude Investment Sub-Trust 3 | **-** | - | **100** | 100 | Investment Trust |
| Latitude Investment Sub-Trust 4 | **-** | - | **100** | 100 | Investment Trust |
| **Country of incorporation - New Zealand:** | | | | | |
| New Zealand Sales Finance and Credit Cards Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| New Zealand Personal Loans Trust | **-** | - | **100** | 100 | Securitisation of receivables |
| Latitude New Zealand Credit Card Master Trust | **-** | - | **100** | - | Securitisation of receivables |
| Latitude Innovation Holdings Limited^ | **100** | 100 | **-** | - | Payment platform |

* These subsidiaries have been granted relief from the necessity to prepare financial reports in accordance with Instrument 2016/785 issued by the Australian Securities and Investments Commission. KVD Australia Holdco Pty Ltd, the holding entity and these subsidiaries, are party to a closed group within a deed of cross guarantee. LatitudePay Pty Ltd joined as a party to the deed of cross guarantee effective 24 October 2019.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 6.1 Interest in other entities (continued)

### (b) Structured entities

A structured entity is one that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements. The Group uses structured entities to support its loan securitisation program. They are consolidated by the Group as it is exposed to variable returns from the securitised entities and it has the ability to affect those returns through its power over the activities of the structured entities.

## 6.2 Contingent liabilities and contingent assets

Latitude is subject to a number of obligations which, if not discharged or considered not to be discharged, may give rise to potential claims or other costs. Where some loss from an actual or alleged non-performance of an obligation is more likely than not and can be reliably estimated, provisions have been made. The Group considers that the outcome of any specific enquiry which is underway as at 31 December 2019, and has not been provided for, is not expected to affect its financial position in any material way, either individually or in aggregate.

**Regulatory and customer exposures**

In recent years there has been an increase in the number of matters on which the industry Group engages with its regulators. There have also been significant increases in the nature and scale of regulatory investigations, surveillance and reviews, civil and criminal enforcement actions (whether by court action or otherwise), formal and informal inquiries, regulatory supervisory activities and the quantum of fines issued by regulators, particularly against financial institutions both in Australia and globally.

The Group has received various notices and requests for information from its regulators as part of both industry-wide and Group-specific reviews and has also made disclosures to its regulators at its own instigation. The nature of these interactions can be wide ranging and, for example, currently include a range of matters including responsible lending practices, regulated lending requirements, product suitability and distribution, interest and fees and the entitlement to charge them, customer remediation and insurance distribution. There may be exposures to customers which are additional to any regulatory exposures. These could include class actions, individual claims or customer remediation or compensation activities. The outcomes and total costs associated with such reviews and possible exposures remain uncertain.

There is a risk that the actual cost of responding to any inquiry or penalty paid following any settlement or determination by a Court for any legal proceedings may be materially higher or lower than the provision or that any contingent liability may be larger than anticipated. There is also a risk that additional litigation or contingent liabilities may arise, all of which could adversely affect our business, prospects, reputation, financial performance or financial condition.

**Taxation**

The tax affairs of the Group are subject to review by the Australian Taxation Office ('ATO') as well as the revenue offices of the various Australian states and territories from time to time.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 6.2 Contingent liabilities and contingent assets (continued)

In particular, the ATO is completing assurance reviews of the top 1,000 companies in Australia. In February 2019, the ATO completed an assurance review of the Group and provided an assurance report which raised a number of matters that the ATO may consider further. The ATO advised in early February 2021 that they will revert with further enquires over the next few months consistent with their top 1000 company review timetable. Accordingly, any potential outcomes and total costs associated with any such activities remain uncertain at this time. One of these matters relates to the corporate structure of the Group and distributions made as part of that structure. Should the Group be subject to a future tax obligation arising from those distributions, the Shareholders have agreed in principle a mechanism to reduce the Group's possible exposure to that issue to an immaterial amount. The Group considers that the residual risk stemming from the items raised in the report is not likely to materially affect its financial position, either individually or in aggregate.

## 6.3 Events occurring after the reporting period

The Coronavirus/COVID-19 outbreak became a global pandemic during the first half of 2020. When the pandemic arose, the duration, scale and impact of the outbreak was uncertain. Multiple lockdowns across both Australia and New Zealand and increased unemployment rates negatively impacted the volume of customer spending and drove higher credit impairment provisioning charges in the 6 months ended 30 June 2020. In addition, customer loan receivable balances fell as customers paid off balances assisted by government stimulus in both Australia and New Zeeland including early access to superannuation balances in Australia, leading to a decline in interest and fee income. In response to the rapidly changing situation, Latitude's Management team and Boards of its controlled entities implemented an action plan, in accordance with Australian and New Zealand Government guidelines, in early March 2020 to mitigate the impact of COVID-19 on its operations.  These action plans focused on Customers, Employees, the Latitude business and Latitude's funding arrangements as follows:

Customers: A dedicated customer information hub was established to ensure that customers were aware of what help and solutions were available, including access to a Hardship program. The Hardship process was simplified making it easier for customers and enabling Latitude to provide a solution to more customers faster. To find additional ways to support customers, during April 2020, Latitude began e mailing customers about Latitude COVID-19 Assistance Programs available, including balance settlement offers, a program offering some customers a temporary interest rate of 0% and reduced minimum monthly payments.

Employees: Latitude ceased all international travel and halted domestic travel within Australia and New Zealand in mid-March 2020. A travel registry and self-isolation policy was also introduced to reduce risk, on return from International travel. To ensure the safety of employees and the workplace, a working from home strategy was put in place in late March 2020 that included technology to replicate the telephony infrastructure for customer contact, general internal communications for phone and videoconferencing. This enabled a large proportion of staff to carry out their roles and support customers and partners from home whilst some operational and other critical staff continued to support customers and partners from office locations. To ensure employee safety, additional cleaning precautions and workstation etiquette was implemented. Additionally, the management of staff well-being and communication on the pandemic was enhanced through the creation of a central employee information hub and additional People & Culture Team communication.

## 6.3 Events occurring after the reporting period (continued)

Latitude Business: The Management team and Boards of the Group's controlled entities continue to assess the potential financial and operational impacts on the Group and its controlled entities, including the impact on expected credit losses on customer receivables. The Group has experienced a reduction in loans and advances and a movement in the provision for impairment losses since the balance date (refer below), however, proactive steps have been taken including preparation of financial forecasting scenarios, cashflow forecasting, the tightening of credit underwriting standards and the review of credit risk models. The IFRS 9 expected credit loss provisioning models at balance date increased as a result of a significant increase in Hardship inventory impacting the Stage 3 population, especially in Australia, and a significant increase in the Stage 1 and 2 probability of default (hardship) due to the increase in Hardship inventory. Latitude also increased the provision for expected credit losses at 31 December 2020 by an additional $71 million above the core model provision to reflect the 12-month macroeconomic outlook at that time. This increase was based on internal business projections for future delinquency and loss which anticipate increase levels of stress across the portfolios due to multiple factors at that time. This subsequent increase in provisioning levels covers both receivables from 31 December 2019 and receivables originated since that date.

Latitude Funding Arrangement: Balance sheet funding was strengthened during 2020 with the refinancing of warehouse borrowing facilities for both credit cards and personal loans and the issuance on 26 February 2020 of $500 million 2020-1 Series loan notes through the Latitude Australia Personal Loans Series 2020-1 Trust. In June 2020 the Australian Sales Finance and Credit Card Trust financing was extended from 22 September 2020 to 22 December 2022 and the total commitment level of the facility was increased by $202 million to $1,429 million. In September 2020, the Australian Auto Loans Trust financing was extended from 19 February 2021 to 21 September 2023 and the total commitment level of the facility was increased by $48 million to $808 million and on 19 October 2020 the New Zealand Personal Loans Trust financing was extended from 17 February 2021 to 17 September 2023. On 24 December 2020, Latitude executed the contracts for the refinancing of the Australian Personal Loans Trust for its personal lending portfolios, with settlement completing after the balance sheet date, on 19 January 2021. The total commitment level of the facility was reduced by $162 million to $1,038 million and the scheduled amortisation date was extended from 17 February 2021 to 17 January 2024.

On 4 February 2021, an Amending Deed was executed to increase the limit for the Australian Auto Loan Trust from $808 million to $926m creating $118m of additional headroom.

In June 2020, the Group also sold its Residential Loan portfolio, a run-off line of business that was a legacy of the previous GE ownership. The sale completed on 14 August 2020, where the Group recognised a loss on sale of $5.6 million.

On 5 February 2021 KVD Australia Holdco Pty Ltd lodged an application for change of company type (ASIC Form 206) to convert the company from a proprietary company limited by shares to a public company limited by shares. At the date of signing the application was still in progress.

## 6.4 Related party transactions

### (a) Parent entity

KVD Singapore Pte. Ltd, a company incorporated in Singapore has 100% ownership interest (2018: 100%) in KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited and is the ultimate owner of the Group.

### (b) Subsidiaries

Interests in subsidiaries are set out in Section 6.1(a).

### (c) Key management personnel compensation

The following compensation is paid to Key Management Personnel (KMP) covering Latitude Financial Services Group and any Australian and New Zealand related party entities:

| | 2019<br>$ | 2018<br>$ |
|---|---|---|
| Short-term employee benefits | **11,219,830** | 7,170,998 |
| Long-term benefits | **119,055** | 28,235 |
| Post-employment benefits | **293,575** | 387,053 |
| Termination benefits | **-** | 150,402 |
| Share based payments | **8,248,072** | 4,861,508 |
| At 31 December | **19,880,532** | 12,598,196 |

At 31 December 2019 KMP had outstanding balances payable totalling $67,194 (2018: $37,903) in respect of lending products. The total available credit facility during the period was $284,373 (2018: $241,219) and the maximum drawn amount during the period was $105,290 (2018: $104,935).

Interest charged on these products issued to KMP was at normal consumer rates and under normal terms and conditions.

Compensation paid above includes share based awards that were granted to participants during their time in a KMP role during the year, as follows:

| | 2019<br>$ | 2018<br>$ |
|---|---|---|
| At 1 January | **3,858,800** | **5,765,785** |
| Granted | **9,941,979** | **-** |
| Equity adjustments | **829,474** | **(1,906,985)** |
| At 31 December | **14,630,253** | 3,858,800 |

## 6.4 Related party transactions (continued)

### (d) Transactions with other related parties

The Group's related parties are predominantly its parent and subsidiaries, KMP and parties with significant influence over the Group arising from its funding and securitisation structure. Transactions between KVD Australia Holdco Pty Ltd, Latitude Financial Services Limited, and their respective subsidiaries are eliminated on consolidation and are not disclosed in this note. Outstanding balances at year end are unsecured.

| | 2019<br>$ | 2018<br>$ |
|---|---|---|
| *Rendering and receiving of services* | | |
| Amounts paid to entities with significant influence | **(6,092,500)** | (6,090,617) |
| Distributions paid to entities with significant influence | **(48,872,285)** | (60,482,790) |
| Distributions accrued to entities with significant influence | **(99,584,607)** | (71,715,932) |

### (e) Outstanding balances arising from transactions with related parties

| | 2019<br>$ | 2018<br>$ |
|---|---|---|
| Entities with significant influence | **(79,889,430)** | (37,225,068) |

### (f) Loans to/from related parties

| | 2019<br>$ | 2018<br>$ |
|---|---|---|
| **Loans from parties with significant influence** | | |
| At 1 January | **907,871,314** | 899,010,879 |
| Effects of exchange rate on translation of foreign operations | **2,057,421** | 9,412,510 |
| Loan repayments made | **(19,013,220)** | - |
| Interest due to related parties | **80,484,289** | 78,665,114 |
| Interest paid | **(80,256,577)** | (79,217,189) |
| At 31 December | **891,143,227** | 907,871,314 |

The loan from related parties represents a loan facility from the shareholders with an original repayment term of five years. During the year, the loan was extended until May 2022. The loan interest is charged at 8.5%in Australia and 9.5% in New Zealand until November 2020 and at 5.74%in Australia and 6.71% in New Zealand thereafter.

There is no allowance account for impaired receivables in relation to any outstanding balances, and no expense has been recognised in respect of impaired receivables due from related parties.

# Notes to the Combined Financial Statements

**For the year ended 31 December 2019**

## 6.5 Share-based payments

### (a) Management equity plan

The Management Equity Plan (MEP) is designed to provide an opportunity for participating people to acquire an interest at fair value in the Latitude Group. The MEP was established on 1 January 2016. Under the MEP, participants are granted an interest in KVD Australia Pty Ltd, where participation in the MEP is at the board's discretion.

The fair value of units granted is recognised at grant date and recognised over the period during which the party becomes unconditionally entitled to the instrument. The fair value of units granted has been determined using a pricing model that had regard to the following specified variables: the underlying equity value; risk-free interest rate; expected volatility of underlying equity value; dividends expected on the shares; and the estimated life.

The key terms and conditions relating to the grants under the MEP are as follows:

1. Time vesting - straight line vesting
2. KPI vesting - straight line vesting upon meeting or exceeding the adjusted profit target on an annual basis
3. Exit event vesting - exercised at the time of an exit event.

Set out below is a summary of units granted under the MEP:

| | **2019 $ issued** | **2018 $ issued** |
|---|---|---|
| At 1 January | **10,209,885** | 10,209,885 |
| Fair value of units granted during the year | **9,941,979** | - |
| At 31 December | **20,151,864** | 10,209,885 |

During the year ended 31 December 2019, units adjusted for equity changes was $27,078,455 (2018: $(9,278,691)). No units were exercised, none expired during the year, and no units were exercisable at year end. At 31 December 2019, 58,247,862 units were outstanding (31 December 2018: 39,399,999 units).

The total expense recognised in the profit and loss for the year ended 31 December 2019 in respect of MEP was $9,941,979 (2018: $1,607,081).