

# **Latitude Financial Services Group**

## **COMBINED FINANCIAL REPORT 2020**



# Latitude Financial Services Group

## Combined financial report for the year ended 31 December 2020

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## Management's Declaration

In the opinion of the Management of KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited and their respective controlled and related entities (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 76:
  - (i) present fairly the financial position of the Group as at 31 December 2020 and of its performance, as represented by the results of its operations and its cash flows, for the year ended 31 December 2020 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 2020, and of its financial performance and its cash flows for the year then ended, in accordance with the combination basis of preparation described in Note 1.1 to the financial statements 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 2020;
- Combined income statements, Combined statement of comprehensive income, 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; and
- 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 (including Independence Standards)* (the Code) that are relevant to our audit of the 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; and
- 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 the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the *Auditing and Assurance Standards Board* website at: [http://www.auasb.gov.au/auditors\\_responsibilities/ar4.pdf](http://www.auasb.gov.au/auditors_responsibilities/ar4.pdf). This description forms part of our Auditor's Report.



KPMG

Melbourne

25 February 2021

# Combined Income Statement

For the year ended 31 December 2020

	Notes	2020 \$'000	2019 \$'000
Interest income	2.2(a)	1,058,127	1,205,581
Interest expense	2.2(a)	(278,583)	(362,004)
<b>Net interest income</b>		<b>779,544</b>	<b>843,577</b>
Other operating income	2.2(b)	21,400	36,625
Net insurance income	2.2(c)	22,451	51,029
<b>Total other operating income</b>		<b>43,851</b>	<b>87,654</b>
<b>Total operating income</b>		<b>823,395</b>	<b>931,231</b>
Loan impairment expense	3.2(g)	(208,792)	(248,847)
<b>Operating expenses</b>			
Depreciation and amortisation expense		(92,924)	(82,751)
Employee benefit expense		(202,043)	(190,571)
Administrative and professional expenses		(43,932)	(61,978)
IT and data processing expenses		(47,163)	(43,346)
Occupancy and operating expenses		(25,605)	(28,652)
Other expenses	2.2(d)	(117,868)	(148,988)
<b>Total operating expenses</b>		<b>(529,535)</b>	<b>(556,286)</b>
Distribution to trust beneficiaries		(104,340)	(103,490)
<b>Profit/(loss) before income tax</b>		<b>(19,272)</b>	<b>22,608</b>
Income tax expense	2.3(a)	(9,534)	(4,966)
<b>Profit/(loss) from continuing operations</b>		<b>(28,806)</b>	<b>17,642</b>
Net profit/(loss) after tax for the year from discontinued operations	6.6(b)	(3,747)	1,803
<b>Net Profit/(Loss) for the year</b>		<b>(32,553)</b>	<b>19,445</b>
Profit/(loss) is attributable to:			
Owners of Latitude Financial Services Group		(11,222)	28,938
Non-controlling interests		(21,331)	(9,493)
<b>Profit/(loss) for the year</b>		<b>(32,553)</b>	<b>19,445</b>

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



# Combined Statement of Comprehensive Income

For the year ended 31 December 2020

	Notes	2020 \$'000	2019 \$'000
<b>Net profit/(loss) from continuing operations</b>		<b>(28,806)</b>	17,642
<b>Other comprehensive income</b>			
<b>Item that may be reclassified to income statement</b>			
Cash flow hedges	3.2(q)	<b>(15,387)</b>	(19,255)
Currency translation differences arising during the year		<b>(1,722)</b>	739
<b>Other comprehensive loss for the year, net of tax</b>		<b>(17,109)</b>	(18,516)
<b>Total comprehensive loss for the year from continuing operations</b>		<b>(45,915)</b>	(874)
Net profit/(loss) after tax for the year from discontinued operations	6.6(b)	<b>(3,747)</b>	1,803
<b>Total comprehensive income/(loss) for the year</b>		<b>(49,662)</b>	929
Total comprehensive income/(loss) for the year is attributable to:			
Owners of Latitude Financial Services Group		<b>(28,331)</b>	10,422
Non-controlling interests		<b>(21,331)</b>	(9,493)
<b>Total comprehensive income/(loss) for the year</b>		<b>(49,662)</b>	929

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

# Combined Balance Sheet

As at 31 December 2020

	Notes	2020 \$'000	2019 \$'000
<b>Assets</b>			
Cash and cash equivalents	3.1(b)	522,668	411,968
Assets held for sale		111	328
Derivative financial instruments	3.1(d)	219	3,896
Loans and other receivables	3.1(c)	6,089,558	7,217,139
Other assets		9,076	8,739
Current tax assets		-	11,363
Deferred tax assets	2.3(d)	205,404	211,094
Other financial assets		1,591	-
Property, plant and equipment		81,726	91,338
Intangible assets	5.1(a)	834,703	858,168
<b>Total assets</b>		<b>7,745,056</b>	<b>8,814,033</b>
<b>Liabilities</b>			
Trade and other liabilities	3.1(e)	423,172	338,428
Current tax liabilities		2,704	-
Derivative financial instruments	3.1(d)	13,770	74
Provisions	5.1(d)	81,449	73,969
Gross insurance policy liabilities	5.1(e)	40,385	65,234
Deferred tax liabilities	2.3(d)	84,293	101,558
Borrowings	3.1(f)	6,715,724	7,830,922
<b>Total liabilities</b>		<b>7,361,497</b>	<b>8,410,185</b>
<b>Net assets</b>		<b>383,559</b>	<b>403,848</b>
<b>Net investment</b>			
Parent investment		496,987	496,987
Reserves		38,158	24,367
Accumulated losses		(113,570)	(100,821)
<b>Net parent investment</b>		<b>421,575</b>	<b>420,533</b>
Non-controlling interests		(38,016)	(16,685)
<b>Total net investment</b>		<b>383,559</b>	<b>403,848</b>

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 2020

	Attributable to owners of Latitude Financial Services Group					
	Parent investment	Reserves	Accumulated losses	Net parent investment	Non- controlling Interests	Total net investment
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>At 1 January 2019</b>	<b>496,987</b>	<b>17,418</b>	<b>(127,489)</b>	<b>386,916</b>	<b>(7,192)</b>	<b>379,724</b>
Adjustment on initial adoption of IFRS 16	-	-	(2,270)	(2,270)	-	(2,270)
<b>At 1 January 2019 IFRS 16 adjusted balance</b>	<b>496,987</b>	<b>17,418</b>	<b>(129,759)</b>	<b>384,646</b>	<b>(7,192)</b>	<b>377,454</b>
Profit/(Loss) for the year from continuing operations	-	-	26,537	26,537	(8,895)	17,642
Profit/(Loss) for the year from discontinued operations	-	-	2,401	2,401	(598)	1,803
Amounts transferred to Profit or loss	-	8,609	-	8,609	-	8,609
Other comprehensive loss from continuing operations	-	(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
<b>At 31 December 2019</b>	<b>496,987</b>	<b>24,367</b>	<b>(100,821)</b>	<b>420,533</b>	<b>(16,685)</b>	<b>403,848</b>
<b>At 1 January 2020</b>	<b>496,987</b>	<b>24,367</b>	<b>(100,821)</b>	<b>420,533</b>	<b>(16,685)</b>	<b>403,848</b>
Loss for the year from continuing operations	-	-	(7,475)	(7,475)	(21,331)	(28,806)
Loss for the year from discontinued operations	-	-	(3,747)	(3,747)	-	(3,747)
Amounts transferred to Profit or loss	-	13,917	-	13,917	-	13,917
Other comprehensive loss from continuing operations	-	(17,109)	-	(17,109)	-	(17,109)
Total comprehensive loss for the year	-	(3,192)	(11,222)	(14,414)	(21,331)	(35,745)
Transactions with owners in their capacity as owners:						
Share-based payments	-	16,983	-	16,983	-	16,983
Dividends declared	-	-	(1,527)	(1,527)	-	(1,527)
<b>At 31 December 2020</b>	<b>496,987</b>	<b>38,158</b>	<b>(113,570)</b>	<b>421,575</b>	<b>(38,016)</b>	<b>383,559</b>

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

# Combined Statement of Cash Flows

For the year ended 31 December 2020

	Notes	2020 \$'000	2019 \$'000
<b>Cash flows from operating activities</b>			
Interest received		1,039,608	1,220,036
Interest paid		(250,076)	(332,892)
Other operating income received		21,944	36,419
Net insurance income			
Premiums received		24,872	48,119
Claims paid		(20,812)	(19,422)
Other		10	(29)
Investment income		2,048	4,509
Operating expenses paid		(325,311)	(332,549)
Distributions paid to trust beneficiaries		(41,037)	(54,735)
Income taxes paid		(4,202)	(45,655)
<b>Cash flow from operating activities before changes in operating assets and liabilities</b>		<b>447,044</b>	<b>523,801</b>
<b>Changes in operating assets and liabilities arising from cash flow movements</b>			
Net decrease/(increase) in loans and other receivables		830,528	(462,501)
Net increase/(decrease) in trade and other liabilities		17,885	(44,920)
Net increase/(decrease) in gross insurance policy liabilities		(7,790)	1,096
Net increase in other balance sheet items		(7,074)	(5,181)
<b>Changes in operating assets and liabilities arising from cash flow movements</b>		<b>833,549</b>	<b>(511,506)</b>
<b>Net cash provided by operating activities</b>	<b>2.2(e)</b>	<b>1,280,593</b>	<b>12,295</b>
<b>Cash flows from investing activities</b>			
Net purchases of intangible assets and property plant & equipment		(69,537)	(55,487)
Purchase of investment securities		(1,591)	-
<b>Net cash used in investing activities</b>		<b>(71,128)</b>	<b>(55,487)</b>
<b>Cash flows from financing activities</b>			
Proceeds from borrowing issuances and drawdowns		3,822,157	2,450,529
Repayment of borrowings		(4,905,735)	(2,455,194)
Payment of interest rate swap break costs		-	(31,168)
Repayment of related party loans		-	(19,209)
Net inflow/(outflow) from share based payments		(2,480)	4,514
Payment of lease liabilities		(11,075)	(10,281)
Payments of transaction costs from financing activities		(2,965)	(3,308)
<b>Net cash provided by/(used in) financing activities</b>		<b>(1,100,098)</b>	<b>(64,117)</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>109,367</b>	<b>(107,309)</b>
Cash and cash equivalents at beginning of financial year		411,968	518,604
Effects of exchange rate changes on cash and cash equivalents		1,333	673
<b>Cash and cash equivalents at end of financial year</b>	<b>3.1(b)</b>	<b>522,668</b>	<b>411,968</b>

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

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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 combined financial statements have been prepared for the purpose of providing historical financial information of the Latitude Financial Services Group relating to a potential transaction.

These financial statements were authorised for issue by the Group’s Management 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.

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 1.1 Basis of preparation (continued)

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 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.

Where necessary, comparative figures have been re-classified for consistency with current period disclosures.

#### (c) Review of operations and the COVID-19 Pandemic

The Group made a loss from continuing operations of \$28.8 million in the 12 months ended 31 December 2020 (2019: \$17.6 million profit), in the year when the Coronavirus/COVID-19 outbreak became a global pandemic. 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 addition, customer loan receivable balances fell as customers paid off balances assisted by government stimulus in both Australia and New Zealand and gained 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 emailing 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 &

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 1.1 Basis of preparation (continued)

Culture Team communication.

Latitude Business: Proactive steps have been taken including robust financial forecasting scenarios, cashflow forecasting and the tightening of credit underwriting standards and the review of credit risk models. Latitude increased the provision for expected credit losses at balance date 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, anticipating increased levels of stress across the portfolio's due to multiple factors at that time.

Latitude Funding Arrangements: Balance sheet funding has been strengthened during 2020 with the refinancing of borrowing facilities, as described in Note 3.1(f).

Given the continued uncertainties, any further financial impact cannot be determined with certainty. However, given Latitude's response to the pandemic, Management believes there is no material uncertainty of going concern and the financial report has been prepared on this basis.

#### (d) 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 through 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.

#### (e) Functional and presentation currency

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

#### (f) Rounding of amounts

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

#### (g) 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:

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 1.1 Basis of preparation (continued)

- 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)
- Section 5.1: Customer remediation

### *Measurement of expected credit losses*

While the core methodologies and assumptions applied in the expected credit loss (ECL) calculations remained unchanged from those applied in the financial statements for the year ended 31 December 2019, the Group has adopted a multi-scenario macroeconomic model and incorporated estimates, assumptions and judgements specific to the impact of the COVID-19 pandemic into the measurement calculations as described in Note 3.2.

## 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.

### (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.



# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 1.2 Other significant accounting policies (continued)

#### (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

##### *Other amended standards*

Other amended Standards that became effective for the financial year ended 31 December 2020 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 2020 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 2020

### 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 Pre-Provision Profit Before Tax (PBT) basis where the Pre-Provision PBT is total revenue, being interest income and other operating income, net of interest expense, net charge offs 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, \$848.1 million of external revenue was generated within the country of Australia (2019: \$1,031.4 million) and \$243.2 million of external revenue was generated within the country of New Zealand (2019: \$279.3 million). At 31 December 2020 there were \$3,180.5 million non-current assets in the country of Australia (2019: \$3,518.4 million) and \$834.4 million non-current assets in the country of New Zealand (2019: \$1,494.9 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 2020

## 2.1 Segment information (continued)

### (b) Segment overview

Year ended 2020	Australia \$'000	New Zealand \$'000	Other/ Unallocated \$'000	Total \$'000
Interest income	814,632	243,495	-	1,058,127
Interest expense	(132,969)	(40,784)	(104,830)	(278,583)
<b>Net interest income</b>	<b>681,663</b>	<b>202,711</b>	<b>(104,830)</b>	<b>779,544</b>
Other operating income	27,254	3,626	150	31,030
Net insurance income	-	-	12,821	12,821
<b>Total other operating income</b>	<b>27,254</b>	<b>3,626</b>	<b>12,971</b>	<b>43,851</b>
<b>Total operating income before inter segment operating income</b>	<b>708,917</b>	<b>206,337</b>	<b>(91,859)</b>	<b>823,395</b>
Inter-segment operating income	(6,530)	(3,100)	9,630	-
<b>Total operating income reported combined group</b>	<b>702,387</b>	<b>203,237</b>	<b>(82,229)</b>	<b>823,395</b>
Management operating expenses	-	-	(529,535)	(529,535)
<b>Operating Profit</b>	<b>702,387</b>	<b>203,237</b>	<b>(611,764)</b>	<b>293,860</b>
Net charge offs	(185,696)	(41,626)	-	(227,322)
<b>Pre-Provision PBT</b>	<b>516,691</b>	<b>161,611</b>	<b>(611,764)</b>	<b>66,538</b>
Movement in loss provisions	22,769	(4,239)	-	18,530
<b>Management PBT</b>	<b>539,460</b>	<b>157,372</b>	<b>(611,764)</b>	<b>85,068</b>
Distribution to Trust beneficiaries	-	-	(104,340)	(104,340)
<b>PBT</b>	<b>539,460</b>	<b>157,372</b>	<b>(716,104)</b>	<b>(19,272)</b>
Income taxes	-	-	(9,534)	(9,534)
<b>Profit/(loss) from continuing operations</b>	<b>539,460</b>	<b>157,372</b>	<b>(725,638)</b>	<b>(28,806)</b>
Loss from discontinued operations	(3,179)	(568)	-	(3,747)

### Segment balance sheet information

Total segment assets	5,141,691	1,468,548	1,146,773	7,757,012
Inter-segment assets eliminated on consolidation	(643)	(10,565)	(748)	(11,956)
<b>Total assets reported by the Combined Group</b>	<b>5,141,048</b>	<b>1,457,983</b>	<b>1,146,025</b>	<b>7,745,056</b>
Total segment liabilities	4,617,353	1,305,030	1,451,070	7,373,453
Inter-segment liabilities eliminated on consolidation	(797)	-	(11,159)	(11,956)
<b>Total liabilities reported by the Combined Group</b>	<b>4,616,556</b>	<b>1,305,030</b>	<b>1,439,911</b>	<b>7,361,497</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 2.1 Segment information (continued)

### (c) Segment overview

Year ended 2019	Australia \$'000	New Zealand \$'000	Other/ Unallocated \$'000	Total \$'000
Interest income	946,628	258,953	-	1,205,581
Interest expense	(196,982)	(55,232)	(109,790)	(362,004)
<b>Net interest income</b>	<b>749,646</b>	<b>203,721</b>	<b>(109,790)</b>	<b>843,577</b>
Other operating income	41,162	5,957	1,147	48,266
Net insurance income	-	-	39,388	39,388
<b>Total other operating income</b>	<b>41,162</b>	<b>5,957</b>	<b>40,535</b>	<b>87,654</b>
<b>Total operating income before inter segment operating income</b>	<b>790,808</b>	<b>209,678</b>	<b>(69,255)</b>	<b>931,231</b>
Inter-segment operating income	(7,793)	(3,848)	11,641	-
<b>Total operating income reported combined group</b>	<b>783,015</b>	<b>205,830</b>	<b>(57,614)</b>	<b>931,231</b>
Management operating expenses	-	-	(556,286)	(556,286)
<b>Operating Profit</b>	<b>783,015</b>	<b>205,830</b>	<b>(613,900)</b>	<b>374,945</b>
Net charge offs	(209,198)	(41,471)	-	(250,669)
<b>Pre-Provision PBT</b>	<b>573,817</b>	<b>164,359</b>	<b>(613,900)</b>	<b>124,276</b>
Movement in loss provisions	(3,616)	5,438	-	1,822
<b>Management PBT</b>	<b>570,201</b>	<b>169,797</b>	<b>(613,900)</b>	<b>126,098</b>
Distribution to Trust beneficiaries	-	-	(103,490)	(103,490)
<b>PBT</b>	<b>570,201</b>	<b>169,797</b>	<b>(717,390)</b>	<b>22,608</b>
Income taxes	-	-	(4,966)	(4,966)
<b>Profit/(loss) from continuing operations</b>	<b>570,201</b>	<b>169,797</b>	<b>(722,356)</b>	<b>17,642</b>
Profit from discontinued operations	1,217	586	-	1,803

### Segment balance sheet information

Total segment assets	5,941,677	1,664,630	1,222,350	8,828,657
Inter-segment assets eliminated on consolidation	(302)	(523)	(13,799)	(14,624)
<b>Total assets reported by the Combined Group</b>	<b>5,941,375</b>	<b>1,664,107</b>	<b>1,208,551</b>	<b>8,814,033</b>
Total segment liabilities	5,354,902	1,539,279	1,530,626	8,424,807
Inter-segment liabilities eliminated on consolidation	(1,491)	(9,121)	(4,010)	(14,622)
<b>Total liabilities reported by the Combined Group</b>	<b>5,353,411</b>	<b>1,530,158</b>	<b>1,526,616</b>	<b>8,410,185</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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 incurred.

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 2020

## 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

	2020	2019
	\$'000	\$'000
<b>Interest income</b>		
Interest income	1,058,127	1,205,581
<b>Total interest income</b>	<b>1,058,127</b>	<b>1,205,581</b>
<b>Interest expense</b>		
Finance costs on borrowings	(274,958)	(359,039)
Lease interest expense	(3,625)	(2,965)
<b>Total interest expense</b>	<b>(278,583)</b>	<b>(362,004)</b>
<b>Net interest income</b>	<b>779,544</b>	<b>843,577</b>

#### (b) Other operating income

	2020	2019
	\$'000	\$'000
Interchange and operating fees	19,573	32,419
Other	1,827	4,206
<b>Total other operating income</b>	<b>21,400</b>	<b>36,625</b>

#### (c) Net insurance income

	2020	2019
	\$'000	\$'000
Insurance premium revenue	49,099	66,104
Insurance claims and expenses	(28,696)	(19,584)
Investment income	2,048	4,509
<b>Total net insurance income</b>	<b>22,451</b>	<b>51,029</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 2.2 Revenue and expenses (continued)

### (d) Other operating expenses

	2020 \$'000	2019 \$'000
Marketing expenses	(19,643)	(41,836)
Indirect taxes and irrecoverable GST	(22,246)	(12,018)
Other expenses	(23,501)	(4,203)
Transition and replatforming	-	(3,085)
Latitude 2.0 - Strategy reset	-	(551)
Latitude 2.0 - Technology investment	(7,440)	(16,330)
Latitude 2.0 - Strategy execution/Brand unification	(12,152)	(14,988)
COVID-19-response - Operations digitalisation	(3,888)	-
Technology investment and simplification	(3,450)	-
BNPL - Big Ticket	(898)	-
Restructuring costs	(11,747)	(6,179)
Remediation and other provisions	(5,112)	(28,296)
Impairment loss on non-financial instruments	(7,791)	(21,502)
<b>Total other operating expenses</b>	<b>(117,868)</b>	<b>(148,988)</b>

Where income and expense disclosures have been presented under different classifications in the current period, comparative figures have been re-classified for consistency.

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

	2020 \$'000	2019 \$'000
Net profit/(loss) after income tax	(32,553)	19,445
(Increase)/decrease in interest receivable	(15,874)	11,917
Increase in interest payable	27,644	29,610
Depreciation and amortisation	92,924	82,751
Loan impairment expense	273,320	349,668
Other expenses and write downs	101,584	30,412
Decrease/(increase) in loans and other receivables	830,528	(462,502)
Increase in other balance sheet items	(7,074)	(5,181)
(Increase)/decrease in deferred tax assets	5,690	(32,653)
Increase/(decrease) in trade and other liabilities	29,458	(24,629)
Increase/(decrease) in gross insurance policy liabilities	(7,790)	1,096
Increase/(decrease) in deferred tax liabilities	(17,265)	12,361
<b>Net cash provided by operating activities</b>	<b>1,280,592</b>	<b>12,295</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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 2020

### 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 2020

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

### (a) Income tax expense

	2020 \$'000	2019 \$'000
Current tax on profits for the year	19,011	19,816
Deferred tax expenses	(11,718)	(9,786)
(Over)/under provision in prior year	658	(4,053)
Foreign exchange differences arising on translation	-	(5)
<b>Income tax expense</b>	<b>7,951</b>	<b>5,972</b>
Profit/(loss) from continuing operations	9,534	4,966
Profit/(loss) from discontinued operations	(1,583)	1,006
<b>Income tax expense</b>	<b>7,951</b>	<b>5,972</b>

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

	2020 \$'000	2019 \$'000
Profit/(loss) from continuing operations before income tax expense	(19,272)	22,608
Profit/(loss) from discontinued operations before income tax expense	(5,330)	2,809
	(24,602)	25,417
Tax at the Australian tax rate of 30%	(7,380)	7,625
Tax effect of amounts which are not deductible (taxable) in calculating taxable income:		
Permanent differences (^)	14,540	2,931
Effect of differences in tax rates in foreign jurisdictions	(555)	(526)
Other	688	(5)
Adjustments of prior periods	658	(4,053)
<b>Income tax expense</b>	<b>7,951</b>	<b>5,972</b>

(^) 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

	2020 \$'000	2019 \$'000
Provisions and other liabilities	(1,190)	(4,821)
Deferred income	4,105	5,605
Acquisition transaction costs	19	3,547
Property, plant and equipment	(1,440)	(495)
Intangible assets	(13,434)	(14,521)
Deferred expenses and prepayments	147	2,060
Others	75	(1,161)
<b>Deferred tax expense/(benefit)</b>	<b>(11,718)</b>	<b>(9,786)</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

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

### (d) Deferred tax assets and liabilities

	2020	2019
	\$'000	\$'000
<b>Deferred tax assets</b>		
Provisions and other liabilities	123,134	122,841
Carry forward tax losses	-	62
Deferred income	37,215	41,431
Acquisition transaction costs	3	22
Lease liability	23,470	27,260
Property, plant and equipment	12,295	9,135
Others	9,287	10,343
<b>Deferred tax assets</b>	<b>205,404</b>	<b>211,094</b>
<b>Deferred tax liabilities</b>		
Intangible assets	53,422	66,856
Deferred expenses & prepayments	9,365	9,329
Right-of-use assets	21,099	24,997
Other	407	376
<b>Deferred tax liabilities</b>	<b>84,293</b>	<b>101,558</b>
<b>Net deferred tax assets/ (liabilities)</b>	<b>121,111</b>	<b>109,536</b>
Amounts expected to be settled within 12 months	88,702	79,787
Amounts expected to be settled after more than 12 months	32,409	29,749
<b>Net deferred tax assets/ (liabilities)</b>	<b>121,111</b>	<b>109,536</b>

## 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

Ordinary share dividends of \$1.527 million were declared during the year (2019: \$nil).

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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.

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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 qualify 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 2020

## 3.1 Financial assets and liabilities (continued)

### (a) Financial assets and financial liabilities

Financial assets		Assets designated FVOCI	Assets designated FVPL	Assets at fair value	Assets at amortised cost	Total
	Notes	\$'000	\$'000	\$'000	\$'000	\$'000
<b>2020</b>						
Cash and cash equivalents	3.1(b)	-	165,576	-	357,092	522,668
Assets held for sale		-	-	111	-	111
Derivative financial instruments	3.1(d)	-	-	219	-	219
Loans and other receivables	3.1(c)	-	1,394	-	6,088,164	6,089,558
Other financial assets		1,591	-	-	-	1,591
<b>Financial assets</b>		<b>1,591</b>	<b>166,970</b>	<b>330</b>	<b>6,445,256</b>	<b>6,614,147</b>
<b>2019</b>						
Cash and cash equivalents	3.1(b)	-	184,503	-	227,465	411,968
Assets held for sale		-	-	328	-	328
Derivative financial instruments	3.1(d)	-	-	3,896	-	3,896
Loans and other receivables	3.1(c)	-	2,195	-	7,214,944	7,217,139
Financial assets		-	186,698	4,224	7,442,409	7,633,331
<b>Financial liabilities</b>						
	Notes	Liabilities at fair value	Liabilities at amortised cost	Total		
		\$'000	\$'000	\$'000	\$'000	\$'000
<b>2020</b>						
Trade and other liabilities	3.1(e)	-	423,172	-	423,172	423,172
Derivative financial instruments	3.1(d)	-	-	13,770	-	13,770
Borrowings	3.1(f)	-	-	-	6,715,724	6,715,724
<b>Financial liabilities</b>		<b>-</b>	<b>-</b>	<b>13,770</b>	<b>7,138,896</b>	<b>7,152,666</b>
<b>2019</b>						
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

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 3.1 Financial assets and liabilities (continued)

#### (b) Cash and cash equivalents

	2020	2019
	\$'000	\$'000
<b>Current assets</b>		
Cash and cash equivalents	359,278	224,305
Short term deposits	124,657	120,012
Restricted cash <sup>(1)</sup>	38,733	67,651
<b>Cash and cash equivalents</b>	<b>522,668</b>	<b>411,968</b>

(1) Being Hallmark Insurance term deposits and cash deposited as security

#### (c) Loans and other receivables

	2020	2019
	\$'000	\$'000
<b>Loans and advances</b>		
Loans and advances	6,521,600	7,672,440
Unearned income	(135,420)	(151,294)
Provision for impairment losses	(301,269)	(322,440)
<b>Total loans and advances</b>	<b>6,084,911</b>	<b>7,198,706</b>
<b>Other receivables</b>		
Trade receivables	742	10,577
Other receivables	3,905	7,856
<b>Total other receivables</b>	<b>4,647</b>	<b>18,433</b>
<b>Total loans and other receivables</b>	<b>6,089,558</b>	<b>7,217,139</b>
<b>Current</b>	<b>3,169,103</b>	<b>3,895,438</b>
<b>Non-current</b>	<b>2,920,455</b>	<b>3,321,701</b>
<b>Total loans and other receivables</b>	<b>6,089,558</b>	<b>7,217,139</b>

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 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.



# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 3.1 Financial assets and liabilities (continued)

#### (d) Derivatives

	2020	2019
	\$'000	\$'000
Current derivative assets		
Forward foreign exchange contracts	-	34
<b>Total current derivative financial instrument assets</b>	<b>-</b>	<b>34</b>
Non-current derivative assets		
Interest rate swap contracts - cash flow hedges	219	3,862
<b>Total non-current derivative financial instruments</b>	<b>219</b>	<b>3,862</b>
<b>Total derivative assets</b>	<b>219</b>	<b>3,896</b>
Current derivative liabilities		
Forward foreign exchange contracts	966	-
<b>Total current derivative financial instrument liabilities</b>	<b>966</b>	<b>-</b>
Non-current derivative liabilities		
Interest rate swap contracts - cash flow hedges	12,804	74
<b>Total non-current derivative financial instrument liabilities</b>	<b>12,804</b>	<b>74</b>
<b>Total derivative liabilities</b>	<b>13,770</b>	<b>74</b>

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.

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 3.1 Financial assets and liabilities (continued)

#### (e) Trade and other liabilities

	Notes	2020 \$'000	2019 \$'000
<b>Current</b>			
Trade and other payables		70,032	50,285
Accrued expenses		56,668	51,524
Payables to related parties	6.4(e)	139,124	79,889
Customer credit balances		49,966	42,600
Outstanding Insurance claims liability		14,905	9,360
Lease liability		11,629	9,692
<b>Total current trade and other liabilities</b>		<b>342,324</b>	<b>243,350</b>
<b>Non-Current</b>			
Trade and other payables		5,217	6,295
Outstanding Insurance claims liability		7,520	6,027
Lease liability		68,111	82,756
<b>Total non-current trade and other liabilities</b>		<b>80,848</b>	<b>95,078</b>
<b>Total trade and other liabilities</b>		<b>423,172</b>	<b>338,428</b>

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 3.79% as at 31 December 2020 (31 December 2019: 3.90%).

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 3.1 Financial assets and liabilities (continued)

#### (f) Borrowings

	2020			2019		
	Current \$'000	Non- current \$'000	Total \$'000	Current \$'000	Non- current \$'000	Total \$'000
<b>Secured</b>						
Securitisation liabilities	450,150	5,380,065	5,830,215	1,443,135	5,496,644	6,939,779
Total secured borrowings	450,150	5,380,065	5,830,215	1,443,135	5,496,644	6,939,779
<b>Unsecured</b>						
Shareholder loan	1,443	884,066	885,509	1,923	889,220	891,143
Total unsecured borrowings	1,443	884,066	885,509	1,923	889,220	891,143
<b>Total borrowings</b>	<b>451,593</b>	<b>6,264,131</b>	<b>6,715,724</b>	<b>1,445,058</b>	<b>6,385,864</b>	<b>7,830,922</b>

Borrowings are shown net of capitalised transaction costs, where unamortised transaction costs of \$10.3 million are set off against borrowings at 31 December 2020 (2019: \$24.1 million). During the year \$2.3 million (2019: \$3.3 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.

Balance sheet funding has been strengthened during 2020 with the refinancing of warehouse borrowing facilities 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. 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 completion occurring 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.

The contractual maturities attached to the securitisation liabilities range between 2-8 years. Actual securitisation liability repayments occur once the trust reaches contractual amortisation periods (commencing in 0-4 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 prior year, the terms of the shareholder loans were amended, and the repayment dates were extended from 24 November 2020 to 24 May 2022. The decrease in the shareholder loans of \$5.6 million in 2020 results from movements in accrued interest and the effects of exchange rate differences on translation of foreign operations (2019: \$16.8 million decrease from loan repayments and \$2.4 million increase from accrued interest and the effects of exchange rate differences).

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 3.1 Financial assets and liabilities (continued)

The decrease in securitisation liabilities of \$1,109 million (2019: \$27.6 million increase) includes proceeds from issuances and drawdowns of \$3,822 million (2019: \$2,450.5 million), net of repayments of borrowings of \$4,905 million (2019: \$2,455.2 million) and transaction costs paid of \$2.3 million (2019: \$3.3 million). In addition, there was a non-cash net decrease of \$23.7 million (2019: \$35.6 million increase) resulting from movements in accrued interest, the effects of exchange rate differences on translation of foreign operations and amortisation of transaction costs.

KVD Australia Holdco Pty Ltd and Latitude Financial Services Limited each have an overdraft facility that can provide funding for the business, as described in Note 3.2. At 31 December 2020, the facilities remained unutilised (2019: unutilised). 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 2020 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.

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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. Equity investments that have no active market are included in this category. The Group has one equity investment within this category where fair value has been deemed to be cost, given that the investment was purchased during the year.

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 3.1 Financial assets and liabilities (continued)

### (h) Recurring fair values

At 31 December 2020	Notes	Level 1 \$'000	Level 2 \$'000	Level 3 \$'000	Total \$'000
<b>Financial assets</b>					
Investments relating to Insurance business		- 166,970		- 166,970	
Assets held for sale		-	111	-	111
Derivative financial assets:					
Derivatives used for hedging - interest rate swaps	3.1(d)	-	219	-	219
Other financial assets		-		1,591	1,591
<b>Total financial assets</b>		<b>- 167,300</b>	<b>1,591</b>	<b>168,891</b>	
<b>Financial Liabilities</b>					
Derivatives used for hedging - interest rate swaps	3.1(d)	-	12,804	-	12,804
Derivatives used for hedging - foreign exchange contracts	3.1(d)	-	967	-	967
<b>Total financial liabilities</b>		<b>- 13,771</b>		<b>- 13,771</b>	
<b>At 31 December 2019</b>					
<b>Financial assets</b>					
Investments relating to Insurance business		-	186,698	-	186,698
Assets held for sale		-	328	-	328
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
<b>Total financial assets</b>		<b>- 190,922</b>		<b>- 190,922</b>	
<b>Financial Liabilities</b>					
Derivative financial liabilities:					
Derivatives used for hedging - interest rate swaps	3.1(d)	-	74	-	74
<b>Total financial liabilities</b>		<b>- 74</b>		<b>- 74</b>	

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:

	2020 \$'000	2019 \$'000
<b>Other financial assets:</b>		
<b>Purchases</b>		
Equity Investments	1,591	-
Balance 31 December	<b>1,591</b>	<b>-</b>

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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 Enterprise Risk Management Committee who manage strategic, credit, operational and financial risks. A 'three-lines 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.

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 3.2 Financial risk management (continued)

#### *Risk management and Expected Credit Losses (ECL)*

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.

A key enhancement to the provisioning models since the previous year ended 31 December 2019, is the adoption of a multi-scenario macroeconomic model to the methodologies, assumptions and policies applied in the ECL calculations at 31 December 2020. The new multi-scenario macroeconomic model includes an upside economic scenario, downside scenario, and baseline forecast, all sourced from Moody's Analytics. Economists from Moody's present the forecast scenarios to an Economic Panel as part of the loan loss provision governance process and agree on appropriate weightings to apply to each economic scenario. A weighted ECL is tabled at the LFS Australia and New Zealand Reserve Committee for discussion, which considers the weightings applied to the various scenarios and appropriate sensitivity to the ECL. The total model overlay applied at 31 December 2020 is \$71 million.

The core model coverage rate increased during 1H20 as a result of significant increase in hardship inventory impacting the Stage 3 population and significant increase in the Stage 1 and 2 probability of default (hardship) due to the increase in hardship inventory. Through 2H20, the core model coverage rate experienced continued improvements. The impacts to the core model were due to:

- strong stimulus support across both Australia and New Zealand;
- financial institutions providing multiple hardship options to their customers; and
- unprecedented withdrawals from superannuation allowing customers to make lump sum repayments and reduce household debt.

These factors collectively led to customers increasing payments rates and deleveraging leading to record low delinquency and losses for Latitude in 2H20, a trend also observed throughout the financial industry.

Whilst the Group's overall provision balance decreased by \$24m at 31 December 2020 in absolute terms, the coverage rate increased by 42bps year on year, with the application of model risk overlays to offset the atypical delinquency and loss trends driving the lower core model coverage rates; anticipating delinquency and loss levels normalising based on expectations that:

- government economic stimulus for both employees and employers will continue to be scaled back during 1H21, leading to flow on effects for customer assistance requests to lenders including Latitude; and
- customers rolling off current hardship arrangements following elevated levels of hardship observed in Q2/Q3 2020, some of which will result in delinquency and subsequent loss.



# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 3.2 Financial risk management (continued)

### Exposure

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

2020	12-month ECL \$'000	Lifetime ECL not credit impaired \$'000	Lifetime ECL credit impaired, not POCI <sup>^</sup> \$'000	Lifetime ECL credit impaired, POCI <sup>^</sup> \$'000	Total \$'000
<b>Loans and advances undrawn</b>					
Very low risk	8,378,640	-	-	2,602	8,381,242
Low risk	642,497	-	-	912	643,409
Medium risk	201,516	-	-	355	201,871
Moderate risk	29,696	-	-	111	29,807
High risk	5,240	-	-	23	5,263
<b>Total</b>	<b>9,257,589</b>	<b>-</b>	<b>-</b>	<b>4,003</b>	<b>9,261,592</b>
<b>2019</b>					
<b>Loans and advances undrawn</b>					
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
<b>Total</b>	<b>9,310,801</b>	<b>-</b>	<b>-</b>	<b>3,821</b>	<b>9,314,622</b>

<sup>^</sup>POCI: Purchased or Originated Credit Impaired

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 3.2 Financial risk management (continued)

*Credit risk rating*

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

2020	12-month ECL \$'000	Lifetime ECL not credit impaired \$'000	Lifetime ECL credit impaired, not POCI <sup>^</sup> \$'000	Lifetime ECL credit impaired, POCI <sup>^</sup> \$'000	Total \$'000
<b>Gross loans and advances</b>					
Very low risk	2,311,229	4,409	-	1,811	2,317,449
Low risk	1,748,316	20,674	-	3,127	1,772,117
Medium risk	1,160,833	42,685	-	3,891	1,207,409
Moderate risk	329,885	29,476	-	1,831	361,192
High risk	329,302	196,106	312,682	9,333	847,423
Unrated	16,010	-	-	-	16,010
<b>Total</b>	<b>5,895,575</b>	<b>293,350</b>	<b>312,682</b>	<b>19,993</b>	<b>6,521,600</b>
<b>2019</b>					
<b>Gross loans and advances</b>					
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
<b>Total</b>	<b>7,141,185</b>	<b>185,095</b>	<b>312,662</b>	<b>33,498</b>	<b>7,672,440</b>

<sup>^</sup>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 2020

## 3.2 Financial risk management (continued)

### *Credit quality*

The ageing of loans and advances is shown below:

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

	2020	2019
	\$'000	\$'000
<b>Gross loans and advances</b>		
Neither past due or impaired (not POCI <sup>^</sup> )	5,592,862	6,450,468
Past due but not impaired (not POCI <sup>^</sup> )	596,063	875,812
Impaired (not POCI <sup>^</sup> )	312,682	312,662
POCI <sup>^</sup>	19,993	33,498
<b>Total</b>	<b>6,521,600</b>	<b>7,672,440</b>

<sup>^</sup>POCI: Purchased or Originated Credit Impaired

#### (d) Loans and advances past due

	2020	2019
	\$'000	\$'000
<b>Gross loans and advances</b>		
Current	5,831,607	6,626,044
Past due 1-29 days	538,023	767,336
Past due 30-89 days	108,410	199,959
Past due > 90 days	43,560	79,101
<b>Total</b>	<b>6,521,600</b>	<b>7,672,440</b>

### *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

	2020	2019
	\$'000	\$'000
<b>Cash and cash equivalents</b>		
<i>Investment grade</i>	522,668	411,968
<b>Derivative financial assets</b>		
<i>Investment grade</i>	219	3,896

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

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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 <sup>^</sup>	Collective provision lifetime ECL credit impaired, POCI <sup>^</sup>	Collective provision Total
	\$'000	\$'000	\$'000	\$'000	\$'000
<b>At 1 January 2019</b>	<b>235,925</b>	<b>11,988</b>	<b>71,199</b>	<b>5,755</b>	<b>324,867</b>
Effects of exchange rate on translation	435	22	113	4	574
<i>Changes in the loss allowance contributed to by changes in the gross carrying amount of financial instruments, due to:</i>					
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)
<b>At 31 December 2019</b>	<b>216,817</b>	<b>17,516</b>	<b>83,978</b>	<b>4,129</b>	<b>322,440</b>
<b>At 1 January 2020</b>	<b>216,817</b>	<b>17,516</b>	<b>83,978</b>	<b>4,129</b>	<b>322,440</b>
Effects of exchange rate on translation	(964)	(65)	(266)	(5)	(1,300)
<i>Changes in the loss allowance contributed to by changes in the gross carrying amount of financial instruments, due to:</i>					
i) financial instruments originated during the reporting period	37,294	1,312	5,101	-	43,707
ii) derecognition of financial instruments during the reporting period	(31,196)	(4,661)	(28,512)	(863)	(65,232)
iii) change in balance during reporting period	(30,205)	(408)	(3,846)	(698)	(35,157)
iv) transfers between stages	(8,687)	2,584	32,112	(20)	25,989
ECL calculation impact	(3,342)	(176)	(23,792)	(662)	(27,972)
Other	27,123	2,680	8,942	49	38,794
<b>At 31 December 2020</b>	<b>206,840</b>	<b>18,782</b>	<b>73,717</b>	<b>1,930</b>	<b>301,269</b>

<sup>^</sup>POCI: Purchased or Originated Credit Impaired

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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:

	2020 \$'000	2019 \$'000
<b>Recognised in profit or loss</b>		
Movement in provision on loans and advances	18,530	1,844
Net impairment loss on loans and advances	<u>(227,322)</u>	<u>(250,691)</u>
<b>Losses recognised in relation to loans and advances</b>	<b><u>(208,792)</u></b>	<b><u>(248,847)</u></b>

### *Enforcement activity*

Loans and advances with a contractual amount of \$101.1 million (2019: \$75.8 million) written off during the year are still subject to enforcement activity.

### *Collateral*

#### **(h) Collateral held**

	2020 \$'000	2019 \$'000
<b>Maximum exposure</b>	<b><u>6,521,600</u></b>	<b><u>7,672,440</u></b>
<b>Collateral classification:</b>		
Secured (%)	<u>17.5</u>	<u>15.1</u>
Unsecured (%)	<u>82.5</u>	<u>84.9</u>

### *Guarantees*

The Group does not have any guarantees at 31 December 2020 (2019: \$nil).

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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 2020 currency risk \$'000	31 December 2019 currency risk \$'000
Net open position - US Dollar	(2,256)	6,775
Net open position - NZ Dollar	(892)	(49)

#### *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:

	2020 \$'000	2019 \$'000
<b>Recognised in profit or loss</b>		
Net foreign exchange gains included in other operating income	927	53
<b>Recognised in other comprehensive income</b>		
Translation of entities with a non-Australian denominated functional currency recognised in foreign currency translation reserve	(1,722)	739

#### *Sensitivity*

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

Index	Impact on post-tax profit		Impact on other components of net investment	
	2020 \$'000	2019 \$'000	2020 \$'000	2019 \$'000
USD/AUD exchange rate-increase 10%	(158)	474	-	-
USD/AUD exchange rate-decrease 10%	158	(474)	-	-
NZD/AUD exchange rate-increase 10%	(62)	(49)	5,790	2,652
NZD/AUD exchange rate-decrease 10%	62	49	(5,790)	(2,652)

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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*

##### **(1) 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:

	2020 \$'000	2019 \$'000
Variable rate borrowings	5,830,215	6,939,779
Fixed interest rate - repricing dates:		
1 – 5 years	885,509	891,143
	<b>6,715,724</b>	<b>7,830,922</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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 2020		31 December 2019	
	Weighted average interest rate %	Balance \$'000	Weighted average interest rate %	Balance \$'000
Interest rate swaps (nominal amount)	0.61%	2,218,283	0.79%	2,456,815

### (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
<b>31 December 2020</b>			
<b>Interest rate risk</b>			
Variable rate borrowings	(16,343)	(9,069)	-
Discontinued hedges <sup>(1)</sup>	-	-	(6,292)
<b>31 December 2019</b>			
<b>Interest rate risk</b>			
Variable rate borrowings	3,785	2,842	-
Discontinued hedges <sup>(1)</sup>	-	-	(16,733)

<sup>(1)</sup> 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 2020

## 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 ineffectiveness recognised in profit or loss \$'000	Amount reclassified from hedge cash flow reserve to profit or loss \$'000
<b>2020</b>						
<b>Interest rate risk</b>						
Interest rate swaps	2,218,283	219	12,804	(16,009)	(334)	-
Discontinued hedges <sup>(1)</sup>	-	-	-	(25)	-	13,917
<b>2019</b>						
<b>Interest rate risk</b>						
Interest rate swaps	2,456,815	3,862	74	3,661	124	-
Discontinued hedges <sup>(1)</sup>	-	-	-	(27,054)	175	8,609

<sup>(1)</sup> 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

	Hedged risk	Cash flow hedge reserve		Total \$'000
		Continuing hedges \$'000	Discontinued hedges \$'000	
<b>2020</b>				
<b>Cash flow hedges</b>				
Variable rate borrowings	Interest rate	(9,069)	(6,292)	(15,361)
<b>2019</b>				
<b>Cash flow hedges</b>				
Variable rate borrowings	Interest rate	2,842	(16,733)	(13,891)

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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:

	2020 \$'000	2019 \$'000
<b>Recognised in profit or loss</b>		
Net gain for ineffective portion of derivatives designated as cash flow hedges	(334)	299
<b>Recognised in other comprehensive income</b>		
(Loss) recognised in other comprehensive income	(15,387)	(19,255)

*Sensitivity*

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

	Impact on post-tax profit		Impact on other components of net investment	
	2020 \$'000	2019 \$'000	2020 \$'000	2019 \$'000
Interest rates - increase by 100 basis points - Increase in profit	7	8	28,118	29,237
Interest rates - decrease by 100 basis points - Decrease in profit	(8)	(8)	(28,832)	(29,951)

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 2020

### 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 (2019: \$15 million) bank overdraft facility and Latitude Financial Services Limited has access to a \$4.7 million (NZ\$ 5 million) (2019: \$4.8 million (NZ\$ 5 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 2020 the overdrafts had not been utilised (2019: unutilised).

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	2020 \$'000	2019 \$'000
Borrowing facilities available	8,164,294	8,906,088
Drawn facilities	<u>(5,836,659)</u>	<u>(6,958,179)</u>
Undrawn facilities	<u>2,327,635</u>	<u>1,947,909</u>

#### *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.

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 3.2 Financial risk management (continued)

### (t) Contractual maturities of financial liabilities

	Less than 6 months	6 - 12 months	Between 1-2 years	Between 2-5 years	Over 5 years	Total contractual cash flows	Carrying amount (assets)/ liabilities
At 31 December 2020	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>Non-derivatives</b>							
Borrowings – Securitisation liabilities	238,176	318,845	1,205,412	4,214,840	106,584	6,083,857	5,840,512
Borrowings – Shareholder loans	26,326	26,326	906,005	-	-	958,657	885,509
Trade and other liabilities	423,172	-	-	-	-	-	423,172
<b>Total non-derivatives</b>	<b>687,674</b>	<b>345,171</b>	<b>2,111,417</b>	<b>4,214,840</b>	<b>106,584</b>	<b>7,042,514</b>	<b>7,149,193</b>
<b>Derivatives</b>							
Derivatives – Forward foreign exchange contracts	946	20	-	-	-	966	966
Derivatives - interest rate swaps	5,174	3,798	4,335	(144)	-	13,163	12,804
<b>Total derivatives</b>	<b>6,120</b>	<b>3,818</b>	<b>4,335</b>	<b>(144)</b>	<b>-</b>	<b>14,129</b>	<b>13,770</b>
At 31 December 2019							
<b>Non-derivatives</b>							
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
<b>Total non-derivatives</b>	<b>783,531</b>	<b>726,102</b>	<b>1,625,184</b>	<b>5,160,583</b>	<b>568,316</b>	<b>8,863,716</b>	<b>8,193,495</b>
<b>Derivatives</b>							
Derivatives - interest rate swaps	(823)	(181)	(1,244)	(356)	-	(2,604)	74
<b>Total derivatives</b>	<b>(823)</b>	<b>(181)</b>	<b>(1,244)</b>	<b>(356)</b>	<b>-</b>	<b>(2,604)</b>	<b>74</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## Section 4 - Capital Management

### 4.1 Commitments

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

	2020 \$'000	2019 \$'000
Commitments for minimum lease payments in relation to non-cancellable operating leases are payable as follows:		
Within one year	15,318	13,236
Later than one year but not later than five years	50,507	52,998
Later than five years	26,605	43,338
<b>Commitments for minimum lease payments in relation to non-cancellable operating leases</b>	<b>92,430</b>	<b>109,572</b>

	2020 \$'000	2019 \$'000
Rental expense relating to operating leases:		
Minimum lease payments	14,690	13,246

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, except for short-term leases.

#### (b) Other commitments

	2020 \$'000	2019 \$'000
Commitment to extend credit	9,261,592	9,314,622
Capital expenditure	2,744	5,986
<b>Other commitments</b>	<b>9,264,336</b>	<b>9,320,608</b>

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 2020

## 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

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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

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.

#### 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 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.

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

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

#### **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.



# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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 2020

### 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 2020

### 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
<b>At 1 January 2020</b>							
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
<b>Year ended 31 December 2020</b>							
Opening net book amount	523,975	86,270	138,206	79,253	30,333	131	858,168
Effects of exchange rate differences on translation of foreign operations	(2,919)	(153)	(441)	(213)	(60)	(2)	(3,788)
Additions	-	-	7,074	2,587	67,384	-	77,045
Disposals	-	-	-	(2,478)	-	-	(2,478)
Amortisation charge	-	(18,401)	(33,039)	(30,275)	-	(33)	(81,748)
Impairment loss	-	-	-	(6,023)	(842)	-	(6,865)
Transfers	-	-	-	45,513	(51,144)	-	(5,631)
Closing net book amount	521,056	67,716	111,800	88,364	45,671	96	834,703
<b>At 31 December 2020</b>							
Cost	521,056	161,585	265,586	147,873	45,671	164	1,141,935
Accumulation amortisation	-	(93,869)	(153,786)	(59,509)	-	(68)	(307,232)
Net book amount	521,056	67,716	111,800	88,364	45,671	96	834,703
<b>Year ended 31 December 2019</b>							
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)
Amortisation on disposals	-	-	-	(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
<b>At 31 December 2019</b>							
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

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 4 years in Australia and 2 years in New Zealand at 31 December 2020 (2019: 5 years in Australia and 3 years in New Zealand).

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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.

	2020 \$'000	2019 \$'000
Australia	396,071	396,071
New Zealand	111,381	114,300
Insurance	13,604	13,604
<b>Total goodwill</b>	<b>521,056</b>	<b>523,975</b>

### (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	
	2020	2019	2020	2019	2020	2019
	%	%	%	%	%	%
Pre-tax discount rate	<b>15.6</b>	16.0	<b>13.8</b>	15.5	<b>15.6</b>	16.0
Terminal growth rate	<b>2.3</b>	2.7	<b>1.3</b>	2.4	<b>2.3</b>	2.7

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 5.1 Other Assets and Liabilities (continued)

### (d) Provisions

	2020			2019		
	Current \$'000	Non- Current \$'000	Total \$'000	Current \$'000	Non- current \$'000	Total \$'000
Leave obligations	18,533	1,682	20,215	17,191	1,230	18,421
Other employee benefit obligations	24,642	-	24,642	14,345	-	14,345
<b>Total employee benefit obligations</b>	<b>43,175</b>	<b>1,682</b>	<b>44,857</b>	<b>31,536</b>	<b>1,230</b>	<b>32,766</b>
<b>Customer remediation and other provisions</b>	<b>34,965</b>	<b>1,627</b>	<b>36,592</b>	<b>39,251</b>	<b>1,952</b>	<b>41,203</b>
<b>Total provisions</b>	<b>78,140</b>	<b>3,309</b>	<b>81,449</b>	<b>70,787</b>	<b>3,183</b>	<b>73,969</b>

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. 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

	2020 \$'000	2019 \$'000
Current	21,441	35,902
Non-current	18,944	29,332
<b>Total gross insurance policy liabilities</b>	<b>40,385</b>	<b>65,234</b>

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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 2020. 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.

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 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 (2019: Accumulation)	Claims (implied)
Disability and involuntary unemployment income	Accumulation (2019: 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 0.01% (2019: 0.93%), New Zealand 0.27% (2019: 1.29%)

5 years: Australia 0.34% (2019: 1.04%), New Zealand 1.29% (2019: 1.36%)

#### (ii) Inflation rates

Allowance for future inflation:

Australia 2.5%. (2019: 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% (2019: 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 2021 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 2019.

Currently claims experience in Australia and New Zealand is not being significantly impacted by the COVID-19 pandemic. There have been no specific adjustments to actuarial assumptions adopted for 31 December 2020 due to COVID-19. The long-term impact of the COVID-19 pandemic remains uncertain and actuarial assumptions will continue to be monitored closely against experience.

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

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

### (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 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\$3,023, Unemployment = NZ\$991), a claims handling expense rate of 12.0% of the projected gross claim payments (based on expense investigation) and a discount rate of 0.26% (based on the yield of 1 year and 2 year New Zealand Government bond yield as at 31 December 2020). Across all classes, changes to the claim termination and average claim size assumptions would cause the most significant change to the liability estimate.

The actuarial estimation of disability and involuntary unemployment liabilities (in the New Zealand statutory fund) allowed for the emergence of experience due to the COVID-19 pandemic. No specific adjustments were implemented to actuarial assumptions for COVID-19 and experience continues to be monitored closely.

### (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 – 26% p.a.(2019: 31% p.a.)

Regular premium term life insurances – 17% p.a.( 2019: 17% p.a.)

For the major classes of New Zealand business, the assumed aggregate rates of discontinuance are:

Consumer credit insurances – 30% p.a.(2019: 39% 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



# Notes to the Combined Financial Statements

For the year ended 31 December 2020

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

liabilities in the current period, unless a product enters loss recognition. As at 31 December 2020, 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 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 equity 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 equity if that change had been experienced during the financial reporting period.

31/12/2020 Australia	Percentage change in Assumptions	Impact on 2020 profit or loss (\$'000)		Impact on 2020 equity (\$'000)	
		Gross of Reinsurance	Net of Reinsurance	Gross of Reinsurance	Net of Reinsurance
Mortality/morbidity	Worsening by 5%	(73)	(68)	(73)	(68)
	Improving by 5%	73	68	73	68
Lapse rates	Worsening by 5%	10	10	10	10
	Improving by 5%	(10)	(10)	(10)	(10)
Expenses	Worsening by 5%	(150)	(150)	(150)	(150)
	Improving by 5%	150	150	150	150

31/12/2019 Australia	Percentage change in Assumptions	Impact on 2019 profit or loss (\$'000)		Impact on 2019 equity (\$'000)	
		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

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

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

31/12/2020 New Zealand	Percentage change in variables	Impact on 2020 profit or loss (\$'000)		Impact on 2020 equity (\$'000)	
		Gross of Reinsurance	Net of Reinsurance	Gross of Reinsurance	Net of Reinsurance
Mortality/morbidity	Worsening by 5%	(33)	(33)	(33)	(33)
	Improving by 5%	33	33	33	33
Lapse rates	Worsening by 5%	8	8	8	8
	Improving by 5%	(8)	(8)	(8)	(8)
Expenses	Worsening by 5%	(39)	(39)	(39)	(39)
	Improving by 5%	39	39	39	39

31/12/2019 New Zealand	Percentage change in variables	Impact on 2019 profit or loss (\$'000)		Impact on 2019 equity (\$'000)	
		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

### 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 actuarial estimation of insurance 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 profit or loss. 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

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

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

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.

### (f) Actuarial assumptions

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

2020	Disability (Personal Loans)	Unemployment (Personal Loans)	Disability (Credit Cards)	Unemployment (Credit Cards)	Protection <sup>^</sup>
<b>Australia:</b>					
Number of future finalisations	601	539	487	653	1,147
Discounted loss ratio*	49%	96%	18%	46%	35%
Expense rate	12%	12%	12%	12%	48%
Discount rate	0.04%pa- 2.9%pa	0.04%pa- 2.9%pa	0.04%pa- 2.9%pa	0.04%pa- 2.9%pa	0.04%pa- 2.9%pa
<b>New Zealand:</b>					
Number of future finalisations	320	351	125	50	39
Discounted loss ratio*	49%	46%	30%	32%	9%
Expense rate	12%	12%	12%	12%	48%
Discount rate	0.26%		n/a	n/a	n/a

2019	Disability (Personal Loans)	Unemployment (Personal Loans)	Disability (Credit Cards)	Unemployment (Credit Cards)	Protection <sup>^</sup>
<b>Australia:</b>					
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%

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

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

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
<b>New Zealand:</b>					
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%				

^ Merchandise protection, price protection and stolen cards (credit cards). \*As at December.

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. The analysis of historical claim reports and finalisation rates were performed separately for COVID-19 related claims and non-COVID-19 related claims. For COVID-19 related claims, the analysis allows for the higher unemployment and underemployment rate and any changes in the claims acceptance process as a result of the lockdowns.
- Adopted average claim size - based on historic ratios of claim payments to factors such as number of claims reported, finalised or handled. Adjustments are also made for the impacts which are not in historical claims experience to arrive the final adopted assumption. Under the COVID-19 economic environment, the adjustment made to average claim size allows for the changes in the claimants' behaviour arising from a higher unemployment or underemployment rate.
- Adopted claims handling expense rate – rate of 12.4% in Australia and 12.2% in New Zealand (2019: 15.5% for both) of the projected gross claim payments, has been determined based on the results of an expense allocation carried out in 2020.
- Central estimates of the outstanding claims liabilities - discounted to allow for future investment income attributable to the liabilities during the run off period. The future investment earnings assumptions are estimates of the future annual risk-free rates of return. The Australian rates have been derived from the yield curve on Australian Government bonds as at 31 December 2020 as published by the Reserve Bank of Australia. The New Zealand discount factor has been based on the annual risk-free rates of return from the yield curve on New Zealand Government Bonds.
- 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. The claims assumptions adopted to determine the outstanding claims liability takes into consideration the impact on claims experience from the change in economic environment (predominantly changes in unemployment rate) as a result of COVID-19.

### (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 profit or loss and equity of the Group. The table below describes how a change in each of the assumptions will affect the outstanding claims liabilities.

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

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

Key actuarial assumptions 2020	Changes	Impact on net outstanding claims liabilities (\$'000's)	Impact on total outstanding claims liabilities (%)
<b>Australia:</b>			
Reported claims chain ladder factor	Increase the chain ladder factor by 10%	+484	+3.1
Discount rate	Decrease discount rate by 1%	+158	+1.0
Claims handling expense rate	Increase claims handling expense rate by 4%	+595	+3.9
<b>New Zealand*:</b>			
Chain ladder factor	Increase the chain ladder factor by 10%	+87	+1.37
Discount rate	Decrease discount rate by 1%	+47	+0.74
Claims handling expense rate	Increase claims handling expense rate by 4%	+256	+4.03

\* Branch credit insurances

Key actuarial assumptions 2019	Changes	Impact on net outstanding claims liabilities (\$'000's)	Impact on total outstanding claims liabilities (%)
<b>Australia:</b>			
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 from claims handling expense rate by 4%	+412	+3.8
<b>New Zealand*:</b>			
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 from claims handling expense rate by 4%	+117	+3.9

\* Branch credit insurances only

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### Section 6 - Other Disclosures

#### 6.1 Interests in other entities

##### (a) Material subsidiaries

The Group's principal subsidiaries at 31 December 2020 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
	2020	2019	2020	2019	
	%	%	%	%	
<b>Country of incorporation - Australia:</b>					
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	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	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
Australian Sales Finance and Credit Card Trust No. 3	-	-	100	-	Securitisation of receivables
Latitude Australia Personal Loans Series 2020-1 Trust	-	-	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
<b>Country of incorporation - New Zealand:</b>					
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	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.

\*\*The Australian Secured Personal Loans Trust was sold during 2020 as part of a discontinued operation. For more information refer to section 6.6.

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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 2020, 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 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.

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 6.2 Contingent liabilities and contingent assets (continued)

#### 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. 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 date

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.

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 2020. 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.



# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 6.4 Related party transactions

### (a) Parent entity

KVD Singapore Pte. Ltd, a company incorporated in Singapore has 100% ownership interest (2019: 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:

	2020 \$	2019 \$
Short-term employee benefits	10,117,946	11,219,830
Long-term benefits	40,624	119,055
Post-employment benefits	290,983	293,575
Termination benefits	1,081,046	-
Share based payments	12,154,566	8,248,072
At 31 December	<b>23,685,165</b>	19,880,532

At 31 December 2020 KMP had outstanding balances payable totalling \$94,137 (2019: \$67,194) in respect of lending products. The total available credit facility during the period was \$349,492 (2019: \$284,373) and the maximum drawn amount during the period was \$165,250 (2019: \$105,290).

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:

	2020 \$	2019 \$
At 1 January	14,630,253	3,858,800
Granted	6,663,950	9,941,979
Plan modification	9,894,284	-
Equity adjustments	<b>(6,849,692)</b>	829,474
At 31 December	<b>24,338,795</b>	14,630,253

# Notes to the Combined Financial Statements

## For the year ended 31 December 2020

### 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.

	2020	2019
	\$	\$
<i>Rendering and receiving of services</i>		
Amounts paid to entities with significant influence	(6,113,033)	(6,092,500)
Distributions paid to entities with significant influence	(32,805,621)	(48,872,285)
Distributions accrued to entities with significant influence	(102,129,817)	(99,584,607)
<i>Other transactions</i>		
Dividend declared to parent	(1,526,720)	-

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

	2020	2019
	\$	\$
Entities with significant influence	(139,123,774)	(79,889,430)

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

	2020	2019
	\$	\$
<b>Loans from parties with significant influence</b>		
At 1 January	891,143,227	907,871,314
Effects of exchange rate on translation of foreign operations	(5,164,998)	2,057,421
Loan repayments made	-	(19,013,220)
Interest due to related parties	76,082,499	80,484,289
Interest paid	(76,551,756)	(80,256,577)
At 31 December	885,508,972	891,143,227

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 2020

### 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:

	<b>2020</b>	<b>2019</b>
	<b>\$ issued</b>	<b>\$ issued</b>
At 1 January	<b>20,151,864</b>	10,209,885
Fair value of units granted during the year	<b>6,663,950</b>	9,941,979
Fair value of plan modification for loan funded units	<b>9,894,284</b>	-
<b>At 31 December</b>	<b>36,710,098</b>	<b>20,151,864</b>

During the year ended 31 December 2020, units adjusted for equity changes was \$5,699,081 (2019: \$27,078,455). No units were exercised, none expired during the year, and no units were exercisable at year end. At 31 December 2020, 64,251,555 units were outstanding (31 December 2019: 58,247,862 units).

The terms and conditions on which some units were previously granted under loan funded agreements were modified during the year, resulting in an increase in fair value granted of \$9,894,284 measured using the same pricing model referred to above.

The total expense recognised in the profit and loss for the year ended 31 December 2020 in respect of MEP was \$16,558,234 (2019: \$9,941,979).

# Notes to the Combined Financial Statements

For the year ended 31 December 2020

## 6.6 Discontinued operation

### (a) Description

In June 2020, Latitude sold its Residential Loan portfolio, a run-off line of business that is a legacy of the previous GE ownership. The sale, effective 30 June 2020, completed on 14 August 2020. The comparative profit or loss has been re-presented to show the results of the discontinued operation separately. An impairment loss of \$5.6 million was recognised in the year ended 31 December 2020 in relation to assets sold within the discontinued operation.

### (b) Financial Performance

	31 December 2020 \$'000	31 December 2019 \$'000
Revenue	1,695	2,919
Expenses	871	(5)
Asset impairment recognised	(5,610)	-
Income tax (expense)/benefit	1,583	(1,006)
Distribution to Trust Beneficiaries	(2,286)	(105)
<b>Profit of discontinued operations</b>	<b>(3,747)</b>	<b>1,803</b>
Net profit/(loss) after tax from discontinued operations attributable to owners of the group	(3,747)	2,401
Net (loss) after tax for the period from discontinued operations not distributed attributable to non-controlling interests	-	(598)
<b>Profit of discontinued operations</b>	<b>(3,747)</b>	<b>1,803</b>

### (c) Cash Flow Statement

	31 December 2020 \$'000	31 December 2019 \$'000
Net cash provided by/(used in) operating activities	4,564	(6,487)
Net cash provided by financing activities	26,385	-
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>30,949</b>	<b>(6,487)</b>

### (d) Assets and liabilities of disposal group classified as held for sale

	31 December 2020 \$'000	31 December 2019 \$'000
<b>Liabilities directly associated with assets classified as held for sale</b>		
Trade and other liabilities	2,163	-
<b>Total liabilities of disposal group held for sale</b>	<b>2,163</b>	<b>-</b>