# Westpac Banking Corporation
# General Disclosure Statement

for the year ended 30 September 2010

**Index**

# General information and definitions

Certain of the information contained in this General Disclosure Statement is required by section 81 of the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**') and the Registered Bank Disclosure Statement (Full and Half-Year – Overseas Incorporated Registered Banks) Order 2008 ('**Order**').

In this General Disclosure Statement reference is made to four main reporting groups:

- Westpac Banking Corporation Group (otherwise referred to as the '**Overseas Banking Group**') - refers to the total worldwide business of Westpac Banking Corporation including its controlled entities.
- Westpac Banking Corporation (otherwise referred to as the '**Overseas Bank**') - refers to the worldwide activities of Westpac Banking Corporation excluding its controlled entities.
- Westpac Banking Corporation New Zealand Division (otherwise referred to as the '**NZ Banking Group**') - refers to the New Zealand operations of Westpac Banking Corporation Group including those entities whose business is required to be reported in financial statements for the Overseas Banking Group's New Zealand business. As at 30 September 2010 the NZ Banking Group included the controlled entities set out in Note 27 Related entities.
- Westpac Banking Corporation New Zealand Branch (otherwise referred to as the '**NZ Branch**') - refers to the New Zealand Branch of Westpac Banking Corporation (trading as Westpac and Westpac Institutional Bank).

Words and phrases defined by the Order have the same meaning when used in this General Disclosure Statement. All amounts referred to in this General Disclosure Statement are in New Zealand dollars unless otherwise stated.

# General matters

## Registered Bank

The Overseas Bank is entered on the register maintained under the Reserve Bank Act. However, for the purposes of this General Disclosure Statement, the registered bank is the NZ Branch. The NZ Branch's head office is situated at, and the address for service is, Level 15, 188 Quay Street, Auckland, New Zealand.

## Overseas Bank

The Overseas Bank was founded on 12 February 1817 and was incorporated on 23 September 1850 pursuant to the Bank of New South Wales Act 1850. In 1982 the Overseas Bank acquired The Commercial Bank of Australia Limited and the Overseas Bank changed its name to Westpac Banking Corporation. On 23 August 2002 the Overseas Bank registered as a public company limited by shares under the Australian Corporations Act 2001 and as of that date the Bank of New South Wales Act 1850 ceased to apply.

The Overseas Bank's principal office and address for service is Westpac Place, 275 Kent Street, Sydney, New South Wales 2000, Australia.

Until 1 November 2006 the Overseas Bank operated as a branch in New Zealand. Effective 1 November 2006 the Overseas Bank has operated in New Zealand through both the NZ Branch (a branch of the Overseas Bank carrying on institutional banking and financial markets operations) and Westpac New Zealand Limited ('**Westpac New Zealand**') (a locally incorporated subsidiary of the Overseas Bank carrying on the Overseas Bank's New Zealand consumer and business banking operations). Westpac New Zealand is a member of the NZ Banking Group.

As a registered bank, Westpac New Zealand is required to produce its own disclosure statement. Accordingly, further information on Westpac New Zealand is available in Westpac New Zealand's General Disclosure Statement for the year ended 30 September 2010.

## Registered bank: Directorate and advisers

***Directors***

The Directors of the Overseas Bank ('**Board**') at the time this General Disclosure Statement was signed were:

| | |
|---|---|
| **Name:** Edward Alfred Evans AC, BEcon (Hons.)<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorship:** Director of Navitas Limited. |
| **Name:** Gail Patricia Kelly, HigherDipED, BA, MBA, HonDBus<br>**Non-executive:** No<br>**Country of Residence:** Australia<br>**Primary Occupation:** Managing Director and Chief Executive Officer, Westpac Banking Corporation<br>**Secondary Occupations:** Director<br>**Board Audit Committee Member:** No<br>**Independent Director:** No | **External Directorships:** Director of each of Melbourne Business School, The Financial Markets Foundation for Children and G&A Kelly Investments Pty Limited. Member of the Financial Services Advisory Council and Director of the Australian Bankers' Association. |
| **Name:** John Simon Curtis AM, BA, LLB (Hons.)<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Chairman of each of Allianz Australia Limited, Landis + Gyr Holdings AG and University of Technology Sydney Faculty of Business Executive Council. Director of each of Allianz Australia Insurance Limited, Allianz Australia Life Insurance Limited, Cetinale Pty Limited, CIC Allianz Insurance Limited, Mirapoint Pty Limited, Rowshore Pty Limited, Sitruc Pty Ltd, South Sydney Central Pty Limited, Stourhead Holdings Pty Limited and Stowe Securities Pty Limited. |

## General matters (continued)

| | |
|---|---|
| **Name:** Elizabeth Blomfield Bryan, BA (Econ.), MA (Econ.)<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Chairman of each of Caltex Australia Limited, Caltex Australia Petroleum Pty Ltd, Caltex Australia Custodians Pty Ltd, UniSuper Limited and UniSuper Management Pty Ltd. Director of each of Australian Institute of Company Directors and E. Bryan Superannuation Fund Pty Ltd. |
| **Name:** Gordon McKellar Cairns, MA (Hons.)<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Chairman of each of Origin Foundation Pty Limited and Rebel Group Limited. Director of each of A-Mart All Sports Pty Ltd, Coyote Retail Investments Pty Limited, Coyote Retail Pty Limited, Ceilidh Pty Limited, Foghorn Holdings Pty Ltd, Next Athleisure Pty Limited, Origin Energy Limited, Piobaireachd Pty Ltd, Quinns Rock Pty Ltd, Rebel Management Services Pty Limited, Rebel Sport Limited, Rebel Wholesale Pty Limited, Rebel Sport.com Pty Limited, Trend Imports Pty Limited, The Centre for Independent Studies Limited and World Education Australia Limited. |
| **Name:** Peter John Oswin Hawkins, BCA (Hons.), SF Fin, FAIM, ACA (NZ), FAICD<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Director of each of Camberwell Grammar School, Clayton Utz, Joshawk Investments Pty Ltd, Liberty Financial Pty Ltd, Lynter Investments Pty Ltd, Minerva Fiduciary Limited, Minerva Financial Group Pty Limited, Mirvac Funds Limited, Mirvac Limited, Murray Goulburn Co-operative Company Limited, Petlyn Holdings Pty Limited, Treasury Corporation of Victoria and Visa Inc. |
| **Name:** Carolyn Judith Hewson AO, BEc (Hons.), MA (Econ.)<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Director of each of BHP Billiton Limited, BT Investment Management Limited, Stockland Corporation Limited, Stockland Trust Management Limited, The Australian Charities Fund Pty Limited and The Australian Charities Fund Operations Ltd. |
| **Name:** Lindsay Philip Maxsted, Dip.Bus. (Gordon), FCA<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes, Chairman<br>**Independent Director:** Yes | **External Directorships:** Chairman of Transurban Group. Director of each of Align Capital Pty Ltd, Align Investments Pty Ltd, Baker IDI Heart and Diabetes Institute Holdings Limited, Belmont Pty Limited, Centip Pty Ltd, Continuum Investments Pty Ltd, Jacobite Investments Pty Ltd, Kaprad Holdings Pty Ltd, Transurban Holdings Limited and Transurban Infrastructure Management Limited. |
| **Name:** Graham John Reaney, BComm, CPA<br>**Non-executive:** Yes<br>**Country of Residence:** Australia<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Chairman of PMP Limited. Director of each of Australian Food Holdings Pty Limited, Elanora Country Club Limited, Holbris Pty Ltd, Holcim (Australia) Pty Ltd, Holcim (Australia) Holdings Pty Ltd, Holcim Finance (Australia) Pty Ltd, Holcim Participations (Australia) Pty Ltd, Holglad Pty Limited, Maxwell Food Products Pty Ltd, Polo Citrus Australia Pty Limited, Renilton Investments Pty Ltd, Renilton Pty Ltd and Vennor Investments Pty Ltd. |
| **Name:** Peter David Wilson, CA<br>**Non-executive:** Yes<br>**Country of Residence:** New Zealand<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Chairman of each of Kermadec Property Fund Limited and PF Olsen Group Limited. Director of each of Farmlands Trading Society Limited, PF Olsen Limited and The Colonial Motor Company Limited. Member of New Zealand Markets Disciplinary Tribunal and Chairman of the Special Division of that Tribunal. |

There has been no change to the composition of the Board since the date of signing of the NZ Branch's General Short Form Disclosure Statement for the nine months ended 30 June 2010.

### Chief Executive Officer, NZ Branch

**Name:** David McLean, LLB (Hons.)
**Country of Residence:** New Zealand
**Primary Occupation:** Chief Executive Officer, NZ Branch
**Secondary Occupations:** General Manager, Private, Wealth and Insurance, Westpac New Zealand
**External Directorships:** None

### Responsible person

George Frazis, Chief Executive, Westpac New Zealand, has been authorised in writing by each Director named on pages 1 and 2, in accordance with section 82 of the Reserve Bank Act, to sign this General Disclosure Statement on the Directors' behalf. Accordingly George Frazis is a Responsible Person under the Order. The following disclosures are made in relation to George Frazis in his capacity as a Responsible Person:
**Name:** George Frazis, B Eng. (Hons.), MBA (AGSM, Wharton)
**Country of Residence:** New Zealand
**Primary Occupation:** Chief Executive, Westpac New Zealand
**Secondary Occupations:** Director

# General matters (continued)

## Address for communications

All communications may be sent to the Directors, the Chief Executive Officer, NZ Branch and the Responsible Person at the head office of the NZ Branch at Level 15, 188 Quay Street, Auckland, New Zealand.

## Conflicts of interest policy

The Board has adopted a procedure to ensure that conflicts and potential conflicts of interest between the Directors' duty to the Overseas Bank and their own interests are avoided or dealt with. Accordingly, each Director must:

(i) give notice to the Board of any direct or indirect interest in any contract, proposed contract or other matter with the Overseas Bank as soon as practicable after the relevant facts have come to that Director's knowledge. Alternatively, a Director may give to the Board a general notice to the effect that the Director is to be regarded as interested in any present or prospective contract or other matter between the Overseas Bank and a person or persons specified in that notice; and

(ii) in relation to any matter that is to be considered at a Directors' meeting in which that Director has a material personal interest, not vote on the matter nor be present while the matter is being considered at the meeting (unless the remaining Directors have previously resolved to the contrary).

## Interested transactions

There have been no transactions entered into by any Director, the Chief Executive Officer, NZ Branch, or any immediate relative or close business associate of any Director or the Chief Executive Officer, NZ Branch, with the NZ Branch, or any member of the NZ Banking Group:

a. on terms other than on those that would in the ordinary course of business of the NZ Branch or any member of the NZ Banking Group, be given to any other person of like circumstances and means; or

b. which could be reasonably likely to influence materially the exercise of the Directors', or the Chief Executive Officer, NZ Branch's duties.

## Auditors

***Overseas Banking Group***

PricewaterhouseCoopers
Darling Park Tower 2
201 Sussex Street
Sydney, NSW 2000
Australia

***NZ Banking Group***

PricewaterhouseCoopers
PricewaterhouseCoopers Tower
188 Quay Street
Auckland, New Zealand

# Credit ratings

The Overseas Bank has the following credit ratings with respect to its long-term senior unsecured obligations, including obligations payable in New Zealand in New Zealand dollars as at the date the Directors signed this General Disclosure Statement.

| Rating Agency | Current Credit Rating | Rating Outlook |
|---|---:|---:|
| Fitch Ratings | AA | Stable |
| Moody's Investors Service | Aa1 | Negative |
| Standard & Poor's | AA | Stable |

On 31 March 2010 the Overseas Bank's credit rating issued by Fitch Ratings was upgraded from AA- to AA with a 'stable' outlook. On 30 September 2008 the rating issued by Fitch Ratings was AA- with a 'positive' outlook and on 3 December 2008 the outlook was changed to 'stable'. This position was unchanged until 31 March 2010 when the credit rating was upgraded to AA with a 'stable' outlook.

In the two years prior to 30 September 2010 the Overseas Bank's credit rating issued by Moody's Investors Service has not changed. However, on 2 March 2009, Moody's Investors Service revised the outlook from 'stable' to 'negative'. In maintaining a 'negative' outlook for all the major Australian banks, Moody's Investors Service highlighted the sector's structural reliance on wholesale funding. Moody's Investors Service has also indicated that it is watching the changes proposed by the Basel Committee on Banking Supervision in relation to liquidity and stable funding and that the proposed changes, if implemented, could address its concerns and have a material impact on bank ratings.

In the two years prior to 30 September 2010 the Overseas Bank's credit rating issued by Standard & Poor's has not changed. The outlook for the rating has also remained unchanged at 'stable' over this period.

A credit rating is not a recommendation to buy, sell or hold securities of the Overseas Bank. Such ratings are subject to revision, qualification, suspension or withdrawal at any time by the assigning rating agency. Investors in the Overseas Bank's securities are cautioned to evaluate each rating independently of any other rating.

# Credit ratings (continued)

## Descriptions of credit rating scales[1]

| | Fitch Ratings | Moody's Investors Service | Standard & Poor's |
|---|---|---|---|
| **The following grades display investment grade characteristics:** | | | |
| Capacity to meet financial commitments is extremely strong. This is the highest issuer credit rating. | AAA | Aaa | AAA |
| Very strong capacity to meet financial commitments. | **AA** | **Aa** | **AA** |
| Strong capacity to meet financial commitments although somewhat susceptible to adverse changes in economic, business or financial conditions. | A | A | A |
| Adequate capacity to meet financial commitments, but adverse business or economic conditions are more likely to impair this capacity. | BBB | Baa | BBB |
| **The following grades have predominantly speculative characteristics:** | | | |
| Significant ongoing uncertainties exist which could affect the capacity to meet financial commitments on a timely basis. | BB | Ba | BB |
| Greater vulnerability and therefore greater likelihood of default. | B | B | B |
| Likelihood of default now considered a real possibility. Capacity to meet financial commitments is dependent on favourable business, economic and financial conditions. | CCC | Caa | CCC |
| Highest risk of default. | CC to C | Ca | CC |
| Obligations currently in default. | RD to D | C | SD to D |

1 This is a general description of the rating categories based on information published by Fitch Ratings, Moody's Investors Service and Standard & Poor's.

Credit ratings by Fitch Ratings and Standard & Poor's may be modified by a plus (higher end) or minus (lower end) sign to show relative standing within the major categories. Moody's Investors Service apply numeric modifiers 1 (higher end), 2 or 3 (lower end) to ratings from Aa to Caa to show relative standing within the major categories.

Ratings stated in **bold** indicate the Overseas Bank's current position within the credit rating scales.

# Financial statements of the Overseas Bank and the Overseas Banking Group

The most recently published financial statements of the Overseas Bank and the Overseas Banking Group are for the year ended 30 September 2010 and can be accessed at the internet address www.westpac.com.au.

Copies of the NZ Branch's most recent General Disclosure Statement and Supplemental Disclosure Statement, which contain a copy of the most recent publicly available financial statements of the Overseas Bank and the Overseas Banking Group, will be provided immediately, free of charge, to any person requesting a copy where the request is made at the NZ Branch's head office, Level 15, 188 Quay Street, Auckland. They are also available, free of charge, at the internet address www.westpac.co.nz and within five working days of any request, at any branch of the NZ Branch and at any staffed premises of any agency of the NZ Branch, primarily engaged in the business of the NZ Branch to which its customers or potential customers have access in order to conduct banking business.

# Historical summary of financial statements

| | NZ Banking Group | | | | |
|---|---|---|---|---|---|
| | **2010 $m[1]** | 2009 $m[2,3] | 2008 $m[4] | 2007 $m | 2006 $m |
| **Income statement** | | | | | |
| Interest income | **3,972** | 4,622 | 5,387 | 4,603 | 3,793 |
| Interest expense | **(2,562)** | (3,142) | (4,049) | (3,359) | (2,625) |
| **Net interest income** | **1,410** | 1,480 | 1,338 | 1,244 | 1,168 |
| Non-interest income | **532** | 610 | 572 | 528 | 524 |
| **Net operating income** | **1,942** | 2,090 | 1,910 | 1,772 | 1,692 |
| Operating expenses | **(788)** | (808) | (814) | (736) | (699) |
| Impairment charges on loans | **(332)** | (690) | (181) | (91) | (31) |
| **Operating profit** | **822** | 592 | 915 | 945 | 962 |
| Share of profit of associate accounted for using equity method | **1** | - | 48 | - | - |
| **Profit before income tax expense** | **823** | 592 | 963 | 945 | 962 |
| Income tax expense | **(60)** | (1,086) | (281) | (295) | (319) |
| **Profit/(loss) after income tax expense** | **763** | (494) | 682 | 650 | 643 |
| **Profit/(loss) after income tax expense attributable to:** | | | | | |
| Head office account and owners of the NZ Banking Group | **760** | (497) | 679 | 646 | 639 |
| Non-controlling interests in subsidiary companies | **3** | 3 | 3 | 4 | 4 |
| | **763** | (494) | 682 | 650 | 643 |
| NZ Branch profit repatriation to the Overseas Bank | **-** | - | (602) | (137) | (322) |
| Dividends paid on ordinary share capital | **(4)** | (13) | (175) | (31) | (160) |
| Dividends paid on preference share capital | **-** | (104) | (15) | - | - |
| Dividends paid on convertible debentures (net of tax) | **(70)** | (69) | (66) | (69) | (67) |
| **Balance sheet** | | | | | |
| Total assets | **72,783** | 73,444 | 70,882 | 64,602 | 52,136 |
| Total impaired assets (including restructured assets) | **890** | 676 | 278 | 118 | 66 |
| Total liabilities | **68,655** | 69,539 | 66,750 | 60,729 | 48,719 |
| Total head office account | **1,192** | 1,392 | 174 | 1,361 | 1,307 |
| Total equity | **4,128** | 3,905 | 4,132 | 3,873 | 3,417 |

1 During the year ended 30 September 2010 the NZ Branch repatriated $500 million of capital to the Overseas Bank.
2 During the year ended 30 September 2009 the Overseas Bank advanced capital of $1.8 billion to the NZ Branch.
3 Income tax expense includes a provision totalling $918 million in relation to nine structured finance transactions which occurred between 1998 and 2002 that were disputed by the New Zealand Commissioner of Inland Revenue. Refer to Note 30 for further information.
4 During the year ended 30 September 2008, the NZ Branch repatriated $1.3 billion to the Overseas Bank from Branch capital ($698 million) and retained profits ($602 million).

The amounts for the years ended 30 September have been extracted from the audited financial statements of the NZ Banking Group.

# Guarantee arrangements

Certain material obligations of the Overseas Bank are guaranteed as at the date the Directors and the Chief Executive Officer, NZ Branch signed this General Disclosure Statement.

## Guarantee of deposits by the Australian Government: Financial Claims Scheme

The Australian Government announced on 12 October 2008 that it would guarantee the deposits in eligible Australian authorised deposit-taking institutions ('**ADIs**'), as that term is defined for the purposes of the Banking Act 1959 of Australia ('**Australian Banking Act**'), for a period of three years from 12 October 2008. As at the date of this General Disclosure Statement the Overseas Bank is an ADI.

The Australian Banking Act was amended to facilitate the deposit guarantee by establishing a financial claims scheme ('**FCS**') to be administered by the Australian Prudential Regulation Authority ('**APRA**'). The FCS will operate on terms set out in the Australian Banking Act until 12 October 2011. Thereafter its continued operation will be subject to review by the Australian Government.

An ADI will be an 'eligible ADI' for the purposes of the FCS in circumstances where APRA has applied for the winding-up of the ADI and a declaration has been made by the responsible Australian Government minister that the FCS applies to that ADI. Once declared to be an eligible ADI, there are no other material conditions applicable to the coverage of deposits up to A$1 million under the FCS other than that eligible ADI becoming unable to meet its obligations or suspending payment. As at the date of this General Disclosure Statement, APRA has not applied for a winding-up of the Overseas Bank nor has a declaration been made by the responsible Australian Government minister that the FCS applies to the Overseas Bank.

The first A$1 million of 'protected accounts' held with an eligible ADI (including most deposits) are guaranteed without charge under the FCS. A 'protected account' (as defined for the purposes of the Australian Banking Act) must be:

- prescribed under the regulations;
- kept under an agreement between the account holder and the ADI requiring the ADI to pay the account-holder the net credit balance on demand or at an agreed time; or
- a 'covered financial product' (that is, one specified in a ministerial declaration) that is kept under an agreement between the account holder and the ADI requiring the ADI to pay the account-holder on demand or at an agreed time the net credit balance.

The A$1 million threshold applies to the total amount of funds held by a depositor in (separate) deposit accounts with an eligible ADI. Eligible institutions were able to obtain coverage for deposit amounts over A$1 million under the Guarantee Facility (described below) in return for a fee.

# Guarantee arrangements (continued)

The Financial Claims Scheme (ADIs) Levy Act 2008 of Australia also provides for the imposition of a levy to fund the excess of certain of APRA's FCS costs connected with an ADI over the sum of specified amounts paid to APRA by that ADI in connection with the FCS or in the winding-up of that ADI. The levy is imposed on liabilities of ADIs to their depositors and cannot be more than 0.5% of the amount of those liabilities.

Further information about the FCS may be obtained from the Australian Federal Treasurer's internet site www.treasurer.gov.au. The Australian Banking Act and the Financial Claims Scheme (ADIs) Levy Act 2008 are also available from the following internet site maintained by the Australian Attorney-General's Department www.comlaw.gov.au.

## Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding: Guarantee Facility

On 20 November 2008 the Australian Government released the details and rules ('**Scheme Rules**') of the Australian Government Guarantee Scheme for Large Deposits and Wholesale Funding ('**Guarantee Facility**'), which provided a guarantee facility for deposits of amounts over A$1 million and wholesale term funding. The obligations of the Commonwealth of Australia are contained in a deed of guarantee executed on behalf of the Commonwealth of Australia ('**Guarantor**') dated 20 November 2008 and taking effect from 28 November 2008 ('**Guarantee**'). The Scheme Rules govern access to protection under the Guarantee.

The Australian Government announced on 7 February 2010 that it would withdraw the Guarantee Facility, which ceased to have effect from 5pm on 31 March 2010. Deposit balances above A$1 million covered by the Guarantee Facility as at 31 March 2010 will be covered until maturity (for term deposits) or until October 2015 (for at call deposits). For at call deposits, the amount covered will be capped at the closing guaranteed amount on 31 March 2010. Deposits and interest payments after this date will only be covered (up to the capped amount) if the guaranteed balance has fallen below the capped amount. For term deposits, interest due after 31 March 2010 will be guaranteed to maturity. Statutory trust accounts will be treated in the same way as other large deposits. Guaranteed wholesale liabilities as at 31 March 2010 with terms to maturity up to five years will also be guaranteed to the earlier of maturity or five years. The Scheme Rules were amended to effect the withdrawal of the Guarantee Facility. The announcement does not affect the FCS, which continues to cover deposits of up to A$1 million until its continued operation is reviewed by the Australian Government in/or around October 2011.

The Guarantee and the Scheme Rules are available at www.guaranteescheme.gov.au and may be amended by the Australian Government from time to time. A copy of the Guarantee is also included in the NZ Branch's most recent Supplemental Disclosure Statement, which is available, free of charge, at the internet address www.westpac.co.nz and immediately on request at the NZ Branch's head office, Level 15, 188 Quay Street, Auckland. The NZ Branch's most recent Supplemental Disclosure Statement is also available, free of charge, within five working days of any request, at any branch of the NZ Branch.

The Guarantor shall not be liable to perform its obligations under the Guarantee in respect of liabilities which have been varied, amended, waived, released, novated, supplemented, extended or restated in any material respect without the written consent of the Guarantor.

The Commonwealth of Australia may also amend the terms of the Guarantee at any time at its discretion, provided that (except insofar as such amendment is required by law) such amendment does not reduce the Commonwealth of Australia's obligations to the beneficiaries under the Guarantee in a manner which is prejudicial to the interests of the beneficiaries in respect of any subsisting guaranteed liability. In particular, see clause 6 of the Guarantee, the form of which is set out in the NZ Branch's most recent Supplemental Disclosure Statement.

The Scheme Rules set out those named institutions that are 'eligible institutions' for the purposes of the Guarantee Facility. As at the date of this General Disclosure Statement the Overseas Bank is such an eligible institution.

As described above, under the heading **Guarantee of deposits by the Australian Government: Financial Claims Scheme**, from 28 November 2008 the first A$1 million in 'protected accounts' held with an eligible ADI (including most deposits) is guaranteed for free under the FCS. However, an eligible institution was able to obtain coverage for deposits of amounts over A$1 million and wholesale term funding under the Guarantee Facility in return for payment of a fee. A different fee applied to eligible institutions based on their long-term credit rating. The fee which applied to the Overseas Bank, based on its long-term rating by Standard & Poor's of AA, was 70 basis points (or 0.70%) and was levied on a monthly basis.

Liabilities of an eligible institution only have the benefit of the Guarantee Facility where an eligibility certificate has been issued by the Commonwealth of Australia in respect of those liabilities. As a result of the withdrawal of the Guarantee Facility with effect from 31 March 2010, the final date on which an eligible institution could apply for an eligibility certificate was 24 March 2010.

As at the date this General Disclosure Statement was signed by the Directors and Chief Executive Officer, NZ Branch, eligibility certificates have been issued by the Commonwealth of Australia in respect of certain of the Overseas Bank's existing deposit and wholesale term funding liabilities. Details of these eligibility certificates are available on www.guaranteescheme.gov.au/liabilities/.

A beneficiary of the Guarantee may rely upon the issue of an eligibility certificate as conclusive evidence that the liability described in the eligibility certificate satisfies the eligibility criteria set out in the Scheme Rules.

A claim for payment under the Guarantee must be in writing and made in the form specified in, and in accordance with, the Scheme Rules.

## Information about the Guarantor

The Guarantor's name and address for service is: The Commonwealth of Australia, c/o - The Treasury of the Commonwealth of Australia, Treasury Building, Langton Crescent, Parkes ACT 2600, Australia. A copy of the most recent audited financial statements of the Guarantor is available at www.finance.gov.au/publications/commonwealth-consolidated-financial-statements/.

The credit ratings assigned to the Guarantor's long-term obligations payable in Australian dollars (the currency of its jurisdiction) are AAA by Standard & Poor's, Aaa by Moody's Investors Service and AAA by Fitch Ratings. The outlook for each of these ratings is 'stable'. There have been no changes in these credit ratings (including outlook) in the two years prior to 30 September 2010.

Ratings are statements of opinion, not statements of fact or recommendations to buy, hold or sell any securities. Ratings may be changed, qualified, withdrawn or suspended at any time. For an explanation of the credit rating scales see the table under the sub-heading "Description of credit rating scales" on page 4 of this General Disclosure Statement.

## New Zealand deposit guarantee scheme and wholesale funding guarantee facility

Westpac New Zealand has entered into the following guarantees with the New Zealand Government ('**Crown**'):

(i) a Crown Wholesale Funding Guarantee Facility Deed and Crown Wholesale Funding Guarantee, each dated 23 February 2009 (together the '**Wholesale Guarantee**');

(ii) a Crown Deed of Guarantee dated 11 November 2008, amended by a supplemental deed dated 24 November 2008, under the New Zealand deposit guarantee scheme ('**Deposit Guarantee**'); and

(iii) a Crown Deed of Guarantee dated 16 December 2009 under the revised deposit guarantee scheme ('**Revised Deposit Guarantee**').

## Guarantee arrangements (continued)

Westpac New Zealand's Deposit Guarantee and Revised Deposit Guarantee expired at the end of 11 October 2010. Westpac New Zealand did not apply for a guarantee under the extension of the Deposit Guarantee that commenced on 12 October 2010 and will expire at the end of 31 December 2011. Therefore, as at the date the Directors signed this General Disclosure Statement, no obligations of Westpac New Zealand are guaranteed by the Crown under the Deposit Guarantee or the Revised Guarantee.

Details of the Wholesale Guarantee can be found in Westpac New Zealand's General Disclosure Statement for the year ended 30 September 2010 (available free of charge at www.westpac.co.nz), and on the Treasury internet site www.treasury.govt.nz.

The NZ Branch has not entered into the deposit guarantee scheme and did not participate in the wholesale guarantee facility.

## Ranking of local creditors in liquidation

There are material legislative restrictions in Australia (being the Overseas Bank's country of incorporation) which subordinate the claims of certain classes of unsecured creditors of the Overseas Bank on the Australian assets of the Overseas Bank (including a claim made or proved in an insolvent winding-up or liquidation of the Overseas Bank) to those of other classes of unsecured creditors of the Overseas Bank, in the event that the Overseas Bank becomes unable to meet its obligations or suspends payment.

The legislation described below is relevant to limitations on possible claims made by unsecured creditors of the NZ Branch (together with all other senior unsecured creditors of the Overseas Bank) and New Zealand depositors on the assets of the Overseas Bank (including a claim made or proved in an insolvent winding-up or liquidation of the Overseas Bank) relative to those of certain other classes of unsecured creditors of the Overseas Bank, in the event that the Overseas Bank becomes unable to meet its obligations or suspends payment.

The Overseas Bank is an ADI for the purposes of the Australian Banking Act. Prior to 27 July 2010, section 13A(3) of the Australian Banking Act provided that, in the event an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to satisfy, in priority to all other liabilities of the ADI:

- first, certain obligations of the ADI to APRA (if any) arising under Division 2AA of Part II of the Australian Banking Act in respect of amounts payable by APRA to holders of 'protected accounts' (as defined for the purposes of the Australian Banking Act) as part of the FCS;
- second, APRA's costs (if any) in exercising its powers and performing its functions relating to the ADI in connection with the FCS; and
- third, the ADI's deposit liabilities in Australia (other than any liabilities under the first priority listed above).

With effect from 27 July 2010, section 13A of the Australian Banking Act was amended so that in the event that the ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to satisfy the liabilities of the ADI in the following order:

- first and second, as above;
- third, the ADI's liabilities (if any) in Australia in relation to 'protected accounts' that account-holders keep with the ADI;
- fourth, the ADI's debts (if any) to the Reserve Bank of Australia;
- fifth, the ADI's liabilities (if any) under an emergency financial 'industry support contract' that is certified by APRA in accordance with the Australian Banking Act; and
- sixth, the ADI's other liabilities (if any) in the order of their priority apart from the above.

Section 13A of the Australian Banking Act affects all unsecured liabilities of the NZ Branch which as at 30 September 2010 amounted to $19,584 million. As at 30 September 2009 section 13A of the Australian Banking Act affected only the unsecured deposit liabilities of the NZ Branch which amounted to $4,401 million.

Section 13A(4) of the Australian Banking Act also provides that it is an offence for an ADI not to hold assets (other than goodwill and, with effect from 27 July 2010, any assets or other amount excluded by the prudential standards) in Australia of a value that is equal to or greater than the total amount of its deposit liabilities in Australia, unless APRA has authorised the ADI to hold assets of a lesser value. During the year ended 30 September 2010, the Overseas Bank has at all times held assets (other than goodwill) in Australia of not less than the value of the Overseas Bank's total deposit liabilities in Australia.

Under section 16 of the Australian Banking Act, on the winding-up of an ADI, APRA's cost of being in control of an ADI's business, or having an administrator in control of an ADI's business, is a debt due to APRA. Debts due to APRA shall have, subject to section 13A(3) of the Australian Banking Act, priority over all other unsecured debts of that ADI.

The requirements of the above provisions have the potential to impact on the management of the liquidity of the NZ Banking Group.

## Pending proceedings or arbitration

There are no legal proceedings pending at the date of this General Disclosure Statement that may have a material adverse effect on the NZ Banking Group or the NZ Branch.

The Overseas Banking Group has worldwide contingent liabilities in respect of actual and potential claims and proceedings, which have not been determined. An assessment of the Overseas Banking Group's likely loss is made on a case-by-case basis and provisions are made where appropriate. Such contingencies are disclosed in the Overseas Banking Group's 30 September 2010 Annual Financial Report.

## Other material matters

There are no matters relating to the business or affairs of the NZ Branch and the NZ Banking Group which are not contained elsewhere in the General Disclosure Statement and which would, if disclosed, materially adversely affect the decision of a person to subscribe for debt securities of which the NZ Branch or any member of the NZ Banking Group is the issuer.

## Conditions of registration

The conditions of registration imposed on the NZ Branch, which have applied from 26 November 2007, are as follows:

1. That the NZ Banking Group does not conduct any non-financial activities that in aggregate are material relative to its total activities, where the term material is based on generally accepted accounting practice, as defined in the Financial Reporting Act 1993.
2. That the NZ Banking Group's insurance business is not greater than 1 percent of its total consolidated assets. For the purposes of this condition:
   (i) Insurance business means any business of the nature referred to in section 4 of the Insurance Companies (Ratings and Inspections) Act 1994 (including those to which the Act is disapplied by sections 4(1)(a) and (b) and 9 of that Act), or any business of the nature referred to in section 3(1) of the Life Insurance Act 1908;

## Conditions of registration (continued)

(ii) In measuring the size of the NZ Banking Group's insurance business:

(a) where insurance business is conducted by any entity whose business predominantly consists of insurance business, the size of that insurance business shall be:

- the total consolidated assets of the group headed by that entity;
- or if the entity is a subsidiary of another entity whose business predominantly consists of insurance business, the total consolidated assets of the group headed by the latter entity;

(b) otherwise, the size of each insurance business conducted by any entity within the NZ Banking Group shall equal the total liabilities relating to that insurance business, plus the equity retained by the entity to meet the solvency or financial soundness needs of the insurance business;

(c) the amounts measured in relation to parts (a) and (b) shall be summed and compared to the total consolidated assets of the NZ Banking Group. All amounts in parts (a) and (b) shall relate to on-balance sheet items only, and shall be determined in accordance with generally accepted accounting practice, as defined in the Financial Reporting Act 1993;

(d) where products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets shall be considered part of the insurance business.

3. That the business of the NZ Branch does not constitute a predominant proportion of the business of Westpac Banking Corporation.
4. That no appointment to the position of the New Zealand Chief Executive Officer of the NZ Branch shall be made unless:
   (i) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   (ii) the Reserve Bank has advised that it has no objection to that appointment.
5. That Westpac Banking Corporation complies with the requirements imposed on it by the Australian Prudential Regulation Authority.
6. That Westpac Banking Corporation complies with the following minimum capital adequacy requirements, as administered by the Australian Prudential Regulation Authority:
   - Tier One Capital of Westpac Banking Corporation is not less than 4 percent of risk-weighted exposures;
   - Total Capital of Westpac Banking Corporation is not less than 8 percent of risk-weighted exposures.
7. That liabilities of the NZ Branch in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the NZ Branch), do not exceed NZ$15 billion.
8. That the retail deposits of the NZ Branch in New Zealand do not exceed $200 million. For the purposes of this condition retail deposits are defined as deposits by natural persons, excluding deposits with an outstanding balance which exceeds $250,000.

Further information on the capital adequacy of the Overseas Bank is contained in Note 37 Capital adequacy.

## Proposed transfer of additional banking operations to Westpac New Zealand

Until 1 November 2006, the Overseas Bank conducted its operations in New Zealand solely through a branch structure. On that date, and after extensive consultation with the Reserve Bank, the Overseas Bank adopted a dual operating model including a locally incorporated subsidiary, Westpac New Zealand, to conduct its consumer and business banking operations in New Zealand, and the NZ Branch, to conduct its institutional and financial markets operations. The conditions of registration of each of Westpac New Zealand and the NZ Branch are consistent with these operating model arrangements.

In May 2009, the Reserve Bank, Westpac New Zealand and the NZ Branch agreed to an independent review of the structure of the operating model of the Overseas Bank's business in New Zealand. This review was conducted under the well established processes and framework of section 95 of the Reserve Bank Act.

The Reserve Bank, Westpac New Zealand and the Overseas Bank have now reached high level agreement on changes to the operating model. Under that agreement, the NZ Branch will transfer the following additional business activities and associated employees to Westpac New Zealand:

- institutional customer deposits;
- institutional customer transactional banking;
- institutional customer lending;
- debt capital markets (including customer loan syndication and securitisation arrangements, but excluding the debt securities team activities, such as arrangement of commercial paper and bond programmes); and
- corporate advisory.

Details of the changes are being worked through in consultation with the Reserve Bank as part of the implementation process.

As at 30 September 2010, business activities proposed to be transferred by the NZ Branch include: customer loans of approximately $6.7 billion and customer deposits of approximately $5.5 billion. It is currently anticipated that term intra-group funding of approximately $3.0 billion will be put in place. In addition, for the year ended 30 September 2010, it is estimated that the business activities to be transferred by the NZ Branch had aggregate revenues of approximately $170 million and aggregate net profit after tax of approximately $110 million.

Under the proposed changes to the operating model, the NZ Branch will retain its financial markets operations for external customers, including sales and trading of capital markets products and foreign exchange for corporate and institutional customers, pricing and risk management for interest rate, foreign exchange and commodity products for retail, business and institutional customers of Westpac New Zealand, and trading of capital markets products and foreign exchange as principal. In addition, the NZ Branch will retain its global intra-group financing functions.

Implementation of the transfer is currently expected to be completed by the end of the 2011 calendar year.

# Directors' and the Chief Executive Officer, NZ Branch's statement

Each Director of the Overseas Bank believes and the Chief Executive Officer, NZ Branch believes, after due enquiry, that as at the date on which this General Disclosure Statement is signed, the General Disclosure Statement:

a. contains all information that is required by the Order; and

b. is not false or misleading.

Each Director of the Overseas Bank believes and the Chief Executive Officer, NZ Branch believes, after due enquiry, that over the year ended 30 September 2010:

a. the NZ Branch has complied with the conditions of registration imposed on it pursuant to section 74 of the Reserve Bank Act; and

b. the NZ Branch had systems in place to monitor and control adequately the NZ Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks and that those systems were being properly applied.

This Directors' Statement has been signed on behalf of the Directors by George Frazis, Chief Executive, Westpac New Zealand, and David McLean in his personal capacity as Chief Executive Officer, NZ Branch.

George Frazis

David McLean

Dated this the 30 November 2010

# Financial statements

**Contents**

## Income statements for the year ended 30 September

| | | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|---|
| | Note | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| Interest income | 2 | **3,972** | 4,622 | **734** | 1,094 |
| Interest expense | 2 | **(2,562)** | (3,142) | **(470)** | (814) |
| **Net interest income** | | **1,410** | 1,480 | **264** | 280 |
| Non-interest income: | | | | | |
| Fees and commissions | 3 | **313** | 360 | **50** | 43 |
| Wealth management revenue | 3 | **88** | 80 | **-** | - |
| Trading income | 3 | **96** | 136 | **96** | 136 |
| Gains on ineffective hedges | 3 | **4** | 3 | **-** | - |
| Other non-interest income | 3 | **31** | 31 | **32** | 16 |
| **Total non-interest income** | | **532** | 610 | **178** | 195 |
| **Net operating income** | | **1,942** | 2,090 | **442** | 475 |
| Operating expenses | 4 | **(788)** | (808) | **(70)** | (87) |
| Impairment charges on loans | 6 | **(332)** | (690) | **2** | (70) |
| **Operating profit** | | **822** | 592 | **374** | 318 |
| Share of profit of associate accounted for using equity method | | **1** | - | **-** | - |
| **Profit before income tax expense** | | **823** | 592 | **374** | 318 |
| Income tax expense on operating profit | 7 | **(248)** | (168) | **(116)** | (94) |
| Income tax related to New Zealand structured finance transactions | 7 | **188** | (918) | **112** | (737) |
| **Profit/(loss) after income tax expense** | | **763** | (494) | **370** | (513) |
| **Profit/(loss) after income tax expense attributable to:** | | | | | |
| Head office account and owners of the NZ Banking Group | | **760** | (497) | **370** | (513) |
| Non-controlling interests | | **3** | 3 | **-** | - |
| | | **763** | (494) | **370** | (513) |

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

# Statements of comprehensive income for the year ended 30 September

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| **Profit/(loss) after income tax expense** | **763** | (494) | **370** | (513) |
| **Other comprehensive income:** | | | | |
| Net unrealised gains from changes in fair value of available-for-sale securities | **7** | 2 | **-** | - |
| Cash flow hedges: | | | | |
| Net gains/(losses) from changes in fair value of cash flow hedges | **66** | (107) | **-** | - |
| Transferred to the income statement | **3** | (3) | **-** | - |
| Actuarial (losses)/gains on employee defined benefit superannuation schemes | **(27)** | 30 | **-** | - |
| Income tax relating to components of other comprehensive income[1] | **(13)** | 22 | **-** | - |
| **Other comprehensive income/(expense), net of tax** | **36** | (56) | **-** | - |
| **Total comprehensive income/(expense)** | **799** | (550) | **370** | (513) |
| **Total comprehensive income/(expense) attributable to:** | | | | |
| Head office account and owners of the NZ Banking Group | **796** | (553) | **370** | (513) |
| Non-controlling interests | **3** | 3 | **-** | - |
| | **799** | (550) | **370** | (513) |

1 The income tax effects relating to each component of other comprehensive income are disclosed in the following table.

## Tax effects relating to each component of other comprehensive income

| | NZ Banking Group | | | NZ Branch | | |
|---|---|---|---|---|---|---|
| | **Before Tax Amount $m** | **Tax (Expense)/ Benefit $m** | **Net of Tax Amount $m** | **Before Tax Amount $m** | **Tax (Expense)/ Benefit $m** | **Net of Tax Amount $m** |
| **For the year ended 30 September 2010** | | | | | | |
| Net unrealised gains from changes in fair value of available-for-sale securities | **7** | **-** | **7** | **-** | **-** | **-** |
| Cash flow hedges: | | | | | | |
| Net gains/(losses) from changes in fair value of cash flow hedges | **66** | **(20)** | **46** | **-** | **-** | **-** |
| Transferred to the income statement | **3** | **(1)** | **2** | **-** | **-** | **-** |
| Actuarial losses on employee defined benefit superannuation schemes | **(27)** | **8** | **(19)** | **-** | **-** | **-** |
| **Other comprehensive income** | **49** | **(13)** | **36** | **-** | **-** | **-** |
| **For the year ended 30 September 2009** | | | | | | |
| Net unrealised gains from changes in fair value of available-for-sale securities | 2 | - | 2 | - | - | - |
| Cash flow hedges: | | | | | | |
| Net losses from changes in fair value of cash flow hedges | (107) | 32 | (75) | - | - | - |
| Transferred to the income statement | (3) | 1 | (2) | - | - | - |
| Actuarial gains on employee defined benefit superannuation schemes | 30 | (11) | 19 | - | - | - |
| **Other comprehensive expense** | (78) | 22 | (56) | - | - | - |

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

# Statements of changes in equity for the year ended 30 September

| | NZ Banking Group | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Head Office Account | | | NZ Banking Group Equity | | | | | | |
| | Branch Capital $m | Retained Profits/ (Accumulated Losses) $m | Convertible Debentures $m | Share Capital $m | Retained Profits $m | Cash Flow Hedge Reserve $m | Available-for-sale Securities Reserve $m | Total before Non-controlling Interests $m | Non-controlling Interests $m | Total Equity $m |
| **As at 1 October 2008** | - | 174 | 1,284 | 1,433 | 1,305 | (88) | 16 | 4,124 | 8 | 4,132 |
| **Year ended 30 September 2009** | | | | | | | | | | |
| (Loss)/profit after income tax expense | - | (513) | - | - | 16 | - | - | (497) | 3 | (494) |
| Other comprehensive income/(expense) | - | - | - | - | 19 | (77) | 2 | (56) | - | (56) |
| **Total comprehensive (expense)/income for the year ended 30 September 2009** | - | (513) | - | - | 35 | (77) | 2 | (553) | 3 | (550) |
| Transaction with owners: | | | | | | | | | | |
| Ordinary share capital issued | - | - | - | 9 | - | - | - | 9 | - | 9 |
| Allocation of Branch Capital from the Overseas Bank[1] | 1,800 | - | - | - | - | - | - | 1,800 | - | 1,800 |
| Preference share capital redeemed[1] | - | - | - | (1,300) | - | - | - | (1,300) | - | (1,300) |
| Dividends paid on convertible debentures (net of tax) | - | (69) | - | - | - | - | - | (69) | - | (69) |
| Dividends paid on ordinary shares | - | - | - | - | (9) | - | - | (9) | (4) | (13) |
| Dividends paid on preference shares | - | - | - | - | (104) | - | - | (104) | - | (104) |
| Aggregation of new entities[2] | - | - | - | 301 | - | - | - | 301 | - | 301 |
| Share capital buy-back[3] | - | - | - | (301) | - | - | - | (301) | - | (301) |
| **As at 30 September 2009** | 1,800 | (408) | 1,284 | 142 | 1,227 | (165) | 18 | 3,898 | 7 | 3,905 |
| **Year ended 30 September 2010** | | | | | | | | | | |
| Profit after income tax expense | **-** | **370** | **-** | **-** | **390** | **-** | **-** | **760** | **3** | **763** |
| Other comprehensive (expense)/income | **-** | **-** | **-** | **-** | **(19)** | **48** | **7** | **36** | **-** | **36** |
| **Total comprehensive income for the year ended 30 September 2010** | **-** | **370** | **-** | **-** | **371** | **48** | **7** | **796** | **3** | **799** |
| Transaction with owners: | | | | | | | | | | |
| Share capital cancellation[4] | **-** | **-** | **-** | **(2)** | **-** | **-** | **-** | **(2)** | **-** | **(2)** |
| Repatriation of Branch Capital to the Overseas Bank[5] | **(500)** | **-** | **-** | **-** | **-** | **-** | **-** | **(500)** | **-** | **(500)** |
| Dividends paid on convertible debentures (net of tax) | **-** | **(70)** | **-** | **-** | **-** | **-** | **-** | **(70)** | **-** | **(70)** |
| Dividends paid on ordinary shares | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **(4)** | **(4)** |
| **As at 30 September 2010** | **1,300** | **(108)** | **1,284** | **140** | **1,598** | **(117)** | **25** | **4,122** | **6** | **4,128** |

1 During the year ended 30 September 2008 the NZ Branch repatriated $1.3 billion to the Overseas Bank from Branch capital ($698 million) and retained profits ($602 million). The amount repatriated was replaced by the issuance of $1.3 billion redeemable preference shares redeemable in 100 years, with distributions at the discretion of the Board. The $1.3 billion redeemable preference shares were subsequently redeemed on 18 February 2009 and, at the same time, the Overseas Bank advanced capital of $1.3 billion to the NZ Branch. On 14 September 2009 the Overseas Bank advanced a further $500 million of capital to the NZ Branch.

2 This represents the net pre-acquisition capital contributed by the aggregation of St.George New Zealand Limited and St.George Financial Investments New Zealand Limited into the NZ Banking Group effective as at 17 November 2008.

3 This represents the buy-back of share capital by St.George New Zealand Limited from St.George Bank Limited during the period 17 November 2008 to 31 December 2008.

4 During the year ended 30 September 2010 BLE Capital (NZ) Limited was liquidated (refer to note 27) resulting in the cancellation of $2 million of ordinary share capital.

5 The NZ Branch repatriated $500 million of capital to the Overseas Bank on 21 June 2010.

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

## Statements of changes in equity (continued) for the year ended 30 September

| | NZ Branch | | | |
|---|---|---|---|---|
| | Head Office Account | | | |
| | Branch Capital $m | Retained Profits $m | Accumulated Losses/ Convertible Debentures $m | Total Equity $m |
| **As at 1 October 2008** | - | 174 | 1,284 | 1,458 |
| **Year ended 30 September 2009** | | | | |
| Loss after income tax expense | - | (513) | - | (513) |
| **Total comprehensive expense for the year ended 30 September 2009** | - | (513) | - | (513) |
| Transaction with owners: | | | | |
| Allocation of Branch Capital from the Overseas Bank[1] | 1,800 | - | - | 1,800 |
| Dividends paid on convertible debentures (net of tax) | - | (69) | - | (69) |
| **As at 30 September 2009** | 1,800 | (408) | 1,284 | 2,676 |
| **Year ended 30 September 2010** | | | | |
| Profit after income tax expense | **-** | **370** | **-** | **370** |
| **Total comprehensive income for the year ended 30 September 2010** | **-** | **370** | **-** | **370** |
| Transaction with owners: | | | | |
| Repatriation of Branch Capital to the Overseas Bank[2] | **(500)** | **-** | **-** | **(500)** |
| Dividends paid on convertible debentures (net of tax) | **-** | **(70)** | **-** | **(70)** |
| **As at 30 September 2010** | **1,300** | **(108)** | **1,284** | **2,476** |

1 During the year ended 30 September 2008 the NZ Branch repatriated $1.3 billion to the Overseas Bank from Branch capital ($698 million) and retained profits ($602 million). The amount repatriated was replaced by the issuance of $1.3 billion redeemable preference shares redeemable in 100 years, with distributions at the discretion of the Board. The $1.3 billion redeemable preference shares were subsequently redeemed on 18 February 2009 and, at the same time, the Overseas Bank advanced capital of $1.3 billion to the NZ Branch. On 14 September 2009 the Overseas Bank advanced a further $500 million of capital to the NZ Branch.

2 The NZ Branch repatriated $500 million of capital to the Overseas Bank on 21 June 2010.

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

# Balance sheets as at 30 September

| | Note | NZ Banking Group 2010 $m | NZ Banking Group 2009 $m | NZ Branch 2010 $m | NZ Branch 2009 $m |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances with central banks | | **1,570** | 798 | **1,048** | 584 |
| Due from other financial institutions | 9 | **36** | 843 | **33** | 841 |
| Derivative financial instruments | 28 | **5,685** | 6,328 | **5,669** | 6,306 |
| Trading securities and other financial assets designated at fair value | 10 | **5,630** | 5,405 | **3,042** | 984 |
| Available-for-sale securities | 11 | **44** | 37 | **-** | - |
| Loans | 12, 13 | **56,738** | 55,592 | **6,699** | 7,583 |
| Life insurance assets | | **133** | 113 | **-** | - |
| Due from related entities | 27 | **1,555** | 2,759 | **5,417** | 7,295 |
| Investment in associate | 27 | **48** | 48 | **-** | - |
| Goodwill and other intangible assets | 14 | **615** | 623 | **-** | - |
| Property, plant and equipment | 15 | **127** | 94 | **-** | - |
| Deferred tax assets | 16 | **405** | 306 | **103** | 40 |
| Other assets | 17 | **197** | 498 | **49** | 357 |
| **Total assets** | | **72,783** | 73,444 | **22,060** | 23,990 |
| **Liabilities** | | | | | |
| Due to other financial institutions | 18 | **794** | 485 | **794** | 485 |
| Deposits at fair value | 19 | **2,453** | 3,773 | **463** | 125 |
| Deposits at amortised cost | 19 | **35,567** | 32,639 | **5,091** | 3,791 |
| Derivative financial instruments | 28 | **5,501** | 6,970 | **5,501** | 6,970 |
| Trading liabilities and other financial liabilities designated at fair value | 20 | **239** | 2,698 | **239** | 813 |
| Debt issues | 21 | **15,439** | 12,369 | **-** | - |
| Current tax liabilities | | **52** | 373 | **59** | 234 |
| Deferred tax liabilities | 16 | **-** | - | **-** | - |
| Provisions | 22 | **102** | 106 | **27** | 28 |
| Other liabilities | 23 | **686** | 663 | **129** | 122 |
| **Total liabilities excluding subordinated debentures and due to related entities** | | **60,833** | 60,076 | **12,303** | 12,568 |
| Subordinated debentures | 24 | **819** | 790 | **819** | 790 |
| **Total liabilities excluding due to related entities** | | **61,652** | 60,866 | **13,122** | 13,358 |
| Due to related entities | 27 | **7,003** | 8,673 | **6,462** | 7,956 |
| **Total liabilities** | | **68,655** | 69,539 | **19,584** | 21,314 |
| **Net assets** | | **4,128** | 3,905 | **2,476** | 2,676 |
| **Equity** | | | | | |
| **Head office account** | | | | | |
| Branch capital | | **1,300** | 1,800 | **1,300** | 1,800 |
| Accumulated losses | | **(108)** | (408) | **(108)** | (408) |
| **Total head office account** | | **1,192** | 1,392 | **1,192** | 1,392 |
| Convertible debentures | 26 | **1,284** | 1,284 | **1,284** | 1,284 |
| **NZ Banking Group equity** | | | | | |
| Ordinary share capital | | **140** | 142 | **-** | - |
| Retained profits | | **1,598** | 1,227 | **-** | - |
| Cash flow hedge reserve | | **(117)** | (165) | **-** | - |
| Available-for-sale securities reserve | | **25** | 18 | **-** | - |
| **Total equity attributable to owners of the NZ Banking Group** | | **1,646** | 1,222 | **-** | - |
| Non-controlling interests | | **6** | 7 | **-** | - |
| **Total equity** | | **4,128** | 3,905 | **2,476** | 2,676 |
| Interest earning and discount bearing assets | | **64,650** | 62,539 | **13,609** | 12,663 |
| Interest and discount bearing liabilities | | **57,824** | 55,384 | **11,176** | 10,319 |

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

# Statements of cash flows for the year ended 30 September

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| **Cash flows from operating activities** | | | | |
| Interest income received | **3,958** | 4,701 | **723** | 1,129 |
| Interest expense paid | **(2,522)** | (3,314) | **(461)** | (821) |
| Non-interest income received | **497** | 617 | **156** | 195 |
| Net decrease/(increase) in trading securities and other financial assets designated at fair value | **60** | (2,019) | **(1,773)** | 430 |
| Net (decrease)/increase in trading liabilities and other financial liabilities designated at fair value | **(2,456)** | 1,552 | **(576)** | (333) |
| Net (decrease)/increase in derivative financial instruments | **(757)** | 1,067 | **(832)** | 1,187 |
| Operating expenses paid | **(714)** | (721) | **(67)** | (70) |
| Income tax paid | **(465)** | (246) | **(340)** | (56) |
| **Net cash (used in)/provided by operating activities** | **(2,399)** | 1,637 | **(3,170)** | 1,661 |
| **Cash flows from investing activities** | | | | |
| Net decrease in due from other financial institutions - term | **-** | 1,028 | **-** | 364 |
| Net loans (advanced to)/repaid by customers | **(1,488)** | (713) | **882** | 1,241 |
| Net increase in life insurance assets | **(20)** | (24) | **-** | - |
| Net decrease/(increase) in due from related entities | **1,204** | (589) | **1,981** | 492 |
| Net decrease/(increase) in other assets | **70** | (69) | **72** | (107) |
| Purchase of capitalised computer software | **(35)** | (44) | **-** | - |
| Purchase of property, plant and equipment | **(58)** | (39) | **-** | - |
| Proceeds from disposal of property, plant and equipment | **1** | 5 | **-** | - |
| **Net cash (used in)/provided by investing activities** | **(326)** | (445) | **2,935** | 1,990 |
| **Cash flows from financing activities** | | | | |
| Redemption of preference share capital | **-** | (1,300) | **-** | - |
| Share capital cancellation | **(2)** | - | **-** | - |
| Branch capital (repatriated to)/received from the Overseas Bank | **(500)** | 1,800 | **(500)** | 1,800 |
| Net increase/(decrease) in deposits | **1,608** | 61 | **1,638** | (208) |
| Net proceeds from debt issues | **3,070** | 1,267 | **-** | - |
| Net decrease in due to related entities | **(1,672)** | (2,637) | **(1,484)** | (5,034) |
| Net (decrease)/increase in other liabilities and subordinated debentures | **(19)** | (203) | **28** | (241) |
| Dividends paid on convertible debentures | **(100)** | (99) | **(100)** | (99) |
| Dividends paid on ordinary shares | **(4)** | (4) | **-** | - |
| Dividends paid on preference shares | **-** | (104) | **-** | - |
| **Net cash provided by/(used in) financing activities** | **2,381** | (1,219) | **(418)** | (3,782) |
| **Net decrease in cash and cash equivalents** | **(344)** | (27) | **(653)** | (131) |
| Cash and cash equivalents at beginning of the year | **1,156** | 1,183 | **940** | 1,071 |
| **Cash and cash equivalents at end of the year** | **812** | 1,156 | **287** | 940 |
| **Cash and cash equivalents at end of the year comprise:** | | | | |
| Cash and balances with central banks | **1,570** | 798 | **1,048** | 584 |
| Due (to)/from other financial institutions - at call (net) | **(758)** | 358 | **(761)** | 356 |
| | **812** | 1,156 | **287** | 940 |
| **Reconciliation of profit/(loss) after income tax expense to net cash flows provided by operating activities** | | | | |
| Profit/(loss) after income tax expense | **763** | (494) | **370** | (513) |
| *Adjustments:* | | | | |
| Software amortisation costs | **43** | 45 | **-** | - |
| Impairment charges on intangible assets | **-** | 3 | **-** | - |
| Impairment charges on loans | **332** | 690 | **(2)** | 70 |
| Depreciation | **24** | 21 | **-** | - |
| Gain on disposal of property, plant and equipment | **-** | (3) | **-** | - |
| Share-based payments | **2** | 3 | **-** | - |
| Movement in accrued assets | **(32)** | 614 | **(12)** | 573 |
| Movement in accrued liabilities and provisions | **60** | (164) | **13** | 10 |
| Movement in current and deferred tax | **(441)** | 292 | **(366)** | 207 |
| Tax on convertible debentures dividends | **30** | 30 | **30** | 30 |
| Movement in trading securities and other financial assets designated at fair value | **38** | (2,019) | **(1,795)** | 430 |
| Movement in trading liabilities and other financial liabilities designated at fair value | **(2,461)** | 1,552 | **(576)** | (333) |
| Movement in derivative financial instruments | **(757)** | 1,067 | **(832)** | 1,187 |
| **Net cash (used in)/provided by operating activities** | **(2,399)** | 1,637 | **(3,170)** | 1,661 |

The accompanying notes (numbered 1 to 40) form part of, and should be read in conjunction with, these financial statements.

# Notes to the financial statements

## Note 1 Statement of accounting policies

### 1.1 General accounting policies

#### Statutory base

These financial statements have been prepared and presented in accordance with the Financial Reporting Act 1993, the Order and the Reserve Bank Act.

These financial statements have also been prepared in accordance with Generally Accepted Accounting Practice in New Zealand ('**NZ GAAP**'), applicable New Zealand equivalents to International Financial Reporting Standards ('**NZ IFRS**') and other authoritative pronouncements of the Accounting Standards Review Board, as appropriate for profit-oriented entities. These financial statements also comply with International Financial Reporting Standards ('**IFRS**'), as issued by the International Accounting Standards Board.

In these financial statements reference is made to the following reporting groups:

- Westpac Banking Corporation Group (otherwise referred to as the '**Overseas Banking Group**') – refers to the total worldwide business of Westpac Banking Corporation including its controlled entities.
- Westpac Banking Corporation (otherwise referred to as the '**Overseas Bank**') – refers to the worldwide activities of Westpac Banking Corporation excluding its controlled entities.
- Westpac Banking Corporation New Zealand Division (otherwise referred to as the '**NZ Banking Group**') – refers to the New Zealand operations of Westpac Banking Corporation including those entities whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business.
- Westpac Banking Corporation New Zealand Branch (otherwise referred to as the '**NZ Branch**') – refers to the New Zealand Branch of Westpac Banking Corporation (trading as Westpac and Westpac Institutional Bank).

These financial statements were authorised for issue by the Board on 30 November 2010. The Board has the power to amend the financial statements after they are authorised for issue.

#### Basis of preparation

The financial statements are based on the general principles of historical cost accounting, as modified by fair value accounting for available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss and all derivative contracts. The going concern concept and the accruals basis of accounting have been adopted. All amounts are expressed in New Zealand dollars unless otherwise stated.

The same accounting policies and methods of computation have been followed in preparing these financial statements that were used in preparing the financial statements for the year ended 30 September 2009, except as amended for changes required due to the adoption of the new and revised accounting standards as explained in Note 1.3 "Changes in accounting policies".

Certain comparative figures have been restated to ensure consistent treatment with the current reporting period. Where there has been a material restatement of comparative figures the nature of, and the reason for, the restatement is disclosed in the relevant note.

#### Basis of aggregation

The NZ Banking Group as at 30 September 2010 has been aggregated by combining the sum of the capital and reserves of the NZ Branch, Hastings Forestry Investments Limited, St.George New Zealand Limited and the consolidated capital and reserves of BT Financial Group (NZ) Limited, Westpac Financial Services Group-NZ-Limited, Westpac Group Investment-NZ-Limited, Westpac New Zealand Group Limited and their controlled entities. For New Zealand entities acquired by the Overseas Banking Group, capital and reserves at acquisition are netted and recognised as capital contributed to the NZ Banking Group.

The NZ Banking Group may invest in or establish special purpose vehicles to enable it to undertake specific types of transactions. Where the NZ Banking Group controls such vehicles, they are consolidated into the NZ Banking Group's financial results.

All transactions and balances between entities within the NZ Banking Group have been eliminated.

#### Foreign currency

Items included in the financial statements of each of the NZ Banking Group's entities are measured using the currency of the primary economic environment in which the entity operates ('**functional currency**'). The financial statements of the NZ Banking Group and the NZ Branch are presented in New Zealand dollars, which is the NZ Branch's functional and presentation currency.

Foreign currency monetary assets and liabilities have been translated into New Zealand dollars at the rate of foreign exchange prevailing as at balance date. Transactions denominated in a foreign currency are converted to New Zealand dollars at the exchange rates in effect at the date of the transaction.

Foreign exchange differences relating to monetary items and gains and losses arising from foreign exchange dealings by the NZ Banking Group have been included in the income statement, except when they are deferred in equity as qualifying cash flow hedges.

### 1.2 Particular accounting policies

#### Revenue recognition

***Interest income***

Interest income for all instruments measured at amortised cost, or those classified as available-for-sale securities, is recognised in the income statement using the effective interest method. Interest income for instruments measured at fair value through profit or loss is also recognised using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument, or where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. When calculating the effective interest rate, cash flows are estimated based upon contractual terms and behavioural aspects of the financial instrument (e.g. prepayment options), but do not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest relating to impaired loans is recognised using the loan's original effective interest rate based on the net carrying value of the impaired loan after giving effect to any impairment losses. This rate is also used to discount the future cash flows for the purpose of measuring the impairment charges. For loans that have been impaired, this method results in cash receipts being apportioned between interest and principal.

# Note 1 Statement of accounting policies (continued)

***Fee and commission income***

Fees and commissions are generally recognised on an accruals basis over the period during which the service is performed. All fees related to the successful origination or settlement of a loan (together with the related direct costs) are deferred and recognised as an adjustment to the effective interest rate on the loan. Asset management fees relating to investment funds are recognised over the period the service is provided.

***Net trading income***

Realised gains and losses, and unrealised gains and losses arising from changes in the fair value of trading assets and liabilities are recognised as trading income or expense within non-interest income in the income statement in the period in which they arise except for recognition of day-one profits and losses which are deferred where certain inputs are unobservable. Dividend income from the trading portfolio is also recorded as part of non-interest income. Interest income and expense on the trading portfolio is recognised as part of net interest income.

***Gain or loss on sale of property, plant and equipment***

The gain or loss arising on the disposal or retirement of property, plant and equipment is determined as the difference between the sale proceeds and the carrying amount of the respective asset and is recognised as non-interest income.

## Expense recognition

***Interest expense***

Interest expense, including premiums or discounts and associated issue expenses incurred on the issue of securities, is recognised in the income statement for all financial liabilities at amortised cost using the effective interest method. Interest expense relating to instruments classified as fair value through profit or loss, including trading liabilities, is also recognised using the effective interest method.

***Losses on loans and receivables carried at amortised cost***

The charge recognised in the income statement for losses on loans and receivables carried at amortised cost reflects the net movement in the provisions for individually assessed and collectively assessed loans, write offs and recoveries of losses previously written off.

***Leasing***

Operating lease payments are recognised in the income statement as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the benefit received. Incentives received on entering into operating leases are recognised as liabilities and are amortised as a reduction of rental expense over the lease term, on a straight-line basis.

***Commissions and other fees***

External commissions and other costs paid to acquire mortgage loans through brokers are capitalised and amortised using the effective interest method. All other fees and commissions paid are recognised in the income statement over the period in which the related service is consumed.

***Share-based compensation***

Certain employees are entitled to participate in option and share ownership schemes granted by the Overseas Bank.

The fair value of options, performance share rights and unhurdled share rights provided to employees as share-based compensation is recognised as an expense with a corresponding payable to the Overseas Bank recognised. The fair value is measured at grant date and is recognised over the expected vesting period during which the employees would become entitled to exercise the option, performance share right or unhurdled share right.

The fair value of options, performance share rights and unhurdled share rights is estimated at the grant date using a Binomial/Monte Carlo simulation pricing model incorporating the vesting and performance hurdle features of the grants. The fair value of the options, performance share rights and unhurdled share rights excludes the impact of any non-market vesting conditions such as participants' continued employment with the NZ Banking Group. The non-market vesting conditions are included in assumptions used when determining the number of options, performance share rights and unhurdled share rights expected to become exercisable for which an expense is recognised. As at each balance date these assumptions are revised and the expense recognised each period takes into account the most recent estimates.

## Taxation

***Income tax***

Income tax expense on the profit for the reporting period comprises current tax and movements in deferred tax balances.

Current tax is the expected tax payable on the taxable income for the reporting period, using tax rates that have been enacted or substantively enacted as at balance date, and any adjustment to tax payable in respect of previous reporting periods.

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding amounts used for taxation purposes. Deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill, the initial recognition (other than in a business combination) of assets and liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates that have been enacted or substantively enacted as at balance date that are expected to apply when the liability is settled or the asset is realised.

Current and deferred tax attributable to amounts recognised directly in other comprehensive income is also recognised directly in other comprehensive income.

Except as noted above, deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

For presentation purposes deferred tax assets and deferred tax liabilities have been offset where they relate to income taxes levied by the same taxation authority on the same taxable entity or group of entities in the NZ Banking Group.

***Goods and services tax***

Revenue, expenses and assets are recognised net of goods and services tax ('**GST**') except to the extent that GST is not recoverable from the Inland Revenue. In these circumstances, the GST is recognised as part of the expense or the cost of the asset.

# Note 1 Statement of accounting policies (continued)

## Business combinations

The acquisition method of accounting is used to account for business combinations. Consideration transferred is measured as the fair value of the assets given, equity instruments issued or liabilities incurred or assumed at the date of exchange. Where equity instruments are issued in an acquisition, the value of the instruments is their published market price as at the date of exchange. Transaction costs arising on the issue of equity instruments are recognised directly in equity; other acquisition-related transaction costs are recognised as an expense in the income statement when they are incurred.

Identifiable assets acquired, and liabilities and contingent liabilities assumed, in a business combination are measured initially at their fair value at the acquisition date. For each business combination, the non-controlling interest is measured either at fair value or at the proportionate share of the acquiree's identifiable net assets. Goodwill is recorded as the excess of the aggregate of the consideration transferred, the amount of any non-controlling interest in the acquiree, and the acquisition date fair value of any previous equity interest in the acquiree, over the fair value of the identifiable net assets acquired.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the NZ Banking Group's incremental borrowing rate.

## Assets

***Financial assets***

The NZ Banking Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss, available-for-sale financial assets and loans and receivables. Management determines the classification of its financial assets at initial recognition.

- ***Financial assets at fair value through profit or loss***
  This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling it in the near term, if it is part of a portfolio of identified financial assets that are managed together and for which there is evidence of a recent pattern of short-term profit taking, if it is a derivative that is not a designated hedging instrument, or if so designated on acquisition by management. This designation may only be made if the financial asset either contains an embedded derivative, or it will be managed on a fair value basis in accordance with a documented risk management strategy or designating it at fair value will reduce an accounting mismatch.
- ***Available-for-sale securities***
  Available-for-sale securities are non-derivative financial assets that are designated as available-for-sale or that are not classified as financial assets at fair value through profit or loss or loans and receivables.
- ***Loans and receivables***
  Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the NZ Banking Group provides money, goods or services directly to a debtor with no intention of trading the receivable.

***Recognition of financial assets***

Purchases and sales of financial assets at fair value through profit or loss and available-for-sale are recognised on trade-date, being the date on which the NZ Banking Group commits to purchase or sell the asset. Loans and receivables are recognised when cash is advanced to the borrowers. Financial assets at fair value through profit or loss are recognised at fair value. All other financial assets are recognised initially at fair value plus directly attributable transaction costs. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the NZ Banking Group has transferred substantially all the risks and rewards of ownership.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortised cost using the effective interest method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in other comprehensive income, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active the NZ Banking Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

***Cash and balances with central banks***

Cash and balances with central banks include cash at branches, central bank account balances and nostro balances. They are brought to account at the face value or the gross value of the outstanding balance, where appropriate.

***Due from other financial institutions***

Due from other financial institutions include loans and settlement account balances due from other financial institutions. They are accounted for as loans and receivables.

***Derivative financial instruments***

Derivative financial instruments including forwards, futures, swaps and options are recognised in the balance sheet at fair value. Fair values are obtained from quoted market prices, dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying instrument. Derivatives are carried as assets when the fair value is positive.

***Trading securities and other financial assets designated at fair value***

Trading securities include debt and equity securities which are actively traded and securities purchased under agreement to resell. They are accounted for as financial assets designated at fair value through profit or loss.

Certain bonds, notes and commercial bills are designated at fair value through profit or loss. This designation may only be made if the financial asset either contains an embedded derivative, or it will be managed on a fair value basis in accordance with a documented risk management strategy or designating it at fair value will reduce an accounting mismatch.

***Available-for-sale securities***

Available-for-sale securities are public and other debt and equity securities that are not classified as financial assets at fair value through profit or loss. The accounting treatment for available-for-sale securities is set out above.

## Note 1 Statement of accounting policies (continued)

***Loans***

Loans include overdrafts, home loans, credit cards and other personal lending, term loans, leasing and redeemable preference share finance. The accounting treatment for loans is set out above.

Security is obtained if, based on an evaluation of the customer's credit-worthiness, it is considered necessary for the customer's overall borrowing facility. Security would normally consist of assets such as cash deposits, receivables, inventory, plant and equipment, real estate and investments.

***Derecognition of financial assets***

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired; or
- the entity has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement and cannot sell or repledge the asset other than to the transferee; and
- either the NZ Banking Group has transferred substantially all the risks and rewards of the asset, or the NZ Banking Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A situation may arise where NZ Banking Group transfers its right to receive cash flows from an asset or has entered into a pass-through arrangement. In some cases the NZ Banking Group would have neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of these assets. Should this occur to the extent that the NZ Banking Group has continuing involvement in the asset, the asset continues to be recognised on the balance sheet.

***Impairment of financial assets***

Impaired financial assets include:

(i) individually impaired assets, which are defined as assets where an individual provision has been raised to cover the expected loss for which full recovery of principal is doubtful; and

(ii) restructured assets, which are defined as assets in which the original contractual terms have been formally modified to provide for concessions of interest or principal for reasons related to the financial difficulties of the customer.

Assets that are in arrears based upon their contractual terms, but not yet impaired are reported separately as 'past due assets'. Assets that are greater than 90 days past their contractual terms, but not yet impaired, are reported separately as '90 days past due assets'.

Assets, not classified as impaired assets or past due assets, in which the counterparty is (a) in receivership, liquidation, bankruptcy, statutory management or any form of administration in New Zealand; or (b) in any other equivalent form of voluntary or involuntary administration in an overseas jurisdiction are reported separately. These are known as 'other assets under administration'.

The following accounting policy applies to the impairment of financial assets:

*i) Assets carried at amortised cost*

The NZ Banking Group assesses as at each balance date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a '**loss event**') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the NZ Banking Group about the following loss events:

(i) significant financial difficulty of the issuer or obligor;

(ii) a breach of contract, such as a default or delinquency in interest or principal payments;

(iii) the NZ Banking Group granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the NZ Banking Group would not otherwise consider;

(iv) it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(v) the disappearance of an active market for that financial asset because of financial difficulties; or

(vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:

   (a) adverse changes in the payment status of borrowers in the group; or

   (b) national or local economic conditions that correlate with defaults on the assets in the group.

The NZ Banking Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If the NZ Banking Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment charge on loans carried at amortised cost has been incurred, the amount of the charge is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable. For the purposes of a collective assessment of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the NZ Banking Group's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being assessed. Future cash flows in a group of financial assets that are collectively assessed for impairment are estimated on the basis of the contractual cash flows of the assets in the NZ Banking Group and historical loss experience for assets with credit risk characteristics similar to those in the NZ Banking Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

## Note 1 Statement of accounting policies (continued)

Estimates of changes in future cash flows for groups of assets should reflect and be directionally consistent with changes in related observable data from period to period (e.g. changes in unemployment rates, property prices, payment status, or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly by the NZ Banking Group to reduce any differences between loss estimates and actual loss experience. When a loan is uncollectible, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the charge for loan impairment in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment charge is reversed by adjusting the provision account. The amount of the reversal is recognised in the income statement.

*ii) Assets carried at fair value*

The NZ Banking Group assesses as at each balance date whether there is objective evidence that a financial asset or a group of financial assets is impaired. For equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement – is removed from other comprehensive income and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. Subsequent reversals of impairment charges on equity instruments are not recognised in the income statement.

***Life insurance assets***

Assets held by the NZ Banking Group's life insurance company, including investments in funds managed by the NZ Banking Group, are initially recorded at fair value and then adjusted to net market value as at each balance date. Net market value adjustments are included in the income statement. The life insurance company's assets comprise the life insurance fund and can only be used within the restrictions imposed under the Life Insurance Act 1908. The main restriction is that the assets in the fund can only be used to meet the liabilities and expenses of the life insurance business of the life insurance company or as distributions when solvency requirements are met, and cannot be used to support any other business of the life insurance company.

***Due from related entities***

This amount includes amounts due from controlled entities of the NZ Banking Group and all other entities controlled by the Overseas Bank.

***Investments in related entities including associates***

Investments in related entities are initially recorded by the NZ Banking Group in the balance sheet at cost. The cost of an acquisition is measured at the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition. Investments in related entities are written-down to recoverable amounts, where appropriate.

Associates are entities over which the NZ Banking Group has significant influence, but not control. Investments in associates are accounted for in the parent entity financial statements using the cost method and in the consolidated financial statements using the equity method of accounting, after initially being recognised at cost.

The NZ Banking Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. Dividends receivable from associates are recognised in the parent entity's income statement, while in the consolidated financial statements they reduce the carrying amount of the investment.

***Goodwill and other intangible assets***

Goodwill represents amounts arising on the acquisition of businesses. Prior to the revised NZ IFRS 3 *Business Combinations*, goodwill represented the excess of purchase consideration, including directly attributable expenses associated with the acquisition, over the fair value of the NZ Banking Group's share of the identifiable net assets of the acquired business. Goodwill arising on the acquisition of a business subsequent to the adoption of the revised NZ IFRS 3 represents the excess of the purchase consideration, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree, over the fair value of the NZ Banking Group's share of the identifiable net assets acquired.

All goodwill is considered to have an indefinite useful life.

Goodwill is tested for impairment at least annually and whenever there is an indication that it may be impaired. Goodwill is carried at cost, less any accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Cash-generating units ('**CGUs**') are the smallest identifiable groups of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Goodwill was last tested for impairment as at 30 September 2010. Other intangible assets are stated at cost less accumulated amortisation and impairment losses. Other intangible assets comprise acquired and internally developed computer software.

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software.

Internal and external costs directly incurred in the purchase or development of computer software, including subsequent upgrades and enhancements are recognised as intangible assets when it is probable that they will generate future economic benefits attributable to the NZ Banking Group. These costs are amortised using the straight-line method to allocate the cost of the asset less any residual value over the estimated useful lives of between three and five years.

***Property, plant and equipment***

Property, plant and equipment is carried at cost less accumulated depreciation and impairment losses. Cost is the fair value of the consideration provided plus incidental costs directly attributable to the acquisition. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as an expense as incurred. Impairment losses are recognised as an operating expense in the income statement.

# Note 1 Statement of accounting policies (continued)

Depreciation is calculated using the straight-line method to allocate the cost of assets less any residual value over their estimated useful lives as follows:

- Leasehold improvements — Up to 10 years
- Furniture and equipment — 3 - 15 years

***Other assets***

Other assets include accrued interest receivable, securities sold but not yet delivered, trade debtors and prepayments.

***Impairment of non-financial assets***

The carrying amount of the NZ Banking Group's non-financial assets, other than deferred tax assets, are reviewed as at each balance date to determine whether there is any indication of impairment. If such an indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its CGU exceeds its recoverable amount. With the exception of goodwill for which impairment losses cannot be reversed, where an impairment loss subsequently reverses, the carrying amount of the asset (or CGU) is increased to the revised estimate of its recoverable amount, such that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (or CGU) in prior periods. Impairment losses and reversals of impairment losses are recognised in the income statement.

The recoverable amount of an asset is the greater of its fair value less costs to sell and value-in-use. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the CGU to which the asset belongs.

## Liabilities

The NZ Banking Group classifies its financial liabilities in the following categories: financial liabilities at fair value through profit or loss and financial liabilities at amortised cost.

- ***Financial liabilities at fair value through profit or loss***
  This category has two sub-categories: financial liabilities held for trading and those designated at fair value through profit or loss at inception. A financial liability is classified in this category if incurred principally for repurchasing it in the near term, if it is part of a portfolio of identified financial liabilities that are managed together and for which there is evidence of a recent pattern of short-term profit taking, if it is a derivative that is not a designated hedging instrument, or if so designated on initial recognition by management. This designation may only be made if the financial liability either contains an embedded derivative, or it will be managed on a fair value basis in accordance with a documented risk management strategy or designating it at fair value will reduce an accounting mismatch.
- ***Financial liabilities at amortised cost***
  This category includes all financial liabilities other than those at fair value through profit or loss. Liabilities in this category are measured at amortised cost.

***Recognition of financial liabilities***

Financial liabilities are initially recognised at fair value less transaction costs except where they are designated at fair value, in which case transaction costs are expensed as incurred. They are subsequently measured at amortised cost except for derivatives and liabilities at fair value, which are held at fair value through profit or loss. Financial liabilities are recognised when an obligation arises and derecognised when it is discharged.

***Due to other financial institutions***

Due to other financial institutions includes deposits, vostro balances and settlement account balances due to other financial institutions. They are measured at amortised cost.

***Deposits at fair value***

Deposits at fair value include certificates of deposit and interest bearing deposits. They are classified at fair value through profit or loss as they are managed as part of a trading portfolio.

***Deposits at amortised cost***

Deposits at amortised cost include non-interest bearing deposits repayable at call and interest bearing deposits. They are measured at amortised cost.

***Derivative financial instruments***

Derivative financial instruments, including forwards, futures, swaps and options, are recognised in the balance sheet at fair value. Fair values are obtained from quoted market prices, dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying instrument. Derivatives are carried as liabilities when the fair value is negative.

***Trading liabilities and other financial liabilities designated at fair value***

Securities sold under repurchase agreements and securities sold short are classified as trading liabilities. They are accounted for as financial liabilities designated at fair value through profit or loss.

***Debt issues***

Debt issues represent bonds, notes and commercial paper that have been issued by the NZ Banking Group. They are either accounted for at amortised cost or at fair value through profit or loss. If the liability is accounted for at amortised cost it is initially recorded at cost, which is the fair value of the consideration received, net of transaction costs. Subsequently, the debt is measured using the effective interest method. If the liability is accounted for at fair value through profit or loss, the debt issue is initially recognised at the fair value of the consideration received. Debt issues are measured at fair value through profit or loss to reduce an accounting mismatch, which arises due to derivatives being executed for risk management purposes.

***Life insurance policy liabilities***

Life insurance policy liabilities are calculated by using the margin on service methodology. Under this methodology, planned profit margins and an estimate of future liabilities are calculated separately for each major product line using applied assumptions at each reporting date. Profit margins are released over each financial period in line with the service that has been provided. The balance of the planned profit is deferred by including them in the value of policy liabilities.

# Note 1 Statement of accounting policies (continued)

***Other liabilities***
Other liabilities include accrued interest payable, securities purchased but not yet delivered, claims reserves on insurance policies, amounts outstanding on the credit card loyalty programme, trade creditors, other accrued expenses and the deficit arising from the defined benefit superannuation scheme.

***Subordinated debentures***
Subordinated debentures issued by the NZ Banking Group are initially recorded at cost, which is the fair value of the consideration received, net of transaction costs. They are subsequently measured at amortised cost using the effective interest method to amortise cost at inception to the redemption value over the expected life of the debt.

***Due to related entities***
This amount includes amounts due to controlled entities of the NZ Banking Group and all other entities controlled by the Overseas Bank.

## Employee entitlements

***Wages and salaries, annual leave and sick leave***
Liabilities for wages and salaries, including non-monetary benefits and annual leave expected to be settled within 12 months of the balance date are recognised in respect of employees' services and are measured at the amounts expected to be paid when the liabilities are settled.

No provision is made for non-vesting sick leave as the pattern of sick leave taken indicates that no additional liability will arise for non-vesting sick leave.

***Long service leave***
Liabilities for long service leave expected to be settled within 12 months of the balance date are recognised in the provision for long service leave and are measured at the amounts expected to be paid when the liabilities are settled.

Liabilities for long service leave and other deferred employee benefits expected to be settled more than 12 months from the balance date are recognised in the provision for long service leave and are measured at the present value of future payments expected to be made in respect of services provided by employees up to the balance date. Consideration is given to expected future wage and salary levels, experience of employee departure and periods of service. Expected future payments are discounted to their net present value using market yields at the reporting date on government bonds with terms that match as closely as possible to the estimated timing of future cash flows.

***Superannuation obligations***
Obligations for contributions to the defined contribution superannuation scheme are recognised as an expense in the income statement as incurred.

The asset or liability recognised in the balance sheet in respect of the defined benefit superannuation scheme is the present value of the defined benefit obligation as at the reporting date less the fair value of the scheme's assets. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of government bonds that have terms to maturity approximating the terms of the related superannuation liability. The calculation is performed annually by an independent qualified actuary using the projected unit credit method.

The actuarial valuation of scheme obligations is dependent upon a series of assumptions, the key ones being price inflation, earnings growth, mortality, morbidity and investment returns assumptions. Different assumptions could significantly alter the amount of difference between scheme assets and obligations, and the superannuation cost charged to the income statement.

Actuarial gains and losses related to the defined benefit superannuation scheme are recorded directly in retained earnings. A net deficit within the scheme is recognised and disclosed separately in 'Other liabilities' as a retirement benefit deficit.

***Termination benefits***
Liabilities for termination benefits are recognised when a detailed plan for terminations has been developed (and is without realistic possibility of withdrawal) and a valid expectation has been raised in those employees affected that the terminations will be carried out. Liabilities for termination benefits are recognised within other liabilities unless the timing or amount is uncertain, in which case they are recognised as provisions.

Liabilities for termination benefits expected to be settled within 12 months are measured at amounts expected to be paid when they are settled. Amounts expected to be settled more than 12 months from the reporting date are measured at the estimated cash outflows, discounted using market yields at the reporting date on government bonds with terms to maturity, that match, as closely as possible, the estimated future payments, where the effect of discounting is material.

## Provisions

***Non-lending losses***
Provision is made for non-lending losses including frauds, litigation costs and the correction of operational issues.

***Provision for impairment on credit commitments***
Provision is made for incurred losses as a result of the commitment to extend credit.

***Provision for restructuring***
Provision for restructuring is only recognised when a detailed formal plan has been approved and the restructuring has either commenced or been announced publicly such that there is little or no discretion to avoid payments to other parties and the amount can be reliably estimated. Costs relating to ongoing activities are not provided for.

## Head office account and equity

***Ordinary shares***
Ordinary shares are recognised at the amount paid up per ordinary share, net of directly attributable issue costs.

***Head office account – Branch capital***
Branch capital comprises funds provided by the Overseas Bank. It is non-interest bearing and there is no fixed date for repatriation.

***Convertible debentures***
Convertible debentures are recognised in the balance sheet at the amount of consideration received, net of issue costs.

# Note 1 Statement of accounting policies (continued)

## Reserves

### *Available-for-sale securities reserve*

The available-for-sale securities reserve comprises the changes in the fair value of available-for-sale securities, net of tax. These changes are recognised in the income statement as other income when the asset is either derecognised or impaired.

### *Cash flow hedge reserve*

The cash flow hedge reserve comprises the fair value gains or losses associated with the effective portion of designated cash flow hedging instruments.

## Hedging

The NZ Banking Group uses derivative instruments as part of its asset and liability management activities to manage exposures to interest rate, foreign currency and credit risks, including exposures arising from forecast transactions. The NZ Banking Group enters into derivative transactions that provide economic hedges for risk exposures, but do not meet the requirements for hedge accounting treatment. Gains and losses on these derivative transactions are recorded in trading income. The NZ Banking Group also enters into derivative transactions that are designated and qualify as either fair value hedges or cash flow hedges for recognised assets and liabilities or forecast transactions. The method of recognising the fair value gain or loss on derivatives depends on the nature of the hedging relationship. Hedging relationships are of two types:

- fair value hedge: a hedge of the change in fair value of recognised assets or liabilities or firm commitments; and
- cash flow hedge: a hedge of highly probable future cash flows attributable to a recognised asset or liability, or a forecasted transaction.

The NZ Banking Group uses hedge accounting for derivatives designated in this way when certain criteria are met. At the time a financial instrument is designated as a hedge, the NZ Banking Group formally documents the relationship between the hedging instrument and hedged item, together with the methods that will be used to assess the effectiveness of the hedging relationship. The NZ Banking Group formally assesses, both at the inception of the hedge and on an ongoing basis, whether the hedging derivatives have been 'highly effective' in offsetting changes in the fair value or cash flows of the hedged items.

A hedge is regarded as highly effective if, at inception and throughout its life, the NZ Banking Group can expect the hedge to offset changes in fair value or cash flows attributable to the hedged risk and actual results are within a range of 80% to 125% of these changes. 'Hedge ineffectiveness' represents the amount by which the changes in the fair value of the hedging derivative differ from changes in the fair value of the hedged item or the amount by which changes in the cash flow of the hedging derivative differ from changes (or expected changes) in the cash flow of the hedged item.

### *Fair value hedge*

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributed to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised in the income statement over the period to maturity. The adjustment to the carrying amount of a hedged equity security remains until the disposal of the equity security.

### *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. The gain or loss relating to any ineffective portion is recognised immediately in the income statement.

Amounts accumulated in other comprehensive income are recycled to the income statement in the periods in which the hedged item affects profit or loss (e.g. when interest income or expense is recognised).

When a hedging instrument expires or is sold, terminated or exercised or when the hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in the period in which the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

### *Embedded derivatives*

In certain instances a derivative may be embedded in a 'host contract'. If the host contract is not carried at fair value with changes in fair value reported in the income statement, the embedded derivative is separated from the host contract and accounted for as a stand-alone derivative instrument at fair value if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

## Loan securitisation

The NZ Banking Group, through its loan securitisation programme, may package and sell loans (principally housing mortgage loans) as securities to investors. In such transactions the NZ Banking Group provides an equitable interest in the loans to investors who provide funding to finance them. Securitised loans that do not qualify for derecognition and the associated funding are included in loans and debt issues respectively. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where substantially all the risks and rewards of ownership have been transferred.

## Funds management activities

Certain controlled entities within the NZ Banking Group conduct investment management and other fiduciary activities as custodian or manager on behalf of individuals, trusts, superannuation schemes and other institutions. These activities involve the management of assets in unit trusts, group investment funds, and superannuation schemes, and the holding or placing of assets on behalf of third parties.

Where controlled entities incur liabilities in respect of these activities, a right of indemnity exists against the assets of the applicable trusts. As these assets are sufficient to cover liabilities, and it is not probable that the controlled entities will be required to settle them, the liabilities are not included in the consolidated financial statements.

## Leases

Leases are classified as either finance leases or operating leases. Under a finance lease, substantially all the risks and rewards incidental to legal ownership are transferred to the lessee, who reports the assets in its balance sheet. In contrast, an operating lease exists where the risks of the leased assets remain with the lessor.

## Note 1 Statement of accounting policies (continued)

In its capacity as a lessor, the NZ Banking Group primarily offers finance leases. The NZ Banking Group recognises the assets held under finance leases in the balance sheet as receivables at an amount equal to the net investment in the leases. The recognition of finance income is based on a pattern reflecting a constant periodic return on the NZ Banking Group's net investment in the finance leases. Finance lease income is included within net interest income in the income statement.

In its capacity as a lessee, the NZ Banking Group mainly leases property, plant and equipment under operating leases. Payments due to the lessor under operating leases are charged to equipment and occupancy expense on a straight-line basis over the term of the lease.

### Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

### Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The NZ Banking Group has determined that the NZ Banking Group executive team is its chief operating decision-maker.

All transactions between business segments are conducted on an arm's length basis, with intra-segment revenue and costs being eliminated at head office. Income and expenses directly associated with each segment are included in determining business segment performance.

### Statement of cash flows

***Basis of presentation***

The statement of cash flows has been presented in accordance with New Zealand International Accounting Standard ('**NZ IAS**') 7 *Statement of Cash Flows* with netting of certain items as disclosed below.

***Cash and cash equivalents***

Cash and cash equivalents reflect the balance of cash and liquid assets used in the day-to-day cash management of the NZ Banking Group, which are readily convertible at the investor's or customer's option and include the interbank balances arising from the daily Reserve Bank settlement process.

***Netting of cash flows***

Certain cash flows have been netted in order to provide more meaningful disclosure, as many of the cash flows are received and disbursed on behalf of customers and reflect the activities of those customers rather than the NZ Banking Group.

## 1.3 Changes in accounting policies

As a result of the new and revised accounting standards which became operative for the annual reporting period commencing 1 October 2009 the following standards, interpretations and amendments have been adopted with effect from 1 October 2009 in the preparation of these financial statements:

- NZ IFRS 3 *Business Combinations* and amended NZ IAS 27 *Consolidated and Separate Financial Statements* – The main changes under these standards which apply prospectively to business combinations are that:
  - acquisition related costs are recognised as an expense in the income statement in the period they are incurred;
  - earn-outs and contingent considerations will be measured at fair value at the acquisition date, however, remeasurement in the future will be recognised in the income statement;
  - step acquisitions, impacting equity interests held prior to control being obtained, are remeasured to fair value, with gains and losses being recognised in the income statement. Similarly where control is lost, any difference between the fair value of the residual holding and its carrying value is recognised in the income statement; and
  - while control is retained, transactions with non-controlling interests are treated as equity transactions.
- NZ IFRS 7 *Financial Instruments: Disclosures* – The amendments require additional disclosures on fair value and liquidity risk.
- NZ IFRS 8 *Operating Segments* – The new standard further aligns external operating segment reporting with internal reporting to key management personnel.
- NZ IAS 1 *Presentation of Financial Statements* (revised) – The amendments affect the presentation of owner changes in equity and of comprehensive income, but do not change the recognition, measurement or disclosure of specific transactions and events required by other standards.
- NZ IAS 32 *Financial Instruments: Presentation* and NZ IAS 1 – The amendments require some puttable financial instruments and some financial instruments, which impose on the entity an obligation to deliver to another party a pro rata share of the net assets on liquidation, to be classified as equity.
- NZ IAS 36 *Impairment of Assets* – The amendments require that the NZ Banking Group and the NZ Branch assess whether any indicators of impairment of the carrying value of the investments in subsidiaries or associates exist upon receipt of dividends from the subsidiaries or associates.

## 1.4 Future accounting developments

The following new standards, interpretations and amendments have been issued, but are not yet effective and have not been early adopted by the NZ Banking Group:

- NZ IFRS 9 *Financial Instruments* – If this standard is not early adopted it will be effective for the 30 September 2014 financial year end. The major changes under the standard are that:
  - it replaces the multiple classification and measurement models in NZ IAS 39 *Financial Instruments: Recognition and Measurement* with a single model that has two classification categories: amortised cost and fair value;
  - a financial asset is measured at amortised cost if two criteria are met: a) the objective of the business model is to hold the financial assets for the collection of the contractual cash flows; and b) the contractual cash flows under the instrument solely represent the payment of principal and interest;
  - if a financial asset is eligible for amortised cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch;

# Note 1 Statement of accounting policies (continued)

  - there will be no separation of an embedded derivative where the host is a financial asset;
  - equity instruments must be measured at fair value, however, an entity can elect on initial recognition to present the fair value changes on an equity investment directly in other comprehensive income. There is no subsequent recycling of fair value gains and losses to profit or loss, however, dividends from such investments will continue to be recognised in profit and loss; and
  - if an entity holds a tranche in a waterfall structure it must determine the classification of that tranche by looking through to the assets ultimately underlying that portfolio and assess the credit quality of the tranche compared with the underlying portfolio. If an entity is unable to look through, then the tranche must be measured at fair value.

  The standard will impact the classification and measurement of the NZ Banking Group's financial assets.
- NZ IFRS 2 *Share-based Payment – Amendment: Group Cash-settled Share-based Payment Transactions* was issued in August 2009 and is applicable to the NZ Banking Group in the 2011 financial year. The amendments clarify the scope of NZ IFRS 2 *Share-based Payment* by requiring an entity that receives goods or services in a share-based payment arrangement to account for those goods or services no matter which entity in the group settles the transaction, and no matter whether the transaction is settled in shares or cash. It is not expected to have a material impact on the NZ Banking Group.
- NZ IAS 1 *Presentation of Financial Statements* – The amendments to the standard were issued in April 2009 and are applicable to the NZ Banking Group in the 2011 financial year. The amendments clarify that the terms of a liability, which could be settled at any time by the issuance of equity instruments at the option of the counterparty, do not affect its classification. It is not expected to have a material impact on the NZ Banking Group.
- NZ IAS 7 *Statement of Cash Flows* – Amendments to the standard were issued in April 2009 and are applicable to the NZ Banking Group in the 2011 financial year. The amendments clarify that only expenditure which results in a recognised asset can be classified as cash flow from investing activities. It is not expected to have a material impact on the NZ Banking Group.
- NZ IAS 17 *Leases* – The amendment to the standard was issued in April 2009 and is applicable to the NZ Banking Group in the 2011 financial year. The amendment removed specific guidance on classifying land as a lease. It is not expected to have a material impact on the NZ Banking Group.
- NZ IAS 24 *Related Party Disclosures* – The revised standard was approved in November 2009 and is applicable to the NZ Banking Group in the 2012 financial year. The main changes to the standard simplify the definition of a related party and clarify its intended meaning. It is not expected to have a material impact on the NZ Banking Group.
- NZ IAS 32 *Financial Instruments: Presentation* – Amendments to the standard were issued in October 2009 and are applicable to the NZ Banking Group in the 2011 financial year. The amendments clarify the classification of rights issues. It is not expected to have a material impact on the NZ Banking Group.

## 1.5 Critical accounting estimates, judgment and assumptions

The application of the NZ Banking Group's accounting policies necessarily requires the use of estimates, judgment and assumptions. Should different estimates, judgment or assumptions be applied, the resulting values would change, impacting the net assets and income of the NZ Banking Group and the NZ Branch.

Management has discussed the accounting policies which are sensitive to the use of estimates, judgment and assumptions with the Board Audit Committee of the Overseas Bank.

### Critical accounting estimates

The nature of estimates and assumptions used and the value of the resulting asset and liability balances are included in the policies below.

#### *Fair value of financial instruments*

Financial instruments classified as held for trading or designated at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured and recognised at fair value.

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Financial instruments are either priced with reference to a quoted market price for that instrument or by using a valuation technique. Where the fair value is calculated using a valuation technique, the methodology used is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to the present value. These models use independently sourced market parameters including, for example, interest rate yield curves, equities and commodities prices, option volatilities and currency rates. Most market parameters are either directly observable or are implied from instrument prices. However, profits or losses are recognised upon initial recognition only when such profits can be measured solely by reference to observable current market transactions or valuation techniques based solely on observable market inputs. In the event that inputs into valuation techniques are non-market observable, any day one profit or loss is amortised over the life of the transaction. These estimates are calibrated against industry standards, economic models and observed transaction prices.

The calculation of fair value for any financial instrument may also require adjustment of the quoted price or model value to reflect the cost of credit risk (where not embedded in underlying models or prices used) or to reflect hedging costs not captured in pricing models (to the extent they would be taken into account by a market participant in determining a price). The process of calculating fair value on illiquid instruments or from a valuation model may require estimation of certain pricing parameters, assumptions or model characteristics.

The fair value of financial instruments is provided in Note 29.

A negligible proportion of the NZ Banking Group's trading derivatives are valued directly from quoted prices, the majority being valued using appropriate valuation techniques, using observable market inputs. The fair value of substantially all securities positions carried at fair value is determined directly from quoted prices or inputs.

#### *Provisions for impairment charges on loans*

The NZ Banking Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans. A loan is impaired when there is objective evidence that events occurring since the loan was recognised have affected expected future cash flows from the loan.

The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate. Provisions for loan impairment losses represent management's estimate of the losses incurred in the loan portfolios as at the balance date. Changes to the allowances for loan impairment and changes to the provisions for undrawn contractually committed facilities and guarantees provided are reported in the income statement as part of the impairment charges on loans.

## Note 1 Statement of accounting policies (continued)

The provisions for impairment charges on loans are disclosed in Notes 12 and 13, whilst the provision for impairment on credit commitments is disclosed in Note 22.

There are two components to the NZ Banking Group's loan impairment provisions, individual and collective as follows:

(a) Individual component – all impaired loans that exceed specified thresholds are individually assessed for impairment. Individually assessed loans principally comprise the NZ Banking Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held (discounted at the loan's original effective interest rate). All relevant considerations that have a bearing on the expected future cash flows are taken into account, including the business prospects for the customer, the realisable value of collateral, the NZ Banking Group's position relative to other claimants, the reliability of customer information and the likely cost and duration of the work-out process. Subjective judgments are made in this process. Furthermore, judgments can change with time as new information becomes available or as work-out strategies evolve, resulting in revisions to the impairment provision as individual decisions are taken.

(b) Collective component – this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collective impaired loan provisions) and for loan losses that have been incurred, but have not been separately identified as at the balance date (incurred but not reported provisions). These are established on a portfolio basis taking into account the level of arrears, collateral, past loss experience and defaults based on portfolio trends. The most significant factors in establishing these provisions are the estimated loss rates and the related emergence period. These portfolios include credit card receivables and other personal advances including mortgages. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, unemployment levels, payment behaviour and bankruptcy rates.

#### *Goodwill*

Goodwill represents amounts arising on the acquisition of businesses. Prior to the revised NZ IFRS 3 *Business Combinations*, goodwill represented the excess of purchase consideration, including directly attributable expenses associated with the acquisition, over the fair value of the NZ Banking Group's share of the identifiable net assets of the acquired business. Goodwill arising on the acquisition of a business subsequent to the adoption of the revised NZ IFRS 3 represents the excess of the purchase consideration, the amount of any non-controlling interest in the acquiree and the acquisition date fair value of any previous equity interest in the acquiree, over the fair value of the NZ Banking Group's share of the identifiable net assets acquired.

The determination of the fair value of assets and liabilities of the acquired businesses requires the exercise of management judgment. Different fair values would result in changes to goodwill and to the post-acquisition performance of the acquisition.

To determine if goodwill is impaired, the carrying value of the identified CGU to which the goodwill is allocated, including the allocated goodwill, is compared to its recoverable amount. Recoverable amount is the higher of the CGU's fair value and its value-in-use. Value-in-use is the present value of expected future cash flows from the CGU. Determination of appropriate cash flows and discount rates for the calculation of value-in-use is subjective. Fair value is the amount obtainable for the sale of the CGU in an arm's length transaction between knowledgeable and willing parties. The assumptions applied to determine impairment, along with the carrying amount of goodwill, are outlined in Note 14.

#### *Superannuation obligations*

The NZ Banking Group has a hybrid (defined contribution and defined benefit) superannuation scheme for staff in New Zealand. For this scheme, actuarial valuations of the scheme's obligations and the fair value measurements of the scheme's assets are performed annually in accordance with the requirements of NZ IAS 19 *Employee Benefits*.

The actuarial valuation of scheme obligations is dependent upon a series of assumptions, the key ones being price inflation, earnings growth, mortality, morbidity and investment returns assumptions. Different assumptions could significantly alter the amount of the difference between scheme assets and obligations, and the superannuation cost charged to the income statement.

The carrying amount of superannuation defined benefit obligations is disclosed in Note 32.

#### *Provisions (other than loan impairment losses)*

Provisions are held in respect of a range of future obligations such as employee entitlements, restructuring costs and non-lending losses, as disclosed in Note 22. Some of the provisions involve significant judgment about the likely outcome of various events and estimated future cash flows. Payments which are expected to be incurred later than one year are discounted at a rate which reflects both current interest rates and the risks specific to that provision.

### Critical accounting judgments

The judgments, apart from those involving estimations, which management have made in applying the NZ Banking Group's accounting policies and that have the most significant impact on the amounts recognised in the financial statements are as follows:

#### *Income taxes*

The NZ Banking Group is subject to income taxes in New Zealand and jurisdictions where it has foreign operations. Significant judgment is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The NZ Banking Group estimates its tax liabilities based on the NZ Banking Group's understanding of the tax law. Where the final outcome of these matters is different from the amounts initially recorded, such differences impact the current and deferred tax provisions in the period when such determinations are made.

#### *Securitisation and the consolidation of special purpose vehicles*

The NZ Banking Group sponsors the formation of special purpose vehicles ('**SPV**') in the ordinary course of business, primarily to provide funding and financial services products to its customers. SPVs are typically set up for a single, pre-defined purpose, have a limited life and generally are not operating entities nor do they have employees. The most common form of SPV structure involves the acquisition of financial assets by the SPV that are funded by the issuance of securities to external investors (securitisation). Repayment of the securities is determined by the performance of the assets acquired by the SPV.

Under NZ GAAP, an SPV is consolidated and reported as part of the NZ Banking Group if it is controlled by the parent entity in line with NZ IAS 27 *Consolidated and Separate Financial Statements* or deemed to be controlled in applying New Zealand equivalent to Standing Interpretation Committee ('**NZ SIC**') 12 *Consolidation – Special Purpose Entities*. The definition of control is based on the substance rather than the legal form. As it can sometimes be difficult to determine whether the NZ Banking Group controls an SPV, management makes judgments about the NZ Banking Group's exposure to the associated risks and rewards, as well as its ability to make operational decisions for the SPV.

## Note 2 Net interest income

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| **Interest income** | | | | |
| Due from other financial institutions | **30** | 57 | **23** | 44 |
| Trading securities and other financial assets designated at fair value | **192** | 223 | **51** | 76 |
| Loans | **3,699** | 4,313 | **364** | 508 |
| Impaired assets | **51** | 29 | **4** | - |
| Due from related entities | **-** | - | **292** | 466 |
| **Total interest income**[1] | **3,972** | 4,622 | **734** | 1,094 |
| **Interest expense** | | | | |
| Due to other financial institutions | **15** | 31 | **15** | 31 |
| Deposits | **1,283** | 1,611 | **149** | 174 |
| Trading liabilities and other financial liabilities designated at fair value | **53** | 214 | **34** | 78 |
| Debt issues | **384** | 362 | **-** | - |
| Subordinated debentures | **39** | 47 | **39** | 47 |
| Due to related entities | **782** | 848 | **227** | 458 |
| Other | **6** | 29 | **6** | 26 |
| **Total interest expense**[2] | **2,562** | 3,142 | **470** | 814 |
| **Net interest income** | **1,410** | 1,480 | **264** | 280 |

1 Total interest income for financial assets that are not at fair value through profit or loss is $3,780 million (30 September 2009: $4,399 million) for the NZ Banking Group and $683 million (30 September 2009: $1,018 million) for the NZ Branch.

2 Total interest expense for financial liabilities that are not at fair value through profit or loss is $2,265 million (30 September 2009: $2,531 million) for the NZ Banking Group and $436 million (30 September 2009: $736 million) for the NZ Branch.

For the year ended 30 September 2010 the NZ Banking Group had no material loans and deposits that were subject to set-off agreements (30 September 2009: nil).

## Note 3 Non-interest income

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| **Fees and commissions** | | | | |
| Transaction fees and commissions | **231** | 243 | **25** | 22 |
| Lending fees (loan and risk) | **54** | 95 | **7** | 8 |
| Insurance commissions received | **6** | 6 | **-** | - |
| Other non-risk fee income | **22** | 16 | **18** | 13 |
| **Total fees and commissions** | **313** | 360 | **50** | 43 |
| **Wealth management revenue** | | | | |
| Fees from trust and other fiduciary activities | **125** | 111 | **-** | - |
| Net life insurance income and change in policy liabilities | **(37)** | (31) | **-** | - |
| **Total wealth management revenue** | **88** | 80 | **-** | - |
| **Trading income** | | | | |
| Foreign exchange trading | **69** | 91 | **69** | 91 |
| Interest rate trading | **27** | 45 | **27** | 45 |
| **Total trading income** | **96** | 136 | **96** | 136 |
| **Gains/(losses) on ineffective hedges** | **4** | 3 | **-** | - |
| **Other non-interest income** | | | | |
| Net gains on derivatives held for risk management purposes | **26** | 25 | **32** | 16 |
| Dividend income | **2** | 2 | **-** | - |
| Rental income | **1** | 1 | **-** | - |
| Gains on disposal of property, plant and equipment | **-** | 3 | **-** | - |
| Other | **2** | - | **-** | - |
| **Total other non-interest income** | **31** | 31 | **32** | 16 |
| **Total non-interest income** | **532** | 610 | **178** | 195 |

## Note 4 Operating expenses

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| **Salaries and other staff expenses** | | | | |
| Salaries and wages | **347** | 342 | **33** | 37 |
| Employee entitlements | **10** | 10 | **-** | - |
| Superannuation costs: | | | | |
| Defined contribution scheme | **25** | 22 | **2** | 2 |
| Defined benefit scheme (refer to Note 32) | **(1)** | 1 | **-** | - |
| Share-based payments | **2** | 3 | **-** | - |
| Restructuring costs | **4** | 1 | **4** | - |
| Other | **11** | 12 | **1** | - |
| **Total salaries and other staff expenses** | **398** | 391 | **40** | 39 |
| **Equipment and occupancy expenses** | | | | |
| Operating lease rentals | **56** | 54 | **-** | 1 |
| Depreciation: | | | | |
| Leasehold improvements | **13** | 9 | **-** | - |
| Furniture and equipment | **11** | 12 | **-** | - |
| Equipment repairs and maintenance | **11** | 8 | **-** | - |
| Electricity, water and rates | **2** | 3 | **-** | - |
| Other | **4** | 12 | **-** | - |
| **Total equipment and occupancy expenses** | **97** | 98 | **-** | 1 |
| **Other expenses** | | | | |
| Impairment charges on other intangible assets | **-** | 3 | **-** | - |
| Software amortisation costs | **43** | 45 | **-** | - |
| Non-lending losses | **6** | 3 | **-** | 1 |
| Consultancy fees and other professional services | **70** | 82 | **10** | 17 |
| Auditors' remuneration (refer to Note 5) | **3** | 2 | **1** | 1 |
| Stationery | **11** | 12 | **-** | - |
| Postage and freight | **18** | 17 | **1** | 1 |
| Telecommunication costs | **1** | 1 | **1** | 1 |
| Advertising | **26** | 25 | **1** | - |
| Training | **5** | 6 | **-** | - |
| Travel | **10** | 7 | **2** | 1 |
| Outsourcing | **75** | 79 | **1** | 1 |
| Related entities – management fees | **13** | 22 | **13** | 18 |
| Other | **12** | 15 | **-** | 6 |
| **Total other expenses** | **293** | 319 | **30** | 47 |
| **Total operating expenses** | **788** | 808 | **70** | 87 |

The NZ Banking Group made donations of $1.12 million during the year ended 30 September 2010 (30 September 2009: $75,000).

## Note 5 Auditors' remuneration

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $'000** | Year Ended 30 September 2009 $'000 | **Year Ended 30 September 2010 $'000** | Year Ended 30 September 2009 $'000 |
| **Auditor of the parent entity** | | | | |
| Audit and review of financial report | **1,842** | 1,702 | **557** | 515 |
| Other audit related work[1] | **276** | 276 | **138** | 138 |
| Other assurance services[2] | **501** | 43 | **-** | - |
| **Total audit and other assurance service** | **2,619** | 2,021 | **695** | 653 |
| Taxation compliance and advice | **45** | 38 | **15** | 19 |
| Other services | **72** | - | **-** | - |
| **Total non-audit fees** | **117** | 38 | **15** | 19 |
| **Total remuneration for audit and non-audit services** | **2,736** | 2,059 | **710** | 672 |

1. Sarbanes-Oxley reporting to the Overseas Banking Group.
2. Primarily assurance provided on certain financial information, including the issue of comfort letters in relation to debt issuance programmes.

## Note 5 Auditors' remuneration (continued)

It is the NZ Banking Group's policy to engage the external auditors on assignments additional to their statutory audit duties only if their independence is not impaired or seen to be impaired, and where their expertise and experience with the NZ Banking Group is important.

The external auditors also provide audit and non-audit services to non-consolidated entities including non-consolidated trusts of which the NZ Banking Group is manager or responsible entity and non-consolidated superannuation funds or pension funds. During the year ended 30 September 2010, the fees in respect of these services were approximately $763,000 (30 September 2009: $832,000).

All amounts disclosed above are GST exclusive.

## Note 6 Impairment charges on loans

| | NZ Banking Group | | | | NZ Branch | | | |
|---|---|---|---|---|---|---|---|---|
| | **Year Ended 30 September 2010** | | | | **Year Ended 30 September 2010** | | | |
| | **Residential Mortgages $m** | **Other Loans for Consumer Purposes $m** | **Loans for Business Purposes $m** | **Total $m** | **Residential Mortgages $m** | **Other Loans for Consumer Purposes $m** | **Loans for Business Purposes $m** | **Total $m** |
| Collectively assessed provision | **38** | **44** | **(76)** | **6** | - | - | **(48)** | **(48)** |
| Individually assessed provisions | **83** | - | **226** | **309** | - | - | **54** | **54** |
| Bad debt write-off direct to the income statement | **9** | **54** | **6** | **69** | - | - | - | - |
| Interest adjustments | **(5)** | **(18)** | **(29)** | **(52)** | - | - | **(8)** | **(8)** |
| **Total impairment charges on loans** | **125** | **80** | **127** | **332** | - | - | **(2)** | **(2)** |

| | NZ Banking Group | | | | NZ Branch | | | |
|---|---|---|---|---|---|---|---|---|
| | Year Ended 30 September 2009 | | | | Year Ended 30 September 2009 | | | |
| | Residential Mortgages $m | Other Loans for Consumer Purposes $m | Loans for Business Purposes $m | Total $m | Residential Mortgages $m | Other Loans for Consumer Purposes $m | Loans for Business Purposes $m | Total $m |
| Collectively assessed provision | 12 | (1) | 212 | 223 | - | - | 75 | 75 |
| Individually assessed provisions | 86 | - | 328 | 414 | - | - | 1 | 1 |
| Bad debt write-off direct to the income statement | 7 | 73 | 8 | 88 | - | - | - | - |
| Interest adjustments | (3) | (10) | (22) | (35) | - | - | (6) | (6) |
| **Total impairment charges on loans** | 102 | 62 | 526 | 690 | - | - | 70 | 70 |

## Note 7 Income tax expense

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| **Income tax expense** | | | | |
| Current tax: | | | | |
| Current year: | | | | |
| – On operating profit | **273** | 257 | **110** | 115 |
| – New Zealand structured finance transactions | **(188)** | 918 | **(112)** | 737 |
| Prior year adjustments | **10** | 3 | **7** | - |
| Deferred tax (refer to Note 16): | | | | |
| Current year – impact of change in tax rate | **7** | - | **1** | - |
| Current year -– other | **(33)** | (88) | **4** | (19) |
| Prior year adjustments | **(9)** | (4) | **(6)** | (2) |
| **Total income tax expense** | **60** | 1,086 | **4** | 831 |
| **Profit before income tax expense** | **823** | 592 | **374** | 318 |
| Tax calculated at tax rate of 30% | **247** | 178 | **113** | 95 |
| Impact of change in tax rate on deferred tax | **7** | - | **1** | - |
| Income not subject to tax | **(8)** | (9) | - | - |
| Expenses not deductible for tax purposes | - | 1 | - | 1 |
| New Zealand structured finance transactions | **(188)** | 918 | **(112)** | 737 |
| Prior year adjustments | **1** | (1) | **1** | (2) |
| Other items | **1** | (1) | **1** | - |
| **Total income tax expense** | **60** | 1,086 | **4** | 831 |
| **Total income tax expense comprises:** | | | | |
| Income tax expense on operating profit | **248** | 168 | **116** | 94 |
| Income tax related to New Zealand structured finance transactions | **(188)** | 918 | **(112)** | 737 |
| **Total income tax expense** | **60** | 1,086 | **4** | 831 |

## Note 7 Income tax expense (continued)

The balance of the dividend withholding payment account as at 30 September 2010 was nil (30 September 2009: nil) and there was no movement during the year ended 30 September 2010 (30 September 2009: nil).

In May 2010 the New Zealand Government enacted a reduction in company tax rates from 30% to 28%, which will apply to the NZ Branch and NZ Banking Group from 1 October 2011. Accordingly, the deferred taxes have been remeasured at 28% to the extent the underlying temporary differences are expected to reverse from 1 October 2011 onwards. As a result of this change in tax rate, the NZ Branch and NZ Banking Group have recorded additional deferred tax expense of $1 million and $7 million respectively in the income statement, and nil in other comprehensive income.

## Note 8 Imputation credit account

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m | **Year Ended 30 September 2010 $m** | Year Ended 30 September 2009 $m |
| Balance at beginning of the year | **1,206** | 1,007 | **289** | 289 |
| Transfers | **-** | - | **(19)** | (56) |
| Imputation credits attached to dividends received | **1** | 4 | **-** | - |
| Imputation credits attached to dividends paid | **(4)** | (31) | **-** | - |
| Income tax payments | **366** | 226 | **289** | 56 |
| **Balance at end of the year** | **1,569** | 1,206 | **559** | 289 |

The availability of these imputation credits is contingent on the Overseas Bank meeting the shareholder continuity rules. As a result of the merger of the Overseas Bank with St.George Bank Limited during the year ended 30 September 2009, it is possible that credits of approximately $835 million for the NZ Banking Group (including $234 million for the NZ Branch) have been forfeited. The NZ Banking Group is currently in discussions with the New Zealand Commissioner of Inland Revenue concerning this issue. If the credits are forfeited there should be no financial impact on the NZ Banking Group.

## Note 9 Due from other financial institutions

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Loans and advances to other banks | **36** | 843 | **33** | 841 |
| **Total due from other financial institutions** | **36** | 843 | **33** | 841 |
| Due from other financial institutions: | | | | |
| At call | **36** | 843 | **33** | 841 |
| Term | **-** | - | **-** | - |
| **Total due from other financial institutions** | **36** | 843 | **33** | 841 |
| Amounts expected to be recovered within 12 months | **36** | 843 | **33** | 841 |
| Amounts expected to be recovered after 12 months | **-** | - | **-** | - |
| **Total due from other financial institutions** | **36** | 843 | **33** | 841 |

## Note 10 Trading securities and other financial assets designated at fair value

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Trading securities** | | | | |
| Listed: | | | | |
| NZ Government securities | **1,955** | 2,669 | **573** | 300 |
| NZ corporate securities | **46** | 4 | **46** | 4 |
| Offshore securities | **-** | 2 | **-** | 2 |
| **Total listed securities** | **2,001** | 2,675 | **619** | 306 |
| Unlisted: | | | | |
| NZ corporate securities: | | | | |
| Certificates of deposit | **3,046** | 2,181 | **1,840** | 129 |
| Corporate bonds | **97** | 50 | **97** | 50 |
| Commercial paper | **204** | 8 | **204** | 8 |
| Mortgage-backed securities | **9** | - | **9** | - |
| Offshore securities | **28** | - | **28** | - |
| **Total unlisted securities** | **3,384** | 2,239 | **2,178** | 187 |
| Securities purchased under agreement to resell | **245** | 491 | **245** | 491 |
| **Total trading securities** | **5,630** | 5,405 | **3,042** | 984 |
| Other financial assets designated at fair value | **-** | - | **-** | - |
| **Total trading securities and other financial assets designated at fair value** | **5,630** | 5,405 | **3,042** | 984 |
| Amounts expected to be recovered within 12 months | **5,587** | 5,405 | **2,999** | 984 |
| Amounts expected to be recovered after 12 months | **43** | - | **43** | - |
| **Total trading securities and other financial assets designated at fair value** | **5,630** | 5,405 | **3,042** | 984 |

As at 30 September 2010 the NZ Banking Group and the NZ Branch had $20 million and $20 million (30 September 2009: $395 million and $395 million) of trading securities respectively that were encumbered through repurchase agreements as part of standard terms of transactions with other banks.

## Note 11 Available-for-sale securities

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Listed securities** | | | | |
| Overseas public securities | **44** | 37 | **-** | - |
| **Total available-for-sale securities** | **44** | 37 | **-** | - |
| Amounts expected to be recovered within 12 months | **-** | - | **-** | - |
| Amounts expected to be recovered after 12 months | **44** | 37 | **-** | - |
| **Total available-for-sale securities** | **44** | 37 | **-** | - |
| Balance at beginning of the year | **37** | 35 | **-** | - |
| Net unrealised gains from changes in fair value | **7** | 2 | **-** | - |
| **Balance at end of the year** | **44** | 37 | **-** | - |

As at 30 September 2010 no available-for-sale securities were pledged as collateral for the NZ Banking Group's liabilities (30 September 2009: nil).

## Note 12 Loans

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Overdrafts | **1,237** | 1,369 | **234** | 312 |
| Credit card outstandings | **1,250** | 1,182 | **-** | - |
| Money market loans | **879** | 1,106 | **288** | 532 |
| Term loans: | | | | |
| Housing | **34,143** | 32,364 | **-** | - |
| Non-housing | **18,930** | 19,235 | **5,544** | 6,252 |
| Other | **1,129** | 947 | **733** | 578 |
| **Total gross loans** | **57,568** | 56,203 | **6,799** | 7,674 |
| Provisions for impairment charges on loans | **(830)** | (611) | **(100)** | (91) |
| **Total net loans** | **56,738** | 55,592 | **6,699** | 7,583 |
| Amounts expected to be recovered within 12 months | **13,508** | 14,176 | **6,526** | 7,463 |
| Amounts expected to be recovered after 12 months | **43,230** | 41,416 | **173** | 120 |
| **Total net loans** | **56,738** | 55,592 | **6,699** | 7,583 |

The repurchase cash amount of the NZ Banking Group's repurchase agreements with the Reserve Bank using residential mortgage-backed securities as at 30 September 2010 was nil (30 September 2009: $1,814 million), with underlying securities to the value of nil (30 September 2009: $2,253 million) provided under this arrangement.

Movements in impaired assets and provisions for impairment charges on loans are outlined in Note 13.

# Note 13 Credit quality, impaired assets and provisions for impairment charges on loans

| | NZ Banking Group | | | | NZ Branch | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | | | | 2010 | | | |
| | Residential Mortgages $m | Other Loans for Consumer Purposes $m | Loans for Business Purposes $m | Total $m | Residential Mortgages $m | Other Loans for Consumer Purposes $m | Loans for Business Purposes $m | Total $m |
| **Neither past due nor impaired** | | | | | | | | |
| Strong | - | - | 8,092 | 8,092 | - | - | 5,560 | 5,560 |
| Good/Satisfactory | 32,633 | 1,565 | 10,200 | 44,398 | - | - | 719 | 719 |
| Weak | - | - | 1,963 | 1,963 | - | - | 262 | 262 |
| **Total neither past due nor impaired** | 32,633 | 1,565 | 20,255 | 54,453 | - | - | 6,541 | 6,541 |
| **Past due assets 1 to 89 days[1]** | | | | | | | | |
| Balance at beginning of the year | 850 | 131 | 426 | 1,407 | - | - | 4 | 4 |
| Additions | 5,981 | 835 | 3,256 | 10,072 | - | - | 110 | 110 |
| Deletions | (5,720) | (829) | (3,102) | (9,651) | - | - | (4) | (4) |
| **Balance at end of the year** | 1,111 | 137 | 580 | 1,828 | - | - | 110 | 110 |
| **Past due assets 90+ days[1,2]** | | | | | | | | |
| Balance at beginning of the year | 88 | 26 | 232 | 346 | - | - | - | - |
| Additions | 296 | 74 | 551 | 921 | - | - | - | - |
| Deletions | (287) | (80) | (503) | (870) | - | - | - | - |
| **Balance at end of the year** | 97 | 20 | 280 | 397 | - | - | - | - |
| **Total past due assets[1]** | 1,208 | 157 | 860 | 2,225 | - | - | 110 | 110 |
| **Individually impaired assets[2]** | | | | | | | | |
| Balance at beginning of the year | 351 | - | 324 | 675 | - | - | 5 | 5 |
| Additions | 383 | - | 593 | 976 | - | - | 147 | 147 |
| Amounts written off | (78) | - | (54) | (132) | - | - | (4) | (4) |
| Returned to performing or repaid | (354) | - | (275) | (629) | - | - | - | - |
| **Balance at end of the year** | 302 | - | 588 | 890 | - | - | 148 | 148 |
| **Restructured assets[2]** | | | | | | | | |
| Balance at beginning of the year | - | - | 1 | 1 | - | - | - | - |
| Additions | - | - | - | - | - | - | - | - |
| Deletions | - | - | (1) | (1) | - | - | - | - |
| **Balance at end of the year** | - | - | - | - | - | - | - | - |
| **Total impaired assets** | 302 | - | 588 | 890 | - | - | 148 | 148 |
| **Total gross loans[3,4]** | 34,143 | 1,722 | 21,703 | 57,568 | - | - | 6,799 | 6,799 |
| **Individually assessed provisions** | | | | | | | | |
| Balance at beginning of the year | 66 | - | 86 | 152 | - | - | 1 | 1 |
| Impairment charges on loans: | | | | | | | | |
| New provisions | 105 | - | 255 | 360 | - | - | 54 | 54 |
| Recoveries | (22) | - | (29) | (51) | - | - | - | - |
| Impairment charges on loans written off | (69) | - | (36) | (105) | - | - | (1) | (1) |
| **Balance at end of the year** | 80 | - | 276 | 356 | - | - | 54 | 54 |
| **Collectively assessed provisions** | | | | | | | | - |
| Balance at beginning of the year | 42 | 60 | 408 | 510 | - | - | 107 | 107 |
| Impairment charges on loans | 38 | 44 | (76) | 6 | - | - | (48) | (48) |
| **Balance at end of the year** | 80 | 104 | 332 | 516 | - | - | 59 | 59 |
| Total provision for impairment charges and credit commitments | 160 | 104 | 608 | 872 | - | - | 113 | 113 |
| Less: Provision for credit commitments (refer to Note 22) | - | - | (42) | (42) | - | - | (13) | (13) |
| **Total impairment provisions** | 160 | 104 | 566 | 830 | - | - | 100 | 100 |
| **Total net loans** | 33,983 | 1,618 | 21,137 | 56,738 | - | - | 6,699 | 6,699 |

1 Past due assets are not impaired assets.
2 The NZ Banking Group and the NZ Branch do not have undrawn balances on past due 90+ days, individually impaired or restructured assets.
3 The NZ Banking Group's policy is to not forgo interest on individually impaired, restructured or past due assets.
4 The NZ Banking Group does not have other assets under administration or any financial, real estate or other assets acquired through security enforcement.

## Note 13 Credit quality, impaired assets and provisions for impairment charges on loans (continued)

| | NZ Banking Group | | | | NZ Branch | | | |
|---|---|---|---|---|---|---|---|---|
| | 2009 | | | | 2009 | | | |
| | Residential Mortgages $m | Other Loans for Consumer Purposes $m | Loans for Business Purposes $m | Total $m | Residential Mortgages $m | Other Loans for Consumer Purposes $m | Loans for Business Purposes $m | Total $m |
| **Neither past due nor impaired** | | | | | | | | |
| Strong | - | - | 8,850 | 8,850 | - | - | 6,390 | 6,390 |
| Good/Satisfactory | 31,075 | 1,487 | 10,062 | 42,624 | - | - | 884 | 884 |
| Weak | - | - | 2,300 | 2,300 | - | - | 391 | 391 |
| **Total neither past due nor impaired** | 31,075 | 1,487 | 21,212 | 53,774 | - | - | 7,665 | 7,665 |
| **Past due assets 1 to 89 days**[1] | | | | | | | | |
| Balance at beginning of the year | 1,394 | 156 | 845 | 2,395 | - | - | 256 | 256 |
| Additions | 6,947 | 865 | 3,708 | 11,520 | - | - | 4 | 4 |
| Deletions | (7,491) | (890) | (4,127) | (12,508) | - | - | (256) | (256) |
| **Balance at end of the year** | 850 | 131 | 426 | 1,407 | - | - | 4 | 4 |
| **Past due assets 90+ days**[1,2] | | | | | | | | |
| Balance at beginning of the year | 75 | 25 | 122 | 222 | - | - | 1 | 1 |
| Additions | 361 | 94 | 560 | 1,015 | - | - | - | - |
| Deletions | (348) | (93) | (450) | (891) | - | - | (1) | (1) |
| **Balance at end of the year** | 88 | 26 | 232 | 346 | - | - | - | - |
| **Total past due assets**[1] | 938 | 157 | 658 | 1,753 | - | - | 4 | 4 |
| **Individually impaired assets**[2] | | | | | | | | |
| Balance at beginning of the year | 190 | - | 88 | 278 | - | - | - | - |
| Additions | 486 | - | 606 | 1,092 | - | - | 5 | 5 |
| Amounts written off | (64) | - | (290) | (354) | - | - | - | - |
| Returned to performing or repaid | (261) | - | (80) | (341) | - | - | - | - |
| **Balance at end of the year** | 351 | - | 324 | 675 | - | - | 5 | 5 |
| **Restructured assets**[2] | | | | | | | | |
| Balance at beginning of the year | - | - | - | - | - | - | - | - |
| Additions | - | - | 1 | 1 | - | - | - | - |
| Deletions | - | - | - | - | - | - | - | - |
| **Balance at end of the year** | - | - | 1 | 1 | - | - | - | - |
| **Total impaired assets** | 351 | - | 325 | 676 | - | - | 5 | 5 |
| **Total gross loans**[3,4] | 32,364 | 1,644 | 22,195 | 56,203 | - | - | 7,674 | 7,674 |
| **Individually assessed provisions** | | | | | | | | |
| Balance at beginning of the year | 24 | - | 42 | 66 | - | - | - | - |
| Impairment charges on loans: | | | | | | | | |
| New provisions | 102 | - | 333 | 435 | - | - | 1 | 1 |
| Recoveries | (16) | - | (5) | (21) | - | - | - | - |
| Impairment charges on loans written off | (44) | - | (284) | (328) | - | - | - | - |
| **Balance at end of the year** | 66 | - | 86 | 152 | - | - | 1 | 1 |
| **Collectively assessed provisions** | | | | | | | | |
| Balance at beginning of the year | 30 | 61 | 196 | 287 | - | - | 32 | 32 |
| Impairment charges on loans | 12 | (1) | 212 | 223 | - | - | 75 | 75 |
| **Balance at end of the year** | 42 | 60 | 408 | 510 | - | - | 107 | 107 |
| Total provision for impairment charges and credit commitments | 108 | 60 | 494 | 662 | - | - | 108 | 108 |
| Less: Provision for credit commitments (refer to Note 22) | - | - | (51) | (51) | - | - | (17) | (17) |
| **Total impairment provisions** | 108 | 60 | 443 | 611 | - | - | 91 | 91 |
| **Total net loans** | 32,256 | 1,584 | 21,752 | 55,592 | - | - | 7,583 | 7,583 |

1 Past due assets are not impaired assets.
2 The NZ Banking Group and the NZ Branch do not have undrawn balances on past due 90+ days, individually impaired or restructured assets.
3 The NZ Banking Group's policy is to not forgo interest on individually impaired, restructured or past due assets.
4 The NZ Banking Group does not have other assets under administration or any financial, real estate or other assets acquired through security enforcement.

## Note 14 Goodwill and other intangible assets

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Goodwill** | | | | |
| Cost | **547** | 547 | **-** | - |
| Accumulated impairment | **(22)** | (22) | **-** | - |
| **Net carrying amount of goodwill** | **525** | 525 | **-** | - |
| **Computer software** | | | | |
| Cost | **274** | 239 | **2** | 2 |
| Accumulated amortisation and impairment | **(184)** | (141) | **(2)** | (2) |
| **Net carrying amount of computer software** | **90** | 98 | **-** | - |
| **Total goodwill and other intangible assets** | **615** | 623 | **-** | - |

| | NZ Banking Group | | | NZ Branch | | |
|---|---|---|---|---|---|---|
| | **Goodwill $m** | **Computer Software $m** | **Total $m** | **Goodwill $m** | **Computer Software $m** | **Total $m** |
| Balance as at 1 October 2009 | **525** | **98** | **623** | **-** | **-** | **-** |
| Additions | **-** | **35** | **35** | **-** | **-** | **-** |
| Amortisation | **-** | **(43)** | **(43)** | **-** | **-** | **-** |
| **Net carrying amount as at 30 September 2010** | **525** | **90** | **615** | **-** | **-** | **-** |
| Balance as at 1 October 2008 | 525 | 102 | 627 | - | - | - |
| Additions | - | 44 | 44 | - | - | - |
| Amortisation | - | (45) | (45) | - | - | - |
| Impairment | - | (3) | (3) | - | - | - |
| **Net carrying amount as at 30 September 2009** | 525 | 98 | 623 | - | - | - |

Goodwill is allocated to and tested at least annually for impairment as a part of identified CGUs.

The recoverable amount of CGUs is determined annually based on value-in-use calculations and was last performed at 30 September 2010. These calculations used discounted cash flow projections based on an approved three-year strategic business plan. While the strategic business plan assumes certain economic conditions, the forecast is not reliant on one particular assumption. These business forecasts applied by management are considered appropriate as they are based on past experience and are consistent with observable current market information. The growth rates after 2013 are assumed to be zero for all CGUs for the purpose of goodwill impairment testing. The discount rate used is the before tax equivalent of the NZ Banking Group's cost of capital of 15.7% as at 30 September 2010 (30 September 2009: 15.7%).

A reasonably possible change in these key assumptions would not cause the CGUs' carrying amount to exceed their recoverable amounts.

Goodwill has been allocated to the following CGUs, which are equal to the operating segments of the same names as described in Note 31:

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Retail banking | **512** | 512 | **-** | - |
| Wealth | **13** | 13 | **-** | - |
| **Net carrying amount of goodwill** | **525** | 525 | **-** | - |

## Note 15 Property, plant and equipment

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Leasehold improvements** | | | | |
| Cost | **199** | 165 | **-** | - |
| Accumulated depreciation and impairment | **(105)** | (97) | **-** | - |
| **Net carrying amount of leasehold improvements** | **94** | 68 | **-** | - |
| **Furniture and equipment** | | | | |
| Cost | **188** | 193 | **3** | 3 |
| Accumulated depreciation and impairment | **(155)** | (167) | **(3)** | (3) |
| **Net carrying amount of furniture and equipment** | **33** | 26 | **-** | - |
| **Total property, plant and equipment** | **127** | 94 | **-** | - |

# Note 15 Property, plant and equipment (continued)

| | NZ Banking Group | | | NZ Branch | | |
|---|---|---|---|---|---|---|
| | **Leasehold Improvements $m** | **Furniture and Equipment $m** | **Total $m** | **Leasehold Improvements $m** | **Furniture and Equipment $m** | **Total $m** |
| Balance as at 1 October 2009 | **68** | **26** | **94** | - | - | - |
| Additions | **39** | **19** | **58** | - | - | - |
| Disposals | **-** | **(1)** | **(1)** | - | - | - |
| Depreciation | **(13)** | **(11)** | **(24)** | - | - | - |
| **Net carrying amount as at 30 September 2010** | **94** | **33** | **127** | - | - | - |
| Balance as at 1 October 2008 | 46 | 32 | 78 | - | - | - |
| Additions | 31 | 8 | 39 | - | - | - |
| Disposals | - | (2) | (2) | - | - | - |
| Depreciation | (9) | (12) | (21) | - | - | - |
| **Net carrying amount as at 30 September 2009** | 68 | 26 | 94 | - | - | - |

## Property, plant and equipment under construction

Property, plant and equipment includes leasehold improvements in the NZ Banking Group with a carrying value of $28 million (30 September 2009: $26 million) that are under construction.

# Note 16 Deferred tax assets and liabilities

## Deferred tax assets

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Deferred tax assets are attributable to the following:** | | | | |
| Property, plant and equipment | **7** | 4 | **-** | - |
| Provision for impairment charges on loans | **255** | 199 | **33** | 32 |
| Provision for employee entitlements | **18** | 21 | **1** | 1 |
| Interest on New Zealand structured finance transactions | **74** | - | **61** | - |
| Other temporary differences | **(9)** | 8 | **5** | 4 |
| Amounts recognised directly in equity: | | | | |
| Cash flow hedges | **49** | 71 | **-** | - |
| Other amounts recognised directly in equity | **11** | 3 | **3** | 3 |
| **Balance at end of the year** | **405** | 306 | **103** | 40 |
| To be recovered within 12 months | **279** | 147 | **87** | 23 |
| To be recovered after more than 12 months | **126** | 159 | **16** | 17 |
| **Balance at end of the year** | **405** | 306 | **103** | 40 |
| **Movements** | | | | |
| Balance at beginning of the year | **306** | 164 | **40** | - |
| Prior year adjustments | **9** | 4 | **6** | 2 |
| Credited/(charged) to the income statement (refer to Note 7) | **33** | 88 | **(4)** | 13 |
| Interest on New Zealand structured finance transactions | **74** | - | **61** | - |
| Other temporary differences | **4** | 26 | **1** | 25 |
| (Charged)/credited to equity | **(14)** | 24 | **-** | - |
| Change in corporate tax rate (refer to Note 7) | **(7)** | - | **(1)** | - |
| **Balance at end of the year** | **405** | 306 | **103** | 40 |
| **The deferred tax charge in income tax expense comprises the following temporary differences:** | | | | |
| Property, plant and equipment | **3** | - | **-** | - |
| Provision for impairment charges on loans | **56** | 93 | **1** | 26 |
| Provision for employee entitlements | **(3)** | (7) | **-** | (2) |
| Other temporary differences | **(21)** | 6 | **-** | (9) |
| **Total deferred tax charge** | **35** | 92 | **1** | 15 |
| **The deferred tax charge in equity comprises the following temporary differences:** | | | | |
| Cash flow hedges | **(22)** | 35 | **-** | - |
| Provision for employee entitlements | **8** | (11) | **-** | - |
| **Total deferred tax charge** | **(14)** | 24 | **-** | - |

## Deferred tax liabilities

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Movements** | | | | |
| Balance at beginning of the year | **-** | - | **-** | 6 |
| Credited to the income statement (refer to Note 7) | **-** | - | **-** | (6) |
| **Balance at end of the year** | **-** | - | **-** | - |
| **The deferred tax charge in income tax expense comprises the following temporary differences:** | | | | |
| Other temporary differences | **-** | - | **-** | (6) |
| **Total deferred tax charge** | **-** | - | **-** | (6) |

As at 30 September 2010 the aggregate temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognised were nil (30 September 2009: nil).

## Note 17 Other assets

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Accrued interest receivable | **146** | 132 | **26** | 15 |
| Securities sold not yet delivered | **13** | 276 | **13** | 276 |
| Trade debtors and prepayments | **18** | 3 | **1** | - |
| Other | **20** | 87 | **9** | 66 |
| **Total other assets** | **197** | 498 | **49** | 357 |
| Amounts expected to be recovered within 12 months | **197** | 498 | **49** | 357 |
| Amounts expected to be recovered after 12 months | **-** | - | **-** | - |
| **Total other assets** | **197** | 498 | **49** | 357 |

## Note 18 Due to other financial institutions

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Interest bearing | **627** | 233 | **627** | 233 |
| Non-interest bearing, repayable at call | **167** | 252 | **167** | 252 |
| **Total due to other financial institutions** | **794** | 485 | **794** | 485 |
| Due to other financial institutions: | | | | |
| At call | **794** | 485 | **794** | 485 |
| **Total due to other financial institutions** | **794** | 485 | **794** | 485 |
| Amounts expected to be settled within 12 months | **794** | 485 | **794** | 485 |
| Amounts expected to be settled after 12 months | **-** | - | **-** | - |
| **Total due to other financial institutions** | **794** | 485 | **794** | 485 |

## Note 19 Deposits

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Deposits at fair value** | | | | |
| Certificates of deposit | **1,902** | 3,468 | **-** | - |
| Term deposits | **551** | 305 | **463** | 125 |
| **Total deposits at fair value** | **2,453** | 3,773 | **463** | 125 |
| **Deposits at amortised cost** | | | | |
| Non-interest bearing, repayable at call | **2,515** | 2,386 | **105** | 166 |
| Other interest bearing: | | | | |
| At call | **13,221** | 12,987 | **2,927** | 2,368 |
| Term | **19,831** | 17,266 | **2,059** | 1,257 |
| **Total deposits at amortised cost** | **35,567** | 32,639 | **5,091** | 3,791 |
| **Total deposits** | **38,020** | 36,412 | **5,554** | 3,916 |
| Amounts expected to be settled within 12 months | **37,079** | 34,877 | **5,548** | 3,904 |
| Amounts expected to be settled after 12 months | **941** | 1,535 | **6** | 12 |
| **Total deposits** | **38,020** | 36,412 | **5,554** | 3,916 |

The NZ Branch held no retail deposits from individuals as at 30 September 2010 (30 September 2009: nil).

## Note 20 Trading liabilities and other financial liabilities designated at fair value

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Held for trading** | | | | |
| Securities sold short | **219** | 418 | **219** | 418 |
| Securities sold under agreements to repurchase | **20** | 2,280 | **20** | 395 |
| **Total trading liabilities** | **239** | 2,698 | **239** | 813 |
| Other financial liabilities designated at fair value | **-** | - | **-** | - |
| **Total trading liabilities and other financial liabilities designated at fair value** | **239** | 2,698 | **239** | 813 |
| Amounts expected to be settled within 12 months | **239** | 2,698 | **239** | 813 |
| Amounts expected to be settled after 12 months | **-** | - | **-** | - |
| **Total trading liabilities and other financial liabilities designated at fair value** | **239** | 2,698 | **239** | 813 |

# Note 21 Debt issues

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Short-term debt** | | | | |
| Commercial paper | **6,546** | 6,027 | **-** | - |
| **Total short-term debt** | **6,546** | 6,027 | **-** | - |
| **Long-term debt** | | | | |
| Euro medium-term notes | **6,711** | 4,139 | **-** | - |
| Domestic medium-term notes | **2,182** | 2,203 | **-** | - |
| **Total long-term debt** | **8,893** | 6,342 | **-** | - |
| **Total debt issues** | **15,439** | 12,369 | **-** | - |
| Government guaranteed debt[1] | **4,141** | 4,129 | **-** | - |
| Non-government guaranteed debt | **11,298** | 8,240 | **-** | - |
| **Total debt issues** | **15,439** | 12,369 | **-** | - |
| Debt issues at amortised cost | **8,893** | 6,287 | **-** | - |
| Debt issues at fair value | **6,546** | 6,082 | **-** | - |
| **Total debt issues** | **15,439** | 12,369 | **-** | - |
| Amounts expected to be settled within 12 months | **7,179** | 6,767 | **-** | - |
| Amounts expected to be settled after 12 months | **8,260** | 5,602 | **-** | - |
| **Total debt issues** | **15,439** | 12,369 | **-** | - |

1 For further information on government guaranteed debt please refer to Guarantee arrangements on page 5.

# Note 22 Provisions

| | Long Service Leave $m | Annual Leave and Other Staff Benefits $m | Non-lending Losses $m | Impairment on Credit Commitments $m | Restructuring $m | Total $m |
|---|---|---|---|---|---|---|
| **NZ Banking Group** | | | | | | |
| **For the year ended 30 September 2010** | | | | | | |
| Balance as at 1 October 2009 | **9** | **43** | **2** | **51** | **1** | **106** |
| Additional provisions recognised | **1** | **20** | **6** | **-** | **3** | **30** |
| Utilised during the year | **(1)** | **(17)** | **(7)** | **(9)** | **-** | **(34)** |
| **Balance as at 30 September 2010** | **9** | **46** | **1** | **42** | **4** | **102** |
| **For the year ended 30 September 2009** | | | | | | |
| Balance as at 1 October 2008 | 9 | 39 | 5 | 28 | - | 81 |
| Additional provisions recognised | - | 30 | 3 | 23 | 1 | 57 |
| Utilised during the year | - | (26) | (6) | - | - | (32) |
| **Balance as at 30 September 2009** | 9 | 43 | 2 | 51 | 1 | 106 |
| **NZ Branch** | | | | | | |
| **For the year ended 30 September 2010** | | | | | | |
| Balance as at 1 October 2009 | **1** | **9** | **-** | **17** | **1** | **28** |
| Additional provisions recognised | **-** | **8** | **-** | **-** | **3** | **11** |
| Utilised during the year | **-** | **(8)** | **-** | **(4)** | **-** | **(12)** |
| **Balance as at 30 September 2010** | **1** | **9** | **-** | **13** | **4** | **27** |
| **For the year ended 30 September 2009** | | | | | | |
| Balance as at 1 October 2008 | 1 | 5 | - | 7 | - | 13 |
| Additional provisions recognised | - | 15 | 1 | 10 | 1 | 27 |
| Utilised during the year | - | (11) | (1) | - | - | (12) |
| **Balance as at 30 September 2009** | 1 | 9 | - | 17 | 1 | 28 |

Provisions represent costs the NZ Banking Group and the NZ Branch expect to incur as a result of past events, where the timing of payment is uncertain. Provisions expected to be utilised beyond 12 months as at 30 September 2010 are $56 million (30 September 2009: $63 million) for the NZ Banking Group and $18 million (30 September 2009: $19 million) for the NZ Branch.

## Note 23 Other liabilities

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Accrued interest payable | **345** | 299 | **19** | 9 |
| Securities purchased but not yet delivered | **102** | 104 | **102** | 104 |
| Claims reserves | **14** | 13 | **-** | - |
| Credit card loyalty programme | **27** | 27 | **-** | - |
| Retirement benefit deficit (refer to note 32) | **47** | 30 | **-** | - |
| Trade creditors and other accrued expenses | **100** | 90 | **7** | 7 |
| Other | **51** | 100 | **1** | 2 |
| **Total other liabilities** | **686** | 663 | **129** | 122 |
| Amounts expected to be settled within 12 months | **639** | 633 | **129** | 122 |
| Amounts expected to be settled after 12 months | **47** | 30 | **-** | - |
| **Total other liabilities** | **686** | 663 | **129** | 122 |

## Note 24 Subordinated debentures

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Subordinated debentures | **819** | 790 | **819** | 790 |
| **Total subordinated debentures** | **819** | 790 | **819** | 790 |

On 5 April 2004 the NZ Branch issued US$525 million of Junior Subordinated Convertible Debentures to the trustee of the Tavarua Funding Trust IV ('**Funding Trust IV**'), being a member of the Overseas Banking Group. The investment by Funding Trust IV in the subordinated convertible debentures was ultimately funded from the proceeds (net of issue costs) of approximately US$525 million of Trust Preferred Securities issued by the Overseas Banking Group in the United States of America.

The subordinated convertible debentures are unsecured obligations of the NZ Branch and rank subordinate and junior in the right of payment of principal and distributions to certain of the NZ Branch's obligations to its depositors and creditors, including other subordinated creditors, other than subordinated creditors holding subordinated indebtedness that ranks equally with, or junior to, the holders of subordinated convertible debentures.

The subordinated convertible debentures will pay semi-annual distributions (31 March and 30 September) in arrears at the annual rate of 5.256% up to, but excluding, 31 March 2016. From, and including, 31 March 2016 the subordinated convertible debentures will pay quarterly distributions (31 December, 31 March, 30 June and 30 September) in arrears at a floating rate equal to London InterBank Offer Rate ('**LIBOR**') plus 1.7675% per annum. The subordinated convertible debentures will only pay distributions to the extent they are declared by the Board, or an authorised committee of the Board. Any distribution is subject to the Overseas Bank having sufficient distributable profits unless approved by APRA. If certain other conditions exist a distribution is not permitted to be declared.

The subordinated convertible debentures have no stated maturity but will automatically convert into American Depositary Receipts ('**ADRs**'), each representing 40 Overseas Bank preference shares (non-cumulative preference shares with a liquidation amount of US$25) on 31 March 2053, or earlier in the event that a distribution is not made or certain other events occur. The holders of the ADRs will, in certain circumstances, have the right to convert their Overseas Bank preference shares into a variable number of Overseas Bank ordinary shares on 31 March 2054 by giving notice to the Overseas Bank.

With the prior written consent of APRA, if required, the Overseas Bank may elect to redeem the subordinated convertible debentures for cash before 31 March 2016 in whole upon the occurrence of certain specific events, and in whole or in part on any distribution date on or after 31 March 2016. The holders of the subordinated convertible debentures do not have the option to require redemption of these instruments.

## Note 25 Priority of financial liabilities in the event of liquidation

There are material legislative restrictions in Australia (being the Overseas Bank's country of incorporation) which subordinate the claims of certain classes of unsecured creditors of the Overseas Bank on the Australian assets of the Overseas Bank (including a claim made or proved in an insolvent winding-up or liquidation of the Overseas Bank) to those of other classes of unsecured creditors of the Overseas Bank, in the event that the Overseas Bank becomes unable to meet its obligations or suspends payment.

The legislation described below is relevant to limitations on possible claims made by unsecured creditors of the NZ Branch (together with all other senior unsecured creditors of the Overseas Bank) and New Zealand depositors on the assets of the Overseas Bank (including a claim made or proved in an insolvent winding-up or liquidation of the Overseas Bank) relative to those of certain other classes of unsecured creditors of the Overseas Bank, in the event that the Overseas Bank becomes unable to meet its obligations or suspends payment.

The Overseas Bank is an ADI for the purposes of the Australian Banking Act. Prior to 27 July 2010, section 13A(3) of the Australian Banking Act provided that, in the event an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to satisfy, in priority to all other liabilities of the ADI:

- first, certain obligations of the ADI to APRA (if any) arising under Division 2AA of Part II of the Australian Banking Act in respect of amounts payable by APRA to holders of 'protected accounts' (as defined for the purposes of the Australian Banking Act) as part of the FCS;
- second, APRA's costs (if any) in exercising its powers and performing its functions relating to the ADI in connection with the FCS; and
- third, the ADI's deposit liabilities in Australia (other than any liabilities under the first priority listed above).

## Note 25 Priority of financial liabilities in the event of liquidation (continued)

With effect from 27 July 2010, section 13A of the Australian Banking Act was amended so that in the event that the ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to satisfy the liabilities of the ADI in the following order:

- first and second, as above;
- third, the ADI's liabilities (if any) in Australia in relation to 'protected accounts' that account-holders keep with the ADI;
- fourth, the ADI's debts (if any) to the Reserve Bank of Australia;
- fifth, the ADI's liabilities (if any) under an emergency financial 'industry support contract' that is certified by APRA in accordance with the Australian Banking Act; and
- sixth, the ADI's other liabilities (if any) in the order of their priority apart from the above.

Under section 16 of the Australian Banking Act, on the winding-up of an ADI, APRA's cost of being in control of an ADI's business, or having an administrator in control of an ADI's business, is a debt due to APRA. Debts due to APRA shall have, subject to section 13A(3) of the Australian Banking Act, priority over all other unsecured debts of that ADI.

## Note 26 Convertible debentures

| | **NZ Banking Group** | | **NZ Branch** | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Convertible debentures | **1,284** | 1,284 | **1,284** | 1,284 |

On 13 August 2003 the NZ Branch issued $1,284 million (net of issue costs) of Junior Subordinated Convertible Debentures to the trustee of the Tavarua Funding Trust III ('**Funding Trust III**'), being a member of the Overseas Banking Group. The investment by Funding Trust III in the convertible debentures was ultimately funded by the proceeds (net of issue costs) of approximately US$750 million of Trust Preferred Securities issued by the Overseas Banking Group in the United States of America.

The convertible debentures are unsecured obligations of the NZ Branch and rank subordinate and junior in the right of payment of principal and distributions to certain of the NZ Branch's obligations to its depositors and creditors, including other subordinated creditors, other than subordinated creditors holding subordinated indebtedness that ranks equally with, or junior to, the holders of convertible debentures.

The convertible debentures will pay semi-annual distributions (31 March and 30 September) in arrears at the annual rate of 7.57% up to but excluding 30 September 2013. From, and including, 30 September 2013 the convertible debentures will pay quarterly distributions (31 December, 31 March, 30 June and 30 September) in arrears at a floating rate equal to the New Zealand Bank Bill Rate plus 2.20% per annum. The convertible debentures will only pay distributions to the extent they are declared by the Board, or an authorised committee of the Board. Any distribution is subject to the Overseas Bank having sufficient distributable profits unless approved by APRA. If certain other conditions exist a distribution is not permitted to be declared.

The convertible debentures have no stated maturity, but will automatically convert into ADRs each representing 40 Overseas Bank preference shares (non-cumulative preference shares with a liquidation amount of US$25) on 30 September 2053, or earlier in the event that a distribution is not made or certain other events occur.

Under the terms of the convertible debentures the NZ Branch will make distributions in New Zealand dollars to Funding Trust III. Funding Trust III has entered into a currency swap with the Overseas Bank under which Funding Trust III has agreed to pay the Overseas Bank the New Zealand dollar distributions it receives on the convertible debentures in exchange for US dollars. The NZ Branch has also entered into a netting agreement under which it has agreed to pay any New Zealand dollar distributions on the convertible debentures direct to the Overseas Bank.

With the prior written consent of APRA, if required, the NZ Branch may elect to redeem the convertible debentures for cash before 30 September 2013 in whole upon the occurrence of certain specific events, and in whole or in part on any distribution date on or after 30 September 2013. The holders of the convertible debentures do not have an option to require redemption of these instruments.

# Note 27 Related entities

## NZ Banking Group

The NZ Banking Group consists of the New Zealand operations of the Overseas Banking Group including the NZ Branch and the following controlled entities as at 30 September 2010 whose business is required to be reported in the financial statements for the Overseas Banking Group's New Zealand business:

| Name of Entity | Principal Activity | Notes |
|---|---|---|
| BT Financial Group (NZ) Limited | Holding company | |
| BT Funds Management (NZ) Limited | Funds management company | |
| Hastings Forestry Investments Limited | Non-trading company | |
| St.George New Zealand Limited | Non-trading company | |
| Westpac Financial Services Group-NZ-Limited | Holding company | |
| Westpac Life-NZ-Limited | Life insurance company | |
| Westpac Nominees-NZ-Limited | Nominee company | |
| Westpac Superannuation Nominees-NZ–Limited | Nominee company | |
| Westpac Group Investment-NZ-Limited | Holding company | |
| Westpac Holdings-NZ-Limited | Holding company | |
| HLT Custodian Trust | Custodian entity | |
| MIF Custodian Trust | Custodian entity | |
| TBNZ Investments (UK) Limited | Finance company | |
| Westpac Capital-NZ-Limited | Finance and holding company | |
| Aotearoa Financial Services Limited | Non-trading company | |
| Westpac Equity Investments NZ Limited | Finance company | |
| Westpac New Zealand Group Limited | Holding company | |
| Westpac New Zealand Limited | Registered bank | |
| Westpac NZ Operations Limited | Holding company | |
| The Home Mortgage Company Limited | Residential mortgage company | |
| The Warehouse Financial Services Limited | Financial services company | 51% owned |
| Westpac (NZ) Investments Limited | Property owning and funding company | |
| Westpac Securities NZ Limited | Funding company | |
| Number 120 Limited | Finance company | Incorporated 11 February 2010 |
| Westpac NZ Securitisation Holdings Limited | Holding company | Incorporated 14 October 2008[1] |
| Westpac NZ Securitisation Limited | Funding company | Incorporated 14 October 2008[1] |
| Westpac Term PIE Fund | Portfolio investment entity | Established 20 July 2009[2] |

1 Westpac NZ Securitisation Holdings Limited ('**WNZSHL**') and its wholly-owned subsidiary company, Westpac NZ Securitisation Limited ('**WNZSL**'), were incorporated on 14 October 2008. The NZ Banking Group, through its subsidiaries, Westpac NZ Operations Limited (9.5%) and Westpac Holdings-NZ-Limited (9.5%), has a total qualifying interest of 19% in WNZSHL. Westpac New Zealand is considered to control both WNZSHL and WNZSL based on contractual arrangements put in place, and as such both WNZSHL and WNZSL are consolidated within the financial statements of the NZ Banking Group.

2 Westpac Term PIE Fund ('**Term PIE**') was established on 20 July 2009 as a unit trust under the Unit Trusts Act 1960. Term PIE is a portfolio investment entity ('**PIE**'), where BT Funds Management (NZ) Limited is the manager and issuer of Term PIE. The manager has appointed Westpac New Zealand to perform all customer management and account administration for Term PIE. Westpac New Zealand is Term PIE's registrar and administration manager. Westpac New Zealand does not hold any units in Term PIE and is considered to control Term PIE based on contractual arrangements put in place, and as such Term PIE is consolidated in the financial statements of the NZ Banking Group.

All entities in the NZ Banking Group are 100% owned unless otherwise stated. All entities within the NZ Banking Group have a balance date of 30 September except Term PIE which has a balance date of 31 March. All entities within the NZ Banking Group are incorporated and domiciled in New Zealand, except TBNZ Investments (UK) Limited which is incorporated and domiciled in the United Kingdom.

Other significant related entities of the NZ Banking Group include branches of the Overseas Bank based in London, Hong Kong, Sydney, New York and Singapore.

Transactions and balances with related parties are disclosed separately in these financial statements.

The following entities were amalgamated into Westpac Holdings-NZ-Limited during the year ended 30 September 2010 in accordance with the New Zealand Companies Act 1993. These amalgamations had no material impact on the results of the NZ Banking Group for the year ended 30 September 2010.

| Name of Entity | Principal Activity | Date of Amalgamation |
|---|---|---|
| Augusta (1962) Limited | Non-trading company | 22 September 2010 |
| Westpac Finance Limited | Finance company | 22 September 2010 |
| WestpacTrust Securities-NZ-Limited | Funding company | 22 September 2010 |
| TBNZ Limited | Holding company | 24 September 2010 |
| TBNZ Capital Limited | Finance company | 24 September 2010 |
| TBNZ Developments Limited | Holding company | 24 September 2010 |
| TBNZ Investments Limited | Finance company | 24 September 2010 |
| TBNZ Equity Limited | Finance company | 24 September 2010 |

## Note 27 Related entities (continued)

The following entities were amalgamated into Westpac Capital-NZ-Limited during the year ended 30 September 2010 in accordance with the New Zealand Companies Act 1993. These amalgamations had no material impact on the results of the NZ Banking Group for the year ended 30 September 2010.

| Name of Entity | Principal Activity | Date of Amalgamation |
|---|---|---|
| Westpac Lease Discounting-NZ-Limited | Finance company | 24 September 2010 |
| Westpac Operations Integrated Limited | Finance company | 24 September 2010 |
| Westpac Financial Synergy Limited | Finance company | 24 September 2010 |
| Westpac Overseas Investments Limited | Finance company | 24 September 2010 |

The following entities ceased to be controlled entities of the NZ Banking Group during the year ended 30 September 2010. These entities had no material impact on the results of the NZ Banking Group for the year ended 30 September 2010.

| Name of Entity | Notes | Date Struck off NZ Companies Office Register |
|---|---|---|
| Waratah Receivables Corporation (NZ) Limited | Company ceased to carry on business | 23 October 2009 |
| WST-NZ Warehouse Trust #1 | Trust terminated on 29 January 2010 | N/A |
| AGRI Private Capital Management Limited | Company ceased to carry on business | 30 March 2010 |
| Waratah Securities Australia Limited-NZ Branch | Branch ceased to carry on business | 28 May 2010 |
| St.George Financial Investments New Zealand Limited | Company ceased to carry on business | 10 September 2010 |
| Westpac NZ Funding Limited | Company liquidated on 29 September 2010 | 5 November 2010 |
| Tasman Funding No.1 Limited | Company liquidated on 29 September 2010 | 5 November 2010 |
| Tasman Funding No.2 Limited | Company liquidated on 29 September 2010 | 5 November 2010 |
| PF No.2 | Company liquidated on 29 September 2010 | 5 November 2010 |
| BLE Capital (NZ) Limited | Company liquidated on 29 September 2010 | 5 November 2010 |

### Investment in associate

The NZ Banking Group holds 15% of Cards NZ Limited's equity plus one VISA Inc access preference share.

| | NZ Banking Group | |
|---|---|---|
| | **2010 $m** | 2009 $m |
| Balance at beginning of the year | **48** | 48 |
| Dividends received | **(1)** | - |
| Equity share of net profit | **1** | - |
| **Balance at end of the year** | **48** | 48 |

The NZ Banking Group has on issue a promissory note to Cards NZ Limited in relation to the purchase of VISA Inc shares. The promissory note bears interest at market rates and will be defeased through an in-kind distribution upon liquidation of Cards NZ Limited.

### Nature of transactions

The NZ Banking Group has transactions with members of the Overseas Banking Group on commercial terms, including the provision of management and administrative services and data processing facilities. Such transactions are not considered to be material either individually or in aggregate.

***Transactions with the Overseas Bank***

Management fees are paid by the NZ Branch to the Overseas Bank for management and administration services (consisting of salaries and other head office expenses) provided by the Overseas Bank. The total amount charged by the Overseas Bank for the year ended 30 September 2010 was $11 million (30 September 2009: $13 million).

The Overseas Bank provides funding to the NZ Branch. Interest is paid on this funding at market rates.

The NZ Banking Group receives funding from the London branch of the Overseas Bank on an as needs basis.

***Transactions with controlled entities of the NZ Banking Group***

The NZ Branch provides financial market services, foreign currency, trade and interest rate risk products to the customers of Westpac New Zealand. Westpac New Zealand receives commission from these sales. Commission received for the year ended 30 September 2010 was $4 million (30 September 2009: $6 million).

The NZ Branch pays subvention payments to members of the NZ Banking Group for the use of tax losses. The total payment made by the NZ Branch for the year ended 30 September 2010 was nil (30 September 2009: nil). Payments made for tax loss transfers between members of the NZ Banking Group are determined having regard to the circumstances of the entities and the value of the tax losses.

The NZ Branch provides loans to members of the NZ Banking Group. Interest is paid on these loans at market rates.

***Transactions with other controlled entities of the Overseas Bank***

The NZ Branch enters into derivative transactions with other members of the Overseas Banking Group, including the NZ Banking Group, in the normal course of business. These transactions are subject to a market standard netting agreement and, as a result, outstanding derivative balances are included in the due from related entities balance on a net basis. Management systems and operational controls are in place in order to manage any resulting interest rate or currency risk. Accordingly, it is not envisaged that any liability resulting in material loss will arise from these transactions.

# Note 27 Related entities (continued)

## Due from and to related entities

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Due from related entities** | | | | |
| Overseas Bank | **1,553** | 2,759 | **1,545** | 2,460 |
| Controlled entities of the NZ Banking Group | **-** | - | **3,870** | 4,835 |
| Other controlled entities of the Overseas Bank | **2** | - | **2** | - |
| **Total due from related entities** | **1,555** | 2,759 | **5,417** | 7,295 |
| **Due to related entities** | | | | |
| Overseas Bank | **6,953** | 8,623 | **4,862** | 6,181 |
| Controlled entities of the NZ Banking Group | **-** | - | **1,598** | 1,775 |
| Other controlled entities of the Overseas Bank | **2** | 2 | **2** | - |
| Associates of the NZ Banking Group | **48** | 48 | **-** | - |
| **Total due to related entities** | **7,003** | 8,673 | **6,462** | 7,956 |

## Other group investments

The NZ Banking Group had significant non-controlling shareholdings in the following New Zealand based entities as at 30 September 2010:

| Name | Shares Held by | Beneficial Interest | Nature of Business |
|---|---|---|---|
| Mondex New Zealand Limited | Westpac Holdings-NZ-Limited | 20% | Smart card operations |
| Paymark Limited (previously Electronic Transaction Services Limited) | Westpac NZ Operations Limited | 25% | Electronic payments processing |
| Interchange and Settlement Limited | Westpac NZ Operations Limited | 14% | Retail payments processing |

The NZ Banking Group does not have significant influence over these entities and therefore they are not classified as associates.

The total carrying amount of the NZ Banking Group's significant non-controlling shareholdings in the above investments, and their contributions to the results of the NZ Banking Group, are not material either individually or in aggregate.

The NZ Banking Group acquired 22.97% of the shares of Payments NZ Limited on 1 October 2010. Payments NZ Limited owns the governance framework for the New Zealand payments system. The consideration paid for these shares was not material to the NZ Banking Group.

# Note 28 Derivative financial instruments

Derivative contracts include forwards, futures, swaps and options, all of which are bilateral contracts or payment exchange agreements whose values derive from the value of an underlying asset, reference rate or index.

A forward contract obliges one party to buy and the other to sell, a specific underlying product or instrument at a specific price, amount and date in the future. A forward rate agreement ('**FRA**') is an agreement between two parties establishing a contract interest rate on a notional principal over a specified period commencing at a specific future date.

A futures contract is similar to a forward contract. A futures contract obliges its owner to buy a specific underlying commodity or financial instrument at a specified price on the contract maturity date (or to settle the value for cash). Futures are exchange traded.

A swap transaction obliges the two parties to the contract to exchange a series of cash flows at specified intervals known as payment or settlement dates.

An option contract gives the option holder the right, but not the obligation, to buy or sell a specified amount of a given commodity or financial instrument at a specified price during a certain period or on a specific date. The writer of the option contract is obliged to perform if the holder exercises the right contained therein.

Certain leveraged derivatives include an explicit leverage factor in the payment formula. The leverage factor has the effect of multiplying the notional amount such that the impact of changes in the underlying price or prices may be greater than that indicated by the notional amount alone. The NZ Banking Group has no significant exposure to those types of transactions.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet, but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the NZ Banking Group's exposure to credit or price risks.

The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms. The notional amount of the derivative financial instruments on hand is the aggregate notional or contractual amounts of instruments that are both favourable or unfavourable.

The NZ Banking Group uses derivatives in two distinct capacities; as a trader and as an end-user as part of its asset and liability management activities.

All derivatives of the NZ Banking Group are held either in the NZ Branch or Westpac New Zealand. Derivatives with related parties are included in due from/due to related entities.

## Trading

As a trader, the NZ Branch's primary objective is to derive income from the sale of derivatives to meet the NZ Banking Group's customers' needs. In addition to the sale of derivatives to customers, the NZ Branch also undertakes market making and discretionary trading activities. This process ensures liquidity in the key markets in which the NZ Banking Group operates. The NZ Branch also trades on its own account to exploit arbitrage opportunities and market anomalies, as well as to take outright views on market direction. These activities, known as proprietary trading, represent a limited part of the NZ Banking Group's derivative activities.

# Note 28 Derivative financial instruments (continued)

## Hedging

The NZ Banking Group enters into derivative transactions that are designated and qualify as either fair value hedges or cash flow hedges for recognised assets and liabilities or forecast transactions. It also enters into derivative transactions that provide economic hedges for risk exposures, but do not meet the requirements for hedge accounting treatment. Gains and losses on these derivative transactions are recorded in trading income.

***Fair value hedges***

The NZ Banking Group hedges part of its existing interest rate risk resulting from any potential decrease in the fair value of fixed rate assets from customers denominated in local currency using swaps. The NZ Banking Group also hedges part of its interest rate risk in the fair value of fixed medium-term debt issuance denominated both in local and foreign currencies through the use of interest rate derivatives.

For the NZ Banking Group, the change in the fair value of hedging instruments designated as fair value hedges was a $294 million gain (30 September 2009: $126 million loss) while the change in the fair value of hedged items, attributed to the hedge risk was a $290 million loss (30 September 2009: $129 million gain).

***Cash flow hedges***

The NZ Banking Group hedges a portion of the cash flows from floating-rate customer deposits and term deposits from customers using swaps. There were no material transactions for which cash flow hedge accounting had to be ceased during the year ended 30 September 2010 as a result of highly probable cash flows no longer being expected to occur. The NZ Banking Group also hedges exposure to foreign currency principal and interest cash flows from floating–rate medium-term debt issuance through the use of cross currency derivatives.

***Dual fair value and cash flow hedges***

The NZ Banking Group hedges foreign currency denominated medium-term debt issuance using cross currency interest rate derivatives, designated as fair value hedges of foreign interest rates and cash flow hedges of foreign exchange rates.

| | NZ Banking Group | | |
|---|---|---|---|
| | 2010 | | |
| | Notional $m | Fair Value Asset $m | Fair Value (Liability) $m |
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Futures | **5,663** | **-** | **(2)** |
| Forwards | **3,575** | **-** | **(7)** |
| Swaps | **228,661** | **4,593** | **(4,016)** |
| Options | **1,241** | **51** | **(28)** |
| **Foreign exchange derivatives** | | | |
| Forwards | **58,231** | **523** | **(529)** |
| Swaps | **27,912** | **345** | **(494)** |
| **Total held for trading derivatives** | **325,283** | **5,512** | **(5,076)** |
| **Fair value hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | **6,621** | **137** | **(151)** |
| **Foreign exchange derivatives** | | | |
| Swaps[1] | **2,557** | **22** | **(14)** |
| **Total fair value hedging derivatives** | **9,178** | **159** | **(165)** |
| **Cash flow hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | **4,727** | **5** | **(255)** |
| **Foreign exchange derivatives** | | | |
| Swaps | **311** | **9** | **(5)** |
| **Total cash flow hedging derivatives** | **5,038** | **14** | **(260)** |
| **Total derivatives** | **339,499** | **5,685** | **(5,501)** |

1 Included with foreign exchange swaps are derivatives designated in both cash flow and fair value hedge relationships under the dual designation strategy.

## Note 28 Derivative financial instruments (continued)

| | NZ Banking Group 2009 Notional $m | Fair Value Asset $m | Fair Value (Liability) $m |
|---|---|---|---|
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Futures | 13,491 | 9 | - |
| Forwards | 2,758 | 1 | - |
| Swaps | 211,487 | 4,393 | (3,521) |
| Options | 3,513 | 36 | (24) |
| **Foreign exchange derivatives** | | | |
| Forwards | 27,210 | 1,061 | (1,668) |
| Swaps | 23,076 | 805 | (1,070) |
| **Total held for trading derivatives** | 281,535 | 6,305 | (6,283) |
| **Fair value hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 10,061 | 18 | (368) |
| **Total fair value hedging derivatives** | 10,061 | 18 | (368) |
| **Cash flow hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 5,980 | 5 | (319) |
| **Total cash flow hedging derivatives** | 5,980 | 5 | (319) |
| **Total derivatives** | 297,576 | 6,328 | (6,970) |

| | NZ Branch 2010 Notional $m | Fair Value Asset $m | Fair Value (Liability) $m |
|---|---|---|---|
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Futures | **5,663** | **-** | **(2)** |
| Forwards | **3,575** | **-** | **(7)** |
| Swaps | **238,899** | **4,719** | **(4,422)** |
| Options | **1,241** | **51** | **(28)** |
| **Foreign exchange derivatives** | | | |
| Forwards | **58,231** | **523** | **(529)** |
| Swaps | **30,780** | **376** | **(513)** |
| **Total held for trading derivatives** | **338,389** | **5,669** | **(5,501)** |
| **Total derivatives** | **338,389** | **5,669** | **(5,501)** |

| | NZ Branch 2009 Notional $m | Fair Value Asset $m | Fair Value (Liability) $m |
|---|---|---|---|
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Futures | 13,491 | 9 | - |
| Forwards | 2,758 | 1 | - |
| Swaps | 227,004 | 4,394 | (4,208) |
| Options | 3,513 | 36 | (24) |
| **Foreign exchange derivatives** | | | |
| Forwards | 27,210 | 1,061 | (1,668) |
| Swaps | 23,076 | 805 | (1,070) |
| **Total held for trading derivatives** | 297,052 | 6,306 | (6,970) |
| **Total derivatives** | 297,052 | 6,306 | (6,970) |

# Note 28 Derivative financial instruments (continued)

Underlying cash flows from cash flow hedges, as a proportion of total cash flows, are expected to occur in the following periods:

| | NZ Banking Group | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | | | | | | | |
| | **Less Than 1 Month %** | **1 Month to 3 Months %** | **3 Months to 1 Year %** | **1 Year to 2 Years %** | **2 Years to 3 Years %** | **3 Years to 4 Years %** | **4 Years to 5 Years %** | **Over 5 Years %** |
| Cash inflows (assets) | **3** | **3** | **16** | **15** | **54** | **4** | **1** | **4** |
| Cash outflows (liabilities) | **5** | **4** | **22** | **20** | **41** | **4** | **1** | **3** |

| | NZ Banking Group | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2009 | | | | | | | |
| | Less Than 1 Month % | 1 Month to 3 Months % | 3 Months to 1 Year % | 1 Year to 2 Years % | 2 Years to 3 Years % | 3 Years to 4 Years % | 4 Years to 5 Years % | Over 5 Years % |
| Cash inflows (assets) | 4 | 3 | 19 | 28 | 23 | 12 | 5 | 6 |
| Cash outflows (liabilities) | 4 | 4 | 33 | 27 | 17 | 9 | 3 | 3 |

For the year ended 30 September 2010 no material loss was recognised due to hedge ineffectiveness on cash flow hedges (30 September 2009: nil) in the NZ Banking Group.

# Note 29 Fair value of financial instruments

Quoted market prices, when available, are used as the measure of fair values. However, for a significant portion of the NZ Banking Group's financial instruments, quoted market prices do not exist. For such financial instruments, fair values presented are estimates derived by reference to actual cash flows implicit in observable market prices or through modelling cash flows using appropriate financial markets pricing models. These techniques involve uncertainties and are affected by the assumptions used and judgments made regarding risk characteristics of various financial instruments, discount rates, estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates and the resulting fair values.

NZ IFRS 7 *Financial Instruments: Disclosure* requires the disclosure of the fair value of those financial instruments not already carried at fair value in the balance sheet. Fair value for financial instruments has been determined as follows:

## Certain short-term financial instruments

For cash and short-term liquid assets, amounts due from other banks with maturities of less than three months, and other types of short-term financial instruments recognised in the balance sheet under 'other assets' and 'other liabilities' the carrying amount is equivalent to fair value.

## Trading securities

For trading securities the fair values, which are also the carrying amounts, are based on quoted market prices.

## Floating rate financial instruments

For floating rate financial instruments (including variable rate loans which comprise a portion of the NZ Banking Group's loan portfolio) with no significant change in credit risk the carrying amount is a reasonable estimate of fair value.

## Due from other financial institutions and fixed rate loans

For amounts due from other financial institutions with maturities of three months or more and fully performing fixed rate loans the fair values have been estimated by reference to current rates at which similar advances would be made to financial institutions and other borrowers with a similar credit rating and the same remaining maturities. For amounts due from other financial institutions with maturities of less than three months the carrying value is a reasonable estimate of fair value.

## Due to other financial institutions, deposits and debt issues

The fair value of demand deposits is the amount payable on demand as at balance date. For other liabilities with maturities of less than three months the carrying amount is a reasonable estimate of fair value.

For liabilities with maturities of three months or longer fair values have been based on quoted market prices, where such prices exist. Otherwise, fair values have been estimated using the rates currently offered for similar liabilities of similar remaining maturities.

## Subordinated debentures

Subordinated debentures are carried at amortised cost which approximates the fair value.

## Exchange rate and interest rate contracts

For exchange rate and interest rate contracts, fair values were obtained from quoted market prices, discounted cash flow models or option pricing models as appropriate. The carrying amount and fair value for these contracts are included in derivative financial instruments and amounts due from/to related entities, as applicable.

## Other financial assets and liabilities

For all other financial assets and liabilities, the carrying amount approximates fair value. These items are either short-term in nature, reprice frequently or are of a high credit rating.

# Note 29 Fair value of financial instruments (continued)

## Interest rates used for determining fair value

The following rates used to discount estimated cash flows, where applicable, are based on the wholesale markets yield curve at the reporting date plus an appropriate constant credit spread:

| | NZ Banking Group and NZ Branch | |
|---|---|---|
| | **2010 %** | 2009 % |
| Loans | 3.12 - 9.28 | 3.88 - 9.51 |
| Deposits | 0.06 - 7.85 | 2.48 - 7.85 |
| Debt issues | 0.28 - 8.81 | 0.06 - 6.35 |

The tables below summarise the categories of financial instruments and the carrying value and fair value of all financial instruments of the NZ Banking Group and the NZ Branch.

| | **NZ Banking Group 2010** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Classified at Fair Value through Profit or Loss** | | | | | | | |
| | **Held for Trading $m** | **Designated upon Initial Recognition $m** | **Hedging $m** | **Loans and Receivables $m** | **Available-for-sale Financial Assets $m** | **Financial Liabilities at Amortised Cost $m** | **Total Carrying Amount $m** | **Estimated Fair Value $m** |
| **Financial assets** | | | | | | | | |
| Cash and balances with central banks | - | - | - | **1,570** | - | - | **1,570** | **1,570** |
| Due from other financial institutions | - | - | - | **36** | - | - | **36** | **36** |
| Derivative financial instruments | **5,512** | - | **173** | - | - | - | **5,685** | **5,685** |
| Trading securities and other financial assets designated at fair value | **5,630** | - | - | - | - | - | **5,630** | **5,630** |
| Available-for-sale securities | - | - | - | - | **44** | - | **44** | **44** |
| Loans | - | - | - | **56,738** | - | - | **56,738** | **56,898** |
| Life insurance assets | - | **133** | - | - | - | - | **133** | **133** |
| Due from related entities | **1,360** | - | - | **195** | - | - | **1,555** | **1,555** |
| Other assets | - | - | - | **197** | - | - | **197** | **197** |
| **Total financial assets** | **12,502** | **133** | **173** | **58,736** | **44** | - | **71,588** | **71,748** |
| **Financial liabilities** | | | | | | | | |
| Due to other financial institutions | - | - | - | - | - | **794** | **794** | **794** |
| Deposits at fair value | **2,453** | - | - | - | - | - | **2,453** | **2,453** |
| Deposits at amortised cost | - | - | - | - | - | **35,567** | **35,567** | **35,610** |
| Derivative financial instruments | **5,076** | - | **425** | - | - | - | **5,501** | **5,501** |
| Trading liabilities and other financial liabilities designated at fair value | **239** | - | - | - | - | - | **239** | **239** |
| Debt issues | - | **6,546** | - | - | - | **8,893** | **15,439** | **16,487** |
| Other liabilities | - | - | - | - | - | **639** | **639** | **639** |
| Subordinated debentures | - | - | - | - | - | **819** | **819** | **783** |
| Due to related entities | **1,764** | - | - | - | - | **5,239** | **7,003** | **7,003** |
| **Total financial liabilities** | **9,532** | **6,546** | **425** | - | - | **51,951** | **68,454** | **69,509** |

# Note 29 Fair value of financial instruments (continued)

| | NZ Banking Group 2009 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Classified at Fair Value through Profit or Loss | | | | | | | |
| | Held for Trading $m | Designated upon Initial Recognition $m | Hedging $m | Loans and Receivables $m | Available-for-Sale Financial Assets $m | Financial Liabilities at Amortised Cost $m | Total Carrying Amount $m | Estimated Fair Value $m |
| **Financial assets** | | | | | | | | |
| Cash and balances with central banks | - | - | - | 798 | - | - | 798 | 798 |
| Due from other financial institutions | - | - | - | 843 | - | - | 843 | 843 |
| Derivative financial instruments | 6,305 | - | 23 | - | - | - | 6,328 | 6,328 |
| Trading securities and other financial assets designated at fair value | 5,405 | - | - | - | - | - | 5,405 | 5,405 |
| Available-for-sale securities | - | - | - | - | 37 | - | 37 | 37 |
| Loans | - | - | - | 55,592 | - | - | 55,592 | 55,975 |
| Life insurance assets | - | 113 | - | - | - | - | 113 | 113 |
| Due from related entities | 2,439 | - | - | 320 | - | - | 2,759 | 2,759 |
| Other assets | - | - | - | 498 | - | - | 498 | 498 |
| **Total financial assets** | 14,149 | 113 | 23 | 58,051 | 37 | - | 72,373 | 72,756 |
| **Financial liabilities** | | | | | | | | |
| Due to other financial institutions | - | - | - | - | - | 485 | 485 | 485 |
| Deposits at fair value | 3,773 | - | - | - | - | - | 3,773 | 3,773 |
| Deposits at amortised cost | - | - | - | - | - | 32,639 | 32,639 | 32,689 |
| Derivative financial instruments | 6,283 | - | 687 | - | - | - | 6,970 | 6,970 |
| Trading liabilities and other financial liabilities designated at fair value | 2,698 | - | - | - | - | - | 2,698 | 2,698 |
| Debt issues | - | 6,082 | - | - | - | 6,287 | 12,369 | 12,540 |
| Other liabilities | - | - | - | - | - | 633 | 633 | 633 |
| Subordinated debentures | - | - | - | - | - | 790 | 790 | 718 |
| Due to related entities | 2,960 | - | - | - | - | 5,713 | 8,673 | 8,673 |
| **Total financial liabilities** | 15,714 | 6,082 | 687 | - | - | 46,547 | 69,030 | 69,179 |

| | NZ Branch 2010 | | | | |
|---|---|---|---|---|---|
| | **Classified at Fair Value through Profit or Loss – Held for Trading $m** | **Loans and Receivables $m** | **Financial Liabilities at Amortised Cost $m** | **Total Carrying Amount $m** | **Estimated Fair Value $m** |
| **Financial assets** | | | | | |
| Cash and balances with central banks | **-** | **1,048** | **-** | **1,048** | **1,048** |
| Due from other financial institutions | **-** | **33** | **-** | **33** | **33** |
| Derivative financial instruments | **5,669** | **-** | **-** | **5,669** | **5,669** |
| Trading securities and other financial assets designated at fair value | **3,042** | **-** | **-** | **3,042** | **3,042** |
| Loans | **-** | **6,699** | **-** | **6,699** | **6,704** |
| Due from related entities | **2,471** | **2,946** | **-** | **5,417** | **5,417** |
| Other assets | **-** | **49** | **-** | **49** | **49** |
| **Total financial assets** | **11,182** | **10,775** | **-** | **21,957** | **21,962** |
| **Financial liabilities** | | | | | |
| Due to other financial institutions | **-** | **-** | **794** | **794** | **794** |
| Deposits at fair value | **463** | **-** | **-** | **463** | **463** |
| Deposits at amortised cost | **-** | **-** | **5,091** | **5,091** | **5,090** |
| Derivative financial instruments | **5,501** | **-** | **-** | **5,501** | **5,501** |
| Trading liabilities and other financial liabilities designated at fair value | **239** | **-** | **-** | **239** | **239** |
| Other liabilities | **-** | **-** | **129** | **129** | **129** |
| Subordinated debentures | **-** | **-** | **819** | **819** | **783** |
| Due to related entities | **1,786** | **-** | **4,676** | **6,462** | **6,462** |
| **Total financial liabilities** | **7,989** | **-** | **11,509** | **19,498** | **19,461** |

## Note 29 Fair value of financial instruments (continued)

| | NZ Branch | | | | |
|---|---|---|---|---|---|
| | 2009 | | | | |
| | Classified at Fair Value through Profit or Loss – Held for Trading $m | Loans and Receivables $m | Financial Liabilities at Amortised Cost $m | Total Carrying Amount $m | Estimated Fair Value $m |
| **Financial assets** | | | | | |
| Cash and balances with central banks | - | 584 | - | 584 | 584 |
| Due from other financial institutions | - | 841 | - | 841 | 841 |
| Derivative financial instruments | 6,306 | - | - | 6,306 | 6,306 |
| Trading securities and other financial assets designated at fair value | 984 | - | - | 984 | 984 |
| Loans | - | 7,583 | - | 7,583 | 7,583 |
| Due from related entities | 4,133 | 3,162 | - | 7,295 | 7,295 |
| Other assets | - | 357 | - | 357 | 357 |
| **Total financial assets** | 11,423 | 12,527 | - | 23,950 | 23,950 |
| **Financial liabilities** | | | | | |
| Due to other financial institutions | - | - | 485 | 485 | 485 |
| Deposits at fair value | 125 | - | - | 125 | 125 |
| Deposits at amortised cost | - | - | 3,791 | 3,791 | 3,790 |
| Derivative financial instruments | 6,970 | - | - | 6,970 | 6,970 |
| Trading liabilities and other financial liabilities designated at fair value | 813 | - | - | 813 | 813 |
| Other liabilities | - | - | 122 | 122 | 122 |
| Subordinated debentures | - | - | 790 | 790 | 718 |
| Due to related entities | 2,999 | - | 4,957 | 7,956 | 7,956 |
| **Total financial liabilities** | 10,907 | - | 10,145 | 21,052 | 20,979 |

***Fair valuation control framework***

The NZ Banking Group uses a well established Fair Valuation Control Framework to determine the fair value of financial assets and liabilities. The framework consists of policies and procedures that ensure the NZ Banking Group is in compliance with relevant accounting, industry and regulatory standards. This framework includes details on the approach taken with respect to the revaluation of financial instruments, independent price verification, fair value adjustments and financial reporting.

The method of determining a fair value according to the Fair Valuation Control Framework falls into one of two main approaches:

- Mark-to–market: where the valuation uses independent, unadjusted, quoted market prices.
- Mark–to-model: where valuation techniques are used to determine the valuation.

Valuation techniques often require adjustments to ensure correct fair value representation. The NZ Banking Group's valuation adjustments include:

- Credit valuation adjustment: Some market and model derived valuations assume similar credit quality for all counterparties. To correct for this assumption, an adjustment is employed on the majority of derivative positions which reflects the market view of both the counterparty credit risk for derivatives with a positive mark-to-market and recorded as assets ('**CVA**'), and for the NZ Banking Group credit risk for derivatives with a negative mark-to-market and recorded as liabilities ('**DVA**'). The NZ Banking Group uses a Monte Carlo simulation methodology to calculate the expected future credit exposure for all derivative exposures including inputs regarding probabilities of default ('**PD**') and loss given default ('**LGD**'). PDs are derived from market observed credit spreads by reference to credit default swap ('**CDS**') sector curves for the relevant tenors to calculate CVA, and the NZ Banking Group's CDS curve for the relevant tenors to calculate DVA. PDs are then applied to the horizon of potential exposures to derive both the CVA and DVA.
- Bid-offer spreads adjustment: The fair value of financial assets and liabilities should reflect bid prices for assets and offer prices for liabilities. Prices are adjusted to reflect current bid-offer spreads.
- Single currency basis risk adjustment: Currently some NZ Banking Group valuation techniques use projected cash flows generated from standard curves. Often these standard curves do not fit the payment frequency of the valued instrument. A single currency basis risk adjustment is made to reflect the difference in payment frequency. Observed market data of single currency basis swaps is used to calculate the adjustment.

The fair values of large holdings of financial instruments are based on a multiple of the estimated value of a single instrument and do not include block adjustments for the size of the holding.

***Fair value hierarchy***

The NZ Banking Group categorises all fair value measurements according to the following fair value hierarchy:

- Quoted market price (Level 1)

  This valuation technique uses recent unadjusted quoted prices for identical assets or liabilities in active markets where the price represents actual and regularly occurring market transactions on an arm's length basis. Financial instruments included in this category are spot and exchange traded derivatives for commodities, foreign exchange and interest rate products.

# Note 29 Fair value of financial instruments (continued)

- Valuation technique using observable inputs (Level 2)

  This valuation technique is used for financial instruments where quoted market prices are not available so prices are derived from standard valuation models, and inputs to these models are directly observable. The valuation techniques include the use of discounted cash flow analysis, option pricing models and other valuation techniques widely used and accepted by market participants. The financial instruments included in this category are mainly over the counter derivatives with observable market inputs; trading securities including government bonds, semi-government bonds, corporate fixed rate bonds and floating rate notes ('**FRN**'); and derivatives including interest rate swaps, foreign exchange swaps, interest rate forwards, foreign exchange forwards, interest rate futures, and interest rate options.
- Valuation technique with significant non-observable inputs (Level 3)

  This valuation technique is used where at least one significant input is not observable and reliance is placed on reasonable assumptions based on market conditions. These estimates are calibrated against industry standards, economic models and observable transaction prices where possible. Financial instruments included in this category show illiquidity in the market. Some valuations rely on estimation from related markets or proxies. Financial instruments included in this category are long-dated NZD caps and inflation-indexed derivative instruments.

***Valuation techniques, valuation inputs and asset classification***

A variety of valuation techniques are used to derive the fair value of each instrument. Mark-to-market is the preferred valuation technique for all products. However when markets are illiquid and prices not quoted modelling techniques are used to derive fair value. The specific valuation techniques, the observability of the inputs used in valuation models and the subsequent classification for each significant product category is outlined below:

*Interest rate ('**IR**') derivatives*

- Exchange traded IR options and futures are liquid and their prices are observable. No modelling or assumptions are used in their valuation and therefore IR options and futures are categorised as Level 1 instruments.
- Other interest rate derivatives are products with a pay-off linked to interest rates i.e. New Zealand Bank Bill Reference Rate ('**BKBM**') or LIBOR or inflation rates. These products include interest rate and inflation swaps, swaptions, caps, floors, collars and other complex interest rate derivatives. For these instruments as market prices are unavailable, the NZ Banking Group uses valuation models to derive fair value. The models are industry standard and mostly employ a Black-Scholes framework to calculate the expected future value of payments by product, which is discounted back to a present value. The model's interest rate inputs are benchmark interest rates such as BKBM and active broker quoted interest rates in the swap, bond and futures markets. Interest rate volatilities are sourced through a consensus data provider. As such the input parameters into the models are deemed observable and therefore other interest rate derivatives are categorised as Level 2 instruments.

*Foreign exchange ('**FX**') products*

- There are observable markets for FX spot contracts in the world's major currencies. No modelling or assumptions are used in the valuation of these instruments. These assets are therefore categorised as Level 1 instruments.
- FX swaps and forwards are not traded on exchanges and are not generally liquid. FX swap and forward valuations are derived from consensus data providers. Both simple and complex derivatives are valued using industry standard models which revolve around a Black-Scholes framework. The inputs to the calculation include FX spot rates, interest rates and FX volatilities. In general, these inputs are market observable or provided by consensus data providers. Therefore, FX swaps, forwards and other foreign exchange derivatives are categorised as Level 2 instruments.

*Debt market products*

Government bonds, corporate bonds, commercial paper and notes generally do not have quoted market prices. The NZ Banking Group uses valuation models to derive the fair value of these instruments. The valuation techniques are standard and mainly use a discounted cash flow approach. The main model inputs are observed instrument data used to derive the discount curves and therefore debt market products are classified as Level 2 instruments.

*Certificates of deposit*

The fair value of certificates of deposit uses a discounted cash flow analysis using markets rates offered for deposits of similar remaining maturities and are therefore classified as Level 2 instruments.

*Debt issues at fair value*

Where a quoted price is not available the fair value of debt issues uses a discounted cash flow approach, using a discount rate which reflects the terms of the instrument and the timing of cash flows adjusted for market observable changes in the applicable credit rating of the NZ Banking Group. These instruments are therefore classified as Level 2 instruments.

***Disclosure of fair value***

Due to the number of different valuation models used and the underlying assumptions made regarding inputs selected, such as timing and amounts of future cash flows, discount rates, credit risk and volatility, it is often difficult to compare the fair value information disclosed here against fair value information disclosed by other financial institutions.

There were no material amounts of changes in fair value, estimated using a valuation technique but incorporating significant non-observable inputs, that were recognised in the income statements of the NZ Banking Group and the NZ Branch during the year ended 30 September 2010 (30 September 2009: nil).

There have been no significant transfers between Levels 1 and 2 during the year ended 30 September 2010 (30 September 2009: nil). There have also been no significant transfers into/out of Level 3 during the year ended 30 September 2010 (30 September 2009: nil).

## Note 29 Fair value of financial instruments (continued)

The following table summarises the basis for the determination of the fair values of financial instruments that are measured at fair value after initial recognition:

| | NZ Banking Group | | | | NZ Branch | | | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | | | | 2010 | | | |
| | Quoted Market Prices $m | Valuation Techniques (Market Observable Inputs) $m | Valuation Techniques (Non-market Observable Inputs)[1] $m | Total $m | Quoted Market Prices $m | Valuation Techniques (Market Observable Inputs) $m | Valuation Techniques (Non-market Observable Inputs)[1] $m | Total $m |
| **Financial assets** | | | | | | | | |
| Derivative financial instruments | **7** | **5,676** | **2** | **5,685** | **7** | **5,660** | **2** | **5,669** |
| Trading securities and other financial assets designated at fair value | **-** | **5,630** | **-** | **5,630** | **-** | **3,042** | **-** | **3,042** |
| Available-for-sale securities | **44** | **-** | **-** | **44** | **-** | **-** | **-** | **-** |
| Life insurance assets | **133** | **-** | **-** | **133** | **-** | **-** | **-** | **-** |
| Due from related entities | **3** | **1,357** | **-** | **1,360** | **3** | **2,468** | **-** | **2,471** |
| **Total financial assets carried at fair value** | **187** | **12,663** | **2** | **12,852** | **10** | **11,170** | **2** | **11,182** |
| **Financial liabilities** | | | | | | | | |
| Deposits at fair value | **-** | **2,453** | **-** | **2,453** | **-** | **463** | **-** | **463** |
| Derivative financial instruments | **5** | **5,490** | **6** | **5,501** | **5** | **5,490** | **6** | **5,501** |
| Trading liabilities and other financial liabilities designated at fair value | **-** | **239** | **-** | **239** | **-** | **239** | **-** | **239** |
| Debt issues at fair value | **-** | **6,546** | **-** | **6,546** | **-** | **-** | **-** | **-** |
| Due to related entities | **20** | **1,744** | **-** | **1,764** | **20** | **1,766** | **-** | **1,786** |
| **Total financial liabilities carried at fair value** | **25** | **16,472** | **6** | **16,503** | **25** | **7,958** | **6** | **7,989** |

1 Derivative balances within this category of the fair value hierarchy are not material to the total derivative balance.

| | NZ Banking Group | | | | NZ Branch | | | |
|---|---|---|---|---|---|---|---|---|
| | 2009 | | | | 2009 | | | |
| | Quoted Market Prices $m | Valuation Techniques (Market Observable Inputs) $m | Valuation Techniques (Non-market Observable Inputs)[1] $m | Total $m | Quoted Market Prices $m | Valuation Techniques (Market Observable Inputs) $m | Valuation Techniques (Non-market Observable Inputs)[1] $m | Total $m |
| **Financial assets** | | | | | | | | |
| Derivative financial instruments | 26 | 6,302 | - | 6,328 | 26 | 6,280 | - | 6,306 |
| Trading securities and other financial assets designated at fair value | - | 5,405 | - | 5,405 | - | 984 | - | 984 |
| Available-for-sale securities | 37 | - | - | 37 | - | - | - | - |
| Life insurance assets | 113 | - | - | 113 | - | - | - | - |
| Due from related entities | 29 | 2,410 | - | 2,439 | 29 | 4,104 | - | 4,133 |
| **Total financial assets carried at fair value** | 205 | 14,117 | - | 14,322 | 55 | 11,368 | - | 11,423 |
| **Financial liabilities** | | | | | | | | |
| Deposits at fair value | - | 3,773 | - | 3,773 | - | 125 | - | 125 |
| Derivative financial instruments | 6 | 6,964 | - | 6,970 | 6 | 6,964 | - | 6,970 |
| Trading liabilities and other financial liabilities designated at fair value | - | 2,698 | - | 2,698 | - | 813 | - | 813 |
| Debt issues at fair value | - | 6,082 | - | 6,082 | - | - | - | - |
| Due to related entities | 9 | 2,951 | - | 2,960 | 9 | 2,990 | - | 2,999 |
| **Total financial liabilities carried at fair value** | 15 | 22,468 | - | 22,483 | 15 | 10,892 | - | 10,907 |

## Note 30 Commitments and contingent liabilities

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Commitments for capital expenditure** | | | | |
| Due within one year | **30** | 16 | **-** | - |
| **Other expenditure commitments:** | | | | |
| One year or less | **88** | 85 | **-** | - |
| Between one and five years | **109** | 182 | **-** | - |
| Over five years | **4** | 4 | **-** | - |
| **Total other expenditure commitments** | **201** | 271 | **-** | - |
| **Lease commitments (all leases are classified as operating leases)** | | | | |
| Premises and sites | **205** | 203 | **-** | - |
| Motor vehicles | **6** | 4 | **-** | - |
| **Total lease commitments** | **211** | 207 | **-** | - |
| **Lease commitments are due as follows:** | | | | |
| One year or less | **43** | 39 | **-** | - |
| Between one and five years | **94** | 86 | **-** | - |
| Over five years | **74** | 82 | **-** | - |
| **Total lease commitments** | **211** | 207 | **-** | - |
| **Contingent liabilities and commitments** | | | | |
| Direct credit substitutes | **319** | 331 | **268** | 285 |
| Loan commitments with certain drawdown | **105** | 208 | **-** | - |
| Transaction related contingent items | **665** | 649 | **411** | 370 |
| Underwriting and sub-underwriting facilities | **-** | - | **-** | - |
| Short-term, self liquidating trade related contingent liabilities | **892** | 740 | **134** | 62 |
| Other commitments to provide financial services which have an original maturity of one year or more | **9,246** | 9,884 | **3,321** | 3,381 |
| Other commitments with original maturity of less than one year or which can be unconditionally cancelled at any time | **6,722** | 6,134 | **2,235** | 2,157 |
| **Total contingent liabilities and commitments** | **17,949** | 17,946 | **6,369** | 6,255 |

The NZ Banking Group is a party to financial instruments with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers and in managing its own risk profile. These financial instruments include commitments to extend credit, financial guarantees, standby letters of credit and underwriting facilities.

The NZ Banking Group's exposure to credit loss in the event of non-performance by the other party to such financial instruments is represented by the contract or notional amount of those instruments. However, some commitments to extend credit and provide underwriting facilities can be cancelled or revoked at any time at the NZ Banking Group's option.

The NZ Banking Group uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet financial instruments.

The NZ Banking Group takes collateral where it is considered necessary to support both on and off-balance sheet financial instruments with credit risk. The NZ Banking Group evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral taken, if deemed necessary, on the provision of a financial facility is based on management's credit evaluation of the counterparty. The collateral taken varies, but may include cash deposits, receivables, inventory, plant and equipment, real estate and investments.

The NZ Banking Group is obliged to repurchase securitised loans held by the Westpac Home Loan Trust ('**HLT**') or the Westpac NZ Securitisation Limited securitisation programme, where it is discovered within 120 days of sale that those loans were not eligible for sale when sold, or where the securitised loans cease to conform to certain terms and conditions of the Westpac NZ Securitisation Limited securitisation programme. It is not envisaged that any liability resulting in material loss to the Banking Group will arise from this obligation.

Westpac New Zealand guarantees commercial paper and other debt securities issued by its wholly owned subsidiary Westpac Securities NZ Limited, the proceeds of which, in accordance with Reserve Bank guidelines, are immediately on-lent to Westpac New Zealand. Guarantees outstanding as at 30 September 2010 were New Zealand dollar equivalent $13,114 million (30 September 2009: $10,168 million).

### Other contingent liabilities

The NZ Banking Group has other contingent liabilities in respect of actual and potential claims and proceedings. An assessment of the NZ Banking Group's likely loss in respect of these claims has been made on a case-by-case basis and provision has been made in these financial statements, where appropriate.

On 23 December 2009 the NZ Banking Group reached a settlement with the New Zealand Commissioner of Inland Revenue ('**CIR**') of the previously reported proceedings relating to nine structured finance transactions undertaken between 1998 and 2002. Under the settlement, the NZ Banking Group agreed to pay the CIR 80% of the full amount of primary tax and interest and with no imposition of penalties. All proceedings have been discontinued and the other terms of the settlement are subject to confidentiality. The NZ Banking Group provided in full for the primary tax and interest claimed by the CIR as part of its 2009 result, and consequently there has been a write back through income tax expense in the year ended 30 September 2010.

Westpac (NZ) Investments Limited, a subsidiary of Westpac New Zealand, leases the majority of the properties occupied by the NZ Banking Group. As is normal practice the lease agreements contain 'make good' provisions, which require Westpac (NZ) Investments Limited, upon termination of a lease, to return the premises to the lessor in the original condition. The maximum amount payable by Westpac (NZ) Investments Limited upon vacation of all leased premises subject to these provisions as at 30 September 2010 was estimated to be $22 million (30 September 2009: $22 million). No amount for the $22 million in estimated maximum vacation payments has been recognised as the NZ Banking Group believes it is highly unlikely that Westpac (NZ) Investments Limited would incur a material operating loss as a result of such 'make good' provisions in the normal course of its business operations.

# Note 30 Commitments and contingent liabilities (continued)

**Other commitments**

As at 30 September 2010, the NZ Banking Group had commitments in respect of forward purchases and sales of foreign currencies, interest rate and currency swap transactions, futures and options contracts, provision of credit, underwriting facilities and other arrangements entered into in the normal course of business. The NZ Banking Group has management systems and operational controls in place to manage interest rate, currency and credit risk (please refer to Note 38). Accordingly, it is not envisaged that any liability resulting in material loss to the NZ Banking Group will arise from these transactions.

# Note 31 Segment information

The NZ Banking Group operates predominantly in the consumer banking, business banking and institutional banking sectors within New Zealand. On this basis no geographical segment information is provided.

The basis of segment reporting reflects the management of the business, rather than the legal structure of the NZ Banking Group. There is no difference in accounting measurement between the management and legal structures. The operating segment results have been presented on a management reporting basis and consequently internal charges and transfer pricing adjustments have been reflected in the performance of each operating segment. Intersegment pricing is determined on an arm's length basis.

With the adoption of NZ IFRS 8 *Operating Segments* ('**NZ IFRS 8**'), the basis used in identifying segment categories has been changed from previous reporting periods. The basis used in the current reporting period reflects the key revenue earning sectors that the NZ Banking Group operates in New Zealand.

The NZ Banking Group does not rely on any single major customer for its revenue base.

The NZ Banking Group's operating segments are defined by the customers they serve and the services they provide. The NZ Banking Group has identified the following main operating segments:

- Business Banking provides financial services for small to medium size enterprise customers, corporates and agricultural businesses. Business Banking also provides domestic transactional banking to the New Zealand Government.
- Retail Banking provides financial services for private individuals.
- Wealth provides financial services for high net worth individuals, funds management and insurance distribution.
- Institutional Banking provides a broad range of financial services to large corporate, institutional and government customers and the supply of derivatives and risk management products to the entire Westpac customer base in New Zealand.

Retail Banking and Wealth have been aggregated and disclosed as the Consumer Banking reportable segment. Business Banking and Institutional Banking are separately reportable segments.

Reconciling items primarily represent:

- non-material segments that do not meet the definition of operating segments under NZ IFRS 8;
- elimination entries on consolidation/aggregation of the results, assets and liabilities of the NZ Banking Group's controlled entities in the preparation of the financial statements of the NZ Banking Group; and
- results of certain business units excluded for management reporting purposes, but included within the financial statements of the NZ Banking Group for statutory financial reporting purposes.

The comparative information has been prepared based on the requirements of NZ IFRS 8.

| | NZ Banking Group | | | | |
|---|---|---|---|---|---|
| | 2010 | | | | |
| | Business Banking $m | Consumer Banking $m | Institutional Banking $m | Reconciling Items $m | Total $m |
| Revenue from external customers[1] | 1,773 | 3,318 | 638 | (1,225) | 4,504 |
| Internal revenue | 3 | 2 | (4) | (1) | - |
| **Total segment revenue** | 1,776 | 3,320 | 634 | (1,226) | 4,504 |
| Net interest income | 414 | 660 | 146 | 190 | 1,410 |
| Non-interest income | 82 | 272 | 147 | 31 | 532 |
| **Net operating income** | 496 | 932 | 293 | 221 | 1,942 |
| Depreciation | - | (2) | - | (22) | (24) |
| Software amortisation costs | - | - | - | (43) | (43) |
| Other operating expenses | (67) | (205) | (61) | (388) | (721) |
| **Total operating expenses** | (67) | (207) | (61) | (453) | (788) |
| **Impairment charges on loans** | (158) | (167) | 3 | (10) | (332) |
| **Share of profit of associate accounted for using equity method** | - | - | - | 1 | 1 |
| **Profit/(loss) before income tax expense** | 271 | 558 | 235 | (241) | 823 |
| Income tax expense | (82) | (156) | (72) | 250 | (60) |
| **Profit after income tax expense** | 189 | 402 | 163 | 9 | 763 |
| **Profit after income tax expense attributable to:** | | | | | |
| Head office account and owners of the NZ Banking Group | 189 | 399 | 163 | 9 | 760 |
| Non-controlling interests | - | 3 | - | - | 3 |
| | 189 | 402 | 163 | 9 | 763 |
| **Total gross loans** | 20,995 | 29,811 | 6,910 | (148) | 57,568 |
| **Total deposits** | 9,410 | 21,066 | 5,091 | 2,453 | 38,020 |

1 Revenue from external customers comprises interest income and non-interest income.

## Note 31 Segment information (continued)

| | NZ Banking Group | | | | |
|---|---|---|---|---|---|
| | 2009 | | | | |
| | Business Banking $m | Consumer Banking $m | Institutional Banking $m | Reconciling Items $m | Total $m |
| Revenue from external customers[1] | 1,983 | 3,688 | 884 | (1,323) | 5,232 |
| Internal revenue | 6 | 1 | (5) | (2) | - |
| **Total segment revenue** | 1,989 | 3,689 | 879 | (1,325) | 5,232 |
| Net interest income | 443 | 671 | 131 | 235 | 1,480 |
| Non-interest income | 90 | 308 | 214 | (2) | 610 |
| **Net operating income** | 533 | 979 | 345 | 233 | 2,090 |
| Depreciation | - | (2) | - | (19) | (21) |
| Software amortisation costs | - | - | - | (45) | (45) |
| Other operating expenses | (60) | (205) | (61) | (416) | (742) |
| **Total operating expenses** | (60) | (207) | (61) | (480) | (808) |
| **Impairment charges on loans** | (446) | (134) | (71) | (39) | (690) |
| **Profit/(loss) before income tax expense** | 27 | 638 | 213 | (286) | 592 |
| Income tax expense | (8) | (183) | (63) | (832) | (1,086) |
| **Profit/(loss) after income tax expense** | 19 | 455 | 150 | (1,118) | (494) |
| **Profit/(loss) after income tax expense attributable to:** | | | | | |
| Head office account and owners of the NZ Banking Group | 19 | 452 | 150 | (1,118) | (497) |
| Non-controlling interests | - | 3 | - | - | 3 |
| | 19 | 455 | 150 | (1,118) | (494) |
| **Total gross loans** | 20,293 | 28,236 | 7,732 | (58) | 56,203 |
| **Total deposits** | 8,738 | 20,109 | 3,791 | 3,774 | 36,412 |

1 Revenue from external customers comprises interest income and non-interest income.

## Note 32 Superannuation commitments

The NZ Banking Group has a hybrid (defined contribution and defined benefit) superannuation scheme for staff in New Zealand. Contributions, as specified in the rules of the scheme, are made by the NZ Banking Group as required. The defined benefit scheme has been closed to new members since 1 April 1990. An actuarial valuation of the scheme is undertaken periodically, with the last actuarial assessment of the funding status undertaken as at 30 June 2010. Contributions to the defined benefit scheme are at a rate sufficient to keep the scheme solvent, and contributions are made to the defined benefit scheme at the rate of 12% of members' salaries.

The NZ Banking Group has no material obligations in respect of post-retirement benefits other than pensions.

Amounts recognised in the balance sheet arising from the NZ Banking Group's obligations in respect of its defined benefit scheme are as follows:

| | NZ Banking Group | |
|---|---|---|
| | **2010 $m** | 2009 $m |
| Benefit obligation at end of the year | **108** | 96 |
| Fair value of scheme assets at end of the year | **(77)** | (76) |
| Net recognised liability | **31** | 20 |
| Contribution tax | **16** | 10 |
| **Net recognised liability including contribution tax** | **47** | 30 |
| **Movement in the net liability recognised in the balance sheet** | | |
| Opening liability with contribution tax | **30** | 64 |
| Superannuation expense with contribution tax | **(1)** | 2 |
| Employer contributions including contribution tax | **(9)** | (6) |
| Amount of losses/(gains) recognised in equity with contribution tax | **27** | (30) |
| **Closing liability with contribution tax** | **47** | 30 |
| **Superannuation expense recognised in the income statement:** | | |
| Current service cost | **1** | 1 |
| Interest cost | **3** | 5 |
| Expected return of fund assets | **(5)** | (5) |
| **Net defined benefit expense** | **(1)** | 1 |

## Note 32 Superannuation commitments (continued)

| | NZ Banking Group | |
|---|---|---|
| | **2010** **$m** | 2009 $m |
| **Change in present value of defined benefit obligation:** | | |
| Benefit obligation at beginning of the year | **96** | 117 |
| Current service cost | **1** | 1 |
| Interest cost | **3** | 5 |
| Actuarial loss/(gain) | **17** | (20) |
| Benefits paid | **(8)** | (8) |
| Exchange and other adjustments | **(1)** | 1 |
| **Benefit obligation at end of the year** | **108** | 96 |
| **Change in fair value of scheme assets:** | | |
| Fair value of scheme assets at beginning of the year | **76** | 74 |
| Expected return on scheme assets | **5** | 5 |
| Employer contributions | **6** | 5 |
| Actuarial loss | **(2)** | - |
| Benefits paid | **(8)** | (8) |
| **Fair value of scheme assets at end of the year** | **77** | 76 |
| **Amounts recognised in equity** | | |
| Cumulative amount of loss recognised in equity at beginning of the year | **-** | 20 |
| Immediate recognition of loss/(gain) | **19** | (20) |
| **Cumulative amount of loss recognised in equity at end of the year** | **19** | - |
| **Value of scheme assets** | | |
| Invested in Overseas Banking Group's debt and equity securities | **9** | 6 |
| **Actual return on scheme assets** | **3** | 5 |
| **Expected employer contributions (net)** | **4** | 6 |

| | NZ Banking Group | |
|---|---|---|
| | **2010** **%** | 2009 % |
| **Primary actuarial assumptions used in the above calculations:** | | |
| Discount rate | **3.7** | 4.0 |
| Expected return on scheme assets – active members (end of year) | **6.0** | 6.4 |
| Expected return on scheme assets – pensioners | **6.0** | 6.4 |
| Rate of increase in salaries | **3.5** | 2.0 |
| Rate of increase for pensions | **2.5** | 1.5 |
| **Asset allocation** | | |
| Cash | **0.9** | 1.3 |
| Equity instruments | **56.7** | 57.9 |
| Debt instruments | **42.4** | 40.8 |
| **Total asset allocation** | **100.0** | 100.0 |

| | NZ Banking Group | | | | |
|---|---|---|---|---|---|
| | **2010** **$m** | 2009 $m | 2008 $m | 2007 $m | 2006 $m |
| **Historical summary** | | | | | |
| Defined benefit scheme obligations | **108** | 96 | 117 | 110 | 131 |
| Scheme assets | **(77)** | (76) | (74) | (99) | (113) |
| **Net deficit** | **31** | 20 | 43 | 11 | 18 |
| **Experience adjustments on scheme assets** | **(2)** | - | (23) | 2 | 8 |
| **Experience adjustments on scheme liabilities** | **(17)** | 20 | (10) | 1 | 2 |

***Expected rate of return on assets assumptions***

The assumed return on assets reflects the average rate of earnings expected in the long-term on the scheme's assets. Accordingly this rate reflects allowances for tax and all investment expenses. The expected returns on assets were calculated as the weighted average return based on the benchmark asset allocation and estimates of the expected future return in each sector in each asset class (consistent with the inflation assumption).

# Note 33 Key management personnel disclosures

## Key management personnel compensation

Key management personnel are defined as being Directors and senior management of the NZ Banking Group. The information relating to the key management personnel disclosed includes transactions with those individuals, their close family members and their controlled entities.

| | NZ Banking Group | |
|---|---|---|
| | **Year Ended 30 September 2010 $'000** | Year Ended 30 September 2009 $'000 |
| Salaries and other short-term benefits | **8,311** | 8,184 |
| Post-employment benefits | **758** | 747 |
| Other termination benefits | **349** | - |
| Share-based payments | **3,772** | 2,913 |
| **Total key management compensation** | **13,190** | 11,844 |

Where the Directors of the Overseas Bank have received remuneration from the NZ Banking Group the amounts are included above. Details of Directors' remuneration are disclosed in the Overseas Banking Group's 30 September 2010 Annual Financial Report.

## Loans and deposits with key management personnel

All loans and deposits are made in the ordinary course of business of the NZ Banking Group, on an arm's length basis and on normal commercial terms and conditions. Loans are on terms of repayment that range between variable, fixed rate up to five years and interest only loans, all of which are in accordance with the NZ Banking Group's lending policies.

As at 30 September 2010 no provisions have been recognised in respect of loans given to key management personnel and their related parties (30 September 2009: nil).

## Other key management personnel transactions

All other transactions with key management personnel, their related entities and other related parties are conducted on an arm's length basis in the normal course of business and on commercial terms and conditions. These transactions principally involve the provision of financial and investment services.

# Note 34 Share-based payments

Selected executives and senior managers of the NZ Banking Group participate in the Overseas Bank's equity settled share-based compensation plans which are the Westpac Reward Plan ('**WRP**'), the Westpac Performance Plan ('**WPP**') and the Senior Officers' Share Purchase Scheme ('**SOSPS**'). The NZ Banking Group compensates the Overseas Bank for the equity granted to employees.

## (i) Westpac Reward Plan

The WRP was approved by shareholders at the Overseas Bank's 2006 Annual General Meeting. It provides the Overseas Bank with a mechanism for rewarding superior long-term performance from the most senior management in Australia, New Zealand and other countries.

Under the WRP senior managers may be invited to receive an award of performance share rights. The exercise price for performance share rights is nil. The share rights may vest over a three to five-year period from the commencement of the performance period, provided a performance hurdle of relative Total Shareholder Return ('**TSR**')[1] is met or exceeded by the Overseas Bank. The comparator group for TSR focuses on 10 Australian financial sector peers. Full vesting of share rights occurs when the Overseas Bank's TSR is at (or exceeds) the 75th percentile relative to the comparator group, scaling down to 50% vesting on a straight-line basis for median performance. Below median performance no vesting occurs.

For NZ Banking Group employees performance options with a three to five-year vesting period were granted under the WRP up until March 2009 and these continue to run their course. The exercise price for the performance options was set at the time of invitation based on a five-day weighted average price of the ordinary shares of the Overseas Bank.

The WRP vesting framework has been designed to strengthen the performance link over the longer term. Initial TSR performance is tested at the third anniversary of the commencement of the performance period, with subsequent performance testing possible at the fourth and fifth anniversaries of commencement of the performance period. Securities vest only if the Overseas Bank's TSR ranking is at or above the median of the comparator group at a performance test date. TSR performance is tested at subsequent performance test dates (where they exist) and further vesting may occur only if the TSR ranking has improved. The model encourages executives to focus on performance over the full five-year period.

Performance share rights and options will lapse where an employee leaves the Overseas Banking Group before the securities vest due to resignation or dismissal, unless the Board determines otherwise.

Upon exercising vested performance options or performance share rights, the employee has the right to take up his or her entitlement in whole or in part as fully paid ordinary shares. The exercise price of a performance option is payable at that time. A performance option or performance share right lapses if it is not exercised prior to the end of its term.

1 TSR measures a company's share price movement and accumulated dividend yields over a specific measurement period (i.e. the change in value of an investment in that company's shares) excluding tax effects.

## Note 34 Share-based payments (continued)

***WRP Performance options***

The following table sets out the details of outstanding performance options granted to employees of the NZ Banking Group under the WRP:

| Commencement Date | Latest Date for Exercise | Exercise Price A$ | Outstanding at Beginning of the Year | Transfers During the Year | Granted During the Year | Exercised During the Year | Lapsed During the Year | Outstanding at End of the Year | Outstanding and Exercisable at End of the Year |
|---|---|---|---|---|---|---|---|---|---|
| **17 December 2007** | **17 December 2017** | **30.10** | **74,852** | **(26,305)** | **-** | **-** | **-** | **48,547** | **-** |
| **1 October 2008** | **1 October 2018** | **23.40** | **90,214** | **(15,533)** | **-** | **-** | **(4,505)** | **70,176** | **3,766** |
| **1 March 2009** | **1 March 2019** | **16.49** | **260,869** | **-** | **-** | **-** | **-** | **260,869** | **-** |
| **Totals for the year ended 30 September 2010** | | | **425,935** | **(41,838)** | **-** | **-** | **(4,505)** | **379,592** | **3,766** |
| **Weighted average exercise price ($)** | | | **20.35** | **27.00** | **-** | **-** | **23.40** | **19.51** | **23.40** |
| Totals for the year ended 30 September 2009 | | | 74,852 | - | 351,083 | - | - | 425,935 | - |
| Weighted average exercise price ($) | | | 31.10 | - | 18.27 | - | - | 20.35 | - |

The weighted average remaining contractual life of outstanding performance options at 30 September 2010 was 8.2 years (30 September 2009: 9.2 years).

***WRP Performance share rights***

The following table sets out the details of outstanding performance share rights granted to employees of the NZ Banking Group under the WRP:

| Commencement Date | Latest Date for Exercise | Outstanding at Beginning of the Year | Transfers During the Year | Granted During the Year | Exercised During the Year | Lapsed During the Year | Outstanding at End of the Year | Outstanding and Exercisable at End of the Year |
|---|---|---|---|---|---|---|---|---|
| **1 October 2009** | **1 October 2019** | **-** | **(3,385)** | **54,535** | **-** | **(1,554)** | **49,596** | **-** |
| **Totals for the year ended 30 September 2010** | | **-** | **(3,385)** | **54,535** | **-** | **(1,554)** | **49,596** | **-** |
| Totals for the year ended 30 September 2009 | | - | - | - | - | - | - | - |

The weighted average fair value at the grant date of performance share rights issued during the year was $15.31 per right (30 September 2009: nil). The weighted average remaining contractual life of outstanding performance share rights at 30 September 2010 was 9.0 years (30 September 2009: nil years).

### (ii) Westpac Performance Plan

For NZ Banking Group employees the WPP is currently used to provide long-term incentive awards or as a mechanism for the mandatory deferral of a portion of their short-term incentive in the form of share rights. These share rights are restricted for a period of one to three years, and vest subject to service conditions. Vested share rights can then be exercised to receive the underlying fully paid ordinary shares in the Overseas Bank. The exercise price for share rights is nil.

For NZ Banking Group employees performance options with a three to five-year vesting period were granted under the WPP up until December 2006, and these continue to run their course. The exercise price for the performance options was set at the time of invitation based on a five-day weighted average price of the ordinary shares of the Overseas Bank.

Awards of options or share rights under the WPP have a life of up to ten years from the grant date. A share right or an option lapses if it is not exercised prior to the end of its life.

***Performance options and performance share rights***

Performance options and performance share rights granted under the WPP to NZ Banking Group employees from 20 January 2003 to 15 December 2006 vest after a period of two to five years, but only if the performance hurdle has been met. The performance hurdle compares the Overseas Bank's TSR against the TSR of a defined ranking group of other companies.

- For grants made up to November 2005, the ranking group is the 50 largest companies listed on the ASX by market capitalisation at the commencement of the performance period (excluding the Overseas Bank, property and investment trusts and certain specified resource companies).
- For grants made from December 2005 to December 2006, 50% of the award is assessed against a TSR ranking group of the top 10 of the largest 13 Australian banking and financial sector companies by market capitalisation at the time of grant (excluding the Overseas Bank). The other 50% assesses TSR performance against a ranking group of the 50 largest companies on the ASX by market capitalisation at the time of grant (excluding the Overseas Bank, specified resource companies and the first ranking group).

Full vesting of performance options and performance share rights occurs when the Overseas Bank's relative TSR is at (or exceeds) the 75th percentile of the ranking group, scaling down to 50% vesting on a straight-line basis for median performance. In the event of below median performance, no vesting occurs.

Upon exercising vested performance options or performance share rights, the employee has the right to take up his or her entitlement in whole or in part as fully paid ordinary shares. The exercise price is payable at that time. A performance option or a performance right lapses if it is not exercised prior to the end of its term.

# Note 34 Share-based payments (continued)

***WPP Performance options***

The following table sets out the details of outstanding performance options granted to employees of the NZ Banking Group under the WPP:

| Commencement Date | Latest Date for Exercise | Exercise Price A$ | Outstanding at Beginning of the Year | Transfers During the Year | Granted During the Year | Exercised During the Year | Lapsed During the Year | Outstanding at End of the Year | Outstanding and Exercisable at End of the Year |
|---|---|---|---|---|---|---|---|---|---|
| **21 January 2004** | **21 January 2014** | **16.34** | **27,106** | **-** | **-** | **-** | **-** | **27,106** | **27,106** |
| **20 January 2005** | **20 January 2015** | **18.98** | **22,474** | **-** | **-** | **-** | **-** | **22,474** | **22,474** |
| **20 December 2005** | **20 December 2015** | **20.53** | **41,812** | **-** | **-** | **-** | **-** | **41,812** | **41,812** |
| **15 December 2006** | **15 December 2016** | **23.98** | **64,047** | **(21,349)** | **-** | **-** | **-** | **42,698** | **42,698** |
| **Totals for the year ended 30 September 2010** | | | **155,439** | **(21,349)** | **-** | **-** | **-** | **134,090** | **134,090** |
| **Weighted average exercise price ($)** | | | **21.00** | **23.98** | **-** | **-** | **-** | **20.52** | **20.52** |
| Totals for the year ended 30 September 2009 | | | 169,627 | - | - | (6,236) | (7,952) | 155,439 | 91,392 |
| Weighted average exercise price ($) | | | 20.06 | - | - | 18.21 | 21.67 | 21.00 | 18.91 |

The weighted average remaining contractual life of outstanding performance options at 30 September 2010 was 5.0 years (30 September 2009: 6.0 years).

***WPP Performance share rights***

The following table sets out the details of outstanding performance share rights granted to employees of the NZ Banking Group under the WPP:

| Commencement Date | Latest Date for Exercise | Outstanding at Beginning of the Year | Transfers During the Year | Granted During the Year | Exercised During the Year | Lapsed During the Year | Outstanding at End of the Year | Outstanding and Exercisable at End of the Year |
|---|---|---|---|---|---|---|---|---|
| **20 January 2003** | **20 January 2013** | **22,596** | **-** | **-** | **(11,133)** | **-** | **11,463** | **11,463** |
| **21 January 2004** | **21 January 2014** | **45,483** | **3,756** | **-** | **(37,119)** | **-** | **12,120** | **12,120** |
| **20 January 2005** | **20 January 2015** | **40,095** | **3,832** | **-** | **(26,340)** | **-** | **17,587** | **17,587** |
| **20 December 2005** | **20 December 2015** | **69,098** | **7,411** | **-** | **(35,230)** | **-** | **41,279** | **39,613** |
| **15 December 2006** | **15 December 2016** | **4,333** | **-** | **-** | **-** | **-** | **4,333** | **4,333** |
| **Totals for the year ended 30 September 2010** | | **181,605** | **14,999** | **-** | **(109,822)** | **-** | **86,782** | **85,116** |
| Totals for the year ended 30 September 2009 | | 335,698 | - | - | (143,344) | (10,749) | 181,605 | 181,605 |

The weighted average share price of performance share rights exercised during the year was $25.02 per right (30 September 2009: $18.71 per right). The weighted average remaining contractual life of outstanding performance share rights at 30 September 2010 was 4.4 years (30 September 2009: 5.2 years).

***WPP Unhurdled share rights***

The WPP is also used for key NZ Banking Group employees who receive unhurdled share rights that vest after a set period of one to three years' service with the Overseas Banking Group. After the restriction period applying to them has passed, vested unhurdled share rights can be exercised to receive the underlying fully paid ordinary shares. The exercise price for share rights is nil.

## Note 34 Share-based payments (continued)

The following tables summarise grants of unhurdled share rights to NZ Banking Group employees under the WPP:

| Commencement Date | Latest Date for Exercise | Outstanding at Beginning of the Year | Transfers During the Year | Granted During the Year | Exercised During the Year | Lapsed During the Year | Outstanding at End of the Year | Outstanding and Exercisable at End of the Year |
|---|---|---|---|---|---|---|---|---|
| **15 December 2006** | **15 December 2016** | **123,157** | **7,702** | **-** | **(76,593)** | **(838)** | **53,428** | **53,428** |
| **2 April 2007** | **2 April 2017** | **1,577** | **-** | **-** | **-** | **-** | **1,577** | **1,577** |
| **3 September 2007** | **3 September 2017** | **6,660** | **-** | **-** | **-** | **-** | **6,660** | **6,660** |
| **1 November 2007** | **1 November 2017** | **1,862** | **-** | **-** | **(1,862)** | **-** | **-** | **-** |
| **17 December 2007** | **17 December 2017** | **141,595** | **6,556** | **-** | **(18,416)** | **(6,959)** | **122,776** | **12,824** |
| **1 July 2008** | **1 July 2018** | **10,752** | **-** | **-** | **-** | **-** | **10,752** | **10,752** |
| **1 September 2008** | **1 September 2018** | **8,876** | **-** | **-** | **-** | **-** | **8,876** | **5,560** |
| **1 October 2008** | **1 October 2018** | **89,095** | **-** | **-** | **-** | **(3,206)** | **85,889** | **2,913** |
| **1 December 2008** | **1 December 2018** | **10,868** | **-** | **-** | **(7,848)** | **-** | **3,020** | **-** |
| **1 January 2009** | **1 January 2019** | **6,677** | **-** | **-** | **-** | **-** | **6,677** | **-** |
| **1 February 2009** | **1 February 2019** | **3,014** | **-** | **-** | **-** | **-** | **3,014** | **-** |
| **1 March 2009** | **1 March 2019** | **140,140** | **60** | **-** | **(58,177)** | **-** | **82,023** | **-** |
| **1 June 2009** | **1 June 2019** | **5,681** | **-** | **-** | **-** | **-** | **5,681** | **5,681** |
| **1 October 2009** | **1 October 2019** | **-** | **(2,838)** | **167,142** | **-** | **(2,762)** | **161,542** | **-** |
| **1 November 2009** | **1 November 2019** | **-** | **-** | **43,129** | **-** | **-** | **43,129** | **-** |
| **1 January 2010** | **1 January 2020** | **-** | **-** | **6,446** | **-** | **-** | **6,446** | **-** |
| **1 April 2010** | **1 April 2020** | **-** | **-** | **11,029** | **-** | **-** | **11,029** | **-** |
| **Totals for the year ended 30 September 2010** | | **549,954** | **11,480** | **227,746** | **(162,896)** | **(13,765)** | **612,519** | **99,395** |
| Totals for the year ended 30 September 2009 | | 329,131 | - | 387,493 | (10,532) | (156,138) | 549,954 | 6,660 |

The weighted average fair value at the grant date of unhurdled share rights issued during the year was $21.80 per right (30 September 2009: $16.68 per right). The weighted average share price of unhurdled share rights exercised during the year was $24.57 per right (30 September 2009: $18.71 per right). The weighted average remaining contractual life of outstanding unhurdled share rights at 30 September 2010 was 8.1 years (30 September 2009: 8.0 years).

### (iii) Senior Officers' Share Purchase Scheme

The SOSPS was approved by shareholders in December 1998. The plan was closed to new invitations in 2002.

The plan provided for the allocation of share options to selected executives and senior officers to acquire fully paid ordinary shares issued by the Overseas Bank. No consideration was payable for the grant of an option. The exercise price for each option was based on the prevailing market price of the ordinary shares at the time of the invitation, and the options have a ten-year life. Options granted under the SOSPS were subject to a tenure-based hurdle.

Upon exercising an option, the officer has the right to take up his or her entitlement in whole or in part as fully paid ordinary shares upon payment of the exercise price. If an option is not exercised prior to the end of its term, it lapses.

The following table sets out details of outstanding options granted under the SOSPS:

| Commencement Date | Latest Date for Exercise | Exercise Price A$ | Outstanding at Beginning of the Year | Transfers During the Year | Granted During the Year | Exercised During the Year | Lapsed During the Year | Outstanding at End of the Year | Outstanding and Exercisable at End of the Year |
|---|---|---|---|---|---|---|---|---|---|
| **8 January 2001** | **8 January 2011** | **13.26** | **45,000** | **-** | **-** | **-** | **-** | **45,000** | **45,000** |
| **9 January 2002** | **9 January 2012** | **14.65** | **50,000** | **-** | **-** | **-** | **-** | **50,000** | **50,000** |
| **Totals for the year ended 30 September 2010** | | | **95,000** | **-** | **-** | **-** | **-** | **95,000** | **95,000** |
| **Weighted average exercise price ($)** | | | **13.99** | **-** | **-** | **-** | **-** | **13.99** | **13.99** |
| Totals for the year ended 30 September 2009 | | | 95,000 | - | - | - | - | 95,000 | 95,000 |
| Weighted average exercise price ($) | | | 13.99 | - | - | - | - | 13.99 | 13.99 |

The weighted average remaining contractual life of options at 30 September 2010 under the SOSPS was 0.8 years (30 September 2009: 1.8 years).

#### *Fair value at grant date*

The fair value of performance share rights granted during the year ended 30 September 2010, as included in the tables above, have been independently calculated at grant date using a Binomial/Monte Carlo simulation pricing model and for which:

- the assumptions included in the valuation of the awards of performance share rights under the WRP include a risk free interest rate of 4.99%, a dividend yield on the Overseas Bank's ordinary shares of 5% and a volatility in the Overseas Bank's share price of 30%;
- the assumptions included in the valuation of the awards of unhurdled share rights under the WPP include a risk free interest rate ranging from 4.2% to 4.7%, a dividend yield on the Overseas Bank's ordinary shares of 5% and a volatility in the Westpac ordinary share price of 30%;
- volatility has been assessed by considering the implied volatility of publicly traded options over the Overseas Bank's ordinary shares and the historic volatility of the market price of the Overseas Bank shares;
- other assumptions include volatilities of, and correlation factors between, share price movements of the ranking group members and the Overseas Bank, which are used to assess the impact of performance hurdles; and
- performance share rights have been valued assuming they will be exercised shortly after the vesting date.

# Note 35 Securitisation, funds management, other fiduciary activities and the marketing and distribution of insurance products

## Securitisation

As at 30 September 2010 the NZ Banking Group had securitised assets amounting to $416 million (30 September 2009: $523 million) which had been sold by the NZ Banking Group to external parties being the HLT and the Westpac Mortgage Investment Fund ('**MIF**') via the HLT. HLT and MIF were established, pursuant to trust deeds between BT Funds Management (NZ) Limited and The New Zealand Guardian Trust Company Limited, with the principal purpose of investing in home loans originated by the NZ Banking Group. The purchase of these home loans has been funded with the proceeds of units subscribed for, and issued to, retail investors in New Zealand. The NZ Banking Group receives fees for various services provided to HLT and MIF on an arm's length basis, including servicing fees. These fees are recognised over the financial periods in which the costs are borne. The securitised assets have been derecognised from the financial statements of the NZ Banking Group as the risks and rewards of the assets have been substantially transferred to external parties.

In addition the NZ Banking Group executed a $5.0 billion internal mortgage-backed securitisation in October 2008, which increased to $7.5 billion in December 2008. These securities are available for external issuance and the most senior rated securities ($7.25 billion) qualify as eligible collateral for repurchase agreements with the Reserve Bank. Reflecting the underlying movement in loan balances in the facility, the NZ Banking Group executed a $1.5 billion substitution to the internal mortgage-backed securitisation programme in September 2009 to ensure the appropriate quality and total value able to be securitised were maintained. Holding a portion of mortgages in securitised format enables the NZ Banking Group to maintain a readily available source of cash should market conditions become difficult. It takes advantage of the Reserve Bank's guidelines for its overnight reverse repo facility and open market operations, which allows banks in New Zealand to offer securitised residential mortgage assets from their own balance sheets as collateral for the Reserve Bank's repurchase agreements.

In addition to its own scheme, the NZ Banking Group provides financial services, on an arm's length basis, to customers' securitisation schemes.

## Funds management and other fiduciary activities

The NZ Banking Group conducts investment and other fiduciary activities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. These assets are not the property of the NZ Banking Group and accordingly are not included in these financial statements, with the exception of Term PIE.

Term PIE is managed by a member of the NZ Banking Group (refer to Note 27 for further details) and invests in deposits with Westpac New Zealand. Westpac New Zealand is considered to control Term PIE, and as such Term PIE is consolidated within the financial statements of the NZ Banking Group.

The value of assets subject to funds management and other fiduciary activities as at balance date were as follows:

| | **2010 $m** | 2009 $m |
|---|---|---|
| Private and priority | **628** | 558 |
| Retirement plans | **921** | 615 |
| Retail unit trusts | **1,339** | 1,527 |
| Wholesale unit trusts | **115** | 108 |
| Term PIE | **316** | 17 |
| **Total funds under management** | **3,319** | 2,825 |

The value of assets in retail units described above includes the assets of HLT and the MIF.

## Marketing and distribution of insurance products

The NZ Banking Group markets both life insurance and general insurance. The insurance products are distributed through the NZ Banking Group's distribution channels. The life insurance products are underwritten by Westpac Life-NZ-Limited. The general insurance products are fully underwritten by external third party insurance companies. Disclosure statements are made in all marketing material that the products are underwritten by those companies and that the Overseas Banking Group does not guarantee the obligations of, or any products issued by, those companies.

## Risk management

The NZ Banking Group's risk management framework (refer to Note 38) will help to minimise the possibility that any difficulties arising from the above activities would impact adversely on the NZ Banking Group.

Furthermore, during the year ended 30 September 2010:

- financial services provided by any member of the NZ Banking Group to entities which conduct the securitisation, funds management and other fiduciary activities described above, or on whose behalf insurance products are marketed or distributed, have been provided on arm's length terms and conditions and at fair value; and
- assets purchased from entities which conduct the securitisation, funds management and other fiduciary activities specified above, or on whose behalf insurance products are marketed or distributed, have been purchased on arm's length terms and conditions and at fair value.

## Note 36 Insurance business

The NZ Banking Group conducts insurance business through one of its controlled entities, Westpac Life-NZ-Limited. Its primary insurance activities are the development, underwriting and management of products under life insurance legislation which provide insurance cover against the risks of death and disability. It also manages a fire and general insurance agency arrangement and underwrites some redundancy and bankruptcy risks. The insurance business comprises less than one percent of the total assets of the NZ Banking Group.

The following table presents the aggregate amount of the NZ Banking Group's insurance business as at balance date:

| | **2010 $m** | 2009 $m |
|---|---|---|
| Total assets | **125** | 109 |
| As a percentage of total assets of the NZ Banking Group | **0.17%** | 0.15% |

The Overseas Bank does not conduct any insurance or non-financial activities in New Zealand outside of the NZ Banking Group.

## Note 37 Capital adequacy

| | **2010 Unaudited %** | 2009 Unaudited % |
|---|---|---|
| **Overseas Banking Group[1]** | | |
| Tier One Capital expressed as a percentage of risk-weighted exposures | **9.1** | 8.1 |
| Total Capital expressed as a percentage of risk-weighted exposures | **11.0** | 10.8 |
| **Overseas Bank (Extended Licensed Entity)[1]** | | |
| Tier One Capital expressed as a percentage of risk-weighted exposures | **9.2** | 9.9 |
| Total Capital expressed as a percentage of risk-weighted exposures | **11.5** | 12.4 |

1 The capital ratios represent information mandated by APRA.

Basel II came into force on 1 January 2008. The Overseas Banking Group received accreditation from APRA to apply the Advanced Internal Ratings Based ('**Advanced IRB**') and Advanced Measurement Approach ('**AMA**') methodologies for calculating regulatory capital (known as 'Advanced Accreditation') and is required by APRA to hold minimum capital at least equal to that specified under the Advanced IRB and AMA methodologies. Under New Zealand regulations, this methodology is referred to as the Basel II (internal models based) approach. With this accreditation, the Overseas Banking Group is required to disclose additional detailed information on its risk management practices and capital adequacy on a quarterly and a semi-annual basis. This information is made available to users via the Overseas Banking Group website (www.westpac.com.au). The aim is to allow the market to better assess the Overseas Banking Group's risk and reward assessment process and hence increase the scrutiny on these processes.

The Overseas Banking Group, and the Overseas Bank (Extended Licensed Entity) as defined by APRA, exceeded the minimum capital adequacy requirements as specified by APRA as at 30 September 2010. APRA specifies a minimum prudential capital ratio for the Overseas Banking Group, which is not made publicly available.

The Overseas Banking Group's approach seeks to balance the fact that capital is an expensive form of funding with the need to be adequately capitalised as an ADI. The Overseas Banking Group considers the need to balance efficiency, flexibility and adequacy when determining sufficiency of capital and when developing capital management plans.

The Overseas Banking Group details these considerations through an Internal Capital Adequacy Assessment Process, the key features of which include:

- consideration of both economic (calibrated to the Overseas Banking Group's AA debt rating) and regulatory capital driven requirements;
- a process which challenges the capital measures, coverage and requirements which incorporates a comparison of economic and regulatory requirements and the use of the Quantitative Scenario Analysis (stress testing) framework that considers amongst others, the impact of adverse economic scenarios that threaten the achievement of planned outcomes;
- consideration of the perspectives of external stakeholders such as regulators, rating agencies and equity investors; and
- the development of a capital management strategy including target capital ratios, capital buffers and contingency plans which guide the development of specific capital plans.

Current market conditions and the uncertainty around responses to the global financial crisis require the Overseas Banking Group to maintain conservative levels of capital.

## Note 38 Risk management

The NZ Banking Group regards the management of risk to be a fundamental management activity performed at all levels. Supporting this approach is a framework of core risk principles, policies and processes for measuring and monitoring risk ('**Risk Governance Framework**').

Westpac New Zealand, a member of the NZ Banking Group, is a locally incorporated registered bank. Westpac New Zealand's risk governance framework is closely aligned with that of the Overseas Banking Group, however, the Board of Westpac New Zealand is responsible for the risk management of that bank and its subsidiaries. For further information on the risk management policies applying to Westpac New Zealand refer to Westpac New Zealand's most recently published General Disclosure Statement.

### Risk governance framework

This Risk Governance Framework is approved by the Board and implemented through the Chief Executive for Westpac New Zealand ('**NZ CEO**') and the executive management team.

The Overseas Bank has a Board Audit Committee ('**Group BAC**') and a Board Risk Management Committee ('**Group BRMC**'). The Group BAC and Group BRMC are Board committees that are responsible for setting the Overseas Banking Group's risk appetite and overseeing the Overseas Banking Group's risk profile.

# Note 38 Risk management (continued)

The Group BAC comprises nine non-executive and independent Directors of the Overseas Bank. The Group BAC assists the Board in fulfilling its responsibilities in relation to the external reporting of financial information, internal control of operational risk and the efficiency and effectiveness of audit and compliance with laws and regulations.

The Group BRMC monitors the alignment of the Overseas Banking Group's risk profile with its risk appetite, which is defined by the Board Risk Appetite Statement, and with its current and future capital requirements. The Group BRMC receives regular reports from executive management on the effectiveness of their management of the Overseas Banking Group's material business risks.

The NZ CEO and executive management team are responsible for implementing the Board-approved Risk Management Framework and developing policies, controls, processes and procedures for identifying and managing risk arising from the NZ Banking Group's activities.

## Core risk principles

The NZ Banking Group's core risk principles are the key guidelines for all risk management within the NZ Banking Group. These principles reflect the standards and ideals expressed in the NZ Banking Group's vision, values and code of conduct and are embedded in all levels of risk management policy including rules, procedures and training.

The principles for managing risk are:

- aligning the NZ Banking Group's actions with its values, strategies and objectives;
- following ethical selling practices and delivering products and services that meet the needs of customers;
- accepting that with responsibility comes accountability;
- establishing clear decision-making criteria;
- ensuring that increased risk is rewarded with increased return; and
- identifying and managing risk in all areas of responsibility.

## Categories of risk

The key risks that the NZ Banking Group is subject to are specific banking risks and risks arising from the general business environment. The Risk Management Framework identifies four broad categories of risk:

- Credit risk: the risk of financial loss where a customer or counterparty fails to meet their financial obligations to the NZ Banking Group.
- Market risk: the risk to earnings from changes in market factors, such as foreign exchange rates, interest rates, commodity prices and equity prices. This includes interest rate risk in the banking book – the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities.
- Operational risk: the risk that arises from inadequate or failed internal processes, people and systems or from external events.
- Compliance risk: the risk of legal or regulatory sanction, financial or reputational loss arising from the NZ Banking Group's failure to apply the regulatory standards expected of the NZ Banking Group as a financial services group.
- Liquidity risk: the risk that the NZ Banking Group will be unable to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses.

Additional details surrounding the risk management activities relating to the management of these risks are disclosed below under the relevant headings.

## Group Assurance

Group Assurance for the Overseas Banking Group ('**Group Assurance**') comprises the Group Audit, Portfolio Risk Review and Model Risk Review functions. Group Audit provides an independent assessment of the adequacy and effectiveness of management's controls over operational, market, liquidity and compliance risks. Portfolio Risk Review provides an independent assessment of the effectiveness of the NZ Banking Group's credit management activities and the adequacy of credit provisioning. Model Risk Review provides an independent assessment on models used in the Risk Rating system and over compliance with Group model risk policy. There is a New Zealand Group Assurance function comprised of a New Zealand based Group Audit team, supported by the Overseas Banking Group's Portfolio Risk Review and Model Risk Review functions. Group Assurance reports on a quarterly basis, or more often as deemed appropriate, to the Overseas Bank's Board Audit Committee, to agree the budget and the annual assurance plan and to report its findings. In addition, the Overseas Bank's Board Audit Committee has private sessions with the General Manager Group Assurance. Furthermore, the General Manager Group Assurance reports into the Overseas Bank's Chief Financial Officer, a member of the Overseas Bank's Executive Team.

New Zealand Group Assurance, and Group Assurance as independent functions, have no direct authority over the activities of management. They have unlimited access to all the NZ Banking Group's activities, records, property and employees. The scope of responsibility of New Zealand Group Assurance covers systems of management control across all business activities and support functions at all levels of management within the NZ Banking Group. The level of operational risk determines the scope and frequency of individual audits. New Zealand Group Assurance periodically reviews the adequacy and effectiveness of the market risk and liquidity systems controls.

## Reviews in respect of risk management systems

New Zealand Group Assurance participates quarterly in the management assurance programme in order to assess the adequacy of the governance framework supporting operational risk management.

The Overseas Bank's Group Assurance Risk Review unit has a rolling review programme throughout the financial year, which includes reviews of credit and model risk. New Zealand Group Assurance, with support from the Overseas Bank's Group Assurance unit, also periodically reviews the NZ Banking Group's Operational, Market, Funding and Liquidity Risk Frameworks. These reviews are not conducted by a party which is external to the NZ Banking Group or the Overseas Bank, though they are independent and have no direct authority over the activities of management.

With a view to continuously improving risk management, Westpac New Zealand also commissioned two external risk reviews that concluded during the year ended 30 September 2010. The reviews were focused on risk governance and risk management practices. The findings of both reviews were considered by Westpac New Zealand's Board and by Westpac New Zealand's Executive Risk and Audit Committee ('**ERAC**'). Westpac New Zealand's risk framework has been improved and its risk management capability enhanced as a result of these reviews.

# Note 38 Risk management (continued)

## 38.1 Compliance and operational risk

ERAC is responsible for overseeing the effectiveness and implementation of the Operational Risk and Compliance Frameworks. ERAC meets quarterly and is required to escalate material matters to Westpac New Zealand's Board Risk Management Committee ('**BRMC**') and the Overseas Bank's Group Operational Risk and Compliance Committee.

### Compliance risk

The NZ Banking Group is subject to regulation and regulatory oversight. Any significant regulatory developments could have an adverse effect on how business is conducted and on results of operations. Business and earnings are also affected by the fiscal or other policies that are adopted by various regulatory authorities of the New Zealand Government, foreign governments and international agencies. The nature and impact of future changes in such policies are not predictable and are beyond the NZ Banking Group's control.

Effective compliance risk management enables the NZ Banking Group to identify emerging issues and where necessary put in place preventative measures.

### Operational risk

Operational risk arises from inadequate or failed internal processes, people and systems or from external events. Operational risk has the potential to negatively impact the NZ Banking Group's financial performance, customer service and/or reputation in the community, or cause other damage to the business as a result of the way business objectives are pursued.

The NZ Banking Group has adopted the Overseas Bank's Operational Risk Framework. This Framework outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management, operational risk in change, reporting and monitoring, and operational risk capital allocation.

All business and support areas are responsible for the ongoing identification, measurement, monitoring and mitigation of operational risk. On a quarterly basis, as part of the operational risk and compliance governance process, each of the business and support areas formally report on the effectiveness of their management of operational risk. This process is supported by active input from Operational Risk, Compliance and Group Audit. The results of this process are reported quarterly to the Overseas Bank's Group Operational Risk and Compliance Committee as well as Westpac New Zealand's ERAC chaired by the Westpac New Zealand Chief Risk Officer.

## 38.2 Funding and liquidity risk

Liquidity risk is the potential inability to fund assets and meet payment obligations as they come due, without incurring unacceptable losses. Liquidity risk is inherent in the NZ Banking Group's balance sheet due to mismatches in the maturity of assets and liabilities. This risk is managed through the Group BRMC approved liquidity framework.

Overall responsibility for liquidity risk management is delegated to the Overseas Banking Group's Treasury unit ('**Group Treasury**'), under oversight of the Overseas Banking Group's Asset and Liability Committee ('**Group ALCO**'). Group Treasury manages liquidity on a daily basis and submits monthly reports to Group ALCO and quarterly reports to the Group BRMC. Regular liquidity reports are provided to both the Reserve Bank and APRA. Westpac New Zealand's Chief Financial Officer is responsible for managing Westpac New Zealand's funding and liquidity position under Westpac New Zealand's Board Risk Committee approved liquidity risk framework.

Key aspects of the NZ Banking Group's liquidity risk management strategy are as follows:

***Liquidity risk management framework***

The Group BRMC has approved the liquidity risk management framework which applies to the NZ Banking Group. In addition, the Westpac New Zealand's Board Risk Committee has approved a liquidity risk management framework for Westpac New Zealand's balance sheet which is consistent with the Overseas Banking Group framework but also meets New Zealand specific requirements. The frameworks cover all aspects of liquidity risk including:

- roles and responsibilities;
- contingency planning;
- principal framework components, policies and reports along with the frequency of review and authority for approval;
- measurement and modelling approaches;
- scenarios covered;
- liquidity risk limits;
- reporting and escalation processes; and
- minimum holdings of liquidity assets.

The frameworks are reviewed at least every two years and submitted to the appropriate committee for approval.

***Daily liquidity modelling and reporting***

The NZ Banking Group's liquidity position is modelled and reported on a daily basis covering:

- the level of liquid assets held;
- a going concern scenario; and
- a crisis funding scenario.

Westpac New Zealand is required to comply with the quantitative measures specified in the Reserve Bank's 'Liquidity Policy' (BS13). Accordingly the following BS13 measures have been reported daily for Westpac New Zealand from 1 April 2010:

- the level of BS13 liquid assets held;
- the one-week mismatch ratio;
- the one-month mismatch ratio; and
- the one-year core funding ratio.

Reports are circulated daily to senior Treasury, Finance and Risk personnel within both Westpac New Zealand and the Overseas Banking Group. Specific oversight of the NZ Banking Group's liquidity risk profile is provided by the NZ Branch's Trading Risk Management unit.

# Note 38 Risk management (continued)

***Annual funding plan***

Each financial year Group Treasury undertakes a comprehensive review of the Overseas Banking Group's funding strategy. In addition, Westpac New Zealand's Treasury unit undertakes an annual review of Westpac New Zealand's funding strategy. These reviews cover areas such as:

- trends in global debt markets;
- funding alternatives;
- peer analysis;
- estimation of wholesale funding task;
- estimated market capacity;
- funding risk analysis; and
- allocation of funding costs.

The output of the reviews is the annual funding plans for the Overseas Banking Group and Westpac New Zealand. The funding plans are approved by the Group BRMC and Westpac New Zealand's Board Risk Management Committee respectively.

***Contingency planning***

Group Treasury maintains a crisis management action plan detailing the broad actions that should be taken in the event of a funding crisis affecting the Overseas Banking Group. Additionally, Westpac New Zealand's Treasury unit maintains a crisis management action plan specific to Westpac New Zealand. These action plans:

- define a committee of senior executives to manage a crisis;
- allocate responsibility to individuals for key tasks;
- include a media relations strategy;
- provide a contingent funding plan; and
- contain detailed contact lists outlining key regulatory, government, ratings agencies, equity and debt investor contact points.

***Sources of liquidity***

The principal sources of the NZ Banking Group's liquidity are as follows:

- customer deposits;
- wholesale debt issuance;
- proceeds from the sale of marketable securities;
- repurchase agreements;
- principal repayments on loans;
- interest income; and
- fee income.

The table below shows the NZ Banking Group's holding of liquid assets and represents the key liquidity information provided to management. Liquid assets include high quality assets (including cash, government securities, registered certificates of deposit issued by other banks and residential mortgage-backed securities) readily convertible to cash to meet the NZ Banking Group's liquidity requirements. In management's opinion liquidity is sufficient to meet the NZ Banking Group's present requirements.

| | NZ Banking Group | |
|---|---|---|
| | **2010 $m** | 2009 $m |
| Cash | **1,248** | 402 |
| Due from other financial institutions | - | 499 |
| NZ Government securities | **1,870** | 2,482 |
| NZ corporate securities | **3,433** | 2,208 |
| Residential mortgage-backed securities | **6,092** | 4,278 |
| **Total liquid assets** | **12,643** | 9,869 |

## Note 38 Risk management (continued)

### Liquidity analysis

The following liquidity analysis for financial assets and liabilities presents contractual undiscounted cash flows receivable and payable, and is based on the remaining period as at balance date to the contractual maturity. The balances in the tables below may not align with the balance sheet totals as the tables incorporate all cash flows on an undiscounted basis, which include both principal and associated future interest income/expense accruals.

| | NZ Banking Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2010 | | | | | | |
| | Overnight $m | Less Than 1 Month $m | Over 1 Month to 3 Months $m | Over 3 Months to 1 Year $m | Over 1 Year to 5 Years $m | Over 5 Years $m | Total $m |
| **Assets** | | | | | | | |
| Cash and balances with central banks | **1,570** | - | - | - | - | - | **1,570** |
| Due from other financial institutions | **36** | - | - | - | - | - | **36** |
| Derivative financial instruments: | | | | | | | |
| Held for trading | **5,512** | - | - | - | - | - | **5,512** |
| Held for hedging purposes (net settled) | - | **(5)** | **19** | **43** | **87** | - | **144** |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | **(8)** | **(25)** | **(809)** | - | **(842)** |
| Cash inflow | - | - | - | **11** | **757** | - | **768** |
| Trading securities and other financial assets designated at fair value | - | **1,584** | **2,561** | **561** | **427** | **696** | **5,829** |
| Available-for-sale securities | - | - | - | - | **44** | - | **44** |
| Loans | **3,147** | **2,738** | **4,833** | **7,294** | **22,908** | **51,756** | **92,676** |
| Life insurance assets | **110** | - | **2** | **21** | - | - | **133** |
| Due from related entities: | | | | | | | |
| Non-derivative balances | **195** | - | - | - | - | - | **195** |
| Derivative financial instruments: | | | | | | | |
| Held for trading | **1,360** | - | - | - | - | - | **1,360** |
| Other assets | **6** | **191** | - | - | - | - | **197** |
| **Total undiscounted financial assets** | **11,936** | **4,508** | **7,407** | **7,905** | **23,414** | **52,452** | **107,622** |
| **Liabilities** | | | | | | | |
| Due to other financial institutions | **553** | **75** | **159** | **10** | - | - | **797** |
| Deposits at fair value | **48** | **808** | **1,410** | **200** | - | - | **2,466** |
| Deposits at amortised cost | **16,183** | **3,568** | **5,751** | **9,685** | **1,059** | **1** | **36,247** |
| Derivative financial instruments: | | | | | | | |
| Held for trading | **5,076** | - | - | - | - | - | **5,076** |
| Held for hedging purposes (net settled) | - | **51** | **26** | **161** | **180** | **1** | **419** |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | **8** | **20** | **86** | **1,209** | **1,638** | **2,961** |
| Cash inflow | - | - | - | **(72)** | **(991)** | **(1,514)** | **(2,577)** |
| Trading liabilities and other financial liabilities designated at fair value | - | **239** | - | - | - | - | **239** |
| Debt issues | - | **701** | **3,011** | **3,835** | **7,492** | **1,637** | **16,676** |
| Other liabilities | - | **639** | - | - | - | - | **639** |
| Subordinated debentures | - | - | - | - | - | **819** | **819** |
| Due to related entities: | | | | | | | |
| Non-derivative balances | **2,120** | - | **38** | **117** | **2,641** | **1,046** | **5,962** |
| Derivative financial instruments: | | | | | | | |
| Held for trading | **1,764** | - | - | - | - | - | **1,764** |
| **Total undiscounted financial liabilities** | **25,744** | **6,089** | **10,415** | **14,022** | **11,590** | **3,628** | **71,488** |
| **Total contingent liabilities and commitments** | | | | | | | |
| Housing loan commitments with certain drawdown | **105** | - | - | - | - | - | **105** |
| Other commitments to provide financial services which have an original maturity of one year or more | **9,246** | - | - | - | - | - | **9,246** |
| Other commitments of original maturity of less than one year or which can be unconditionally cancelled at any time | **6,722** | - | - | - | - | - | **6,722** |
| **Total undiscounted contingent liabilities and commitments** | **16,073** | - | - | - | - | - | **16,073** |

# Note 38 Risk management (continued)

| | NZ Banking Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2009 | | | | | | |
| | Overnight $m | Less Than 1 Month $m | Over 1 Month to 3 Months $m | Over 3 Months to 1 Year $m | Over 1 Year to 5 Years $m | Over 5 Years $m | Total $m |
| **Assets** | | | | | | | |
| Cash and balances with central banks | 798 | - | - | - | - | - | 798 |
| Due from other financial institutions | 843 | - | - | - | - | - | 843 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 5,261 | 1,044 | - | - | - | - | 6,305 |
| Held for hedging purposes (net settled) | - | (8) | 23 | 26 | (23) | 5 | 23 |
| Trading securities and other financial assets designated at fair value | 845 | 1,237 | 1,883 | 1,579 | - | - | 5,544 |
| Available-for-sale securities | - | - | - | - | 37 | - | 37 |
| Loans | 2,515 | 2,278 | 5,348 | 6,459 | 23,785 | 52,816 | 93,201 |
| Life insurance assets | 92 | 20 | - | - | 1 | - | 113 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 320 | - | - | - | - | - | 320 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 484 | 1,955 | - | - | - | - | 2,439 |
| Other assets | 1 | 497 | - | - | - | - | 498 |
| **Total undiscounted financial assets** | 11,159 | 7,023 | 7,254 | 8,064 | 23,800 | 52,821 | 110,121 |
| **Liabilities** | | | | | | | |
| Due to other financial institutions | 387 | 25 | 58 | 15 | - | - | 485 |
| Deposits at fair value | 220 | 1,309 | 1,861 | 385 | 19 | - | 3,794 |
| Deposits at amortised cost | 16,106 | 2,430 | 6,010 | 7,047 | 1,634 | 2 | 33,229 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 4,622 | 1,662 | - | - | - | - | 6,284 |
| Held for hedging purposes (net settled) | - | 65 | 63 | 372 | 209 | (1) | 708 |
| Trading liabilities and other financial liabilities designated at fair value | 814 | 254 | 1,639 | - | - | - | 2,707 |
| Debt issues | - | 1,819 | 2,976 | 2,322 | 6,340 | 52 | 13,509 |
| Other liabilities | - | 633 | - | - | - | - | 633 |
| Subordinated debentures | - | - | - | - | - | 790 | 790 |
| Due to related entities: | | | | | | | |
| Non-derivative balances | 2,715 | - | 30 | 110 | 2,854 | 1,037 | 6,746 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 1,603 | 1,357 | - | - | - | - | 2,960 |
| **Total undiscounted financial liabilities** | 26,467 | 9,554 | 12,637 | 10,251 | 11,056 | 1,880 | 71,845 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Housing loan commitments with certain drawdown | 208 | - | - | - | - | - | 208 |
| Other commitments to provide financial services which have an original maturity of one year or more | 9,884 | - | - | - | - | - | 9,884 |
| Other commitments of original maturity of less than one year or which can be unconditionally cancelled at any time | 6,134 | - | - | - | - | - | 6,134 |
| **Total undiscounted contingent liabilities and commitments** | 16,226 | - | - | - | - | - | 16,226 |

## Note 38 Risk management (continued)

| | NZ Branch 2010 Overnight $m | Less Than 1 Month $m | Over 1 Month to 3 Months $m | Over 3 Months to 1 Year $m | Over 1 Year to 5 Years $m | Over 5 Years $m | Total $m |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and balances with central banks | 1,048 | - | - | - | - | - | 1,048 |
| Due from other financial institutions | 33 | - | - | - | - | - | 33 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 5,669 | - | - | - | - | - | 5,669 |
| Trading securities and other financial assets designated at fair value | - | 367 | 1,530 | 210 | 427 | 696 | 3,230 |
| Loans | 317 | 554 | 840 | 1,532 | 3,868 | 76 | 7,187 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 2,946 | - | - | - | - | - | 2,946 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 2,471 | - | - | - | - | - | 2,471 |
| Other assets | - | 49 | - | - | - | - | 49 |
| **Total undiscounted financial assets** | 12,484 | 970 | 2,370 | 1,742 | 4,295 | 772 | 22,633 |
| **Liabilities** | | | | | | | |
| Due to other financial institutions | 553 | 75 | 159 | 10 | - | - | 797 |
| Deposits at fair value | 34 | 406 | 24 | - | - | - | 464 |
| Deposits at amortised cost | 1,980 | 1,613 | 809 | 720 | 7 | 1 | 5,130 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 5,501 | - | - | - | - | - | 5,501 |
| Trading liabilities and other financial liabilities designated at fair value | - | 239 | - | - | - | - | 239 |
| Other liabilities | - | 129 | - | - | - | - | 129 |
| Subordinated debentures | - | - | - | - | - | 819 | 819 |
| Due to related entities: | | | | | | | |
| Non-derivative balances | 3,673 | - | 13 | 40 | 229 | 1,046 | 5,001 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 1,786 | - | - | - | - | - | 1,786 |
| **Total undiscounted financial liabilities** | 13,527 | 2,462 | 1,005 | 770 | 236 | 1,866 | 19,866 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Other commitments to provide financial services which have an original maturity of one year or more | 3,321 | - | - | - | - | - | 3,321 |
| Other commitments of original maturity of less than one year or which can be unconditionally cancelled at any time | 2,235 | - | - | - | - | - | 2,235 |
| **Total undiscounted contingent liabilities and commitments** | 5,556 | - | - | - | - | - | 5,556 |

# Note 38 Risk management (continued)

| | NZ Branch | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2009 | | | | | | |
| | Overnight $m | Less Than 1 Month $m | Over 1 Month to 3 Months $m | Over 3 Months to 1 Year $m | Over 1 Year to 5 Years $m | Over 5 Years $m | Total $m |
| **Assets** | | | | | | | |
| Cash and balances with central banks | 584 | - | - | - | - | - | 584 |
| Due from other financial institutions | 841 | - | - | - | - | - | 841 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 5,262 | 1,044 | - | - | - | - | 6,306 |
| Trading securities and other financial assets designated at fair value | 845 | 10 | 110 | 20 | - | - | 985 |
| Loans | 560 | 294 | 1,058 | 1,409 | 4,722 | 201 | 8,244 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 3,162 | - | - | - | - | - | 3,162 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 2,166 | 1,967 | - | - | - | - | 4,133 |
| Other assets | - | 357 | - | - | - | - | 357 |
| **Total undiscounted financial assets** | 13,420 | 3,672 | 1,168 | 1,429 | 4,722 | 201 | 24,612 |
| **Liabilities** | | | | | | | |
| Due to other financial institutions | 387 | 25 | 58 | 15 | - | - | 485 |
| Deposits at fair value | 61 | 32 | 22 | 11 | - | - | 126 |
| Deposits at amortised cost | 1,851 | 962 | 671 | 318 | 14 | 1 | 3,817 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 5,308 | 1,662 | - | - | - | - | 6,970 |
| Trading liabilities and other financial liabilities designated at fair value | 813 | - | - | - | - | - | 813 |
| Other liabilities | - | 122 | - | - | - | - | 122 |
| Subordinated debentures | - | - | - | - | - | 790 | 790 |
| Due to related entities: | | | | | | | |
| Non-derivative balances | 4,027 | 8 | 8 | 33 | 241 | 1,037 | 5,354 |
| Derivative financial instruments | 1,631 | 1,368 | - | - | - | - | 2,999 |
| **Total undiscounted financial liabilities** | 14,078 | 4,179 | 759 | 377 | 255 | 1,828 | 21,476 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Other commitments to provide financial services which have an original maturity of one year or more | 3,381 | - | - | - | - | - | 3,381 |
| Other commitments of original maturity of less than one year or which can be unconditionally cancelled at any time | 2,157 | - | - | - | - | - | 2,157 |
| **Total undiscounted contingent liabilities and commitments** | 5,538 | - | - | - | - | - | 5,538 |

## 38.3 Credit risk

Credit risk is the risk of financial loss resulting from the failure of customers to honour fully the terms and conditions of a contract with the NZ Banking Group. It arises from the NZ Banking Group's lending, interbank, treasury and international trade activities.

### Credit risk management

The Board approves major prudential policies and limits that govern large customer exposures, country risk, industry concentration and dealings with related entities. The Board delegates approval authorities to the NZ CEO and the Group Chief Risk Officer, who in turn appoint independent credit officers in each business area. These credit specialists work with line managers to ensure that approved policies are applied appropriately so as to optimise the balance between risk and reward. The Portfolio Risk Review unit provides independent assessments of the quality of the NZ Banking Group's credit portfolio.

In applying its Control Principles of Credit the NZ Banking Group recognises and reflects two approaches to managing credit risk based on the nature of the customer and product:

- **Transaction-managed approach**: For larger customers the NZ Banking Group evaluates credit requests by undertaking detailed individual customer and transaction risk analysis (the '**transaction-managed**' approach). Such customers are assigned a customer risk grade ('**CRG**') based on the NZ Banking Group's estimate of their PD. Each facility is assigned a LGD taking into account the realistic distress value of assets over which the NZ Banking Group holds security and considering the seniority of exposure in the capital and debt structure of the customer. The final assignment of CRGs and LGDs are approved by independent credit officers with appropriate authority. Divisional operational units are responsible for ensuring accurate and timely recording of all changes to customer and facility data.
- **Program-managed approach**: High-volume customer credit portfolios with homogenous credit risk characteristics are managed on a statistical basis according to predetermined objective criteria (the '**program–managed**' approach). Quantitative scorecards are used to assign application and behavioural scores to enable risk–based decision-making within these portfolios. The scorecard outcomes and decisions are regularly monitored and validated against subsequent customer performance and recalibrated (or rebuilt) when required. For capital estimation, and other purposes, risk–based customer segments are created based on expected PD, and LGDs are assigned for each segment based on historic experience and management judgment.

## Note 38 Risk management (continued)

The NZ Banking Group is responsible for implementing and operating within established risk management frameworks and policies and has adapted the Overseas Banking Group's credit risk policy to the NZ Banking Group's customer and product set. Accordingly, the NZ Banking Group has its own credit manuals and delegated approval authorities which are approved by the Overseas Banking Group.

The NZ Banking Group monitors its portfolio to guard against the development of risk concentrations. This process ensures that the NZ Banking Group's credit risk remains well diversified throughout the New Zealand economy. The NZ Banking Group has established separate reporting and prudential limits for borrowings that can be accessed by a single customer group. These limits apply to both borrowing equivalents and settlement risk. Separate limits apply to corporates, governments, financial institutions and banks and are scaled by risk grade. Any excesses of limits are reported quarterly to the Board and the Group BRMC along with a strategy addressing the ongoing management of the excess.

All business units produce regular delinquency reports that detail excesses and delinquency positions. These reports trigger appropriate remedial action consistent with risk management procedures aligned to credit approval authority. Delinquency reporting is used to monitor portfolio performance, origination policies and credit decision-making.

Credit policies with group-wide implications are owned by the Group Risk division of the Overseas Bank ('**Overseas Bank Group Risk**'). Compliance with these policies is administered locally.

Overseas Bank Group Risk establishes and maintains group-wide credit risk management framework, policies and risk concentration limits which incorporate sound credit risk management practices, reflect approved risk appetite and strategy and meet relevant regulatory and legislative obligations. Within these boundaries the NZ Banking Group has its own credit approval limits as delegated by the Overseas Bank Group Credit Risk Officer. These establish a hierarchy of credit approval levels, aligned to customer risk grades and consistent with normal customer exposures in the business.

### Internal credit risk ratings system

The principal objective of the credit risk rating system is to produce a reliable quantitative assessment of the credit risk to which the NZ Banking Group is exposed.

The NZ Banking Group's internal credit risk rating system for transaction-managed customers is based on the Overseas Banking Group's internal credit risk rating system and assigns a CRG to each customer, corresponding to their expected PD, and has 20 risk grades for non-defaulted customers and 10 risk grades for defaulted customers. Non-defaulted CRGs are mapped to Moody's and Standard & Poor's external senior ranking unsecured ratings. This mapping is reviewed annually and allows the NZ Banking Group to use the rating agencies' long-run default history to calculate long-run average PDs.

The table below shows the current alignment between the NZ Banking Group's CRGs and the corresponding external rating. Note that only high-level CRG groupings are shown.

| NZ Banking Group's customer risk grade | Standard & Poor's rating | Moody's rating | Supervisory slotting grade |
|---|---|---|---|
| A | AAA to AA- | Aaa to Aa3 | Strong |
| B | A+ to A- | A1 to A3 | Strong |
| C | BBB+ to BBB- | Baa1 to Baa3 | Strong |
| D | BB+ to B+ | Ba1 to B1 | Good/satisfactory |
| **NZ Banking Group rating** | | | |
| E | Watchlist | | Weak |
| F | Specific mention | | Weak |
| G | Substandard/default | | Weak/default |
| H | Default | | Default |

The retail (program-managed) portfolio is segmented into pools of similar risk. Segments are created by analysing characteristics that have historically proven predictive in determining if an account is likely to go into default. Customers are then grouped according to these predictive characteristics of default. Each segment is assigned a quantified measure of its PD, LGD and exposure at default ('**EAD**').

The NZ Banking Group's credit risk rating system is reviewed to ensure the rating criteria and procedures are applicable to the current portfolio and external conditions. The annual review of the Credit Risk Rating Framework is approved by the Group BRMC.

To ensure the credit risk rating system is applied consistently across the NZ Banking Group, the Overseas Banking Group's Portfolio Risk Review team independently evaluates the portfolio performance and the adherence to credit risk policies, procedures and reporting across Business Units. The assessment involves reviewing the accuracy of risk grades, delinquency profile, actual loss performance, the quality of management information available and the adequacy of provisioning.

Specific credit risk estimates (including PD, LGD and EAD levels) are overseen and approved by a subcommittee of the Overseas Banking Group Credit Risk Committee.

### Use of internal credit risk estimates

In addition to using the credit risk estimates for regulatory capital purposes they are also used for the following purposes:

#### *Economic capital*

The NZ Banking Group allocates economic capital to all exposures. Economic capital includes both credit and non-credit components. Economic credit capital is allocated using a framework that considers estimates of PD, LGD, EAD, Total Committed Exposure and loan tenor as well as measures of portfolio composition not reflected in regulatory capital formulae[1].

#### *Pricing*

The NZ Banking Group prices loans so as to produce an acceptable return on the economic capital allocated to the loan, after expected credit losses (and other costs) are incurred. Estimates of economic capital and expected credit losses take into account estimates of PD, LGD and EAD.

1 The NZ Banking Group uses economic capital as the basis for risk-adjusted decision-making and allows differences between economic and regulatory capital where such differences drive better medium-term to long-term business decisions.

# Note 38 Risk management (continued)

***Provisioning***

Impairment provisions are reserves held by the NZ Banking Group to cover credit losses that are incurred in the loan portfolio. Individual provisions are calculated on impaired loans taking into account management's best estimate of the present value of future cash flows. Collective provisions are established on a portfolio basis taking into account the level of arrears, collateral, past loss experience and emergence periods. Transaction-managed portfolio provisions use the risk grading framework and suitable PD, LGD and EADs are assigned to each customer/facility as the basis for the calculation. Program-managed portfolios use estimated loss rates based on recent past experience as the primary basis of the calculation. These estimates are then adjusted for the specific requirements of the NZ IFRS accounting standards.

***Credit approval authorities***

For transaction-managed facilities the approval authorities are allocated based on the CRG with lower limits applicable for lower graded customers. Program-managed facilities are approved on the basis of application scorecard outcomes and product-based approval authorities.

***Risk–adjusted performance measurement***

Business unit performance is measured using an economic profit framework which incorporates charges for economic credit capital as well as capital for other risk types.

## Regulatory capital

The credit risk rating system is a key input to evaluate the level of capital to be held against loans for regulatory capital purposes.

***Overview of the internal credit risk ratings process by portfolio***

***(a) Transaction-managed approach (including corporate, sovereign, banking, business lending and specialised lending)***

The process for assignment and approval of individual PDs and LGDs involves business unit representatives recommending CRGs and LGDs under criteria guidelines. Credit officers then independently evaluate the recommendations and approve the final outcomes. An expert judgment decision-making process is employed to evaluate the CRG.

The following represent the types of corporate, sovereign and banking exposures included within the transaction-managed portfolio approach:

- direct lending;
- contingent lending;
- pre-settlement;
- foreign currency settlement; and
- other intraday settlement obligations.

All of the above exposure categories also apply to Specialised Lending, which in the NZ Banking Group comprises Property Finance (Income Producing Real Estate).

*Definitions, methods and data for estimation and validation of PD, LGD and EAD*

*(i) Probability of Default ('PD')*

The PD is a through the cycle assessment of the likelihood of a customer defaulting on its financial obligations within one year. The NZ Banking Group reflects its PD estimate in a CRG.

*(ii) Loss Given Default ('LGD')*

The LGD represents an estimate of the expected severity of a loss to the NZ Banking Group should a customer default occur during an economic downturn. The NZ Banking Group assigns an LGD to each credit facility, assuming an event of default has occurred, and taking into account a conservative estimate of the net realisable value of assets to which the NZ Banking Group has recourse and over which it has security. LGDs also reflect the seniority of exposure in the customer's capital and debt structure.

LGD estimates are benchmarked against observed historical LGDs from internal and external data and are calibrated to reflect losses expected in an economic downturn. The calculation of historical LGDs is based on an economic loss and includes allowances for workout costs and the discounting of future cash flows to the date of default.

LGD values range from 5% to 100%. The range of LGD values ensures that the risk of loss is differentiated across many credit facilities extended to customers.

*(iii) Exposure at Default* ('*EAD*') *and Credit Conversion Factor* ('*CCF*')

EAD represents an estimate of the amount of committed exposure expected to be drawn by the customer at the time of default. To calculate EAD historical data is analysed to determine what proportion of undrawn commitments are ultimately utilised by customers who end up in default. The proportion of undrawn commitments ultimately is termed the CCF. EAD therefore consists of the initial outstanding balances plus the CCF multiplied by undrawn commitments. For transaction-managed exposures CCF's are all 100%.

***(b) Retail (program-managed) approach (including residential mortgages, small business and other retail)***

Each customer is rated using details of their account performance or application details and segmented into pools of similar risk. These segments are created by analysing characteristics that have historically proven predictive in determining if an account is likely to go into default. Customers are then grouped according to these predictive characteristics of default. The retail (program-managed) portfolio is divided into a number of segments per product with each segment assigned a quantified measurement of its PD, LGD and EAD.

## Note 38 Risk management (continued)

Retail asset classes exposures included in the retail (program-managed) portfolio approach are split into the following categories of products:

| Asset sub–classes | Product categories |
|---|---|
| Residential mortgages | ▪ Mortgages |
| Small business | ▪ Equipment finance |
| | ▪ Business overdrafts |
| | ▪ Business term loans |
| | ▪ Business credit cards |
| Other retail | ▪ Credit cards |
| | ▪ Personal loans |
| | ▪ Overdrafts |

*Definitions, methods and data for estimation and validation of PD, LGD and EAD*

*(i) Probability of Default*

PDs are assigned at the segment level and reflect the likelihood of accounts within that segment to default. A long-run average is used to assign a PD to each account in a segment based on the segment's characteristics. The PD estimate for each segment is based on internal data.

Models are used to help determine or establish the appropriate internal rating for program-managed portfolios.

*(ii) Loss Given Default*

LGD measures the proportion of the exposure that will be lost if default occurs. LGD is measured as a percentage of EAD. The approach to LGD varies depending on whether the retail product is secured or unsecured. A downturn period is used to reflect the effect on the collateral for secured products. For unsecured products a long-run estimate is used for LGD.

*(iii) Exposure at Default*

EAD represents an estimate of the amount of committed exposure expected to be drawn by the customer at the time of default. To calculate EAD historical data is analysed to determine what proportion of undrawn commitments are ultimately utilised by customers who end up in default.

***(c) Reconciling financial statement and regulatory capital disclosures***

Within Note 13 the financial statement category 'Loans for business purposes' includes all transaction-managed asset classes and small business asset class. 'Residential mortgages' per Note 13 are defined consistently for financial statement and regulatory capital disclosure purposes. 'Other loans for consumer purposes' in Note 13 are classified as 'Other retail' for regulatory capital disclosure purposes.

### Credit risk mitigation and limit control

The NZ Banking Group achieves credit risk mitigation through either risk reduction or risk transfer:

***Risk reduction***

The NZ Banking Group reduces credit risk exposure to a customer through either:

- collateralisation, where the exposure is secured by eligible financial collateral or protection is bought via credit-linked notes, provided the proceeds are invested in eligible financial collateral; or
- formal set-off arrangements.

***Risk transfer***

The NZ Banking Group transfers credit risk exposure to a customer to an unrelated entity by:

- credit substitution (use of guarantees and standby Letters of Credit, or similar instruments) where the NZ Banking Group has direct recourse to a third party on default or non–payment by the customer; or
- credit protection bought via credit default swaps where the NZ Banking Group is entitled to recover either full principal or credit losses on occurrence of defined credit events.

The credit risk of the mitigation provider may not in any way directly or indirectly relate to the customer.

### Collateral valuation and management

The NZ Banking Group excluding NZ Branch uses a qualitative scale to record the quality of the security taken. This is referred to as the security quality index ('**SQI**'). The SQI is applied in determining the LGD. NZ Branch evaluates LGD without reference to SQI.

The NZ Banking Group revalues all financial markets and associated collateral positions on a daily basis to monitor the net risk position, and has formal processes in place to ensure calls for collateral top–up or exposure reduction are made promptly. The Collateral Management unit and the Financial Markets Credit Risk team have responsibility for monitoring those positions. Collateral securing direct and contingent credit exposures is monitored and revalued less frequently by the originating business unit.

***Types of collateral taken***

The NZ Banking Group recognises the following as eligible collateral for credit risk mitigation by way of risk reduction:

- cash;
- deposits;
- securities issued by other entities with a minimum risk grade equivalent of A3/A–; and
- credit-linked notes, provided the proceeds are invested in cash or other eligible collateral described above.

# Note 38 Risk management (continued)

The NZ Banking Group currently has not obtained any financial or non-financial assets by taking possession of collateral it holds as security or calling on other credit enhancements.

***Guarantor/credit derivative counterparties***

For credit risk mitigation by risk transfer, the NZ Banking Group only recognises unconditional irrevocable guarantees or standby letters of credit issued by, or eligible credit derivative protection bought from, the following entities provided they are not related to the underlying obligor:

- sovereign entities, public sector entities, banks or securities firms; and
- other entities with a minimum risk grade equivalent of A3/A–.

## Market and/or credit risk concentrations

All exposures to risk transfer counterparties are separately approved under the NZ Banking Group's usual credit approval process with the amount and tenor of mitigation recorded against the counterparty in the NZ Banking Group's exposure management systems. The credit quality of mitigation providers is reviewed regularly in accordance with the NZ Banking Group's usual periodic review processes.

Market risks arising from credit risk mitigation activities are managed similarly to market risks arising from any other trading activities. These risks are managed under either the market risk banking book or trading book frameworks as appropriate.

The banking book is managed by credit limits to restrict credit exposure. Net interest positions are managed within the banking book market risk framework by Value at Risk ('**VaR**') and structural risk limits. The structural risk limits restrict the size of market risk exposures that can be taken on any part of the yield curve.

In the trading book market risk flowing from credit risk mitigation deals is combined with the underlying market risk and assessed against structural (and VaR) risk limits. The structural risk limits include volume, basis point, 'greeks' and other limits to avoid undue concentration of market risk. These are set and overseen by the independent market risk management unit. The structural risk limits are set taking into account business strategy, trader experience and market liquidity.

## Foreign exchange and derivative credit risk management

Foreign exchange and derivative activities expose the NZ Banking Group to pre-settlement and settlement risk. A real-time global limits system is used to record exposure against limits for these risk types. Pre-settlement risk is the risk that the counterparty to a contract defaults prior to settlement when the value of the contract is positive. Both the current replacement cost and the potential future credit risk are taken into consideration in the assessment of pre-settlement risk. 'Close out' netting is used to reduce gross credit exposures for counterparties where legally enforceable netting agreements are in place. In a close out netting situation the positive and negative mark-to-market values of all eligible foreign exchange and derivative contracts with the same counterparty are netted in the event of default and regardless of maturity.

## Maximum exposure to credit risk

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Financial assets** | | | | |
| Cash and balances with central bank | **1,570** | 798 | **1,048** | 584 |
| Due from other financial institutions | **36** | 843 | **33** | 841 |
| Derivative financial instruments | **5,685** | 6,328 | **5,669** | 6,306 |
| Trading securities and other financial assets designated at fair value | **5,630** | 5,405 | **3,042** | 984 |
| Available-for-sale securities | **44** | 37 | **-** | - |
| Loans | **56,738** | 55,592 | **6,699** | 7,583 |
| Life insurance assets | **133** | 113 | **-** | - |
| Due from related entities | **1,555** | 2,759 | **5,417** | 7,295 |
| Other assets | **197** | 498 | **49** | 357 |
| **Total financial assets** | **71,588** | 72,373 | **21,957** | 23,950 |
| **Contingent liabilities** | | | | |
| Direct credit substitutes | **319** | 331 | **268** | 285 |
| Loan commitments with certain drawdown | **105** | 208 | **-** | - |
| Transaction related contingent items | **665** | 649 | **411** | 370 |
| Underwriting and sub-underwriting facilities | **-** | - | **-** | - |
| Short term, self liquidating trade related contingent liabilities | **892** | 740 | **134** | 62 |
| Other commitments to provide financial services which have an original maturity of one year or more | **9,246** | 9,884 | **3,321** | 3,381 |
| Other commitments with original maturity of less than one year or which can be unconditionally cancelled at any time | **6,722** | 6,134 | **2,235** | 2,157 |
| **Total contingent liabilities and commitments** | **17,949** | 17,946 | **6,369** | 6,255 |
| **Total maximum credit risk exposure** | **89,537** | 90,319 | **28,326** | 30,205 |

# Note 38 Risk management (continued)

## Risk-weighted exposures

The following risk-weighted exposures are derived in accordance with the Reserve Bank's Capital Adequacy Framework (the '**Framework**') as required by the Order.

On-balance sheet non-risk-weighted assets consist of market related contracts (derivatives) and intangible assets. These items have been excluded from the calculation of on-balance sheet risk-weighted exposures in accordance with the Framework. Derivatives have been included in the table of off-balance sheet exposures for the purposes of risk-weighting.

Securitised mortgages in non-consolidated entities are excluded from the balance sheet, but are included in the New Zealand risk-adjusted exposures as required by the Framework.

The current exposure method has been used to calculate the credit equivalent of all market related contracts.

The NZ Banking Group and the NZ Branch's credit risk management practice as disclosed in this note is consistent with the Overseas Banking Group's practice. The Overseas Banking Group is accredited to apply the Advanced IRB and AMA methodologies under Basel II. However, under the Order, the NZ Banking Group and the NZ Branch are required to disclose capital under the Basel I approach as outlined in the tables below.

### *Calculation of on-balance sheet exposures*

| | NZ Banking Group 2010 (Unaudited) Principal Amount $m | Risk Weighting | Risk-weighted Exposure $m |
|---|---|---|---|
| Cash and short-term claims on government | 3,568 | 0% | - |
| Long-term claims on government | 232 | 10% | 23 |
| Claims on banks | 3,096 | 20% | 619 |
| Claims on public sector entities | 231 | 20% | 46 |
| Residential mortgages | 34,109 | 50% | 17,055 |
| Other assets | 23,480 | 100% | 23,480 |
| Non-risk-weighted assets | 8,067 | | |
| **Total on-balance sheet exposures** | **72,783** | | **41,223** |
| ***Calculation of off-balance sheet securitised mortgage exposures*** | | | |
| Securitised mortgages | 416 | 50% | 208 |
| **Total off-balance sheet securitised mortgage exposures** | **416** | | **208** |

### *Calculation of off-balance sheet and derivative exposures*

| | Principal Amount $m | Credit Conversion Factor | Credit Equivalent Amount $m | Average Counterparty Risk Weighting | Risk-weighted Exposure $m |
|---|---|---|---|---|---|
| **Direct credit substitutes** | | | | | |
| Standby letters of credit and financial guarantees | 319 | 100% | 319 | 100% | 319 |
| **Total direct credit substitutes** | **319** | | **319** | | **319** |
| **Commitments** | | | | | |
| Loan commitments with certain drawdown | 105 | 100% | 105 | 50% | 53 |
| Transaction related contingent items | 665 | 50% | 333 | 100% | 333 |
| Underwriting and sub-underwriting facilities | - | 50% | - | 0% | - |
| Short-term, self liquidating trade related contingent liabilities | 892 | 20% | 178 | 100% | 178 |
| Other commitments to provide financial services which have an original maturity of one year or more | 9,246 | 50% | 4,623 | 0% | - |
| Other commitments with original maturity of less than one year or which can be unconditionally cancelled at any time | 6,722 | 0% | - | 0% | - |
| **Total commitments** | **17,630** | | **5,239** | | **564** |
| **Market related contracts (derivatives)** | | | | | |
| Foreign exchange contracts: | | | | | |
| Forwards | 48,435 | | 1,463 | 31% | 457 |
| Swaps | 47,756 | | 3,378 | 21% | 698 |
| Interest rate contracts: | | | | | |
| Forwards | 3,575 | | - | 0% | - |
| Futures | 11,202 | | - | 0% | - |
| Options | 4,100 | | 13 | 54% | 7 |
| Swaps | 230,942 | | 5,799 | 24% | 1,398 |
| **Total market related contracts (derivatives)** | **346,010** | | **10,653** | | **2,560** |
| **Total off-balance sheet and derivative exposures** | **363,959** | | **16,211** | | **3,443** |
| **Total risk-weighted exposures** | | | | | **44,874** |

## Note 38 Risk management (continued)

***Calculation of on-balance sheet exposures***

| | NZ Branch 2010 (Unaudited) Principal Amount $m | Risk Weighting | Risk-weighted Exposure $m |
|---|---|---|---|
| Cash and short-term claims on government | 1,673 | 0% | - |
| Long-term claims on government | 232 | 10% | 23 |
| Claims on banks | 1,886 | 20% | 377 |
| Claims on public sector entities | 82 | 20% | 16 |
| Residential mortgages | - | 50% | - |
| Other assets | 9,944 | 100% | 9,944 |
| Non-risk-weighted assets | 8,243 | | |
| **Total on-balance sheet exposures** | 22,060 | | 10,360 |

***Calculation of off-balance sheet securitised mortgage exposures***

| | Principal Amount $m | Risk Weighting | Risk-weighted Exposure $m |
|---|---|---|---|
| Securitised mortgages | - | 50% | - |
| **Total off-balance sheet securitised mortgage exposures** | - | | - |

***Calculation of off-balance sheet and derivative exposures***

| | Principal Amount $m | Credit Conversion Factor | Credit Equivalent Amount $m | Average Counterparty Risk Weighting | Risk-weighted Exposure $m |
|---|---|---|---|---|---|
| **Direct credit substitutes** | | | | | |
| Standby letters of credit and financial guarantees | 268 | 100% | 268 | 100% | 268 |
| **Total direct credit substitutes** | 268 | | 268 | | 268 |
| **Commitments** | | | | | |
| Loan commitments with certain drawdown | - | 100% | - | 50% | - |
| Transaction related contingent items | 411 | 50% | 206 | 100% | 206 |
| Underwriting and sub-underwriting facilities | - | 50% | - | 100% | - |
| Short-term, self liquidating trade related contingent liabilities | 134 | 20% | 27 | 100% | 27 |
| Other commitments to provide financial services which have an original maturity of one year or more | 3,321 | 50% | 1,661 | 100% | 1,661 |
| Other commitments with original maturity of less than one year or which can be unconditionally cancelled at any time | 2,235 | 0% | - | 0% | - |
| **Total commitments** | 6,101 | | 1,894 | | 1,894 |
| **Market related contracts (derivatives)** | | | | | |
| Foreign exchange contracts: | | | | | |
| Forwards | 48,435 | | 1,463 | 31% | 457 |
| Swaps | 62,027 | | 4,899 | 20% | 1,002 |
| Interest rate contracts: | | | | | |
| Forwards | 29,855 | | 14 | 21% | 3 |
| Futures | 11,202 | | - | 0% | - |
| Options | 4,100 | | 13 | 54% | 7 |
| Swaps | 247,703 | | 6,270 | 24% | 1,492 |
| **Total market related contracts (derivatives)** | 403,322 | | 12,659 | | 2,961 |
| **Total off-balance sheet and derivative exposures** | 409,691 | | 14,821 | | 5,123 |
| **Total risk-weighted exposures** | | | | | 15,483 |

### Additional mortgage information

The information below relates to the residential mortgage loan-to-value ratios ('**LVR**') reflected in the capital calculation.

***New Zealand Banking Group Residential Mortgages by loan-to-value ratio:***

| | NZ Banking Group 2010 (Unaudited) | | |
|---|---|---|---|
| **LVR range** | 0-80% | 81-90% | Over 90% |
| Value of exposures ($m) | 26,493 | 4,923 | 2,948 |

# Note 38 Risk management (continued)

## 38.4 Market risk

Market risk is the potential for loss arising from adverse movements in the level and volatility of market factors such as foreign exchange rates, interest rates, commodity prices and equity prices. The NZ Banking Group's exposure to market risk arises out of its Financial Markets and Treasury activities.

### Traded market risk

***Approach***

The NZ Banking Group's exposure to traded market risk arises out of its Financial Markets and Treasury trading activities. These activities are controlled by the Overseas Banking Group's market risk management framework approved by the Group BRMC. VaR is the primary mechanism for measuring and controlling market risk. Market risk is managed using VaR and structural risk limits (including volume limits and basis point value limits) in conjunction with scenario analysis and stress testing. Market risk limits are allocated to business management based upon business strategies and experience, in addition to market liquidity and concentration risks. All trades are fair valued daily, using independently sourced or reviewed rates. Rates that have limited independent sources are reviewed at least on a monthly basis.

Financial Markets ('**FM**') trading book activity represents dealings that encompass book running and distribution activity. The types of market risk arising from FM trading activity include interest rate risk, foreign exchange risk, credit spread risk and volatility risk.

Treasury's trading activity represents dealings that include the management of interest rate, foreign exchange and credit spread risks associated with the wholesale funding task, liquid asset portfolios and foreign exchange repatriations.

***VaR limits***

Market risks arising from trading book activities are primarily measured using VaR based on historical simulation methodology. VaR is the potential loss in earnings from an adverse market movement calculated using a 99% confidence level, with a minimum of one year of historical rate data and a one-day time horizon. VaR takes account of all material market variables that may cause a change in the value of the trading portfolio, including interest rates, foreign exchange rates, price change, volatility and the correlations between these variables.

The Group BRMC has approved a VaR limit for the combined trading activities of the Overseas Banking Group's FM and Group Treasury units.

***Backtesting***

Daily backtesting of VaR results is performed to ensure model integrity is maintained. A review of both the potential profit and loss outcomes is also undertaken to monitor any skew created by the historical data.

***Stress testing***

Daily stress testing against pre-determined scenarios is performed to analyse potential losses beyond the 99% confidence level. An escalation framework around selective stress tests is approved by the Overseas Banking Group's Market Risk Committee ('**Group MARCO**').

***Profit and loss notification framework***

The Group BRMC has approved a profit and loss notification framework. Included in this framework are levels of escalation in accordance with the size of the profit or loss. Triggers are applied to both a 1-day and a rolling 20-day cumulative total.

***Structure and organisation***

An independent Market Risk Management unit ('**Market Risk Management**') is responsible for the daily measurement and monitoring of market risk exposures. This unit performs daily stress tests on the trading portfolios to quantify the impact of extreme or unexpected movements in market factors. Stress tests include historical market movements, tests defined by one of the market risk committees or management and independent scenarios developed by the NZ Banking Group's economics department.

***Risk reporting***

Daily monitoring of current exposure and limit utilisation is conducted independently by Market Risk Management, which monitors market risk exposures against VaR and structural limits. Daily VaR position reports are produced by risk type, by product lines and by geographic region. These are supplemented by structural risk reporting, advice of profit and loss trigger levels and stress test escalation trigger points. Model accreditation has been granted by APRA for the use of the internal model approach for the determination of regulatory capital for the key classes of interest rate (general market), foreign exchange, commodity and equity (including specific risk) risks. Specific risk refers to the variations in individual security prices that cannot be explained by general market movements and event and default risk.

***Risk mitigation***

Market risk positions are managed by the trading desks consistent with delegated trading and product authorities. Risks are consolidated into portfolios based on product and risk type. Risk management is carried out by suitably qualified personnel with varying levels of seniority commensurate with the nature and scale of market risks under management.

The following controls allow for continuous monitoring of market risks by management:

- trading authorities and responsibilities are clearly delineated at all levels to ensure accountability;
- a structured system of limits and reporting of exposures;
- all new products and significant product variations undergo a rigorous approval process to ensure business risks have been identified prior to launch;
- models that are used to determine risk or profit and loss for the NZ Banking Group's accounts are independently reviewed; and
- duties are segregated to ensure that employees involved in the origination, processing and valuation of transactions operate under separate reporting lines, minimising the opportunity for collusion.

Segregation of duties is a significant feature of the NZ Banking Group's internal controls. Separation of persons executing transactions from those responsible for processing contracts, confirming transactions, settling transactions, approving the accounting methodology or entries and performing revaluations minimises opportunities for fraud or embezzlement.

# Note 38 Risk management (continued)

## Non-traded market risk (Interest rate risk in the banking book)

***Approach***

The banking book activities that give rise to market risk include lending activities, balance sheet funding and capital management. Interest rate risk, currency risk and funding and liquidity risk are inherent in these activities. Westpac New Zealand Treasury is responsible for managing the interest rate risk arising from these activities.

***Asset and liability management***

Westpac New Zealand Treasury manages the structural interest rate mismatch associated with the transfer priced balance sheet, including the investment of the NZ Banking Group's capital to its agreed benchmark duration. A key risk management objective is to help ensure the reasonable stability of net interest income ('**NII**') over time. These activities are performed under the direction of Group MARCO with oversight from the NZ Branch's Trading Risk Management unit and conducted within a risk framework and appetite set down by the Group BRMC.

***NII sensitivity***

NII sensitivity is managed in terms of the net interest income-at-risk ('**NaR**') modelled over a one-year time horizon using a 99% confidence interval for movements in wholesale market interest rates. A simulation model is used to calculate the NZ Banking Group's potential NaR. The NII simulation framework combines the underlying balance sheet data with assumptions about run off and new business, expected repricing behaviour and changes in wholesale market interest rates. Simulations using a range of interest rate scenarios are used to provide a series of potential future NII outcomes. The interest rate scenarios modelled include those projected using historical market interest rate volatility as well as 100 and 200 basis point shifts up and down from current market yield curves. Additional stressed interest rate scenarios are also considered and modelled.

A comparison between the NII outcomes from these modelled scenarios indicates the sensitivity to interest rate changes.

***Limits***

The BRMC has approved NaR and VaR limits for banking book risk across the Overseas Banking Group. A NaR sub limit has been assigned to the NZ Banking Group and in addition structural limits, expressed as interest rate delta, are also in place for the NZ Banking Group.

***Risk reporting***

Interest rate risk in the banking book risk measurement systems and personnel are centralised in Sydney, Australia. These include front office product systems which capture all treasury funding and derivative transactions, the transfer pricing system which captures all retail transactions in Australia and New Zealand, traded and non-traded VaR systems which calculate Group Treasury VaR and the NII system which calculates NII and NaR for the Australian and New Zealand balance sheets.

Daily monitoring of current exposure and limit utilisation is conducted independently by the Overseas Banking Group's Market Risk Management unit, which monitors market risk exposures against VaR and NaR limits. Oversight of risk specific to the NZ Banking Group is monitored by the NZ Branch's Trading Risk Management unit. Management reports detailing structural positions and VaR are produced and distributed daily for use by dealers and management across all stakeholder groups. Monthly and quarterly reports are produced for the senior management market risk forums of Group MARCO and Group BRMC respectively to ensure transparency of material market risks and issues.

***Risk mitigation***

Market risk arising in the banking book stems from the ordinary course of banking activities, including structural interest rate risk (the mismatch between the duration of assets and liabilities) and capital management. Hedging of the NZ Banking Group's exposure to interest rate risk is undertaken using derivatives. The hedge accounting strategy adopted is to utilise a combination of the cash flow, fair value and net investment hedge approaches. Some derivatives held for economic hedging purposes do not meet the criteria for hedge accounting and therefore are accounted for in the same way as derivatives held for trading.

The same controls as used to monitor traded market risk allow for continuous monitoring by management.

## Market risk notional capital charges

The NZ Banking Group's aggregate market risk exposure is derived in accordance with the Reserve Bank document 'Capital adequacy framework (standardised approach) (BS2A)'. The peak end-of-day exposures below have been calculated by determining the maximum end-of-day aggregate market risk exposure over the quarter, and then dividing that amount by the Overseas Banking Group's equity as at 30 September 2010 (30 September 2009 for comparatives). The end-of-period exposures below have been calculated by determining the end-of-day aggregate market risk as at 30 September 2010 (30 September 2009 for comparatives) and then dividing that amount by the Overseas Banking Group's equity as at 30 September 2010 (30 September 2009 for comparatives).

For each category of market risk the peak end-of-day notional capital charge is the aggregate capital charge for that category of market risk derived in accordance with the Reserve Bank document 'Capital adequacy framework (standardised approach) (BS2A)'.

For each category of market risk the peak end-of-day notional capital charge as a percentage of the Overseas Banking Group's equity is the peak end-of-day notional capital charge for that category of market risk divided by the Overseas Banking Group's equity as at 30 September 2010 (30 September 2009 for comparatives).

## Note 38 Risk management (continued)

***Market risk notional capital charges***

The following table provides a summary of the NZ Banking Group's notional capital charges by risk type as at balance date and the peak end-of -day notional capital charges by risk type for the three months ended 30 September 2010 (30 September 2009 for comparatives):

| | NZ Banking Group | | | | | |
|---|---|---|---|---|---|---|
| | **2010 (Unaudited)** | | | 2009 (Unaudited) | | |
| | **Implied Risk-weighted Exposure $m** | **Notional Capital Charge $m** | **Notional Capital Charge as a Percentage of the Overseas Banking Group's Equity %** | Implied Risk-weighted Exposure $m | Notional Capital Charge $m | Notional Capital Charge as a Percentage of the Overseas Banking Group's Equity % |
| **End-of-period** | | | | | | |
| Interest rate risk | **1,750** | **140** | **0.27** | 4,013 | 321 | 0.72 |
| Foreign exchange risk | **46** | **4** | **0.01** | 50 | 4 | 0.01 |
| Equity risk | **44** | **4** | **0.01** | 37 | 3 | 0.01 |
| **Peak end-of-day** | | | | | | |
| Interest rate risk | **2,913** | **233** | **0.44** | 9,025 | 722 | 1.62 |
| Foreign exchange risk | **102** | **8** | **0.02** | 160 | 13 | 0.03 |
| Equity risk | **44** | **4** | **0.01** | 38 | 3 | 0.01 |

***VaR***

The NZ Banking Group applies a VaR methodology to its portfolios, to estimate the market risk of positions held and the maximum losses expected, based upon a number of assumptions for various changes in market conditions. VaR is an estimate of the potential loss in value to a 99% confidence level assuming positions were held unchanged for one day. The NZ Banking Group uses a historical simulation method to calculate VaR taking into account all material market variables. Actual outcomes are monitored and the model is back-tested daily. The use of this approach does not prevent losses outside of these limits in the event of more significant market movements.

The following table provides a summary of VaR by risk type for the NZ Banking Group and the NZ Branch's trading and non-trading activities.

***Trading***

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Interest rate risk | **1.7** | 1.9 | **1.7** | 1.9 |
| Foreign exchange risk | **0.1** | 0.1 | **0.1** | 0.1 |
| Price risk | **0.2** | 0.1 | **0.2** | 0.1 |
| Volatility risk | **0.1** | 0.3 | **0.1** | 0.3 |
| Net market risk | **1.6** | 2.0 | **1.6** | 2.0 |

***Non-trading***

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| Interest rate risk | **0.9** | 1.3 | **0.8** | 1.6 |

# Note 38 Risk management (continued)

## Interest rate sensitivity

Sensitivity to interest rates arises from mismatches in the interest rate characteristics of assets and their corresponding liability funding. One of the major causes of these mismatches is timing differences in the repricing of assets and liabilities. These mismatches are actively managed as part of the overall interest rate risk management process which is conducted in accordance with the NZ Banking Group policy guidelines.

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the NZ Banking Group's net asset position as at 30 September 2010. The NZ Banking Group uses this contractual repricing information as a base, which is then altered to take account of consumer behaviour, to manage its interest rate risk.

| | NZ Banking Group | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2010 | | | | | | | | | |
| | Less Than 1 Month $m | 1 Month to 3 Months $m | 3 Months to 1 Year $m | 1 Year to 2 Years $m | 2 Years to 3 Years $m | 3 Years to 4 Years $m | 4 Years to 5 Years $m | Over 5 Years $m | Non-interest Bearing $m | Total $m |
| **Financial assets** | | | | | | | | | | |
| Cash and balances with central banks | 1,248 | - | - | - | - | - | - | - | 322 | 1,570 |
| Due from other financial institutions | 3 | - | - | - | - | - | - | - | 33 | 36 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 5,685 | 5,685 |
| Trading securities and other financial assets designated at fair value | 1,607 | 2,553 | 531 | 32 | 52 | 18 | 222 | 615 | - | 5,630 |
| Available-for-sale securities | - | - | - | - | - | - | - | - | 44 | 44 |
| Loans | 27,906 | 7,684 | 10,334 | 8,408 | 1,876 | 1,151 | 109 | 100 | (830) | 56,738 |
| Life insurance assets | 4 | 2 | 21 | - | - | - | - | - | 106 | 133 |
| Due from related entities | 174 | - | - | - | - | - | - | - | 1,381 | 1,555 |
| Other assets | - | - | - | - | - | - | - | - | 197 | 197 |
| **Total financial assets** | 30,942 | 10,239 | 10,886 | 8,440 | 1,928 | 1,169 | 331 | 715 | 6,938 | 71,588 |
| Non-financial assets | | | | | | | | | | 1,195 |
| **Total assets** | | | | | | | | | | 72,783 |
| **Financial liabilities** | | | | | | | | | | |
| Due to other financial institutions | 460 | 157 | 10 | - | - | - | - | - | 167 | 794 |
| Deposits at fair value | 853 | 1,333 | 267 | - | - | - | - | - | - | 2,453 |
| Deposits at amortised cost | 17,166 | 5,613 | 9,332 | 380 | 215 | 207 | 139 | - | 2,515 | 35,567 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 5,501 | 5,501 |
| Trading liabilities and other financial liabilities designated at fair value | - | - | - | - | 30 | - | 184 | 25 | - | 239 |
| Debt issues | 4,890 | 1,859 | 1,083 | 2,341 | 754 | 2,478 | 523 | 1,511 | - | 15,439 |
| Other liabilities | - | - | - | - | - | - | - | - | 639 | 639 |
| Subordinated debentures | - | - | - | - | - | - | - | 819 | - | 819 |
| Due to related entities | 5,147 | - | 48 | - | - | - | - | - | 1,808 | 7,003 |
| **Total financial liabilities** | 28,516 | 8,962 | 10,740 | 2,721 | 999 | 2,685 | 846 | 2,355 | 10,630 | 68,454 |
| Non-financial liabilities | | | | | | | | | | 201 |
| **Total liabilities** | | | | | | | | | | 68,655 |
| **Off-balance sheet financial instruments** | | | | | | | | | | |
| Net interest rate contracts (notional): | | | | | | | | | | |
| Receivable/(payable) | 4,549 | (1,538) | (3,661) | (2,547) | (1,015) | 2,968 | (31) | 1,275 | - | - |

## Note 38 Risk management (continued)

| | NZ Banking Group | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2009 | | | | | | | | | |
| | Less Than 1 Month $m | 1 Month to 3 Months $m | 3 Months to 1 Year $m | 1 Year to 2 Years $m | 2 Years to 3 Years $m | 3 Years to 4 Years $m | 4 Years to 5 Years $m | Over 5 Years $m | Non-interest Bearing $m | Total $m |
| **Financial assets** | | | | | | | | | | |
| Cash and balances with central banks | 402 | - | - | - | - | - | - | - | 396 | 798 |
| Due from other financial institutions | 502 | - | - | - | - | - | - | - | 341 | 843 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 6,328 | 6,328 |
| Trading securities and other financial assets designated at fair value | 1,281 | 2,269 | 1,287 | - | 139 | 78 | 2 | 349 | - | 5,405 |
| Available-for-sale securities | - | - | - | - | - | - | - | - | 37 | 37 |
| Loans | 23,568 | 7,820 | 10,606 | 7,460 | 4,340 | 1,202 | 1,096 | 111 | (611) | 55,592 |
| Life insurance assets | 23 | - | - | - | - | - | - | - | 90 | 113 |
| Due from related entities | 4 | - | - | - | - | - | - | - | 2,755 | 2,759 |
| Other assets | - | - | - | - | - | - | - | - | 498 | 498 |
| **Total financial assets** | 25,780 | 10,089 | 11,893 | 7,460 | 4,479 | 1,280 | 1,098 | 460 | 9,834 | 72,373 |
| Non-financial assets | | | | | | | | | | 1,071 |
| **Total assets** | | | | | | | | | | 73,444 |
| **Financial liabilities** | | | | | | | | | | |
| Due to other financial institutions | 160 | 58 | 15 | - | - | - | - | - | 252 | 485 |
| Deposits at fair value | 1,517 | 1,855 | 383 | 16 | 1 | - | 1 | - | - | 3,773 |
| Deposits at amortised cost | 16,093 | 5,866 | 6,777 | 1,196 | 126 | 44 | 150 | 1 | 2,386 | 32,639 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 6,970 | 6,970 |
| Trading liabilities and other financial liabilities designated at fair value | 317 | 1,568 | - | - | 97 | 63 | - | 653 | - | 2,698 |
| Debt issues | 2,975 | 2,616 | 1,643 | 357 | 2,359 | 74 | 2,296 | 49 | - | 12,369 |
| Other liabilities | - | - | - | - | - | - | - | - | 633 | 633 |
| Subordinated debentures | - | - | - | - | - | - | - | 790 | - | 790 |
| Due to related entities | 5,151 | 8 | 109 | - | - | - | - | - | 3,405 | 8,673 |
| **Total financial liabilities** | 26,213 | 11,971 | 8,927 | 1,569 | 2,583 | 181 | 2,447 | 1,493 | 13,646 | 69,030 |
| Non-financial liabilities | | | | | | | | | | 509 |
| **Total liabilities** | | | | | | | | | | 69,539 |
| **Off-balance sheet financial instruments** | | | | | | | | | | |
| Net interest rate contracts (notional): | | | | | | | | | | |
| Receivable/(payable) | 4,138 | 3,908 | (3,192) | (4,126) | (348) | (1,311) | 1,001 | (70) | - | - |

# Note 38 Risk management (continued)

| | Less Than 1 Month $m | 1 Month to 3 Months $m | 3 Months to 1 Year $m | 1 Year to 2 Years $m | 2 Years to 3 Years $m | 3 Years to 4 Years $m | 4 Years to 5 Years $m | Over 5 Years $m | Non-interest Bearing $m | Total $m |
|---|---|---|---|---|---|---|---|---|---|---|
| | NZ Branch 2010 | | | | | | | | | |
| **Financial assets** | | | | | | | | | | |
| Cash and balances with central banks | 849 | - | - | - | - | - | - | - | 199 | 1,048 |
| Due from other financial institutions | - | - | - | - | - | - | - | - | 33 | 33 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 5,669 | 5,669 |
| Trading securities and other financial assets designated at fair value | 391 | 1,528 | 184 | 32 | 52 | 18 | 222 | 615 | - | 3,042 |
| Loans | 3,618 | 2,941 | 86 | 86 | 31 | 6 | 7 | 24 | (100) | 6,699 |
| Due from related entities | 2,919 | - | - | - | - | - | - | - | 2,498 | 5,417 |
| Other assets | - | - | - | - | - | - | - | - | 49 | 49 |
| **Total financial assets** | 7,777 | 4,469 | 270 | 118 | 83 | 24 | 229 | 639 | 8,348 | 21,957 |
| Non-financial assets | | | | | | | | | | 103 |
| **Total assets** | | | | | | | | | | 22,060 |
| **Financial liabilities** | | | | | | | | | | |
| Due to other financial institutions | 460 | 157 | 10 | - | - | - | - | - | 167 | 794 |
| Deposits at fair value | 440 | 23 | - | - | - | - | - | - | - | 463 |
| Deposits at amortised cost | 3,483 | 798 | 699 | 5 | - | 1 | - | - | 105 | 5,091 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 5,501 | 5,501 |
| Trading liabilities and other financial liabilities designated at fair value | - | - | - | - | 30 | - | 184 | 25 | - | 239 |
| Other liabilities | - | - | - | - | - | - | - | - | 129 | 129 |
| Subordinated debentures | - | - | - | - | - | - | - | 819 | - | 819 |
| Due to related entities | 4,042 | - | - | - | - | - | - | - | 2,420 | 6,462 |
| **Total financial liabilities** | 8,425 | 978 | 709 | 5 | 30 | 1 | 184 | 844 | 8,322 | 19,498 |
| Non-financial liabilities | | | | | | | | | | 86 |
| **Total liabilities** | | | | | | | | | | 19,584 |
| **Off-balance sheet financial instruments** | | | | | | | | | | |
| Net interest rate contracts (notional): | | | | | | | | | | |
| Receivable/(payable) | 3,523 | (4,235) | (6,770) | 3,858 | (145) | 2,699 | (89) | 1,159 | - | - |

## Note 38 Risk management (continued)

**NZ Branch**

| | 2009 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Less Than 1 Month $m | 1 Month to 3 Months $m | 3 Months to 1 Year $m | 1 Year to 2 Years $m | 2 Years to 3 Years $m | 3 Years to 4 Years $m | 4 Years to 5 Years $m | Over 5 Years $m | Non-interest Bearing $m | Total $m |
| **Financial assets** | | | | | | | | | | |
| Cash and balances with central banks | 370 | - | - | - | - | - | - | - | 214 | 584 |
| Due from other financial institutions | 500 | - | - | - | - | - | - | - | 341 | 841 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 6,306 | 6,306 |
| Trading securities and other financial assets designated at fair value | 128 | 228 | 129 | - | 132 | 47 | - | 320 | - | 984 |
| Loans | 3,977 | 3,448 | 54 | 21 | 78 | 10 | 7 | 79 | (91) | 7,583 |
| Due from related entities | 3,135 | - | - | - | - | - | - | - | 4,160 | 7,295 |
| Other assets | - | - | - | - | - | - | - | - | 357 | 357 |
| **Total financial assets** | 8,110 | 3,676 | 183 | 21 | 210 | 57 | 7 | 399 | 11,287 | 23,950 |
| Non-financial assets | | | | | | | | | | 40 |
| **Total assets** | | | | | | | | | | 23,990 |
| **Financial liabilities** | | | | | | | | | | |
| Due to other financial institutions | 160 | 58 | 15 | - | - | - | - | - | 252 | 485 |
| Deposits at fair value | 91 | 23 | 11 | - | - | - | - | - | - | 125 |
| Deposits at amortised cost | 2,646 | 662 | 305 | 11 | - | - | 1 | - | 166 | 3,791 |
| Derivative financial instruments | - | - | - | - | - | - | - | - | 6,970 | 6,970 |
| Trading liabilities and other financial liabilities designated at fair value | - | - | - | - | 97 | 63 | - | 653 | - | 813 |
| Other liabilities | - | - | - | - | - | - | - | - | 122 | 122 |
| Subordinated debentures | - | - | - | - | - | - | - | 790 | - | 790 |
| Due to related entities | 4,733 | - | - | - | - | - | - | - | 3,223 | 7,956 |
| **Total financial liabilities** | 7,630 | 743 | 331 | 11 | 97 | 63 | 1 | 1,443 | 10,733 | 21,052 |
| Non-financial liabilities | | | | | | | | | | 262 |
| **Total liabilities** | | | | | | | | | | 21,314 |
| **Off-balance sheet financial instruments** | | | | | | | | | | |
| Net interest rate contracts (notional): | | | | | | | | | | |
| Receivable/(payable) | 1,490 | (4,803) | 954 | (707) | 2,577 | (236) | 796 | (71) | - | - |

### Foreign currency exposures

The net open position in each foreign currency, detailed in the table below, represents the net on-balance sheet assets and liabilities in that foreign currency aggregated with the net expected future cash flows from off-balance sheet purchases and sales from foreign exchange transactions in that foreign currency. Amounts are stated in New Zealand dollar equivalents translated using end of reporting period spot foreign exchange rates.

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Receivable/(payable)** | | | | |
| Australian dollar | **-** | (2) | **-** | (2) |
| Euro | **(1)** | (1) | **(1)** | (1) |
| Great British pound | **(1)** | - | **(1)** | - |
| Japanese yen | **-** | - | **-** | - |
| United States dollar | **38** | 34 | **(6)** | (3) |
| Others | **1** | 2 | **1** | 2 |

# Note 39 Concentration of funding

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **Funding consists of** | | | | |
| Due to other financial institutions | **794** | 485 | **794** | 485 |
| Deposits at fair value | **2,453** | 3,773 | **463** | 125 |
| Deposits at amortised cost | **35,567** | 32,639 | **5,091** | 3,791 |
| Trading liabilities and other financial liabilities designated at fair value | **239** | 2,698 | **239** | 813 |
| Debt issues[1] | **15,439** | 12,369 | **-** | - |
| Subordinated debentures | **819** | 790 | **819** | 790 |
| Due to related entities | **7,003** | 8,673 | **6,462** | 7,956 |
| **Total funding** | **62,314** | 61,427 | **13,868** | 13,960 |
| **Analysis of funding by product** | | | | |
| Certificates of deposits | **1,902** | 3,468 | **-** | - |
| Savings accounts | **5,589** | 5,829 | **19** | 7 |
| Demand deposits | **5,883** | 5,916 | **2,024** | 1,805 |
| Other deposits | **4,264** | 3,628 | **989** | 722 |
| Term deposits | **20,382** | 17,571 | **2,522** | 1,382 |
| Securities short sold and under agreements to repurchase | **239** | 2,698 | **239** | 813 |
| Debt issues | **15,439** | 12,369 | **-** | - |
| Subordinated debentures | **819** | 790 | **819** | 790 |
| **Subtotal** | **54,517** | 52,269 | **6,612** | 5,519 |
| Due to other financial institutions | **794** | 485 | **794** | 485 |
| Due to related entities | **7,003** | 8,673 | **6,462** | 7,956 |
| **Total funding** | **62,314** | 61,427 | **13,868** | 13,960 |
| **Analysis of funding by geographical areas[1]** | | | | |
| New Zealand | **39,911** | 37,654 | **7,859** | 6,102 |
| Australia | **5,958** | 9,894 | **4,890** | 6,937 |
| United Kingdom | **2,516** | 2,790 | **102** | 30 |
| United States of America | **7,095** | 6,139 | **894** | 804 |
| Other | **6,834** | 4,950 | **123** | 87 |
| **Total funding** | **62,314** | 61,427 | **13,868** | 13,960 |
| **Analysis of funding by industry and economic sector** | | | | |
| Accommodation, cafes and restaurants | **127** | 110 | **35** | 18 |
| Agriculture, forestry and fishing | **1,365** | 1,388 | **159** | 180 |
| Construction | **425** | 442 | **83** | 98 |
| Finance and insurance | **24,310** | 23,093 | **4,932** | 3,543 |
| Government, administration and defence | **1,090** | 644 | **156** | 172 |
| Manufacturing | **938** | 816 | **400** | 241 |
| Mining | **81** | 24 | **26** | 2 |
| Property | **3,036** | 3,337 | **245** | 376 |
| Services | **3,456** | 3,317 | **734** | 696 |
| Trade | **973** | 862 | **213** | 210 |
| Transport and storage | **385** | 493 | **63** | 127 |
| Utilities | **500** | 334 | **232** | 144 |
| Retail | **17,848** | 17,104 | **-** | - |
| Other | **777** | 790 | **128** | 197 |
| **Subtotal** | **55,311** | 52,754 | **7,406** | 6,004 |
| Due to related entities | **7,003** | 8,673 | **6,462** | 7,956 |
| **Total funding** | **62,314** | 61,427 | **13,868** | 13,960 |

1 The geographic region used for debt issues is the location of the original purchaser. These instruments may have subsequently been on-sold.

Australian and New Zealand Standard Industrial Classifications have been used as the basis for disclosing industry sectors.

## Note 40 Concentration of credit exposures

| | NZ Banking Group | | NZ Branch | |
|---|---|---|---|---|
| | **2010 $m** | 2009 $m | **2010 $m** | 2009 $m |
| **On-balance sheet credit exposures consists of** | | | | |
| Cash and balances with central banks | **1,570** | 798 | **1,048** | 584 |
| Due from other financial institutions | **36** | 843 | **33** | 841 |
| Derivative financial instruments | **5,685** | 6,328 | **5,669** | 6,306 |
| Trading securities and other financial assets designated at fair value | **5,630** | 5,405 | **3,042** | 984 |
| Available-for-sale securities | **44** | 37 | **-** | - |
| Loans | **56,738** | 55,592 | **6,699** | 7,583 |
| Life insurance assets | **133** | 113 | **-** | - |
| Due from related entities | **1,555** | 2,759 | **5,417** | 7,295 |
| Other assets | **197** | 498 | **49** | 357 |
| **Total on-balance sheet credit exposures** | **71,588** | 72,373 | **21,957** | 23,950 |
| **Analysis of on-balance sheet credit exposures by geographical areas** | | | | |
| New Zealand | **69,065** | 69,074 | **19,652** | 20,691 |
| Australia | **1,962** | 2,929 | **1,788** | 2,926 |
| United States of America | **96** | 37 | **52** | - |
| Asia and Europe | **465** | 333 | **465** | 333 |
| **Total on-balance sheet credit exposures** | **71,588** | 72,373 | **21,957** | 23,950 |
| **Analysis of on-balance sheet credit exposures by industry and economic sector** | | | | |
| Accommodation, cafes and restaurants | **539** | 580 | **4** | 3 |
| Agriculture, forestry and fishing | **6,295** | 5,936 | **572** | 564 |
| Construction | **1,430** | 1,385 | **69** | 4 |
| Finance and insurance | **9,853** | 13,035 | **7,521** | 9,752 |
| Government, administration and defence | **4,393** | 3,331 | **2,031** | 607 |
| Manufacturing | **2,281** | 2,263 | **874** | 859 |
| Mining | **420** | 323 | **344** | 264 |
| Property | **9,887** | 9,831 | **1,147** | 1,175 |
| Property services and business services | **1,926** | 1,790 | **417** | 420 |
| Services | **2,680** | 2,602 | **355** | 286 |
| Trade | **3,594** | 3,377 | **1,236** | 1,238 |
| Transport and storage | **1,385** | 1,372 | **610** | 686 |
| Utilities | **1,333** | 927 | **1,108** | 755 |
| Retail lending | **24,371** | 23,234 | **-** | - |
| Other | **438** | 149 | **342** | 67 |
| **Subtotal** | **70,825** | 70,135 | **16,630** | 16,680 |
| Provisions for impairment charges on loans | **(830)** | (611) | **(100)** | (91) |
| Due from related entities | **1,555** | 2,759 | **5,417** | 7,295 |
| Other assets | **38** | 90 | **10** | 66 |
| **Total on-balance sheet credit exposures** | **71,588** | 72,373 | **21,957** | 23,950 |
| **Off-balance sheet credit exposures** | | | | |
| Contingent liabilities and commitments | **5,558** | 5,952 | **2,162** | 2,173 |
| **Total off-balance sheet credit exposures** | **5,558** | 5,952 | **2,162** | 2,173 |
| **Analysis of off-balance sheet credit exposures by industry and economic sector** | | | | |
| Accommodation, cafes and restaurants | **27** | 32 | **9** | 8 |
| Agriculture, forestry and fishing | **116** | 198 | **52** | 58 |
| Construction | **259** | 288 | **132** | 99 |
| Finance and insurance | **330** | 260 | **210** | 221 |
| Government, administration and defence | **322** | 193 | **297** | 110 |
| Manufacturing | **380** | 445 | **277** | 291 |
| Mining | **68** | 128 | **65** | 122 |
| Property services and business services | **551** | 780 | **284** | 287 |
| Trade | **292** | 366 | **97** | 123 |
| Transport and storage | **110** | 205 | **99** | 166 |
| Utilities | **641** | 696 | **640** | 688 |
| Retail lending | **2,459** | 2,361 | **-** | - |
| Other | **3** | - | **-** | - |
| **Total off-balance sheet credit exposures** | **5,558** | 5,952 | **2,162** | 2,173 |

Australian and New Zealand Standard Industrial Classifications have been used as the basis for disclosing industry sectors.

# Note 40 Concentration of credit exposures (continued)

## Analysis of credit exposures to individual counterparties

The following credit exposures are based on actual credit exposures to individual counterparties and groups of closely related counterparties.

The number of individual bank counterparties (which are not members of a group of closely related counterparties), and groups of closely related counterparties of which a bank is the parent, to which the NZ Banking Group has an aggregate credit exposure that equals or exceeds 10% of the Overseas Banking Group's equity:

- as at 30 September 2010 was nil (30 September 2009: nil); and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 September 2010 was nil (three months ended 30 September 2009: nil).

The number of individual non-bank counterparties (which are not members of a group of closely related counterparties), and groups of closely related counterparties of which a bank is not the parent, to which the NZ Banking Group has an aggregate credit exposure that equals or exceeds 10% of the Overseas Banking Group's equity:

- as at 30 September 2010 was nil (30 September 2009: nil); and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 September 2010 was nil (three months ended 30 September 2009: nil).

The peak end-of-day exposures have been calculated by determining the maximum end-of-day aggregate amount of actual credit exposure over the relevant three-month period, and then dividing that amount by the Overseas Banking Group's equity as at the end of the period. Credit exposures to individual counterparties (not being members of a group of closely related counterparties), and to groups of closely related counterparties do not include exposures to the central government of any country with a long-term credit rating of A- or A3 or above, or its equivalent. These calculations relate only to exposures held in the financial records of the NZ Banking Group and were calculated net of individually assessed provisions.

# Auditors' report

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## Independent Auditors' Report

To the Directors of Westpac Banking Corporation

### Report on the Financial Statements (excluding Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy)

We have audited pages 11 to 84 of the General Disclosure Statement of Westpac Banking Corporation – New Zealand Branch (the '**NZ Branch**') which consists of the financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 37, 38.3 and 38.4) required by Schedules 4 and 6 to 8 and Clauses 19 and 20 of Schedule 3 of the Registered Bank Disclosure Statement (Full and Half-Year – Overseas Incorporated Registered Banks) Order 2008 (the '**Order**'). The financial statements comprise the balance sheets as at 30 September 2010, the income statements, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information for both the NZ Branch and the aggregated results of Westpac Banking Corporation New Zealand Division (the '**NZ Banking Group**').

*Directors' Responsibility for the Financial Statements*

The Directors of Westpac Banking Corporation are responsible for the General Disclosure Statement, which includes financial statements prepared in accordance with Clause 22 of the Order and generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for including supplementary information in the General Disclosure Statement which complies with Schedules 4 and 6 to 8 and Clauses 19 and 20 of the Order.

*Auditors' Responsibility*

Our responsibility is to express an opinion on the financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 37, 38.3 and 38.4) disclosed in accordance with Clause 22, Schedules 4 and 6 to 8 and Clauses 19 and 20 of Schedule 3 of the Order and presented to us by the Directors. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal controls relevant to the entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

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

We carry out other assignments on behalf of the NZ Branch and the NZ Banking Group in the areas of taxation advice and other assurance services. In addition, certain partners and employees of our firm may deal with the NZ Branch, the NZ Banking Group and Westpac Banking Corporation Group on normal terms within the ordinary course of trading activities of the NZ Branch, the NZ Banking Group and Westpac Banking Corporation Group. These matters have not impaired our independence as auditors of the NZ Branch and the NZ Banking Group. We have no other interests in the NZ Branch, the NZ Banking Group or Westpac Banking Corporation Group.

*Opinion*

In our opinion, the financial statements on pages 11 to 84 (excluding the supplementary information disclosed in the balance sheets and Notes 35, 36, 37, 38.3, 38.4 and 40):

(i) comply with generally accepted accounting practice in New Zealand;

(ii) comply with International Financial Reporting Standards; and

(iii) give a true and fair view of the financial position of the NZ Branch and the NZ Banking Group as at 30 September 2010, and their financial performance and cash flows for the year then ended.

In our opinion, the supplementary information disclosed in the balance sheets and Notes 35, 36 and 40 prescribed by Schedules 4 and 6 to 8 and Clauses 19 and 20 of Schedule 3 of the Order fairly states the matters to which it relates in accordance with those Schedules.

**Report on Other Legal and Regulatory Requirements (excluding Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy)**

We also report in accordance with the requirements of Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993 and Clauses 2(d) and 2(e) of Schedule 1 of the Order. In relation to our audit of the financial statements (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 37, 38.3 and 38.4) for the year ended 30 September 2010:

(i) we have obtained all the information and explanations that we have required; and

(ii) in our opinion, proper accounting records have been kept by the NZ Branch and the NZ Banking Group as far as appears from an examination of those records.

**Report on the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy**

We have reviewed the supplementary information relating to credit and market risk exposures and capital adequacy as disclosed in Notes 37, 38.3 and 38.4 of the financial statements of the NZ Branch and the NZ Banking Group for the year ended 30 September 2010.

*Directors' Responsibility for the Supplementary Information Relating to Credit and Market Risk Exposures and Capital Adequacy*

The Directors are responsible for including supplementary information relating to credit and market risk exposures and capital adequacy prepared in accordance with Schedule 5 of the Order.

*Auditors' Responsibility*

Our responsibility is to express an opinion on the supplementary information relating to credit and market risk exposures and capital adequacy, disclosed in Notes 37, 38.3 and 38.4, based on our review.

# Auditors' report (continued)

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We are responsible for reviewing the disclosures in order to state whether, on the basis of the procedures described below, anything has come to our attention that would cause us to believe that the supplementary information is not, in all material respects:

(i) prepared in accordance with Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A); and

(ii) disclosed in accordance with Schedule 5 of the Order

and for reporting our findings to you.

We conducted our review in accordance with review engagement standard RS-1 Statement of Review Engagement Standards issued by the Institute of Chartered Accountants of New Zealand. A review is limited primarily to enquiries of NZ Branch and NZ Banking Group personnel and analytical procedures applied to financial data, and thus provides less assurance than an audit. We have not performed an audit on the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 37, 38.3 and 38.4 and, accordingly, we do not express an audit opinion on that supplementary information.

*Opinion*

Based on our review procedures, which are not an audit, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 37, 38.3 and 38.4, as required by Schedule 5 of the Order, is not in all material respects:

(i) prepared in accordance with Capital Adequacy Framework (Basel I Approach) (BS2) and Capital Adequacy Framework (Standardised Approach) (BS2A); and

(ii) disclosed in accordance with Schedule 5 of the Order.

**Restriction on Distribution or Use**

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

PricewaterhouseCoopers

30 November 2010

Chartered Accountants Auckland