Westpac Banking Corporation – New Zealand Banking Group

Disclosure Statement

For the year ended 30 September 2018

Contents

General information

Certain information contained in this Disclosure Statement is required by the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (‘**Order**’).

In this Disclosure Statement, reference is made to five main reporting groups:

- Westpac Banking Corporation (otherwise referred to as the ‘**Overseas Bank**’) – refers to the worldwide business of Westpac Banking Corporation excluding its controlled entities;
- 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 New Zealand Branch (otherwise referred to as the ‘**NZ Branch**’) – refers to the New Zealand Branch of Westpac Banking Corporation (trading as Westpac);
- Westpac New Zealand Limited (otherwise referred to as ‘**Westpac New Zealand**’) – refers to a locally incorporated subsidiary of the Overseas Bank (carrying on the Overseas Bank’s New Zealand consumer, business and institutional banking operations); and
- Westpac Banking Corporation - New Zealand Banking Group (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 the financial statements of the Overseas Banking Group’s New Zealand business. Controlled entities of the NZ Banking Group as at 30 September 2018 are set out in Note 25 Related entities.

Words and phrases not defined in this Disclosure Statement, but defined by the Order, have the meaning given by the Order when used in this Disclosure Statement.

Corporate information

The Overseas Bank is entered on the register maintained under the Reserve Bank of New Zealand Act 1989 (‘**Reserve Bank Act**’). The NZ Branch’s head office is situated at Westpac on Takutai Square, 16 Takutai Square, Auckland 1010, New Zealand and the address for service of process on the NZ Branch is Westpac on Takutai Square, 53 Galway Street, Auckland, New Zealand.

Overseas Bank

The Overseas Bank was founded in 1817 and was incorporated in 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 provides a broad range of banking and financial services, including consumer, business and institutional banking and wealth management services.

The Overseas Bank’s principal office and address for service of process is Level 18 Westpac Place, 275 Kent Street, Sydney, New South Wales 2000, Australia.

Limits on material financial support by the ultimate parent bank

On 19 November 2015, the Australian Prudential Regulation Authority (‘**APRA**’) informed the Overseas Bank that its Extended Licensed Entity (‘**ELE**’) non-equity exposures to New Zealand banking subsidiaries is to transition to be below a limit of 5% of the Overseas Bank’s Level 1 Tier 1 capital, as part of an initiative to reduce Australian bank non-equity exposure to their respective New Zealand banking subsidiaries and branches.

The ELE consists of the Overseas Bank and its subsidiary entities that have been approved by APRA to be included in the ELE for the purposes of measuring capital adequacy.

APRA has allowed a period of five years commencing on 1 January 2016 to transition to be less than the 5% limit. Exposures for the purposes of this limit include all committed, non-intraday, non-equity exposures including derivatives and off-balance sheet exposures. For the purposes of assessing this exposure, the 5% limit excludes equity investments and holdings of capital instruments in New Zealand banking subsidiaries.

While the limit and associated conditions do not apply to the ELE’s non-equity exposures to the NZ Branch (which is within the ELE), the limit and associated conditions do apply to the NZ Branch’s non-equity exposures to the rest of the NZ Banking Group other than Westpac New Zealand Group Limited. As at 30 September 2018, the ELE’s non-equity exposures to New Zealand banking subsidiaries affected by the limit were below 5% of Level 1 Tier 1 capital of the Overseas Bank.

APRA has also confirmed the terms on which the Overseas Bank ‘may provide contingent funding support to a New Zealand banking subsidiary during times of financial stress’. APRA has confirmed that, at this time, only covered bonds meet its criteria for contingent funding arrangements.

Registered bank: Directorate

Directors

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

Name: Lindsay Philip Maxsted, DipBus (Gordon), FCA, FAICD
Non-executive: Yes
Country of Residence: Australia
Primary Occupation: Director
Secondary Occupations: None
Board Audit Committee Member: Yes
Independent Director: Yes

External Directorships: Chairman of Transurban Holdings Limited, Transurban Infrastructure Management Limited and Transurban International Limited. Managing Director of Align Capital Pty Ltd. Director of BHP Billiton Limited, BHP Billiton plc, Align Investments Pty Ltd, Baker Heart and Diabetes Institute, Belmont Pty Ltd, Centip Pty Ltd, Continuum Investments Pty Ltd, Jacobite Investments Pty Ltd and 139 Pty Ltd. Member of the Coolmore Australia Advisory Board.

General information (continued)

Name: Brian Charles Hartzer, BA, CFA **Non-executive:** No **Country of Residence:** Australia **Primary Occupation:** Managing Director & Chief Executive Officer, Westpac Banking Corporation **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** No	**External Directorships:** Director of Australian Banking Association Incorporated, The Financial Markets Foundation for Children, Neville Street Pty Ltd and Springfield 2012 Pty Ltd. Chairman of The Australian National University Business and Industry Advisory Board.
Name: Nerida Frances Caesar, BCom, MBA, GAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of TNCJ Pty Limited and C A J Caesar Pty Ltd. Member of the Australian Government's FinTech Advisory Group and the Advisory Board of IXUP Limited. Advisor to Equifax Australia and New Zealand.
Name: Ewen Graham Wolseley Crouch AM, BEc (Hons.), LLB, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of BlueScope Steel Limited, Sydney Symphony Orchestra Holdings Pty Limited, Sydney Symphony Limited, Jawun, NCNC Funds Limited, Wersley Investments Pty Limited, Wersley Pty Limited, G.J. Crouch Properties Pty. Limited, Grajon Investments Pty. Limited and Maharg Pty. Ltd. Member of the Law Committee of the Australian Institute of Company Directors, the Corporations Committee of the Law Council of Australia, the Commonwealth Remuneration Tribunal and ASIC's Director Advisory Panel.
Name: Catriona Alison Deans, BA, MBA, GAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Cochlear Limited, Ramsay Health Care Limited, The Observership Program Limited, SCEGGS Darlinghurst Limited, The SCEGGS Endowment Fund Limited, The SCEGGS Overseas Aid Fund Limited, Chessholme Pty Ltd and Ascog Pty Ltd. Investment Committee member of the CSIRO Innovation Fund (Main Sequence Ventures) and Senior Advisor to McKinsey & Company.
Name: Craig William Dunn, BCom, FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of Stone and Chalk Limited (retires 27 November 2018), The Australian Ballet and the International Standards Technical Committee on Blockchain and Distributed Ledger Technologies (ISO/TC 307). Co-Chair of the Australian Government's Fintech Advisory Group. Director of Telstra Corporation Limited, Amiala Pty Ltd and Carringbush Consulting Services Pty Ltd. Board Member of Jobs for New South Wales. Member of the Australian Securities and Investments Commission's External Advisory Panel, the New South Wales Government's Quantum Computing Fund Advisory Panel and the Sydney Technology & Innovation Precinct Panel. Consultant to King & Wood Mallesons.
Name: Yuen Mei Anita Fung, BSocSc, MAppFin **Non-executive:** Yes **Country of Residence:** Hong Kong **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Hong Kong Exchanges and Clearing Limited, China Construction Bank Corporation and Hang Lung Properties Limited. Board Member of Airport Authority Hong Kong. Member of Hong Kong Museum Advisory Committee.
Name: Peter John Oswin Hawkins, BCA (Hons.), SF Fin, ACA (NZ), FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of Mirvac Funds Limited, Mirvac Limited, Liberty Financial Ltd, Liberty Financial Pty Ltd, Liberty Financial Group Pty Ltd, Liberty Fiduciary Ltd, Crestone Holdings Limited, Joshawk Investments Pty Ltd, Lynter Investments Pty Ltd, LFI Group Pty Ltd, and Petlyn Holdings Pty Ltd.
Name: Peter Ralph Marriott, BEc (Hons.), FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes, Chairman **Independent Director:** Yes	**External Directorships:** Director of Austraclear Limited. Director of ASX Limited, ASX Settlement Corporation Limited, ASX Clear (Futures) Pty Limited, ASX Clear Pty Limited, ASX Clearing Corporation Limited, ASX Settlement Pty Limited, P. & E. Marriott Investments Pty Ltd, P. & E. Marriott Holdings Pty Ltd and P. & E. Marriott Pty Ltd. Member of the Review Panel & Policy Council of the Banking & Finance Oath.
Name: Peter Stanley Nash, BCom, FCA, F Fin **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships**: Chairman of Johns Lyng Group Limited. Director of Mirvac Funds Limited, Mirvac Limited, Reconciliation Australia Limited, Golf Victoria Limited, Peter Nash Pty Ltd and Nash Family Pty Ltd. Board Member of Koorie Heritage Trust and Migration Council Australia. Advisory Board Member of University of Melbourne Centre for Chinese Contemporary Studies.

General information (continued)

Changes to Directorate

Robert George Elstone ceased to be a director on 8 December 2017. Peter Stanley Nash was appointed as a director effective 7 March 2018. Yuen Mei Anita Fung was appointed as a director effective 1 October 2018. There have been no other changes in the composition of the Overseas Bank's Board since 30 September 2017.

Chief Executive Officer, NZ Branch

Name: Karen Lee Silk, B.Com
Country of Residence: New Zealand
Primary Occupation: Chief Executive Officer, NZ Branch
Secondary Occupations: General Manager, Commercial Corporate and Institutional, Westpac New Zealand
External Directorships: Director of Waianiwa Pastoral Limited, Payments NZ Limited (alternate Director), Sustainable Business Council

Responsible person

All the current Directors named above have authorised in writing David Alexander McLean, Chief Executive, Westpac New Zealand to sign this Disclosure Statement on the Directors' behalf in accordance with section 82 of the Reserve Bank Act.

Name: David Alexander McLean, LLB (Hons.)
Country of Residence: New Zealand
Primary Occupation: Chief Executive, Westpac New Zealand
Secondary Occupations: None

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 Westpac on Takutai Square, 16 Takutai Square, Auckland 1010, New Zealand.

Conflicts of interest policy

The Board follows a procedure to ensure that conflicts and potential conflicts of interest between the Directors' duty to the Overseas Bank and their personal, professional or business 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 Overseas Bank, 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 Overseas Bank 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.

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 Disclosure Statement:

Rating Agency	Current Credit Rating	Rating Outlook
Fitch Ratings	AA-	Stable
Moody's Investors Service ('**Moody's**')	Aa3	Stable
S&P Global Ratings ('**S&P**')	AA-	Negative

On 19 June 2017, Moody's downgraded the Overseas Bank's credit rating to Aa3. The downgrade followed Moody's revision of the Australian Macro Profile to "Strong +" from "Very Strong -". At the same time, Moody's revised the outlook to 'stable' from 'negative'.

General information (continued)

Descriptions of credit rating scales[1]

	Fitch Ratings	Moody's	S&P
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 and S&P.

Credit ratings by Fitch Ratings and S&P may be modified by a plus (higher end) or minus (lower end) sign to show relative standing within the major categories. Moody's 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.

The Overseas Bank's current position is at the lower end of the credit rating scale indicated in bold.

Disclosure statements of the NZ Banking Group and the financial statements of the Overseas Bank and the Overseas Banking Group

Disclosure Statements of the NZ Banking Group for the last five years are available, free of charge, at the internet address www.westpac.co.nz. A printed copy will also be made available, free of charge, upon request and will be dispatched by the end of the second working day after the day on which the request is made.

The most recently published financial statements of the Overseas Bank and the Overseas Banking Group are for the year ended 30 September 2018 and can be accessed at the internet address www.westpac.com.au.

General information (continued)

Historical summary of financial statements

	NZ BANKING GROUP				
$ millions	**Year Ended 30-Sep-18**	**Year Ended 30-Sep-17**	**Year Ended 30-Sep-16**	**Year Ended 30-Sep-15**	**Year Ended 30-Sep-14**
Income statement					
Interest income	**4,067**	3,981	4,172	4,451	4,037
Interest expense	**(2,155)**	(2,193)	(2,398)	(2,670)	(2,447)
Net interest income	**1,912**	1,788	1,774	1,781	1,590
Non-interest income	**602**	625	588	590	678
Net operating income before operating expenses and impairment charges	**2,514**	2,413	2,362	2,371	2,268
Operating expenses	**(969)**	(1,006)	(953)	(943)	(868)
Impairment (charges)/benefits	**3**	76	(73)	(47)	(26)
Profit before income tax	**1,548**	1,483	1,336	1,381	1,374
Income tax expense	**(431)**	(424)	(373)	(375)	(355)
Net profit for the year	**1,117**	1,059	963	1,006	1,019
Net profit for the year attributable to:					
Head office account and owners of the NZ Banking Group	**1,117**	1,059	963	1,003	1,016
Non-controlling interests	**-**	-	-	3	3
	1,117	1,059	963	1,006	1,019
Dividends paid on ordinary share capital	**(572)**	(316)	(111)	(159)	(251)
Balance sheet					
Total assets	**96,656**	95,666	93,358	88,861	81,678
Total individually impaired assets	**145**	173	222	282	346
Total liabilities	**88,273**	87,835	86,321	82,668	76,179
Total head office account	**2,169**	2,040	1,913	1,824	1,750
Total equity	**8,383**	7,831	7,037	6,193	5,499

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

Guarantee arrangements

No material obligations of the Overseas Bank that relate to the NZ Branch are guaranteed as at the date the Directors and the Chief Executive Officer, NZ Branch signed this Disclosure Statement.

Auditor

PricewaterhouseCoopers
PricewaterhouseCoopers Tower
188 Quay Street
Auckland
New Zealand

General information (continued)

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 NZ Branch on the 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.

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.

Section 13A(3) of the Banking Act 1959 of Australia ('**Australian Banking Act**') provides that if an authorised deposit-taking institution ('**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, 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 in the Australian Banking Act) as part of the Financial Claims Scheme ('**FCS**') for the Australian government guarantee of 'protected accounts' (including most deposits) up to A$250,000 in the winding-up of the ADI;
- second, APRA's costs (if any) in exercising its powers and performing its functions relating to the ADI in connection with the FCS;
- 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(3) of the Australian Banking Act affects all unsecured liabilities of the NZ Branch, which, as at 30 September 2018, amounted to $9,911 million (30 September 2017: $11,494 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 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 2018, 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.

Other material matters

Certain matters relating to the business or affairs of the Overseas Bank and the NZ Banking Group have been disclosed on the New Zealand and/or Australian stock exchanges.

In May 2018, the Financial Markets Authority ('**FMA**') and Reserve Bank commenced thematic reviews into the conduct and culture at New Zealand's retail banks and life insurers. These reviews were established to assess whether misconduct of the type highlighted by the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry may be taking place in New Zealand. The thematic review report concerning the retail banks review was released on 5 November 2018. That report identifies no widespread instances of misconduct and notes that each bank will be required to provide the regulators with a plan by March 2019 to address the issues identified in the report and in individualised letters due to be received by the banks in late 2018. The thematic review report in respect of the life insurers is currently due to be released in late January 2019. In addition to these broader conduct and culture thematic reviews, the FMA issued its industry findings from a separate, but related, thematic review concerning retail bank incentives on 15 November 2018. Each of these reports may lead to further scrutiny of the financial services industry in New Zealand.

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

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

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

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

(b) is not false or misleading.

Each Director of the Overseas Bank and the Chief Executive Officer, NZ Branch, believe, after due enquiry, that, over the year ended 30 September 2018:

(a) the Overseas Bank has complied with all conditions of registration imposed on it pursuant to section 74 of the Reserve Bank Act; and

(b) the NZ Branch and other members of the NZ Banking Group had systems in place to monitor and control adequately the material risks of relevant members of the NZ Banking Group, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk and other business risks, and that those systems were being properly applied. For this purpose, a relevant member of the NZ Banking Group means a member of the NZ Banking Group that is not a member of Westpac New Zealand's banking group. Refer to Note 36 of the financial statements for further detail regarding the entities which had systems in place to monitor and control the material risks of relevant members of NZ Banking Group.

The Disclosure Statement has been signed on behalf of all of the Directors by David Alexander McLean, Chief Executive, Westpac New Zealand, and by Karen Lee Silk as Chief Executive Officer, NZ Branch.

David McLean

DA McLean

KL Silk

Dated this 26th day of November 2018

Income statement for the years ended 30 September

$ millions	Note	NZ BANKING GROUP Year Ended 30-Sep-18	 Year Ended 30-Sep-17
Interest income	2	**4,067**	3,981
Interest expense	2	**(2,155)**	(2,193)
Net interest income		**1,912**	1,788
Non-interest income	3	**602**	625
Net operating income before operating expenses and impairment charges		**2,514**	2,413
Operating expenses	4	**(969)**	(1,006)
Impairment (charges)/benefits	6	**3**	76
Profit before income tax		**1,548**	1,483
Income tax expense	7	**(431)**	(424)
Net profit attributable to the owners of the NZ Banking Group		**1,117**	1,059

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

Statement of comprehensive income for the years ended 30 September

$ millions	NZ BANKING GROUP Year Ended 30-Sep-18	 Year Ended 30-Sep-17
Net profit attributable to the owners of the NZ Banking Group	**1,117**	1,059
Other comprehensive income		
Items that may be reclassified subsequently to profit and loss		
Gains/(losses) on available-for-sale securities:		
Recognised in equity	**-**	11
Gains/(losses) on cash flow hedging instruments:		
Recognised in equity	**(34)**	(58)
Transferred to income statement	**46**	104
Income tax on items taken to or transferred from equity:		
Available-for-sale securities reserve	**-**	(3)
Cash flow hedge reserve	**(3)**	(13)
Items that will not be reclassified subsequently to profit or loss		
Remeasurement of defined benefit obligation recognised in equity (net of tax)	**(2)**	10
Other comprehensive income for the year (net of tax)	**7**	51
Total comprehensive income attributable to the owners of the NZ Banking Group	**1,124**	1,110

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

Balance sheet as at 30 September

		NZ BANKING GROUP	
$ millions	Note	**2018**	2017
Assets			
Cash and balances with central banks	40	**1,472**	1,761
Receivables due from other financial institutions	9	**237**	471
Other assets	10	**465**	423
Trading securities and financial assets designated at fair value	11	**3,016**	3,949
Derivative financial instruments	26	**3,509**	3,420
Available-for-sale securities	12	**3,810**	4,087
Loans	13, 14	**80,860**	77,681
Life insurance assets		**310**	304
Due from related entities	25	**2,023**	2,623
Property and equipment		**144**	146
Deferred tax assets	15	**127**	136
Intangible assets	16	**683**	665
Total assets		**96,656**	95,666
Liabilities			
Payables due to other financial institutions	18	**1,253**	1,043
Other liabilities	19	**861**	635
Deposits and other borrowings	20	**63,105**	58,998
Other financial liabilities at fair value through income statement	21	**223**	302
Derivative financial instruments	26	**3,569**	3,475
Due to related entities	25	**2,440**	3,646
Debt issues	22	**13,725**	16,729
Current tax liabilities		**111**	88
Provisions	23	**120**	97
Loan capital	24	**2,866**	2,822
Total liabilities		**88,273**	87,835
Net assets		**8,383**	7,831
Head office account			
Branch capital		**1,300**	1,300
Retained profits		**869**	740
Total head office account		**2,169**	2,040
NZ Banking Group equity			
Share capital		**143**	143
Reserves		**(55)**	(64)
Retained profits		**6,126**	5,712
Total NZ Banking Group equity		**6,214**	5,791
Total equity attributable to the owners of the NZ Banking Group		**8,383**	7,831
Interest earning and discount bearing assets		**91,003**	90,225
Interest and discount bearing liabilities		**76,948**	77,611

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

Signed on behalf of the Board of Directors.

Director

26 November 2018

Director

26 November 2018

Statement of changes in equity for the years ended 30 September

	NZ BANKING GROUP						
	NZ BRANCH		OTHER MEMBERS OF THE NZ BANKING GROUP				
	Head Office Account			Reserves			
$ millions	Branch Capital	Retained Profits	Share Capital	Available-for-sale Securities Reserve	Cash Flow Hedge Reserve	Retained Profits	Total Equity
As at 1 October 2016	1,300	613	143	1	(106)	5,086	7,037
Year ended 30 September 2017							
Net profit attributable to the owners of the NZ Banking Group	-	127	-	-	-	932	1,059
Net gains/(losses) from changes in fair value	-	-	-	11	(58)	-	(47)
Income tax effect	-	-	-	(3)	16	-	13
Transferred to income statement	-	-	-	-	104	-	104
Income tax effect	-	-	-	-	(29)	-	(29)
Remeasurement of defined benefit obligations	-	-	-	-	-	14	14
Income tax effect	-	-	-	-	-	(4)	(4)
Total comprehensive income for the year ended 30 September 2017	-	127	-	8	33	942	1,110
Transactions with owners:							
Dividends paid on ordinary shares (refer to Note 25)	-	-	-	-	-	(316)	(316)
As at 30 September 2017	1,300	740	143	9	(73)	5,712	7,831
Year ended 30 September 2018							
Net profit attributable to the owners of the NZ Banking Group	**-**	**129**	**-**	**-**	**-**	**988**	**1,117**
Net gains/(losses) from changes in fair value	**-**	**-**	**-**	**-**	**(34)**	**-**	**(34)**
Income tax effect	**-**	**-**	**-**	**-**	**10**	**-**	**10**
Transferred to income statement	**-**	**-**	**-**	**-**	**46**	**-**	**46**
Income tax effect	**-**	**-**	**-**	**-**	**(13)**	**-**	**(13)**
Remeasurement of defined benefit obligations	**-**	**-**	**-**	**-**	**-**	**(3)**	**(3)**
Income tax effect	**-**	**-**	**-**	**-**	**-**	**1**	**1**
Total comprehensive income for the year ended 30 September 2018	**-**	**129**	**-**	**-**	**9**	**986**	**1,124**
Transactions with owners:							
Dividends paid on ordinary shares (refer to Note 25)	**-**	**-**	**-**	**-**	**-**	**(572)**	**(572)**
As at 30 September 2018	**1,300**	**869**	**143**	**9**	**(64)**	**6,126**	**8,383**

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

Statement of cash flows for the years ended 30 September

		NZ BANKING GROUP	
$ millions	Note	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Cash flows from operating activities			
Interest received		**4,062**	3,968
Interest paid		**(2,175)**	(2,182)
Non-interest income received		**514**	641
Operating expenses paid		**(867)**	(887)
Income tax paid		**(402)**	(397)
Cash flows from operating activities before changes in operating assets and liabilities		**1,132**	1,143
Net (increase)/decrease in:			
Receivables due from other financial institutions		**251**	355
Other assets		**(7)**	(17)
Trading securities and financial assets designated at fair value		**1,052**	11
Loans		**(3,172)**	(2,090)
Due from related entities		**643**	(1,689)
Net increase/(decrease) in:			
Payables due to other financial institutions		**210**	427
Other liabilities		**98**	7
Deposits and other borrowings		**4,107**	207
Other financial liabilities at fair value through income statement		**(79)**	(274)
Due to related entities		**(880)**	849
Net movement in external and related entity derivative financial instruments		**1,143**	(902)
Net cash provided by/(used in) operating activities	40	**4,498**	(1,973)
Cash flows from investing activities			
Purchase of available-for-sale securities		**(268)**	(533)
Proceeds from available-for-sale securities		**499**	162
Net movement in life insurance assets		**(6)**	(35)
Purchase of capitalised computer software		**(64)**	(64)
Purchase of property and equipment		**(44)**	(31)
Net cash provided by/(used in) investing activities		**117**	(501)
Cash flows from financing activities			
Net movement in due to related entities		**(401)**	(437)
Proceeds from debt issues	22	**550**	7,490
Repayments of debt issues	22	**(4,464)**	(5,698)
Issue of loan capital (net of transaction fees)		**-**	1,706
Dividends paid to ordinary shareholders	25	**(572)**	(316)
Net cash provided by/(used in) financing activities		**(4,887)**	2,745
Net increase/(decrease) in cash and cash equivalents		**(272)**	271
Cash and cash equivalents at beginning of the year		**1,801**	1,530
Cash and cash equivalents at end of the year	40	**1,529**	1,801

The above statement of cash flows should be read in conjunction with the accompanying notes. Details of the reconciliation of net cash provided by/(used in) operating activities to net profit are provided in Note 40.

Notes to the financial statements

Note 1 Financial statement preparation

In these financial statements, reference is made to:

- Westpac Banking Corporation (otherwise referred to as the '**Overseas Bank**') – refers to the worldwide business of Westpac Banking Corporation excluding its controlled entities;
- 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 New Zealand Branch (otherwise referred to as the '**NZ Branch**') – refers to the New Zealand Branch of Westpac Banking Corporation (trading as Westpac);
- Westpac New Zealand Limited (otherwise referred to as '**Westpac New Zealand**') – refers to a locally incorporated subsidiary of the Overseas Bank (carrying on the Overseas Bank's New Zealand consumer, business and institutional banking operations); and
- Westpac Banking Corporation - New Zealand Banking Group (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 the financial statements of the Overseas Banking Group's New Zealand business.

These financial statements are for the NZ Banking Group.

These financial statements were authorised for issue by the Overseas Bank's Board of Directors (the '**Board**') on 26 November 2018. The Board has the power to amend the financial statements after they are authorised for issue.

The principal accounting policies are set out below and in the relevant notes to the financial statements. These policies have been consistently applied to all the years presented, unless otherwise stated.

a. Basis of preparation

i. Basis of accounting

These financial statements are general purpose financial statements prepared in accordance with:

- the requirements of the Financial Markets Conduct Act 2013; and
- the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) ('**Order**').

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

All amounts in these financial statements have been rounded to the nearest million dollars unless otherwise stated.

ii. Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by applying fair value accounting to available-for-sale securities and financial assets and liabilities (including derivative instruments) measured at fair value through income statement or in other comprehensive income. The going concern concept has been applied.

iii. Comparative revisions

Comparative information has been revised where appropriate to conform to changes in presentation in the current year and to enhance comparability. Where there has been a material restatement of comparative information the nature of, and the reason for, the restatement is disclosed in the relevant note.

iv. Changes in accounting standards

The NZ Banking Group adopted the requirements of Disclosure Initiative: Amendments to NZ IAS 7 *Statement of Cash Flows* which require additional disclosures regarding both cash and non-cash changes in liabilities arising from financing activities. These disclosures have been made in Note 22 and Note 24. As permitted by the standard, comparatives are not required on first application.

No other new accounting standards have been adopted for the year ended 30 September 2018.

b. Basis of aggregation

The NZ Banking Group as at 30 September 2018 has been aggregated by combining the sum of the capital and reserves of the NZ Branch, and the consolidated capital and reserves of Westpac New Zealand Group Limited, BT Financial Group (NZ) Limited, Westpac Financial Services Group-NZ-Limited, Westpac Group Investment-NZ-Limited, Capital Finance New Zealand Limited and their subsidiaries (including structured 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.

Subsidiaries (including structured entities) are those entities over which the members of the NZ Banking Group have control. Control exists when it is exposed to, or has rights to, variable returns from the subsidiaries, and has the ability to affect those returns through its power over the entities. All transactions between entities within the NZ Banking Group are eliminated. Subsidiaries are fully consolidated from the date on which control commences and are de-consolidated from the date that control ceases.

i. Business combinations

Business combinations are accounted for using the acquisition method of accounting. Acquisition cost is measured as the aggregate of the fair value at the date of acquisition of the assets given, equity instruments issued or liabilities incurred or assumed. Acquisition-related costs are expensed as incurred (except for those costs arising on the issue of equity instruments which are recognised directly in equity).

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured at fair value on the acquisition date. Goodwill is measured as the excess of the acquisition cost, the amount of any non-controlling interest and the fair value of any previous NZ Banking Group's equity interest in the acquiree, over the fair value of the identifiable net assets acquired.

ii. Foreign currency translation

Functional and presentational currency

The consolidated financial statements are presented in New Zealand dollars which is the NZ Banking Group's functional and presentation currency.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in other comprehensive income for qualifying cash flow hedges.

Notes to the financial statements

Note 1 Financial statement preparation (continued)

iii. Head office account, share capital and reserves

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.

Ordinary shares

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

Available-for-sale securities reserve

This comprises the changes in the fair value of available-for-sale securities, net of tax. These changes are transferred to non-interest income in the income statement when the asset is either disposed of or impaired.

Cash flow hedge reserve

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

c. Financial assets and financial liabilities

i. Recognition

Purchases and sales of regular way financial assets, except for loans and receivables, are recognised on trade-date; the date on which the NZ Banking Group commits to purchase or sell the asset. Loans and receivables are recognised on settlement date, when cash is advanced to the borrowers.

Financial liabilities are recognised when an obligation arises.

ii. Classification and measurement

The NZ Banking Group classifies its significant financial assets in the following categories: cash and balances with central banks, receivables due from other financial institutions, trading securities and financial assets designated at fair value, derivative financial instruments, available-for-sale securities, loans, life insurance assets and due from related entities. The NZ Banking Group has not classified any of its financial assets as held-to-maturity investments.

The NZ Banking Group classifies its significant financial liabilities in the following categories: payables due to other financial institutions, deposits and other borrowings, other financial liabilities at fair value through income statement, derivative financial instruments, due to related entities, debt issues and loan capital.

Financial assets and financial liabilities measured at fair value through income statement are recognised initially at fair value. All other financial assets and financial liabilities are recognised initially at fair value plus directly attributable transaction costs.

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

The NZ Banking Group's policies for determining the fair value of financial assets and financial liabilities are set out in Note 27.

iii. Derecognition

Financial assets are derecognised when the rights to receive cash flows from the asset have expired, or when the NZ Banking Group has either transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full under a 'pass through' arrangement and transferred substantially all the risks and rewards of ownership.

There may be situations where the NZ Banking Group has partially transferred the risks and rewards of ownership but has neither transferred nor retained substantially all the risks and rewards of ownership. In such situations, the asset continues to be recognised on the balance sheet to the extent of the NZ Banking Group's continuing involvement in the asset.

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

d. Critical accounting assumptions and estimates

Applying the NZ Banking Group's accounting policies requires the use of judgment, assumptions and estimates which impact the financial information. The significant assumptions and estimates used are discussed in the relevant notes below.

- Note 7 Income tax expense
- Note 14 Asset quality
- Note 15 Deferred tax assets
- Note 16 Intangible assets
- Note 27 Fair value of financial assets and financial liabilities
- Note 34 Insurance business

e. Future developments in accounting standards

The following new standards and interpretations which may have a material impact on the NZ Banking Group have been issued but are not yet effective, and unless otherwise stated, have not been early adopted by the NZ Banking Group:

NZ IFRS 9 *Financial Instruments* (September 2014) ('**NZ IFRS 9**') will replace NZ IAS 39 *Financial Instruments: Recognition and Measurement* ('**NZ IAS 39**'). It includes a forward looking 'expected credit loss' impairment model, revised classification and measurement model and modifies the approach to hedge accounting. The standard is effective from 1 October 2018.

The adoption of NZ IFRS 9 is expected to reduce retained profits at 1 October 2018 by approximately $27 million (net of tax) primarily due to the increase in impairment provisions under the new standard. The NZ Banking Group continues to assess and refine certain aspects of our impairment provisioning process and the opening adjustment may change. There is no significant impact to our regulatory capital. These estimates are based on accounting policies, assumptions, judgements and estimation techniques that remain subject to change until the NZ Banking Group finalises its financial statements for the year ending 30 September 2019.

The major changes under the standard and details of the implementation project are outlined below.

Impairment

NZ IFRS 9 introduces a revised impairment model which requires entities to recognise expected credit losses based on unbiased forward looking information, replacing the existing incurred loss model in NZ IAS 39 which only recognises impairment if there is objective evidence that a loss has been incurred. This will result in the earlier recognition of impairment provisions. The revised impairment model applies to all financial assets at amortised cost, lease receivables, debt securities measured at fair value through other comprehensive income, loan commitments and financial guarantee contracts.

Note 1 Financial statement preparation (continued)

Key elements of the new impairment model are:

- earlier recognition of expected credit losses using a three stage approach. For financial assets where there has been no significant increase in credit risk since origination, a provision for 12 months expected credit losses is required (stage 1). For financial assets where there has been a significant increase in credit risk or where the asset is credit impaired, a provision for full lifetime expected losses is required (stages 2 and 3 respectively);
- expected credit losses are probability-weighted amounts determined by evaluating a range of possible outcomes and taking into account the time value of money, past events, current conditions and forecasts of future economic conditions. This will involve a greater use of judgment than the existing impairment model; and
- interest is calculated on the gross carrying amount of a financial asset, except where the asset is credit impaired (stage 3). This will result in an increase in interest income and impairment charges as currently interest is calculated on the net carrying value for all loans.

Implementation

Measurement

Models have been developed, tested and approved while certain aspects of the impairment provisioning process continue to be assessed and refined. These models use three main components (as well as the time value of money) being:

- Probability of default ('**PD**'): the probability that a counterparty will default;
- Loss given default ('**LGD**'): the loss that is expected to arise in the event of a default; and
- Exposure at default ('**EAD**'): the estimated outstanding amount of credit exposure at the time of the default.

The models use a 12 month timeframe for expected losses in stage 1 and a lifetime timeframe for expected losses in stages 2 and 3. The models incorporate past experience, current conditions and multiple probability-weighted macroeconomic scenarios for reasonably supportable future economic conditions. Where appropriate, adjustments will be made to modelled outcomes to reflect reasonable and supportable information not already incorporated in the models.

Significant increase in credit risk and movement between stages

An asset will move from stage 1 to stage 2 if there has been a significant increase in credit risk.

The judgment to determine this will be primarily based on changes in internal customer risk grades since origination of the facility. The NZ Banking Group does not intend to rebut the presumption that instruments that are 30 days past due have experienced a significant increase in risk but this will be used as a backstop rather than the primary indicator.

The NZ Banking Group will not be applying the low credit risk exemption which assumes investment grade facilities do not have a significant increase in credit risk.

The movement between stages 2 and 3 will be based on whether financial assets are credit-impaired at the reporting date which is expected to be similar to the individual assessment of impairment for financial assets under the current NZ IAS 39.

Assets may move in both directions through the stages of the impairment model. Assets previously in stage 2 may move back to stage 1 if it is no longer considered that there has been a significant deterioration of credit risk. Similarly, assets in stage 3 may move back to stage 2 if they are no longer assessed to be credit-impaired.

Forward looking information

The estimation of forward looking information is a key area requiring judgement. The NZ Banking Group intends to consider a minimum of three future macroeconomic scenarios. These will include a base case scenario along with upside and downside scenarios. The macroeconomic variables used in these scenarios, based on current economic forecasts, include (but are not limited to) unemployment rates, gross domestic product growth rates and residential and commercial property price indices. The macroeconomic variables and probability weightings of the three scenarios will be subject to the approval of the NZ Banking Group's Chief Financial Officer and the Chief Risk Officer with oversight from the Board of Directors (and its Committees).

Governance

The NZ Banking Group has established a governance framework and has implemented controls to address disclosure of the impact of the new requirements of NZ IFRS 9 including key areas of judgment such as the determination of a significant increase in credit risk and the use of forward looking information in future economic scenarios along with the controls addressing credit data and systems and the expected credit loss models.

The NZ IFRS 9 provision calculation models have been independently reviewed in accordance with the NZ Banking Group's model risk policies and approved by the Credit Risk Estimates Committee. The key judgments in relation to the new provisioning methodology have been discussed and agreed with the Board Risk and Compliance Committee ('**BRCC**') and the Board Audit Committee ('**BAC**').

Models and credit risk processes have been tested in parallel run since May 2018 to provide a better understanding of the implications of the new impairment requirements. This included an evaluation of the effect on the NZ Banking Group's results as well as ongoing validation of the controls and effectiveness of the governance and operational processes. The control environment will continue to evolve as the NZ Banking Group embeds processes and controls during the financial year ending 30 September 2019.

Classification and measurement

NZ IFRS 9 replaces the classification and measurement model in NZ IAS 39 with a new model that categorises financial assets based on a) the business model within which the assets are managed, and b) whether the contractual cash flows under the instrument solely represent the payment of principal and interest. Financial assets will be measured at:

- amortised cost where the business model is to hold the financial assets in order to collect contractual cash flows and those cash flows represent solely payments of principal and interest;
- fair value through other comprehensive income where the business model is to both collect contractual cash flows and sell financial assets and the cash flows represent solely payments of principal and interest. Non-traded equity instruments can also be measured at fair value through other comprehensive income; or
- fair value through profit or loss if they are held for trading or if the cash flows on the asset do not solely represent payments of principal and interest. An entity can also elect to measure a financial asset at fair value through profit or loss if it eliminates or reduces an accounting mismatch.

The accounting for financial liabilities is largely unchanged.

Implementation

The NZ Banking Group's classification and measurement implementation project has identified no material reclassifications of financial assets required under NZ IFRS 9.

Notes to the financial statements

Note 1 Financial statement preparation (continued)

Hedging

NZ IFRS 9 will change hedge accounting by increasing the eligibility of both hedged items and hedging instruments and introducing a more principles-based approach to assessing hedge effectiveness. Adoption of the new hedge accounting model is optional until the IASB completes its accounting for dynamic risk management project. Until this time, current hedge accounting under NZ IAS 39 can continue to be applied.

Implementation

The NZ Banking Group will apply the option to continue hedge accounting under NZ IAS 39, however will implement the amended NZ IFRS 7 hedge accounting disclosures as required.

Transition

The impairment and classification and measurement requirements of NZ IFRS 9 will be applied retrospectively by adjusting the opening balance sheet at the date of initial application, 1 October 2018, with no restatement of comparatives as permitted by the standard. However, detailed transitional disclosures will be provided in accordance with the amended requirements of NZ IFRS 7.

NZ IFRS 15 *Revenue from Contracts with Customers* ('**NZ IFRS 15**') was issued on 3 July 2014 and will be effective from 1 October 2018. The standard replaces NZ IAS 18 *Revenue* and related interpretations, and applies to all contracts with customers, except leases, financial instruments and insurance contracts. The standard provides a systematic approach to revenue recognition by introducing a five-step model governing revenue measurement and recognition. This includes (1) identifying the contract with customer, (2) identifying each of the performance obligations included in the contract, (3) determining the amount of consideration in the contract, (4) allocating the consideration to each of the identified performance obligations and (5) recognising revenue as each performance obligation is satisfied.

The NZ Banking Group will elect to apply NZ IFRS 15 retrospectively by adjusting the opening balance of retained earnings at the date of initial application, 1 October 2018, with no comparatives restatement.

The NZ Banking Group has assessed the revenue streams existing at transition. Based on this assessment, the primary impacts from the adoption of NZ IFRS 15 are expected to be a grossing up of some income and expenses which are currently reported on a net basis. In addition, certain facility fees will be reclassified from non-interest income to interest income. These presentation changes will not have a material impact on the Group's net profit, retained earnings or capital position.

NZ IFRS 16 *Leases* ('**NZ IFRS 16**') was issued on 11 February 2016 and will be effective for the 30 September 2020 financial year. The standard will not result in significant changes for lessor accounting. The main changes under the standard are:

- all operating leases of greater than 12 months duration will be required to be presented on balance sheet by the lessee as a right-of-use asset and lease liability. The asset and liability will initially be measured at the present value of non-cancellable lease payments and payments to be made in optional periods where it is reasonably certain that the option will be exercised. Details of the Banking Group's lease obligations are included in Note 29 ; and
- all leases on balance sheet will give rise to a combination of interest expense on the lease liability and depreciation of the right-of-use asset.

Alternative methods of calculating the right-of-use asset are allowed under NZ IFRS 16 which impact the size of the transition adjustment. The NZ Banking Group is still evaluating which transition method to apply.

Current project implementation efforts are focused on the review and evaluation of contracts within scope of the standard.

NZ IFRS 17 Insurance Contracts was issued on 10 August 2017 and will be effective for the 30 September 2022 year end unless early adopted. This will replace NZ IFRS 4 Insurance Contracts. The main changes under the standard are:

- the scope of the standard may result in some contracts that are currently "unbundled", i.e. accounted for separately as insurance and investment contracts being required to be "bundled" and accounted for as an insurance contract;
- portfolios of contracts (with similar risks which are managed together) will be required to be disaggregated to a more granular level by both the age of a contract and the likelihood of the contract being onerous in order to determine the recognition of profit over the contract period (i.e. the contractual service margin). The contractual service margin uses a different basis to recognise profit to the current Margin on Services approach for life insurance and therefore the pattern of profit recognition is likely to differ;
- risk adjustments, which reflect uncertainties in the amount and timing of future cash flows, are required for both general and life insurance contracts rather than just general insurance contracts under the current accounting standards;
- the contract boundary, which is the period over which profit is recognised, differs and is determined based on the ability to compel the policyholder to pay premiums or the substantive obligation to provide coverage/services. For some general insurance contracts (e.g. some lender mortgage insurance and reinsurance contracts) this may result in the contract boundary being longer. For life insurance, in particular term renewable contracts, the contract boundary is expected to be shorter. Both will be impacted by different patterns of profit recognition compared to the current standards;
- a narrower definition of what acquisition costs may be deferred;
- an election to recognise changes in assumptions regarding discount rate in other comprehensive income rather than in profit and loss;
- an election to recognise changes in the fair value of assets supporting policy liabilities in other comprehensive income rather than through profit and loss;
- reinsurance contracts and the associated liability is to be determined separately to the gross contract liability and may have different contract boundaries; and
- additional disclosure requirements.

The standard is expected to result in a reduction in the level of deferred acquisition costs, however the quantum of this and the profit and loss impacts to the NZ Banking Group are not yet practicable to determine.

Notes to the financial statements

Note 2 Net interest income

Accounting policy

Interest income and expense for all interest earning financial assets and interest bearing financial liabilities, detailed within the table below, are recognised using the effective interest rate method. Net income from treasury's interest rate and liquidity management activities is included in net interest income.

The effective interest rate method calculates the amortised cost of a financial instrument by discounting the financial instrument's estimated future cash receipts or payments to their present value and allocates the interest income or interest expense, including any fees, costs, premiums or discounts integral to the instrument, over its expected life.

		NZ BANKING GROUP	
$ millions	Note	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Interest income			
Cash and balances with central banks		**31**	32
Trading securities and financial assets designated at fair value		**87**	102
Available-for-sale securities		**148**	157
Loans		**3,774**	3,677
Due from related entities	25	**27**	13
Total interest income		**4,067**	3,981
Interest expense			
Deposits and other borrowings		**1,303**	1,250
Due to related entities	25	**53**	75
Debt issues		**317**	314
Loan capital		**146**	55
Other[1]		**336**	499
Total interest expense		**2,155**	2,193
Net interest income		**1,912**	1,788

[1] Includes the net impact of treasury's interest rate and liquidity management activities.

Of the amounts noted in total interest income and total interest expense, the amounts related to financial instruments not measured at fair value through income statement were as follows:

	NZ BANKING GROUP	
$ millions	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Interest income	**3,974**	3,872
Interest expense	**2,118**	2,127

Notes to the financial statements

Note 3 Non-interest income

Accounting policy

Fees and commissions

Fees and commission income are recognised as follows:

- Transaction fees are earned for facilitating transactions and are recognised once the transaction is executed;
- Lending fees are primarily earned for the provision of credit and other facilities to customers and are recognised as the services are provided;
- Other non-risk fee income includes advisory and underwriting fees which are recognised when the related service is completed.

Income which forms an integral part of the effective interest rate of a financial instrument is recognised using the effective interest method and recorded in interest income (for example, loan origination fees).

Fees from trust and other fiduciary activities

Net funds management fees earned for the ongoing management of customer funds and investments are recognised over the period of management.

Net life insurance income and change in policy liabilities

Net insurance policy assets relating to life insurance contracts are calculated by using the margin on service methodology in accordance with New Zealand Society of Actuaries Professional Standard 3 Determination of Life Insurance Policy Liabilities. 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 in line with the service that has been provided.

Premium income

Life insurance premiums with a regular due date are recognised as revenue on an accrual basis. Premiums with no due date are recognised on a cash received basis.

Claims expense

Life insurance contract claims are recognised as an expense when the liability has been established.

Trading income

- Realised and unrealised gains or losses from changes in the fair value of trading assets, liabilities and derivatives are recognised in the period in which they arise (except day one profits or losses which are deferred, refer to Note 27).
- Net income related to Treasury's interest rate and liquidity management activities is included in net interest income.

	NZ BANKING GROUP	
$ millions	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Fees and commissions		
Transaction fees and commissions	**187**	218
Lending fees	**61**	61
Other non-risk fee income	**49**	51
Total fees and commissions	**297**	330
Wealth management and insurance income		
Fees from trust and other fiduciary activities	**55**	47
Net life insurance income and change in policy liabilities	**97**	83
Total wealth management and insurance income	**152**	130
Trading income	**139**	158
Net ineffectiveness on qualifying hedges	**4**	(10)
Other non-interest income		
Share of associate's net profit	**5**	5
Other	**5**	12
Total other non-interest income	**10**	17
Total non-interest income	**602**	625

Notes to the financial statements

Note 4 Operating Expenses

	NZ BANKING GROUP	
$ millions	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Staff expenses	**484**	482
Operating lease rentals	**63**	67
Depreciation	**44**	46
Technology services and telecommunications	**100**	104
Purchased services	**129**	166
Software amortisation costs	**46**	49
Related entities - management fees (refer to Note 25)	**7**	7
Other	**96**	85
Total operating expenses	**969**	1,006

Note 5 Auditor's remuneration

	NZ BANKING GROUP	
$'000s	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Audit and audit related services		
Audit and review of financial statements [1]	**2,674**	2,249
Other audit related services [2]	**63**	57
Total remuneration for audit and other audit related services	**2,737**	2,306
Other services [3]	**129**	134
Total remuneration for non-audit services	**129**	134
Total remuneration for audit, other audit related services and non-audit services	**2,866**	2,440

[1] Fees for the annual audit of the financial statements including audit procedures in relation to the transition impact of new accounting standards, the review or other procedures performed on the interim financial statements and Sarbanes-Oxley reporting undertaken in the role of auditor.

[2] Primarily assurance provided on certain financial information performed in the role of auditor, including the issue of comfort letters in relation to debt issuance programmes.

[3] Assurance and agreed procedures relating to other regulatory and compliance matters.

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

The external auditor also provides audit and non-audit services to non-consolidated entities, including non-consolidated trusts of which a member of the NZ Banking Group is manager or responsible entity and non-consolidated superannuation funds or pension funds. During the year ended 30 September 2018, the fees in respect of these services were approximately $483,425 (30 September 2017: $562,100).

Notes to the financial statements

Note 6 Impairment charges/(benefits)

Accounting policy

At each balance sheet date, the NZ Banking Group assesses whether there is any objective evidence of impairment of its loan portfolio. An impairment charge is recognised if there is objective evidence that principal or interest repayments may not be recoverable and when the financial impact of the non-recoverable loan can be reliably measured.

Objective evidence of impairment could include a breach of contract with the NZ Banking Group such as a default on interest or principal payments, a borrower experiencing significant financial difficulties or observable economic conditions that correlate to defaults on a group of loans.

The impairment charge is measured as the difference between the loan's current carrying amount and the present value of its estimated future cash flows. The estimated future cash flows exclude any expected future credit losses which have not yet occurred and are discounted to their present value using the loan's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment is the current effective interest rate.

The impairment charge is recognised in the income statement with a corresponding reduction of the carrying value of the loan through an offsetting provision account (refer to Note 14).

In subsequent periods, objective evidence may indicate that an impairment charge should be reversed. Objective evidence could include a borrower's credit rating or financial circumstances improving. The impairment charge is reversed in the income statement of that future period and the related provision for impairment is reduced.

Uncollectable loans

A loan may become uncollectable in full or part if, after following the NZ Banking Group's loan recovery procedures, the NZ Banking Group remains unable to collect that loan's contractual repayments. Uncollectable amounts are written off against their related provision for impairment, after all possible repayments have been received.

The NZ Banking Group may subsequently be able to recover cash flows from loans written off. In the period which these recoveries are made, they are recognised in the income statement.

Critical accounting assumptions and estimates relating to impairment charges are included in Note 14.

	NZ BANKING GROUP	
$ millions	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Individually assessed provisions raised	**28**	18
Reversal of previously recognised impairment charges	**(18)**	(67)
Collectively assessed provisions released	**(34)**	(56)
Bad debts written-off directly to the income statement	**21**	29
Total impairment charges/(benefits)	**(3)**	(76)

Refer to Note 14 for further details on provisions for impairment charges.

Notes to the financial statements

Note 7 Income tax expense

Accounting policy

The income tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income, in which case it is recognised in the statement of comprehensive income.

Current tax is the tax payable for the year using enacted or substantively enacted tax rates and laws. Current tax also includes adjustments to tax payable for previous years.

Goods and services tax ('GST')

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

Critical accounting assumptions and estimates

Significant judgment is required in determining the current tax liability. There may be transactions with uncertain tax outcomes and provisions are held to reflect these tax uncertainties where appropriate.

	NZ BANKING GROUP	
$ millions	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Income tax expense		
Current tax:		
Current year	**424**	405
Prior year adjustments	**-**	6
Deferred tax (refer to Note 15):		
Current year	**10**	16
Prior year adjustments	**(3)**	(3)
Total income tax expense	**431**	424
Profit before income tax	**1,548**	1,483
Tax calculated at tax rate of 28%	**433**	415
Income not subject to tax	**-**	(1)
Expenses not deductible for tax purposes	**2**	2
Prior year adjustments	**(3)**	3
Other items	**(1)**	5
Total income tax expense	**431**	424

The effective tax rate for the year ended 30 September 2018 was 27.8% (30 September 2017: 28.6%).

Note 8 Imputation credit account

	NZ BANKING GROUP	
$ millions	**2018**	2017
Imputation credits available for use in subsequent reporting periods	**1,072**	1,118

Note 9 Receivables due from other financial institutions

Accounting policy

Receivables due from other financial institutions are recognised initially at fair value and subsequently at amortised cost using the effective interest rate method.

		NZ BANKING GROUP	
$ millions	Note	**2018**	2017
Cash collateral	17	**180**	431
Receivables due from other financial institutions classified as cash and cash equivalents	40	**57**	40
Total receivables due from other financial institutions		**237**	471

Notes to the financial statements

Note 10 Other assets

$ millions	NZ BANKING GROUP 2018	2017
Accrued interest receivable	**160**	149
Securities sold not yet delivered	**159**	143
Trade debtors and prepayments	**50**	41
Other	**96**	90
Total other assets	**465**	423

Note 11 Trading securities and financial assets designated at fair value

Accounting policy

Trading securities include actively traded debt (government, semi-government and other) and those acquired for sale in the near term and are held at fair value.

Gains and losses on trading securities are recognised in the income statement. Interest received from government and other debt securities is recognised in net interest income (refer to Note 2).

Securities purchased under agreements to resell ('reverse repos')

Reverse repos are not recognised on the balance sheet as the NZ Banking Group has not obtained the risks and rewards of ownership. The cash consideration paid is recognised as an asset. Reverse repos which are part of a trading portfolio are designated at fair value. Gains and losses on these financial assets are recognised in non-interest income. Interest received under these agreements is recognised in interest income.

$ millions	NZ BANKING GROUP 2018	2017
Government and semi-government securities	**1,143**	1,027
Other debt securities	**1,657**	2,165
Securities purchased under agreement to resell	**216**	757
Total trading securities and financial assets designated at fair value	**3,016**	3,949

Note 12 Available-for-sale securities

Accounting policy

Available-for-sale debt (government, semi-government and other) securities are held at fair value with gains and losses recognised in other comprehensive income except for the following amounts, which are recognised in the income statement:

- Interest on debt securities; and
- Impairment charges.

The cumulative gain or loss recognised in other comprehensive income is subsequently recognised in the income statement when the instrument is disposed.

At each reporting date, the NZ Banking Group assesses whether any available-for-sale securities are impaired. Impairment exists if one or more events have occurred which have a negative impact on the security's estimated cash flows.

Evidence of impairment includes significant financial difficulties or adverse changes in the payment status of an issuer. If impairment exists, the cumulative loss is removed from other comprehensive income and recognised in the income statement. Any subsequent reversals of impairment on debt securities are also recognised in the income statement.

$ millions	NZ BANKING GROUP 2018	2017
Government and semi-government securities	**2,155**	2,467
Other debt securities	**1,655**	1,620
Total available-for-sale securities	**3,810**	4,087

Notes to the financial statements

Note 13 Loans

Accounting policy

Loans are financial assets initially recognised at fair value plus directly attributable transaction costs. Loans are subsequently measured at amortised cost using the effective interest rate method and are presented net of any provisions for impairment.

Loan products that have both mortgage and deposit facilities are presented gross on the balance sheet, segregating the asset and liability component, because they do not meet the criteria to be offset. Interest earned on these products is presented on a net basis in the income statement as this reflects how the customer is charged.

The following table shows loans disaggregated by type of product.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Overdrafts	**1,117**	1,296
Credit card outstandings	**1,499**	1,518
Money market loans	**1,361**	1,250
Term loans:		
Housing	**48,893**	46,943
Non-housing	**27,031**	25,780
Other	**1,283**	1,244
Total gross loans	**81,184**	78,031
Provisions for impairment charges on loans	**(324)**	(350)
Total net loans	**80,860**	77,681

Movements in impaired assets and provisions for impairment charges on loans are outlined in Note 14.

Note 14 Asset quality

Accounting policy

The NZ Banking Group recognises two types of impairment provisions for its loans, being provisions for loans which are:

- individually assessed for impairment; and
- collectively assessed for impairment.

Note 6 explains how impairment charges are determined. The NZ Banking Group assesses impairment as follows:

- individually for loans that exceed specified thresholds. Where there is objective evidence of impairment, individually assessed provisions will be recognised; and
- collectively for loans below the specified thresholds noted above or if there is no objective evidence of impairment. These loans are included in a group of loans with similar risk characteristics and collectively assessed for impairment. If there is objective evidence that the group of loans is collectively impaired, collectively assessed provisions will be recognised.

Critical accounting assumptions and estimates

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the NZ Banking Group to reduce differences between impairment provisions and actual loss experience.

Individual component

Key judgments include 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 recovering the loan.

Judgments can change with time as new information becomes available or as loan recovery strategies evolve, which may result in revisions to the impairment provision.

Collective component

Collective provisions are established on a portfolio basis taking into account the level of arrears, collateral and security, past loss experience, current economic conditions, expected default and timing of recovery based on portfolio trends.

Key judgments include estimated loss rates and their related emergence periods. The emergence period for each loan type is determined through studies of loss emergence patterns. Loan files are reviewed to identify the average time period between observable loss indicator events and the loss becoming identifiable.

Actual credit losses may differ materially from reported loan impairment provisions due to uncertainties including interest rates and their effect on consumer spending, unemployment levels, payment behaviour and bankruptcy rates.

Notes to the financial statements

Note 14 Asset quality (continued)

	NZ BANKING GROUP 2018					NZ BANKING GROUP 2017				
$ millions	**Residential Mortgages**	**Other Retail**	**Corporate**	**Other**	**Total**	Residential Mortgages	Other Retail	Corporate	Other	Total
Neither past due nor impaired	**47,974**	**3,726**	**27,775**	**278**	**79,753**	46,019	3,767	26,613	225	76,624
Past due but not impaired assets										
Less than 30 days past due	**739**	**143**	**162**	**-**	**1,044**	752	132	107	-	991
At least 30 days but less than 60 days past due	**80**	**25**	**6**	**-**	**111**	67	22	10	-	99
At least 60 days but less than 90 days past due	**33**	**10**	**2**	**-**	**45**	27	13	24	-	64
At least 90 days past due	**43**	**18**	**25**	**-**	**86**	46	19	15	-	80
Total past due assets not impaired	**895**	**196**	**195**	**-**	**1,286**	892	186	156	-	1,234
Individually impaired assets[1]										
Balance at beginning of the period	**32**	**5**	**136**	**-**	**173**	25	4	193	-	222
Additions	**31**	**8**	**40**	**-**	**79**	40	5	39	-	84
Amounts written off	**(6)**	**(2)**	**(14)**	**-**	**(22)**	(4)	(1)	(3)	-	(8)
Returned to performing or repaid	**(33)**	**(5)**	**(47)**	**-**	**(85)**	(29)	(3)	(93)	-	(125)
Balance at end of the period	**24**	**6**	**115**	**-**	**145**	32	5	136	-	173
Total gross loans[2]	**48,893**	**3,928**	**28,085**	**278**	**81,184**	46,943	3,958	26,905	225	78,031
Individually assessed provisions										
Balance at beginning of the period	**7**	**5**	**36**	**-**	**48**	7	3	95	-	105
Impairment charges/(benefits):										
New provisions	**9**	**2**	**17**	**-**	**28**	8	4	6	-	18
Reversal of previously recognised impairment charges	**(3)**	**(2)**	**(13)**	**-**	**(18)**	(4)	(1)	(62)	-	(67)
Amounts written off	**(6)**	**(2)**	**(14)**	**-**	**(22)**	(4)	(1)	(3)	-	(8)
Balance at end of the year	**7**	**3**	**26**	**-**	**36**	7	5	36	-	48
Collectively assessed provisions										
Balance at beginning of the year	**54**	**97**	**181**	**-**	**332**	46	95	220	-	361
Impairment charges/(benefits)	**(2)**	**(10)**	**(22)**	**-**	**(34)**	5	(10)	(51)	-	(56)
Interest adjustments	**2**	**12**	**10**	**-**	**24**	3	12	12	-	27
Balance at end of the year	**54**	**99**	**169**	**-**	**322**	54	97	181	-	332
Total provisions for impairment charges on loans and credit commitments	**61**	**102**	**195**	**-**	**358**	61	102	217	-	380
Provision for credit commitments (refer to Note 23)	**-**	**(4)**	**(30)**	**-**	**(34)**	-	(4)	(26)	-	(30)
Total provisions for impairment charges on loans	**61**	**98**	**165**	**-**	**324**	61	98	191	-	350
Total net loans	**48,832**	**3,830**	**27,920**	**278**	**80,860**	46,882	3,860	26,714	225	77,681

[1] The NZ Banking Group had undrawn commitments of $4 million (30 September 2017: $4 million) to counterparties for whom drawn balances are classified as individually impaired assets under corporate loans as at 30 September 2018.
[2] The NZ Banking Group does not have other assets under administration as at 30 September 2018.

Notes to the financial statements

Note 15 Deferred tax assets

Accounting policy

Deferred tax accounts for temporary differences between the carrying amounts of assets and liabilities in the financial statements and their values for taxation purposes.

Deferred tax is determined using the enacted or substantively enacted tax rates and laws which are expected to apply when the assets will be realised or the liabilities settled.

Deferred tax assets and liabilities have been offset where they relate to the same taxable entity or group and where there is a legal right and intention to settle on a net basis.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available to utilise the assets.

Deferred tax is not recognised for the following temporary differences:

- the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither the accounting nor taxable profit or loss; and
- the initial recognition of goodwill in a business combination.

Critical accounting assumptions and estimates

On a similar basis to that described in Note 7, determining deferred tax assets and liabilities is considered one of the NZ Banking Group's critical accounting assumptions and estimates.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Deferred tax assets/(liabilities) comprise the following temporary differences:		
Provision for impairment charges on loans	**94**	101
Cash flow hedges	**26**	29
Provision for employee entitlements	**16**	13
Software, property and equipment	**10**	9
Life insurance policy liabilities	**(35)**	(33)
Financial instruments	**4**	6
Other temporary differences	**12**	11
Net deferred tax assets	**127**	136
The deferred tax (charge)/credit in income tax expense comprises the following temporary differences:		
Provision for impairment charges on loans	**(7)**	(24)
Provision for employee entitlements	**2**	(1)
Software, property and equipment	**1**	-
Life insurance policy liabilities	**(2)**	1
Financial instruments	**(2)**	6
Other temporary differences	**1**	5
Total deferred tax charge in income tax expense	**(7)**	(13)
The deferred tax (charge)/credit in other comprehensive income comprises the following temporary differences:		
Cash flow hedges	**(3)**	(13)
Provision for employee entitlements	**1**	(4)
Total deferred tax charge in other comprehensive income	**(2)**	(17)

Notes to the financial statements

Note 16 Intangible assets

Accounting policy

Indefinite life intangible assets

Goodwill

Goodwill acquired in a business combination is initially measured at cost, generally being the excess of:

i. the consideration paid; over
ii. the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

Subsequently, goodwill is not amortised but rather tested for impairment. Impairment is tested at least annually or whenever there is an indication of impairment. An impairment charge is recognised when a cash generating unit's (CGU) carrying value exceeds its recoverable amount. Recoverable amount means the higher of the CGU's fair value less costs to sell and its value-in-use.

Finite life intangible assets

Finite life intangibles include computer software which are recognised initially at cost and subsequently at amortised cost less any impairment.

Intangible	Useful life	Depreciation method
Goodwill	Indefinite	Not applicable
Computer software	3 to 8 years	Straight-line or diminishing balance method (using the Sum of the Years Digits)

Critical accounting assumptions and estimates

Judgment is required in determining the fair value of assets and liabilities acquired in a business combination. A different assessment of fair values would have resulted in a different goodwill balance and different post-acquisition performance of the acquired entity.

When assessing impairment of intangible assets, significant judgment is needed to determine the appropriate cash flows and discount rates to be applied to the calculations. The significant assumptions applied to the value-in-use calculations are outlined below.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Goodwill	**525**	525
Computer software	**158**	140
Total intangible assets	**683**	665

Significant assumptions used in recoverable amount calculations

Assumptions are used to determine the CGU's recoverable amount for goodwill, which is based on value-in-use calculations. Value-in-use refers to the present value of expected cash flows under its current use. The NZ Banking Group discounts the projected cash flows by its adjusted pre-tax equity rate.

- NZ Banking Group's equity rate was 11.0% (2017: 11.0%)
- NZ Banking Group's adjusted pre-tax equity rate was 15.3% (2017: 15.3%)

For the purpose of goodwill impairment testing, the assumptions in the following table are made for each significant CGU. The forecasts applied by management are not reliant on any one particular assumption.

Assumption	Based on:
Cash flows	Zero growth rate beyond 2 year forecast
Economic market conditions	Current market expectations
Business performance	Observable historical information and current market expectations of the future

There are no reasonably possible changes in assumptions for any significant CGU that would result in an indication of impairment or have a material impact on the NZ Banking Group's reported results.

Goodwill has been allocated to the following CGUs:

	NZ BANKING GROUP	
$ millions	**2018**	2017
Consumer Banking and Wealth	**512**	512
BT New Zealand[1]	**13**	13
Net carrying amount of goodwill	**525**	525

[1] BT New Zealand forms part of the Investments and Insurance operating segment, as described in Note 31.

Note 17 Financial assets pledged as collateral

Accounting policy

Security repurchase agreements

Where securities are sold subject to an agreement to repurchase at a predetermined price, they remain recognised on the balance sheet in their original category (i.e. trading securities and financial assets designated at fair value or available-for-sale securities).

The cash consideration received is recognised as a liability ('security repurchase agreements'). Security repurchase agreements are designated at fair value and recognised as part of other financial liabilities at fair value through income statement (refer to Note 21), where they are managed as part of a trading portfolio.

The NZ Banking Group is required to provide collateral to other financial institutions, as part of standard terms, to secure liabilities. In addition to assets supporting Westpac New Zealand's Global Covered Bond Programme ('**CB Programme'**) disclosed in Note 32, the carrying value of these financial assets pledged as collateral is:

	NZ BANKING GROUP	
$ millions	**2018**	2017
Cash[1]	**180**	430
Securities pledged under repurchase agreements:		
Available-for-sale securities	**-**	19
Trading securities and financial assets designated at fair value	**41**	216
Total amount pledged to secure liabilities (excluding CB Programme)	**221**	665

[1] Comprises receivables due from other financial institutions.

Note 18 Payables due to other financial institutions

Accounting policy

Payables due to other financial institutions are recognised initially at fair value and subsequently at amortised cost using the effective interest rate method.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Interest bearing interbank deposits	**1,183**	1,026
Non-interest bearing, repayable at call	**70**	17
Total payables due to other financial institutions	**1,253**	1,043

Note 19 Other liabilities

	NZ BANKING GROUP	
$ millions	**2018**	2017
Accrued interest payable	**361**	331
Securities purchased but not yet delivered	**184**	89
Retirement benefit obligations	**18**	14
Trade creditors and other accrued expenses	**75**	79
Other	**223**	122
Total other liabilities	**861**	635

Note 20 Deposits and other borrowings

Accounting policy

Deposits and other borrowings are initially recognised at fair value and subsequently measured at either amortised cost using the effective interest rate method or at fair value.

Deposits and other borrowings are designated at fair value if they are managed on a fair value basis, reduce or eliminate an accounting mismatch or contain an embedded derivative.

Where they are measured at fair value, any changes in fair value (except those due to changes in credit risk) are recognised as non-interest income.

The change in the fair value that is due to changes in credit risk is recognised in other comprehensive income except where it would create an accounting mismatch, in which case it is also recognised in the income statement.

Interest expense incurred is recognised in net interest income using the effective interest rate method.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Certificates of deposit	**1,218**	593
Non-interest bearing, repayable at call	**5,903**	5,274
Other interest bearing:		
At call	**23,335**	23,117
Term	**32,649**	30,014
Total deposits and other borrowings	**63,105**	58,998
Deposits at fair value	**1,221**	593
Deposits at amortised cost	**61,884**	58,405
Total deposits and other borrowings	**63,105**	58,998

The NZ Branch held $3 million retail deposits and other borrowings from individuals as at 30 September 2018 (30 September 2017: nil).

Note 21 Other financial liabilities at fair value through income statement

Accounting policy

Other financial liabilities at fair value through income statement include trading securities sold short and security repurchase agreements which have been designated at fair value at initial recognition. The accounting policy for security repurchase agreements is consistent with that detailed in Note 17.

Securities sold short reflect the obligation to deliver securities to a buyer for the sale of securities the NZ Banking Group does not own at the time of sale but that are promised to be delivered to the buyer. Securities delivered to the buyer are usually borrowed and/or subsequently purchased.

Subsequent to initial recognition, these liabilities are measured at fair value with changes in fair value (except credit risk) recognised through the income statement as they arise. The change in fair value that is attributable to credit risk is recognised in other comprehensive income except where it would create an accounting mismatch, in which case it is recognised through the income statement.

Interest expense is recognised in net interest income using the effective interest rate method.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Securities sold short	**182**	67
Security repurchase agreements	**41**	235
Total other financial liabilities at fair value through income statement	**223**	302

Note 22 Debt issues

Accounting policy

Debt issues are bonds, notes and commercial paper that have been issued by the NZ Banking Group.

Debt issues are initially measured at fair value and subsequently either measured at amortised cost using the effective interest rate method or at fair value.

Debt issues are designated at fair value if they reduce or eliminate an accounting mismatch.

They are measured at fair value with changes in fair value (except those due to changes in credit risk) recognised as non-interest income.

The change in the fair value that is due to credit risk is recognised in other comprehensive income except where it would create an accounting mismatch, in which case it is also recognised in the income statement.

Interest expense incurred is recognised within net interest income using the effective interest rate method.

In the following table, the distinction between short-term (12 months or less) and long-term (greater than 12 months) debt is based on the maturity of the underlying security at origination.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Short-term debt		
Commercial paper	-	1,642
Total short-term debt	-	1,642
Long-term debt		
Non-domestic medium-term notes	**6,100**	6,628
Covered bonds	**5,640**	5,236
Domestic medium-term notes	**1,985**	3,223
Total long-term debt	**13,725**	15,087
Total debt issues	**13,725**	16,729
Debt issues at fair value	-	1,642
Debt issues at amortised cost	**13,725**	15,087
Total debt issues	**13,725**	16,729

	NZ BANKING GROUP
$ millions	**2018**
Movement reconciliation	
Balance as at 1 October 2017	**16,729**
Issuances	**550**
Maturities, repayments, buy backs and reductions	**(4,464)**
Total cash movements	**(3,914)**
Foreign exchange translation impact	**933**
Fair value adjustments	**(1)**
Fair value hedge accounting adjustments	**(27)**
Other[1]	**5**
Total non-cash movements	**910**
Balance as at 30 September 2018	**13,725**

[1] Includes items such as amortisation of issue costs.

Notes to the financial statements

Note 23 Provisions

Accounting policy

Provisions are recognised for present obligations arising from past events where a payment (or other economic transfer) is likely to be necessary to settle the obligation and can be reliably estimated.

Employee benefits – annual leave and other employee benefits

The provision for annual leave and other employee benefits (including long service leave, wages and salaries, inclusive of non-monetary benefits, and any associated on-costs (e.g. payroll tax)) is calculated based on expected payments.

Provision for impairment on credit commitments

The NZ Banking Group is committed to provide facilities and guarantees as explained in Note 30. If it is probable that a facility will be drawn and the resulting asset will be less than the drawn amount then a provision for impairment is recognised. The provision for impairment is calculated using the same methodology as the provision for impairment charges on loans (refer to Note 6).

	NZ BANKING GROUP	
$ millions	**2018**	2017
Annual leave and other employee benefits	**66**	66
Provision for impairment on credit commitments	**34**	30
Other	**20**	1
Total provisions	**120**	97

Note 24 Loan Capital

Accounting policy

Loan capital are instruments which qualify for inclusion as regulatory capital under either the Reserve Bank of New Zealand ('**Reserve Bank**') Capital Adequacy Framework or, in relation to the Overseas Bank, the Australian Prudential Regulation Authority ('**APRA**') Prudential Standards. Loan capital is initially measured at fair value and subsequently measured at amortised cost using the effective interest rate method. Interest expense incurred is recognised in net interest income.

		NZ BANKING GROUP	
$ millions	Note	**2018**	2017
Additional Tier 1 loan capital - USD AT1 securities[1]		**1,731**	1,691
Tier 2 loan capital - Convertible subordinated notes[1]	25	**1,135**	1,131
Total loan capital		**2,866**	2,822

[1] Net of capitalised transaction costs.

	NZ BANKING GROUP
$ millions	**2018**
Movement reconciliation	
Balance as at 1 October 2017	**2,822**
Total cash movements	**-**
Foreign exchange translation impact	**163**
Fair value hedge accounting adjustments	**(120)**
Other[1]	**1**
Total non-cash movements	**44**
Balance as at 30 September 2018	**2,866**

[1] Includes items such as amortisation of issue costs.

Notes to the financial statements

Note 24 Loan Capital (continued)

Additional Tier 1 loan capital

A summary of the key terms and features of the Additional Tier 1 loan capital ('**USD AT1 securities**') is provided below.

$	Issue date	Interest rate	Optional redemption date
US$1,250 million securities[1]	21 September 2017	5.00% p.a.[2]	21 September 2027 and every fifth anniversary thereafter

[1] The USD AT1 securities are issued by the Overseas Bank acting through its NZ Branch.

[2] Fixed interest rate of 5.00% p.a., until, but excluding 21 September 2027 (the '**first reset date**'). Every fifth anniversary thereafter is a reset date. If the USD AT1 securities are not redeemed, converted or written-off by the first reset date, the interest rate from, and including, each reset date thereafter to, but excluding the next succeeding reset date, will be a fixed rate per annum equal to the prevailing 5-year USD mid-market swap rate plus 2.888% per annum.

Interest payable

Semi-annual interest payments on the USD AT1 securities are at the absolute discretion of the Overseas Bank and will only be paid if the payment conditions are satisfied, including that the payment will not result in a breach of the Overseas Bank's capital requirements under APRA's prudential standards; not result in the Overseas Bank becoming, or being likely to become, insolvent; and if APRA does not object to the payment.

Broadly, if for any reason an interest payment has not been paid in full on the relevant payment date, the Overseas Bank must not determine or pay any dividends on Overseas Bank ordinary shares or undertake a discretionary buy back or capital reduction of Overseas Bank ordinary shares, unless the unpaid interest is paid in full within 20 business days of the relevant payment date or in certain other circumstances.

Redemption

The Overseas Bank may redeem all (but not some) USD AT1 securities on 21 September 2027 and every fifth anniversary thereafter, or for certain taxation or regulatory reasons, subject to APRA's prior written approval.

Conversion

If a capital trigger event or non-viability trigger event occurs, the Overseas Bank must convert some or all of the USD AT1 securities into a variable number of Overseas Bank ordinary shares calculated using the formula described in the terms of the USD AT1 securities but subject to a maximum conversion number. The conversion number of the Overseas Bank's ordinary shares will be calculated using the outstanding principal amount of each USD AT1 security translated into Australian dollars and the Overseas Bank ordinary share price determined over the five business day period prior to the capital trigger event date or non-viability trigger event date and includes a 1% discount. The maximum conversion number is calculated using the outstanding principal amount of each USD AT1 security translated into Australian dollars at the time of issue and the Overseas Bank share price which is broadly equivalent to 20% of the Overseas Bank ordinary share price at the time of issue of the USD AT1 securities.

A capital trigger event occurs when the Overseas Bank determines, or APRA notifies the Overseas Bank in writing that it believes, the Overseas Bank's Common Equity Tier 1 Capital ratio is equal to or less than 5.125% (on a level 1 or level 2 basis). A non-viability trigger event will occur when APRA notifies the Overseas Bank in writing that it believes conversion of all or some USD AT1 securities (or conversion or write-down of relevant capital instruments of the Overseas Banking Group), or public sector injection of capital (or equivalent support), in each case is necessary because without it, the Overseas Bank would become non-viable. No conversion conditions apply in these circumstances.

If conversion of the USD AT1 securities does not occur within five business days, holders' rights in relation to the USD AT1 securities will be immediately and irrevocably terminated.

Tier 2 loan capital

A summary of the key terms and features of the Tier 2 loan capital ('**Tier 2 notes**') is provided below.

$	Issue date	Counterparty	Interest rate	Maturity date	Optional redemption date
AU$1,040 million notes	8 September 2015	London Branch of the Overseas Bank	Australian 90 day bank bill rate + 2.87% p.a.	22 March 2026	22 March 2021 and every interest payment date thereafter

Interest payable

Interest payments on the Tier 2 notes are subject to Westpac New Zealand being solvent at the time of, and immediately following the interest payment. Refer to Note 25.

Early redemption

Westpac New Zealand may elect to redeem all or some of the Tier 2 notes for their face value together with accrued interest (if any) on 22 March 2021 or any interest payment date thereafter, subject to the Reserve Bank's prior written approval. Early redemption of all of the Tier 2 notes for certain tax or regulatory reasons is permitted on an interest payment date subject to the Reserve Bank's prior written approval.

Conversion

If a non-viability trigger event occurs, Westpac New Zealand must convert such number of the Tier 2 notes into a variable number of ordinary shares issued by Westpac New Zealand (calculated with reference to the net assets of Westpac New Zealand and the total number of ordinary shares on issue on the conversion date) that is sufficient to satisfy the direction of the Reserve Bank or the decision of the statutory manager. A non-viability trigger event occurs when the Reserve Bank or the statutory manager (appointed pursuant to section 117 of the Reserve Bank Act) directs Westpac New Zealand to convert or write off all or some of Westpac New Zealand's Tier 2 notes. If conversion of the Tier 2 notes fails to take effect within five business days, holders' rights in relation to the Tier 2 notes will be immediately and irrevocably terminated.

Notes to the financial statements

Note 25 Related entities

Related entities

The NZ Banking Group's related parties are those it controls or can exert significant influence over. Examples include subsidiaries, associates, joint ventures and superannuation plans as well as key management personnel and their related parties.

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 2018 whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business:

Name of Entity	Principal Activity	Notes
BT Financial Group (NZ) Limited ('**BTFGNZL**')	Holding company	
BT Funds Management (NZ) Limited ('**BTNZ**')	Funds management company	
Capital Finance New Zealand Limited	Finance company	
Sie-Lease (New Zealand) Pty Limited	Leasing company	
Westpac Financial Services Group-NZ-Limited ('**WFSGNZL**')	Holding company	
Westpac Life-NZ-Limited ('**Westpac Life**')	Life insurance company	
Westpac Nominees -NZ-Limited ('**WNNZL**')	Nominee company	
Westpac Superannuation Nominees-NZ-Limited ('**WSNNZL**')	Nominee company	
Westpac Group Investment-NZ-Limited ('**WGINZL**')	Holding company	
Westpac Holdings-NZ-Limited ('**WHNZL**')	Holding company	
Westpac Capital-NZ-Limited ('**WCNZL**')	Finance company	
Westpac Equity Investments NZ Limited	Non-active company	
Westpac New Zealand Group Limited ('**WNZGL**')	Holding company	
Westpac New Zealand Limited	Registered bank	
Westpac NZ Operations Limited ('**WNZOL**')[1]	Holding company	
Aotearoa Financial Services Limited	Non-active company	
Number 120 Limited	Finance company	
The Home Mortgage Company Limited	Residential mortgage company	
Westpac New Zealand Staff Superannuation Scheme Trustee Limited ('**WNZSSSTL**')	Trustee company	Established on 30 June 2016
Westpac (NZ) Investments Limited ('**WNZIL**')	Property company	
Westpac Securities NZ Limited ('**WSNZL**')	Funding company	
Westpac NZ Covered Bond Holdings Limited ('**WNZCBHL**')	Holding company	19% owned[2]
Westpac NZ Covered Bond Limited ('**WNZCBL**')	Guarantor	19% owned[2]
Westpac NZ Securitisation Holdings Limited ('**WNZSHL**')	Holding company	19% owned[3]
Westpac NZ Securitisation Limited ('**WNZSL**')	Funding company	19% owned[3]
Westpac NZ Securitisation No.2 Limited ('**WNZSL2**')	Non-active company	19% owned[3]
Westpac Cash PIE Fund	Portfolio investment entity	Not owned[4]
Westpac Notice Saver PIE Fund	Portfolio investment entity	Not owned[4]
Westpac Term PIE Fund	Portfolio investment entity	Not owned[4]

[1] As at 30 September 2018, WNZOL held 25% equity in Paymark Limited, an associate, which is not a controlled entity. See Note 41 Subsequent events.

[2] The NZ Banking Group, through WNZOL (9.5%) and WHNZL (9.5%), has a total qualifying interest of 19% in WNZCBHL and its wholly-owned subsidiary company, WNZCBL. Westpac New Zealand is considered to control both WNZCBHL and WNZCBL based on contractual arrangements in place, and as such both WNZCBHL and WNZCBL are consolidated within the financial statements of the NZ Banking Group.

[3] The NZ Banking Group, through WNZOL (9.5%) and WHNZL (9.5%), has a total qualifying interest of 19% in WNZSHL and its wholly-owned subsidiaries, WNZSL and WNZSL2. Westpac New Zealand is considered to control WNZSHL, WNZSL and WNZSL2 based on contractual arrangements in place, and as such WNZSHL, WNZSL and WNZSL2 are consolidated within the financial statements of the NZ Banking Group.

[4] Westpac Term PIE Fund, Westpac Cash PIE Fund and Westpac Notice Saver PIE Fund (collectively referred to as the '**PIE Funds**') were established as unit trusts. The PIE Funds are Portfolio Investment Entities ('**PIE**'), where BTNZ is the manager and issuer. The manager has appointed Westpac New Zealand to perform all customer management and account administration for the PIE Funds. Westpac New Zealand is the PIE Funds' registrar and administration manager. Westpac New Zealand does not hold any units in the PIE Funds however is considered to control them based on contractual arrangements put in place, and as such the PIE Funds are consolidated in the financial statements of the NZ Banking Group.

Note 25 Related entities (continued)

Hastings Forestry Investments Limited was removed from the Companies Office register on 2 August 2018.

There have been no changes in the ownership percentages since 30 September 2017.

All entities in the NZ Banking Group are 100% owned unless otherwise stated. All the entities within the NZ Banking Group have a balance date of 30 September and are incorporated in New Zealand except the PIE Funds and WNZSSSTL which have a balance date of 31 March and 30 June respectively.

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

The total liabilities of the NZ Branch, net of amounts due to related entities as at 30 September 2018, amounted to $6,311 million (30 September 2017: $5,981 million).

Nature of transactions

The NZ Banking Group has transactions with members of the Overseas Banking Group on commercial terms, including the provision of management, distribution and administrative services and data processing facilities.

Loan finance and current account banking facilities are provided by the NZ Branch and the Overseas Bank to members of the NZ Banking Group on normal commercial terms. The interest earned on these loans and the interest paid on deposits are at market rates.

The NZ Banking Group enters into derivative transactions with the Overseas Bank (refer to Note 26). They are accounted for as trading derivatives except for cross currency swaps in place with the Overseas Bank, which are designated in a cash flow hedge relationship to hedge the currency risk exposure of funding from the London Branch and Tier 2 notes issued to the London Branch (refer to Note 24).

Transactions with related entities

		NZ BANKING GROUP	
$ millions	Note	**2018**	2017
Overseas Bank			
Interest income	2	**27**	13
Interest expense:			
Loan capital[1]		**55**	52
Other[2]	2	**53**	75
Operating expenses - management fees		**7**	7
Funding repaid		**400**	421
Other controlled entities of the Overseas Bank			
Non interest income:			
Investment management fees paid[3]		**-**	7
WGINZL dividend paid to Westpac Overseas Holdings Pty Limited and Westpac Custodian Nominees Pty Limited		**4**	4
WFSGNZL dividend paid to Westpac Equity Holdings Pty Limited ('**WEHPL**')		**58**	16
BTFGNZL dividend paid to WEHPL		**10**	16
WNZGL dividend paid to Westpac Overseas Holdings No. 2 Pty Limited		**500**	280

[1] Interest expense paid on the Tier 2 notes issued by the NZ Banking Group and held by related parties.

[2] Includes interest expense incurred on funding from the Overseas Banking Group.

[3] Non-interest income contains management fee income which is presented net of investment management fees paid to related parties.

Notes to the financial statements

Note 25 Related entities (continued)

Due from and to related entities

	NZ BANKING GROUP	
$ millions	**2018**	2017
Due from related entities		
Overseas Bank	**2,017**	2,622
Other controlled entities of the Overseas Banking Group	**6**	1
Total due from related entities	**2,023**	2,623
Due from related entities at fair value[1]	**459**	410
Due from related entities at amortised cost	**1,564**	2,213
Total due from related entities	**2,023**	2,623
Due to related entities		
Overseas Bank	**2,436**	3,642
Other controlled entities of the Overseas Banking Group	**4**	4
Total due to related entities	**2,440**	3,646
Due to related entities at fair value	**644**	575
Due to related entities at amortised cost	**1,796**	3,071
Total due to related entities	**2,440**	3,646

[1] Includes derivative and debt issues.

Key management personnel compensation

Key management personnel are those who, directly or indirectly, have authority and responsibility for planning, directing and controlling the activities of NZ Banking Group. This includes all Executive and Non-Executive Directors.

	NZ BANKING GROUP	
$'000s	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Salaries and other short-term benefits	**8,441**	8,527
Post-employment benefits	**653**	492
Other termination benefits	**615**	-
Share-based payments	**2,711**	2,779
Total key management personnel compensation	**12,420**	11,798
Loans to key management personnel	**22,349**	22,769
Deposits from key management personnel	**6,006**	1,229
Interest income on amounts due from key management personnel	**819**	842
Interest expense on amounts due to key management personnel	**107**	19

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 2018 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 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 2018, no individual provision has been recognised in respect of loans given to key management personnel and their related parties (30 September 2017: nil). These individual loans have been included within the loan portfolio when determining collectively assessed provisions.

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.

Notes to the financial statements

Note 26 Derivative financial instruments

Accounting policy

Derivative financial instruments are instruments whose values derive from the value of an underlying asset, reference rate or index and include forwards, futures, swaps and options.

All derivatives are held at fair value. Changes in fair value are recognised in the income statement, unless designated in a cash flow hedge relationship. Derivatives are presented as an asset where they have a positive fair value at balance date or as a liability where the fair value at balance date is negative. Derivatives with related parties are included in due from/due to related entities.

The NZ Banking Group uses derivative instruments for trading and also as part of its asset and liability risk management activities, which are discussed in Note 36. Derivatives used for risk management activities include designating derivatives into one of two types of hedge accounting relationships: fair value hedge or cash flow hedge, where permitted under NZ IAS 39. These hedge designations and associated accounting treatment are as follows:

Fair value hedges

Fair value hedges hedge the exposure to changes in the fair value of an asset or liability.

- Changes in the fair value of derivatives and the changes in the fair value of the hedged asset or liability in fair value hedges attributable to the hedged risk are recognised in non-interest income. The carrying value of the hedged asset or liability is adjusted for the changes in fair value related to the hedged risk.
- If a hedge is discontinued, any fair value adjustments to the carrying value of the asset or liability are amortised to net interest income over the period to maturity. If the asset or liability is sold, any unamortised adjustment is immediately recognised in the income statement.

Cash flow hedges

Cash flow hedges hedge the exposure to variability of cash flows attributable to an asset, liability or future forecast transaction.

- For effective hedges, changes in the fair value of derivatives are recognised in the cash flow hedge reserve through other comprehensive income and subsequently recognised in net interest income when the asset or liability that was hedged impacts the income statement.

For hedges with some ineffectiveness, the changes in the fair value of the derivatives relating to the ineffective portion are immediately recognised in the income statement.

- If a hedge is discontinued, any cumulative gain or loss remains in other comprehensive income. It is amortised to net interest income over the period which the asset or liability that was hedged also impacts the income statement.
- If a hedge of a forecast transaction is no longer expected to occur, any cumulative gain or loss in other comprehensive income is immediately recognised in the income statement.

Derivatives of the NZ Banking Group are mainly held either in the NZ Branch or Westpac New Zealand.

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 risk management activities. Market making involves providing quotes to other dealers, who reciprocate by providing the NZ Branch with their own quotes. This process provides liquidity in the key markets in which the NZ Branch operates.

Fair value hedges

The NZ Banking Group hedges a proportion of its interest rate risk and foreign exchange interest rate risk from debt issuances and fixed interest rate assets with single currency and cross currency swaps.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Change in fair value of hedging instruments	**6**	10
Change in fair value of hedged items attributed to hedged risk	**(6)**	(16)
Ineffectiveness in non-interest income	**-**	(6)

Note 26 Derivative financial instruments (continued)

Cash flow hedges

Exposure to the volatility of interest cash flows from customer deposits and loans is hedged with interest rate derivatives. Exposure to foreign currency principal and interest cash flows from floating rate debt issuances is hedged through the use of cross currency derivatives.

Gross cash inflows and outflows on derivatives designated in cash flow hedges are, as a proportion of total gross cash flows, expected to occur in the following periods:

	NZ BANKING GROUP							
	2018							
	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	0%	0%	19%	18%	24%	22%	3%	14%
Cash outflows	1%	1%	18%	19%	24%	20%	3%	14%

	NZ BANKING GROUP							
	2017							
	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	11%	1%	5%	19%	7%	23%	20%	14%
Cash outflows	11%	1%	6%	18%	8%	23%	19%	14%

	NZ BANKING GROUP	
$ millions	**2018**	2017
Cash flow hedge ineffectiveness	**4**	(4)

Dual fair value and cash flow hedges

Fixed rate foreign currency denominated debt is hedged using cross currency interest rate derivatives, designated as fair value hedges of foreign interest rates and cash flow hedges of foreign exchange rates.

The notional amount and fair value of derivative instruments held for trading and designated in hedge relationships are set out in the following tables:

Derivatives held with external counterparties

	NZ BANKING GROUP								
	2018								
		FAIR VALUE							
				Hedging				Total Fair Value	
		Trading		Fair Value		Cash Flow			
$ millions	**Notional Amount**	**Assets**	**Liabilities**	**Assets**	**Liabilities**	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate contracts									
Futures contracts[1]	**10,467**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Swap agreements	**310,702**	**2,988**	**(2,708)**	**18**	**(365)**	**36**	**(115)**	**3,042**	**(3,188)**
Options	**105**	**1**	**(1)**	**-**	**-**	**-**	**-**	**1**	**(1)**
Total interest rate contracts	**321,274**	**2,989**	**(2,709)**	**18**	**(365)**	**36**	**(115)**	**3,043**	**(3,189)**
Foreign exchange contracts									
Spot and forward contracts	**16,501**	**156**	**(145)**	**-**	**-**	**-**	**-**	**156**	**(145)**
Cross currency swap agreements	**70,842**	**796**	**(1,226)**	**25**	**(7)**	**543**	**(56)**	**1,364**	**(1,289)**
Total foreign exchange contracts	**87,343**	**952**	**(1,371)**	**25**	**(7)**	**543**	**(56)**	**1,520**	**(1,434)**
Total of gross derivatives	**408,617**	**3,941**	**(4,080)**	**43**	**(372)**	**579**	**(171)**	**4,563**	**(4,623)**
Impact of netting arrangements[2]	**-**	**(1,054)**	**1,054**	**-**	**-**	**-**	**-**	**(1,054)**	**1,054**
Total of net derivatives	**408,617**	**2,887**	**(3,026)**	**43**	**(372)**	**579**	**(171)**	**3,509**	**(3,569)**

[1] The fair value differential of futures contracts are settled daily with the exchange. The notional balance represents open contracts as at 30 September.

[2] Amounts offset against derivatives consist of NZ Branch derivative trades settled directly with a central clearing counterparty. Refer to Note 28.

Notes to the financial statements

Note 26 Derivative financial instruments (continued)

$ millions	Notional Amount	FAIR VALUE							
NZ BANKING GROUP 2017		Trading		Hedging Fair Value		Hedging Cash Flow		Total Fair Value	
		Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts									
Futures contracts[1]	14,827	-	-	-	-	-	-	-	-
Swap agreements	241,031	2,860	(2,507)	21	(296)	36	(129)	2,917	(2,932)
Options	193	-	-	-	-	-	-	-	-
Total interest rate contracts	256,051	2,860	(2,507)	21	(296)	36	(129)	2,917	(2,932)
Foreign exchange contracts									
Spot and forward contracts	13,255	92	(112)	-	-	-	-	92	(112)
Cross currency swap agreements	64,821	920	(821)	31	(5)	170	(315)	1,121	(1,141)
Total foreign exchange contracts	78,076	1,012	(933)	31	(5)	170	(315)	1,213	(1,253)
Total of gross derivatives	334,127	3,872	(3,440)	52	(301)	206	(444)	4,130	(4,185)
Impact of netting arrangements[2]	-	(710)	710	-	-	-	-	(710)	710
Total of net derivatives	334,127	3,162	(2,730)	52	(301)	206	(444)	3,420	(3,475)

[1] The fair value differential of futures contracts are settled daily with the exchange. The notional balance represents open contracts as at 30 September.

[2] Amounts offset against derivatives consist of NZ Branch derivative trades settled directly with a central clearing counterparty. Refer to Note 28.

Derivatives held with related parties

$ millions	**Notional Amount**	**FAIR VALUE**							
NZ BANKING GROUP 2018		**Trading**		**Hedging Fair Value**		**Hedging Cash Flow**		**Total Fair Value**	
		Assets	**Liabilities**	**Assets**	**Liabilities**	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate contracts									
Swap agreements	**23,914**	**131**	**(281)**	**-**	**-**	**-**	**-**	**131**	**(281)**
Options	**83**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total interest rate contracts	**23,997**	**131**	**(281)**	**-**	**-**	**-**	**-**	**131**	**(281)**
Foreign exchange contracts									
Spot and forward contracts	**17,359**	**135**	**(146)**	**-**	**-**	**-**	**-**	**135**	**(146)**
Cross currency swap agreements	**18,439**	**187**	**(164)**	**-**	**-**	**-**	**(53)**	**187**	**(217)**
Total foreign exchange contracts	**35,798**	**322**	**(310)**	**-**	**-**	**-**	**(53)**	**322**	**(363)**
Total of gross derivatives	**59,795**	**453**	**(591)**	**-**	**-**	**-**	**(53)**	**453**	**(644)**
Impact of netting arrangements	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total of net derivatives	**59,795**	**453**	**(591)**	**-**	**-**	**-**	**(53)**	**453**	**(644)**

Note 26 Derivative financial instruments (continued)

		NZ BANKING GROUP							
		2017							
		FAIR VALUE							
				Hedging				Total Fair Value	
		Trading		Fair Value		Cash Flow			
$ millions	Notional Amount	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts									
Swap agreements	18,605	137	(235)	-	-	-	-	137	(235)
Options	108	-	-	-	-	-	-	-	-
Total interest rate contracts	18,713	137	(235)	-	-	-	-	137	(235)
Foreign exchange contracts									
Spot and forward contracts	15,345	133	(103)	-	-	-	-	133	(103)
Cross currency swap agreements	15,472	140	(175)	-	-	-	(62)	140	(237)
Total foreign exchange contracts	30,817	273	(278)	-	-	-	(62)	273	(340)
Total of gross derivatives	49,530	410	(513)	-	-	-	(62)	410	(575)
Impact of netting arrangements	-	-	-	-	-	-	-	-	-
Total of net derivatives	49,530	410	(513)	-	-	-	(62)	410	(575)

Note 27 Fair value of financial assets and financial liabilities

Accounting policy

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

On initial recognition, the transaction price generally represents the fair value of the financial instrument unless there is observable information from an active market to the contrary. Where unobservable information is used, the difference between the transaction price and the fair value (day one profit or loss) is recognised in the income statement over the life of the instrument when the inputs become observable.

Critical accounting assumptions and estimates

The majority of valuation models used by the NZ Banking Group employ only observable market data as inputs. However, for certain financial instruments, data may be employed which is not readily observable in current markets.

The availability of observable inputs is influenced by factors such as:

- product type;
- depth of market activity;
- maturity of market models; and
- complexity of the transaction.

Where unobservable market data is used, more judgment is required to determine fair value. The significance of these judgments depends on the significance of the unobservable input to the overall valuation. Unobservable inputs are generally derived from other relevant market data and adjusted against:

- standard industry practice;
- economic models; and
- observed transaction prices.

In order to determine a reliable fair value for a financial instrument, management may apply adjustments to the techniques previously described. These adjustments reflect the NZ Banking Group's assessment of factors that market participants would consider in setting the fair value.

These adjustments incorporate bid/offer spreads, credit valuation adjustments and funding valuation adjustments.

Note 27 Fair value of financial assets and financial liabilities (continued)

Fair Valuation Control Framework

The NZ Banking Group uses a Fair Valuation Control Framework where the fair value is either determined or validated by a function independent of the transaction. This framework formalises the policies and procedures used to achieve compliance with relevant accounting, industry and regulatory standards. The framework includes specific controls relating to:

- the revaluation of financial instruments;
- independent price verification;
- fair value adjustments; and
- financial reporting.

A key element of the Framework is the Revaluation Committee, comprising senior valuation specialists from within the Overseas Banking Group. The Revaluation Committee reviews the application of the agreed policies and procedures to assess that a fair value measurement basis has been applied.

The method of determining fair value differs depending on the information available.

Fair value hierarchy

A financial instrument's categorisation within the valuation hierarchy is based on the lowest level input that is significant to the fair value measurement.

The NZ Banking Group categorises all fair value instruments according to the hierarchy described below.

Valuation techniques

The NZ Banking Group applies market accepted valuation techniques in determining the fair valuation of Over the Counter derivatives. This includes credit valuation adjustments and funding valuation adjustments, which incorporates credit risk and funding costs and benefits that arise in relation to uncollateralised derivative positions, respectively.

The specific valuation techniques, the observability of the inputs used in valuation models and the subsequent classification for each significant product category are outlined below:

Financial instruments measured at fair value

Level 1 instruments

The fair value of financial instruments traded in active markets based on recent unadjusted quoted prices. These prices are based on actual arm's length basis transactions.

The valuations of Level 1 instruments require little or no management judgment.

<table>
<tr><th>Instrument</th><th>Balance sheet category</th><th>Includes:</th><th>Valuation technique</th></tr>
<tr><td rowspan="3">Exchange traded products</td><td>Derivative financial instruments</td><td rowspan="3">Exchange traded interest rate futures - derivative financial instruments</td><td rowspan="7">These instruments are traded in liquid, active markets where prices are readily observable. No modelling or assumptions are used in the valuation.</td></tr>
<tr><td>Due from related entities</td></tr>
<tr><td>Due to related entities</td></tr>
<tr><td>Foreign exchange products</td><td>Derivative financial instruments</td><td>FX spot contracts</td></tr>
<tr><td rowspan="3">Non-asset backed debt instruments</td><td>Trading securities and financial assets designated at fair value</td><td rowspan="3">New Zealand Government bonds</td></tr>
<tr><td>Available-for-sale securities</td></tr>
<tr><td>Other financial liabilities at fair value through income statement</td></tr>
</table>

Level 2 instruments

The fair value for financial instruments that are not actively traded are determined using valuation techniques which maximise the use of observable market prices. Valuation techniques include:

- the use of market standard discounting methodologies;
- option pricing models; and
- other valuation techniques widely used and accepted by market participants.

Notes to the financial statements

Note 27 Fair value of financial assets and financial liabilities (continued)

Instrument	Balance sheet category	Includes:	Valuation technique
Interest rate products	Derivative financial instruments Due from related entities Due to related entities	Interest rate swaps and options - derivative financial instruments	Industry standard valuation models are used 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 and active broker quoted interest rates in the swap, bond and futures markets. Interest rate volatilities are sourced from brokers and consensus data providers.
Foreign exchange products	Derivative financial instruments Due from related entities Due to related entities	FX swaps and FX forward contracts - derivative financial instruments	Derived from market observable inputs or consensus pricing providers using industry standard models.
Asset backed debt instruments	Trading securities and financial assets designated at fair value Available-for-sale securities	Asset backed securities	Valued using an industry approach to value floating rate debt with prepayment features. The main inputs to the model are the trading margin and the weighted average life of the security. These inputs are sourced from a consensus data provider. If consensus prices are not available these are classified as Level 3 instruments.
Non-asset backed debt instruments	Trading securities and financial assets designated at fair value Available-for-sale securities Other financial liabilities at fair value through income statement	Local authority and NZ public securities, other bank issued certificates of deposit, commercial paper, other government securities, off-shore securities and corporate bonds Security repurchase agreements and reverse repurchase agreements over non-asset backed debt securities	Valued using observable market prices which are sourced from consensus pricing services, broker quotes or inter-dealer prices.
Deposits and other borrowings at fair value	Deposits and other borrowings	Certificates of deposit	Discounted cash flow using market rates offered for deposits of similar remaining maturities.
Debt issues at fair value	Debt issues	Commercial paper	Discounted cash flows, 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 Westpac New Zealand.
Life insurance assets	Life insurance assets	Local authority securities, investment grade corporate bonds, life insurance contract liabilities and units in unlisted unit trusts	Valued using observable market prices or other widely used and accepted valuation techniques utilising observable market inputs.

Level 3 instruments

Financial instruments valued where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data due to illiquidity or complexity of the product. These inputs are generally derived and extrapolated from other relevant market data and calibrated against current market trends and historical transactions.

These valuations are calculated using a high degree of management judgment.

Instrument	Balance sheet category	Includes:	Valuation technique
Asset backed debt instruments	Trading securities and financial assets designated at fair value	Residential mortgage-backed securities ('**RMBS**') and certain other asset backed securities	RMBS are classified as Level 3 as consensus prices are not available as valuation inputs. Quotes by a third party broker or lead manager are used to derive the fair value for these instruments.
Interest rate derivatives	Derivative financial instruments	Non-vanilla interest rate (inflation indexed) derivatives and long-dated NZD caps	Valued using industry standard valuation models utilising observable market inputs which are determined separately for each parameter. Where unobservable, inputs will be set with reference to an observable proxy.

Notes to the financial statements

Note 27 Fair value of financial assets and financial liabilities (continued)

The table below summarises the attribution of financial instruments measured at fair value on a recurring basis to the fair value hierarchy:

	NZ BANKING GROUP							
	2018				2017			
$ millions	**Level 1**	**Level 2**	**Level 3**[1]	**Total**	Level 1	Level 2	Level 3[1]	Total
Financial assets measured at fair value								
Trading securities and financial assets designated at fair value	**159**	**2,857**	**-**	**3,016**	91	3,800	58	3,949
Derivative financial instruments	**-**	**3,509**	**-**	**3,509**	1	3,419	-	3,420
Available-for-sale securities	**1,167**	**2,643**	**-**	**3,810**	1,556	2,531	-	4,087
Life insurance assets	**-**	**310**	**-**	**310**	-	304	-	304
Due from related entities	**1**	**458**	**-**	**459**	1	409	-	410
Total financial assets measured at fair value	**1,327**	**9,777**	**-**	**11,104**	1,649	10,463	58	12,170
Financial liabilities measured at fair value								
Deposits and other borrowings at fair value	**-**	**1,221**	**-**	**1,221**	-	593	-	593
Other financial liabilities at fair value through income statement	**145**	**78**	**-**	**223**	39	263	-	302
Derivative financial instruments	**-**	**3,569**	**-**	**3,569**	-	3,475	-	3,475
Due to related entities	**2**	**642**	**-**	**644**	1	574	-	575
Debt issues at fair value	**-**	**-**	**-**	**-**	-	1,642	-	1,642
Total financial liabilities measured at fair value	**147**	**5,510**	**-**	**5,657**	40	6,547	-	6,587

[1] Balances within this category of the fair value hierarchy are not considered material to the total trading securities and financial assets designated at fair value and derivative financial instrument balances.

There were no material amounts of changes in fair value estimated using a valuation technique incorporating significant non-observable inputs that were recognised in the income statement or the statement of comprehensive income of the NZ Banking Group during the year ended 30 September 2018 (30 September 2017: no material changes in fair value).

Analysis of movements between fair value hierarchy levels

During the year there were no material transfers between levels of the fair value hierarchy (30 September 2017: nil).

Financial instruments not measured at fair value

For financial instruments not measured at fair value on a recurring basis, fair value has been derived as follows:

Instrument	Valuation technique
Loans	Where available, the fair value of loans is based on observable market transactions; otherwise fair value is estimated using discounted cash flow models. For variable rate loans, the discount rate used is the current effective interest rate. The discount rate applied for fixed rate loans reflects the market rate for the maturity of the loan and the credit worthiness of the borrower.
Deposits and other borrowings	Fair values of deposit liabilities payable on demand (interest free, interest bearing and savings deposits) approximate their carrying value. Fair values for term deposits are estimated using discounted cash flows, applying market rates offered for deposits of similar remaining maturities.
Debt issues and loan capital	Fair values are calculated using a discounted cash flow model. The discount rates applied reflect the terms of the instruments, the timing of the estimated cash flows and are adjusted for any changes in the applicable credit spreads.
Due to related entities	Fair values are calculated in respect of long-term debt using a discounted cash flow model. The discount rate applied reflects the terms of the loan and the timing of the estimated cash flows. The carrying value of all other balances due to related entities approximates the fair value. These items are either short-term in nature or re-price frequently.
All other financial assets and financial liabilities	For all other financial assets and financial liabilities, the carrying value approximates the fair value. These items are either short-term in nature or re-price frequently, and are of a high credit rating.

Note 27 Fair value of financial assets and financial liabilities (continued)

The following table summarises the estimated fair value of the NZ Banking Group's financial instruments not measured at fair value:

	NZ BANKING GROUP				
	2018				
		Fair Value			
$ millions	**Carrying Amount**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets not measured at fair value					
Cash and balances with central banks	**1,472**	**1,472**	**-**	**-**	**1,472**
Receivables due from other financial institutions	**237**	**180**	**57**	**-**	**237**
Other assets	**411**	**-**	**-**	**411**	**411**
Loans	**80,860**	**-**	**-**	**80,989**	**80,989**
Due from related entities	**1,564**	**-**	**1,558**	**6**	**1,564**
Total financial assets not measured at fair value	**84,544**	**1,652**	**1,615**	**81,406**	**84,673**
Financial liabilities not measured at fair value					
Payables due to other financial institutions	**1,253**	**592**	**661**	**-**	**1,253**
Other liabilities	**737**	**-**	**737**	**-**	**737**
Deposits and other borrowings	**61,884**	**-**	**61,276**	**647**	**61,923**
Due to related entities	**1,796**	**-**	**1,806**	**-**	**1,806**
Debt issues	**13,725**	**-**	**13,845**	**-**	**13,845**
Loan capital	**2,866**	**-**	**1,692**	**1,180**	**2,872**
Total financial liabilities not measured at fair value	**82,261**	**592**	**80,017**	**1,827**	**82,436**

	NZ BANKING GROUP				
	2017				
		Fair Value			
$ millions	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets not measured at fair value					
Cash and balances with central banks	1,761	1,761	-	-	1,761
Receivables due from other financial institutions	471	431	40	-	471
Other assets	378	-	-	378	378
Loans	77,681	-	-	77,717	77,717
Due from related entities	2,213	-	2,212	1	2,213
Total financial assets not measured at fair value	82,504	2,192	2,252	78,096	82,540
Financial liabilities not measured at fair value					
Payables due to other financial institutions	1,043	210	833	-	1,043
Other liabilities	521	-	521	-	521
Deposits and other borrowings	58,405	-	57,849	601	58,450
Due to related entities	3,071	-	3,084	-	3,084
Debt issues	15,087	-	15,259	-	15,259
Loan capital	2,822	-	1,733	1,188	2,921
Total financial liabilities not measured at fair value	80,949	210	79,279	1,789	81,278

Note 28 Offsetting financial assets and financial liabilities

Accounting policy

Financial assets and liabilities are presented net on the balance sheet when the NZ Banking Group has a legally enforceable right to offset them in all circumstances and there is an intention to settle the asset and liability on a net basis, or to realise the asset and settle the liability simultaneously. The gross assets and liabilities behind the net amounts reported on the balance sheet are disclosed in the table below.

Some of the NZ Banking Group's offsetting arrangements are not enforceable in all circumstances. The assets and liabilities under such agreements are also disclosed in the table below, to illustrate the net balance sheet amount if these future events should occur. The amounts in the tables below may not tie back to the balance sheet if there are balances which are not subject to offsetting arrangements. The amounts presented in this note do not represent the credit risk exposure of the NZ Banking Group. Refer to Note 36.2 for information on credit risk management. The offsetting and collateral arrangements and other credit risk mitigation strategies used by the NZ Banking Group are further explained in the 'Management of risk mitigation' section under Note 36.2.

Note 28 Offsetting financial assets and financial liabilities (continued)

	NZ BANKING GROUP						
	2018						
	Effects of Offsetting on Balance Sheet			Amounts Subject to Enforceable Netting Arrangements But Not Offset			
$ millions	**Gross Amounts**	**Amounts Offset**	**Net Amounts Reported on the Balance Sheet**	**Other Recognised Financial Instruments**	**Cash Collateral**	**Financial Instrument Collateral**	**Net amount**
Assets							
Securities purchased under agreement to resell[1]	**216**	**-**	**216**	**-**	**-**	**(216)**	**-**
Derivative financial instruments	**4,563**	**(1,054)**	**3,509**	**(1,598)**	**(495)**	**-**	**1,416**
Due from related entities - derivative financial instruments[2]	**453**	**-**	**453**	**(453)**	**-**	**-**	**-**
Total assets	**5,232**	**(1,054)**	**4,178**	**(2,051)**	**(495)**	**(216)**	**1,416**
Liabilities							
Security repurchase agreements[3]	**41**	**-**	**41**	**-**	**-**	**(41)**	**-**
Derivative financial instruments	**4,623**	**(1,054)**	**3,569**	**(1,598)**	**(71)**	**-**	**1,900**
Due to related entities - derivative financial instruments[4]	**644**	**-**	**644**	**(453)**	**-**	**-**	**191**
Total liabilities	**5,308**	**(1,054)**	**4,254**	**(2,051)**	**(71)**	**(41)**	**2,091**

	NZ BANKING GROUP						
	2017						
	Effects of Offsetting on Balance Sheet			Amounts Subject to Enforceable Netting Arrangements But Not Offset			
$ millions	Gross Amounts	Amounts Offset	Net Amounts Reported on the Balance Sheet	Other Recognised Financial Instruments	Cash Collateral	Financial Instrument Collateral	Net amount
Assets							
Securities purchased under agreement to resell[1]	757	-	757	-	-	(754)	3
Derivative financial instruments	4,130	(710)	3,420	(1,731)	(58)	-	1,631
Due from related entities - derivative financial instruments[2]	410	-	410	(410)	-	-	-
Total assets	5,297	(710)	4,587	(2,141)	(58)	(754)	1,634
Liabilities							
Security repurchase agreements[3]	235	-	235	-	-	(235)	-
Derivative financial instruments	4,185	(710)	3,475	(1,731)	(332)	-	1,412
Due to related entities - derivative financial instruments[4]	575	-	575	(410)	-	-	165
Total liabilities	4,995	(710)	4,285	(2,141)	(332)	(235)	1,577

[1] Forms part of trading securities and financial assets designated at fair value on the balance sheet (refer to Note 11).
[2] Forms part of due from related entities on the balance sheet (refer to Note 25).
[3] Forms part of other financial liabilities at fair value through income statement on the balance sheet (refer to Note 21).
[4] Forms part of due to related entities on the balance sheet (refer to Note 25).

Other recognised financial instruments

These financial assets and liabilities are subject to master netting agreements which are not enforceable in all circumstances, so they are recognised gross on the balance sheet. The offsetting rights of the master netting arrangements can only be enforced if a predetermined event occurs in the future, such as a counterparty defaulting.

Cash collateral and financial instrument collateral

These amounts are received or pledged under master netting arrangements against the gross amounts of assets and liabilities. Financial instrument collateral typically comprises securities which can be readily liquidated in the event of counterparty default. The offsetting rights of the master netting arrangement can only be enforced if a predetermined event occurs in the future, such as a counterparty defaulting.

Note 29 Operating lease commitments

The NZ Banking Group leases various commercial and retail premises and related plant and equipment. The lease commitments at 30 September are as follows:

	NZ BANKING GROUP	
$ millions	**2018**	2017
Due within one year	**55**	55
Due after one year but not later than five years	**147**	141
Due after five years	**197**	159
Total lease commitments	**399**	355

Operating leases are entered into to meet the business needs of entities in the NZ Banking Group. Lease rentals are determined in accordance with market conditions when leases are entered into or on rental review dates.

Note 30 Credit related commitments, contingent assets and contingent liabilities

Accounting policy

Undrawn credit commitments

The NZ Banking Group enters into various arrangements with customers which are only recognised in the balance sheet when called upon. These arrangements include commitments to extend credit, bill endorsements, financial guarantees, standby letters of credit and underwriting facilities.

Contingent assets

Contingent assets are possible assets whose existence will be confirmed only by uncertain future events. Contingent assets are not recognised on the balance sheet but are disclosed if an inflow of economic benefits is probable.

Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events, and present obligations where the transfer of economic resources is not probable or cannot be reliably measured. Contingent liabilities are not recognised on the balance sheet but are disclosed unless the outflow of economic resources is remote.

Undrawn credit commitments

The NZ Banking Group enters into various arrangements with customers which are only recognised on the balance sheet when called upon. These arrangements include commitments to extend credit, bill endorsements, financial guarantees, standby letters of credit and underwriting facilities.

They expose the NZ Banking Group to liquidity risk when called upon and also to credit risk if the customer fails to repay the amounts owed at the due date. The maximum exposure to credit loss is the contractual or notional amount of the instruments disclosed below. Some of the arrangements can be cancelled by the NZ Banking Group at any time and a significant portion is expected to expire without being drawn. The actual required liquidity and credit risk exposure is therefore less than the amounts disclosed. The NZ Banking Group uses the same credit policies when entering into these arrangements as it does for on-balance sheet instruments. Refer to Note 36 for further details on liquidity risk and credit risk management.

Westpac New Zealand is obliged to repurchase any loan sold to and held by:

a. WNZSL (pursuant to its securitisation programme) where the loan does not meet certain terms and conditions of the WNZSL securitisation programme;

b. WNZCBL (pursuant to the CB Programme) where:

   i. it is discovered that there has been a material breach of a sale warranty (or any such sale warranty is materially untrue);

   ii. the loan becomes materially impaired or is enforced prior to the second monthly covered bond payment date falling after the assignment of the loan; or

   iii. at the cut-off date relating to the loan, there were arrears of interest and that loan subsequently becomes a delinquent loan prior to the second monthly covered bond payment date falling after the assignment of the loan.

It is not envisaged that any liability resulting in material loss to the NZ Banking Group will arise from these obligations.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Letters of credit and guarantees[1]	**1,104**	1,041
Commitments to extend credit[2]	**24,722**	25,111
Other	**60**	10
Total undrawn credit commitments	**25,886**	26,162

[1] Letters of credit and guarantees are undertakings to pay, against presentation documents, an obligation in the event of a default by a customer. Guarantees are unconditional undertakings given to support the obligations of a customer to third parties. The NZ Banking Group may hold cash as collateral for certain guarantees issued.

[2] Commitments to extend credit include all obligations on the part of the NZ Banking Group to provide credit facilities. As facilities may expire without being drawn upon, the notional amounts do not necessarily reflect future cash requirements.

Notes to the financial statements

Note 30 Credit related commitments, contingent assets and contingent liabilities (continued)

Contingent assets

The credit commitments shown in the table above also constitute contingent assets. These commitments would be classified as loans on the balance sheet on the contingent event occurring.

Contingent liabilities

The NZ Banking Group has 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 matters has been made on a case-by-case basis and provision has been made in these financial statements where appropriate.

Additional information relating to any provision or contingent liability has not been provided where disclosure of such information might be expected to seriously prejudice the position of the NZ Banking Group.

WNZIL, a subsidiary of Westpac New Zealand, leases the majority of the properties occupied by the NZ Banking Group. Westpac New Zealand guarantees a significant portion of lease obligations. As is normal practice, the lease agreements contain 'make good' provisions which require WNZIL, upon termination of the lease, to return the premises to the lessor in the original condition. The maximum amount payable by WNZIL upon vacation of all leased premises subject to these provisions as at 30 September 2018 was estimated to be $30 million (30 September 2017: $30 million).

No amount has been recognised for the $30 million in estimated maximum vacation payments as the NZ Banking Group believes it is highly unlikely that WNZIL would incur a material operating loss as a result of such 'make good' provisions in the normal course of its business operations.

Note 31 Segment reporting

Accounting policy

Operating segments are presented on a basis that is consistent with information provided internally to the NZ Banking Group's chief operating decision-makers and reflects the management of the business, rather than the legal structure of the NZ Banking Group. 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 inter-segment revenue and costs being eliminated at head office. Income and expenses directly associated with each segment are included in determining business segment performance.

The NZ Banking Group operates predominantly in the consumer banking and wealth, commercial, corporate and institutional banking, and investments and insurance sectors within New Zealand. On this basis, no geographical segment reporting is provided.

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 a cost recovery basis.

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

Comparative information for the year ended 30 September 2017 has been restated following changes to the allocation of costs and the Overseas Bank updating its capital allocation framework. Comparative information has been restated to ensure consistent presentation with the current reporting period. The revised presentation has no impact on total profit before income tax expense for the year ended 30 September 2017.

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:

- Consumer Banking and Wealth provides financial services predominantly for individuals;
- Commercial, Corporate and Institutional Banking provides a broad range of financial services for commercial, corporate, property finance, agricultural, institutional and government customers, and the supply of derivatives and risk management products to the entire Westpac customer base in New Zealand; and
- Investments and Insurance provides funds management and insurance services.

Reconciling items primarily represent:

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

Note 31 Segment reporting (continued)

$ millions	Consumer Banking and Wealth	Commercial, Corporate and Institutional	Investments and Insurance	Reconciling Items	Total
	NZ BANKING GROUP				
Year ended 30 September 2018					
Net interest income	**1,145**	**737**	**1**	**29**	**1,912**
Non-interest income	**177**	**263**	**138**	**24**	**602**
Net operating income before operating expenses and impairment charges	**1,322**	**1,000**	**139**	**53**	**2,514**
Operating expenses	**(679)**	**(247)**	**(32)**	**(11)**	**(969)**
Impairment (charges)/benefits	**(33)**	**14**	**-**	**22**	**3**
Profit before income tax	**610**	**767**	**107**	**64**	**1,548**
Total gross loans	**46,605**	**34,550**	**-**	**29**	**81,184**
Total deposits and other borrowings	**36,147**	**25,737**	**-**	**1,221**	**63,105**
Year ended 30 September 2017 (restated)					
Net interest income	1,053	717	1	17	1,788
Non-interest income	219	288	131	(13)	625
Net operating income before operating expenses and impairment charges	1,272	1,005	132	4	2,413
Operating expenses	(708)	(250)	(29)	(19)	(1,006)
Impairment (charges)/benefits	(34)	97	-	13	76
Profit before income tax	530	852	103	(2)	1,483
Total gross loans	44,707	33,294	-	30	78,031
Total deposits and other borrowings	34,044	24,361	-	593	58,998

Note 32 Securitisation, covered bonds and other transferred assets

The NZ Banking Group enters into transactions in the normal course of business by which financial assets are transferred to counterparties or structured entities. Depending on the circumstances, these transfers may result in derecognition of the assets in their entirety, partial derecognition or no derecognition of the assets subject to the transfer. For the NZ Banking Group's accounting policy on derecognition of financial assets, refer to Note 1.

Securitisation

Securitisation is the transferring of assets (or an interest in either the assets or the cash flows arising from the assets) to a structured entity which then issues interest bearing debt securities to third party investors.

Own assets securitised

Securitisation of its own assets is used by the NZ Banking Group as a funding and liquidity tool.

For securitisation structured entities which the NZ Banking Group controls, as defined in Note 33, the structured entities are classified as subsidiaries and consolidated. When assessing whether the NZ Banking Group controls a structured entity, it considers its exposure to and ability to affect variable returns. The NZ Banking Group may have variable returns from a structured entity through ongoing exposures to the risks and rewards associated with the assets, the provision of derivatives, liquidity facilities, trust management and operational services.

In October 2008, WNZSL was set up as part of Westpac New Zealand's internal residential mortgage-backed securitisation programme. Under this programme Westpac New Zealand sold the rights (but not the obligations) of a pool of housing loans to WNZSL. The purchase was funded by WNZSL's issuance of residential mortgage-backed securities ('**RMBS**'). The RMBS and an equivalent liability in the form of a deemed loan from Westpac New Zealand to WNZSL are fully eliminated in the NZ Banking Group's financial statements. Refer to Note 30 for a description of the NZ Banking Group's obligation to repurchase certain housing loans sold to WNZSL.

Covered bonds

The NZ Banking Group has a covered bond programme whereby selected pools of housing loans it originates are assigned to a bankruptcy remote structured entity. WNZCBL is a special purpose entity established to purchase from time to time, and hold the rights, but not the obligations, of a pool of housing loans ('**cover pool**') and to provide a financial guarantee (in addition to that of Westpac New Zealand) in respect of obligations under the covered bonds issued from time to time by WSNZL under the CB Programme. That financial guarantee is supported by WNZCBL granting security in favour of the covered bondholders over the cover pool.

The intercompany loan made by Westpac New Zealand to WNZCBL to fund the initial purchase (and subsequent further purchases which increased the cover pool) and the liability representing the deemed loan from WNZCBL to Westpac New Zealand are fully eliminated in the NZ Banking Group's financial statements. Refer to Note 30 for a description of the NZ Banking Group's obligation to repurchase certain housing loans sold to WNZCBL.

Note 32 Securitisation, covered bonds and other transferred assets (continued)

Security repurchase agreements

Where securities are sold subject to an agreement to repurchase at a predetermined price, they remain recognised on the balance sheet in their original category (i.e. trading securities or available-for-sale securities).

The cash consideration received is recognised as a liability (security repurchase agreements). Refer to Notes 17 and 21 for further details.

The following table presents the NZ Banking Group's assets transferred and their associated liabilities:

	NZ BANKING GROUP				
			For those liabilities that only have recourse to the transferred assets:		
$ millions	Carrying amount of transferred assets	Carrying amount of associated liabilities	Fair value of transferred assets	Fair value of associated liabilities	Net fair value position
2018					
Securitisation - own assets[1]	**5,033**	**5,015**	**5,021**	**5,015**	**6**
Covered bonds[2]	**7,533**	**5,656**	**n/a**	**n/a**	**n/a**
Security repurchase agreements	**41**	**41**	**n/a**	**n/a**	**n/a**
Total	**12,607**	**10,712**	**5,021**	**5,015**	**6**
2017					
Securitisation - own assets[1]	5,034	5,013	5,018	5,013	5
Covered bonds[2]	7,535	5,246	n/a	n/a	n/a
Security repurchase agreements	235	235	n/a	n/a	n/a
Total	12,804	10,494	5,018	5,013	5

[1] The most senior rated securities at 30 September 2018 of $4,700 million (30 September 2017: $4,700 million) qualify as eligible collateral for repurchase agreements with the Reserve Bank. Westpac New Zealand 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 RMBS as collateral for the Reserve Bank's repurchase agreements.

[2] The difference between the carrying values of the covered bonds and the assets pledged allows for the immediate issuance of additional covered bonds if required. These additional assets can be repurchased by Westpac New Zealand at its discretion, subject to the conditions set out in the transaction documents. The cover pool is comprised of housing loans up to a value of $7,500 million as at 30 September 2018 (30 September 2017: $7,500 million). Over time, the composition of the cover pool will include, in addition to housing loans, accrued interest (representing accrued and unpaid interest on the outstanding housing loans) and cash (representing collections of principal and interest from the underlying housing loans).

Note 33 Structured entities

Accounting policy

Structured entities are generally created to achieve a specific, defined objective and their operations are restricted such as only purchasing specific assets. Structured entities are commonly financed by debt or equity securities that are collateralised by and/or indexed to their underlying assets. The debt and equity securities issued by structured entities may include tranches with varying levels of subordination.

Structured entities are classified as subsidiaries and consolidated if they meet the definition in Note 1. If the NZ Banking Group does not control a structured entity then it will not be consolidated.

The NZ Banking Group engages in various transactions with both consolidated and unconsolidated structured entities that are mainly involved in securitisations, asset backed structures and managed funds.

Consolidated structured entities

Securitisation and covered bonds

The NZ Banking Group uses structured entities to securitise its financial assets through the CB Programme and the Bank's internal residential mortgage-backed securitisation programme. Refer to Note 32 for further details.

NZ Banking Group managed funds

As disclosed in Note 25 and the 'Funds management and other fiduciary activities' section below, the PIE Funds are consolidated within the financial statements of the NZ Banking Group.

Non-contractual financial support

The NZ Banking Group does not provide non-contractual financial support to these consolidated structured entities.

Note 33 Structured entities (continued)

Unconsolidated structured entities

The NZ Banking Group has interests in various unconsolidated structured entities including debt instruments, guarantees, liquidity arrangements, lending, loan commitments, certain derivatives and investment management agreements.

Interests exclude non-complex derivatives (e.g. interest rate swap agreements) and lending to a structured entity with recourse to a wider operating entity, not just the structured entity.

The NZ Banking Group's main interests in unconsolidated structured entities, which arise in the normal course of business, are:

Trading securities and financial assets designated at fair value	The NZ Banking Group actively trades interests in structured entities and normally has no other involvement with the structured entity. This includes RMBS or other asset-backed securities. These assets are highly rated, investment grade and eligible for repurchase agreements with the RBNZ or another central bank. The NZ Banking Group earns interest income on these securities and also recognises fair value changes through trading income in non-interest income.
Loans and other credit commitments	The NZ Banking Group lends to unconsolidated structured entities, subject to the NZ Banking Group's collateral and credit approval processes, in order to earn interest and fee income. The structured entities are mainly securitisation entities.
Investment management agreements	The NZ Banking Group manages funds that provide customers with investment opportunities. The NZ Banking Group also manages superannuation funds for its employees. The NZ Banking Group earns management and performance fee income which is recognised in non-interest income. The NZ Banking Group may also retain units in these investment management funds, primarily through its consolidated life insurance entity. The NZ Banking Group earns fund distribution income and recognises fair value movements through non-interest income.

The following table shows the NZ Banking Group's interests in unconsolidated structured entities and its maximum exposure to loss in relation to those interests. The maximum exposure does not take into account any collateral or hedges that will reduce the risk of loss.

- For on-balance sheet instruments, including debt instruments in and loans to unconsolidated structured entities, the maximum exposure to loss is the carrying value; and
- For off-balance sheet instruments, including liquidity facilities, loan and other credit commitments and guarantees, the maximum exposure to loss is the notional amounts.

	NZ BANKING GROUP							
	2018				2017			
$ millions	**Investment in Third Party Mortgage and other Asset- Backed Securities[1]**	**Financing to Securitisation Vehicles**	**Group Managed Funds**	**Total**	Investment in Third Party Mortgage and other Asset- Backed Securities[1]	Financing to Securitisation Vehicles	Group Managed Funds	Total
Assets								
Trading securities and financial assets designated at fair value	**50**	**-**	**-**	**50**	78	-	-	78
Loans	**-**	**2,632**	**-**	**2,632**	-	2,297	-	2,297
Life insurance assets	**-**	**-**	**191**	**191**	-	-	196	196
Total on-balance sheet exposures	**50**	**2,632**	**191**	**2,873**	78	2,297	196	2,571
Total notional amounts of off-balance sheet exposures	**-**	**765**	**87**	**852**	-	1,052	65	1,117
Maximum exposure to loss	**50**	**3,397**	**278**	**3,725**	78	3,349	261	3,688
Size of structured entities[2]	**813**	**3,397**	**10,219**	**14,429**	820	3,349	9,109	13,278

[1] The NZ Banking Group's interests in third party mortgage and other asset-backed securities are senior tranches of notes and are investment grade rated.
[2] Represented by the total assets or market capitalisation of the entity, or if not available, the NZ Banking Group's total committed exposure (for lending arrangements and external debt holdings), funds under management (for Group managed funds) or the total value of notes on issue (for investments in third-party asset-backed securities).

Non-contractual financial support

The NZ Banking Group does not provide non-contractual financial support to these unconsolidated structured entities.

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 the PIE Funds which are treated as controlled entities of Westpac New Zealand (refer to Note 25 for further details) and life insurance assets owned by Westpac Life which are included in wholesale client portfolios. Where controlled entities incur certain 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.

The PIE Funds are managed by a member of the NZ Banking Group (refer to Note 25 for further details) and invest in deposits with Westpac New Zealand. Westpac New Zealand is considered to control the PIE Funds, and as such they are consolidated within the financial statements of the NZ Banking Group.

Notes to the financial statements

Note 33 Structured entities (continued)

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

$ millions	2018	2017
Private and priority	**637**	627
Retirement plans	**6,312**	5,418
Retail unit trusts	**2,546**	2,365
Wholesale client portfolios	**724**	699
Term PIE	**2,031**	1,746
Cash PIE	**762**	815
Notice Saver PIE	**456**	309
Total funds under management	**13,468**	11,979

Marketing and distribution of insurance products

The NZ Banking Group markets and distributes both life and general insurance products. The life insurance products are underwritten by Westpac Life and by external third party insurance companies. The general insurance products are fully underwritten by external third party insurance companies. Disclosures are made in marketing material that the products are underwritten by those companies. Where the products are underwritten by Westpac Life, the disclosures state that other members of the Overseas Banking Group do not guarantee the obligations of, or any products issued by, Westpac Life. Where the products are underwritten by third parties, the disclosures state that Westpac New Zealand does not guarantee the obligations of, or any products issued by, those companies.

Risk management

The NZ Banking Group's risk management strategy (refer to Note 36) will help minimise the possibility that any difficulties arising from the above activities would adversely impact the NZ Banking Group.

Note 34 Insurance business

Accounting policy

The NZ Banking Group conducts insurance business through one of its controlled entities, Westpac Life, which is licensed under the Insurance (Prudential Supervision) Act 2010 ('**IPSA**').

Life insurance assets include investments held by the NZ Banking Group's life insurance company and net insurance policy assets relating to life insurance contracts.

Assets held by the NZ Banking Group's life insurance company, including investments in funds managed by the NZ Banking Group, are designated at fair value through profit or loss. Changes in fair value are recognised in non-interest income.

It is a requirement of the IPSA that a life insurance company must have at least one statutory fund in respect of its life insurance business. A statutory fund was established by Westpac Life on 1 October 2012. The statutory fund is subject to restrictions imposed under IPSA. The main restrictions are:

- that the assets in the statutory fund are only available to meet the liabilities and expenses of the life insurance business and cannot be used to support any other business of the life insurance company; and
- distribution of the retained profits of a statutory fund may only be made when certain solvency and other requirements are met.

Refer to Note 3 for details on the accounting policy related to net life insurance income and change in policy liabilities.

Critical accounting assumptions and estimates

The key factors that affect the estimation of net insurance policy assets are:

- the cost of providing benefits and administrating contracts;
- mortality and morbidity experience which includes policyholder benefit enhancements;
- discontinuance rates, which affects the NZ Banking Group's ability to recover the cost of acquiring new business over the life of the contracts; and
- the discount rate of projected future cash flows.

Regulation, competition, interest rates, taxes, securities market conditions and general economic conditions also affect the estimation of net insurance policy assets.

Westpac Life's primary insurance activities are the development, underwriting and management of products under life insurance legislation which provide insurance cover against the risks of death, disability, redundancy and bankruptcy. Westpac Life also manages insurance agency arrangements whereby general insurance and life insurance products are made available to NZ Banking Group customers. The insurance business of Westpac Life comprises less than one percent of the total assets of the NZ Banking Group.

Notes to the financial statements

Note 34 Insurance business (continued)

The following table presents the aggregate amount of the NZ Banking Group's insurance business calculated in accordance with the Overseas Bank's conditions of registration as at the reporting date:

	NZ BANKING GROUP	
$ millions	**2018**	2017
Total assets of insurance business	**219**	228
As a percentage of total consolidated assets of the NZ Banking Group	**0.23%**	0.24%

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

Note 35 Capital adequacy

The table below represents the capital adequacy calculation for the Overseas Banking Group and Overseas Bank as at 30 September 2018 based on APRA's application of the Basel III capital adequacy framework.

%	**2018 Unaudited**	2017 Unaudited
Overseas Banking Group (excluding entities specifically excluded by APRA regulations)[1, 2]		
Common equity Tier 1 capital ratio	**10.6**	10.6
Additional Tier 1 capital ratio	**2.2**	2.1
Tier 1 capital ratio	**12.8**	12.7
Tier 2 capital ratio	**1.9**	2.1
Total regulatory capital ratio	**14.7**	14.8
Overseas Bank (Extended Licensed Entity)[1, 3]		
Common equity Tier 1 capital ratio	**10.5**	10.4
Additional Tier 1 capital ratio	**2.3**	2.2
Tier 1 capital ratio	**12.8**	12.6
Tier 2 capital ratio	**2.0**	2.4
Total regulatory capital ratio	**14.8**	15.0

[1] The capital ratios represent information mandated by APRA. The capital ratios of the Overseas Banking Group are publicly available in the Overseas Banking Group's Pillar 3 report. This information is made available to users via the Overseas Bank's website (www.westpac.com.au).

[2] Overseas Banking Group (excluding entities specifically excluded by APRA regulations) comprises the consolidation of the Overseas Bank and its subsidiary entities except those entities specifically excluded by APRA regulations for the purposes of measuring capital adequacy (Level 2). The head of the Level 2 group is the Overseas Bank.

[3] Overseas Bank (Extended Licensed Entity) comprises the Overseas Bank and its subsidiary entities that have been approved by APRA as being part of a single Extended Licensed Entity for the purpose of measuring capital adequacy (Level 1).

Under APRA's Prudential Standards, Australian authorised deposit-taking institutions ('**ADI**'), including the Overseas Banking Group are required to maintain minimum ratios of capital to risk-weighted assets ('**RWA**'), as determined by APRA. For the calculation of RWAs, the Overseas Banking Group is accredited by APRA to apply advanced models permitted by the Basel III global capital adequacy regime. The Overseas Banking Group uses the Advanced Internal Ratings Based ('**Advanced IRB**') approach for credit risk, the Advanced Measurement Approach ('**AMA**') for operational risk and the internal model approach for interest rate risk in the banking book for calculating regulatory capital. APRA's prudential standards are generally consistent with the International Regulatory Framework for Banks, also known as Basel III, issued by the Basel Committee on Banking Supervision ('**BCBS**'), except where APRA has exercised certain discretions.

The Overseas Banking Group is required to disclose additional detailed information on its risk management practices and capital adequacy on a quarterly basis. This information is made available to users via the Overseas Banking Group's website (www.westpac.com.au).

The Overseas Banking Group (excluding entities specifically excluded by APRA regulations), 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 2018.

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 evaluates these considerations through an Internal Capital Adequacy Assessment Process, the key features of which include:

- the development of a capital management strategy, including consideration of regulatory minimums, capital buffers and contingency plans;
- consideration of both economic and regulatory capital requirements;
- a stress testing framework that challenges the capital measures, coverage and requirements, including the impact of adverse economic scenarios; and
- consideration of the perspectives of external stakeholders including rating agencies and equity and debt investors.

Notes to the financial statements

Note 36 Risk management

The NZ Banking Group regards the management of risk to be a fundamental management activity performed at all levels of its business. The NZ Banking Group's risk management strategy includes a sound risk culture and sets out minimum standards for risk management across all risk types ('**Risk Management Strategy**'). The NZ Banking Group adopts a 'Three Lines of Defence' approach to risk management which reflects our culture of 'risk is everyone's business in which all employees are responsible for identifying and managing risk and operating within the NZ Banking Group's desired risk profile.

The 1st Line of Defence – Risk identification, risk management and self-assurance

Divisional business units are responsible for identifying, evaluating and managing the risks that they originate within approved risk appetite and policies. They are required to establish and maintain appropriate risk management controls, resources and self-assurance processes.

The 2nd Line of Defence – Establishment of risk management frameworks and policies and risk management oversight

The 2nd Line of Defence comprises separate risk and compliance advisory, control, assurance and monitoring functions, which establish frameworks, policies, limits and processes for the management, monitoring and reporting of risk. The 2nd Line of Defence may approve risks outside the authorities granted to the 1st Line and also evaluate and opine on the adequacy and effectiveness of 1st Line controls and application of frameworks and policies and, where necessary, require improvement and monitor the 1st Line's progress toward remediation of identified deficiencies.

The 3rd Line of Defence – Independent assurance

The audit function independently evaluates the adequacy and effectiveness of the Group's overall risk management framework and controls.

Financial instruments are fundamental to the NZ Banking Group's business of providing banking and financial services. The associated financial risks (including credit risk, funding and liquidity risk and market risk) are a significant proportion of the total risks faced by the NZ Banking Group.

This note details the risk management policies, practices and quantitative information of the NZ Banking Group's principal risk exposures.

Principal risks	Note name	Note number
Overview	Risk management frameworks	36.1.1
	Group audit	36.1.2
	Reviews in respect of risk management systems	36.1.3
Credit risk The risk of financial loss where a customer or counterparty fails to meet their financial obligation to the NZ Banking Group.	Credit risk ratings system	36.2.1
	Credit risk mitigation, collateral and other credit enhancements	36.2.2
	Credit risk concentrations	36.2.3
	Regulatory capital	36.2.4
	Residential mortgages by loan-to-value ratio ('**LVR**')	36.2.5
	Credit quality of financial assets	36.2.6
	Collateral held	36.2.7
Operational risk and compliance risk Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The definition is aligned to the regulatory (Basel II) definition, including legal and regulatory risk but excluding strategic and reputation risk. Compliance risk is the risk of legal or regulatory sanction, financial loss or reputation loss arising from the NZ Banking Group's failure to abide by the compliance obligations required of the NZ Banking Group.	Operational risk and compliance risk	36.3
Funding and liquidity risk The risk that the NZ Banking Group will be unable to fund assets and meet obligations as they become due.	Liquidity modelling	36.4.1
	Sources of liquidity	36.4.2
	Contractual maturity of financial instruments	36.4.3
	Expected maturity	36.4.4
Market risk The risk of an adverse impact on earnings resulting from changes in market factors, such as foreign exchange rates, interest rates, commodity prices and equity prices.	Value-at-Risk ('**VaR**')	36.5.1
	Traded market risk	36.5.2
	Non-traded market risk	36.5.3
	Market risk notional capital charges	36.5.4
	Interest rate sensitivity	36.5.5

Note 36 Risk management (continued)

36.1 Overview

36.1.1 Risk management frameworks

The Board is responsible for approving the Overseas Banking Group's Risk Management Strategy and Overseas Banking Group's Risk Appetite Statement and monitoring the effectiveness of risk management by the Overseas Banking Group.

The Board has delegated to the Overseas Bank's Board Risk and Compliance Committee ('**Group BRCC'**) responsibility to:

- review and recommend the Overseas Banking Group's Risk Management Strategy and Risk Appetite Statement to the Board for approval;
- set risk appetite consistent with the Overseas Banking Group's Risk Appetite Statement;
- approve frameworks, policies and processes for managing risk (consistent with the Overseas Banking Group's Risk Management Strategy and Risk Appetite Statement); and
- review and, where appropriate, approve risks beyond the approval discretion provided to management.

The Board is also supported by the Overseas Bank's Board Audit Committee ('**Group BAC**') which assists the Board in fulfilling its responsibilities in relation to:

- oversight of financial reporting and compliance with prudential regulatory reporting. With reference to the Group BRCC, this includes an oversight of regulatory and statutory reporting requirements;
- reviewing, discussing with management and the external auditor, and assessing the processes used to monitor and comply with laws, regulations and other requirements relating to external reporting of financial and non-financial information;
- oversight of the external audit engagement, including the external auditor's qualifications, performance, independence and fees; and
- oversight of the performance of the internal audit function.

Further to the Directors' Statement on page 7:

- the Overseas Bank and Westpac New Zealand together had systems in place to monitor and control adequately the material risks of the following relevant members of the NZ Banking Group:
  - BTNZ;
  - BTFGNZL;
  - WFSGNZL;
  - Westpac Life;
  - WNNZL;
  - WSNNZL;
  - WGINZL;
  - WHNZL;
  - WCNZL; and
  - WNZGL;
- the Overseas Bank and Westpac New Zealand together had systems in place to monitor and control adequately the material risks of the NZ Branch;
- the Overseas Bank had systems in place to monitor and control adequately the material risks of Capital Finance New Zealand Limited and Sie-Lease (New Zealand) Pty Limited; and
- the remaining relevant members of the NZ Banking Group are not considered to have material risks.

The NZ Banking Group has an Executive Risk Committee ('**ERC**') which meets quarterly, and which oversees the management of enterprise risks across the New Zealand incorporated entities within the Overseas Banking Group of companies (excluding Westpac New Zealand and its subsidiaries which are overseen by the Westpac New Zealand Executive Risk Committee ('**WNZL RISKCO**')). Enterprise risks include, but are not limited to, credit risk, compliance risk, operational risk, funding and liquidity risk, market risk, conduct risk, business risk, sustainability risk, equity risk, insurance risk, related entity (contagion) risk and reputation risk.

Westpac Life and BTNZ maintain separate Risk Management Frameworks. Both documents are approved by the respective Board of each entity and are closely aligned to the Group and WNZL Risk Management Strategy whilst reflecting each entity's specific regulatory and operating environment.

Westpac New Zealand, a member of the NZ Banking Group, is a locally incorporated registered bank. Westpac New Zealand's Risk Management Strategy is closely aligned with that of the Overseas Banking Group, and the Board of Westpac New Zealand is responsible for the risk management of that bank and its subsidiaries.

The Boards of the other entities making up the NZ Banking Group have ultimate responsibility for overseeing the effective deployment of the Risk Management Strategy for these entities.

Note 36 Risk management (continued)

For each of its primary risks, the NZ Banking Group maintains risk management frameworks and a number of supporting policies that define roles and responsibilities, acceptable practices, limits and key controls:

Risk	Risk management framework and controls	
Credit risk	– The Overseas Bank's Credit Risk Management Framework describes the principles, methodologies, systems, roles and responsibilities, reports and key controls for managing credit risk. Within the Credit Risk Management Framework, the NZ Banking Group has its own credit approval limits approved by Westpac New Zealand's Board and delegated by the Overseas Banking Group's Chief Risk Officer. – The Westpac New Zealand Board Risk and Compliance Committee ('**WNZL BRCC**') and ERC monitor the risk profile, performance and management of the NZ Banking Group's credit portfolio and the development and review of key credit risk policies. – The Credit Risk Rating System Policy describes the credit risk rating system philosophy, design, key features and uses of rating outcomes. – All models materially impacting the risk rating process are periodically reviewed in accordance with the NZ Banking Group's model risk policies. – An annual review is performed of the Credit Risk Rating System by the WNZL BRCC and ERC and is approved by the Group BRCC.	– Specific credit risk estimates (including PD, LGD and EAD levels) are overseen, reviewed annually and supported by the Overseas Bank's Credit Risk Estimates Committee (a subcommittee of the Group BRCC). – Policies for the delegation of credit approval authorities and formal limits for the extension of credit are established throughout the NZ Banking Group including those for the approval and management of all credit risk arising from other banks and related entities. – Credit manuals are established throughout the NZ Banking Group including policies governing the origination, evaluation, approval, documentation, settlement and ongoing management of credit risks. – Sector policies guide credit extension where industry-specific guidelines are considered necessary (e.g. acceptable financial ratios or permitted collateral). – The Related Entity Risk Management Framework and supporting policies govern credit exposures to related entities to minimise the spread of credit risk between Overseas Banking Group entities and to comply with prudential requirements prescribed by APRA.
Operational risk and compliance risk	– The NZ Banking Group has an Operational Risk Management Framework ('**ORMF**') which outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management, and reporting and monitoring. The ORMF is approved by the Group BRCC. Westpac New Zealand has its own ORMF that is closely aligned with that of the Overseas Bank. The Westpac New Zealand ORMF is approved by the WNZL BRCC.	– The NZ Banking Group has a Compliance Risk Management Framework and a dedicated compliance function to assist the business in managing its compliance risks. The Framework is approved by the Group BRCC. Westpac New Zealand operates its own Compliance Risk Management Framework that is closely aligned with that of the Overseas Bank. The Westpac New Zealand Framework is approved by the WNZL BRCC.
Funding and liquidity risk	– The Liquidity Risk Management Framework sets out the liquidity risk appetite, roles and responsibilities, tools for measuring and managing liquidity risk, reporting procedures and supporting policies. It also documents the limits and targets for cash flow mismatch levels and wholesale funding and balance sheet ratios. It is reviewed by the Overseas Banking Group's Asset and Liability Committee ('**Group ALCO**') prior to approval by the Group BRCC. The WNZL BRCC 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 Overseas Banking Group's Treasury function is responsible for managing funding and liquidity including managing the balance sheet against approved limits and targets and managing the NZ Banking Group's funding base so that it is appropriately maintained, stable and diversified.	– Daily liquidity risk reports are reviewed by Treasury and the Liquidity risk teams. Liquidity reports are presented to Group ALCO monthly and to the Group BRCC quarterly. – An annual funding strategy is established by the Overseas Banking Group's Treasury unit which includes consideration of trends in global markets, peer analysis, wholesale funding capacity, expected funding requirements and funding risk analysis. The strategy is regularly reviewed to take into account current market conditions. In addition, Westpac New Zealand's Treasury unit undertakes an annual review of Westpac New Zealand's funding strategy. – A contingency funding plan is also maintained, which details actions to be taken in response to severe disruptions in the NZ Banking Group's ability to conduct its activities in a timely manner and at a reasonable cost. The plan identifies the committee of senior executives to manage any crisis and their responsibilities. The plan is aligned with the Overseas Banking Group's broader Liquidity Crisis Management Policy. Additionally, Westpac New Zealand's Treasury unit maintains a contingency funding plan specific to Westpac New Zealand.
Market risk	– The Market Risk Framework describes the Overseas Banking Group's approach to managing traded and non-traded market risk and is approved by the Group BRCC. Westpac New Zealand operates its own Market Risk Management Framework that is closely aligned with that of the Overseas Banking Group. The Westpac New Zealand Framework is approved by the WNZL BRCC. – Traded market risk includes interest rate, foreign exchange, commodity, equity price, credit spread and volatility risks. Non-traded market risk includes interest rate and foreign exchange risks. – Market risk is managed using VaR limits, Net interest income at risk ('**NaR**') and structural risk limits (including credit spread and interest rate basis point value limits) as well as scenario analysis and stress testing. – The Group BRCC approves the risk appetite for traded and non-traded risks through the use of VaR, NaR and specific structural risk limits. – The Overseas Banking Group's RISKCO ('**Group RISKCO**') has approved separate VaR sub-limits for the trading activities of the Overseas Banking Group's Financial Markets and Treasury units. – Market risk limits are assigned to business managers based upon business strategies, experience, and the consideration of market liquidity and the concentration of risks.	– Market risk positions are managed by the trading desks and Asset and Liability Management ('**ALM**') unit consistent with their delegated authorities and the nature and scale of the market risks involved. – 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 structural risk limits. Oversight of risk specific to the NZ Banking Group is monitored by the NZ Branch's Trading Risk Management Unit. Daily VaR position reports are produced by risk type, by product lines and by geographic region. Quarterly reports are produced for the Overseas Banking Group's Market Risk Committee ('**Group MARCO**'), Group RISKCO and Group BRCC. – Daily stress testing and backtesting of VaR results is performed to support model integrity and to analyse extreme or unexpected movements. A review of both the potential profit and loss outcomes is also undertaken to monitor any skew created by the historical data. – The Group BRCC has approved a framework for profit or loss escalation which considers both single day and 20 day cumulative results. – Treasury's ALM unit is responsible for managing the non-traded interest rate risk including risk mitigation through hedging using derivatives. This is overseen by the market risk unit and reviewed by the Group MARCO, Group RISKCO and Group BRCC.

Note 36 Risk management (continued)

Other risk classes include:

- Conduct risk: the risk that the NZ Banking Group's provision of services and products results in unsuitable or unfair outcomes for the NZ Banking Group's customers or undermines market integrity;
- Business risk: the risk associated with the vulnerability of a line of business to changes in the business environment;
- Equity risk: the potential for financial loss arising from movements in equity values. Equity risk may be direct, indirect or contingent;
- Insurance risk: the risk of mis-estimation of the expected cost of insured events, volatility in the number or severity of insured events, and mis-estimation of the cost of incurred claims;
- Related entity (contagion) risk: the risk that problems arising in other members of the Overseas Banking Group may compromise the financial and operational position of the authorised deposit-taking institutions in the NZ Banking Group;
- Reputation risk: the risk of the loss of reputation, stakeholder confidence, or public trust and standing; and
- Sustainability risk: the risk of reputation or financial loss due to failure to recognise or address material existing or emerging sustainability related environmental, social or governance issues.

36.1.2 Group Audit

Group Audit for the Overseas Banking Group ('**Group Audit**') comprises the Group Audit and Credit Portfolio Review (including Model Risk) functions. Group Audit provides an independent assessment of the adequacy and effectiveness of management's controls over operational, market, liquidity and compliance risks. Credit Portfolio Review provides an independent assessment of the effectiveness of the NZ Banking Group's credit management activities and the adequacy of credit provisioning, as well as an independent assessment over compliance with Group model risk policy. The New Zealand Audit function comprises a New Zealand based Audit team, supported by the Overseas Banking Group's Credit Portfolio Review (including Model Risk) functions. Group Audit reports on a quarterly basis, or more often as deemed appropriate, to the Group BAC, to agree the budget and the annual audit plan and to report its findings. In addition, the Group BAC has private sessions with the General Manager Group Audit. Furthermore, the General Manager Group Audit reports to the Chair of the Group BAC, and for administrative purposes to the Overseas Bank's Chief Financial Officer, a member of the Overseas Bank's Executive Team.

As independent functions, New Zealand Audit and Group Audit have no direct authority over the activities of management. They have unlimited access to all of the NZ Banking Group's activities, records, property and employees. The scope of responsibility of New Zealand Audit 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 risk across all material risk classes determines the scope and frequency of individual audits. New Zealand Audit periodically reviews the adequacy and effectiveness of management's controls over market risk and liquidity risk.

36.1.3 Reviews in respect of risk management systems

Group Audit's Credit Portfolio Review function has a rolling programme of credit and model risk reviews throughout the financial year. New Zealand Audit, with support from Group Audit, also periodically reviews the NZ Banking Group's Operational, Compliance, Market, Funding and Liquidity Risk Frameworks.

The reviews discussed above in this section are not conducted by a party which is external to the NZ Banking Group or the Overseas Banking Group, though they are independent and have no direct authority over the activities of management.

Various external reviews of the NZ Banking Group's risk management system have been conducted during the year ended 30 September 2018 as part of ongoing compliance with regulatory requirements.

36.2 Credit risk

36.2.1 Credit risk ratings system

The principal objective of the credit risk rating system is to reliably assess the credit risk to which the NZ Banking Group is exposed. The NZ Banking Group has two main approaches to this assessment.

Transaction-managed customers

The NZ Banking Group assigns a Customer Risk Grade ('**CRG**') to each customer, corresponding to their expected PD. Each facility is assigned an LGD. The NZ Banking Group's risk rating system has a tiered scale of risk grades for both non-defaulted customers and defaulted customers. Non-defaulted CRGs are mapped to Moody's Investor Service ('**Moody's**') and S&P Global Ratings ('**S&P**') external senior ranking unsecured ratings.

Program-managed portfolio

Customers that are not transaction-managed are grouped into pools of similar risk. Pools are created by analysing characteristics that have historically predicted that an account is likely to go into default. Customers grouped according to these predictive characteristics are assigned a PD and LGD relative to their pool.

Notes to the financial statements

Note 36 Risk management (continued)

Customer risk grades

The table below maps the NZ Banking Group's high level CRGs to their corresponding external rating.

Financial Statement Disclosure	NZ Banking Group's CRG	Moody's Rating	S&P Rating
Strong	A	Aaa – Aa3	AAA – AA-
	B	A1 – A3	A+ – A-
	C	Baa1 – Baa3	BBB+ – BBB-
Good/satisfactory	D	Ba1 – B1	BB+ – B+
		NZ Banking Group Rating	
Weak	E	Watchlist	
	F	Special Mention	
Weak/default	G	Substandard/Default	
	H	Default	

36.2.2 Credit risk mitigation, collateral and other credit enhancements

The NZ Banking Group uses a variety of techniques to reduce the credit risk arising from its lending activities.

This includes the NZ Banking Group establishing that it has direct, irrevocable and unconditional recourse to collateral and other credit enhancements through obtaining legally enforceable documentation.

Collateral

The table below describes the nature of collateral or security held for each relevant class of financial asset:

Financial assets	Nature of collateral
Loans – housing and personal[1]	Housing loans are secured by a mortgage over property and additional security may take the form of guarantees and deposits. Personal lending (including credit cards and overdrafts) is predominantly unsecured. Where security is taken, it is restricted to eligible motor vehicles, caravans, campers, motor homes and boats.
Loans – business[1]	Business loans may be secured, partially secured or unsecured. Security is typically taken by way of a mortgage over property and/or a general security agreement over business assets or other assets. Other security such as guarantees or standby letters of credit may also be taken as collateral, if appropriate.
Trading securities, financial assets designated at fair value and derivative financial instruments	These exposures are carried at fair value which reflects the credit risk. For trading securities, no collateral is sought directly from the issuer or counterparty; however this may be implicit in the terms of the instrument (such as an asset-backed security). The terms of debt securities may include collateralisation. Master netting agreements are typically used to enable the effects of derivative assets and derivative liabilities with the same counterparty to be offset when measuring these exposures. Additionally, collateralisation agreements are also typically entered into with major institutional counterparties to avoid the potential build-up of excessive mark-to-market positions. Derivative transactions are increasingly being cleared through central clearers.

[1] This includes collateral held in relation to associated credit commitments.

Notes to the financial statements

Note 36 Risk management (continued)

Management of risk mitigation

The NZ Banking Group mitigates credit risk through controls covering:

Collateral and valuation management	The Overseas Bank manages collateral under collateralisation agreements centrally for all branches of the Overseas Bank and Westpac New Zealand. The estimated realisable value of collateral held in support of loans is based on a combination of: – formal valuations currently held for such collateral; and – management's assessment of the estimated realisable value of all collateral held. This analysis also takes into consideration any other relevant knowledge available to management at the time. Updated valuations are obtained when appropriate. The NZ Banking Group revalues collateral related to financial markets positions on a daily basis and has formal processes in place to promptly call for collateral top-ups, if required. These processes include margining for non-centrally cleared customer derivatives where required under APRA's Prudential Standard CPS226. The collateralisation arrangements are documented via the Credit Support Annex of the International Swaps and Derivatives Association dealing agreements.
Other credit enhancements	The NZ Banking Group only recognises guarantees, standby letters of credit, or credit derivative protection from the following entities (provided they are not related to the entity with which the NZ Banking Group has a credit exposure): – Sovereign; – Australia and New Zealand public sector; – Authorised deposit-taking institutions and overseas banks with a minimum risk grade equivalent of A3 / A-; and – Other entities with a minimum risk grade equivalent of A3 / A-.
Offsetting	Creditworthy customers domiciled in New Zealand may enter into formal agreements with the NZ Banking Group, permitting the NZ Banking Group to set-off gross credit and debit balances in their nominated accounts. Cross-border set-offs are not permitted. Close-out netting is undertaken with counterparties with whom the NZ Banking Group has entered into a legally enforceable master netting agreement for their off-balance sheet financial market transactions in the event of default. Further details of offsetting are provided in Note 28.
Central clearing (ASX/LCH)	The NZ Banking Group increasingly executes derivative transactions through central clearing counterparties. Central clearing counterparties mitigate risk through stringent membership requirements, the collection of margin against all trades placed, the default fund, and an explicitly defined order of priority of payments in the event of default.

36.2.3 Credit risk concentrations

Credit risk is concentrated when a number of counterparties are engaged in similar activities, have similar economic characteristics and thus may be similarly affected by changes in economic or other conditions.

The NZ Banking Group monitors its credit portfolio to manage risk concentrations and rebalance the portfolio.

Individual customers or groups of related customers

The NZ Banking Group has large exposure limits governing the aggregate size of credit exposure normally acceptable to individual customers and groups of related customers. These limits are tiered by customer risk grade.

Specific industries

Exposures to businesses, governments and other financial institutions are classified into a number of industry clusters based on related Australian and New Zealand Standard Industrial Classification ('**ANZSIC**') codes and are monitored against the NZ Banking Group's industry risk appetite limits.

Individual countries

The NZ Banking Group has limits governing risks related to individual countries, such as political situations, government policies and economic conditions that may adversely affect either a customer's ability to meet its obligations to the NZ Banking Group, or the NZ Banking Group's ability to realise its assets in a particular country.

Maximum exposure to credit risk

The carrying amount of on-balance sheet financial assets and undrawn credit commitments, represents the maximum exposure to credit risk (excluding any collateral received) as set out in the following table. Life insurance assets held as an investment in unit trusts are excluded as the unit price is affected by movements in equity prices which are a market risk.

Note 36 Risk management (continued)

	NZ BANKING GROUP	
$ millions	2018	2017
Financial assests		
Cash and balances with central banks	**1,472**	1,761
Receivables due from other financial institutions	**237**	471
Other assets	**411**	378
Trading securities and financial assets designated at fair value	**3,016**	3,949
Derivative financial instruments	**3,509**	3,420
Available-for-sale securities	**3,810**	4,087
Loans	**80,860**	77,681
Life insurance assets	**9**	9
Due from related entities	**2,023**	2,623
Total financial assets	**95,347**	94,379
Undrawn credit commitments		
Letters of credit and guarantees	**1,104**	1,041
Commitments to extend credit	**24,722**	25,111
Other commitments	**60**	10
Total undrawn credit commitments	**25,886**	26,162
Total maximum credit risk exposure	**121,233**	120,541

36.2.4 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 business lending, corporate, sovereign and bank)

The process for assignment and approval of individual PDs and LGDs involves business unit representatives recommending the 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 business lending, corporate, sovereign and banking exposures included within the transaction-managed portfolio approach:

- direct lending exposures;
- contingent lending exposures;
- pre-settlement exposures;
- foreign exchange settlement exposures; and
- transaction exposures.

All of the above exposure categories also apply to Specialised Lending, which is a sub-asset class of Corporate and in the NZ Banking Group comprises Property Finance and Project Finance. Regulatory risk-weights are also applied to Specialised Lending.

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

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.

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 exposures 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.

Note 36 Risk management (continued)

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 utilised by customers 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) asset class 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.

Retail asset class 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

PD

PDs are assigned at the retail 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.

LGD

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.

EAD

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.

36.2.5 Residential mortgages by LVR as at 30 September 2018 (Unaudited)

LVRs are calculated as the current exposure divided by the NZ Banking Group's valuation of the residential security at origination.

For loans originated from 1 January 2008, the NZ Banking Group utilises data from its loan system. For loans originated prior to 1 January 2008, the origination valuation is not separately recorded and is therefore not available for disclosure. For these loans, the NZ Banking Group utilises its dynamic LVR process to estimate an origination valuation. Refer to the disclosures in relation to Westpac New Zealand's conditions of registration on page 72.

Exposures for which no LVR is available have been included in the 'Exceeds 90%' category in accordance with the requirements of the Order.

	NZ BANKING GROUP					
	2018					
LVR range ($ millions)	**Does not exceed 60%**	**Exceeds 60% and not 70%**	**Exceeds 70% and not 80%**	**Exceeds 80% and not 90%**	**Exceeds 90%**	**Total**
On-balance sheet exposures	**20,561**	**11,727**	**12,092**	**2,717**	**1,601**	**48,698**
Undrawn commitments and other off-balance sheet exposures	**5,161**	**1,168**	**821**	**110**	**178**	**7,438**
Value of exposures	**25,722**	**12,895**	**12,913**	**2,827**	**1,779**	**56,136**

Note 36 Risk management (continued)

Reconciliation of residential mortgage-related amounts

The table below provides the NZ Banking Group's reconciliation between any amounts disclosed in this Disclosure Statement that relate to mortgages on residential property.

	NZ BANKING GROUP
$ millions	**2018**
Term loans - Housing (Note 13) and Residential Mortgages (Note 14)	**48,893**
Reconciling items:	
Unamortised deferred fees and expenses	**(166)**
Fair value hedge adjustments	**(29)**
Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages	**9,983**
Undrawn at default[1]	**(2,545)**
Residential mortgages by LVR	**56,136**

[1] Estimate of the amount of committed exposure not expected to be drawn by the customer at the time of default.

36.2.6 Credit quality of financial assets

An asset is considered to be past due when any payment under the contractual terms has been missed. The entire contractual balance is considered to be past due, rather than only the overdue portion. Assets may be overdue for a number of reasons, including late payments or incomplete documentation. Late payment may be influenced by the timing of weekends and holidays. This does not always align with the underlying basis by which credit risk is managed.

All the financial assets of the NZ Banking Group as at 30 September 2018 and 2017, other than loans (as disclosed in Note 14), are neither past due nor impaired.

The credit quality of financial assets of the NZ Banking Group that are neither past due nor impaired is determined by reference to the credit risk ratings system (refer to Note 36.2.1). All the financial assets of the NZ Banking Group that are neither past due nor impaired fall into the 'Strong' category in their entirety except those financial assets disclosed below:

	NZ BANKING GROUP							
	2018				2017			
$ millions	**Strong**	**Good/ Satisfactory**	**Weak**	**Total**	Strong	Good/ Satisfactory	Weak	Total
Receivables due from other financial institutions (refer to Note 9)	**237**	**-**	**-**	**237**	465	6	-	471
Accrued interest receivable (refer to Note 10)	**70**	**87**	**3**	**160**	63	82	4	149
Trading securities and financial assets designated at fair value (refer to Note 11)	**3,015**	**1**	**-**	**3,016**	3,931	18	-	3,949
Derivative financial instruments (refer to Note 26)	**3,342**	**167**	**-**	**3,509**	3,314	104	2	3,420
Loans (refer to Note 14)	**35,119**	**43,202**	**1,432**	**79,753**	32,167	42,586	1,871	76,624

36.2.7 Collateral held

Loans

The NZ Banking Group analyses the coverage of the loan portfolio which is secured by the collateral that it holds. Coverage is measured as follows:

Coverage	Secured loan to collateral value ratio
Fully secured	Less than or equal to 100%
Partially secured	Greater than 100% but not more than 150%
Unsecured	Greater than 150%, or no security held (e.g. can include credit cards, personal loans, and exposure to highly rated corporate entities)

Note 36 Risk management (continued)

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

	NZ BANKING GROUP	
%	2018	2017
Fully secured	**78**	77
Partially secured	**12**	13
Unsecured	**10**	10
Total net loans	**100**	100

Collateral held against financial assets other than loans

	NZ BANKING GROUP	
$ millions	2018	2017
Cash, primarily for derivatives	**591**	191
Securities under reverse repurchase agreements[1]	**216**	754
Total other collateral held	**807**	945

[1] Securities received as collateral are not recognised on the NZ Banking Group's balance sheet.

36.3 Operational risk and compliance risk

Operational risk

Operational risk has the potential, as a result of the way business objectives are pursued, 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.

Westpac New Zealand has its own Operational Risk Management Framework that is closely aligned with that of the Overseas Bank. The Westpac New Zealand Framework is approved by the WNZL BRCC.

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 the 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.

Westpac New Zealand operates its own Compliance Risk Management Framework that is closely aligned with that of the Overseas Bank. The Westpac New Zealand Framework is approved by the WNZL BRCC.

36.4 Funding and liquidity risk

36.4.1 Liquidity modelling

Westpac New Zealand is subject to the conditions specified in the Reserve Bank document 'Liquidity Policy' ('**BS13**'). The following metrics are calculated and reported on a daily basis by Westpac New Zealand in accordance with BS13:

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

In addition, the NZ Banking Group calculates the following liquidity ratios in accordance with the Overseas Bank's liquidity risk framework under APRA Prudential Standard APS 210 Liquidity:

- liquidity coverage ratio; and
- net stable funding ratio.

Notes to the financial statements

Note 36 Risk management (continued)

36.4.2 Sources of liquidity

Sources of liquidity are regularly reviewed to maintain a wide diversification by currency, geography, product and term. Sources include, but are not limited to:

- deposits;
- debt issues;
- proceeds from sale of marketable securities;
- repurchase agreements with central banks;
- principal repayments on loans;
- interest income; and
- fee income.

Liquid assets

The NZ Banking Group holds a portfolio of high-quality liquid assets as a buffer against unforeseen funding requirements. These assets are eligible for repurchase agreements with the Reserve Bank and are held in cash, government, local government and highly rated investment grade securities. The level of liquid asset holdings is reviewed frequently and is consistent with both the requirements of the balance sheet and market conditions.

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 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	
$ millions	**2018**	2017
Cash and balances with central banks	**1,472**	1,761
Receivables due from other financial institutions	**57**	40
Supranational securities	**1,502**	1,484
NZ Government securities	**1,322**	2,372
NZ public securities	**1,809**	1,609
NZ corporate securities	**1,522**	2,073
Residential mortgage-backed securities	**3,950**	3,950
Total liquid assets	**11,634**	13,289

Notes to the financial statements

Note 36 Risk management (continued)

36.4.3 Contractual maturity of financial liabilities

The table below presents cash flows associated with financial liabilities, payable at the balance sheet date, by remaining contractual maturity. The amounts disclosed in the table are the future contractual undiscounted cash flows, whereas the NZ Banking Group manages inherent liquidity risk based on expected cash flows.

Cash flows associated with these financial liabilities include both principal payments as well as fixed or variable interest payments incorporated into the relevant coupon period. Principal payments reflect the earliest contractual maturity date. Derivative liabilities designated for hedging purposes are expected to be held for their remaining contractual lives, and reflect gross cash flows over the remaining contractual term.

Derivatives held for trading and certain liabilities classified in "Other financial liabilities at fair value through income statement" are not managed for liquidity purposes on the basis of their contractual maturity, and accordingly these instruments are presented in either the on demand or up to 1 month columns. Only the financial instruments that the NZ Banking Group manages based on their contractual maturity are presented on a contractual undiscounted basis in the tables below.

	NZ BANKING GROUP						
	2018						
$ millions	On Demand	Up to 1 Month	Over 1 Month and Up to 3 Months	Over 3 Months and Up to 1 Year	Over 1 Year and Up to 5 Years	Over 5 Years	Total
Financial liabilities							
Payables due to other financial institutions	536	717	-	-	-	-	1,253
Other liabilities	-	376	-	-	-	-	376
Deposits and other borrowings	28,083	6,488	12,166	14,759	2,363	-	63,859
Other financial liabilities at fair value through income statement	182	41	-	-	-	-	223
Derivative financial instruments:							
Held for trading	3,026	-	-	-	-	-	3,026
Held for hedging purposes (net settled)	-	18	69	105	229	84	505
Held for hedging purposes (gross settled):							
Cash outflow	-	5	5	32	682	581	1,305
Cash inflow	-	-	-	(15)	(529)	(584)	(1,128)
Due to related entities:							
Non-derivative balances	1,475	-	-	9	340	-	1,824
Derivative financial instruments:							
Held for trading	591	-	-	-	-	-	591
Held for hedging purposes (gross settled):							
Cash outflow	-	-	18	54	1,605	-	1,677
Cash inflow	-	-	(17)	(50)	(1,551)	-	(1,618)
Debt issues	-	10	52	1,772	11,595	1,017	14,446
Loan capital	-	-	14	41	232	3,174	3,461
Total undiscounted financial liabilities	33,893	7,655	12,307	16,707	14,966	4,272	89,800
Total contingent liabilities and commitments							
Letters of credit and guarantees	1,104	-	-	-	-	-	1,104
Commitments to extend credit	24,722	-	-	-	-	-	24,722
Other commitments	60	-	-	-	-	-	60
Total undiscounted contingent liabilities and commitments	25,886	-	-	-	-	-	25,886

Note 36 Risk management (continued)

	NZ BANKING GROUP						
	2017						
$ millions	On Demand	Up to 1 Month	Over 1 Month and Up to 3 Months	Over 3 Months and Up to 1 Year	Over 1 Year and Up to 5 Years	Over 5 Years	Total
Financial liabilities							
Payables due to other financial institutions	466	551	-	26	-	-	1,043
Other liabilities	-	190	-	-	-	-	190
Deposits and other borrowings	28,455	4,456	12,404	12,205	2,158	-	59,678
Other financial liabilities at fair value through income statement	67	235	-	-	-	-	302
Derivative financial instruments:							
Held for trading	2,730	-	-	-	-	-	2,730
Held for hedging purposes (net settled)	-	21	75	128	160	52	436
Held for hedging purposes (gross settled):							
Cash outflow	-	929	23	238	3,065	830	5,085
Cash inflow	-	(800)	-	(153)	(2,453)	(753)	(4,159)
Due to related entities:							
Non-derivative balances	2,761	-	3	9	343	-	3,116
Derivative financial instruments:							
Held for trading	512	-	-	-	-	-	512
Held for hedging purposes (gross settled):							
Cash outflow	-	-	18	54	1,699	-	1,771
Cash inflow	-	-	(15)	(48)	(1,568)	-	(1,631)
Debt issues	-	910	692	3,090	11,640	1,189	17,521
Loan capital	-	-	13	40	244	3,084	3,381
Total undiscounted financial liabilities	34,991	6,492	13,213	15,589	15,288	4,402	89,975
Total contingent liabilities and commitments							
Letters of credit and guarantees	1,041	-	-	-	-	-	1,041
Commitments to extend credit	25,111	-	-	-	-	-	25,111
Other commitments	10	-	-	-	-	-	10
Total undiscounted contingent liabilities and commitments	26,162	-	-	-	-	-	26,162

Notes to the financial statements

Note 36 Risk management (continued)

36.4.4 Expected maturity

The table below presents a maturity analysis of assets and liabilities on the balance sheet which combine amounts expected to be realised or due to be settled within one year and after more than one year. The balances in the table will not agree to the contractual maturity table due to the analysis below being based on expected rather than contractual maturities, the impact of discounting and the exclusion of interest accruals.

	NZ BANKING GROUP					
	2018			2017		
$ millions	Due within 12 months	Greater than 12 months	Total	Due within 12 months	Greater than 12 months	Total
Assets						
Cash and balances with central banks	1,472	-	1,472	1,761	-	1,761
Receivables due from other financial institutions	237	-	237	471	-	471
Trading securities and financial assets designated at fair value	2,506	510	3,016	3,590	359	3,949
Derivative financial instruments	2,771	738	3,509	2,703	717	3,420
Available-for-sale securities	1,386	2,424	3,810	511	3,576	4,087
Loans	11,467	69,393	80,860	10,393	67,288	77,681
Life insurance assets	201	109	310	204	100	304
Due from related entities	1,976	47	2,023	2,603	20	2,623
All other assets	576	843	1,419	542	828	1,370
Total assets	**22,592**	**74,064**	**96,656**	22,778	72,888	95,666
Liabilities						
Payables due to other financial institutions	1,253	-	1,253	1,043	-	1,043
Deposits and other borrowings	60,881	2,224	63,105	56,965	2,033	58,998
Derivative financial instruments	2,715	854	3,569	2,573	902	3,475
Due to related entities	2,024	416	2,440	3,235	411	3,646
Debt issues	1,567	12,158	13,725	4,406	12,323	16,729
Loan capital	-	2,866	2,866	-	2,822	2,822
All other liabilities	1,228	87	1,315	1,044	78	1,122
Total liabilities	**69,668**	**18,605**	**88,273**	69,266	18,569	87,835

36.5 Market risk

36.5.1 Value-at-Risk

The NZ Banking Group uses VaR as one of the mechanisms for controlling both traded and non-traded market risk.

VaR is a statistical estimate of the potential loss in earnings over a specified period of time and to a given level of confidence based on historical market movements. The confidence level indicates the probability that the loss will not exceed the VaR estimate on any given day.

VaR seeks to take account of all material market variables that may cause a change in the value of the portfolio, including interest rates, foreign exchange rates, price changes, volatility and the correlations between these variables. Daily monitoring of current exposure and limit utilisation is conducted independently by the Market Risk unit which monitors market risk exposures against VaR and structural concentration limits. These are supplemented by escalation triggers for material profits or losses and stress testing of risks beyond the 99% confidence level.

The key parameters of VaR are:

Holding period	1 day
Confidence level	99%
Period of historical data used	1 year

Notes to the financial statements

Note 36 Risk management (continued)

36.5.2 Traded market risk

The NZ Banking Group's exposure to traded market risk arises out of its Financial Markets ('**FM**') and Treasury trading activities. The 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.

The table below depicts the aggregate VaR, by risk type, for the year ended 30 September:

	NZ BANKING GROUP							
	2018				2017			
$ millions	**As at**	**Maximum Exposure**	**Minimum Exposure**	**Average Exposure**	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	**1.5**	**1.9**	**0.6**	**1.1**	1.6	3.0	0.6	1.2
Foreign exchange risk	**0.5**	**2.6**	**-**	**0.7**	0.1	0.7	-	0.2
Price risk	**0.3**	**0.6**	**0.1**	**0.2**	0.1	0.2	-	0.1
Volatility risk	**-**	**-**	**-**	**-**	-	-	-	-
Net market risk	**1.7**	**2.6**	**0.7**	**1.4**	1.6	3.0	0.6	1.2

36.5.3 Non-traded market risk

Non-traded market risk includes interest rate risk in the banking book ('**IRRBB**') – the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities.

Net interest income ('**NII**') sensitivity is managed in terms of the NaR. A simulation model is used to calculate the NZ Banking Group's potential NaR. This 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, over a three year time horizon using a 99% confidence interval, include those projected using historical market interest rate volatility as well as 100 and 200 basis point shifts up and down from the current market yield curves in Australia and New Zealand. 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.

Net interest income-at-risk ('NaR')

The table below depicts NaR assuming a 100 basis point shock (decrease) over the next 12 months as a percentage of reported net interest income:

	NZ BANKING GROUP							
	2018				2017			
%	**As at**	**Maximum Exposure**	**Minimum Exposure**	**Average Exposure**	As at	Maximum Exposure	Minimum Exposure	Average Exposure
NaR	**0.37**	**0.58**	**0.28**	**0.39**	0.39	0.54	0.37	0.44

Value at Risk – IRRBB[1]

The table below depicts VaR for IRRBB:

	NZ BANKING GROUP							
	2018				2017			
$ millions	**As at**	**Maximum Exposure**	**Minimum Exposure**	**Average Exposure**	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	**0.5**	**0.7**	**0.1**	**0.4**	0.9	1.7	0.6	1.0

[1] IRRBB VaR includes interest rate risk, credit spread risk on liquid assets and other basis risks used for internal management purposes.

Risk mitigation

IRRBB 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.

The NZ Banking Group hedges its exposure to such interest rate risk using derivatives. Details on the NZ Banking Group's use of hedge accounting are discussed in Note 26.

The same controls as used to monitor traded market risk allow management to continuously monitor and manage IRRBB.

Note 36 Risk management (continued)

36.5.4 Market risk notional capital charges (Unaudited)

The NZ Banking Group's aggregate market risk exposure is derived in accordance with the Reserve Bank document 'Capital Adequacy Framework (Standardised Approach) (BS2A)' ('**BS2A**') and is calculated on a six monthly basis. The end-of-period aggregate market risk exposure is calculated from the period end balance sheet information.

For each category of market risk, the NZ Banking Group's peak end-of-day aggregate capital charge is derived by determining the maximum over the six months ended 30 September 2018 of the aggregate capital charge for that category of market risk at the close of each business day derived in accordance with BS2A.

The following table provides a summary of the NZ Banking Group's notional capital charges by risk type as at the reporting date and the peak end-of-day notional capital charges by risk type for the six months ended 30 September 2018.

	NZ BANKING GROUP	
	2018	
$ millions	**Implied Risk-weighted Exposure**	**Notional Capital Charge**
End-of-period		
Interest rate risk	**3,369**	**270**
Foreign currency risk	**14**	**1**
Equity risk	**-**	**-**
Peak end-of-day		
Interest rate risk	**4,794**	**384**
Foreign currency risk	**99**	**8**
Equity risk	**-**	**-**

36.5.5 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's 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 2018. 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.

Notes to the financial statements

Note 36 Risk management (continued)

	NZ BANKING GROUP						
	2018						
$ millions	**Up to 3 Months**	**Over 3 Months and Up to 6 Months**	**Over 6 Months and Up to 1 Year**	**Over 1 Year and Up to 2 Years**	**Over 2 Years**	**Non-interest Bearing**	**Total**
Financial assets							
Cash and balances with central banks	1,184	-	-	-	-	288	1,472
Receivables due from other financial institutions	237	-	-	-	-	-	237
Other assets	-	-	-	-	-	411	411
Trading securities and financial assets designated at fair value	2,334	307	58	17	300	-	3,016
Derivative financial instruments	-	-	-	-	-	3,509	3,509
Available-for-sale securities	43	1,343	-	1,186	1,238	-	3,810
Loans	43,774	5,405	12,477	14,808	4,720	(324)	80,860
Life insurance assets	10	-	-	-	-	300	310
Due from related entities	1,556	-	-	-	6	461	2,023
Total financial assets	49,138	7,055	12,535	16,011	6,264	4,645	95,648
Non-financial assets							1,008
Total assets							96,656
Financial liabilities							
Payables due to other financial institutions	1,183	-	-	-	-	70	1,253
Other liabilities	-	-	-	-	-	737	737
Deposits and other borrowings	40,590	9,167	5,221	1,541	683	5,903	63,105
Other financial liabilties at fair value through income statement	223	-	-	-	-	-	223
Derivative financial instruments	-	-	-	-	-	3,569	3,569
Due to related entities	1,739	-	-	-	10	691	2,440
Debt issues	4,102	-	1,567	602	7,454	-	13,725
Loan capital	1,135	-	-	-	1,731	-	2,866
Total financial liabilities	48,972	9,167	6,788	2,143	9,878	10,970	87,918
Non-financial liabilities							355
Total liabilities							88,273
On-balance sheet interest rate repricing gap	166	(2,112)	5,747	13,868	(3,614)		
Net derivative notional principals							
Net interest rate contracts (notional):							
Receivable/(payable)	13,440	(3,275)	(5,215)	(11,011)	6,061		
Net interest rate repricing gap	13,606	(5,387)	532	2,857	2,447		

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 year end spot foreign exchange rates.

	NZ BANKING GROUP	
$ millions	**2018**	2017
Receivable/(payable)		
Australian dollar	(6)	-
Euro	(1)	-
British pound	2	-
US dollar	9	(5)
Others	2	2

Notes to the financial statements

Note 37 Concentration of funding

	NZ BANKING GROUP	
$ millions	**2018**	2017
Funding consists of		
Payables due to other financial institutions	**1,253**	1,043
Deposits and other borrowings	**63,105**	58,998
Other financial liabilities at fair value through income statement	**223**	302
Due to related entities[2]	**1,778**	3,047
Debt issues[1]	**13,725**	16,729
Loan capital	**2,866**	2,822
Total funding	**82,950**	82,941
Analysis of funding by geographical areas[1]		
New Zealand	**61,572**	59,049
Australia	**2,811**	4,103
United Kingdom	**8,589**	8,962
United States of America	**2,442**	3,794
Other	**7,536**	7,033
Total funding	**82,950**	82,941
Analysis of funding by industry sector		
Accommodation, cafes and restaurants	**405**	282
Agriculture	**1,373**	1,260
Construction	**1,739**	1,713
Finance and insurance	**30,742**	31,445
Forestry and fishing	**222**	398
Government, administration and defence	**2,068**	2,337
Manufacturing	**1,530**	1,573
Mining	**67**	57
Property services and business services	**5,809**	5,868
Services	**4,152**	4,334
Trade	**1,444**	1,542
Transport and storage	**593**	628
Utilities	**485**	630
Households	**26,141**	24,184
Other	**4,402**	3,643
Subtotal	**81,172**	79,894
Due to related entities[2]	**1,778**	3,047
Total funding	**82,950**	82,941

[1] The geographic region used for debt issues is based on the nature of the debt programmes. The nature of the debt programmes is used as a proxy for the location of the original purchaser. Where the nature of the debt programme does not necessarily represent an appropriate proxy, the debt issues are classified as 'Other'. These instruments may have subsequently been on-sold.

[2] Amounts due to related entities, as presented above, are in respect of deposits and borrowings and exclude amounts which relate to derivatives and other liabilities.

ANZSIC has been used as the basis for disclosing industry sectors.

Notes to the financial statements

Note 38 Concentration of credit exposures

	NZ BANKING GROUP	
$ millions	**2018**	2017
On-balance sheet credit exposures (refer to Note 36.2.3 Maximum exposure to credit risk)		
Analysis of on-balance sheet credit exposures by geographical areas		
New Zealand	**89,199**	87,285
Australia	**2,572**	3,321
United Kingdom	**1,726**	1,385
United States of America	**173**	343
Others	**1,677**	2,045
Total on-balance sheet credit exposures	**95,347**	94,379
Analysis of on-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**443**	408
Agriculture	**8,498**	8,065
Construction	**551**	520
Finance and insurance[1]	**8,135**	8,995
Forestry and fishing	**464**	414
Government, administration and defence[1]	**6,381**	7,035
Manufacturing	**2,443**	2,285
Mining	**243**	157
Property	**6,851**	6,454
Property services and business services	**1,321**	1,161
Services	**1,858**	1,747
Trade	**2,564**	2,261
Transport and storage	**1,194**	1,294
Utilities	**1,804**	2,281
Retail lending	**50,805**	48,940
Other	**1**	3
Subtotal	**93,556**	92,020
Provisions for impairment charges on loans	**(324)**	(350)
Due from related entities	**2,023**	2,623
Other assets	**92**	86
Total on-balance sheet credit exposures	**95,347**	94,379
Off-balance sheet credit exposures (refer to Note 36.2.3 Maximum exposure to credit risk)		
Credit risk-related instruments	**25,886**	26,162
Total off-balance sheet credit exposures	**25,886**	26,162
Analysis of off-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**93**	81
Agriculture	**606**	615
Construction	**528**	493
Finance and insurance	**1,608**	2,142
Forestry and fishing	**143**	133
Government, administration and defence	**756**	620
Manufacturing	**1,776**	1,588
Mining	**175**	210
Property	**1,544**	1,527
Property services and business services	**529**	405
Services	**600**	599
Trade	**1,750**	2,248
Transport and storage	**879**	950
Utilities	**1,779**	1,535
Retail lending	**13,120**	13,016
Total off-balance sheet credit exposures	**25,886**	26,162

[1] Comparative information has been restated to align disclosure with the classification in the Reserve Bank requirements.

ANZSIC has been used as the basis for disclosing industry sectors.

Notes to the financial statements

Note 39 Other information on the Overseas Banking Group

Other information on the Overseas Banking Group is from the most recently published financial statements of the Overseas Banking Group for the year ended 30 September 2018.

Profitability	2018
Net profit for the year ended 30 September 2018 (A$millions)	8,099
Net profit for the year ended 30 September 2018 as a percentage of average total assets	0.9%

Total assets and equity	2018
Total assets (A$millions)	879,592
Percentage change in total assets over the year ended 30 September 2018	3.3%
Total shareholder's equity (A$millions)	64,573

Asset quality	2018
Total individually impaired assets[1, 2] (A$millions)	1,416
Total individually impaired assets expressed as a percentage of total assets	0.2%
Total individual credit impairment allowance[3] (A$millions)	653
Total individual credit impairment allowance expressed as a percentage of total individually impaired assets	46.1%
Total collective credit impairment allowance[3] (A$millions)	2,631

[1] Total individually impaired assets are before allowances for credit impairment loss and net of interest held in suspense. Total individually impaired assets includes A$718 million of assets which are determined to be impaired, but which are not individually significant, and therefore have been grouped into pools of assets for the purpose of collectively calculating an impairment provision.

[2] Non-financial assets have not been acquired through the enforcement of security.

[3] Total individual credit impairment allowance and total collective credit impairment allowance both include A$231 million of credit impairment allowance that has been calculated collectively on groups of assets which have been determined to be impaired, but which are not individually significant.

Note 40 Notes to the statement of cash flows

Accounting policy

Cash and cash equivalents includes cash held at branches and in ATMs, balances with overseas banks in their local currency and balances with central banks.

Cash and cash equivalents

		NZ BANKING GROUP	
$ millions	Note	2018	2017
Cash and cash equivalents comprise:			
Cash and balances with central banks:			
Cash on hand		288	282
Balances with central banks		1,184	1,479
Receivables due from other financial institutions classified as cash and cash equivalents	9	57	40
Cash and cash equivalents at end of the year		1,529	1,801

Notes to the financial statements

Note 40 Notes to the statement of cash flows (continued)

Reconciliation of net cash provided by/(used in) operating activities to net profit attributable to the owners of the NZ Banking Group.

	NZ BANKING GROUP	
$ millions	**Year Ended 30-Sep-18**	Year Ended 30-Sep-17
Net profit attributable to the owners of the NZ Banking Group	**1,117**	1,059
Adjustments:		
Impairment charges/(benefits) on loans	**(3)**	(76)
Computer software amortisation costs	**46**	49
Depreciation	**44**	46
(Gain)/loss from hedging ineffectiveness	**(4)**	10
Movement in accrued interest receivable	**(5)**	(13)
Movement in accrued interest payable	**(9)**	16
Movement in current and deferred tax	**29**	27
Share of profit of associate accounted for using the equity method	**1**	-
Share-based payments	**5**	5
Other non-cash items[1]	**(89)**	20
Cash flows from operating activities before changes in operating assets and liabilities	**1,132**	1,143
Movement in receivables due from other financial institutions	**251**	355
Movement in other assets	**(7)**	(17)
Movement in trading securities and financial assets designated at fair value	**1,052**	11
Movement in loans	**(3,172)**	(2,090)
Movement in due from related entities	**643**	(1,689)
Movement in payables due to other financial institutions	**210**	427
Movement in other liabilities	**98**	7
Movement in deposits and other borrowings	**4,107**	207
Movement in other financial liabilities at fair value through income statement	**(79)**	(274)
Movement in due to related entities	**(880)**	849
Net movement in external and related entity derivative financial instruments	**1,143**	(902)
Net cash provided by/(used in) operating activities	**4,498**	(1,973)

[1] Includes revaluation (gains)/losses on assets and non-cash movements in derivatives.

Note 41 Subsequent events

All regulatory approvals necessary for the sale by WNZOL of its 25% shareholding in Paymark Limited ('**Paymark**') to Ingenico Group were received on 2 November 2018.

Conditions of registration

The registration of Westpac Banking Corporation (the '**registered bank**') in New Zealand is subject to the following conditions, which applied from 1 January 2018:

1. That the Banking Group does not conduct any non-financial activities that in aggregate are material relative to its total activities. In this condition of registration, the meaning of 'material' is based on generally accepted accounting practice.
2. That the Banking Group's insurance business is not greater than 1% of its total consolidated assets.
   For the purposes of this condition of registration, the Banking Group's insurance business is the sum of the following amounts for entities in the Banking Group:
   a. if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the Banking Group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and
   b. if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the Banking Group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity's insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business.

   In determining the total amount of the Banking Group's insurance business—
   a. all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and
   b. if products or assets of which an insurance business is comprised also contain a non-insurance component, the whole of such products or assets must be considered part of the insurance business.

   For the purposes of this condition of registration—
   'insurance business' means the undertaking or assumption of liability as an insurer under a contract of insurance;
   'insurer' and 'contract of insurance' have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.
3. That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.
4. That no appointment to the position of the New Zealand Chief Executive Officer of the registered bank shall be made unless:
   a. the Reserve Bank of New Zealand ('**Reserve Bank**') has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   b. the Reserve Bank has advised that it has no objection to that appointment.
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:
   a. Common Equity Tier 1 capital of Westpac Banking Corporation is not less than 4.5% of risk-weighted exposures;
   b. Tier 1 capital of Westpac Banking Corporation is not less than 6% of risk-weighted exposures; and
   c. Total capital of Westpac Banking Corporation is not less than 8% of risk-weighted exposures.
7. That liabilities of the registered bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed $15 billion.
8. That the retail deposits of the registered bank 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.
9. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 65%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
10. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 15% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
11. That the business of the registered bank in New Zealand must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

In these conditions of registration:

'Banking Group'—

means the New Zealand business of the registered bank and its subsidiaries as required to be reported in group financial statements for the group's New Zealand business under section 461B(2) of the Financial Markets Conduct Act 2013.

'business of the registered bank in New Zealand'—

means the New Zealand business of the registered bank as defined in the requirement for financial statements for New Zealand business in section 461B(1) of the Financial Markets Conduct Act 2013.

'generally accepted accounting practice'—

has the same meaning as in section 8 of the Financial Reporting Act 2013.

'liabilities of the registered bank in New Zealand'—

means the liabilities that the registered bank would be required to report in financial statements for its New Zealand business if section 461B(1) of the Financial Markets Conduct Act 2013 applied.

In conditions of registration 9 to 11,—

"loan-to-valuation ratio", "non property-investment residential mortgage loans", property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of property-investment residential mortgage loans" and "residential mortgage loan" have the same meaning as in the Reserve Bank document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated January 2018, where the version of the Reserve Bank document "Capital Adequacy Framework (Standardised Approach)" (BS2A) referred to in BS19 for the purpose of defining these terms is that dated November 2015.

'loan-to-valuation measurement period' means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of June 2018.

Conditions of registration

Changes to conditions of registration.

There have been no changes to the conditions of registration imposed on the Overseas Bank in New Zealand since 31 March 2018.

Westpac New Zealand conditions of registration.

In February 2017 the Reserve Bank required Westpac New Zealand to obtain an independent review of its compliance with advanced internal rating-based aspects of the Reserve Bank's 'Capital Adequacy Framework (Internal Models Based Approach) (BS2B)' ('**BS2B**'). Following the independent review, the Reserve Bank increased the minimum total capital ratio, tier 1 capital ratio and common equity tier 1 capital ratio for Westpac New Zealand and its controlled entities by 2%. Westpac New Zealand has also undertaken to the Reserve Bank to maintain the total capital ratio for Westpac New Zealand and its controlled entities above 15.1%. As at 30 September 2018, the total capital ratio for Westpac New Zealand and its controlled entities is 16.6%. Westpac New Zealand is progressing remediation of the non-compliance issues.

Westpac New Zealand has disclosed non-compliance with BS2B (compliance with which is a condition of registration for Westpac New Zealand) in its disclosure statements since September 2016. In particular, Westpac New Zealand has disclosed that when calculating LVRs for less than one percent of its residential mortgages by loan value, Westpac New Zealand uses total committed exposure rather than EAD for capital adequacy purposes and for less than 5% of accounts by number, it uses an updated valuation of the security value and not the origination value. These limitations on Westpac New Zealand's LVR calculations are reflected in the LVR values disclosed by the NZ Banking Group in Note 36.2.5.

These matters have no impact on the compliance by the Overseas Bank with its conditions of registration.

Independent auditor's report

To the Directors of Westpac Banking Corporation

This report is for the NZ Banking Group, comprising the aggregation of the New Zealand operations of Westpac Banking Corporation.

This report includes our:

- audit opinion on the financial statements prepared in accordance with Clause 25 of the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'), New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS');
- audit opinion on the supplementary information prepared in accordance with Schedules 4, 7, 11 and 13 of the Order;
- audit opinion on other legal and regulatory requirements in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order; and
- review conclusion on the supplementary information relating to credit and market risk exposures and capital adequacy prepared in accordance with Schedule 9 of the Order.

Report on the audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy)

We have audited the NZ Banking Group's financial statements required by Clause 25 of the Order and the supplementary information required by Schedules 4, 7, 11 and 13 of the Order which comprises:

- the balance sheet as at 30 September 2018;
- the income statement for the year then ended;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended;
- the notes to the financial statements, which include the principal accounting policies; and
- the supplementary information required by Schedules 4, 7, 11 and 13 of the Order.

Our opinion

In our opinion:

- the NZ Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 11 and 13 of the Order and included within the balance sheet and Notes 14, 33, 34, 35, 36, 38 and 39):
  - i. comply with generally accepted accounting practice in New Zealand;
  - ii. comply with NZ IFRS and IFRS; and
  - iii. give a true and fair view of the financial position of the NZ Banking Group as at 30 September 2018, and its financial performance and cash flows for the year then ended.
- the supplementary information disclosed in accordance with Schedules 4, 7, 11 and 13 of the Order and included within the balance sheet and Notes 14, 33, 34, 36, 38 and 39:
  - i. has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
  - ii. is in accordance with the books and records of the NZ Banking Group; and
  - iii. fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

PricewaterhouseCoopers, 188 Quay Street, Private Bag 92162, Auckland 1142, New Zealand
T: +64 9 355 8000, F: +64 9 355 8001, pwc.co.nz

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Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs (NZ)) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy)* section of our report.

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

Our audit approach

Overview

An audit is designed to obtain reasonable assurance about whether the financial statements are free from material misstatement.

The overall NZ Banking Group materiality: $76.8 million, which represents approximately 5% of profit before income tax.

We chose profit before income tax as the basis for our benchmark because, in our view, it is the benchmark against which the performance of the NZ Banking Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% based on our professional judgement, noting that it is also within the range of commonly accepted profit-related thresholds.

We have determined that there are three key audit matters:

- Provisions for impairment charges on loans
- NZ IFRS 9 financial instruments
- Operation of IT systems and controls

Materiality

The scope of our audit was influenced by our application of materiality.

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

Audit scope

We designed our audit by assessing the risks of material misstatement in the financial statements and our application of materiality. As in all of our audits, we also addressed the risk of management override of internal controls including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

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

Key audit matters

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

<table>
<tr><th>Key Audit Matter</th><th>How our audit addressed the Key Audit Matter</th></tr>
<tr><td>
Provisions for impairment charges on loans
(Refer to Notes 6 and 14 of the financial statements)

We focused on provisions for impairment charges on loans because of the subjective and complex judgements made by the NZ Banking Group in determining the necessity for, and then estimating the size of, provisions for impairment charges on loans.

Provisions for impairment charges on loans that exceed specific thresholds are individually assessed by management with reference to the estimated future cash repayments and proceeds from the realisation of collateral held by the NZ Banking Group in respect of those loans.

If an individually assessed loan is not impaired, it is then included in a group of loans with similar risk characteristics and, along with those loans below the specific thresholds noted above, is collectively assessed on a portfolio basis using models developed by the NZ Banking Group.

Key elements in the provisioning for impairment charges on loans include:
• the identification of impaired loans and the cash flow forecasts (including the expected realisable value of any collateral held) supporting the calculation of individually assessed provisions; and
• the application of impairment models used in the collectively assessed provision calculations, the appropriateness of the key assumptions used in the impairment models, the probability of default (PD) and the loss given default (LGD) factors.
</td><td>
We assessed the design and tested the operating effectiveness of key controls over the provisioning for impairment charges on loans. The key controls included:
• governance oversight, including the continuous re-assessment by the NZ Banking Group that the impairment models are operating in a way which is appropriate for the credit risks in the NZ Banking Group's loan portfolios;
• controls over timely identification of deterioration in the credit quality of individual loans;
• controls inherent in the IT systems that manage and transfer the data between underlying source systems and the impairment models; and
• the review and approval process for the outputs of the impairment models, and the adjustments and economic overlays that are applied to the modelled outputs.

Our work over the provisions for impairment charges on loans included:
• for all portfolios, recalculated the collective provision using the key assumptions in the model, such as PDs and LGDs;
• considered whether the calculations and underlying assumptions are consistent with those applied in the previous year, or that any changes are appropriate in the circumstances;
• performed analyses on key assumptions related to the collective provision;
• for a sample of individually assessed loans not identified as impaired, considered the latest financial information provided to the NZ Banking Group, to test the Credit Risk Grade rating that has been allocated to the borrower. We also inspected the valuation of collateral (where applicable) to test the LGD factor applied; and
• for a sample of individually assessed loans identified as impaired, considered the latest financial information, valuation of collateral, and independent expert advice (where available) provided to the NZ Banking Group, to test the basis of measuring the individually assessed provision.
</td></tr>
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Key Audit Matter	How our audit addressed the Key Audit Matter
NZ IFRS 9 Financial Instruments *(Refer to Note 1 of the financial statements)* On 1 October 2018 the NZ Banking Group transitioned to financial instruments accounting standard NZ IFRS 9 *Financial Instruments* which replaced NZ IAS 39 *Financial Instruments: Recognition and Measurement*. The estimated transition impact, net of deferred tax, in the period of initial application is disclosed in Note 1 to the financial statements in accordance with NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. NZ IFRS 9 introduces an expected credit loss ('ECL') model which takes into account forward-looking information reflecting the NZ Banking Group's view on potential future economic events. Given this is a new and complex accounting standard which requires considerable judgement to estimate ECL provisions against financial instruments, we considered the transition impact disclosure to be a key audit matter. Key elements in the provisioning for impairment charges on loans under NZ IFRS 9 include: • the judgements applied in determining exposures that have a significant increase in credit risk; • judgements in setting the assumptions used in the ECL models, such as estimating forward looking probability of default (PD), loss given default (LGD) of financial instruments and macro-economic scenarios and their weightings; • judgements over the use of data inputs required by the models; and • overlays added to reflect emerging trends or particular situations which are not otherwise captured by the impairment models.	We assessed the design and tested the operating effectiveness of key controls over the NZ Banking Group's estimate of the transition impact. The key controls included: • governance over the development, validation and approval of the NZ Banking Group's ECL models to assess compliance with NZ IFRS 9; • review and approval of key judgements, assumptions and forward looking information used in the ECL models; • interfaces and reconciliations over transfer of data inputs from source systems to the models; and • review and approval of ECL model outputs, overlays and disclosures of the transition impact. Our work over a sample of ECL models included: • consideration of the methodology inherent within the models against the requirements of NZ IFRS 9; • assessment of key assumptions in the ECL models, including staging, PD and LGD. This included using our credit modelling specialists in our assessment; • consideration of economic information used within, and weightings applied to, forward looking scenarios; • testing the accuracy and completeness of data inputs by testing reconciliations between source systems and the ECL models; • recalculation of the ECL; and • consideration of the potential for the ECL provision to be affected by events not captured by the NZ Banking Group's ECL models, and assessing whether the overlays were appropriate. We assessed the appropriateness of the NZ Banking Group's transition disclosure in the financial statements.

Key Audit Matter	How our audit addressed the Key Audit Matter
Operation of IT systems and controls We focused on this area because the NZ Banking Group is heavily dependent on complex IT systems for the processing and recording of significant volumes of transactions. In considering the complexity of the NZ Banking Group's processes and the design of the internal control environment, there are some areas of the audit where we seek to place reliance on automated controls or reports. The effective operation of these areas is dependent on the NZ Banking Group's IT General Control (ITGC) environment. For example: • change management internal controls are important because they help ensure that changes to systems and data are authorised and made appropriately; • IT operations are important as they help ensure errors in processing are resolved in a timely manner; and • user access controls are important to help ensure staff have appropriate access to IT systems and that access is monitored.	For significant financial statement balances, we gained an understanding of the business processes, key controls and IT systems used to generate and support those balances. Where relevant to our planned audit approach, we assessed the design and tested the operating effectiveness of the key controls which support the continued integrity of the in-scope IT systems. This involved considering, and where appropriate, testing the following elements of the ITGC environment: • governance controls used to monitor and enforce internal control consciousness throughout the NZ Banking Group's technology teams and third party suppliers; • program change management controls, where applicable, to help ensure changes to systems and data are tested, authorised and reviewed; • IT operations controls that help ensure any significant IT issues or incidents are escalated and resolved in a timely manner; and • user access security controls that help make sure that access to IT systems is adequately restricted to appropriate personnel, periodically reviewed and promptly removed when access is no longer required. For in-scope IT systems where technology services are provided by a third party, we: • obtained assurance from the third party's auditors on the design and operating effectiveness of controls; and/or • tested control design and operating effectiveness ourselves. In performing our procedures over in-scope IT systems, we identified certain deficiencies in IT internal controls which have impacted the level of reliance we can directly place on the NZ Banking Group's IT internal control environment. In response, we carried out further direct tests of the operation of key programs to establish the accuracy of calculations, the reliability of reports, and to assess the operation of automated controls and technology-dependent manual controls across the financial year. We also performed additional compensating control tests and/or substantive audit procedures over key financial balances where required to support our audit.

Information other than the financial statements, supplementary information and auditor's report

The Directors of Westpac Banking Corporation (the 'Directors') are responsible for the other information included in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 1 to 7 and 71 to 72. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

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

Responsibilities of the Directors for the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy)

The Directors are responsible, on behalf of Westpac Banking Corporation, for the preparation of the financial statements in accordance with Clause 25 of the Order, NZ IFRS and IFRS and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal control as the Directors determine is 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 the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 11 and 13 of the Order.

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

Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy)

Our objectives are to obtain reasonable assurance about whether the financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) disclosed in accordance with Clause 25 and Schedules 4, 7, 11 and 13 of the Order, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (NZ) and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at:
https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/

This description forms part of our auditor's report.

Report on other legal and regulatory requirements (excluding the supplementary information relating to credit and market risk exposures and capital adequacy)

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) for the year ended 30 September 2018:

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 Banking Group as far as appears from an examination of those records.

Report on the review of the supplementary information relating to credit and market risk exposures and capital adequacy

We have examined the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in Notes 35 and 36 of the financial statements of the NZ Banking Group for the year ended 30 September 2018.

Our conclusion

Based on our review, 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 35 and 36, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

This conclusion is to be read in the context of what we say in the remainder of this report.

Basis for our conclusion

We conducted our review in accordance with the New Zealand Standard on Review Engagements 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity* (NZ SRE 2410). Our responsibilities under this standard are further described in the *Auditor's responsibilities for the review of the supplementary information relating to credit and market risk exposures and capital adequacy* section of our report.

Responsibilities of the Directors for the supplementary information relating to credit and market risk exposures and capital adequacy

The Directors are responsible, on behalf of Westpac Banking Corporation, for the preparation of the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in accordance with Schedule 9 of the Order. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of the supplementary information relating to credit and market risk exposures and capital adequacy that is free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the review of the supplementary information relating to credit and market risk exposures and capital adequacy

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to credit and market risk exposures and capital adequacy, disclosed in Notes 35 and 36, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

A review of the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36 in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with ISAs (NZ) and ISAs. Accordingly we do not express an audit opinion on the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36.

Auditor independence

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

Our firm carries out other services for the NZ Banking Group in the areas of other assurance services and agreed procedures relating to the issuance of comfort letters on debt issuance programmes and other regulatory and compliance matters. In addition, certain partners and employees of our firm may deal with the NZ Banking Group on normal terms within the ordinary course of trading activities of the NZ Banking Group. These matters have not impaired our independence as auditor of the NZ Banking Group.

Who we report to

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

The engagement partner on the engagement resulting in this independent auditor's report is Jonathan Freeman.

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants Auckland
26 November 2018

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