# Westpac New Zealand Limited

# Disclosure Statement

For the year ended 30 September 2013

**Index**

## General information and definitions

Certain of the information contained in this Disclosure Statement is required by section 81 of the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**') and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order (No 2) 2013 ('**Order**').

In this Disclosure Statement, reference is made to:

- Westpac New Zealand Limited (otherwise referred to as the '**Bank**').
- Westpac New Zealand Limited and its controlled entities (otherwise referred to as the '**Banking Group**'). Controlled entities of the Bank as at 30 September 2013 are set out in Note 25.

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. All amounts referred to in this Disclosure Statement are in New Zealand dollars unless otherwise stated.

## General matters

### Registered Bank

The Bank was incorporated as Westpac New Zealand Limited under the Companies Act 1993 (Company Number 1763882) on 14 February 2006. The head office of the Bank is situated at Westpac on Takutai Square, 16 Takutai Square, Auckland 1010, New Zealand and the address for service of process on the Bank is Westpac on Takutai Square, 53 Galway Street, Auckland 1010, New Zealand.

The Bank is a subsidiary of Westpac New Zealand Group Limited ('**WNZGL**'), a New Zealand company, which in turn is a wholly-owned subsidiary of Westpac Overseas Holdings No. 2 Pty Limited ('**WOHL**'), an Australian company. WOHL is, in turn, a wholly-owned subsidiary of Westpac Banking Corporation, an Australian company ('**Ultimate Parent Bank**'). The Ultimate Parent Bank is incorporated in Australia under the Australian Corporations Act 2001 and its address for service of process is Level 20, Westpac Place, 275 Kent Street, Sydney, New South Wales 2000, Australia.

At 30 September 2013, WNZGL has a direct qualifying interest in 100% of the voting securities of the Bank. The Ultimate Parent Bank has an indirect qualifying interest in 100% of the voting securities of the Bank.

WNZGL has the ability to directly appoint up to 100% of the Board of Directors of the Bank (the '**Board**') and, as indirect holding companies of the Bank, both the Ultimate Parent Bank and WOHL have the ability to indirectly appoint up to 100% of the Board.

In addition, the Ultimate Parent Bank has the power under the Bank's constitution to directly appoint up to 100% of the Board from time to time by giving written notice to the Bank.

All appointments to the Board must be approved by the Reserve Bank of New Zealand ('**Reserve Bank**') (refer to the Bank's conditions of registration on page 6 of this Disclosure Statement for details of the Reserve Bank's approval process).

Until 1 November 2006, the Ultimate Parent Bank operated through a branch in New Zealand. Effective 1 November 2006, the Ultimate Parent Bank has operated in New Zealand through both a branch of the Ultimate Parent Bank ('**NZ Branch**') (carrying on financial markets operations, and institutional banking activities until 1 November 2011) and the Bank (a locally incorporated subsidiary of the Ultimate Parent Bank carrying on the Ultimate Parent Bank's New Zealand consumer and business banking operations). On 1 November 2011, the NZ Branch transferred additional business activities and associated employees to the Bank (refer to Note 2 Business combination – transfer of operations for further details).

### Limits on material financial support by the Ultimate Parent Bank

The Ultimate Parent Bank is an authorised deposit-taking institution ('**ADI**') under the Banking Act 1959 of Australia ('**Australian Banking Act**') and, as such, is subject to prudential regulation and supervision by the Australian Prudential Regulation Authority ('**APRA**'). APRA has the power to prescribe prudential requirements which may affect the ability of the Ultimate Parent Bank to provide material financial support to the Bank. Pursuant to current APRA requirements, and unless APRA provides otherwise, the Ultimate Parent Bank must comply with, among other prudential requirements, APRA's Prudential Standard APS 222 Associations with Related Entities ('**APS 222**'). APS 222 includes the following prudential requirements:

- the Ultimate Parent Bank's exposure to the Bank (being a related ADI as defined in APS 222) must not exceed 50% of the Ultimate Parent Bank's Level 1 capital base (as defined in APS 222);
- the Ultimate Parent Bank must not hold unlimited exposures to the Bank (such as a general guarantee covering any of the Bank's obligations);
- the Ultimate Parent Bank must not enter into cross-default clauses whereby a default by the Bank on an obligation (whether financial or otherwise) is deemed to trigger a default of the Ultimate Parent Bank in its obligations;
- when determining limits on acceptable levels of exposure to the Bank, the Board of Directors of the Ultimate Parent Bank must have regard to:
  - the level of exposures that would be approved to third parties of broadly equivalent credit status; and
  - the impact on the Ultimate Parent Bank's stand-alone capital and liquidity positions, and its ability to continue operating, in the event of a failure by the Bank or any other related entity to which it is exposed.

## General matters (continued)

In January 2013, a new provision in APS 222 took effect which allows APRA to set specific limits on the Ultimate Parent Bank's exposures to related entities, which include the Bank. No specific limits that may materially inhibit the legal ability of the Ultimate Parent Bank to provide material financial support to the Bank have been set under this provision.

The Ultimate Parent Bank complies with the requirements set by APRA in respect of the extent of financial support that is provided to the Bank.

Section 13A(3) of the Australian Banking Act provides that, in the event that the Ultimate Parent Bank becomes unable to meet its obligations or suspends payment, the assets of the Ultimate Parent Bank in Australia are to be available to satisfy the liabilities of the Ultimate Parent Bank in the following order:

- first, certain obligations of the Ultimate Parent Bank 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 Ultimate Parent Bank;
- second, APRA's costs (if any) in exercising its powers and performing its functions relating to the Ultimate Parent Bank in connection with the FCS;
- third, the Ultimate Parent Bank's liabilities (if any) in Australia in relation to 'protected accounts' that account-holders keep with the Ultimate Parent Bank;
- fourth, the Ultimate Parent Bank's debts (if any) to the Reserve Bank of Australia;
- fifth, the Ultimate Parent Bank's liabilities (if any) under an 'industry support contract' that is certified by APRA in accordance with the Australian Banking Act; and
- sixth, the Ultimate Parent Bank's other liabilities (if any) in the order of their priority apart from the above.

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

### Directorate

The Directors of the Bank at the time this Disclosure Statement was signed were:

| | |
|---|---|
| **Name:** Peter David Wilson, CA<br>**Non-executive:** Yes<br>**Country of Residence:** New Zealand<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Chairman of each of Augusta Capital Limited, PF Olsen Limited and PF Olsen Group Limited. Deputy Chairman of Meridian Energy Limited. Director of Farmlands Trading Society Limited. |
| **Name:** Peter Graham Clare, B.Com, MBA<br>**Non-executive:** No<br>**Country of Residence:** New Zealand<br>**Primary Occupation:** Chief Executive, Westpac New Zealand Limited<br>**Secondary Occupations:** Director<br>**Board Audit Committee Member:** No<br>**Independent Director:** No | **External Directorships:** Director of each of Westpac New Zealand Group Limited, BT Funds Management (NZ) Limited, BT Financial Group (NZ) Limited and Banking Ombudsman Scheme Limited. |
| **Name:** Malcolm Guy Bailey, B.Ag.Econ.<br>**Non-executive:** Yes<br>**Country of Residence:** New Zealand<br>**Primary Occupation:** Director<br>**Secondary Occupations:** None<br>**Board Audit Committee Member:** Yes<br>**Independent Director:** Yes | **External Directorships:** Chairman of each of the Dairy Companies Association of NZ and Red Meat Profit Partnership General Partner Limited.[1] Director of Fonterra Co-operative Group Limited. Board Member of the NZ US Council. Member of the International Food and Agriculture Trade Policy Council. Director of each of Bailey Agriculture Limited, Bailey Family Properties Limited, Embryo Technologies Limited, Agrico Holdings Limited, Hopkins Farming Group Limited and Gleneig Holdings Limited. |

## General matters (continued)

**Name:** Philip Matthew Coffey, BEc (Hons.)
**Non-executive:** Yes
**Country of Residence:** Australia
**Primary Occupation:** Chief Financial Officer, Westpac Banking Corporation
**Secondary Occupations:** Director
**Board Audit Committee Member:** Yes
**Independent Director:** No

**External Directorships:** Director of each of MBMC Pty Ltd and MBMC Futures Pty Ltd.

**Name:** Janice Amelia Dawson, B.Com, FCA
**Non-executive:** Yes
**Country of Residence:** New Zealand
**Primary Occupation:** Director
**Secondary Occupations:** None
**Board Audit Committee Member:** Yes, Chair
**Independent Director:** Yes

**External Directorships:** Deputy Chair of Counties Manukau District Health Board. Director of each of AIG Insurance New Zealand Limited, Air New Zealand Limited, Meridian Energy Limited, Erua Limited, Goodman Fielder Limited and Jan Dawson Limited. Member of each of the Capital Investment Committee of the National Health Board, the Council of the University of Auckland, the Voyager Maritime Museum, the Council of the International Sailing Federation and the Events Committee of the International Sailing Federation. Chair of the Audit Committee of the International Sailing Federation.

**Name:** Christopher John David Moller, BCA Dip Accounting, ACA
**Non-executive:** Yes
**Country of Residence:** New Zealand
**Primary Occupation:** Director
**Secondary Occupations:** None
**Board Audit Committee Member:** Yes
**Independent Director:** Yes

**External Directorships:** Chairman of each of New Zealand Transport Agency, Meridian Energy Limited and SKYCITY Entertainment Group Limited. Director of Urenui Consultants Limited.

[1] Malcolm Bailey was appointed as a Director and Chairman of Red Meat Profit Partnership General Partner Limited in November 2013.

All communications may be sent to the Directors at the head office of the Bank at Westpac on Takutai Square, 16 Takutai Square, Auckland 1010, New Zealand.

***Changes to Directorate***

There have been no changes in the composition of the Board of Directors of the Bank since 30 September 2012.

### Conflicts of interest policy

The Board has adopted a procedure to ensure that conflicts and potential conflicts of interest between the Directors' duty to the Bank and their personal, professional or business interests are avoided or dealt with. The Bank's policy is consistent with the conflicts of interest policy of the Ultimate Parent Bank and its subsidiaries.

Accordingly, each Director must:

(a) give notice to the Board of any direct or indirect interest in any contract or proposed contract with the 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 between the Bank and a person or persons specified in that notice; and

(b) 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, or any immediate relative or close business associate of any Director, with the Bank, or any member of the Banking Group:

(a) on terms other than on those which would, in the ordinary course of business of the Bank or any member of the Banking Group, be given to any other person of like circumstances or means; or

(b) which could otherwise be reasonably likely to influence materially the exercise of that Director's duties.

## Credit ratings

The 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 | Aa3 | Stable |
| Standard & Poor's | AA- | Stable |

On 30 January 2012, Fitch Ratings ('**Fitch**') placed the Bank's credit rating outlook on 'rating watch negative'. The announcement by Fitch formed part of a broader review of the debt ratings Fitch applies to the largest banking institutions in the world. On 24 February 2012, the Bank's credit rating issued by Fitch was downgraded from AA to AA- with a 'stable' outlook.

On 9 November 2011, Standard & Poor's released its new global bank rating criteria and Banking Industry Country Risk Assessments ('**BICRA**') methodology. Also on 9 November 2011, Standard & Poor's announced the BICRA score for New Zealand of three, down from a score of two under the previous methodology. On 1 December 2011, as a result of the Standard & Poor's bank rating criteria changes, the Bank's credit rating was lowered from AA to AA- with a 'stable' outlook.

There have been no other changes to the above Bank's credit ratings or ratings outlooks in the two years prior to 30 September 2013.

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

### Descriptions of credit rating scales[1]

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

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

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

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

## Guarantee arrangements

Certain material obligations of the Bank are guaranteed as at the date the Directors signed this Disclosure Statement.

### Government guarantees

The Bank has a Crown Wholesale Funding Guarantee Facility Deed and Crown Wholesale Funding Guarantee with the New Zealand Government ('**Crown**'), each dated 23 February 2009 (together the '**Wholesale Guarantee**').

The Wholesale Guarantee closed on 30 April 2010 from which date no new Guarantee Eligibility Certificates can be issued. Guaranteed Liabilities (as defined below) as at 30 April 2010 were not affected.

The following description of the Wholesale Guarantee is for general information purposes only and does not purport to be exhaustive. Further information about the Wholesale Guarantee is available from the Treasury internet site www.treasury.govt.nz.

### Wholesale Guarantee

The guarantor of the Bank's obligations under the Wholesale Guarantee is the Crown. The Crown's address for service in relation to the Wholesale Guarantee is:

(a) Minister of Finance, Parliament Buildings, Wellington; or

(b) New Zealand High Commissioner in London at the address of the New Zealand High Commission in London for the time being; or

(c) New Zealand Consul and Trade Commissioner at the address of the New Zealand Consulate-General in New York for the time being;

in each case with a copy (with delivery made by hand or facsimile) to: The Treasurer, The New Zealand Debt Management Office, 1 The Terrace, Wellington, New Zealand.

The most recent audited financial statements of the Crown can also be obtained from the Treasury internet site www.treasury.govt.nz.

The Crown has the following credit ratings in respect of its long-term obligations payable in New Zealand dollars as at the date the Directors signed this Disclosure Statement.

| Rating Agency | The Crown's Current Credit Rating | Rating Outlook |
|---|---|---|
| Fitch Ratings | AA+ | Stable |
| Moody's Investors Service | Aaa | Stable |
| Standard & Poor's | AA+ | Stable |

There have been no changes to any of the above Crown's domestic currency credit ratings or rating outlooks in the two years prior to 30 September 2013.

For an explanation of the credit rating scales see the table under the sub-heading 'Descriptions of credit rating scales' on page 4 of this Disclosure Statement.

***Obligations guaranteed***

The obligations guaranteed by the Crown under the Wholesale Guarantee are obligations of the Bank to pay money to a Beneficiary (as defined below) under a Guaranteed Liability. A '**Guaranteed Liability**' is a liability to pay principal or interest in respect of which the Crown has issued a Guarantee Eligibility Certificate under the Wholesale Guarantee.

The Crown:

(a) guarantees to each Beneficiary the payment by the Bank of any Guaranteed Liability owed to that Beneficiary; and

(b) undertakes to each Beneficiary that, if the Bank does not pay any Guaranteed Liability owed to that Beneficiary on its due date, the Crown will pay that Guaranteed Liability.

In this context, a '**Beneficiary**' means each person to whom a Guaranteed Liability is owed, excluding a 'Related Party' of the Bank as that term is defined in the Wholesale Guarantee and anyone acting as a nominee of, or trustee for, a Related Party.

The Crown has issued Guarantee Eligibility Certificates in respect of payment obligations of the Bank under certain notes issued by the Bank. The Crown has also issued Guarantee Eligibility Certificates in respect of payment obligations of the Bank as guarantor of certain notes issued by Westpac Securities NZ Limited, a controlled entity of the Bank. Copies of the Guarantee Eligibility Certificates issued, which provide further details of the obligations of the Bank guaranteed by the Crown under the Wholesale Guarantee, are available on the New Zealand Treasury internet site www.treasury.govt.nz.

***Limits on the amount of obligations guaranteed***

The obligations of the Crown in respect of a Guaranteed Liability are limited to the relevant payment obligations of the Bank in respect of principal and interest under the particular debt securities that are specified in the relevant Guarantee Eligibility Certificate.

***Material conditions applicable to the guarantee***

The material conditions applicable to the Wholesale Guarantee, other than non-performance by the Bank, are summarised below:

(a) The Crown is not liable in respect of any Guaranteed Liability that has been amended in any respect without the prior written consent of the Crown.

(b) The Crown is not liable in respect of any Guaranteed Liability until the Crown receives a written demand for that payment that complies with the requirements set out in the Wholesale Guarantee.

(c) Special conditions may be specified in the Guarantee Eligibility Certificate in respect of a particular Guaranteed Liability.

## Guarantee arrangements (continued)

Prior to a change to the conditions of registration that took effect on 1 January 2013, locally incorporated registered banks having the benefit of the Wholesale Funding Guarantee Facility were required to maintain an additional 2% Tier One Capital ratio buffer above the then 4% regulatory minimum. Following the change, all locally incorporated registered banks are required to hold a minimum Tier One Capital ratio of 6%.

***Expiry of the Wholesale Guarantee***

For each Guaranteed Liability the guarantee under the Wholesale Guarantee will expire at midnight on the date falling 30 days after the earlier of:

(a) the scheduled maturity date of the security under which that Guaranteed Liability arises; and

(b) the date falling five years after the issue date of the security under which that Guaranteed Liability arises.

There is no provision for the withdrawal of the Wholesale Guarantee in respect of a Guaranteed Liability.

There have been no changes to the terms of the Wholesale Guarantee since the date of signing of the Bank's Disclosure Statement for the year ended 30 September 2012.

## Pending proceedings or arbitration

There are no pending legal proceedings or arbitration at the date of this Disclosure Statement involving any member of the Banking Group, whether in New Zealand or elsewhere, that may have a material adverse effect on the Banking Group or the Bank.

In March 2013, litigation funder, Litigation Lending Services (NZ) Limited, announced potential representative actions against five New Zealand Banks in relation to certain fees. In June 2013, proceedings were filed against one of those banks. As at the date of signing this Disclosure Statement, no proceedings have been filed against Westpac New Zealand Limited. At this stage the impact of any such potential proceeding cannot be determined with any certainty.

The contingent liabilities of the Banking Group and the Bank are set out in Note 28 Commitments and contingent liabilities.

## Conditions of registration

The conditions of registration imposed on the Bank, which applied from 30 June 2013 to 30 September 2013, are as follows:

1. That:

   (a) the Total Capital ratio of the Banking Group is not less than 8 percent;

   (b) the Tier One Capital ratio of the Banking Group is not less than 6 percent;

   (c) the Common Equity Tier One Capital ratio of the Banking Group is not less than 4.5 percent;

   (d) the Total Capital of the Banking Group is not less than $30 million; and

   (e) the process in Subpart 2H of the Reserve Bank document: 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated May 2013 is followed for the recognition and repayment of capital.

   For the purposes of this condition of registration,—

   the scalar referred to in the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated May 2013 is 1.06.

   'Total Capital ratio', 'Tier One Capital ratio', 'Common Equity Tier One Capital ratio', and 'Total Capital' must be calculated in accordance with the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated May 2013.

1A. That:

   (a) the Bank has an internal capital adequacy assessment process ('ICAAP') that accords with the requirements set out in the document 'Guidelines on a Bank's Internal Capital Adequacy Assessment Process ('ICAAP')' (BS12) dated December 2007;

   (b) under its ICAAP the Bank identifies and measures its 'other material risks' defined as all material risks of the Banking Group that are not explicitly captured in the calculation of Common Equity Tier One Capital ratio, the Tier One Capital ratio and Total Capital ratio under the requirements set out in the document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated May 2013; and

   (c) the Bank determines an internal capital allocation for each identified and measured 'other material risk'.

1B. That the Banking Group complies with all requirements set out in the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated May 2013.

1C. That, if the buffer ratio of the Banking Group is 2.5% or less, the Bank must:

   (a) according to the following table, limit the aggregate distributions of the Bank's earnings to the percentage limit to distributions that corresponds to the Banking Group's buffer ratio:

| Banking Group's buffer ratio | Percentage limit to distributions of the Bank's earnings |
|---|---|
| 0% – 0.625% | 0% |
| >0.625 – 1.25% | 20% |
| >1.25 – 1.875% | 40% |
| >1.875 – 2.5% | 60% |

   (b) prepare a capital plan to restore the Banking Group's buffer ratio to above 2.5% within any timeframe determined by the Reserve Bank for restoring the buffer ratio; and

   (c) have the capital plan approved by the Reserve Bank.

## Conditions of registration (continued)

For the purposes of this condition of registration,—

'buffer ratio', 'distributions', and 'earnings' have the same meaning as in Part 3 of the Reserve Bank document: 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated May 2013.

the scalar referred to in the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated May 2013 is 1.06.

This condition of registration applies on and after 1 January 2014.

2. That the Banking Group does not conduct any non-financial activities that in aggregate are material relative to its total activities.

   In this condition of registration, the meaning of 'material' is based on generally accepted accounting practice.

3. That the Banking Group's insurance business is not greater than 1% of its total consolidated assets.

   For the purposes of this condition of registration, the Banking Group's insurance business is the sum of the following amounts for entities in the Banking Group:

   (a) if the business of an entity predominantly consists of insurance business and the entity is not a subsidiary of another entity in the Banking Group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total consolidated assets of the group headed by the entity; and

   (b) if the entity conducts insurance business and its business does not predominantly consist of insurance business and the entity is not a subsidiary of another entity in the Banking Group whose business predominantly consists of insurance business, the amount of the insurance business to sum is the total liabilities relating to the entity's insurance business plus the equity retained by the entity to meet the solvency or financial soundness needs of its insurance business:

   In determining the total amount of the Banking Group's insurance business:

   (a) all amounts must relate to on balance sheet items only, and must comply with generally accepted accounting practice; and

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

   For the purposes of this condition of registration, —

   'insurance business' means the undertaking or assumption of liability as an insurer under a contract of insurance;

   'insurer' and 'contract of insurance' have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.

4. That the aggregate credit exposures (of a non-capital nature and net of any allowances for impairment) of the Banking Group to all connected persons do not exceed the rating-contingent limit outlined in the following matrix:

| Credit rating of the Bank[1] | Connected exposure limit (% of the Banking Group's Tier One Capital) |
|---|---|
| AA/Aa2 and above | 75 |
| AA-/Aa3 | 70 |
| A+/A1 | 60 |
| A/A2 | 40 |
| A-/A3 | 30 |
| BBB+/Baa1 and below | 15 |

[1] This table uses the rating scales of Standard & Poor's, Fitch Ratings and Moody's Investors Service (Fitch Ratings' scale is identical to Standard & Poor's).

   Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15% of the Banking Group's Tier One Capital.

   For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank document entitled 'Connected Exposures Policy' (BS8) dated May 2013.

5. That exposures to connected persons are not on more favourable terms (e.g. as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.

6. That the Bank complies with the following corporate governance requirements:

   (a) the Board of the Bank must have at least five directors;

   (b) the majority of the Board members must be non-executive directors;

   (c) at least half of the Board members must be independent directors;

   (d) an alternate director:

      (i) for a non-executive director must be non-executive; and

      (ii) for an independent director must be independent;

   (e) at least half of the independent directors of the Bank must be ordinarily resident in New Zealand;

   (f) the chairperson of the Board of the Bank must be independent; and

   (g) the Bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the Bank).

   For the purposes of this condition of registration, 'non-executive' and 'independent' have the same meaning as in the Reserve Bank document entitled 'Corporate Governance' (BS14) dated March 2011.

## Conditions of registration (continued)

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the Bank unless:
   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   (b) the Reserve Bank has advised that it has no objection to that appointment.
8. That a person must not be appointed as chairperson of the Board of the Bank unless:
   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
   (b) the Reserve Bank has advised that it has no objection to that appointment.
9. That the Bank has a Board audit committee, or other separate board committee covering audit matters, that meets the following requirements:
   (a) the mandate of the committee must include: ensuring the integrity of the Bank's financial controls, reporting systems and internal audit standards;
   (b) the committee must have at least three members;
   (c) every member of the committee must be a non-executive director of the Bank;
   (d) the majority of the members of the committee must be independent; and
   (e) the chairperson of the committee must be independent and must not be the chairperson of the Bank.

   For the purposes of this condition of registration, 'non-executive' and 'independent' have the same meaning as in the Reserve Bank document entitled 'Corporate Governance' (BS14) dated March 2011.
10. That a substantial proportion of the Bank's business is conducted in and from New Zealand.
11. That the Bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the Bank that are carried on by a person other than the Bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the Bank or of a service provider to the Bank, the following outcomes:
    (a) that the Bank's clearing and settlement obligations due on a day can be met on that day;
    (b) that the Bank's financial risk positions on a day can be identified on that day;
    (c) that the Bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
    (d) that the Bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

    For the purposes of this condition of registration, the term 'legal and practical ability to control and execute' is explained in the Reserve Bank document entitled 'Outsourcing Policy' (BS11) dated January 2006.
12. That:
    (a) the business and affairs of the Bank are managed by, or under the direction or supervision of, the Board of the Bank;
    (b) the employment contract of the chief executive officer of the Bank or person in an equivalent position (together '**CEO**') is with the Bank, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the Board of the Bank; and
    (c) all staff employed by the Bank have their remuneration determined by (or under the delegated authority of) the Board or the CEO of the Bank and are accountable (directly or indirectly) to the CEO of the Bank.
13. That, for the purposes of calculating the Bank's capital ratios on a solo basis, a credit conversion factor of zero is only applied to a guarantee of a financing subsidiary's financial obligations if, in substance, the guarantee does not create a risk of loss for the Bank.
14. That the Banking Group complies with the following quantitative requirements for liquidity-risk management:
    (a) the one-week mismatch ratio of the Banking Group is not less than 0% at the end of each business day;
    (b) the one-month mismatch ratio of the Banking Group is not less than 0% at the end of each business day; and
    (c) the one-year core funding ratio of the Banking Group is not less than 75% at the end of each business day.

    For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank documents entitled 'Liquidity Policy' (BS13) dated March 2011 and 'Liquidity Policy Annex: Liquid Assets' (BS13A) dated December 2011.
15. That the Bank has an internal framework for liquidity risk management that is adequate in the Bank's view for managing the Bank's liquidity risk at a prudent level, and that, in particular:
    (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
    (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
    (c) identifies the principal methods that the Bank will use for measuring, monitoring and controlling liquidity risk; and
    (d) considers the material sources of stress that the Bank might face, and prepares the Bank to manage stress through a contingency funding plan.

## Conditions of registration (continued)

16. That no more than 10% of total assets may be beneficially owned by a SPV.

    For the purposes of this condition:

    'total assets' means all assets of the Banking Group plus any assets held by any SPV that are not included in the Banking Group's assets:

    'SPV' means a person:

    (a) to whom any member of the Banking Group has sold, assigned, or otherwise transferred any asset;

    (b) who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and

    (c) who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the Banking Group under a covered bond:

    'covered bond' means a debt security issued by any member of the Banking Group, for which repayment to holders is guaranteed by a SPV, and investors retain an unsecured claim on the issuer.

17. That:

    (a) no member of the Banking Group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:

        (i) the Bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and

        (ii) at the time of notifying the Reserve Bank of the intended acquisition or business combination, the Bank provided the Reserve Bank with the information required under the Reserve Bank Banking Supervision Handbook document 'Significant Acquisitions Policy' (BS15) dated December 2011; and

    (b) no member of the Banking Group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:

        (i) the Bank has notified the Reserve Bank in writing of the intended acquisition or business combination;

        (ii) at the time of notifying the Reserve Bank in writing of the intended acquisition or business combination, the Bank provided the Reserve Bank with the information required under the Reserve Bank Banking Supervision Handbook document 'Significant Acquisitions Policy' (BS15) dated December 2011; and

        (iii) the Reserve Bank has given the Bank a notice of non-objection to the significant acquisition or business combination.

    For the purposes of this condition of registration, 'qualifying acquisition or business combination', 'notification threshold' and 'non-objection threshold' have the same meaning as in the Reserve Bank Banking Supervision Handbook document 'Significant Acquisitions Policy' (BS15) dated December 2011.

18. That the Bank is pre-positioned for Open Bank Resolution and in accordance with a direction from the Reserve Bank, the Bank can:

    (a) close promptly at any time of the day and on any day of the week and that effective upon the appointment of the statutory manager:

        (i) all liabilities are frozen in full; and

        (ii) no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;

    (b) apply a *de minimis* to relevant customer liability accounts;

    (c) apply a partial freeze to the customer liability account balances;

    (d) reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;

    (e) maintain a full freeze on liabilities not pre-positioned for Open Bank Resolution; and

    (f) reinstate customers' access to some or all of their residual frozen funds.

19. That the Bank has an Implementation Plan that:

    (a) is up-to-date; and

    (b) demonstrates that the Bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: 'Open Bank Resolution Pre-positioning Requirements Policy' (BS 17).

20. That the Bank has a compendium of liabilities that:

    (a) at the product-class level lists all liabilities, indicating which are:

        (i) pre-positioned for Open Bank Resolution; and

        (ii) not pre-positioned for Open Bank Resolution;

    (b) is agreed to by the Reserve Bank; and

    (c) if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

21. That on an annual basis the Bank tests all the component parts of its OBR solution that demonstrates the Bank's prepositioning for Open Bank Resolution as specified in their Implementation Plan.

    For the purposes of this condition of registration, 'de minimis', 'partial freeze', 'customer liability account', 'frozen and unfrozen funds', 'Implementation Plan', 'compendium of liabilities', and 'pre-positioned and non pre-positioned liabilities' have the same meaning as in the Reserve Bank document entitled 'Open Bank Resolution (OBR) Pre-positioning Requirements Policy' (BS17) dated June 2013.

## Conditions of registration (continued)

In these conditions of registration:

- 'Banking Group' means Westpac New Zealand Limited's financial reporting group as defined in section 2(1) of the Financial Reporting Act 1993; and
- 'generally accepted accounting practice' has the same meaning as in section 2 of the Financial Reporting Act 1993.

The Bank's conditions of registration were amended on 27 September 2013. The amendments came into effect from 1 October 2013. The principal change was to add new conditions of registration restricting high loan-to-valuation residential mortgage lending. The Reserve Bank also made some minor amendments to the 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B), revised the document 'Application for capital recognition or repayment: material to be provided to the Reserve Bank' (BS16), which is referred to in BS2B, and amended its 'Connected Exposures Policy' (BS8) to update version references. Minor amendments were also made to the conditions of registration relating to Open Bank Resolution.

## Other material matters

There are no matters relating to the business or affairs of the Bank and the 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 Bank or any member of the Banking Group is the issuer.

## Auditors

**PricewaterhouseCoopers**

PricewaterhouseCoopers Tower

188 Quay Street

Auckland, New Zealand

## Historical summary of financial statements

| $ millions | The Banking Group<br>Year Ended 30-Sep-13 | Year Ended 30-Sep-12 | Year Ended 30-Sep-11 | Year Ended 30-Sep-10 | Year Ended 30-Sep-09 |
|---|---|---|---|---|---|
| **Income statement** | | | | | |
| Interest income | **3,768** | 3,881 | 3,521 | 3,501 | 3,988 |
| Interest expense | **(2,232)** | (2,382) | (2,205) | (2,337) | (2,672) |
| **Net interest income** | **1,536** | 1,499 | 1,316 | 1,164 | 1,316 |
| Non-interest income | **371** | 356 | 308 | 291 | 363 |
| **Net operating income** | **1,907** | 1,855 | 1,624 | 1,455 | 1,679 |
| Operating expenses | **(810)** | (807) | (771) | (704) | (708) |
| Impairment charges on loans | **(107)** | (190) | (224) | (334) | (620) |
| **Operating profit** | **990** | 858 | 629 | 417 | 351 |
| Share of profit of associate accounted for using the equity method | **1** | 1 | 1 | 1 | - |
| **Profit before income tax expense** | **991** | 859 | 630 | 418 | 351 |
| Income tax expense | **(277)** | (246) | (197) | (132) | (103) |
| **Profit after income tax expense** | **714** | 613 | 433 | 286 | 248 |
| **Profit after income tax expense attributable to:** | | | | | |
| Owners of the Banking Group | **711** | 610 | 429 | 283 | 245 |
| Non-controlling interests | **3** | 3 | 4 | 3 | 3 |
| | **714** | 613 | 433 | 286 | 248 |
| **Dividends paid or provided** | **(4)** | (484) | (2) | (4) | (328) |
| **Balance sheet** | | | | | |
| Total assets | **70,512** | 68,822 | 60,656 | 55,179 | 54,509 |
| Total impaired assets | **573** | 867 | 794 | 742 | 670 |
| Total liabilities | **63,946** | 63,026 | 56,160 | 51,131 | 50,745 |
| Total equity | **6,566** | 5,796 | 4,496 | 4,048 | 3,764 |

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

## Directors' statement

Each Director of the Bank believes, 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 Bank believes, after due enquiry, that, over the year ended 30 September 2013:

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

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

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

This Disclosure Statement has been signed by all the Directors:

Peter David Wilson

Peter Graham Clare

Malcolm Guy Bailey

Philip Matthew Coffey

Janice Amelia Dawson

Christopher John David Moller

Dated this 21st day of November 2013

## Index to financial statements

**Page** **Contents**

## **Income statements** for the year ended 30 September

| $ millions | Note | The Banking Group Year Ended 30-Sep-13 | The Banking Group Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | The Bank Year Ended 30-Sep-12 |
|---|---|---|---|---|---|
| Interest income | 3 | **3,768** | 3,881 | **4,097** | 4,187 |
| Interest expense | 3 | **(2,232)** | (2,382) | **(2,578)** | (2,704) |
| **Net interest income** | | **1,536** | 1,499 | **1,519** | 1,483 |
| Non-interest income | 4 | **371** | 356 | **358** | 344 |
| **Net operating income** | | **1,907** | 1,855 | **1,877** | 1,827 |
| Operating expenses | 5 | **(810)** | (807) | **(814)** | (809) |
| Impairment charges on loans | 7 | **(107)** | (190) | **(104)** | (180) |
| **Operating profit** | | **990** | 858 | **959** | 838 |
| Share of profit of associate accounted for using the equity method | | **1** | 1 | **-** | - |
| **Profit before income tax expense** | | **991** | 859 | **959** | 838 |
| Income tax expense | 8 | **(277)** | (246) | **(268)** | (236) |
| **Profit after income tax expense** | | **714** | 613 | **691** | 602 |
| **Profit after income tax expense attributable to:** | | | | | |
| Owners of the Banking Group | | **711** | 610 | **691** | 602 |
| Non-controlling interests | | **3** | 3 | **-** | - |
| | | **714** | 613 | **691** | 602 |

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

## **Statements of comprehensive income** for the year ended 30 September

| $ millions | The Banking Group Year Ended 30-Sep-13 | The Banking Group Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | The Bank Year Ended 30-Sep-12 |
|---|---|---|---|---|
| **Profit after income tax expense** | **714** | 613 | **691** | 602 |
| **Other comprehensive income which may be reclassified to the income statement:** | | | | |
| Available-for-sale securities: | | | | |
| Net unrealised gains from changes in fair value of available-for-sale securities | **23** | 66 | **23** | 66 |
| Exchange differences | **1** | (6) | **1** | (6) |
| Income tax effect | **2** | (11) | **2** | (11) |
| Cash flow hedges: | | | | |
| Net gains from changes in fair value of cash flow hedges | **30** | 18 | **30** | 18 |
| Transferred to the income statement | **(22)** | (4) | **(22)** | (4) |
| Income tax effect | **(2)** | (4) | **(2)** | (4) |
| **Total other comprehensive income which may be reclassified to the income statement** | **32** | 59 | **32** | 59 |
| **Other comprehensive income/(expense) which will not be reclassified to the income statement:** | | | | |
| Actuarial gains/(losses) on employee defined benefit obligations | **39** | (25) | **39** | (25) |
| Income tax effect | **(11)** | 7 | **(11)** | 7 |
| **Total other comprehensive income/(expense) which will not be reclassified to the income statement** | **28** | (18) | **28** | (18) |
| **Total other comprehensive income, net of tax** | **60** | 41 | **60** | 41 |
| **Total comprehensive income** | **774** | 654 | **751** | 643 |
| **Total comprehensive income attributable to:** | | | | |
| Owners of the Banking Group | **771** | 651 | **751** | 643 |
| Non-controlling interests | **3** | 3 | **-** | - |
| | **774** | 654 | **751** | 643 |

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

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

| | The Banking Group | | | | | | |
|---|---|---|---|---|---|---|---|
| $ millions | Share Capital | Retained Profits | Available-for-sale Securities Reserve | Cash Flow Hedge Reserve | Total before Non-controlling Interests | Non-controlling Interests | Total |
| **As at 1 October 2011** | 3,470 | 967 | 31 | 20 | 4,488 | 8 | 4,496 |
| **Year ended 30 September 2012** | | | | | | | |
| Profit after income tax expense | - | 610 | - | - | 610 | 3 | 613 |
| Net gains from changes in fair value | - | - | 66 | 18 | 84 | - | 84 |
| Income tax effect | - | - | (11) | (5) | (16) | - | (16) |
| Exchange differences | - | - | (6) | - | (6) | - | (6) |
| Income tax effect | - | - | - | - | - | - | - |
| Transferred to the income statement | - | - | - | (4) | (4) | - | (4) |
| Income tax effect | - | - | - | 1 | 1 | - | 1 |
| Actuarial losses on employee defined benefit obligations | - | (25) | - | - | (25) | - | (25) |
| Income tax effect | - | 7 | - | - | 7 | - | 7 |
| **Total comprehensive income for the year ended 30 September 2012** | - | 592 | 49 | 10 | 651 | 3 | 654 |
| Transaction with owners: | | | | | | | |
| Ordinary share capital issued | 1,130 | - | - | - | 1,130 | - | 1,130 |
| Dividends paid on ordinary shares | - | (480) | - | - | (480) | (4) | (484) |
| **As at 30 September 2012** | 4,600 | 1,079 | 80 | 30 | 5,789 | 7 | 5,796 |
| **Year ended 30 September 2013** | | | | | | | |
| Profit after income tax expense | **-** | **711** | **-** | **-** | **711** | **3** | **714** |
| Net gains from changes in fair value | **-** | **-** | **23** | **30** | **53** | **-** | **53** |
| Income tax effect | **-** | **-** | **2** | **(8)** | **(6)** | **-** | **(6)** |
| Exchange differences | **-** | **-** | **1** | **-** | **1** | **-** | **1** |
| Income tax effect | **-** | **-** | **-** | **-** | **-** | **-** | **-** |
| Transferred to the income statement | **-** | **-** | **-** | **(22)** | **(22)** | **-** | **(22)** |
| Income tax effect | **-** | **-** | **-** | **6** | **6** | **-** | **6** |
| Actuarial gains on employee defined benefit obligations | **-** | **39** | **-** | **-** | **39** | **-** | **39** |
| Income tax effect | **-** | **(11)** | **-** | **-** | **(11)** | **-** | **(11)** |
| **Total comprehensive income for the year ended 30 September 2013** | **-** | **739** | **26** | **6** | **771** | **3** | **774** |
| Transaction with owners: | | | | | | | |
| Dividends paid on ordinary shares | **-** | **-** | **-** | **-** | **-** | **(4)** | **(4)** |
| **As at 30 September 2013** | **4,600** | **1,818** | **106** | **36** | **6,560** | **6** | **6,566** |

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

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

| $ millions | The Bank<br>Share Capital | Retained Profits | Available-for-sale Securities Reserve | Cash Flow Hedge Reserve | Total |
|---|---|---|---|---|---|
| **As at 1 October 2011** | 3,470 | 905 | 31 | 20 | 4,426 |
| **Year ended 30 September 2012** | | | | | |
| Profit after income tax expense | - | 602 | - | - | 602 |
| Net gains from changes in fair value | - | - | 66 | 18 | 84 |
| Income tax effect | - | - | (11) | (5) | (16) |
| Exchange differences | - | - | (6) | - | (6) |
| Income tax effect | - | - | - | - | - |
| Transferred to the income statement | - | - | - | (4) | (4) |
| Income tax effect | - | - | - | 1 | 1 |
| Actuarial losses on employee defined benefit obligations | - | (25) | - | - | (25) |
| Income tax effect | - | 7 | - | - | 7 |
| **Total comprehensive income for the year ended 30 September 2012** | - | 584 | 49 | 10 | 643 |
| Transaction with owners: | | | | | |
| Ordinary share capital issued | 1,130 | - | - | - | 1,130 |
| Dividends paid on ordinary shares | - | (480) | - | - | (480) |
| **As at 30 September 2012** | 4,600 | 1,009 | 80 | 30 | 5,719 |
| **Year ended 30 September 2013** | | | | | |
| Profit after income tax expense | **-** | **691** | **-** | **-** | **691** |
| Net gains from changes in fair value | **-** | **-** | **23** | **30** | **53** |
| Income tax effect | **-** | **-** | **2** | **(8)** | **(6)** |
| Exchange differences | **-** | **-** | **1** | **-** | **1** |
| Income tax effect | **-** | **-** | **-** | **-** | **-** |
| Transferred to the income statement | **-** | **-** | **-** | **(22)** | **(22)** |
| Income tax effect | **-** | **-** | **-** | **6** | **6** |
| Actuarial gains on employee defined benefit obligations | **-** | **39** | **-** | **-** | **39** |
| Income tax effect | **-** | **(11)** | **-** | **-** | **(11)** |
| **Total comprehensive income for the year ended 30 September 2013** | **-** | **719** | **26** | **6** | **751** |
| **As at 30 September 2013** | **4,600** | **1,728** | **106** | **36** | **6,470** |

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

## **Balance sheets** as at 30 September

| $ millions | Note | The Banking Group 2013 | 2012 | The Bank 2013 | 2012 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and balances with central banks | | **1,804** | 1,595 | **1,804** | 1,595 |
| Due from other financial institutions | 10 | **173** | 322 | **173** | 322 |
| Derivative financial instruments | 26 | **8** | 10 | **8** | 10 |
| Trading securities | 11 | **1,578** | 2,040 | **1,578** | 2,040 |
| Available-for-sale securities | 12 | **2,715** | 2,694 | **2,715** | 2,694 |
| Loans | 13, 14 | **61,585** | 59,422 | **61,479** | 59,303 |
| Due from related entities | 25 | **1,376** | 1,527 | **11,019** | 10,377 |
| Investments in controlled entities | | **-** | - | **281** | 281 |
| Investment in associate | 25 | **48** | 48 | **-** | - |
| Goodwill and other intangible assets | 15 | **660** | 598 | **660** | 598 |
| Property, plant and equipment | | **169** | 162 | **14** | 15 |
| Deferred tax assets | 16 | **180** | 209 | **161** | 189 |
| Other assets | 17 | **216** | 195 | **214** | 171 |
| **Total assets** | | **70,512** | 68,822 | **80,106** | 77,595 |
| **Liabilities** | | | | | |
| Due to other financial institutions | 18 | **100** | 3 | **100** | 3 |
| Deposits | 19 | **48,182** | 43,390 | **46,866** | 42,670 |
| Derivative financial instruments | 26 | **178** | 360 | **178** | 360 |
| Debt issues | 20 | **11,645** | 12,914 | **3,741** | 2,674 |
| Current tax liabilities | | **19** | 48 | **12** | 37 |
| Provisions | 21 | **77** | 83 | **77** | 83 |
| Other liabilities | 22 | **548** | 579 | **475** | 503 |
| **Total liabilities excluding related entities liabilities** | | **60,749** | 57,377 | **51,449** | 46,330 |
| Perpetual subordinated notes | 23 | **-** | 970 | **-** | 970 |
| Due to related entities | 25 | **3,197** | 4,679 | **22,187** | 24,576 |
| **Total related entities liabilities** | | **3,197** | 5,649 | **22,187** | 25,546 |
| **Total liabilities** | | **63,946** | 63,026 | **73,636** | 71,876 |
| **Net assets** | | **6,566** | 5,796 | **6,470** | 5,719 |
| **Equity** | | | | | |
| Share capital | 24 | **4,600** | 4,600 | **4,600** | 4,600 |
| Retained profits | | **1,818** | 1,079 | **1,728** | 1,009 |
| Available-for-sale securities reserve | | **106** | 80 | **106** | 80 |
| Cash flow hedge reserve | | **36** | 30 | **36** | 30 |
| **Total equity attributable to owners of the Banking Group** | | **6,560** | 5,789 | **6,470** | 5,719 |
| Non-controlling interests | | **6** | 7 | **-** | - |
| **Total equity** | | **6,566** | 5,796 | **6,470** | 5,719 |
| Interest earning and discount bearing assets | | **69,476** | 67,935 | **78,855** | 76,558 |
| Interest and discount bearing liabilities | | **59,359** | 57,999 | **68,934** | 66,834 |

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

Signed on behalf of the Board of Directors.

P.D. Wilson
21 November 2013

J.A. Dawson
21 November 2013

## Statements of cash flows for the year ended 30 September

| $ millions | The Banking Group Year Ended 30-Sep-13 | The Banking Group Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | The Bank Year Ended 30-Sep-12 |
|---|---|---|---|---|
| **Cash flows from operating activities** | | | | |
| Interest income received | **3,778** | 3,866 | **4,108** | 4,171 |
| Interest expense paid | **(2,236)** | (2,388) | **(2,579)** | (2,690) |
| Non-interest income received | **358** | 347 | **321** | 344 |
| Net loans advanced to customers | **(2,270)** | (2,026) | **(2,280)** | (2,040) |
| Net increase in deposits | **4,792** | 3,444 | **4,196** | 3,220 |
| Net decrease in trading securities | **449** | 3,178 | **449** | 3,178 |
| Net movement in derivative financial instruments | **(188)** | 339 | **(188)** | 339 |
| Operating expenses paid | **(735)** | (761) | **(759)** | (785) |
| Income tax paid | **(273)** | (220) | **(268)** | (215) |
| **Net cash provided by operating activities[1]** | **3,675** | 5,779 | **3,000** | 5,522 |
| **Cash flows from investing activities** | | | | |
| Purchase of available-for-sale securities | **(23)** | (1,179) | **(23)** | (1,179) |
| Proceeds from maturities of available-for-sale securities | **26** | 63 | **26** | 63 |
| Net decrease/(increase) in due from related entities | **151** | (10) | **(642)** | (866) |
| Purchase of capitalised computer software | **(97)** | (67) | **(97)** | (67) |
| Purchase of property, plant and equipment | **(37)** | (35) | **(4)** | (4) |
| Net cash acquired from the transfer of additional banking operations | **-** | (154) | **-** | (154) |
| **Net cash provided by/(used in) investing activities[1]** | **20** | (1,382) | **(740)** | (2,207) |
| **Cash flows from financing activities** | | | | |
| Issue of ordinary share capital | **-** | 1,130 | **-** | 1,130 |
| Net (decrease)/increase in debt issues | **(1,269)** | (4,716) | **1,067** | 1,076 |
| Net decrease in due to related entities | **(1,489)** | (227) | **(2,394)** | (4,941) |
| Decrease in perpetual subordinated notes | **(970)** | - | **(970)** | - |
| Payment of dividends | **(4)** | (484) | **-** | (480) |
| **Net cash used in financing activities[1]** | **(3,732)** | (4,297) | **(2,297)** | (3,215) |
| **Net (decrease)/increase in cash and cash equivalents** | **(37)** | 100 | **(37)** | 100 |
| Cash and cash equivalents at beginning of the year | **1,914** | 1,814 | **1,914** | 1,814 |
| **Cash and cash equivalents at end of the year** | **1,877** | 1,914 | **1,877** | 1,914 |
| **Cash and cash equivalents at end of the year comprise:** | | | | |
| Cash and balances with central banks | **1,804** | 1,595 | **1,804** | 1,595 |
| Due from other financial institutions (net) | **73** | 319 | **73** | 319 |
| | **1,877** | 1,914 | **1,877** | 1,914 |

1 The presentation of the Statements of cash flows has been revised this year to better reflect the nature of our business. Cash flows from loans and deposits have been reclassified from investing and financing activities, respectively, to operating activities. Comparative figures have been revised in order to ensure consistency. These changes have had no impact on the reported net (decrease)/increase in cash and cash equivalents.

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

# Notes to the financial statements

## Note 1 Statement of accounting policies

### 1.1 General accounting policies

### Statutory base

In these financial statements, reference is made to:

- Westpac New Zealand Limited (otherwise referred to as the '**Bank**').
- Westpac New Zealand Limited and its controlled entities (otherwise referred to as the '**Banking Group**').

These financial statements have been prepared and presented in accordance with the Financial Reporting Act 1993, the Reserve Bank of New Zealand Act 1989 and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order (No 2) 2013 ('**Order**'). The Bank's financial statements are for Westpac New Zealand Limited as a separate entity and the consolidated financial statements are for the Banking Group, which comprises the Bank and its controlled entities.

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

These financial statements were authorised for issue by the Board of Directors of the Bank (the '**Board**') on 21 November 2013. The Board has the power to amend the financial statements after they are authorised for issue.

### Basis of preparation

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

The same accounting policies and methods of computation have been followed in preparing these financial statements that were used in preparing the financial statements for the year ended 30 September 2012, except as amended for the changes required due to the adoption of the new and revised accounting standards as explained in Note 1.3 Changes in accounting policies.

Certain comparative information has been restated to ensure consistent treatment with the current reporting period. 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.

### Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiaries (including special purpose entities) controlled by the Bank and the results of those subsidiaries. The effects of all transactions between entities in the Banking Group are eliminated. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The definition of control is based on the substance rather than the legal form of an arrangement. In assessing control, potential voting rights that are presently exercisable or convertible are taken into account.

Subsidiaries are fully consolidated from the date on which control commences and they are de-consolidated from the date on which that control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Banking Group.

Changes in the Banking Group's ownership interest in a subsidiary after control is obtained that do not result in a loss of control are accounted for as transactions with equity holders in their capacity as equity holders. Any difference between the amount by which the non-controlling interest is adjusted and the fair value of the consideration paid or received is recognised directly in equity.

When the Banking Group ceases to control a subsidiary, any retained interest in the entity is remeasured to its fair value, with any resulting gain or loss recognised in the income statement.

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

The interest of non-controlling shareholders is stated at their proportion of the net profit and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly by the Bank. Losses are attributed to the non-controlling interest even if that results in a deficit balance.

### Foreign currency

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

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

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

## Note 1 Statement of accounting policies (continued)

### 1.2 Particular accounting policies

### Revenue recognition

***Interest income***

Interest income for all interest earning financial assets including those at fair value is recognised in the income statement using the effective interest method.

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

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

***Leasing***

Finance leases are accounted for under the net investment method whereby income recognition is based on a pattern reflecting a constant periodic rate of return on the net investment in the finance lease and is included as part of interest income.

***Fee and commission income***

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

***Other dividend income***

Dividends on quoted shares are recognised on the ex-dividend date. Dividends on unquoted shares are recognised when the company's right to receive payment is established.

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

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

### Expense recognition

***Interest expense***

Interest expense, including premiums or discounts and associated expenses incurred on the issue of financial liabilities, is recognised in the income statement using the effective interest method.

***Impairment charges on loans and receivables carried at amortised cost***

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

***Leasing***

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

***Commissions and other fees***

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

***Share-based payment***

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

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

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

## Note 1 Statement of accounting policies (continued)

### Taxation

***Income tax***

Income tax expense on the profit for the year comprises current tax and movement in deferred tax balances.

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

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

Current and deferred taxes attributable to amounts recognised in other comprehensive income are also recognised in other comprehensive income.

Except as noted above, deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. For presentation purposes deferred tax assets and deferred tax liabilities have been offset where they relate to income taxes levied by the same taxation authority on the same taxable entity or group of entities in the Banking Group.

***Goods and services tax***

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

### Business combinations

***External acquisitions***

The acquisition method of accounting is used to account for external business combinations. Cost is measured as the fair value of the assets given, equity instruments issued or liabilities incurred or assumed at the date of exchange. Acquisition-related costs are expensed as incurred. Where equity instruments are issued in an acquisition, the value of the instruments is their published market price as at the date of exchange. Transaction costs arising on the issue of equity instruments are recognised directly in equity.

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

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

***Common control transactions***

The predecessor method of accounting is used to account for business combinations between entities in the Banking Group.

Assets acquired and liabilities assumed in a common control transaction are measured initially at the acquisition date at the carrying value from the Ultimate Parent Bank's perspective. The excess of cost of acquisition over the initial carrying values of the entity's share of the net assets acquired is recorded as part of a common control reserve.

### Assets

***Financial assets***

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

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

Other investments, which comprise unlisted equity securities that do not have a quoted price in an active market and where fair value cannot be estimated within a reasonable range of probable outcomes, are carried at cost.

## Note 1 Statement of accounting policies (continued)

***Recognition and measurement of financial assets***

Purchases and sales of financial assets at fair value through profit or loss and available-for-sale are recognised on the trade-date, the date on which the Banking Group commits to purchase or sell the asset. Loans and receivables are recognised when cash is advanced to the borrower. Financial assets at fair value through profit or loss are recognised initially at fair value. All other financial assets are recognised initially at fair value plus directly attributable transaction costs.

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

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

***Derecognition of financial assets***

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

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

Where the Banking Group transfers its right to receive cash flows from an asset or has entered into a pass-through arrangement without transferring nor retaining substantially all the risks and rewards of ownership nor transferred control of these assets, the asset continues to be recognised on the balance sheet to the extent of the Banking Group's continuing involvement in the asset.

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

Cash and balances with central banks include cash at branches, central bank settlement account balances and nostro balances. They are brought to account at the face value or the gross value of the outstanding balance, where appropriate. These balances have a maturity of less than three months.

***Due from other financial institutions***

Due from other financial institutions includes collateral placed, loans and settlement account balances due from other financial institutions. They are accounted for as loans and receivables and subsequently measured at amortised cost using the effective interest method.

***Derivative financial instruments***

Derivative financial instruments, including forwards, futures, swaps and options, are recognised in the balance sheet at fair value. Fair value is obtained from quoted market prices, independent dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying instrument. Also included in the determination of the fair value of derivatives is a credit valuation adjustment ('**CVA**'). Where the derivative has a positive fair value (asset), this credit adjustment is to reflect the credit worthiness of the counterparty. Where the derivative has a negative fair value (liability), this credit adjustment reflects the Banking Group's own credit risk. These credit adjustments are taken into account after considering any relevant collateral or master netting agreements.

***Trading securities***

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

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

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

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

***Loans***

Loans include advances, overdrafts, housing loans, credit card and other personal lending, term loans and leasing receivables. The accounting policy for loans and receivables is set out above.

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

Loan products that have both a mortgage and deposit facility are presented on a gross basis in the balance sheet, segregating the loan and deposit component into the respective balance sheet line items. Interest earned on this product is presented on a net basis in the income statement as this reflects how the customer is charged.

## Note 1 Statement of accounting policies (continued)

***Due from related entities***

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

***Impairment of financial assets***

Impaired financial assets include:

- individually impaired assets, which are defined as assets where an individual provision has been raised to cover the expected loss for which full recovery of principal is doubtful; and
- restructured assets, which are defined as assets in which the original contractual terms have been formally modified to provide for concessions of interest or principal for reasons related to the financial difficulties of the customer.

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

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

The following accounting policies apply to the impairment of financial assets:

*i) Assets carried at amortised cost*

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

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

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

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

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

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

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

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

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

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

If there is objective evidence that an impairment on loans and receivables has been incurred, the amount of the charge is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment is the current effective interest rate determined under the contract. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

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

## Note 1 Statement of accounting policies (continued)

*ii) Available-for-sale*

The Banking Group assesses at each reporting date whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt instruments classified as available-for-sale, impairment is determined using the same methodology as Note 1 – Impairment of financial assets (i) Assets carried at amortised cost. For equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is also considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment charge on that financial asset previously recognised in the income statement – is removed from other comprehensive income and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment charge was recognised in the income statement, the impairment charge is reversed through the income statement. Subsequent reversal of impairment charges on equity instruments is not recognised in the income statement.

***Non-financial assets***

***Investments in controlled entities and associates***

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

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

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

***Goodwill and other intangible assets***

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

All goodwill is considered to have an indefinite life.

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

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

Goodwill was last tested for impairment as at 30 September 2013 and no impairment has been recognised in the income statement.

Other intangible assets are stated at cost less accumulated amortisation and impairment. Other intangible assets consist of acquired and internally developed computer software.

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

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

***Property, plant and equipment***

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

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

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

***Other assets***

Other assets include accrued interest receivable, trade debtors and prepayments.

## Note 1 Statement of accounting policies (continued)

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

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

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

### Liabilities

***Financial liabilities***

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

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

***Recognition and measurement of financial liabilities***

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

***Derecognition of financial liabilities***

A financial liability is derecognised when the obligation under the liability 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 financial liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

***Due to other financial institutions***

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

***Deposits at fair value***

Deposits at fair value represent certificates of deposits. They are classified at fair value through profit or loss as they are managed as part of a trading portfolio.

***Deposits at amortised cost***

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

***Derivative financial instruments***

Derivative financial instruments, including forwards, futures, swaps and options, are recognised in the balance sheet at fair value. Fair values are obtained from quoted market prices, independent dealer price quotations, discounted cash flow models and option pricing models, which incorporate current market and contractual prices for the underlying instrument, time to expiry, yield curves and volatility of the underlying instrument. Also included in the determination of the fair value of derivatives is a CVA. Where the derivative has a positive fair value (asset), this credit adjustment is to reflect the credit worthiness of the counterparty. Where the derivative has a negative fair value (liability), this credit adjustment reflects the Banking Group's own credit risk. These credit adjustments are taken into account after considering any relevant collateral or master netting agreements.

***Trading liabilities***

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

***Debt issues***

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

## Note 1 Statement of accounting policies (continued)

***Financial guarantees***

Financial guarantee contracts are recognised as financial liabilities at the time the guarantee is issued. The liability is initially measured at fair value and subsequently at the higher of the amount determined in accordance with New Zealand International Accounting Standard ('**NZ IAS**') 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less cumulative amortisation, where appropriate.

The fair value of a financial guarantee contract is determined as the present value of the difference in net cash flows between the contractual payments under the debt instrument and the payments that would be required without the guarantee, or the estimated amount that would be payable to a third party for assuming the obligation.

***Other liabilities***

Other liabilities include accrued interest payable, amounts outstanding on the credit card loyalty programme, trade creditors, other accrued expenses and the deficit arising from the defined benefit superannuation scheme.

***Perpetual subordinated notes***

Perpetual subordinated notes are measured at amortised cost and qualified as Upper Tier Two Capital, as defined by the Reserve Bank of New Zealand ('**Reserve Bank**') for capital adequacy purposes.

***Due to related entities***

This amount includes amounts due to controlled entities of the Banking Group and all other entities controlled by the Ultimate Parent Bank.

### Employee entitlements

***Wages and salaries, annual leave and sick leave***

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

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

***Long service leave***

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

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

***Superannuation obligations***

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

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

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

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

***Termination benefits***

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

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

### Provisions

***Provision for litigation and non-lending losses***

A provision for litigation is recognised where it is probable that there will be an outflow of economic resources. Non-lending losses are any losses that have not arisen as a consequence of an impaired credit decision. Those provisions include litigation and associated costs, frauds and the correction of operational issues.

## Note 1 Statement of accounting policies (continued)

***Provision for impairment on credit commitments***

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

***Provision for restructuring***

A provision for restructuring is recognised where there is a demonstrable commitment and a detailed plan such that there is little or no discretion to avoid payments to other parties and the amount can be reliably estimated.

***Provision for leasehold premises***

The provision for leasehold premises covers net outgoings on certain unoccupied leased premises or sub-let premises where projected rental income falls short of rental expense. The liability is determined on the basis of the present value of net future cash flows.

### Equity and reserves

***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***

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

***Cash flow hedge reserve***

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

***Non-controlling interests***

Non-controlling interests represent the share in the net assets of subsidiaries attributable to equity interests that are not owned directly or indirectly by the parent entity.

### Hedging

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

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

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

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

***Fair value hedge***

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

If the hedge no longer meets the criteria for hedge accounting, any previous adjustment to the carrying amount of a hedged item recognised at amortised cost is amortised to the income statement over the period to maturity.

***Cash flow hedge***

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to any ineffective portion is recognised immediately in the income statement. When a hedging instrument expires or is sold, terminated or exercised, or when the hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in the period in which the hedged item affects profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the income statement.

### Embedded derivatives

In certain instances a derivative may be embedded in a host contract. If the host contract is not carried at fair value through profit or loss, the embedded derivative is separated from the host contract and accounted for as a stand-alone derivative instrument at fair value where the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

## Note 1 Statement of accounting policies (continued)

### Recognition of deferred day one profit or loss

The best evidence of fair value at initial recognition is the transaction price, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument, or based on a valuation technique whose variables include only data from observable markets.

The Banking Group may enter into transactions where fair value is determined using valuation models for which not all significant inputs are market observable prices or rates. Such a financial instrument is initially recognised at the transaction price which is the best indicator of fair value, although the value obtained from the relevant valuation model may differ. The difference between the transaction price and the model value, commonly referred to as 'day one profit or loss', is not recognised immediately in profit or loss.

The timing of recognition of deferred day one profit or loss is determined individually. It is either amortised over the life of the transaction, deferred until the instrument's fair value can be determined using market observable inputs, or realised through settlement. The financial instrument is subsequently measured at fair value, adjusted for the deferred day one profit or loss. Subsequent changes in fair value are recognised immediately in the income statement without reversal of deferred day one profits or losses.

### Loan securitisation

The Banking Group, through its loan securitisation programme, packages and sells loans (principally housing mortgage loans) as securities to investors. In such transactions, the Banking Group provides an equitable interest in the loans to investors who provide funding to the Banking Group. Securitised loans that do not qualify for derecognition and the associated funding are included in loans and debt issues respectively.

### Leases

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

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

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

### Offsetting

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

### Securities borrowed or lent and repurchase or reverse repurchase agreements

The Banking Group lends and borrows securities on a collateralised basis. The securities subject to the borrowing or lending are not derecognised from the balance sheet, as the risks and rewards of ownership remain with the initial holder. Where cash is provided as collateral, the cash paid to third parties on securities borrowed is recorded as a receivable, while cash received from third parties on securities lent is recorded as a borrowing. Repurchase transactions, where the Banking Group sells securities under an agreement to repurchase, and reverse repurchase transactions, where the Banking Group purchases securities under an agreement to resell, are conducted on a collateralised basis. Trading securities sold, but subject to repurchase agreements are disclosed as part of trading liabilities. Fees and interest relating to stock borrowing or lending and repurchase or reverse repurchase agreements are recognised in interest income and interest expense in the income statement, using the effective interest rate method, over the expected life of the agreements. The Banking Group continually reviews the fair value of the underlying securities and, where appropriate, requests or provides additional collateral to support the transactions.

### Segment reporting

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

### Statement of cash flows

***Basis of presentation***

The statement of cash flows has been presented in accordance with NZ IAS 7 *Statement of Cash Flows* with netting of certain items as disclosed below.

***Cash and cash equivalents***

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

## Note 1 Statement of accounting policies (continued)

***Netting of cash flows***

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

### 1.3 Changes in accounting policies

From 1 October 2012, the Banking Group applied *Presentation of Items of Other Comprehensive Income* (Amendments to NZ IAS 1 *Presentation of Financial Statements*). The change only relates to disclosures and has had no impact on consolidated net income. The changes have been applied retrospectively and require the Banking Group to separately present those items of other comprehensive income that may be reclassified to profit or loss in the future from those that will never be reclassified to profit or loss. These changes are included in the statements of comprehensive income.

### 1.4 Future accounting developments

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

- *Disclosures – Offsetting Financial Assets and Financial Liabilities* (Amendments to NZ IFRS 7 *Financial Instruments: Disclosures* ('**NZ IFRS 7**')) was issued in February 2012 and will be effective to the Banking Group in the 2014 financial year. The amendment requires disclosure of information that will enable users to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with recognised financial assets and financial liabilities on the Banking Group's balance sheet. The amendment is expected to result in additional disclosures.
- NZ IFRS 9 *Financial Instruments* – If this standard is not early adopted it will be effective to the Banking Group in the 2016 financial year. The major changes under the standard are that:
  - it replaces the multiple classification and measurement models in NZ IAS 39 *Financial Instruments: Recognition and Measurement* with a single model that has two classification categories: amortised cost and fair value;
  - a financial asset is measured at amortised cost if two criteria are met: a) the objective of the business model is to hold the financial assets for the collection of the contractual cash flows; and b) the contractual cash flows under the instrument solely represent the payment of principal and interest;
  - if a financial asset is eligible for amortised cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch;
  - there will be no separation of an embedded derivative where the instrument is a financial asset;
  - equity instruments must be measured at fair value, however, an entity can elect on initial recognition to present the fair value changes on an equity investment directly in other comprehensive income. There is no subsequent recycling of fair value gains and losses to profit or loss, however, dividends from such investments will continue to be recognised in profit or loss;
  - if an entity holds an investment in asset-backed securities it must determine the classification of that investment by looking through to the underlying assets and assess the credit quality of the investment compared with the underlying portfolio of assets. If an entity is unable to look through, then the investment must be measured at fair value; and
  - the portion of a change of fair value relating to the entity's own credit risk for financial liabilities measured at fair value utilising the fair value option is presented in other comprehensive income, except when that would create an accounting mismatch. If such a mismatch would be created or enlarged, the entity is required to present all changes in fair value (including the effects of changes in the credit risk of the liability) in profit or loss.

  The IASB currently has an active project that may result in limited amendments to the classification and measurement requirements of NZ IFRS 9 and add new requirements to address the impairment of financial assets and hedge accounting.

  The standard will impact the classification and measurement of the Banking Group's financial instruments when adopted.
- NZ IFRS 10 *Consolidated Financial Statements* ('**NZ IFRS 10**'), NZ IFRS 11 *Joint Arrangements* ('**NZ IFRS 11**') and NZ IFRS 12 *Disclosure of Interests in Other Entities* ('**NZ IFRS 12**') – These new standards were issued in June 2011 and will be effective to the Banking Group in the 2014 financial year.
  - NZ IFRS 10 changes the definition of control and requires that it be applied to all entities to determine whether control exists. The new definition focuses on the need for both power and exposure to variability of returns in order for control to be present.

    NZ IFRS 10 replaces guidance on control and consolidation in NZ IAS 27 *Consolidated and Separate Financial Statements* ('**NZ IAS 27**') and NZ Equivalent to Standing Interpretations Committee Interpretation 12 *Consolidation – Special Purpose Entities* ('**NZ SIC 12**'). The core principle that a consolidated entity presents a parent and its subsidiaries as if they are a single economic entity remains unchanged, as do the mechanics of consolidation.

    The standard introduces a single definition of control that applies to all entities. It focuses on the need to have both power and rights or exposure to variable returns. Power is the current ability to direct the activities that significantly influence returns. Returns must vary and can be positive, negative or both.

    Control exists when the investor can use its power to affect the amount of its returns. There is also new guidance on participating and protective rights and on agent/principal relationships.

    The Banking Group does not expect NZ IFRS 10 to have a material impact on the composition of its controlled entities.
  - NZ IFRS 11 introduces a principles-based approach to accounting for joint arrangements. The focus is no longer on the legal structure of joint arrangements, but rather on how rights and obligations are shared by the parties to the joint arrangement. Based on the assessment of rights and obligations, a joint arrangement will be classified as either a joint operation or a joint venture. Joint ventures are accounted for using the equity method, and the choice to proportionately consolidate will no longer be permitted. Parties to a joint operation will account for their share of revenues, expenses, assets and liabilities in much the same way as under the previous standard. Application of NZ IFRS 11 is not expected to have a material impact on the Banking Group.

## Note 1 Statement of accounting policies (continued)

  - NZ IFRS 12 sets out the required disclosures for entities reporting under the two new standards, NZ IFRS 10 and NZ IFRS 11, and replaces the disclosure requirements currently found in NZ IAS 27 *Consolidated and Separate Financial Statements* and NZ IAS 28 *Investments in Associates* ('**NZ IAS 28**'). Application of this standard by the Banking Group will not affect any of the amounts recognised in the financial statements, but will impact the type of information disclosed in relation to the Banking Group's investments.
- NZ IFRS 13 *Fair Value Measurement* ('**NZ IFRS 13**') – The new standard was issued in June 2011 and will be effective to the Banking Group in the 2014 financial year. The new standard replaces existing guidance on fair value measurement in several standards with a single, unified definition of fair value and a framework for measuring and disclosing fair values. NZ IFRS 13 applies to all assets and liabilities measured at fair value, not just financial instruments. The new standard is not expected to have a material impact on the Banking Group.
- NZ IAS 19 *Employee Benefits* ('**NZ IAS 19**') – The amendments were issued in August 2011 and will be effective to the Banking Group in the 2014 financial year. The amendments require entities to account immediately, in retained earnings, for all estimated changes in the cost of providing these benefits and all changes in the value of plan assets (often referred to as the removal of the 'corridor amount'). It is estimated that the adoption of the revisions to NZ IAS 19 will have the following impact on the financial statements:

| $ millions | The Banking Group and the Bank 2013 | 2012 |
|---|---|---|
| Decrease in deferred tax assets at 30 September | **5** | 6 |
| Decrease in defined benefit obligation at 30 September | **18** | 22 |
| Increase to equity at 1 October | **13** | 16 |

- NZ IAS 27 *Separate Financial Statements* – The amendments were issued in June 2011 and will be effective to the Banking Group in the 2014 financial year. The amendments remove the accounting and disclosure requirements for consolidated financial statements as a result of the issuance of NZ IFRS 10 and NZ IFRS 12. It is not expected to have a material impact on the Banking Group.
- NZ IAS 28 *Investments in Associates and Joint Ventures* ('**Revised NZ IAS 28**') – The standard was issued in June 2011 and will be effective to the Banking Group in the 2014 financial year. This standard supersedes NZ IAS 28 as a result of the issuance of NZ IFRS 12. It is not expected to have a material impact on the Banking Group.
- *Offsetting Financial Assets and Financial Liabilities* (Amendments to NZ IAS 32 *Financial Instruments: Presentation* ('**NZ IAS 32**')) was issued in February 2012 and will be effective to the Banking Group in the 2015 financial year. The amendment provides application guidance to addressing inconsistencies applied to offsetting criteria provided in NZ IAS 32, including clarifying that the meaning of 'current legal enforceable rights of set-off' is legally enforceable in all circumstances and that some gross settlement systems (such as through a clearing house) may be considered as the equivalent to net settlement. The amendment is not expected to have a material impact on the Banking Group.
- *Annual Improvements 2009 – 2011 Cycle* was issued in June 2012 and will be effective to the Banking Group in the 2014 financial year. The amendments relate to the following:
  - NZ IAS 1 – clarifies the difference between voluntary additional comparative information and the minimum required comparative information. Generally, the minimum required comparative period is the previous period.
  - NZ IAS 32 – clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with NZ IAS 12 *Income Taxes*.
  - NZ IAS 34 – clarifies the requirements in NZ IAS 34 relating to segment information for total assets and liabilities for each reportable segment to enhance consistency with the requirements in NZ IFRS 8 *Operating Segments*.

  The amendments are not expected to have a material impact on the Banking Group.

### 1.5 Critical accounting estimates, judgments and assumptions

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

### Critical accounting estimates, judgments and assumptions

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

***Fair value of financial instruments***

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

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

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

## Note 1 Statement of accounting policies (continued)

The calculation of fair value for any financial instrument may also require adjustment of the quoted price or model value to reflect the cost of credit risk (where not embedded in underlying models or prices used). The process of calculating fair value on illiquid instruments or from a valuation model may require estimation of certain pricing parameters, assumptions or model characteristics.

These estimates are calibrated against industry standards, economic models and observed transaction prices.

The fair value of financial instruments is provided in Note 27 as well as the mechanism by which fair value has been derived.

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

***Provisions for impairment charges on loans and credit commitments***

The Banking Group's loan impairment provisions are established to recognise incurred impairment in its portfolio of loans. A loan is impaired when there is objective evidence that events occurring since the loan was recognised have affected expected cash flows from the loan. The impairment charge is the difference between the carrying value of the loan and the present value of estimated future cash flows calculated at the loan's original effective interest rate for fixed rate loans and the loan's current effective interest rate for variable rate loans. Provisions for loan impairment represent management's estimate of the impairment charges incurred in the loan portfolios as at the balance date. Changes to the provisions for loan impairment and changes to the provisions for undrawn contractually committed facilities and guarantees provided are reported in the income statement as part of the impairment charges on loans.

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

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

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

The provisions for impairment charges on loans are disclosed in Note 13 and Note 14 whilst the provisions for impairment on credit commitments are disclosed in Note 21. The impairment charge reflected in the income statement is disclosed in Note 7.

***Goodwill***

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

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

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

The assumptions applied to determine if any impairment exists along with the carrying amount of goodwill, are outlined in Note 15.

***Superannuation obligations***

The Banking Group operates a defined benefit superannuation scheme for staff in New Zealand. For this scheme, actuarial valuation of the scheme's obligations and the fair value measurements of the scheme's assets are performed annually in accordance with the requirements of NZ IAS 19.

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

## Note 1 Statement of accounting policies (continued)

The carrying amount and the primary assumptions used in the calculation of superannuation defined benefit obligation are disclosed in Note 22 and Note 30.

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

Provisions are held in respect of a range of obligations such as employee entitlements, restructuring costs, litigation provisions, non-lending losses and onerous contracts as disclosed in Note 21. Some of the provisions involve significant judgment about the likely outcome of various events and estimated future cash flows. Payments which are expected to be incurred after more than one year are discounted at a rate which reflects both current interest rates and the risks specific to that provision.

***Income taxes***

The Banking Group is subject to income taxes in New Zealand and jurisdictions where it has foreign operations. Significant judgment is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax outcome is unclear. Provisions for tax are held to reflect these uncertainties.

The Banking Group estimates its tax liabilities based on the Banking Group's understanding of the tax law. Where the final outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current and deferred tax provisions in the period when such determinations are made.

Refer to Note 16 for details of the Banking Group's deferred tax balances.

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

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

Under NZ GAAP, an SPV is consolidated and reported as part of the Banking Group if it is controlled by the parent entity in line with NZ IAS 27 or deemed to be controlled in applying NZ SIC 12. The definition of control is based on the substance rather than the legal form of the arrangement. As it can sometimes be difficult to determine whether the Banking Group controls an SPV, management makes judgments about the Banking Group's exposure to the associated risks and rewards, as well as its ability to make operational decisions for the SPV.

## Note 2 Business combination – transfer of operations

Until 1 November 2006, the Ultimate Parent Bank conducted its operations in New Zealand through a branch structure. On that date, and after extensive consultation with the Reserve Bank, the Ultimate Parent Bank adopted a dual operating model including a locally incorporated subsidiary, the Bank, to conduct its consumer and business banking operations in New Zealand, and a branch of the Ultimate Parent Bank ('**NZ Branch**') to conduct its institutional and financial markets operations.

Following an independent review of the structure of the operating model of the Ultimate Parent Bank's business in New Zealand, the Reserve Bank, the Bank and the Ultimate Parent Bank reached agreement on changes to the operating model. On 1 November 2011, assets and liabilities associated with certain business activities formerly conducted by the NZ Branch were transferred to the Bank. The transfer occurred pursuant to the Westpac New Zealand Act 2011.

The following business activities were transferred to the Bank:

- institutional customer deposits;
- institutional customer transactional banking;
- institutional customer lending (other than trade financing activities);
- debt capital markets activities carried out in assisting corporate customers to obtain funding, such as loan syndication and securitisation arrangements, but excluding the debt securities team activities, such as arrangement of commercial paper and bond programmes;
- corporate advisory; and
- institutional customer foreign currency accounts.

The NZ Branch has retained:

- financial markets operations for external customers, including sales and trading of capital markets products and foreign exchange for corporate and institutional customers;
- pricing and risk management for interest rate, foreign exchange and commodity products for consumer, business and institutional customers of the Bank;
- trading of capital markets products and foreign exchange as principal;
- global intra-group financing functions;
- correspondent bank relationships;
- debt securities team activities, such as arrangement of commercial paper and bond programmes; and
- international business, including trade finance activities but excluding customer foreign currency accounts.

The acquisition involved the transfer to the Bank of $6,446 million of assets consisting primarily of loans to corporate customers of $6,336 million and $5,303 million of liabilities consisting primarily of deposits of $5,060 million.

### Funding of acquisition

To fund the purchase of the assets and liabilities relating to the business activities transferred from the NZ Branch (as well as the additional liquid assets required to be held by the Banking Group as a result of the transfer), a loan of $3.1 billion was provided to the Bank by the NZ Branch and the Bank raised $1,130 million in additional share capital.

The loan of $3.1 billion was for a period of three years and was priced at the New Zealand Bank Bill Reference Rate plus a margin that reflected market pricing on 1 November 2011 (refer to Note 25).

The Bank issued a total of 1,130 million additional ordinary shares for $1 per share to the Bank's immediate parent company, Westpac New Zealand Group Limited ('**WNZGL**'), in connection with the transfer. On 28 October 2011, the Bank issued 900 million ordinary shares for $1 per share, and on 31 October 2011, the Bank issued an additional 230 million ordinary shares for $1 per share. Immediately prior to the issuance of these additional 230 million ordinary shares, the Bank paid a dividend to WNZGL of $230 million.

### Compliance with condition of registration 14 and BS13 requirements (unaudited)

As a result of the transfer of the business activities set out above, the Banking Group is required to hold additional liquid assets in order to comply with condition of registration 14, which relates to liquidity, and the Reserve Bank document 'Liquidity Policy' (BS13). These liquid assets were acquired through a combination of on market purchases and a purchase of liquid assets from the NZ Branch. The Banking Group was compliant with both condition of registration 14 and BS13 immediately following the transfer on 1 November 2011.

## Note 2 Business combination – transfer of operations (continued)

### Assets and liabilities transferred from NZ Branch to the Bank as at 1 November 2011

| $ millions | Assets and Liabilities Transferred As at 1 November 2011 |
|---|---|
| **Assets** | |
| Cash and balances with central banks | **58** |
| Loans | **6,336** |
| Deferred tax assets | **28** |
| Other assets | **24** |
| **Total assets** | **6,446** |
| **Liabilities** | |
| Due to other financial institutions | **212** |
| Deposits | **5,060** |
| Provisions | **12** |
| Other liabilities | **19** |
| **Total liabilities** | **5,303** |
| **Net assets acquired** | **1,143** |

### Contingent liabilities and commitments transferred from the NZ Branch to the Bank as at 1 November 2011

| $ millions | The Bank As at 1 November 2011 |
|---|---|
| **Contingent liabilities and commitments** | |
| Transaction-related contingent items | **421** |
| Short-term, self-liquidating trade-related contingent liabilities | **107** |
| Other commitments to provide financial services | **6,464** |
| **Total contingent liabilities and commitments** | **6,992** |

### Consideration paid for the business transferred from the NZ Branch to the Bank on 1 November 2011

| $ millions | The Bank As at 1 November 2011 |
|---|---|
| **Consideration transferred** | |
| Intragroup payables | **3,100** |
| Trading securities | **(1,957)** |
| **Total consideration transferred** | **1,143** |

## Note 2 Business combination – transfer of operations (continued)

### Impact of the transferred business activities on the Banking Group

| $ millions | Note | The Banking Group<br>Pre-existing Operations | Transferred Operations[1] | Total |
|---|---|---|---|---|
| **For the year ended 30 September 2012** | | | | |
| **Net interest income** | 3 | **1,362** | **137** | **1,499** |
| Non-interest income: | | | | |
| Fees and commissions | 4 | **302** | **34** | **336** |
| Net ineffectiveness on qualifying hedges | 4 | **1** | **-** | **1** |
| Other non-interest income | 4 | **19** | **-** | **19** |
| **Total non-interest income** | | **322** | **34** | **356** |
| **Net operating income** | | **1,684** | **171** | **1,855** |
| Operating expenses | | **(788)** | **(19)** | **(807)** |
| Impairment charges on loans | 7 | **(178)** | **(12)** | **(190)** |
| Share of profit of associate accounted for using equity method | | **1** | **-** | **1** |
| **Profit before income tax expense** | | **719** | **140** | **859** |
| Income tax expense | | **(206)** | **(40)** | **(246)** |
| **Profit after income tax expense** | | **513** | **100** | **613** |

1 Represents the 11 month result of the transferred business operations since the acquisition date on 1 November 2011, as included in the Banking Group's consolidated income statement.

### Impact of the transferred business activities on the Bank

| $ millions | Note | The Bank<br>Pre-existing Operations | Transferred Operations[1] | Total |
|---|---|---|---|---|
| **For the year ended 30 September 2012** | | | | |
| **Net interest income** | 3 | **1,346** | **137** | **1,483** |
| Non-interest income: | | | | |
| Fees and commissions | 4 | **301** | **34** | **335** |
| Net ineffectiveness on qualifying hedges | 4 | **1** | **-** | **1** |
| Other non-interest income | 4 | **8** | **-** | **8** |
| **Total non-interest income** | | **310** | **34** | **344** |
| **Net operating income** | | **1,656** | **171** | **1,827** |
| Operating expenses | | **(790)** | **(19)** | **(809)** |
| Impairment charges on loans | 7 | **(168)** | **(12)** | **(180)** |
| **Profit before income tax expense** | | **698** | **140** | **838** |
| Income tax expense | | **(196)** | **(40)** | **(236)** |
| **Profit after income tax expense** | | **502** | **100** | **602** |

1 Represents the 11 month result of the transferred business operations since the acquisition date on 1 November 2011, as included in the Bank's income statement.

### Transferred business activities for the year ended 30 September 2012

| $ millions | The Banking Group and the Bank<br>Pre-acquisition result[1] | Transferred Operations[2] | Total |
|---|---|---|---|
| **For the year ended 30 September 2012** | | | |
| **Net interest income** | **16** | **137** | **153** |
| Non-interest income: | | | |
| Fees and commissions | **4** | **34** | **38** |
| **Total non-interest income** | **4** | **34** | **38** |
| **Net operating income** | **20** | **171** | **191** |
| Operating expenses | **(2)** | **(19)** | **(21)** |
| Impairment charges on loans | **2** | **(12)** | **(10)** |
| **Profit before income tax expense** | **20** | **140** | **160** |
| Income tax expense | **(5)** | **(40)** | **(45)** |
| **Profit after income tax expense** | **15** | **100** | **115** |

1 Represents the pre-acquisition result of the transferred business operations from 1 October 2011 through 31 October 2011.
2 Represents the 11 month result of the transferred business operations since the acquisition date on 1 November 2011, as included in the Banking Group's consolidated income statement.

## Note 3 Net interest income

| $ millions | The Banking Group Year Ended 30-Sep-13 | The Banking Group Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | The Bank Year Ended 30-Sep-12 |
|---|---|---|---|---|
| **Interest income** | | | | |
| Cash and balances with central banks | **40** | 30 | **40** | 30 |
| Trading securities | **75** | 94 | **75** | 94 |
| Available-for-sale securities | **113** | 104 | **113** | 104 |
| Loans | **3,469** | 3,557 | **3,457** | 3,540 |
| Impaired assets | **43** | 51 | **40** | 51 |
| Related entities | **28** | 45 | **372** | 368 |
| **Total interest income**[1] | **3,768** | 3,881 | **4,097** | 4,187 |
| **Interest expense** | | | | |
| Due to other financial institutions | **-** | 2 | **-** | 2 |
| Deposits | **1,475** | 1,364 | **1,438** | 1,338 |
| Debt issues | **352** | 392 | **157** | 144 |
| Other[2] | **405** | 624 | **983** | 1,220 |
| **Total interest expense**[3] | **2,232** | 2,382 | **2,578** | 2,704 |
| **Net interest income** | **1,536** | 1,499 | **1,519** | 1,483 |

1 Total interest income for financial assets that are not at fair value through profit or loss is $3,682 million (30 September 2012: $3,787 million) for the Banking Group and $4,011 million (30 September 2012: $4,093 million) for the Bank.

2 Includes interest expense due to related entities (including perpetual subordinated notes) and the net impact of Treasury balance sheet management activities (refer to note 25).

3 Total interest expense for financial liabilities that are not at fair value through profit or loss is $2,109 million (30 September 2012: $2,215 million) for the Banking Group and $2,517 million (30 September 2012: $2,660 million) for the Bank.

In the current year, the presentation of interest income and interest expense relating to certain related entity transactions has been revised to better reflect the net impact of the underlying transactions. To improve presentation, comparative figures have been revised for interest income – related entities for the Banking Group (2012: $45 million) and the Bank (2012: $368 million) respectively and interest expense – other for the Banking Group (2012: $624 million) and the Bank (2012: $1,220 million) respectively. The revised presentation has no impact on total net interest income for the year ended 30 September 2012.

## Note 4 Non-interest income

| $ millions | The Banking Group Year Ended 30-Sep-13 | The Banking Group Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | The Bank Year Ended 30-Sep-12 |
|---|---|---|---|---|
| **Fees and commissions** | | | | |
| Transaction fees and commissions | **262** | 244 | **256** | 239 |
| Lending fees (loan and risk) | **62** | 56 | **61** | 56 |
| Management fees received from related entities | **4** | 3 | **6** | 6 |
| Other non-risk fee income | **30** | 33 | **31** | 34 |
| **Total fees and commissions** | **358** | 336 | **354** | 335 |
| **Net ineffectiveness on qualifying hedges** | **1** | 1 | **1** | 1 |
| **Other non-interest income** | | | | |
| Net gains on derivatives held for trading | **-** | 3 | **-** | 3 |
| Dividend income | **2** | 2 | **2** | 1 |
| Other | **10** | 14 | **1** | 4 |
| **Total other non-interest income** | **12** | 19 | **3** | 8 |
| **Total non-interest income** | **371** | 356 | **358** | 344 |

In the current year, the presentation of certain transactions of the Banking Group and the Bank has been revised to better reflect the nature of the underlying transactions. The revised presentation has no impact on total non-interest income for the year ended 30 September 2012.

## Note 5 Operating expenses

| $ millions | The Banking Group Year Ended 30-Sep-13 | The Banking Group Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | The Bank Year Ended 30-Sep-12 |
|---|---|---|---|---|
| **Salaries and other staff expenses** | | | | |
| Salaries and wages | **371** | 360 | **370** | 358 |
| Employee entitlements | **11** | 10 | **11** | 10 |
| Superannuation costs: | | | | |
| Defined contribution scheme | **27** | 25 | **27** | 25 |
| Share-based payments | **4** | 5 | **4** | 5 |
| Restructuring costs | **5** | 4 | **5** | 4 |
| Other | **9** | 6 | **9** | 6 |
| **Total salaries and other staff expenses** | **427** | 410 | **426** | 408 |
| **Equipment and occupancy expenses** | | | | |
| Operating lease rentals: | | | | |
| Related entities (refer to Note 25) | **-** | - | **101** | 98 |
| Other | **65** | 62 | **8** | 8 |
| Depreciation: | | | | |
| Leasehold improvements | **15** | 16 | **-** | - |
| Furniture and equipment | **12** | 11 | **5** | 4 |
| Equipment repairs and maintenance | **9** | 9 | **4** | 3 |
| Electricity, water and rates | **2** | 2 | **-** | - |
| Other | **9** | 6 | **2** | 1 |
| **Total equipment and occupancy expenses** | **112** | 106 | **120** | 114 |
| **Other expenses** | | | | |
| Software amortisation costs | **35** | 38 | **35** | 38 |
| Non-lending losses (refer to Note 21) | **2** | 3 | **2** | 3 |
| Consultancy fees and other professional services | **59** | 67 | **56** | 63 |
| Auditors' remuneration (refer to Note 6) | **2** | 2 | **1** | 2 |
| Stationery | **13** | 12 | **13** | 12 |
| Postage and freight | **18** | 18 | **15** | 15 |
| Advertising | **28** | 28 | **28** | 28 |
| Training | **3** | 3 | **3** | 3 |
| Travel | **6** | 10 | **6** | 10 |
| Outsourcing | **88** | 93 | **88** | 93 |
| Related entities - management fees (refer to Note 25) | **3** | 4 | **9** | 9 |
| Other | **14** | 13 | **12** | 11 |
| **Total other expenses** | **271** | 291 | **268** | 287 |
| **Total operating expenses** | **810** | 807 | **814** | 809 |

## Note 6 Auditors' remuneration

| $'000s | The Banking Group Year Ended 30-Sep-13 | The Banking Group Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | The Bank Year Ended 30-Sep-12 |
|---|---|---|---|---|
| **Auditor of the parent entity** | | | | |
| Audit and review of financial report | **1,022** | 968 | **869** | 784 |
| Other audit related work[1] | **179** | 165 | **179** | 165 |
| Other assurance services[2] | **84** | 278 | **84** | 278 |
| **Total audit and other assurance services** | **1,285** | 1,411 | **1,132** | 1,227 |
| Taxation compliance and advice | **-** | 30 | **-** | 30 |
| Other services[3] | **260** | 267 | **260** | 267 |
| **Total non-audit fees** | **260** | 297 | **260** | 297 |
| **Total remuneration for audit and non-audit services** | **1,545** | 1,708 | **1,392** | 1,524 |

1 Sarbanes-Oxley reporting to the Ultimate Parent Bank and its subsidiaries ('**Ultimate Parent Bank Group**').
2 Primarily assurance provided on certain financial information, including the issue of comfort letters in relation to debt issuance programmes.
3 Assurance and advisory services relating to other regulatory and compliance matters.

It is the Banking Group's policy to engage the external auditors 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 Banking Group is important.

## Note 7 Impairment charges on loans

| $ millions | The Banking Group For the year ended 30 September 2013 Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total | The Bank For the year ended 30 September 2013 Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total |
|---|---|---|---|---|---|---|---|---|
| Collectively assessed provisions | **7** | **4** | **(21)** | **(10)** | **8** | **4** | **(21)** | **(9)** |
| Individually assessed provisions | **27** | **-** | **55** | **82** | **27** | **-** | **55** | **82** |
| Bad debts written-off directly to the income statement | **3** | **39** | **21** | **63** | **3** | **36** | **20** | **59** |
| Interest adjustments | **(4)** | **(10)** | **(14)** | **(28)** | **(5)** | **(9)** | **(14)** | **(28)** |
| **Total impairment charges on loans** | **33** | **33** | **41** | **107** | **33** | **31** | **40** | **104** |

| $ millions | The Banking Group For the year ended 30 September 2012 Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total | The Bank For the year ended 30 September 2012 Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total |
|---|---|---|---|---|---|---|---|---|
| Collectively assessed provisions | (5) | (6) | (57) | (68) | (6) | (5) | (57) | (68) |
| Individually assessed provisions | 23 | - | 192 | 215 | 23 | - | 182 | 205 |
| Bad debts written-off directly to the income statement | 2 | 43 | 29 | 74 | 2 | 42 | 29 | 73 |
| Interest adjustments | (4) | (10) | (17) | (31) | (4) | (9) | (17) | (30) |
| **Total impairment charges on loans** | 16 | 27 | 147 | 190 | 15 | 28 | 137 | 180 |

## Note 8 Income tax expense

| $ millions | The Banking Group Year Ended 30-Sep-13 | Year Ended 30-Sep-12 | The Bank Year Ended 30-Sep-13 | Year Ended 30-Sep-12 |
|---|---|---|---|---|
| **Income tax expense** | | | | |
| Current tax: | | | | |
| Current year | **261** | 230 | **251** | 216 |
| Prior year adjustments | **2** | (1) | **-** | - |
| Deferred tax (refer to Note 16): | | | | |
| Current year | **15** | 16 | **18** | 19 |
| Prior year adjustments | **(1)** | 1 | **(1)** | 1 |
| **Total income tax expense** | **277** | 246 | **268** | 236 |
| **Profit before income tax expense** | **991** | 859 | **959** | 838 |
| Tax calculated at tax rate of 28% | **277** | 241 | **269** | 235 |
| Expenses not deductible for tax purposes | **(2)** | 1 | **-** | 1 |
| Prior year adjustments | **1** | - | **(1)** | 1 |
| Other items | **1** | 4 | **-** | (1) |
| **Total income tax expense** | **277** | 246 | **268** | 236 |

## Note 9 Imputation credit account

| $ millions | The Banking Group 2013 | 2012 | The Bank 2013 | 2012 |
|---|---|---|---|---|
| Imputation credits available for use in subsequent reporting periods | **644** | 836 | **622** | 816 |

The NZ Branch and the Bank formed an imputation group with effect from 1 April 2012.

## Note 10 Due from other financial institutions

| $ millions | The Banking Group and the Bank 2013 | 2012 |
|---|---|---|
| Loans and advances to other banks | **173** | 322 |
| **Total due from other financial institutions** | **173** | 322 |
| Due from other financial institutions: | | |
| At call | **173** | 322 |
| Term | **-** | - |
| **Total due from other financial institutions** | **173** | 322 |
| Amounts expected to be recovered within 12 months | **173** | 322 |
| Amounts expected to be recovered after 12 months | **-** | - |
| **Total due from other financial institutions** | **173** | 322 |

## Note 11 Trading securities

| $ millions | The Banking Group and the Bank 2013 | 2012 |
|---|---|---|
| **Trading securities** | | |
| Certificates of deposit | **892** | 1,549 |
| Corporate bonds | **337** | 255 |
| NZ Government securities | **1** | 61 |
| Local authority securities | **348** | 175 |
| **Total trading securities** | **1,578** | 2,040 |
| Amounts expected to be recovered within 12 months | **1,311** | 1,742 |
| Amounts expected to be recovered after 12 months | **267** | 298 |
| **Total trading securities** | **1,578** | 2,040 |

As at 30 September 2013 no trading securities in the Banking Group and the Bank (30 September 2012: nil) were encumbered through repurchase agreements.

## Note 12 Available-for-sale securities

| $ millions | The Banking Group and the Bank 2013 | 2012 |
|---|---|---|
| NZ Government securities | **1,993** | 2,122 |
| Local authority securities | **109** | 32 |
| NZ debt securities | **80** | 56 |
| Overseas debt securities | **433** | 414 |
| Overseas equity securities | **100** | 70 |
| **Total available-for-sale securities** | **2,715** | 2,694 |
| Amounts expected to be recovered within 12 months | **165** | 26 |
| Amounts expected to be recovered after 12 months | **2,550** | 2,668 |
| **Total available-for-sale securities** | **2,715** | 2,694 |

As at 30 September 2013, no available-for-sale securities were pledged as collateral for the Banking Group or the Bank's liabilities (30 September 2012: nil).

## Note 13 Loans

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| Overdrafts | **1,281** | 1,460 | **1,281** | 1,460 |
| Credit card outstandings | **1,352** | 1,311 | **1,284** | 1,240 |
| Money market loans | **997** | 1,165 | **997** | 1,165 |
| Term loans: | | | | |
| Housing | **37,594** | 35,986 | **37,553** | 35,935 |
| Non-housing | **20,515** | 19,769 | **20,504** | 19,760 |
| Other | **398** | 336 | **398** | 334 |
| **Total gross loans** | **62,137** | 60,027 | **62,017** | 59,894 |
| Provisions for impairment charges on loans | **(552)** | (605) | **(538)** | (591) |
| **Total net loans** | **61,585** | 59,422 | **61,479** | 59,303 |
| Amounts expected to be recovered within 12 months | **7,714** | 7,611 | **7,649** | 7,543 |
| Amounts expected to be recovered after 12 months | **53,871** | 51,811 | **53,830** | 51,760 |
| **Total net loans** | **61,585** | 59,422 | **61,479** | 59,303 |

As at 30 September 2013, $4.2 billion of housing loans are used by the Banking Group to secure the obligations of Westpac Securities NZ Limited (‘**WSNZL**’) under the Bank’s Global Covered Bond Programme (‘**CB Programme**’) (30 September 2012: $3.1 billion). These housing loans were not derecognised from the Bank’s balance sheet in accordance with the accounting polices outlined in Note 1 (refer to Note 25 for details of the CB Programme). As at 30 September 2013, the New Zealand dollar equivalent of bonds issued by WSNZL under the CB Programme was $2.2 billion (30 September 2012: $2.0 billion).

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

## Note 14 Credit quality, impaired assets and provisions for impairment charges on loans

| | The Banking Group | | | | The Bank | | | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | | | | 2013 | | | |
| $ millions | Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total | Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total |
| **Neither past due nor impaired** | 36,403 | 1,717 | 21,905 | 60,025 | 36,362 | 1,656 | 21,905 | 59,923 |
| **Past due assets** | | | | | | | | |
| Less than 30 days past due | 916 | 108 | 217 | 1,241 | 916 | 104 | 217 | 1,237 |
| At least 30 days but less than 60 days past due | 90 | 20 | 5 | 115 | 90 | 19 | 5 | 114 |
| At least 60 days but less than 90 days past due | 42 | 10 | 2 | 54 | 42 | 9 | 2 | 53 |
| At least 90 days past due | 50 | 15 | 64 | 129 | 50 | 14 | 64 | 128 |
| **Total past due assets**[1] | 1,098 | 153 | 288 | 1,539 | 1,098 | 146 | 288 | 1,532 |
| **Individually impaired assets**[2] | | | | | | | | |
| Balance at beginning of the year | 124 | - | 743 | 867 | 124 | - | 733 | 857 |
| Additions | 154 | - | 215 | 369 | 154 | - | 214 | 368 |
| Amounts written off | (35) | - | (95) | (130) | (35) | - | (95) | (130) |
| Returned to performing or repaid | (150) | - | (383) | (533) | (150) | - | (383) | (533) |
| **Balance at end of the year** | 93 | - | 480 | 573 | 93 | - | 469 | 562 |
| **Total gross loans**[3] | 37,594 | 1,870 | 22,673 | 62,137 | 37,553 | 1,802 | 22,662 | 62,017 |
| **Individually assessed provisions** | | | | | | | | |
| Balance at beginning of the year | 38 | - | 238 | 276 | 38 | - | 228 | 266 |
| Impairment charges on loans: | | | | | | | | |
| New provisions | 50 | - | 107 | 157 | 50 | - | 107 | 157 |
| Recoveries | (13) | - | (4) | (17) | (13) | - | (4) | (17) |
| Reversal of previously recognised impairment charges on loans | (10) | - | (48) | (58) | (10) | - | (48) | (58) |
| Amounts written off | (35) | - | (95) | (130) | (35) | - | (95) | (130) |
| Interest adjustments | - | - | 5 | 5 | - | - | 4 | 4 |
| **Balance at end of the year** | 30 | - | 203 | 233 | 30 | - | 192 | 222 |
| **Collectively assessed provisions** | | | | | | | | |
| Balance at beginning of the year | 61 | 63 | 240 | 364 | 59 | 61 | 240 | 360 |
| Impairment charges on loans | 7 | 4 | (21) | (10) | 8 | 4 | (21) | (9) |
| **Balance at end of the year** | 68 | 67 | 219 | 354 | 67 | 65 | 219 | 351 |
| Total provisions for impairment charges on loans and credit commitments | 98 | 67 | 422 | 587 | 97 | 65 | 411 | 573 |
| Provision for credit commitments (refer to Note 21) | - | - | (35) | (35) | - | - | (35) | (35) |
| **Total provisions for impairment charges on loans** | 98 | 67 | 387 | 552 | 97 | 65 | 376 | 538 |
| **Total net loans** | 37,496 | 1,803 | 22,286 | 61,585 | 37,456 | 1,737 | 22,286 | 61,479 |

1 Past due assets are not impaired assets under NZ IFRS.

2 The Bank and Banking Group had undrawn commitments of $27 million to counterparties for whom drawn balances are classified as individually impaired assets under loans for business purposes as at 30 September 2013.

3 The Bank and Banking Group did not have other assets under administration as at 30 September 2013.

## Note 14 Credit quality, impaired assets and provisions for impairment charges on loans (continued)

| | The Banking Group | | | | The Bank | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | | | 2012 | | | |
| **$ millions** | Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total | Residential Mortgages | Other Loans for Consumer Purposes | Loans for Business Purposes | Total |
| **Neither past due nor impaired** | 34,733 | 1,660 | 21,008 | 57,401 | 34,682 | 1,595 | 21,008 | 57,285 |
| **Past due assets** | | | | | | | | |
| Less than 30 days past due | 917 | 105 | 348 | 1,370 | 917 | 101 | 348 | 1,366 |
| At least 30 days but less than 60 days past due | 99 | 20 | 13 | 132 | 99 | 19 | 13 | 131 |
| At least 60 days but less than 90 days past due | 48 | 10 | 15 | 73 | 48 | 9 | 15 | 72 |
| At least 90 days past due | 65 | 15 | 104 | 184 | 65 | 14 | 104 | 183 |
| **Total past due assets**[1] | 1,129 | 150 | 480 | 1,759 | 1,129 | 143 | 480 | 1,752 |
| **Individually impaired assets**[2] | | | | | | | | |
| Balance at beginning of the year | 196 | - | 598 | 794 | 196 | - | 598 | 794 |
| Additions | 201 | - | 389 | 590 | 201 | - | 379 | 580 |
| Amounts written off | (51) | - | (189) | (240) | (51) | - | (189) | (240) |
| Individually impaired assets acquired in a business combination | - | - | 118 | 118 | - | - | 118 | 118 |
| Returned to performing or repaid | (222) | - | (173) | (395) | (222) | - | (173) | (395) |
| **Balance at end of the year** | 124 | - | 743 | 867 | 124 | - | 733 | 857 |
| **Total gross loans**[3] | 35,986 | 1,810 | 22,231 | 60,027 | 35,935 | 1,738 | 22,221 | 59,894 |
| **Individually assessed provisions** | | | | | | | | |
| Balance at beginning of the year | 64 | - | 160 | 224 | 64 | - | 160 | 224 |
| Impairment charges on loans: | | | | | | | | |
| New provisions | 59 | - | 217 | 276 | 59 | - | 207 | 266 |
| Recoveries | (17) | - | (9) | (26) | (17) | - | (9) | (26) |
| Reversal of previously recognised impairment charges on loans | (19) | - | (16) | (35) | (19) | - | (16) | (35) |
| Amounts written off | (49) | - | (160) | (209) | (49) | - | (160) | (209) |
| Interest adjustments | - | - | 6 | 6 | - | - | 6 | 6 |
| Individually assessed provisions acquired in a business combination | - | - | 40 | 40 | - | - | 40 | 40 |
| **Balance at end of the year** | 38 | - | 238 | 276 | 38 | - | 228 | 266 |
| **Collectively assessed provisions** | | | | | | | | |
| Balance at beginning of the year | 66 | 69 | 240 | 375 | 65 | 66 | 240 | 371 |
| Impairment charges on loans | (5) | (6) | (57) | (68) | (6) | (5) | (57) | (68) |
| Collectively assessed provisions acquired in a business combination | - | - | 57 | 57 | - | - | 57 | 57 |
| **Balance at end of the year** | 61 | 63 | 240 | 364 | 59 | 61 | 240 | 360 |
| Total provisions for impairment charges on loans and credit commitments | 99 | 63 | 478 | 640 | 97 | 61 | 468 | 626 |
| Provision for credit commitments (refer to Note 21) | - | - | (35) | (35) | - | - | (35) | (35) |
| **Total provisions for impairment charges on loans** | 99 | 63 | 443 | 605 | 97 | 61 | 433 | 591 |
| **Total net loans** | 35,887 | 1,747 | 21,788 | 59,422 | 35,838 | 1,677 | 21,788 | 59,303 |

1 Past due assets are not impaired assets under NZ IFRS.
2 The Bank and Banking Group had undrawn commitments of $14 million to counterparties for whom drawn balances are classified as individually impaired assets under loans for business purposes as at 30 September 2012.
3 The Bank and Banking Group did not have other assets under administration as at 30 September 2012.

## Note 15 Goodwill and other intangible assets

| $ millions | The Banking Group and the Bank 2013 | 2012 |
|---|---|---|
| **Goodwill** | | |
| Cost | **477** | 477 |
| Accumulated impairment | **-** | - |
| **Net carrying amount of goodwill** | **477** | 477 |
| **Computer software** | | |
| Cost | **479** | 382 |
| Accumulated amortisation and impairment | **(296)** | (261) |
| **Net carrying amount of computer software** | **183** | 121 |
| **Total goodwill and other intangible assets** | **660** | 598 |

Goodwill is allocated to and tested at least annually for impairment as a part of its identified Cash-generating units ('**CGU**'). The operating segment of Retail Banking is the CGU to which the goodwill has been allocated.

The recoverable amount of the CGU is determined annually based on value-in-use calculations. These calculations use discounted cash flow projections based on an approved two-year strategic business plan. While the strategic business plan assumes certain economic conditions, the forecast is not reliant on one particular assumption. These business forecasts applied by management are considered appropriate as they are based on past experience and are consistent with observable current market information. The growth rates after 2015 are assumed to be zero for all CGUs for the purpose of goodwill impairment testing. The discount rate used is the before tax equivalent of the Banking Group's cost of capital of 15.3% as at 30 September 2013 (30 September 2012:15.3%).

A reasonably possible change in these key assumptions would not cause the CGU's carrying amount to exceed its recoverable amount.

## Note 16 Deferred tax assets

| | The Banking Group | | The Bank | |
|---|---|---|---|---|
| $ millions | 2013 | 2012 | 2013 | 2012 |
| **Deferred tax assets are attributable to the following:** | | | | |
| Property, plant and equipment | **9** | 9 | **(2)** | (1) |
| Provisions for impairment charges on loans | **164** | 179 | **161** | 175 |
| Provision for employee entitlements | **16** | 29 | **16** | 29 |
| Cashflow hedges | **(15)** | (15) | **(15)** | (15) |
| Other temporary differences | **6** | 7 | **1** | 1 |
| **Balance at end of the year** | **180** | 209 | **161** | 189 |
| To be recovered within 12 months | **126** | 156 | **117** | 147 |
| To be recovered after 12 months | **54** | 53 | **44** | 42 |
| **Balance at end of the year** | **180** | 209 | **161** | 189 |
| **The deferred tax charge in income tax expense comprises the following temporary differences:** | | | | |
| Property, plant and equipment | **-** | 2 | **(1)** | 3 |
| Provisions for impairment charges on loans | **(15)** | (17) | **(14)** | (19) |
| Provision for employee entitlements | **(2)** | (4) | **(2)** | (4) |
| Other temporary differences | **3** | 2 | **-** | - |
| **Total deferred tax charge** | **(14)** | (17) | **(17)** | (20) |
| Deferred tax acquired in business combination | **-** | 28 | **-** | 28 |
| Other | **(4)** | (2) | **-** | (1) |
| **Total deferred tax charge - other** | **(4)** | 26 | **-** | 27 |
| **The deferred tax charge in equity comprises the following temporary differences:** | | | | |
| Cash flow hedges | **-** | (1) | **-** | (1) |
| Provision for employee entitlements | **(11)** | 7 | **(11)** | 7 |
| **Total deferred tax charge in equity** | **(11)** | 6 | **(11)** | 6 |

As at 30 September 2013, the aggregate temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognised were nil (30 September 2012: nil).

## Note 17 Other assets

| $ millions | The Banking Group 2013 | 2012 | The Bank 2013 | 2012 |
|---|---|---|---|---|
| Accrued interest receivable | **140** | 150 | **139** | 150 |
| Securities sold not yet delivered | **13** | - | **13** | - |
| Trade debtors and prepayments | **21** | 39 | **20** | 15 |
| Account fees and commissions receivable | **3** | 3 | **3** | 3 |
| Other | **39** | 3 | **39** | 3 |
| **Total other assets** | **216** | 195 | **214** | 171 |
| Amounts expected to be recovered within 12 months | **216** | 195 | **214** | 171 |
| Amounts expected to be recovered after 12 months | **-** | - | **-** | - |
| **Total other assets** | **216** | 195 | **214** | 171 |

Included in accrued interest receivable of the Bank and the Banking Group as at 30 September 2013 were balances that amounted to $6 million (30 September 2012: $5 million) which related to accrued interest on housing loans sold to a special purpose entity under the CB Programme (refer to Note 25 for details of the CB Programme).

## Note 18 Due to other financial institutions

| $ millions | The Banking Group and the Bank 2013 | 2012 |
|---|---|---|
| Interest bearing | **100** | 3 |
| **Total due to other financial institutions** | **100** | 3 |
| Due to other financial institutions: | | |
| At call | **-** | 3 |
| Term | **100** | - |
| **Total due to other financial institutions** | **100** | 3 |
| Amounts expected to be settled within 12 months | **100** | 3 |
| Amounts expected to be settled after 12 months | **-** | - |
| **Total due to other financial institutions** | **100** | 3 |

## Note 19 Deposits

| $ millions | The Banking Group 2013 | 2012 | The Bank 2013 | 2012 |
|---|---|---|---|---|
| **Deposits at fair value** | | | | |
| Certificates of deposit | **1,534** | 1,423 | **1,534** | 1,423 |
| **Total deposits at fair value** | **1,534** | 1,423 | **1,534** | 1,423 |
| **Deposits at amortised cost** | | | | |
| Non-interest bearing, repayable at call | **3,271** | 2,969 | **3,271** | 2,969 |
| Other interest bearing: | | | | |
| At call | **18,488** | 15,931 | **17,967** | 15,931 |
| Term | **24,889** | 23,067 | **24,094** | 22,347 |
| **Total deposits at amortised cost** | **46,648** | 41,967 | **45,332** | 41,247 |
| **Total deposits** | **48,182** | 43,390 | **46,866** | 42,670 |
| Amounts expected to be settled within 12 months | **46,670** | 41,385 | **45,386** | 40,666 |
| Amounts expected to be settled after 12 months | **1,512** | 2,005 | **1,480** | 2,004 |
| **Total deposits** | **48,182** | 43,390 | **46,866** | 42,670 |

***Priority of financial liabilities in the event of liquidation***

In the unlikely event that the Bank was put into liquidation or ceased to trade, claims of secured creditors and those creditors set out in the Seventh Schedule of the Companies Act 1993 would rank ahead of the claims of unsecured creditors. Deposits from customers are unsecured and rank equally with other unsecured liabilities of the Bank, and such liabilities rank ahead of any subordinated instruments issued by the Bank.

## Note 20 Debt issues

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| **Short-term debt** | | | | |
| Commercial paper | **2,776** | 4,033 | **-** | - |
| **Total short-term debt** | **2,776** | 4,033 | **-** | - |
| **Long-term debt** | | | | |
| Non-domestic medium-term notes | **5,128** | 6,207 | **-** | - |
| Domestic medium-term notes | **3,741** | 2,674 | **3,741** | 2,674 |
| **Total long-term debt** | **8,869** | 8,881 | **3,741** | 2,674 |
| **Total debt issues** | **11,645** | 12,914 | **3,741** | 2,674 |
| Debt issues at amortised cost | **8,869** | 8,851 | **3,741** | 2,674 |
| Debt issues at fair value | **2,776** | 4,063 | **-** | - |
| **Total debt issues** | **11,645** | 12,914 | **3,741** | 2,674 |
| **Movement in debt issues** | | | | |
| Balance at beginning of the year | **12,914** | 17,630 | **2,674** | 1,598 |
| Issuance during the year | **7,641** | 12,589 | **1,153** | 1,386 |
| Repayments during the year | **(9,094)** | (16,196) | **(75)** | (310) |
| Effect of foreign exchange movements during the year | **277** | (1,188) | **-** | - |
| Effect of fair value movements and fair value hedge adjustments during the year | **(93)** | 79 | **(11)** | - |
| **Balance at end of the year** | **11,645** | 12,914 | **3,741** | 2,674 |
| Amounts expected to be settled within 12 months | **5,067** | 5,284 | **1,079** | 69 |
| Amounts expected to be settled after 12 months | **6,578** | 7,630 | **2,662** | 2,605 |
| **Total debt issues** | **11,645** | 12,914 | **3,741** | 2,674 |

As at 30 September 2013, the Banking Group and the Bank had New Zealand Government guaranteed debt of $1,881 million and $670 million on issue (30 September 2012: $1,970 million and $674 million) respectively. For further information on New Zealand Government guaranteed debt refer to Guarantee arrangements on page 5. For information relating to funding and liquidity risk refer to Note 35.2.

## Note 21 Provisions

| $ millions | Long Service Leave | Annual Leave and Other Staff Benefits | Non-lending Losses | Impairment on Credit Commitments | Total |
|---|---|---|---|---|---|
| | The Banking Group and the Bank | | | | |
| **For the year ended 30 September 2013** | | | | | |
| Balance as at 1 October 2012 | **5** | **41** | **2** | **35** | **83** |
| Additional provisions recognised | **1** | **25** | **2** | **-** | **28** |
| Utilised during the year | **-** | **(31)** | **(3)** | **-** | **(34)** |
| **Balance as at 30 September 2013** | **6** | **35** | **1** | **35** | **77** |
| **For the year ended 30 September 2012** | | | | | |
| Balance as at 1 October 2011 | 7 | 35 | 2 | 26 | 70 |
| Additional provisions recognised | - | 23 | 3 | 9 | 35 |
| Utilised during the year | (2) | (17) | (3) | - | (22) |
| **Balance as at 30 September 2012** | 5 | 41 | 2 | 35 | 83 |

Provisions represent costs the Banking Group and the Bank expect to incur as a result of past events, where the timing of payment is uncertain. Provisions expected to be utilised beyond 12 months as at 30 September 2013 are $41 million (30 September 2012: $40 million) for the Banking Group and the Bank.

## Note 22 Other liabilities

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| Accrued interest payable | **334** | 338 | **274** | 275 |
| Credit card loyalty programme | **28** | 31 | **28** | 31 |
| Retirement benefit obligations (refer to Note 30) | **32** | 77 | **32** | 77 |
| Trade creditors and other accrued expenses | **66** | 80 | **63** | 79 |
| Other | **88** | 53 | **78** | 41 |
| **Total other liabilities** | **548** | 579 | **475** | 503 |
| Amounts expected to be settled within 12 months | **516** | 502 | **443** | 426 |
| Amounts expected to be settled after 12 months | **32** | 77 | **32** | 77 |
| **Total other liabilities** | **548** | 579 | **475** | 503 |

## Note 23 Perpetual subordinated notes

Perpetual subordinated notes had been issued by the Bank to WNZGL (the Bank's immediate parent company) in 2006 and constituted Upper Tier Two Capital of the Banking Group. The notes had no maturity date, but were able to be redeemed at par only at the option of the Bank. The notes paid quarterly distributions provided that at the time payment was made the Bank would be solvent immediately after payment. The notes were direct and unsecured obligations of the Bank and were subordinated to the claims of all creditors (including depositors) of the Bank other than those creditors whose claims against the Bank are expressed to rank equally with or after the claims of the note holder. On 29 November 2012, the Bank repaid $470 million of the perpetual subordinated notes and on 29 May 2013, the Bank repaid the remaining $500 million of perpetual subordinated notes.

| | The Banking Group and the Bank | |
|---|---|---|
| **$ millions** | **2013** | 2012 |
| Perpetual subordinated notes | - | 970 |
| **Total perpetual subordinated notes** | - | 970 |

## Note 24 Share capital

### Ordinary shares fully paid

| | The Banking Group and the Bank | |
|---|---|---|
| | **2013 Number of Shares Issued and Authorised** | 2012 Number of Shares Issued and Authorised |
| Balance at beginning of the year | **4,600,001,000** | 3,470,001,000 |
| Shares issued during the year | **-** | 1,130,000,000 |
| **Balance at end of the year** | **4,600,001,000** | 4,600,001,000 |

In accordance with the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) ordinary share capital is classified as Common Equity Tier One Capital.

The ordinary shares have no par value. Subject to the constitution of the Bank, each ordinary share of the Bank carries the right to one vote on a poll at meetings of shareholders, the right to an equal share in dividends authorised by the Board and the right to an equal share in the distribution of the surplus assets of the Bank in the event of liquidation.

In the year ended 30 September 2012, the Bank issued a total of 1,130 million additional ordinary shares for $1 per share to the Bank's immediate parent company, WNZGL (refer to Note 2). On 28 October 2011, the Bank issued 900 million ordinary shares for $1 per share, and on 31 October 2011, the Bank issued an additional 230 million ordinary shares for $1 per share, each to WNZGL. Immediately prior to the issuance of these additional 230 million ordinary shares, the Bank paid a dividend to WNZGL of $230 million (5.26 cents per share). On 30 May 2012, the Directors of the Bank paid a dividend of $250 million on the ordinary shares on issue to WNZGL (5.44 cents per share).

The aggregate amount of dividends paid by the Bank on the ordinary shares for the year ended 30 September 2013 was nil (30 September 2012: $480 million). Dividends paid per ordinary share by the Bank for the year ended 30 September 2013 were nil (30 September 2012: 10.70 cents per share).

## Note 25 Related entities

### Banking Group

The Bank is a controlled entity of WNZGL. The Ultimate Parent Bank of the Bank is Westpac Banking Corporation.

The Banking Group consists of the Bank and all of its controlled entities. As at 30 September 2013 the Bank had the following controlled entities:

| Name of Entity | Principal Activity | Notes |
|---|---|---|
| Westpac NZ Operations Limited | Holding company | |
| Aotearoa Financial Services Limited | Non-active company | |
| Number 120 Limited | Finance company | |
| The Home Mortgage Company Limited | Residential mortgage company | |
| The Warehouse Financial Services Limited | Financial services company | 51% owned |
| Westpac (NZ) Investments Limited | Property company | |
| Westpac NZ Leasing Limited | Non-active company | |
| Westpac Securities NZ Limited | Funding company | |
| Westpac NZ Covered Bond Holdings Limited | Holding company | 9.5% owned[1] |
| Westpac NZ Covered Bond Limited | Guarantor | 9.5% owned[1] |
| Westpac NZ Securitisation Holdings Limited | Holding company | 9.5% owned[2] |
| Westpac NZ Securitisation Limited | Funding company | 9.5% owned[2] |
| Westpac NZ Securitisation No.2 Limited | Non-active company | 9.5% owned – Established 2 November 2012.[2] |
| Westpac Cash PIE Fund | Portfolio investment entity | Not owned – Established 14 November 2012.[3] |
| Westpac Term PIE Fund | Portfolio investment entity | Not owned[3] |

1 The Banking Group, through its subsidiary, Westpac NZ Operations Limited ('**WNZO**'), has a qualifying interest of 9.5% in Westpac NZ Covered Bond Holdings Limited ('**WNZCBHL**') and its wholly-owned subsidiary company, Westpac NZ Covered Bond Limited ('**WNZCBL**'). The Bank is considered to control both WNZCBHL and WNZCBL based on contractual arrangements put in place, and as such both WNZCBHL and WNZCBL are consolidated within the financial statements of the Banking Group.

2 The Banking Group, through its subsidiary WNZO, has a qualifying interest of 9.5% in Westpac NZ Securitisation Holdings Limited ('**WNZSHL**') and its wholly-owned subsidiary companies, Westpac NZ Securitisation Limited ('**WNZSL**') and Westpac NZ Securitisation No.2 Limited ('**WNZSL2**'). The Bank is considered to control WNZSHL, WNZSL and WNZSL2 based on contractual arrangements put in place, and as such WNZSHL, WNZSL and WNZSL2 are consolidated within the financial statements of the Banking Group.

3 Westpac Term PIE Fund ('**Term PIE**') and Westpac Cash PIE Fund ('**Cash PIE**') were established as unit trusts under the Unit Trusts Act 1960. Term PIE and Cash PIE are Portfolio Investment Entities ('**PIE**'), where BT Funds Management (NZ) Limited ('**BTNZ**') (an indirectly wholly-owned subsidiary of the Ultimate Parent Bank) is the manager and issuer. The manager has appointed the Bank to perform all customer management and account administration for Term PIE and Cash PIE. The Bank is the Term PIE and Cash PIE's registrar and administration manager. The Bank does not hold any units in Term PIE or Cash PIE and is considered to control them based on contractual arrangements put in place, and as such these funds are consolidated in the financial statements of the Banking Group.

All entities in the Banking Group are 100% owned unless otherwise stated. All the entities within the Banking Group have a balance date of 30 September and are incorporated in New Zealand, except Term PIE and Cash PIE which have a balance date of 31 March.

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

### Investment in associate

The Bank holds 18.8% (30 September 2012: 18.8%) of Cards NZ Limited's equity plus one Visa Inc. access preference share issued by Cards NZ Limited. Cards NZ Limited has a balance date of 30 September.

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

### Nature of transactions

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

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

***Transactions with the Ultimate Parent Bank***

Management fees are paid by the Bank to the Ultimate Parent Bank for management and administration services (consisting of salaries and other head office expenses) provided by the Ultimate Parent Bank. The total amount charged by the Ultimate Parent Bank for the year ended 30 September 2013 was $3 million (30 September 2012: $4 million).

Derivative transactions are entered into by the Banking Group with the NZ Branch. Management systems and operational controls are in place to manage any resulting interest rate or currency risk. Accordingly, it is not envisaged that any liability resulting in material loss will arise from these transactions.

The NZ Branch provides financial market services, foreign currency, trade and interest rate risk products to the customers of the Bank. The Bank receives commission from these sales. Commission received for the year ended 30 September 2013 was $11 million (30 September 2012: $11 million).

Management fees are paid by the NZ Branch for certain operating costs incurred by the Bank. Management fees paid to the Bank for the year ended 30 September 2013 were $1 million (30 September 2012: $1 million).

## Note 25 Related entities (continued)

In September 2013, the Bank repaid $1.0 billion of the $3.1 billion funding provided by the NZ Branch to finance the Bank's acquisition of business activities transferred to it by the NZ Branch (refer to Note 2). The loan's term was also extended and the margin was changed to reflect market pricing.

Included in interest expense – other for the year ended 30 September 2013 is interest expense of $135 million (30 September 2012: $125 million) on related entity borrowings in relation to the transfer of additional banking operations (refer to Note 2).

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

Rental expenses are paid by the Bank to Westpac (NZ) Investments Limited ('**WNZIL**'). The total charge for the year ended 30 September 2013 was $101 million (30 September 2012: $98 million).

Westpac Securities NZ Limited ('**WSNZL**') provides offshore funding to the Bank. Management fees are paid by the Bank for these services. Management fees paid for the year ended 30 September 2013 were $6 million (30 September 2012: $5 million).

The Bank guarantees all payment obligations in respect of debt securities issued by controlled entities of the Banking Group, other than Westpac NZ Securitisation Limited ('**WNZSL**').

Management fees are paid by members of the Banking Group for certain operating costs incurred by the Bank. Management fees paid to the Bank for the year ended 30 September 2013 were $2 million (30 September 2012: $3 million).

In October 2008, WNZSL was set up as part of the Bank's internal mortgage-backed securitisation programme. Under this programme the Bank sold the rights but not the obligations on a pool of housing loans to WNZSL (refer to Note 32). The purchase was funded by WNZSL's issuance of residential mortgage-backed securities ('**RMBS**'). These RMBS are currently held by the Bank and are included in 'Due from related entities'. The housing loans were not derecognised from the Bank's financial statements in accordance with the accounting polices outlined in Note 1. Accordingly, an equivalent amount of liabilities associated with the transferred rights of the pool of housing loans is recognised (in the form of a 'deemed loan' from WNZSL) which is included in 'Due to related entities'. The RMBS and the liability to WNZSL are fully eliminated in the Banking Group's financial statements. Refer to Note 28 for a description of the Banking Group's obligation to repurchase the rights on the pool of housing loans sold to WNZSL.

WNZCBL is a special purpose entity established to purchase from time to time, and hold, the rights and not the obligations of a pool of housing loans ('**cover pool**') and to provide a financial guarantee (in addition to that of the Bank) 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 initial cover pool comprised housing loans with a value of $2.75 billion, the purchase of which was funded by an intercompany loan made by the Bank to WNZCBL. The amount of the cover pool was increased to $3.75 billion in March 2012 and was further increased to $4.5 billion in August 2013. The intercompany loan made by the Bank to WNZCBL to fund the initial purchase (and subsequent further purchases which increased the cover pool) is included in the Bank's 'Due from related entities'. The housing loans purchased by WNZCBL were not derecognised from the Bank's financial statements (and therefore the Bank and the Banking Group recognises these housing loans) in accordance with the accounting policies outlined in Note 1. For this reason, the Bank recognises a liability owed to WNZCBL (in the form of a 'deemed loan' from WNZCBL) of an amount equivalent to the sum of the value of the housing loans, cash and unpaid accrued interest arising from, and in respect of, the housing loans and the asset performance fee, and is included in the Bank's 'Due to related entities'.

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). As at 30 September 2013, the assets of WNZCBL were $4.52 billion (30 September 2012: $3.76 billion), comprising housing loans, accrued interest and cash.

Refer to Note 13 and Note 17 for the amounts of housing loans and accrued interest receivable respectively relating to the assets securing the obligations of WSNZL under the CB Programme. Refer to Note 28 for a description of the Banking Group's obligation to repurchase housing loans sold to WNZCBL.

All loans sold by the Bank to WNZSL and WNZCBL are legally owned by WNZSL and WNZCBL respectively, and therefore the Bank does not have any right to sell or grant security over those loans.

***Transactions with other controlled entities of the Ultimate Parent Bank***

Management fees are paid by members of the Ultimate Parent Bank Group for certain operating costs incurred by the Bank. Management fees paid to the Bank for the year ended 30 September 2013 were $3 million (30 September 2012: $2 million).

Managed fund products are sold by the Bank on behalf of members of the Ultimate Parent Bank Group. The Bank receives commission from these sales. Commission received for the year ended 30 September 2013 was $9 million (30 September 2012: $5 million).

Life and general insurance products are sold by the Bank on behalf of other members of the Ultimate Parent Bank Group. The Bank receives commission on these sales. Life and general insurance commissions received for the year ended 30 September 2013 were $25 million and $12 million respectively from Westpac Life-NZ- Limited (30 September 2012: $23 million and $12 million).

Refer to Note 23 for details of the settlement of the perpetual subordinated notes.

***Transactions with associates***

In 2008, the Banking Group purchased Visa Inc shares from Cards NZ Limited at fair value totalling $48 million. The purchase was satisfied through the issue of an interest bearing promissory note. $1 million interest was paid on the promissory note during the year ended 30 September 2013 (30 September 2012: $1 million).

## Note 25 Related entities (continued)

### Due from and to related entities

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| **Due from related entities** | | | | |
| Parent companies[1] | **1,365** | 1,509 | **1,365** | 1,509 |
| Controlled entities of the Banking Group | **-** | - | **9,643** | 8,850 |
| Other members of the Overseas Banking Group | **11** | 18 | **11** | 18 |
| **Total due from related entities** | **1,376** | 1,527 | **11,019** | 10,377 |
| Amounts expected to be recovered within 12 months | **1,376** | 1,527 | **1,519** | 1,593 |
| Amounts expected to be recovered after 12 months | **-** | - | **9,500** | 8,784 |
| **Total due from related entities** | **1,376** | 1,527 | **11,019** | 10,377 |
| **Due to related entities** | | | | |
| Parent companies[1] | **3,148** | 4,631 | **3,081** | 4,622 |
| Controlled entities of the Banking Group | **-** | - | **19,058** | 19,906 |
| Other members of the Overseas Banking Group | **1** | - | **-** | - |
| Associates of the Banking Group | **48** | 48 | **48** | 48 |
| **Total due to related entities** | **3,197** | 4,679 | **22,187** | 24,576 |
| Amounts expected to be settled within 12 months | **942** | 1,068 | **6,705** | 7,135 |
| Amounts expected to be settled after 12 months | **2,255** | 3,611 | **15,482** | 17,441 |
| **Total due to related entities** | **3,197** | 4,679 | **22,187** | 24,576 |

1 Parent companies include the Ultimate Parent Bank (including the NZ Branch) and all intermediate parent companies of the Bank.

### Other group investments

The Banking Group had significant non-controlling shareholdings in the following New Zealand based entities as at 30 September 2013:

| Name | Shares Held by | Beneficial Interest | Nature of Business |
|---|---|---|---|
| Paymark Limited | Westpac NZ Operations Limited | 25% | EFTPOS Settlements |
| Payments NZ Limited | Westpac New Zealand Limited | 23% | Payments Rules |

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

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

Interchange and Settlement Limited ('**ISL**') was removed from the New Zealand Companies Register on 25 February 2013. The removal of ISL did not have a significant impact on the Banking Group's financial position or results of operations for the year ended 30 September 2013.

## Note 26 Derivative financial instruments

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

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

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

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

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

The notional amount is a measure of the volume which may be used for examining changes in derivative activity over time. The notional amount is the face value of the contract and does not reflect the amount at risk, which is generally only a small fraction of this value.

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

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

The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in the reference rate or index relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time.

## Note 26 Derivative financial instruments (continued)

The Banking Group uses derivatives mainly as an end-user as part of its asset and liability management activities. Derivatives with related parties are included in due from/due to related entities.

### Hedging

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

***Fair value hedges***

The Banking Group hedges part of its interest rate risk resulting from any potential changes in the fair value of fixed rate assets denominated in local currency using swaps. The Banking Group also hedges part of its interest rate risk exposure from medium-term debt issuances denominated in local currency through the use of interest rate derivatives.

For the Banking Group and the Bank, the change in the fair value of hedging instruments designated as fair value hedges for the year ended 30 September 2013 was a $75 million gain (30 September 2012: $7 million loss) while the change in the fair value of the hedged items attributed to the hedge risk for the year ended 30 September 2013 was a $74 million loss (30 September 2012: $8 million gain).

***Cash flow hedges***

The Banking Group hedges a portion of the cash flows from floating-rate customer deposits, term deposits and loans using swaps. The Banking Group also hedges exposure to foreign currency principal and interest cash flows from floating-rate medium-term debt issuance through the use of cross-currency swaps.

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

| | The Banking Group and the Bank 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **%** | **Less Than 1 Month** | **1 Month to 3 Months** | **3 Months to 1 Year** | **1 Year to 2 Years** | **2 Years to 3 Years** | **3 Years to 4 Years** | **4 Years to 5 Years** | **Over 5 Years** |
| Cash inflows (assets) | **3** | **5** | **26** | **42** | **11** | **7** | **5** | **1** |
| Cash outflows (liabilities) | **4** | **5** | **25** | **44** | **10** | **6** | **5** | **1** |

| | The Banking Group and the Bank 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **%** | Less Than 1 Month | 1 Month to 3 Months | 3 Months to 1 Year | 1 Year to 2 Years | 2 Years to 3 Years | 3 Years to 4 Years | 4 Years to 5 Years | Over 5 Years |
| Cash inflows (assets) | 1 | 5 | 39 | 12 | 39 | 2 | 1 | 1 |
| Cash outflows (liabilities) | 2 | 4 | 38 | 12 | 40 | 2 | 1 | 1 |

For the year ended 30 September 2013, the hedge ineffectiveness recognised in relation to cash flow hedges was nil (30 September 2012: nil) in the Banking Group and the Bank.

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

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

## Note 26 Derivative financial instruments (continued)

### Derivatives held with external counterparties

| $ millions | The Banking Group and the Bank 2013 Notional | Fair Value Asset | Fair Value (Liability) |
|---|---|---|---|
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | **159** | **6** | **-** |
| **Total held for trading derivatives** | **159** | **6** | **-** |
| **Fair value hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | **2,705** | **2** | **(115)** |
| **Foreign exchange derivatives** | | | |
| Swaps[1] | **1,630** | **-** | **(55)** |
| **Total fair value hedging derivatives** | **4,335** | **2** | **(170)** |
| **Cash flow hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | **25** | **-** | **-** |
| **Foreign exchange derivatives** | | | |
| Swaps | **434** | **-** | **(8)** |
| **Total cash flow hedging derivatives** | **459** | **-** | **(8)** |
| **Total derivatives** | **4,953** | **8** | **(178)** |
| Amounts expected to be settled within 12 months | | **-** | **(2)** |
| Amounts expected to be settled after 12 months | | **8** | **(176)** |
| **Total derivatives** | | **8** | **(178)** |

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

| $ millions | The Banking Group and the Bank 2012 Notional | Fair Value Asset | Fair Value (Liability) |
|---|---|---|---|
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 216 | 9 | - |
| **Total held for trading derivatives** | 216 | 9 | - |
| **Fair value hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 2,550 | 1 | (234) |
| **Foreign exchange derivatives** | | | |
| Swaps[1] | 1,548 | - | (101) |
| **Total fair value hedging derivatives** | 4,098 | 1 | (335) |
| **Cash flow hedging derivatives** | | | |
| **Foreign exchange derivatives** | | | |
| Swaps | 416 | - | (25) |
| **Total cash flow hedging derivatives** | 416 | - | (25) |
| **Total derivatives** | 4,730 | 10 | (360) |
| Amounts expected to be settled within 12 months | | - | - |
| Amounts expected to be settled after 12 months | | 10 | (360) |
| **Total derivatives** | | 10 | (360) |

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

## Note 26 Derivative financial instruments (continued)

### Derivatives held with related entities

| $ millions | The Banking Group and the Bank 2013 Notional | Fair Value Asset | Fair Value (Liability) |
|---|---|---|---|
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Forwards | 11,450 | - | (1) |
| Swaps | 14,076 | 4 | (13) |
| **Foreign exchange derivatives** | | | |
| Swaps | 3,454 | 15 | (59) |
| **Total held for trading derivatives** | 28,980 | 19 | (73) |
| **Fair value hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 5,040 | 1 | (22) |
| **Foreign exchange derivatives** | | | |
| Swaps[1] | 2,902 | 9 | (457) |
| **Total fair value hedging derivatives** | 7,942 | 10 | (479) |
| **Cash flow hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 22,522 | 105 | (36) |
| **Foreign exchange derivatives** | | | |
| Swaps | - | - | - |
| **Total cash flow hedging derivatives** | 22,522 | 105 | (36) |
| **Total derivatives** | 59,444 | 134 | (588) |
| Amounts expected to be settled within 12 months | | 59 | (406) |
| Amounts expected to be settled after 12 months | | 75 | (182) |
| **Total derivatives** | | 134 | (588) |

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

| $ millions | The Banking Group and the Bank 2012 Notional | Fair Value Asset | Fair Value (Liability) |
|---|---|---|---|
| **Held for trading derivatives** | | | |
| **Interest rate derivatives** | | | |
| Forwards | 6,350 | - | - |
| Swaps | 5,388 | 5 | (34) |
| **Foreign exchange derivatives** | | | |
| Swaps | 5,316 | 2 | (318) |
| **Total held for trading derivatives** | 17,054 | 7 | (352) |
| **Fair value hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 8,070 | - | (69) |
| **Foreign exchange derivatives** | | | |
| Swaps[1] | 3,413 | 10 | (585) |
| **Total fair value hedging derivatives** | 11,483 | 10 | (654) |
| **Cash flow hedging derivatives** | | | |
| **Interest rate derivatives** | | | |
| Swaps | 9,742 | 130 | (62) |
| **Foreign exchange derivatives** | | | |
| Swaps | 284 | - | (22) |
| **Total cash flow hedging derivatives** | 10,026 | 130 | (84) |
| **Total derivatives** | 38,563 | 147 | (1,090) |
| Amounts expected to be settled within 12 months | | 24 | (504) |
| Amounts expected to be settled after 12 months | | 123 | (586) |
| **Total derivatives** | | 147 | (1,090) |

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

## Note 27 Fair value of financial instruments

***Fair valuation control framework***

The Banking Group's control environment uses a well-established Fair Valuation Control Framework to ensure that fair value is either determined or validated by a function that is independent of the party that undertakes the transaction. This framework formalises the policies and procedures used by the Banking Group to ensure 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.

The method of determining a fair value according to the Fair Valuation Control Framework differs depending on the information available.

*Quoted price in an active market*

The best evidence of fair value is a quoted price in an active market. Wherever possible the Banking Group determines the fair value of a financial instrument based on the quoted price.

*Valuation techniques*

Where no direct quoted price in an active market is available, the Banking Group applies present value estimates or other market accepted valuation techniques. The use of a market accepted valuation technique will typically involve the use of a valuation model and appropriate inputs to the model.

The majority of models used by the 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. Typically in these instances valuation inputs will be derived using alternative means (including extrapolation from other relevant market data) and tested against historic transactions. The use of these inputs will require a high degree of management judgment.

In order to determine a reliable fair value, where appropriate, management may apply adjustments to the techniques used above. These adjustments reflect the Banking Group's assessment of factors that market participants would consider in setting the fair value.

When determining the fair value of financial instruments, adjustments are made to the mid-market valuations to cover credit risk and bid-offer spreads.

- Credit valuation adjustment ('**CVA**')

  Some market and model derived valuations assume similar credit quality for all counterparties. To correct for this assumption, a CVA is employed on the majority of derivative positions which reflects the market view of the counterparty credit risk. A debit valuation adjustment ('**DVA**') is employed to adjust for our own credit risk.

  The Banking Group uses a Monte Carlo simulation methodology to calculate the expected future credit exposure for all derivative exposures including inputs regarding probabilities of default ('**PDs**') and loss given default ('**LGD**'). PDs are derived from market observed credit spreads by reference to credit default swap ('**CDS**') for individual or sector curves for the relevant tenors to calculate CVA, and the Ultimate Parent Bank's CDS curve for the relevant tenors to calculate DVA. PDs are then applied to the horizon of potential exposures to derive both the CVA and DVA.

- Bid-offer spreads

  The fair value of financial assets and financial liabilities should reflect bid prices for assets and offer prices for liabilities. Prices are adjusted to reflect current bid-offer spreads.

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

***Fair value hierarchy***

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

- Quoted market price ('**Level 1**')

  Financial instruments valued using recent unadjusted quoted prices in active markets for identical assets or liabilities. An active market is one in which prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis.

  Valuation of Level 1 instruments requires little or no management judgment.

  Financial instruments included in the Level 1 category are exchange traded equities.

- Valuation technique using observable inputs ('**Level 2**')

  Valuation techniques utilising observable market prices applied to these assets or liabilities include the use of discounted cash flow analysis, option pricing models and other valuation techniques widely used and accepted by market participants. Management judgment will be used in the application of these techniques (e.g. the selection of the appropriate discount rate to value a bond).

  The financial instruments included in this category are mainly over-the-counter ('**OTC**') derivatives with observable market inputs and financial instruments with fair value derived from consensus pricing with sufficient contributors. Financial instruments included in the Level 2 category are:

  - trading securities – including government bonds, state government bonds, corporate fixed rate bonds and floating rate bonds; and
  - derivatives – including interest rate swaps, interest rate forwards, interest rate futures, interest rate options and foreign exchange ('**FX**') swaps.

## Note 27 Fair value of financial instruments (continued)

- Valuation technique with significant non-observable inputs ('**Level 3**')

  Financial instruments valued using at least one input that could have a significant effect on the instrument's valuation which is not based on observable market data (unobservable input). Unobservable inputs are those not readily available in an active market 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 historic transactions.

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

Financial instruments included in the Level 3 category are nil (30 September 2012: nil).

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

***Valuation techniques***

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:

- *Interest rate ('IR') products*

  These are products linked to interest rates (e.g. Bank Bill Mid-Market Settlement Rate ('**BKBM**') or LIBOR) or inflation indices. This includes interest rate swaps, interest rate forwards, exchange traded interest rate futures and interest rate options.

  Exchange traded interest rate futures are traded in liquid, active markets where prices are readily observable. No modelling or assumptions are used in the valuation. Exchange traded interest rate futures are classified as Level 1 instruments.

  Interest rate derivative cash flows are valued using interest rate curves whereby observable market data is used to construct the term structure of forward rates. This term structure is used to project and discount future cash flows based on the terms of the trade. Instruments with volatility are valued using volatilities implied from market observable or consensus provided inputs. Exotic interest rate derivatives are valued using industry standard models based on market observable inputs which are determined separately for each parameter. Where unobservable, inputs will be set with reference to an observable proxy.

  In general, interest rate derivatives are classified as level 2 instruments.

- *FX products*

  These are products linked to the foreign exchange market. This includes FX spot, FX forward contracts and FX swaps.

  There are observable markets for spot contracts in major global currencies. No modelling or assumptions are used in the valuation of these instruments. These assets are therefore categorised as Level 1 instruments.

  FX swaps and forwards are not traded on exchanges. FX swap and forward valuations are derived from consensus data providers. Both simple and complex derivatives are valued using industry standard models. In general, these inputs use market observable data or data provided by consensus providers for FX spot rates, interest rates and FX volatilities. Where unobservable, inputs will be set with reference to an observable proxy.

  FX swaps and FX forwards are categorised as Level 2 instruments.

- *Debt market products*

  Government bonds, local government bonds, corporate bonds, commercial paper and certificates of deposit are valued using observable market prices which are sourced from broker quotes, inter-dealer prices or consensus pricing services.

  Fair valued notes are valued using discounted cash flow techniques and industry standard models incorporating various observable input parameters depending on the terms of the instrument.

  These debt market products are classified as Level 2 instruments.

- *Certificates of deposit*

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

- *Debt issues at fair value*

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

## Note 27 Fair value of financial instruments (continued)

The following table summarises the attribution of financial instruments to the fair value hierarchy based on the measurement basis after initial recognition:

| | The Banking Group 2013 | | | The Bank 2013 | | |
|---|---|---|---|---|---|---|
| **$ millions** | **Level 1** | **Level 2** | **Total** | **Level 1** | **Level 2** | **Total** |
| **Financial assets** | | | | | | |
| Derivative financial instruments | **-** | **8** | **8** | **-** | **8** | **8** |
| Trading securities | **-** | **1,578** | **1,578** | **-** | **1,578** | **1,578** |
| Available-for-sale securities | **100** | **2,615** | **2,715** | **100** | **2,615** | **2,715** |
| Due from related entities | **-** | **460** | **460** | **-** | **460** | **460** |
| **Total financial assets carried at fair value** | **100** | **4,661** | **4,761** | **100** | **4,661** | **4,761** |
| **Financial liabilities** | | | | | | |
| Deposits | **-** | **1,534** | **1,534** | **-** | **1,534** | **1,534** |
| Derivative financial instruments | **-** | **178** | **178** | **-** | **178** | **178** |
| Debt issues at fair value | **-** | **2,776** | **2,776** | **-** | **-** | **-** |
| Due to related entities | **-** | **454** | **454** | **-** | **3,230** | **3,230** |
| **Total financial liabilities carried at fair value** | **-** | **4,942** | **4,942** | **-** | **4,942** | **4,942** |

| | The Banking Group 2012 | | | The Bank 2012 | | |
|---|---|---|---|---|---|---|
| **$ millions** | Level 1 | Level 2 | Total | Level 1 | Level 2 | Total |
| **Financial assets** | | | | | | |
| Derivative financial instruments | - | 10 | 10 | - | 10 | 10 |
| Trading securities | - | 2,040 | 2,040 | - | 2,040 | 2,040 |
| Available-for-sale securities | 70 | 2,624 | 2,694 | 70 | 2,624 | 2,694 |
| Due from related entities | - | 393 | 393 | - | 393 | 393 |
| **Total financial assets carried at fair value** | 70 | 5,067 | 5,137 | 70 | 5,067 | 5,137 |
| **Financial liabilities** | | | | | | |
| Deposits | - | 1,423 | 1,423 | - | 1,423 | 1,423 |
| Derivative financial instruments | - | 360 | 360 | - | 360 | 360 |
| Debt issues at fair value | - | 4,063 | 4,063 | - | - | - |
| Due to related entities | - | 943 | 943 | - | 5,010 | 5,010 |
| **Total financial liabilities carried at fair value** | - | 6,789 | 6,789 | - | 6,793 | 6,793 |

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 statements of the Banking Group and the Bank during the year ended 30 September 2013 (30 September 2012: no material changes in fair value).

There have been no significant transfers between Levels 1 and 2 during the year ended 30 September 2013 (30 September 2012: nil). There have also been no significant transfers into/out of Level 3 during the year ended 30 September 2013 (30 September 2012: nil).

## Note 27 Fair value of financial instruments (continued)

***Classification of financial instruments and estimates of fair value***

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. NZ IFRS 7 requires the disclosure of the fair value of those financial instruments not already carried at fair value in the balance sheet. The fair value is the amount for which an asset could be exchanged, or a liability settled, in an arm's length transaction between knowledgeable, willing parties. The fair value disclosure does not cover those instruments that are not considered to be financial instruments from an accounting perspective, such as income tax and intangible assets.

The tables below summarise the categories of financial instruments and the carrying value and fair value of all financial instruments of the Banking Group and the Bank:

| | The Banking Group 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Classified at Fair Value through Profit or Loss | | | | | | | |
| $ millions | Held for Trading | Designated upon Initial Recognition | Hedging | Loans and Receivables | Available-for-sale Financial Assets | Financial Liabilities at Amortised Cost | Total Carrying Amount | Estimated Fair Value |
| **Financial assets** | | | | | | | | |
| Cash and balances with central banks | - | - | - | 1,804 | - | - | 1,804 | 1,804 |
| Due from other financial institutions | - | - | - | 173 | - | - | 173 | 173 |
| Derivative financial instruments | 6 | - | 2 | - | - | - | 8 | 8 |
| Trading securities | 1,578 | - | - | - | - | - | 1,578 | 1,578 |
| Available-for-sale securities | - | - | - | - | 2,715 | - | 2,715 | 2,715 |
| Loans | - | - | - | 61,585 | - | - | 61,585 | 61,488 |
| Due from related entities | 460 | - | - | 916 | - | - | 1,376 | 1,376 |
| Other assets | - | - | - | 190 | - | - | 190 | 190 |
| **Total financial assets** | 2,044 | - | 2 | 64,668 | 2,715 | - | 69,429 | 69,332 |
| **Financial liabilities** | | | | | | | | |
| Due to other financial institutions | - | - | - | - | - | 100 | 100 | 100 |
| Deposits | 1,534 | - | - | - | - | 46,648 | 48,182 | 48,255 |
| Derivative financial instruments | - | - | 178 | - | - | - | 178 | 178 |
| Debt issues | - | 2,776 | - | - | - | 8,869 | 11,645 | 11,897 |
| Other liabilities | - | - | - | - | - | 434 | 434 | 434 |
| Due to related entities | 54 | - | 400 | - | - | 2,743 | 3,197 | 3,197 |
| **Total financial liabilities** | 1,588 | 2,776 | 578 | - | - | 58,794 | 63,736 | 64,061 |

| | The Banking Group 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Classified at Fair Value through Profit or Loss | | | | | | | |
| $ millions | Held for Trading | Designated upon Initial Recognition | Hedging | Loans and Receivables | Available-for-sale Financial Assets | Financial Liabilities at Amortised Cost | Total Carrying Amount | Estimated Fair Value |
| **Financial assets** | | | | | | | | |
| Cash and balances with central banks | - | - | - | 1,595 | - | - | 1,595 | 1,595 |
| Due from other financial institutions | - | - | - | 322 | - | - | 322 | 322 |
| Derivative financial instruments | 9 | - | 1 | - | - | - | 10 | 10 |
| Trading securities | 2,040 | - | - | - | - | - | 2,040 | 2,040 |
| Available-for-sale securities | - | - | - | - | 2,694 | - | 2,694 | 2,694 |
| Loans | - | - | - | 59,422 | - | - | 59,422 | 59,537 |
| Due from related entities | 393 | - | - | 1,134 | - | - | 1,527 | 1,527 |
| Other assets | - | - | - | 186 | - | - | 186 | 186 |
| **Total financial assets** | 2,442 | - | 1 | 62,659 | 2,694 | - | 67,796 | 67,911 |
| **Financial liabilities** | | | | | | | | |
| Due to other financial institutions | - | - | - | - | - | 3 | 3 | 3 |
| Deposits | 1,423 | - | - | - | - | 41,967 | 43,390 | 43,474 |
| Derivative financial instruments | - | - | 360 | - | - | - | 360 | 360 |
| Debt issues | - | 4,063 | - | - | - | 8,851 | 12,914 | 12,902 |
| Other liabilities | - | - | - | - | - | 415 | 415 | 415 |
| Perpetual subordinated notes | - | - | - | - | - | 970 | 970 | 970 |
| Due to related entities | 345 | - | 598 | - | - | 3,736 | 4,679 | 4,679 |
| **Total financial liabilities** | 1,768 | 4,063 | 958 | - | - | 55,942 | 62,731 | 62,803 |

## Note 27 Fair value of financial instruments (continued)

| | The Bank 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Classified at Fair Value through Profit or Loss | | | | | | | |
| $ millions | Held for Trading | Designated upon Initial Recognition | Hedging | Loans and Receivables | Available-for-sale Financial Assets | Financial Liabilities at Amortised Cost | Total Carrying Amount | Estimated Fair Value |
| **Financial assets** | | | | | | | | |
| Cash and balances with central banks | - | - | - | 1,804 | - | - | 1,804 | 1,804 |
| Due from other financial institutions | - | - | - | 173 | - | - | 173 | 173 |
| Derivative financial instruments | 6 | - | 2 | - | - | - | 8 | 8 |
| Trading securities | 1,578 | - | - | - | - | - | 1,578 | 1,578 |
| Available-for-sale securities | - | - | - | - | 2,715 | - | 2,715 | 2,715 |
| Loans | - | - | - | 61,479 | - | - | 61,479 | 61,382 |
| Due from related entities | 460 | - | - | 10,559 | - | - | 11,019 | 11,019 |
| Other assets | - | - | - | 188 | - | - | 188 | 188 |
| **Total financial assets** | 2,044 | - | 2 | 74,203 | 2,715 | - | 78,964 | 78,867 |
| **Financial liabilities** | | | | | | | | |
| Due to other financial institutions | - | - | - | - | - | 100 | 100 | 100 |
| Deposits | 1,534 | - | - | - | - | 45,332 | 46,866 | 46,936 |
| Derivative financial instruments | - | - | 178 | - | - | - | 178 | 178 |
| Debt issues | - | - | - | - | - | 3,741 | 3,741 | 3,850 |
| Other liabilities | - | - | - | - | - | 372 | 372 | 372 |
| Due to related entities | 54 | 2,776 | 400 | - | - | 18,957 | 22,187 | 22,332 |
| **Total financial liabilities** | 1,588 | 2,776 | 578 | - | - | 68,502 | 73,444 | 73,768 |

| | The Bank 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Classified at Fair Value through Profit or Loss | | | | | | | |
| $ millions | Held for Trading | Designated upon Initial Recognition | Hedging | Loans and Receivables | Available-for-sale Financial Assets | Financial Liabilities at Amortised Cost | Total Carrying Amount | Estimated Fair Value |
| **Financial assets** | | | | | | | | |
| Cash and balances with central banks | - | - | - | 1,595 | - | - | 1,595 | 1,595 |
| Due from other financial institutions | - | - | - | 322 | - | - | 322 | 322 |
| Derivative financial instruments | 9 | - | 1 | - | - | - | 10 | 10 |
| Trading securities | 2,040 | - | - | - | - | - | 2,040 | 2,040 |
| Available-for-sale securities | - | - | - | - | 2,694 | - | 2,694 | 2,694 |
| Loans | - | - | - | 59,303 | - | - | 59,303 | 59,418 |
| Due from related entities | 393 | - | - | 9,984 | - | - | 10,377 | 10,377 |
| Other assets | - | - | - | 163 | - | - | 163 | 163 |
| **Total financial assets** | 2,442 | - | 1 | 71,367 | 2,694 | - | 76,504 | 76,619 |
| **Financial liabilities** | | | | | | | | |
| Due to other financial institutions | - | - | - | - | - | 3 | 3 | 3 |
| Deposits | 1,423 | - | - | - | - | 41,247 | 42,670 | 42,752 |
| Derivative financial instruments | - | - | 360 | - | - | - | 360 | 360 |
| Debt issues | - | - | - | - | - | 2,674 | 2,674 | 2,771 |
| Other liabilities | - | - | - | - | - | 352 | 352 | 352 |
| Perpetual subordinated notes | - | - | - | - | - | 970 | 970 | 970 |
| Due to related entities | 345 | 4,067 | 598 | - | - | 19,566 | 24,576 | 24,467 |
| **Total financial liabilities** | 1,768 | 4,067 | 958 | - | - | 64,812 | 71,605 | 71,675 |

## Note 27 Fair value of financial instruments (continued)

Fair values of financial instruments not carried at fair value in the balance sheet have been determined as follows:

- *Certain short-term financial instruments*

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

- *Floating rate financial instruments*

  For floating rate financial instruments, including variable rate loans, with no significant change in credit risk, the carrying amount is a reasonable estimate of fair value.

- *Due from other financial institutions and fixed rate loans*

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

- *Due to other financial institutions, deposits and debt issues*

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

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

- *Other financial assets and liabilities*

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

*Rates used for determining fair value*

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

| % | **The Banking Group and the Bank 2013** | 2012 |
|---|---|---|
| Loans | **4.08 - 9.20** | 2.63 - 8.20 |
| Deposits | **0.00 - 5.29** | 0.10 - 4.99 |
| Debt issues | **0.00 - 5.12** | 0.01 - 3.46 |

## Note 28 Commitments and contingent liabilities

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| **Commitments for capital expenditure** | | | | |
| Due within one year | **3** | 4 | **-** | - |
| **Other expenditure commitments:** | | | | |
| One year or less | **108** | 95 | **108** | 95 |
| Between one and five years | **209** | 293 | **209** | 293 |
| Over five years | **1** | - | **1** | - |
| **Total other expenditure commitments** | **318** | 388 | **318** | 388 |
| **Lease commitments (all leases are classified as operating leases)** | | | | |
| Premises and sites | **263** | 219 | **-** | - |
| Motor vehicles | **7** | 8 | **7** | 8 |
| **Total lease commitments** | **270** | 227 | **7** | 8 |
| **Lease commitments are due as follows:** | | | | |
| One year or less | **54** | 44 | **3** | 3 |
| Between one and five years | **145** | 117 | **4** | 5 |
| Over five years | **71** | 66 | **-** | - |
| **Total lease commitments** | **270** | 227 | **7** | 8 |
| **Other contingent liabilities and commitments** | | | | |
| Direct credit substitutes | **74** | 80 | **74** | 80 |
| Loan commitments with certain drawdown | **205** | 177 | **205** | 177 |
| Transaction-related contingent items | **818** | 796 | **818** | 796 |
| Short-term, self-liquidating trade-related contingent liabilities | **386** | 397 | **386** | 397 |
| Other commitments to provide financial services | **19,369** | 19,030 | **19,224** | 18,886 |
| **Total other contingent liabilities and commitments** | **20,852** | 20,480 | **20,707** | 20,336 |

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

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

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

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

The Banking Group is obliged to repurchase any loan sold to and:

(a) held by the Westpac Home Loan Trust ('**HLT**') where it is discovered within 120 days of sale that those loans were not eligible for sale when sold;

(b) held by WNZSL (pursuant to its securitisation programme) where the loan ceases to conform to certain terms and conditions of the WNZSL securitisation programme;

(c) held by 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 Banking Group will arise from these obligations.

The Bank guarantees the due and punctual payment of all sums payable to the holders of the debt securities issued by its indirect, wholly-owned subsidiary, WSNZL, the proceeds of which are immediately on-lent to the Bank. The aggregate amount of outstanding principal and interest as at 30 September 2013 was $7,784 million (30 September 2012: $10,041 million). As the proceeds of the debt issuances are immediately on-lent to the Bank, the aggregate amount guaranteed is already reflected in the Bank's Balance sheet as part of the amounts due to related entities.

In addition, the Banking Group (through WNZCBL) guarantees covered bonds issued by WSNZL (refer to Note 13 for further details).

### Other contingent liabilities

The Banking Group has other contingent liabilities in respect of actual and potential claims and proceedings. An assessment of the 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.

## Note 28 Commitments and contingent liabilities (continued)

WNZIL, a subsidiary of the Bank, leases the majority of the properties it occupies. 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 2013 was estimated to be $22 million (30 September 2012: $22 million).

No amount has been recognised for the $22 million in estimated maximum vacation payments as the 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.

### Other commitments

As at 30 September 2013, the Banking Group had commitments in respect of interest swap transactions, provision of credit, underwriting facilities and other arrangements entered into in the normal course of business. The Banking Group has management systems and operational controls in place to manage interest rate, currency and credit risks (refer to Note 35). Accordingly, it is not envisaged that any liability resulting in a material loss to the Banking Group will arise from these transactions to the extent that a provision has not been provided for under the Banking Group's usual practices.

## Note 29 Segment information

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

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

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

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

- Retail Banking provides financial services for private individuals;
- Wealth provides financial services for high net worth individuals, funds management and insurance distribution;
- Business Banking provides financial services for small to medium sized enterprise customers, corporates and agricultural businesses; and
- Institutional Banking provides a broad range of financial services to large corporate, institutional and government customers[1].

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

Reconciling items primarily represent:

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

Certain comparative information has been changed to ensure consistent presentation with the current reporting period.

[1] On 1 November 2011, the NZ Branch transferred additional institutional banking business activities and associated employees to the Bank (refer to Note 2 for further details). Further information on the NZ Branch is available in Westpac Banking Corporation's most recently published Disclosure Statement.

## Note 29 Segment information (continued)

| $ millions | Consumer Banking | Business Banking | Institutional Banking | Reconciling Items[1] | Total |
|---|---|---|---|---|---|
| | The Banking Group | | | | |
| **Year ended 30 September 2013** | | | | | |
| Net interest income | **800** | **467** | **178** | **91** | **1,536** |
| Non-interest income | **298** | **92** | **42** | **(61)** | **371** |
| **Net operating income** | **1,098** | **559** | **220** | **30** | **1,907** |
| Net operating income from external customers | **1,355** | **990** | **167** | **(605)** | **1,907** |
| Net internal operating (expense)/income | **(257)** | **(431)** | **53** | **635** | **-** |
| **Net operating income** | **1,098** | **559** | **220** | **30** | **1,907** |
| Depreciation | **-** | **-** | **-** | **(27)** | **(27)** |
| Software amortisation costs | **-** | **-** | **(1)** | **(34)** | **(35)** |
| Other operating expenses | **(180)** | **(72)** | **(20)** | **(476)** | **(748)** |
| **Total operating expenses** | **(180)** | **(72)** | **(21)** | **(537)** | **(810)** |
| Impairment (charges)/recoveries on loans | **(64)** | **1** | **(45)** | **1** | **(107)** |
| Share of profit of associate accounted for using the equity method | **-** | **-** | **-** | **1** | **1** |
| **Profit before income tax expense** | **854** | **488** | **154** | **(505)** | **991** |
| **Total gross loans** | **32,959** | **22,390** | **6,950** | **(162)** | **62,137** |
| **Total deposits** | **26,700** | **11,381** | **8,567** | **1,534** | **48,182** |
| **Year ended 30 September 2012[2]** | | | | | |
| Net interest income | 800 | 488 | 155 | 56 | 1,499 |
| Non-interest income | 283 | 94 | 39 | (60) | 356 |
| **Net operating income** | 1,083 | 582 | 194 | (4) | 1,855 |
| Net operating income from external customers | 1,466 | 1,063 | 178 | (852) | 1,855 |
| Net internal operating (expense)/income | (383) | (481) | 16 | 848 | - |
| **Net operating income** | 1,083 | 582 | 194 | (4) | 1,855 |
| Depreciation | (2) | - | - | (25) | (27) |
| Software amortisation costs | - | - | - | (38) | (38) |
| Other operating expenses | (182) | (73) | (20) | (467) | (742) |
| **Total operating expenses** | (184) | (73) | (20) | (530) | (807) |
| Impairment charges on loans | (39) | (144) | (12) | 5 | (190) |
| Share of profit of associate accounted for using the equity method | - | - | - | 1 | 1 |
| **Profit before income tax expense** | 860 | 365 | 162 | (528) | 859 |
| **Total gross loans** | 31,383 | 22,129 | 6,713 | (198) | 60,027 |
| **Total deposits** | 24,744 | 10,809 | 6,414 | 1,423 | 43,390 |

1 Included in the reconciling items for total operating expenses is $573 million (30 September 2012: $565 million) of head office operating expenses, which are not allocated to a business unit that meets the definition of an operating segment.

2 Institutional Banking represents the 11 month result of the transferred business operations since the acquisition date on 1 November 2011, as included in the Banking Group's consolidated income statement.

## Note 30 Superannuation commitments

The Banking Group has a hybrid (defined contribution and defined benefit) superannuation scheme for staff in New Zealand. Contributions, as specified in the rules of the scheme, are made by the Banking Group as required. The defined benefit scheme has been closed to new members since 1 April 1990. An actuarial valuation of the scheme is undertaken every three years, with the last actuarial assessment of the funding status undertaken as at 30 June 2011. Contributions to the defined benefit scheme are at a rate sufficient to keep the scheme solvent, and contributions are currently being made to the defined benefit scheme at the rate of 12% (before employer's superannuation contribution tax) of members' salaries.

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

## Note 30 Superannuation commitments (continued)

The table below details the primary actuarial assumptions used in the calculations of the defined benefit scheme obligation:

| % | The Banking Group and the Bank 2013 | 2012 |
|---|---|---|
| **Primary actuarial assumptions used in the above calculations** | | |
| Discount rate | **3.4** | 2.5 |
| Expected return on scheme assets – active members (end of year) | **6.0** | 6.0 |
| Expected return on scheme assets – pensioners | **6.0** | 6.0 |
| Rate of increase in salaries | **3.0** | 3.5 |
| Rate of increase for pensions | **2.5** | 2.5 |
| **Asset allocation** | | |
| Cash | **0.5** | 0.9 |
| Equity instruments | **58.5** | 57.1 |
| Debt instruments | **41.0** | 42.0 |
| **Total asset allocation** | **100.0** | 100.0 |

The carrying value of the retirement benefit obligation is disclosed as part of Note 22.

## Note 31 Key management personnel

### Key management personnel compensation

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

| $'000s | The Banking Group and the Bank Year Ended 30-Sep-13 | Year Ended 30-Sep-12 |
|---|---|---|
| Salaries and other short-term benefits | **10,352** | 11,484 |
| Post-employment benefits | **523** | 653 |
| Other termination benefits | **-** | 210 |
| Share-based payments | **3,787** | 3,282 |
| **Total key management compensation** | **14,662** | 15,629 |
| Loans to key management personnel | **6,290** | 5,166 |
| Deposits from key management personnel | **4,284** | 3,598 |
| Interest income on amounts due from key management personnel | **305** | 218 |
| Interest expense on amounts due to key management personnel | **129** | 67 |

The Directors have received remuneration from the Banking Group and these amounts are included in the table above.

### Loans and deposits with key management personnel

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

As at 30 September 2013 no provisions have been recognised in respect of loans given to key management personnel and their related parties (30 September 2012: nil).

### Other key management personnel transactions

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

## Note 32 Securitisation, funds management and other fiduciary activities

### Securitisation

AAs at 30 September 2013 the Bank and the Banking Group had securitised loans amounting to $158 million (30 September 2012: $215 million), which had been sold by the Bank and the Banking Group to external parties being the Home Loan Trust (‘**HLT**’) and the Westpac Mortgage Investment Fund (‘**MIF**’) via HLT. HLT and MIF were established, pursuant to trust deeds between BTNZ and The New Zealand Guardian Trust Company Limited, with the principal purpose of investing in housing loans. The purchase of these housing loans has been funded with the proceeds of units subscribed for, and issued to, retail investors in New Zealand. The Bank and the Banking Group receive fees for various services provided to HLT and MIF on an arm’s length basis, including servicing fees. These fees are recognised over the financial periods in which the costs are borne. The securitised assets have been derecognised from the financial statements of the Bank and the Banking Group as the risks and rewards of the assets have been substantially transferred to external parties.

The Bank has a $5.0 billion (30 September 2012: $5.0 billion) internal mortgage-backed securitisation programme. WNZSL issued residential mortgage-backed securities to fund the purchase of housing loans from the Bank. Those securities are currently held by the Bank. The most senior rated securities (30 September 2013: $4.75 billion, 30 September 2012: $4.75 billion) qualify as eligible collateral for repurchase agreements with the Reserve Bank. Holding a portion of housing loans in securitised format enables the Bank to maintain a readily available source of cash should market conditions become difficult. It takes advantage of the Reserve Bank’s guidelines for its overnight reverse repo facility and open market operations, which allows banks in New Zealand to offer residential mortgage-backed securities (secured by residential mortgage assets from their own balance sheets) as collateral for the Reserve Bank’s repurchase agreements.

### Funds management and other fiduciary activities

The Bank markets the products of BTNZ, a member of the Ultimate Parent Bank Group, through its branches, advisory network and private bank. The Bank derives distribution fees from the sale of managed fund products, superannuation and unit trusts marketed on behalf of BTNZ. The Bank also provides investment advice to a number of clients, which includes the provision of other fiduciary activities.

Term PIE and Cash PIE are administered by the Banking Group (refer to Note 25 for further details) and invest in deposits with the Bank. The Bank is considered to control Term PIE and Cash PIE, and as such both are consolidated within the financial statements of the Banking Group. As at 30 September 2013 $795 million and $521 million (30 September 2012: $720 million and nil) of funds under management were invested by Term PIE and Cash PIE, respectively, in the Bank’s deposits.

### Marketing and distribution of insurance products

The Bank markets and distributes both life and general insurance products. The life insurance products are underwritten by Westpac Life-NZ- Limited, a member of the Ultimate Parent Bank Group, and by external third party insurance companies. The general insurance products are fully underwritten by external third party insurance companies. Disclosure statements are made in all marketing material that the products are underwritten by those companies and that the Bank does not guarantee the obligations of, or any products issued by, those companies.

### Risk management

The Banking Group’s risk management framework (refer to Note 35) will help minimise the possibility that any difficulties arising from the above activities would impact adversely on the Banking Group.

Furthermore, during the year ended 30 September 2013:

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

### Peak aggregate funding provided to entities

The Banking Group did not provide any funding to entities conducting funds management and other fiduciary activities, or insurance product marketing and distribution activities described in this note, during the year ended 30 September 2013 (30 September 2012: nil).

## Note 33 Insurance business

The Banking Group does not conduct any insurance business (as that term is defined in the Order).

## Note 34 Capital adequacy

The information contained in this note has been derived in accordance with the Banking Group's conditions of registration which relate to capital adequacy and the document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) issued by the Reserve Bank. Effective from 1 January 2013 the Banking Group incorporated the Reserve Bank's application of the Basel III capital adequacy requirements.

The Banking Group maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the Banking Group's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision ('**BCBS**') and adopted by the Reserve Bank in supervising the Banking Group.

During the year ended 30 September 2013 the Banking Group complied in full with all its externally imposed capital requirements.

### Capital management

The primary objectives of the Banking Group's capital management are to ensure the Banking Group complies with externally imposed capital requirements and maintains strong credit ratings and healthy capital ratios in order to support its business and maximise shareholders' value.

The Banking Group manages its capital structure and makes adjustments in light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Banking Group may adjust the amount of dividend payments to shareholders, reduce discretionary expenditure, return/issue capital to shareholders or issue capital securities. No changes were made in the objectives, policies and processes during the year ended 30 September 2013.

Three independent processes, undertaken by Directors and senior management of the Bank, are designed to ensure that the Banking Group's capital is adequate to support its current and future activities:

1. The Board has approved a risk appetite statement. This statement outlines the target debt rating, target capital ratios and the degree of earnings volatility that is acceptable. Capital ratios are set at a higher level than required by the regulator, which both reduces the risk of breaching the conditions of registration and provides investor confidence. The Banking Group actively monitors its capital adequacy as part of the annual Banking Group internal capital adequacy assessment process ('**ICAAP**') and reports this to senior management and the Board.
2. The Banking Group calculates the capital required to be held for its current risk profile and forecasts the estimated capital position based on expected future activities. The forecast capital required is assessed against the target ranges that have been approved by the Board in regard to capital ratios.
3. The Ultimate Parent Bank Group takes capital considerations into account during its Board Strategy Review ('**BSR**'). The BSR is an annual process where the current strategic direction of the Ultimate Parent Bank Group is reviewed and refinements are made.

## Note 34 Capital adequacy (continued)

### Summary of ICAAP

The Banking Group's ICAAP outlines the Banking Group's approach to ensuring it has sufficient available capital to meet minimum capital requirements, even under stressed scenarios. The Reserve Bank document 'Guidelines on a Bank's Internal Capital Adequacy Assessment Process (ICAAP)' (BS12) reinforces this internal discipline by incorporating a specific requirement that the board of a New Zealand incorporated bank has a duty to ensure that capital held by the bank is commensurate with the level and extent of its risks.

The Banking Group's ICAAP is founded on the principle that its target level of capital is directly related to its risk appetite and corresponding risk profile. The ICAAP supplements the minimum regulatory capital requirements in respect of credit, market and operational risk through the consideration of a broader range of risk types and the Banking Group's risk and capital management capabilities. The ICAAP also takes account of stress testing, regulatory developments, minimum prudential capital ratios and peer group comparatives.

### The Banking Group's capital summary

| $ millions | The Banking Group 2013 Unaudited |
|---|---|
| **Tier One Capital** | |
| **Common Equity Tier One Capital** | |
| Paid-up ordinary shares issued by the Bank plus related share premium | **4,600** |
| Retained earnings (net of appropriations) | **1,818** |
| Accumulated other comprehensive income and other disclosed reserves[1] | **142** |
| ***Less deductions from Common Equity Tier One Capital*** | |
| Goodwill | **(477)** |
| Other intangible assets | **(183)** |
| Cash flow hedge reserve | **(36)** |
| Deferred tax asset deduction | **(180)** |
| Expected loss excess over eligible allowance | **(163)** |
| **Total Common Equity Tier One Capital** | **5,521** |
| **Additional Tier One Capital** | |
| Interests arising from ordinary shares issued by fully consolidated subsidiaries and held by third parties[2] | **2** |
| **Total Tier One Capital** | **5,523** |
| **Tier Two Capital** | |
| Tier Two Capital instruments | **-** |
| Revaluation reserves | **-** |
| Eligible impairment allowance in excess of expected loss | **-** |
| **Total Tier Two Capital** | **-** |
| **Total Capital** | **5,523** |

1 Accumulated other comprehensive income and other disclosed reserves consist of available-for-sale securities reserve of $106 million and cash flow hedge reserve of $36 million.

2 Additional Tier One Capital is recognised as equity in the Banking Group's balance sheet.

## Note 34 Capital adequacy (continued)

### Capital ratios

The Basel banking accords ('**the Accords**') have been developed and strengthened over time by the BCBS to enhance the banking regulatory framework. The Accords are made up of the different Basel frameworks with the latest being Basel III. Basel III builds on the Basel I and Basel II frameworks, and seeks to improve the banking sector's ability to deal with financial and economic stress, improve risk management and strengthen banks' transparency. The Basel III framework is built on three mutually reinforcing pillars. Pillar 1 sets out the mechanics for minimum capital adequacy requirements for credit, market and operational risks. Pillar 2 relates to the internal assessment of capital adequacy and the supervisory review process. Pillar 3 deals with market disclosure and market discipline.

The table below is disclosed under the Reserve Bank's Basel III framework in accordance with Clause 15 of Schedule 11 to the Order and represents the capital adequacy calculation based on the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B). The information for the comparative period is calculated based on the Reserve Bank's Basel II framework.

| % | The Banking Group 2013 Unaudited | 2012 Unaudited |
|---|---|---|
| **Capital adequacy ratios** | | |
| Common Equity Tier One Capital ratio | **12.3** | N/A |
| Tier One Capital ratio | **12.3** | 12.0 |
| Total Capital ratio | **12.3** | 14.1 |
| **Reserve Bank minimum ratios** | | |
| Common Equity Tier One Capital ratio | **4.5** | N/A |
| Tier One Capital ratio[1] | **6.0** | 4.0 |
| Total Capital ratio | **8.0** | 8.0 |
| **Buffer ratios** | | |
| Buffer ratio[2] | **4.3** | N/A |
| Buffer ratio requirement[2] | **2.5** | N/A |

1 Prior to a change to the Conditions of registration that took effect on 1 January 2013, locally incorporated registered banks having the benefit of the Wholesale Funding Guarantee Facility were required to maintain an additional 2% Tier One Capital ratio buffer above the then 4% regulatory minimum. Following the change, all locally incorporated registered banks are required to hold a minimum Tier One Capital ratio of 6%. See the 'Wholesale Guarantee' section on page 5 for more information.

2 As at 30 September 2013, there is no prescribed minimum regulatory buffer ratio. A prescribed minimum regulatory ratio of 2.5% will be effective from 1 January 2014.

### Banking Group Pillar I total capital requirement

| $ millions | 2013 Total Exposure After Credit Risk Mitigation Unaudited | Risk-weighted Exposure or Implied Risk-weighted Exposure Unaudited | Total Capital Requirement Unaudited |
|---|---|---|---|
| **Credit risk** | | | |
| Exposures subject to the internal ratings based approach | **83,709** | **33,576** | **2,686** |
| Equity exposures | **100** | **318** | **25** |
| Specialised lending subject to the slotting approach | **5,093** | **4,795** | **384** |
| Exposures subject to the standardised approach | **2,180** | **871** | **70** |
| **Total credit risk[1]** | **91,082** | **39,560** | **3,165** |
| **Operational risk** | **N/A** | **4,500** | **360** |
| **Market risk** | **N/A** | **833** | **67** |
| **Supervisory adjustment** | **N/A** | **-** | **-** |
| **Total** | **91,082** | **44,893** | **3,592** |

1 As required by the Bank's conditions of registration, the value of the scalar used in determining the minimum capital requirement (Required Regulatory Capital) is 1.06.

### Capital for other material risk

The Banking Group's ICAAP identifies, reviews and measures additional material risks that must be captured within the Banking Group's capital adequacy assessment process. These other material risks are those not captured by Pillar I regulatory capital requirements and consist of liquidity risk, reputational risk, environmental, social and governance risk, business risk, model risk and subsidiary risk.

The Banking Group's internal capital allocation for other material risks is:

| $ millions | The Banking Group 2013 Unaudited | 2012 Unaudited |
|---|---|---|
| **Internal capital allocation** | | |
| Other material risk | **571** | 517 |

## Note 34 Capital adequacy (continued)

### Solo capital adequacy

For the purposes of calculating the capital adequacy ratios for the Bank on a solo basis, wholly-owned and wholly-funded subsidiaries of the Banking Group are consolidated with the Bank. In this context, wholly-funded by the Bank means there are no liabilities (including off-balance sheet obligations) to anyone other than the Bank, the Inland Revenue or trade creditors, where aggregate exposure to trade creditors does not exceed 5% of the subsidiary's shareholders' equity. Wholly-owned by the Bank means that all equity issued by the subsidiary is held by the Bank or is ultimately owned by the Bank through a chain of ownership where each entity is 100% owned by its parent.

The table below represents the solo capital adequacy calculation based on the Reserve Bank's Basel III framework as contained in the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B). The information for the comparative period is calculated based on the Reserve Bank's Basel I capital adequacy framework.

| | The Bank | |
|---|---|---|
| % | **2013 Unaudited** | 2012 Unaudited |
| **Capital adequacy ratios** | | |
| Common Equity Tier One Capital ratio | **10.0** | N/A |
| Tier One Capital ratio | **10.0** | 8.7 |
| Total Capital ratio | **10.0** | 10.2 |

### Ultimate Parent Bank Group Basel III capital adequacy ratios

The table below represents the capital adequacy calculation for the Ultimate Parent Bank and the Ultimate Parent Bank together with its controlled entities ('**Ultimate Parent Bank Group**') based on the Australian Prudential Regulation Authority's ('**APRA**') application of the Basel III capital adequacy framework. The information for the comparative period is calculated based on APRA's application of the Basel 2.5 capital adequacy framework.

| % | **2013 Unaudited** | 2012 Unaudited |
|---|---|---|
| **Ultimate Parent Bank Group**[1, 2] | | |
| Common Equity Tier One Capital ratio | **9.1** | 8.4 |
| Additional Tier One Capital ratio | **1.6** | 1.9 |
| Tier One Capital ratio | **10.7** | 10.3 |
| Tier Two Capital ratio | **1.6** | 1.4 |
| Total Regulatory Capital ratio | **12.3** | 11.7 |
| **Ultimate Parent Bank (Extended Licensed Entity)**[1, 2] | | |
| Common Equity Tier One Capital ratio | **9.3** | 8.1 |
| Additional Tier One Capital ratio | **1.7** | 2.0 |
| Tier One Capital ratio | **11.0** | 10.1 |
| Tier Two Capital ratio | **1.8** | 1.7 |
| Total Regulatory Capital ratio | **12.8** | 11.8 |

1 The capital ratios represent information mandated by APRA.
2 The capital ratios of the Ultimate Parent Bank Group and the Ultimate Parent Bank (Extended Licensed Entity) are publicly available in the Ultimate Parent Bank Group's Pillar 3 report. This information is made available to users via the Ultimate Parent Bank's website (www.westpac.com.au).

APRA's new capital standards came into effect on 1 January 2013. The Ultimate Parent Bank Group is accredited by APRA to apply 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 (known as 'Advanced Accreditation') and is required by APRA to hold minimum capital at least equal to that specified under the Advanced IRB and AMA methodologies. Under New Zealand regulations this methodology is referred to as Basel III (internal models based approach). With this accreditation the Ultimate Parent Bank Group is required to disclose additional detailed information on its risk management practices and capital adequacy on a quarterly and a semi-annual basis. This information is made available to users via the Ultimate Parent Bank's website (www.westpac.com.au). The aim is to allow the market to better assess the Ultimate Parent Bank Group's risk and reward assessment process and hence increase the scrutiny of this process.

The Ultimate Parent Bank Group, and the Ultimate Parent Bank (Extended Licensed Entity as defined by APRA), exceeded the minimum capital adequacy requirements as specified by APRA as at 30 September 2013. APRA specifies a minimum prudential capital ratio for the Ultimate Parent Bank Group, which is not made publicly available.

## Note 35 Risk management

### General

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

## Note 35 Risk management (continued)

### Risk management framework and governance

The Board is responsible for determining the Bank's appetite for risk. The Bank is ultimately a subsidiary of the Ultimate Parent Bank and, therefore, a member of the group of companies comprising the Ultimate Parent Bank and its subsidiaries. Accordingly, the Banking Group's Risk Governance Framework is closely aligned with the Ultimate Parent Bank's Risk Governance Framework.

The Board is supported by the Bank's Board Audit Committee ('**Bank's BAC**') and the Bank's Board Risk Management Committee ('**Bank's BRMC**'), which are subcommittees of the Board responsible for monitoring risk management performance and controls across the Banking Group. The Bank's BAC comprises five Directors of the Bank all of whom are non-executive and of which four are independent. The Bank's BAC assists the Board in fulfilling its responsibilities in relation to external reporting of financial information, internal control of operational risk and the efficiency and effectiveness of audit and compliance with laws and regulations. It reviews the interim and annual financial statements, the activities of the Banking Group's auditors and monitors the relationship between management and the external auditors.

The Bank's BRMC comprises all of the non-executive Directors of the Board. The Bank's BRMC has power delegated by the Board to set risk appetites and approve frameworks, policies and processes for the management of risk. The Bank's BRMC approves the Risk Governance Framework at least every two years.

The Bank's Risk Governance Framework is designed to reflect that everyone in the Bank is responsible for identifying and managing risk and operating within the Bank's desired risk profile. Effective risk management is about achieving a balanced approach to risk and reward, and enables the Bank to both increase financial growth opportunities and mitigate potential loss or damage. Optimisation and mitigation strategies are equally important, along with maintaining an appropriate segregation of duties.

The Risk Governance Framework is owned by the Bank's Chief Risk Officer ('**CRO**'). Implementation is achieved through developing policies, controls, processes and procedures for identifying and managing risk arising from the Bank's activities.

### Risk types

The Bank maintains a risk reward oriented approach to creating shareholder value utilising a range of supporting frameworks covering all material risk classes. The Bank distinguishes between different risk types and takes an integrated approach to managing them. These key risks are:

- Credit risk: the risk of financial loss where a customer or counterparty fails to meet their financial obligations;
- Liquidity risk: the risk that the Bank will not be able to fund its assets and meet obligations as they come due, without incurring unacceptable losses;
- 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. This includes interest rate risk in the banking book – the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities;
- Operational risk: the risk of loss resulting from inadequate or failed internal processes, human error or misconduct, or from external events. It includes, among other things, technology risk, model risk and outsourcing risk; and
- Compliance risk: the risk of legal or regulatory sanction, and financial or reputational loss arising from the Banking Group's failure to abide by the compliance obligations required of the Banking Group.

Other risks include:

- Business risk: the risk associated with the vulnerability of a line of business to changes in the business environment;
- Environmental, Social and Governance risk: the risk that the Bank damages its reputation or financial performance due to failure to recognise or address material existing or emerging sustainability related environmental, social and governance issues;
- Reputation risk: the risk to earnings or capital arising from negative public opinion, resulting from the loss of reputation or public trust and standing; and
- Subsidiary (contagion) risk: the risk that problems arising in other members of the Banking Group may compromise the financial position of the Bank.

The essential elements of sound risk management include:

- a healthy risk culture with strong support from the Board, the Chief Executive and the Executive Team;
- observable linkages between strategy, risk appetite, risk and reward, and capital adequacy;
- clearly defined accountabilities, responsibilities and authorities;
- an appropriate level of risk management resources with the skills required to fulfil their responsibilities and support the strategy;
- clearly defined operating structures, reporting lines and governance structures;
- clear goals, objectives and incentives, including an appropriate risk-focused component of employee performance measurement;
- processes and systems that facilitate effective:
  - risk identification, analysis, evaluation and quantification;
  - consideration of risk avoidance or mitigation;
  - acceptance and management of residual risk;
  - capture and reporting of risk data for both internal and external purposes;
  - risk-adjusted measurement where there are rewards for taking risk; and
  - risk oversight and analysis, including stress testing; and
- assurance processes which ensure that risk-related practices and controls are appropriately embedded and are effective, and comply with internal, regulatory and legislative requirements.

## Note 35 Risk management (continued)

### Management assurance programme

The Bank has an Executive Risk and Audit Committee (‘**Bank’s ERAC**’) which meets quarterly, and which oversees credit, operational, compliance and reputational risks within the context of the Bank’s risk appetite as determined by the Bank’s Board as well as an Asset and Liability Committee (‘**Bank’s ALCO**’) which meets monthly, that leads the management of balance sheet risk and oversees market risk, liquidity risk and equity risk within the context of the Bank’s risk appetite as determined by the Bank’s Board.

The Banking Group has a management assurance programme designed to identify the key operational and compliance risks, the controls in place to mitigate those risks and to obtain assurance that those controls have continued to operate effectively. This programme allows senior management to affirm their satisfaction with the quality of the processes under their responsibility and with the effectiveness of the controls that support that assurance. The results of this process are reported to the Bank’s ERAC. The Bank’s Chief Executive (‘**CE**’) provides management assurance to the Ultimate Parent Bank Board Risk Management Committee, the Ultimate Parent Bank Board Audit Committee and the CEO of the Ultimate Parent Bank.

This system of management assurance assists the Ultimate Parent Bank’s Board in satisfying itself that the Banking Group’s risk management systems are adequate, that they operate effectively and that any deficiencies have been identified and are being addressed.

### Independent New Zealand Assurance unit

The Banking Group has an independent assurance unit (‘**New Zealand Assurance**’) comprised of a New Zealand based Audit team, supported by the Ultimate Parent Bank Credit Risk Assurance and Group Model Risk Management functions, which reports to the Bank’s BAC, as well as to the Ultimate Parent Bank.

New Zealand Assurance, as an independent function, has no direct authority over the activities of management. It has unlimited access to all the Banking Group’s activities, records, property and employees. The scope of responsibility of New Zealand Assurance covers systems of management control across all business activities and support functions at all levels of management within the Banking Group. The level of operational risk determines the scope and frequency of individual audits. The Head of New Zealand Assurance reports on a quarterly basis, or more often as deemed appropriate, to the Bank’s BAC, to agree the budget and the annual assurance plan and to report its findings. In addition, the Bank’s BAC has private sessions with the Head of New Zealand Assurance. Furthermore, the Head of New Zealand Assurance reports to the Chair of the Bank’s BAC, and for administrative purposes to the NZ Chief Financial Officer (‘**CFO**’) and the Ultimate Parent Bank’s General Manager Group Assurance.

### Reviews in respect of risk management systems

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

Group Assurance’s Credit Risk Assurance and Group Model Risk Management functions have a rolling programme of credit and model risk reviews throughout the financial year. New Zealand Assurance, with support from the Ultimate Parent Bank’s Group Assurance unit, also periodically reviews the Bank’s Operational, Market, Funding and Liquidity Risk Frameworks.

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

With a view to continuously improving its risk management, an external review of the Bank’s operational risk management framework was conducted during the year ended 30 September 2013.

## 35.1 Compliance and operational risk

The Bank’s ERAC, chaired by the Bank’s CRO, meets quarterly and is responsible for overseeing the effectiveness and implementation of the Operational Risk and Compliance Frameworks. ERAC monitors the operational risk profiles and the action plans, and has the discretion to escalate material matters to the Bank’s BRMC and/or the relevant Ultimate Parent Bank Group Risk Committee.

### Compliance risk

The Bank 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 Bank’s control.

The Bank has a dedicated Operational Risk and Compliance function. Effective compliance risk management enables the Bank to identify emerging issues and, where necessary, put in place preventative measures.

### Operational risk

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

The Bank has a dedicated Operational Risk function which uses its Operational Risk Management Framework (which is aligned to the Ultimate Parent Bank Group Operational Risk Management Framework) as a tool to assist its business units in the achievement of their objectives through assisting the business to understand and manage those risks that could hinder progress. This framework outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management and reporting and monitoring.

The Bank has implemented the AMA methodology for calculating operational risk capital. An outline of this methodology, as set out below, takes into consideration both internal and external factors.

## Note 35 Risk management (continued)

### Calculating operational risk capital

The calculation of operational risk capital is designed to estimate the amount of capital required to withstand losses from extreme unexpected operational risk events in future years. The Banking Group adopts a hybrid approach, relying on a variety of data sources that combines actual loss experience with estimates of potential future losses based on expert business judgment.

The Operational Risk Capital Model (‘**ORCM**’) has been developed to provide a reliable, reasonable and conservative estimate of the capital to be held by the Banking Group’s regulated entities. It includes capital for both expected and unexpected losses arising from operational risk events.

The Banking Group undertakes three streams of analysis. Each stream utilises different data sets to generate an estimate of potential financial loss. The three capital estimates are then weighted and combined to produce an estimate of capital. Three streams are used to provide a more comprehensive assessment of possible operational risks by:

- covering larger/infrequent losses via scenario analysis;
- providing for losses experienced by the Banking Group; and
- utilising loss history from peers with similar business models.

Together these three streams give an indication of the future losses that are possible.

The calculation of operational risk capital does not currently make any adjustment or deduction for risks that may be covered by insurance or any expected losses that are the subject of financial provisions.

Operation risk capital is calculated quarterly. The ORCM is reviewed annually to re-assess the appropriateness of the model framework, model methodology, assumptions and the parameters used in the model in light of industry developments, advancements in modelling techniques and changes in the broader Operational Risk Management Framework.

The following table sets out the Banking Group’s implied risk-weighted exposures under the AMA methodology and the operational risk capital requirement:

| | 2013 | |
|---|---|---|
| $ millions | Implied Risk-weighted Exposure Unaudited | Total Operational Risk Capital Requirement Unaudited |
| **Methodology implemented** | | |
| **Advanced Measurement Approach** | | |
| Operational risk | **4,500** | **360** |

## 35.2 Funding and liquidity risk

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

Responsibility for liquidity management is delegated to the Bank’s CFO under the oversight of the Bank’s CE. The Bank’s Treasury unit reports to the CFO and manages the liquidity position on a day to day basis. Liquidity risk positions are modelled and reported daily. Independent oversight is provided by the Head of Market Risk in conjunction with the Bank’s CRO, with executive oversight provided by the Bank’s ALCO. Reporting of liquidity and funding risk is provided to the Bank’s ALCO. Quarterly reporting is presented to the Bank’s BRMC who also approve the funding strategy, liquidity limits structure and liquidity risk management framework. In addition, reporting is also provided to the Ultimate Parent Bank’s Banking Book Risk Committee and Asset and Liability Committee.

The Bank aims to operate a mix of retail and wholesale funding, with emphasis on the value of core funding consistent with the principles inherent in BS13.

Key aspects of the liquidity management strategy are as follows:

### Liquidity risk management framework

The liquidity risk management framework (the ‘**framework**’) is owned by the Bank’s CRO and approved by the Bank’s BRMC. The framework covers all aspects of liquidity risk including:

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

The framework is reviewed at least every two years and submitted to the Bank’s BRMC for endorsement.

## Note 35 Risk management (continued)

### Daily liquidity modelling and reporting

The Bank is subject to the conditions of the Reserve Bank's liquidity policy, BS13. The following metrics are calculated and reported on a daily basis 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 Bank calculates the following liquidity ratios in accordance with the Ultimate Parent Bank's liquidity risk framework under APS 210 Liquidity:

- a going concern scenario; and
- a name crisis scenario.

Reports are circulated daily to the Bank's Treasury, Risk and Finance personnel, including the Bank's CRO and CFO. Exceptions to internal limits are escalated immediately to senior management, ALCO or the Board depending on the status of the limit.

### Annual funding plan

Each financial year the Bank's Treasury unit undertakes a comprehensive review resulting in the preparation of the Bank's annual funding plan. This review outlines the current funding strategy, proposes a funding strategy for the coming financial year and covers areas such as:

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

The Bank's annual funding plan is reviewed by the Bank's ALCO prior to approval by the Bank's BRMC.

### Contingency planning

Treasury maintains a Crisis Management Action Plan detailing broad actions that should be taken in the event of a funding crisis. This action plan:

- defines a committee of senior executives to manage a crisis;
- allocates responsibility to individuals for key tasks;
- includes a media relations strategy;
- provides a contingent funding plan; and
- contains detailed contact lists outlining key regulatory, government, ratings agencies and debt investor contact points.

### Sources of liquidity

The principal sources of liquidity for the Bank are:

- customer deposits;
- wholesale funding;
- proceeds from sales of marketable securities;
- repurchase agreements;
- principal repayments on loans;
- interest income; and
- fee income.

## Note 35 Risk management (continued)

### Wholesale funding

The wholesale funding base is diversified with respect to term, investor base, currency and funding instruments. The Bank and its subsidiary, WSNZL, maintain funding programmes for both short and long-term debt in several jurisdictions including New Zealand, Europe and the United States.

| | The Banking Group | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| Markets | Issuer | Programme Type | Programme Limit | Issuer | Programme Type | Programme Limit |
| Euro market | **Ultimate Parent Bank/ WSNZL[1]** | **Euro Commercial Paper and Certificate of Deposit Programme** | **US$20 billion** | Ultimate Parent Bank / WSNZL[1] | Euro Commercial Paper and Certificate of Deposit Programme | US$20 billion |
| Euro market | **WSNZL[1]** | **Programme for Issuance of Debt Instruments** | **US$7.5 billion** | WSNZL[1] | Programme for Issuance of Debt Instruments | US$7.5 billion |
| Euro market | **WSNZL[1]** | **Global Covered bond Programme** | **€5.0 billion** | WSNZL[1] | Global Covered bond Programme | €5.0 billion |
| United States | **WSNZL[1]** | **Section 4(2) US Commercial Paper Programme** | **US$10 billion** | WSNZL[1] | Section 4(2) US Commercial Paper Programme | US$10 billion |
| United States | **-** | **-** | **-** | WSNZL[1] | Rule 144A US Medium-term Note Programme | US$10 billion |
| New Zealand | **The Bank** | **Medium-term Note Programme and Registered Certificate of Deposit Programme** | **No limit** | The Bank | Medium-term Note Programme and Registered Certificate of Deposit Programme | No limit |

1 Notes issued by WSNZL are guaranteed by the Bank.

### Liquid assets

The table below shows the 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 Banking Group's liquidity requirements. In management's opinion, liquidity is sufficient to meet the Banking Group's present requirements.

| | The Banking Group and the Bank | |
|---|---|---|
| $ millions | 2013 | 2012 |
| Cash and balances with central banks | **1,804** | 1,595 |
| Due from other financial institutions (included in due from related entities) | **467** | 534 |
| Supranational securities | **433** | 414 |
| NZ Government securities | **2,454** | 2,575 |
| NZ public securities | **457** | 206 |
| NZ corporate securities | **1,309** | 1,861 |
| Residential mortgage-backed securities | **3,992** | 3,992 |
| **Total liquid assets** | **10,916** | 11,177 |

## Note 35 Risk management (continued)

### Liquidity analysis

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

| | The Banking Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2013 | | | | | | |
| $ millions | On Demand | Less Than 1 Month | 1 Month to 3 Months | 3 Months to 1 Year | 1 Year to 5 Years | Over 5 Years | Total |
| **Financial Assets** | | | | | | | |
| Cash and balances with central banks | 1,804 | - | - | - | - | - | 1,804 |
| Due from other financial institutions | 173 | - | - | - | - | - | 173 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 6 | - | - | - | - | - | 6 |
| Held for hedging purposes (net settled) | - | - | 1 | (2) | 3 | - | 2 |
| Trading securities | - | 362 | 766 | 202 | 303 | - | 1,633 |
| Available-for-sale securities | - | 113 | 23 | 158 | 1,628 | 1,240 | 3,162 |
| Loans | 6,146 | 5,818 | 4,604 | 6,024 | 21,154 | 46,621 | 90,367 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 916 | 460 | - | - | - | - | 1,376 |
| Other assets | - | 50 | - | - | - | - | 50 |
| **Total undiscounted financial assets** | 9,045 | 6,803 | 5,394 | 6,382 | 23,088 | 47,861 | 98,573 |
| **Financial Liabilities** | | | | | | | |
| Due to other financial institutions | - | 100 | - | - | - | - | 100 |
| Deposits | 21,759 | 5,378 | 8,604 | 11,501 | 1,635 | - | 48,877 |
| Derivative financial instruments: | | | | | | | |
| Held for hedging purposes (net settled) | - | 12 | 10 | 33 | 61 | 6 | 122 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | 19 | 61 | 1,955 | - | 2,035 |
| Cash inflow | - | - | - | (57) | (1,744) | - | (1,801) |
| Debt issues | - | 431 | 1,403 | 3,577 | 6,846 | 248 | 12,505 |
| Other liabilities | - | 100 | - | - | - | - | 100 |
| Due to related entities: | | | | | | | |
| Non-derivative balances | 508 | 48 | 29 | 63 | 2,403 | - | 3,051 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 54 | - | - | - | - | - | 54 |
| Held for hedging purposes (net settled) | (1) | 22 | 10 | (34) | (51) | (1) | (55) |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | 14 | 21 | 1,642 | 2,189 | - | 3,866 |
| Cash inflow | - | - | (1) | (1,306) | (1,846) | - | (3,153) |
| **Total undiscounted financial liabilities** | 22,320 | 6,105 | 10,095 | 15,480 | 11,448 | 253 | 65,701 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Loan commitments with certain drawdown | 205 | - | - | - | - | - | 205 |
| Other commitments to provide financial services | 19,369 | - | - | - | - | - | 19,369 |
| **Total undiscounted contingent liabilities and commitments** | 19,574 | - | - | - | - | - | 19,574 |

## Note 35 Risk management (continued)

| | The Banking Group | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2012 | | | | | | |
| $ millions | On Demand | Less Than 1 Month | 1 Month to 3 Months | 3 Months to 1 Year | 1 Year to 5 Years | Over 5 Years | Total |
| **Financial Assets** | | | | | | | |
| Cash and balances with central banks | 1,595 | - | - | - | - | - | 1,595 |
| Due from other financial institutions | 322 | - | - | - | - | - | 322 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 9 | - | - | - | - | - | 9 |
| Held for hedging purposes (net settled) | - | (2) | - | 4 | 4 | (3) | 3 |
| Trading securities | - | 350 | 1,378 | 35 | 277 | 52 | 2,092 |
| Available-for-sale securities | - | 84 | 20 | 117 | 1,266 | 1,608 | 3,095 |
| Loans | 7,378 | 5,691 | 4,792 | 5,298 | 20,209 | 44,228 | 87,596 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 1,527 | - | - | - | - | - | 1,527 |
| Other assets | - | 36 | - | - | - | - | 36 |
| **Total undiscounted financial assets** | 10,831 | 6,159 | 6,190 | 5,454 | 21,756 | 45,885 | 96,275 |
| **Financial Liabilities** | | | | | | | |
| Due to other financial institutions | 3 | - | - | - | - | - | 3 |
| Deposits | 18,900 | 5,914 | 7,800 | 9,324 | 2,180 | - | 44,118 |
| Derivative financial instruments: | | | | | | | |
| Held for hedging purposes (net settled) | - | 11 | 7 | 44 | 166 | 33 | 261 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | 18 | 69 | 2,464 | - | 2,551 |
| Cash inflow | - | - | - | (57) | (2,132) | - | (2,189) |
| Debt issues | - | 1,026 | 642 | 3,938 | 7,848 | 259 | 13,713 |
| Other liabilities | - | 77 | - | - | - | - | 77 |
| Perpetual subordinated notes | - | - | - | - | - | 970 | 970 |
| Due to related entities: | | | | | | | |
| Non-derivative balances | 588 | 48 | 34 | 99 | 3,273 | - | 4,042 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 345 | - | - | - | - | - | 345 |
| Held for hedging purposes (net settled) | - | 8 | 12 | (5) | (10) | (1) | 4 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | 46 | 1,112 | 3,815 | - | 4,973 |
| Cash inflow | - | - | (1) | (986) | (3,055) | - | (4,042) |
| **Total undiscounted financial liabilities** | 19,836 | 7,084 | 8,558 | 13,538 | 14,549 | 1,261 | 64,826 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Loan commitments with certain drawdown | 177 | - | - | - | - | - | 177 |
| Other commitments to provide financial services | 19,030 | - | - | - | - | - | 19,030 |
| **Total undiscounted contingent liabilities and commitments** | 19,207 | - | - | - | - | - | 19,207 |

## Note 35 Risk management (continued)

| | The Bank | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2013 | | | | | | |
| $ millions | On Demand | Less Than 1 Month | 1 Month to 3 Months | 3 Months to 1 Year | 1 Year to 5 Years | Over 5 Years | Total |
| **Financial Assets** | | | | | | | |
| Cash and balances with central banks | 1,804 | - | - | - | - | - | 1,804 |
| Due from other financial institutions | 173 | - | - | - | - | - | 173 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 6 | - | - | - | - | - | 6 |
| Held for hedging purposes (net settled) | - | - | 1 | (2) | 3 | - | 2 |
| Trading securities | - | 362 | 766 | 202 | 303 | - | 1,633 |
| Available-for-sale securities | - | 113 | 23 | 158 | 1,628 | 1,240 | 3,162 |
| Loans | 6,081 | 5,817 | 4,604 | 6,024 | 21,148 | 46,585 | 90,259 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 1,028 | 476 | 77 | 280 | 1,490 | 11,666 | 15,017 |
| Other assets | - | 49 | - | - | - | - | 49 |
| **Total undiscounted financial assets** | 9,092 | 6,817 | 5,471 | 6,662 | 24,572 | 59,491 | 112,105 |
| **Financial Liabilities** | | | | | | | |
| Due to other financial institutions | - | 100 | - | - | - | - | 100 |
| Deposits | 21,238 | 5,225 | 8,396 | 11,080 | 1,602 | - | 47,541 |
| Derivative financial instruments: | | | | | | | |
| Held for hedging purposes (net settled): | - | 12 | 10 | 33 | 61 | 6 | 122 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | 19 | 61 | 1,955 | - | 2,035 |
| Cash inflow | - | - | - | (57) | (1,744) | - | (1,801) |
| Debt issues | - | 7 | 437 | 833 | 2,821 | 248 | 4,346 |
| Other liabilities | - | 98 | - | - | - | - | 98 |
| Due to related entities: | | | | | | | |
| Non-derivative balances[1] | 1,417 | 638 | 1,279 | 3,508 | 7,952 | 11,432 | 26,226 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 54 | - | - | - | - | - | 54 |
| Held for hedging purposes (net settled) | (1) | 22 | 10 | (34) | (51) | (1) | (55) |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | 14 | 21 | 1,642 | 2,189 | - | 3,866 |
| Cash inflow | - | - | (1) | (1,306) | (1,846) | - | (3,153) |
| **Total undiscounted financial liabilities** | 22,708 | 6,116 | 10,171 | 15,760 | 12,939 | 11,685 | 79,379 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Loan commitments with certain drawdown | 205 | - | - | - | - | - | 205 |
| Other commitments to provide financial services | 19,224 | - | - | - | - | - | 19,224 |
| **Total undiscounted contingent liabilities and commitments** | 19,429 | - | - | - | - | - | 19,429 |

[1] The Bank provides a financial guarantee in relation to commercial paper and other debt securities issued by WSNZL, the proceeds of which are immediately on lent to the Bank. As a result, the financial guarantee provided by the Bank is reflected as part of the amounts due to related entities.

## Note 35 Risk management (continued)

| $ millions | On Demand | Less Than 1 Month | 1 Month to 3 Months | 3 Months to 1 Year | 1 Year to 5 Years | Over 5 Years | Total |
|---|---|---|---|---|---|---|---|
| | The Bank 2012 | | | | | | |
| **Financial Assets** | | | | | | | |
| Cash and balances with central banks | 1,595 | - | - | - | - | - | 1,595 |
| Due from other financial institutions | 322 | - | - | - | - | - | 322 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 9 | - | - | - | - | - | 9 |
| Held for hedging purposes (net settled) | - | (2) | - | 4 | 4 | (3) | 3 |
| Trading securities | - | 350 | 1,378 | 35 | 277 | 52 | 2,092 |
| Available-for-sale securities | - | 84 | 20 | 117 | 1,266 | 1,608 | 3,095 |
| Loans | 7,310 | 5,691 | 4,792 | 5,298 | 20,202 | 44,183 | 87,476 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 1,627 | - | 44 | 131 | 696 | 8,996 | 11,494 |
| Other assets | - | 13 | - | - | - | - | 13 |
| **Total undiscounted financial assets** | 10,863 | 6,136 | 6,234 | 5,585 | 22,445 | 54,836 | 106,099 |
| **Financial Liabilities** | | | | | | | |
| Due to other financial institutions | 3 | - | - | - | - | - | 3 |
| Deposits | 18,900 | 5,752 | 7,594 | 9,013 | 2,118 | - | 43,377 |
| Derivative financial instruments: | | | | | | | |
| Held for hedging purposes (net settled) | - | 11 | 7 | 44 | 166 | 33 | 261 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | 18 | 69 | 2,464 | - | 2,551 |
| Cash inflow | - | - | - | (57) | (2,132) | - | (2,189) |
| Debt issues | - | 6 | 21 | 191 | 2,673 | 259 | 3,150 |
| Other liabilities | - | 77 | - | - | - | - | 77 |
| Perpetual subordinated notes | - | - | - | - | - | 970 | 970 |
| Due to related entities: | | | | | | | |
| Non-derivative balances[1] | 2,271 | 1,168 | 901 | 4,349 | 9,212 | 6,725 | 24,626 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 345 | - | - | - | - | - | 345 |
| Held for hedging purposes (net settled) | - | 8 | 12 | (5) | (10) | (1) | 4 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | 46 | 1,112 | 3,815 | - | 4,973 |
| Cash inflow | - | - | (1) | (986) | (3,055) | - | (4,042) |
| **Total undiscounted financial liabilities** | 21,519 | 7,022 | 8,598 | 13,730 | 15,251 | 7,986 | 74,106 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Loan commitments with certain drawdown | 177 | - | - | - | - | - | 177 |
| Other commitments to provide financial services | 18,886 | - | - | - | - | - | 18,886 |
| **Total undiscounted contingent liabilities and commitments** | 19,063 | - | - | - | - | - | 19,063 |

[1] The Bank provides a financial guarantee in relation to commercial paper and other debt securities issued by WSNZL, the proceeds of which are immediately on lent to the Bank. As a result, the financial guarantee provided by the Bank is reflected as part of the amounts due to related entities.

## 35.3 Credit risk

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

### Credit risk management

The Banking Group adopts two approaches to managing credit risk depending upon the nature of the customer and product:

- **Transaction-managed approach**

  For larger customers, the Banking Group evaluates credit requests by undertaking detailed individual customer and transaction risk analysis (the '**transaction-managed**' approach). Such customers are assigned a customer risk grade ('**CRG**') based on the Banking Group's estimate of their PD. Each facility is assigned a LGD taking into account the realistic distress value of assets over which the Banking Group holds security and considering the seniority of exposures in the capital and debt structure of the customer. The final assignment of CRGs and LGDs are approved by independent credit officers with appropriate authority. Divisional operational units are responsible for ensuring accurate and timely recording of all changes to customer and facility data.

## Note 35 Risk management (continued)

- **Program-managed approach**

  High-volume customer credit portfolios with homogenous credit risk characteristics are managed on a statistical basis according to predetermined objective criteria (the '**program-managed**' approach). Quantitative scorecards are used to assign application and behavioural scores to enable risk-based decision-making within these portfolios. The scorecard outcomes and decisions are regularly monitored and validated against subsequent customer performance and recalibrated (or rebuilt) when required. For capital estimation (and other purposes), risk-based customer segments are created based on expected PDs, and LGDs are assigned for each segment based on historic experience and management judgment.

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

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

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

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

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

### Credit risk mitigation, collateral and other credit enhancements

The Banking Group uses a variety of techniques to reduce the credit risk arising from its lending activities. Enforceable legal documentation establishes the Banking Group's direct, irrevocable and unconditional recourse to any collateral, security or other credit enhancements provided.

The Banking Group includes the effect of credit risk mitigation through eligible guarantees within the calculation applied to LGD. The value of the guarantee is not always separately recorded, and therefore not available for disclosure, under Clause 7 of Schedule 11 to the Order.

The table below describes the nature of collateral held for financial asset classes:

| | |
|---|---|
| Cash and balances with central bank | These exposures are generally considered to be low risk due to the nature of the counterparties. These balances are not collateralised. |
| Due from other financial institutions | These exposures are mainly to relatively low risk banks (Rated A+, AA– or better). These balances are not collateralised. |
| Derivative financial instruments | Netting agreements are typically used to enable the effects of derivative assets and liabilities with the same counterparty to be offset when measuring these exposures. Additionally, collateralisation agreements are also typically entered into with major derivatives counterparties to avoid the potential build up of excessive mark-to-market positions. |
| Trading securities | These exposures are carried at fair value which reflects the credit risk. No collateral is sought directly from the issuer or counterparty. |
| Available-for-sale securities | Collateral is not sought directly with respect to these exposures. |
| Loans | Housing and other loans for consumer purposes may be secured, partially secured or unsecured depending on the product. Security is typically taken by a fixed and/or floating charge over property or other assets. Loans for business purposes may be secured, partially secured or unsecured. Security is typically taken by way of a fixed and/or floating charge over property, business assets, or other assets. Other forms of credit protection may also be sought or taken out if warranted. |
| Due from subsidiaries | These exposures are generally considered to be low risk due to the nature of the counterparties. These balances are not collateralised. |
| Other assets | Collateral is generally not sought on these balances except on accrued interest receivable which is assumed to follow the principal amount recorded in Loans. |

## Note 35 Risk management (continued)

***Risk reduction***

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

- collateralisation, where the exposure is secured by eligible financial collateral or protection; or
- formal set-off arrangements.

*Collateral valuation and management*

The Banking Group revalues exposures and collateral related to financial markets positions on a daily basis to monitor the net risk position, and formal processes are in place to ensure calls for collateral top-up or exposure reduction are made promptly. An independent operational unit has responsibility for monitoring these positions. The collaterisation arrangements are documented via the Support Annex of the International Swaps and Derivatives Association dealing agreements.

The Banking Group only recognises cash as eligible collateral for credit risk mitigation by way of risk reduction.

*Netting*

Risk reduction by way of current account set-offs is recognised for exposures to creditworthy customers domiciled in New Zealand only. Customers are required to enter into formal agreements giving the Banking Group the unfettered right to set-off gross credit and debit balances in their nominated accounts to determine the Bank's net exposure within New Zealand.

Payment and close-out netting is undertaken for off-balance sheet financial market transactions with counterparties with whom the Banking Group has entered into legally enforceable master dealing agreements which allow such netting in specified jurisdictions. Payment netting allows the Bank to net settlements on any day to reduce cash flow exchanges between counterparties. Close-out netting effectively aggregates pre-settlement risk exposure at the time of default, thus reducing overall exposure.

***Risk transfer***

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

- sovereign entities;
- public sector entities in Australia and New Zealand;
- ADIs and overseas banks; and
- other entities with a minimum risk grade equivalent of A3/A–.

### Internal credit risk rating system

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

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

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

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

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

## Note 35 Risk management (continued)

The Banking Group's credit risk rating system is reviewed to ensure the rating criteria and procedures are applicable to the current portfolio and external conditions. The annual review of the credit risk rating framework is approved by the Ultimate Parent Bank BRMC.

To ensure the credit risk rating system is applied consistently across the Banking Group, the Ultimate Parent Bank Group's Credit Risk Assurance team independently reviews end-to-end technical and operational aspects of the overall process. Models materially impacting the risk rating process are reviewed annually in accordance with the Ultimate Parent Bank Group's model risk policy.

Specific credit risk estimates (including PD, LGD and EAD levels) are overseen and approved by ERAC and by the Ultimate Parent Bank Group Credit Risk Committees for utilisation within the Banking Group.

### Use of internal credit risk estimates

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

***Economic capital***

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

***Pricing***

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

***Provisioning***

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

***Credit approval authorities***

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

***Risk-adjusted performance measurement***

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

### Regulatory capital

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

***Overview of 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 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*

*(i) PD*

The PD is a through the cycle assessment of the likelihood of a customer defaulting on its financial obligations within one year. PD is represented in a CRG.

*(ii) LGD*

The LGD represents an estimate of the expected severity of a loss to the Banking Group should a customer default occur during an economic downturn. The 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 Banking Group has recourse and over which it has security. LGDs also reflect the seniority of exposures in the customers' capital and debt structure.

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

## Note 35 Risk management (continued)

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

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

*(iii) EAD and Credit Conversion Factor ('**CCF**')*

EAD represents an estimate of the amount of committed exposure expected to be drawn by the customer at the time of default. To calculate EAD, historical data is analysed to determine what proportion of undrawn commitments are ultimately utilised by customers who end up in default. The proportion of undrawn commitments ultimately is termed the CCF. EAD therefore consists of 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<br>▪ Business overdrafts<br>▪ Business term loans<br>▪ Business credit cards |
| Other retail | ▪ Credit cards<br>▪ Personal loans<br>▪ Overdrafts |

*(i) 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.

*(ii) 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.

*(iii) 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.

*(iv) TCE*

TCE represents the sum of on- and off-balance sheet exposures.

## Note 35 Risk management (continued)
### Maximum exposure to credit risk

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and balances with central banks | **1,804** | 1,595 | **1,804** | 1,595 |
| Due from other financial institutions | **173** | 322 | **173** | 322 |
| Derivative financial instruments | **8** | 10 | **8** | 10 |
| Trading securities | **1,578** | 2,040 | **1,578** | 2,040 |
| Available-for-sale securities | **2,715** | 2,694 | **2,715** | 2,694 |
| Loans | **61,585** | 59,422 | **61,479** | 59,303 |
| Due from related entities | **1,376** | 1,527 | **11,019** | 10,377 |
| Other assets | **190** | 186 | **188** | 163 |
| **Total financial assets** | **69,429** | 67,796 | **78,964** | 76,504 |
| **Contingent liabilities and commitments** | | | | |
| Direct credit substitutes | **74** | 80 | **74** | 80 |
| Loan commitments with certain drawdown | **205** | 177 | **205** | 177 |
| Transaction-related contingent items | **818** | 796 | **818** | 796 |
| Short-term, self-liquidating trade-related contingent liabilities | **386** | 397 | **386** | 397 |
| Other commitments to provide financial services | **19,369** | 19,030 | **19,224** | 18,886 |
| **Total contingent liabilities and commitments** | **20,852** | 20,480 | **20,707** | 20,336 |
| **Total maximum credit risk exposure** | **90,281** | 88,276 | **99,671** | 96,840 |

### Mapping of Basel categories to the Banking Group portfolios

| Asset Class | Sub-asset Class | Banking Group Category | Segmentation Criteria |
|---|---|---|---|
| Corporate | Corporate | Corporate | All transaction-managed customers not elsewhere classified where annual turnover exceeds $50 million. |
| | SME corporate | Business lending | All transaction-managed customers not elsewhere classified where annual turnover is $50 million or less. |
| | Specialised lending | Specialised lending-property | Applied to transaction-managed customers where the primary source of debt service, security and repayment is derived from either the sale of a property development or income produced by one or more investment properties. |
| | | Specialised lending-project finance | Applied to transaction-managed customers where the primary source of debt service, repayment and security is revenues generated by a project. |
| Sovereign | | Sovereign | Applied to transaction-managed customers identified by Australian and New Zealand Standard Industrial Classification code. |
| Bank | | Bank | Applied to transaction-managed customers identified by Australian and New Zealand Standard Industrial Classification code. |
| Residential mortgages | | Residential mortgages | All program-managed exposures secured by residential mortgages defined as housing lending. |
| Other retail | | Small business | Program-managed business lending. |
| | | Other retail | All other program-managed lending to retail customers, including New Zealand credit cards. |

## Note 35 Risk management (continued)

### Credit risk exposures by asset class

***The Banking Group's credit risk exposures by asset class as at 30 September 2013 (Unaudited)***

| PD Band (%) | TCE $ millions | EAD $ millions | Average PD % | Average LGD % | Average Risk Weight % | Risk-weighted Assets (scaled)[1] $ millions | Required Regulatory Capital $ millions |
|---|---|---|---|---|---|---|---|
| **Residential mortgages** | | | | | | | |
| 0.00 to 0.10 | - | - | - | - | - | - | - |
| 0.10 to 0.25 | 2,272 | 1,944 | - | 21.59 | 8.49 | 165 | 13 |
| 0.25 to 1.0 | 22,162 | 21,233 | 0.56 | 21.59 | 20.33 | 4,317 | 346 |
| 1.0 to 2.5 | 15,870 | 15,457 | 1.39 | 21.59 | 38.24 | 5,911 | 473 |
| 2.5 to 10.0 | 3,986 | 3,936 | 4.63 | 21.59 | 78.10 | 3,074 | 246 |
| 10.0 to 99.99 | - | - | - | - | - | - | - |
| Default | 378 | 375 | 100.00 | 21.59 | 214.40 | 804 | 64 |
| **Total** | 44,668 | 42,945 | 2.09 | 21.59 | 33.23 | 14,271 | 1,142 |
| **Other retail (Credit cards, personal loans, personal overdrafts)** | | | | | | | |
| 0.00 to 0.10 | - | - | - | - | - | - | - |
| 0.10 to 0.25 | 707 | 483 | - | 40.58 | 13.87 | 67 | 5 |
| 0.25 to 1.0 | 1,906 | 1,139 | - | 63.48 | 39.77 | 453 | 36 |
| 1.0 to 2.5 | 1,378 | 1,209 | 2.20 | 67.55 | 93.88 | 1,135 | 91 |
| 2.5 to 10.0 | 361 | 344 | 5.34 | 83.03 | 131.10 | 451 | 36 |
| 10.0 to 99.99 | 237 | 235 | 19.70 | 70.26 | 154.04 | 362 | 29 |
| Default | 18 | 21 | 100.00 | 64.50 | 114.29 | 24 | 2 |
| **Total** | 4,607 | 3,431 | 3.41 | 64.12 | 72.63 | 2,492 | 199 |
| **Small business** | | | | | | | |
| 0.00 to 0.10 | - | - | - | - | - | - | - |
| 0.10 to 0.25 | 269 | 195 | - | 73.76 | 26.15 | 51 | 4 |
| 0.25 to 1.0 | 578 | 576 | 0.77 | 22.82 | 21.88 | 126 | 10 |
| 1.0 to 2.5 | - | - | - | - | - | - | - |
| 2.5 to 10.0 | 1,587 | 1,586 | 2.87 | 18.11 | 29.19 | 463 | 37 |
| 10.0 to 99.99 | 24 | 24 | 19.16 | 25.22 | 58.33 | 14 | 1 |
| Default | 47 | 70 | 92.30 | 40.42 | 165.71 | 116 | 9 |
| **Total** | 2,505 | 2,451 | 4.87 | 24.35 | 31.42 | 770 | 61 |

[1] As required by the conditions of registration, the value of the scalar used in determining the minimum capital requirement (Required Regulatory Capital) is 1.06. The full details of the Bank's conditions of registration are included on page 6.

## Note 35 Risk management (continued)

| PD Grade | TCE $ millions | EAD $ millions | Average PD % | Average LGD % | Average Risk Weight % | Risk-weighted Assets (scaled)[1] $ millions | Required Regulatory Capital $ millions |
|---|---|---|---|---|---|---|---|
| **Banking Group - Corporate/Business lending** | | | | | | | |
| AAA | 269 | 269 | - | 25.84 | 11.90 | 32 | 3 |
| AA | 1,545 | 1,443 | - | 36.89 | 13.24 | 191 | 15 |
| A | 3,840 | 3,659 | - | 51.38 | 27.47 | 1,005 | 80 |
| BBB | 6,543 | 6,520 | - | 45.92 | 46.60 | 3,038 | 243 |
| BB | 10,348 | 10,312 | 1.57 | 35.35 | 78.27 | 8,071 | 645 |
| B | 353 | 349 | 3.62 | 37.55 | 106.02 | 370 | 30 |
| Other | 1,068 | 1,067 | 25.75 | 42.27 | 218.84 | 2,335 | 187 |
| Default | 315 | 414 | 99.95 | 47.25 | 94.20 | 390 | 31 |
| **Total** | 24,281 | 24,033 | 3.66 | 41.19 | 64.21 | 15,432 | 1,234 |
| **Sovereign** | | | | | | | |
| AAA | 628 | 628 | - | 10.00 | 3.18 | 20 | 2 |
| AA | 4,647 | 4,568 | - | 7.42 | 2.93 | 134 | 11 |
| A | 930 | 930 | - | 20.83 | 10.86 | 101 | 8 |
| BBB | 27 | 27 | - | 20.58 | 11.11 | 3 | - |
| BB | 66 | 66 | 1.97 | 34.82 | 13.64 | 9 | 1 |
| B | - | - | - | - | - | - | - |
| Other | - | - | - | - | - | - | - |
| Default | - | - | - | - | - | - | - |
| **Total** | 6,298 | 6,219 | - | 10.03 | 4.29 | 267 | 22 |
| **Bank** | | | | | | | |
| AAA | - | - | - | - | - | - | - |
| AA | 1,276 | 1,257 | - | 60.00 | 26.17 | 329 | 27 |
| A | 61 | 60 | - | 60.00 | 23.33 | 14 | 1 |
| BBB | 12 | 12 | - | 20.72 | 8.33 | 1 | - |
| BB | - | - | - | - | - | - | - |
| B | 1 | - | - | - | - | - | - |
| Other | - | - | - | - | - | - | - |
| Default | - | - | - | - | - | - | - |
| **Total** | 1,350 | 1,329 | - | 59.65 | 25.88 | 344 | 28 |

[1] As required by the conditions of registration, the value of the scalar used in determining the minimum capital requirement (Required Regulatory Capital) is 1.06. The full details of the Bank's conditions of registration are included on page 6.

The following table summarises the Banking Group's credit risk exposures by asset class arising from undrawn commitments and other off-balance sheet exposures. These unaudited amounts are included in the above tables.

| $ millions | Undrawn Commitments and Other Off-balance Sheet Amounts Value | EAD | Market Related Contracts Value | EAD |
|---|---|---|---|---|
| Residential mortgages | 7,096 | 5,373 | - | - |
| Other retail (Credit cards, personal loans, personal overdrafts) | 2,775 | 1,594 | - | - |
| Small business | 900 | 823 | - | - |
| Corporate/Business lending | 8,145 | 7,828 | - | - |
| Sovereign | 1,276 | 1,198 | - | - |
| Bank | 59 | 42 | - | - |
| **Total** | 20,251 | 16,858 | - | - |

| Equity | TCE $ millions | EAD $ millions | Average PD % | Average LGD % | Average Risk Weight % | Risk-weighted Assets (scaled)[1] $ millions | Required Regulatory Capital $ millions |
|---|---|---|---|---|---|---|---|
| Equity holdings (not deducted from capital) that are publicly traded | 100 | 100 | - | - | 318.00 | 318 | 25 |

## Note 35 Risk management (continued)

### The Banking Group's Specialised lending: Project and property finance credit risk exposures as at 30 September 2013 (Unaudited)

| Supervisory slotting grade | TCE $ millions | EAD $ millions | Average Risk Weight % | Risk-weighted Assets (scaled)[1] $ millions | Required Regulatory Capital $ millions |
|---|---|---|---|---|---|
| Strong | 1,100 | 1,100 | 74.18 | 816 | 65 |
| Good | 2,560 | 2,560 | 95.39 | 2,442 | 196 |
| Satisfactory | 1,008 | 1,008 | 121.92 | 1,229 | 98 |
| Weak | 116 | 116 | 265.52 | 308 | 25 |
| Default | 309 | 386 | - | - | - |
| **Total** | 5,093 | 5,170 | 92.75 | 4,795 | 384 |

The following table summarises the Banking Group's Specialised lending: Project and property finance credit risk exposures arising from undrawn commitments and other off-balance sheet exposures. These amounts are included in the above table.

| | TCE $ millions | EAD $ millions | Average Risk Weight % | Risk-weighted Assets (scaled)[1] $ millions | Required Regulatory Capital $ millions |
|---|---|---|---|---|---|
| Undrawn commitments and other off-balance sheet exposures | 601 | 601 | 88.00 | 529 | 42 |

### The Banking Group's credit risk exposures subject to the standardised approach as at 30 September 2013 (Unaudited)

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

| | TCE $ millions | EAD $ millions | Average Risk Weight % | Risk-weighted Exposure $ millions | Required Regulatory Capital $ millions |
|---|---|---|---|---|---|
| Property, plant and equipment and other assets | 265 | 265 | 100.00 | 265 | 21 |
| Related parties | 1,424 | 1,424 | 29.44 | 419 | 34 |
| **Total on-balance sheet exposures** | 1,689 | 1,689 | | 684 | 55 |

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

| | Total Principal Amount $ millions | Credit Equivalent Amount $ millions | Average Risk Weight % | Risk-weighted Exposure $ millions | Required Regulatory Capital $ millions |
|---|---|---|---|---|---|
| **Market related contracts subject to the standardised approach** | | | | | |
| Foreign exchange contracts | 9,253 | 293 | 20.00 | 59 | 5 |
| Interest rate contracts | 55,818 | 198 | 20.00 | 40 | 3 |
| Credit value adjustment | | | | 39 | 3 |
| **Total market related contracts subject to the standardised approach** | 65,071 | 491 | | 138 | 11 |
| **Standardised subtotal** | 66,760 | 2,180 | | 822 | 66 |
| **After adjustment for scalar[1]** | | | | 871 | 70 |

1 As required by the conditions of registration, the value of the scalar used in determining the minimum capital requirement (Required Regulatory Capital) is 1.06. The full details of the Bank's conditions of registration are included on page 6.

### The Banking Group's residential mortgages by loan-to-value ratio ('LVR') as at 30 September 2013 (Unaudited)

In order to calculate origination LVR, the current exposure is that used in the internal ratings based approach for mortgage lending. For loans originated from 1 January 2008, the Bank utilises its loan origination system.

For loans originated prior to 1 January 2008, the origination LVR is not separately recorded, and therefore not available for disclosure as required under Clause 4 of Schedule 11 of the Order. For these loans, the Bank utilises its dynamic LVR process to calculate an origination LVR. Exposures for which no LVR is available have been included in the 'Exceeds 90%' category in accordance with the requirements of the Order.

| 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 | 14,131 | 6,263 | 8,575 | 5,722 | 2,814 | 37,505 |
| Undrawn commitments and other off-balance sheet exposures | 4,351 | 1,085 | 1,056 | 423 | 181 | 7,096 |
| **Value of exposures** | 18,482 | 7,348 | 9,631 | 6,145 | 2,995 | 44,601 |

## Note 35 Risk management (continued)

### The Banking Group's reconciliation of residential mortgage-related amounts

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

| $ millions | The Banking Group 30-Sep-13 Unaudited |
|---|---|
| **Term loans – Housing (as disclosed in Note 13) and Residential mortgages - total gross loans (as disclosed in Note 14)** | **37,594** |
| *Reconciling items:* | |
| Unamortised deferred fees and expenses | **(93)** |
| Fair value hedge adjustments | **4** |
| Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages | **7,096** |
| **Residential mortgages by LVR** | **44,601** |
| *Reconciling item:* | |
| Accrued interest receivable | **67** |
| **Residential mortgages - TCE (as disclosed in Credit risk exposures by asset class)** | **44,668** |

### Credit quality of financial assets

An asset is considered to be past due when any payment under the contractual terms has been missed. The amount included as past due is the entire contractual balance, rather than the overdue portion. The breakdown in the tables below does not always align with the underlying basis by which credit risk is managed within the Banking Group. The Banking Group considers loans for business purposes to be delinquent after considering all relevant circumstances surrounding the customer. Residential mortgages and personal loans that are more than five days past due are considered to be delinquent.

All the financial assets of the Banking Group and Bank as at 30 September 2013 and 2012, other than loans (as disclosed in Note 14) are neither past due nor impaired.

The following analysis shows the Bank's assessment of the coverage provided by collateral held in support of loan balances. The estimated realisable value of collateral held is based on a combination of:

- formal valuations currently held in respect of such collateral; and
- management's assessment of the estimated realisable value of all collateral held given its experience with similar types of assets in similar situations and the circumstances peculiar to the subject collateral.

This analysis also takes into consideration any other relevant knowledge available to management at the time. It is the Bank's practice to obtain updated valuations when either management considers that it cannot satisfactorily estimate a realisable value or when it is determined to be necessary to move to a forced sale of the collateral.

In the table below, a loan is deemed to be 'fully secured' where the ratio of the asset amount to the Bank's current estimated net present value of the realisable collateral is less than or equal to 100%. Such assets are deemed to be 'partially secured' when this ratio exceeds 100% but not more than 150%, and 'unsecured' when either no security is held (e.g. can include credit cards, personal loans, and exposure to highly rated corporate entities) or where the secured loan to estimated recoverable value exceeds 150%.

| | The Banking Group | | The Bank | |
|---|---|---|---|---|
| % | **2013** | 2012 | **2013** | 2012 |
| Fully secured | **71** | 69 | **71** | 69 |
| Partially secured | **15** | 16 | **15** | 16 |
| Unsecured | **14** | 15 | **14** | 15 |
| **Total net loans** | **100** | 100 | **100** | 100 |

### Financial assets that are neither past due nor impaired

The credit quality of financial assets of the Banking Group and the Bank that are neither past due nor impaired have been assessed by reference to the credit risk rating system adopted internally. All the financial assets of the Banking Group and the Bank that are neither past due nor impaired fall into 'Strong' category except those disclosed below:

| | The Banking Group | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | | | | 2012 | | | |
| $ millions | **Strong** | **Good/ Satisfactory** | **Weak** | **Total** | Strong | Good/ Satisfactory | Weak | Total |
| Loans | **18,323** | **40,363** | **1,339** | **60,025** | 17,390 | 38,313 | 1,698 | 57,401 |

| | The Bank | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | | | | 2012 | | | |
| $ millions | **Strong** | **Good/ Satisfactory** | **Weak** | **Total** | Strong | Good/ Satisfactory | Weak | Total |
| Loans | **18,317** | **40,273** | **1,333** | **59,923** | 17,390 | 38,197 | 1,698 | 57,285 |

## Note 35 Risk management (continued)

## 35.4 Market risk

Market risk is the potential for loss arising from adverse movements in the level and volatility of market factors such as foreign exchange rates, interest rates and equity prices. As the Ultimate Parent Bank's financial markets business in New Zealand is conducted by the NZ Branch, the market risks faced by the Banking Group are only of a non-traded nature (interest rate risk in the banking book). With the exception of the available-for-sale investment in Visa shares (refer to Note 25), neither the Banking Group nor the Bank carries material foreign currency or equity price risk due to the risks being hedged with the Ultimate Parent Bank.

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

***Approach***

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

***Asset and liability management***

The Bank's Treasury unit manages the structural interest rate mismatch associated with the transfer priced balance sheet, including the investment of the Bank's capital to its agreed benchmark duration. A key risk management objective is to help ensure the reasonable stability of net interest income ('**NII**') over time. These activities are performed within the Market Risk Management Framework approved by the Bank's BRMC.

***NII sensitivity***

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

***Limits***

The Bank's BRMC has approved NaR and Value-at-risk ('**VaR**') limits for interest rate risk management. In addition, interest rate delta limits are specified by the Bank's ALCO and the Bank's Market Risk Unit.

***Risk reporting***

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

Daily monitoring of current exposure and limit utilisation is conducted independently by the Head of Market Risk. Management reports detailing structural positions and VaR are produced and distributed daily for use by dealers and management across all stakeholder groups. Monthly and quarterly reports are produced for the Ultimate Parent Bank's risk forums of the Market Risk Committee and Ultimate Parent Bank BRMC, respectively, to ensure transparency of material market risks and issues.

***Risk mitigation***

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

### Market risk notional capital charges

The Banking Group's aggregate market risk exposure is derived in accordance with the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) 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 Banking Group's peak end-of-day aggregate capital charge is derived by determining the maximum over the six month period ended 30 September 2013 of the aggregate capital charge for that category of market risk at the close of each business day derived in accordance with the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B).

## Note 35 Risk management (continued)

The following table provides a summary of the Banking Group's capital charges by risk type as at balance date and the peak end-of-day capital charges by risk type for the six months ended 30 September 2013:

| | The Banking Group | |
|---|---|---|
| | 2013 | |
| | Unaudited | |
| $ millions | Implied Risk-weighted Exposure | Aggregate Capital Charge |
| **End-of-period** | | |
| Interest rate risk | **633** | **51** |
| Foreign currency risk | **100** | **8** |
| Equity risk | **100** | **8** |
| | **833** | **67** |
| **Peak end-of-day** | | |
| Interest rate risk | **1,214** | **97** |
| Foreign currency risk | **101** | **8** |
| Equity risk | **101** | **8** |

### VaR

The Banking Group applies a VaR methodology to its portfolios, to estimate the market risk of positions held and the maximum losses expected, based upon a number of assumptions for various changes in market conditions.

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

The Banking Group does not have any significant foreign currency and equity risk. The following table provides a summary of Interest Rate Risk VaR for the Banking Group's non-traded market risk activities.

| $ millions | 2013 | 2012 |
|---|---|---|
| Interest rate risk | **0.96** | 0.71 |

### 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 Banking Group's policy guidelines.

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the Banking Group's net asset position as at 30 September 2013. The 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.

## Note 35 Risk management (continued)

| The Banking Group 2013 $ 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 | 1,626 | - | - | - | - | 178 | 1,804 |
| Due from other financial institutions | 169 | - | - | - | - | 4 | 173 |
| Derivative financial instruments | - | - | - | - | - | 8 | 8 |
| Trading securities | 1,578 | - | - | - | - | - | 1,578 |
| Available-for-sale securities | - | 25 | 40 | 489 | 2,061 | 100 | 2,715 |
| Loans | 37,536 | 3,834 | 8,132 | 8,486 | 4,149 | (552) | 61,585 |
| Due from related entities | 1,351 | - | - | - | - | 25 | 1,376 |
| Other assets | - | - | - | - | - | 190 | 190 |
| **Total financial assets** | 42,260 | 3,859 | 8,172 | 8,975 | 6,210 | (47) | 69,429 |
| Non-financial assets | | | | | | | 1,083 |
| **Total assets** | | | | | | | 70,512 |
| **Financial liabilities** | | | | | | | |
| Due to other financial institutions | 100 | - | - | - | - | - | 100 |
| Deposits | 32,251 | 6,364 | 4,784 | 918 | 594 | 3,271 | 48,182 |
| Derivative financial instruments | - | - | - | - | - | 178 | 178 |
| Debt issues | 4,057 | 905 | 1,879 | 647 | 4,157 | - | 11,645 |
| Other liabilities | - | - | - | - | - | 434 | 434 |
| Due to related entities | 2,675 | - | - | 9 | 19 | 494 | 3,197 |
| **Total financial liabilities** | 39,083 | 7,269 | 6,663 | 1,574 | 4,770 | 4,377 | 63,736 |
| Non-financial liabilities | | | | | | | 210 |
| **Total liabilities** | | | | | | | 63,946 |
| **Net derivative notional principals** | | | | | | | |
| Net interest rate contracts (notional): | | | | | | | |
| Receivable/(payable) | 7,733 | 876 | (2,344) | (5,830) | (435) | - | - |

| The Bank 2013 $ 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 | 1,626 | - | - | - | - | 178 | 1,804 |
| Due from other financial institutions | 169 | - | - | - | - | 4 | 173 |
| Derivative financial instruments | - | - | - | - | - | 8 | 8 |
| Trading securities | 1,578 | - | - | - | - | - | 1,578 |
| Available-for-sale securities | - | 25 | 40 | 489 | 2,061 | 100 | 2,715 |
| Loans | 37,428 | 3,830 | 8,126 | 8,486 | 4,147 | (538) | 61,479 |
| Due from related entities | 10,850 | - | - | - | - | 169 | 11,019 |
| Other assets | - | - | - | - | - | 188 | 188 |
| **Total financial assets** | 51,651 | 3,855 | 8,166 | 8,975 | 6,208 | 109 | 78,964 |
| Non-financial assets | | | | | | | 1,142 |
| **Total assets** | | | | | | | 80,106 |
| **Financial liabilities** | | | | | | | |
| Due to other financial institutions | 100 | - | - | - | - | - | 100 |
| Deposits | 31,377 | 6,126 | 4,612 | 893 | 587 | 3,271 | 46,866 |
| Derivative financial instruments | - | - | - | - | - | 178 | 178 |
| Debt issues | 1,754 | - | 666 | 191 | 1,130 | - | 3,741 |
| Other liabilities | - | - | - | - | - | 372 | 372 |
| Due to related entities | 14,981 | 1,577 | 1,385 | 498 | 3,057 | 689 | 22,187 |
| **Total financial liabilities** | 48,212 | 7,703 | 6,663 | 1,582 | 4,774 | 4,510 | 73,444 |
| Non-financial liabilities | | | | | | | 192 |
| **Total liabilities** | | | | | | | 73,636 |
| **Net derivative notional principals** | | | | | | | |
| Net interest rate contracts (notional): | | | | | | | |
| Receivable/(payable) | 7,733 | 876 | (2,344) | (5,830) | (435) | - | - |

## Note 36 Concentration of funding

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| **Funding consists of** | | | | |
| Due to other financial institutions | **100** | 3 | **100** | 3 |
| Deposits | **48,182** | 43,390 | **46,866** | 42,670 |
| Debt issues[1] | **11,645** | 12,914 | **3,741** | 2,674 |
| Perpetual subordinated notes | **-** | 970 | **-** | 970 |
| Due to related entities[2] | **2,703** | 3,691 | **21,531** | 23,486 |
| **Total funding** | **62,630** | 60,968 | **72,238** | 69,803 |
| **Analysis of funding by product** | | | | |
| Certificates of deposit | **1,534** | 1,423 | **1,534** | 1,423 |
| Savings accounts | **11,982** | 9,411 | **11,461** | 9,411 |
| Demand deposits | **8,064** | 7,552 | **8,064** | 7,552 |
| Other deposits | **1,713** | 1,937 | **1,713** | 1,937 |
| Term deposits | **24,889** | 23,067 | **24,094** | 22,347 |
| Debt issues | **11,645** | 12,914 | **3,741** | 2,674 |
| Perpetual subordinated notes | **-** | 970 | **-** | 970 |
| **Subtotal** | **59,827** | 57,274 | **50,607** | 46,314 |
| Due to other financial institutions | **100** | 3 | **100** | 3 |
| Due to related entities[2] | **2,703** | 3,691 | **21,531** | 23,486 |
| **Total funding** | **62,630** | 60,968 | **72,238** | 69,803 |
| **Analysis of funding by geographical areas[1]** | | | | |
| New Zealand | **52,147** | 47,256 | **69,667** | 66,945 |
| Australia | **495** | 869 | **495** | 853 |
| United Kingdom | **4,928** | 5,891 | **225** | 128 |
| United States of America | **2,986** | 4,454 | **210** | 213 |
| Other | **2,074** | 2,498 | **1,641** | 1,664 |
| **Total funding** | **62,630** | 60,968 | **72,238** | 69,803 |
| **Analysis of funding by industry sector** | | | | |
| Accommodation, cafes and restaurants | **237** | 198 | **237** | 198 |
| Agriculture | **996** | 932 | **996** | 932 |
| Construction | **1,323** | 1,058 | **1,323** | 1,058 |
| Finance and insurance | **21,624** | 21,097 | **13,720** | 10,857 |
| Forestry and fishing | **146** | 126 | **146** | 126 |
| Government, administration and defence | **1,344** | 1,243 | **1,344** | 1,243 |
| Manufacturing | **1,365** | 1,389 | **1,365** | 1,389 |
| Mining | **85** | 73 | **85** | 73 |
| Property services and business services | **3,918** | 3,394 | **3,918** | 3,394 |
| Services | **4,155** | 3,923 | **4,155** | 3,923 |
| Trade | **1,425** | 1,194 | **1,425** | 1,194 |
| Transport and storage | **243** | 258 | **243** | 258 |
| Utilities | **586** | 387 | **586** | 387 |
| Households | **18,696** | 17,150 | **18,696** | 17,150 |
| Other | **3,784** | 4,855 | **2,468** | 4,135 |
| **Subtotal** | **59,927** | 57,277 | **50,707** | 46,317 |
| Due to related entities[2] | **2,703** | 3,691 | **21,531** | 23,486 |
| **Total funding** | **62,630** | 60,968 | **72,238** | 69,803 |

1 The geographic region used for debt issues is based on the nature of the debt programmes. The nature of the debt programme is used as a proxy for the location of the original purchaser. When 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 intra group deposits and borrowings and exclude amounts which relate to intra group derivatives and other liabilities.

Australian and New Zealand Standard Industrial Classifications ('**ANZSIC**') have been used as the basis for disclosing industry sectors.

## Note 37 Concentration of credit exposures

| $ millions | The Banking Group 2013 | The Banking Group 2012 | The Bank 2013 | The Bank 2012 |
|---|---|---|---|---|
| **On-balance sheet credit exposures consists of** | | | | |
| Cash and balances with central banks | **1,804** | 1,595 | **1,804** | 1,595 |
| Due from financial institutions | **173** | 322 | **173** | 322 |
| Derivative financial instruments | **8** | 10 | **8** | 10 |
| Trading securities | **1,578** | 2,040 | **1,578** | 2,040 |
| Available-for-sale securities | **2,715** | 2,694 | **2,715** | 2,694 |
| Loans | **61,585** | 59,422 | **61,479** | 59,303 |
| Due from related entities | **1,376** | 1,527 | **11,019** | 10,377 |
| Other assets | **190** | 186 | **188** | 163 |
| **Total on-balance sheet credit exposures** | **69,429** | 67,796 | **78,964** | 76,504 |
| **Analysis of on-balance sheet credit exposures by geographical areas** | | | | |
| New Zealand | **67,714** | 65,793 | **77,250** | 74,501 |
| Australia | **876** | 993 | **876** | 993 |
| United States of America | **131** | 132 | **131** | 132 |
| Other | **708** | 878 | **707** | 878 |
| **Total on-balance sheet credit exposures** | **69,429** | 67,796 | **78,964** | 76,504 |
| **Analysis of on-balance sheet credit exposures by industry sector** | | | | |
| Accommodation, cafes and restaurants | **513** | 551 | **513** | 551 |
| Agriculture | **6,565** | 6,364 | **6,565** | 6,364 |
| Construction | **1,346** | 1,440 | **1,346** | 1,440 |
| Finance and insurance | **4,125** | 4,915 | **4,115** | 4,905 |
| Forestry and fishing | **345** | 234 | **345** | 234 |
| Government, administration and defence | **4,676** | 4,501 | **4,676** | 4,501 |
| Manufacturing | **2,229** | 2,181 | **2,229** | 2,181 |
| Mining | **539** | 490 | **539** | 490 |
| Property | **10,361** | 9,563 | **10,361** | 9,563 |
| Property services and business services | **1,894** | 2,057 | **1,894** | 2,057 |
| Services | **2,587** | 2,621 | **2,587** | 2,621 |
| Trade | **3,187** | 3,120 | **3,187** | 3,120 |
| Transport and storage | **1,216** | 1,304 | **1,216** | 1,304 |
| Utilities | **1,328** | 1,310 | **1,328** | 1,310 |
| Retail lending | **27,605** | 26,148 | **27,494** | 26,025 |
| Other | **52** | 39 | **52** | 39 |
| **Subtotal** | **68,568** | 66,838 | **68,447** | 66,705 |
| Provisions for impairment charges on loans | **(552)** | (605) | **(538)** | (591) |
| Due from related entities | **1,376** | 1,527 | **11,019** | 10,377 |
| Other assets | **37** | 36 | **36** | 13 |
| **Total on-balance sheet credit exposures** | **69,429** | 67,796 | **78,964** | 76,504 |
| **Off-balance sheet credit exposures** | | | | |
| Contingent liabilities and commitments | **20,852** | 20,480 | **20,707** | 20,336 |
| **Total off-balance sheet credit exposures** | **20,852** | 20,480 | **20,707** | 20,336 |
| **Analysis of off-balance sheet credit exposures by industry sector** | | | | |
| Accommodation, cafes and restaurants | **98** | 87 | **98** | 87 |
| Agriculture | **677** | 560 | **677** | 560 |
| Construction | **418** | 426 | **418** | 426 |
| Finance and insurance | **2,009** | 2,551 | **2,009** | 2,551 |
| Forestry and fishing | **70** | 54 | **70** | 54 |
| Government, administration and defence | **991** | 905 | **991** | 905 |
| Manufacturing | **1,519** | 1,307 | **1,519** | 1,307 |
| Mining | **176** | 290 | **176** | 290 |
| Property | **1,693** | 1,421 | **1,693** | 1,421 |
| Property services and business services | **869** | 784 | **869** | 784 |
| Services | **1,027** | 1,064 | **1,027** | 1,064 |
| Trade | **1,731** | 1,823 | **1,731** | 1,823 |
| Transport and storage | **799** | 699 | **799** | 699 |
| Utilities | **1,318** | 1,446 | **1,318** | 1,446 |
| Retail lending | **7,437** | 6,838 | **7,292** | 6,694 |
| Other | **20** | 225 | **20** | 225 |
| **Total off-balance sheet credit exposures** | **20,852** | 20,480 | **20,707** | 20,336 |

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

## Note 37 Concentration of credit exposures (continued)

### Analysis of credit exposures to individual counterparties

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

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

- as at 30 September 2013 was nil; and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 September 2013 was nil.

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

- as at 30 September 2013 was one counterparty with a credit rating of A- or A3 or above, or its equivalent, having an aggregate credit exposure between 15-19%; and
- for the three months ended 30 September 2013 was one counterparty with a credit rating of A- or A3 or above, or its equivalent, having a peak end-of-day aggregate exposure between 15-19%.

The peak end-of-day aggregate credit exposure to each individual counterparty or a group of closely related counterparties has been calculated by determining the maximum end-of-day aggregate amount of actual credit exposure over the relevant three-month period and then dividing that by the Banking Group's equity as at the end of the period.

Credit exposures to individual counterparties (not being members of a group of closely related counterparties) and to groups of closely related counterparties exclude exposures to connected persons, to the central government of any country with a long-term credit rating of A- or A3 or above, or its equivalent, or to any bank with a long-term credit rating of A- or A3 or above, or its equivalent. These calculations relate only to exposures held in the financial records of the Banking Group and were calculated net of individually assessed provisions.

## Note 38 Credit exposures to connected persons and non-bank connected persons

The Banking Group's credit exposure to connected persons is derived in accordance with the Bank's conditions of registration and the Reserve Bank document 'Connected Exposures Policy' (BS8), is net of individual credit impairment allowances and excludes advances to connected persons of a capital nature.

The Reserve Bank defines connected persons to be other members of the Ultimate Parent Bank Group and Directors of the Bank. Controlled entities of the Bank are not connected persons. Credit exposures to connected persons are based on actual credit exposures rather than internal limits. Peak end-of-day aggregate credit exposures to connected persons expressed as a percentage of Tier One Capital of the Banking Group have been derived by determining the maximum end-of-day aggregate amount of credit exposure over the year ended 30 September 2013 and then dividing that amount by the Banking Group's Tier One Capital as at 30 September 2013.

Credit exposures to connected persons reported in the table below have been calculated partially on a bilateral net basis and partially on a gross basis. Netting has occurred in respect of certain transactions which are the subject of a bilateral netting agreement. On this basis, there is a limit of 125% of the Banking Group's Tier One Capital in respect of the gross amount of aggregate credit exposure to connected persons that can be netted off in determining the net exposure.

| | The Banking Group | |
|---|---|---|
| **$ millions** | **As at 30-Sep-13** | **Peak End-of-day for the Year Ended 30-Sep-13** |
| Credit exposures to connected persons: | | |
| On gross basis, before netting | **1,659** | **2,427** |
| As a percentage of Tier One Capital of the Banking Group at end of the year | **30.0%** | **43.9%** |
| Amount that has been netted off in determining the net exposure | **583** | **564** |
| As a percentage of Tier One Capital of the Banking Group at end of the year | **10.6%** | **10.2%** |
| On partial bilateral net basis | **1,076** | **1,863** |
| As a percentage of Tier One Capital of the Banking Group at end of the year | **19.5%** | **33.7%** |
| Credit exposures to non-bank connected persons | **-** | **-** |
| As a percentage of Tier One Capital of the Banking Group at end of the year | **0.0%** | **0.0%** |

As at 30 September 2013, the rating-contingent limit applicable to the Banking Group was 70% of Tier One Capital. This has not changed during the year ended 30 September 2013. Within this overall rating-contingent limit there is a sub-limit of 15% of Tier One Capital which applies to the aggregate credit exposure to non-bank connected persons.

The limits on aggregate credit exposures to all connected persons and to non-bank connected persons in the Bank's conditions of registration have been complied with at all times during the year ended 30 September 2013.

Where a bank is funding a large loan it is common practice to share the risk of a customer default with a syndicate of banks. These arrangements are called risk lay-off arrangements. As at 30 September 2013, the Banking Group had no aggregate contingent exposures to connected persons arising from risk lay-off arrangements in respect of credit exposures to counterparties (excluding counterparties that are connected persons).

The aggregate amount of the Banking Group's individual credit provisions provided against credit exposures to connected persons was nil as at 30 September 2013.

## Note 39 Reconciliation of profit after income tax expense to net cash provided by operating activities

| | The Banking Group | | The Bank | |
|---|---|---|---|---|
| $ millions | **Year ended 30-Sep-13** | Year ended 30-Sep-12 | **Year ended 30-Sep-13** | Year ended 30-Sep-12 |
| **Reconciliation of profit after income tax expense to net cash provided by operating activities** | | | | |
| Profit after income tax expense | **714** | 613 | **691** | 602 |
| *Adjustments:* | | | | |
| Impairment charges on loans | **107** | 190 | **104** | 180 |
| Computer software amortisation costs | **35** | 38 | **35** | 38 |
| Depreciation on property, plant and equipment | **27** | 27 | **5** | 4 |
| Share-based payments | **4** | 5 | **4** | 5 |
| Movement in other assets | **(5)** | (25) | **(30)** | (20) |
| Movement in other liabilities | **5** | (30) | **14** | (5) |
| Movement in current and deferred tax | **(11)** | (5) | **(8)** | (6) |
| Tax losses transferred from related entities | **16** | 46 | **8** | 42 |
| Tax on cash flow hedge reserve | **(2)** | (4) | **(2)** | (4) |
| Tax on available-for-sale securities reserve | **2** | (11) | **2** | (11) |
| Net loans advanced to customers | **(2,270)** | (2,026) | **(2,280)** | (2,040) |
| Net increase in deposits | **4,792** | 3,444 | **4,196** | 3,220 |
| Movement in trading securities | **449** | 3,178 | **449** | 3,178 |
| Movement in derivative financial instruments | **(188)** | 339 | **(188)** | 339 |
| **Net cash flows provided by operating activities** | **3,675** | 5,779 | **3,000** | 5,522 |

## Note 40 Events after the reporting date

The Bank's conditions of registration were amended on 27 September 2013. The amendments came into effect from 1 October 2013. The principal change was to add new conditions of registration restricting high loan-to-valuation residential mortgage lending. The Reserve Bank also made some minor amendments to the 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B), revised the document 'Application for capital recognition or repayment: material to be provided to the Reserve Bank' (BS16), which is referred to in BS2B, and amended its 'Connected Exposures Policy' (BS8) to update version references. Minor amendments were also made to the conditions of registration relating to Open Bank Resolution.

On 21 November 2013, the Directors resolved to pay an unimputed dividend of $375 million on ordinary shares.

# Independent Auditors' Report

To the shareholder of Westpac New Zealand Limited

## Report on the Financial Statements (excluding Supplementary Information Relating to Capital Adequacy)

We have audited pages 14 to 93 of the Disclosure Statement of Westpac New Zealand Limited (the 'Bank') which consists of the financial statements required by Clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order (No 2) 2013 (the 'Order') and the supplementary information (excluding the supplementary information relating to capital adequacy disclosed in Notes 34 and 35) required by Schedules 4, 7, 13, 14, 15 and 17 of the Order. The financial statements comprise the balance sheets as at 30 September 2013, the income statements, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and the notes to the financial statements that include a summary of significant accounting policies and other explanatory information for both the Bank and the Banking Group. The 'Banking Group' comprises the Bank and the entities it controlled at 30 September 2013 or from time to time during the financial year.

### *Directors' Responsibility for the Financial Statements*

The Directors of Westpac New Zealand Limited (the 'Directors') are responsible for the Disclosure Statement, which includes financial statements prepared in accordance with Clause 24 of the Order and generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the financial statements and the supplementary information (excluding the supplementary information relating to capital adequacy disclosed in Notes 34 and 35) disclosed in accordance with Clause 24 and Schedules 4, 7, 13, 14, 15 and 17 of the Order and presented to us by the Directors. We conducted our audit in accordance with International Standards on Auditing (New Zealand) and International Standards on Auditing. These standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider the internal controls relevant to the Bank and Banking Group's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank and Banking Group's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, as well as evaluating the overall presentation of the financial statements.

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

We carry out other assignments on behalf of the Bank and the Banking Group in the areas of other assurance and advisory services. In addition, certain partners and employees of our firm may deal with the Bank, the Banking Group and Westpac Banking Corporation Group on normal terms within the ordinary course of trading activities of the Bank, the Banking Group and Westpac Banking Corporation Group. These matters have not impaired our independence as auditors of the Bank and the Banking Group. We have no other interests in the Bank, the Banking Group or Westpac Banking Corporation Group.

### *Opinion*

In our opinion, the financial statements on pages 14 to 93 (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 11, 13, 14, 15 and 17 of the Order and included within the balance sheets and Notes 14, 32, 33, 34, 35, 37 and 38):

(i) comply with generally accepted accounting practice in New Zealand;

(ii) comply with International Financial Reporting Standards; and

(iii) give a true and fair view of the financial position of the Bank and the Banking Group as at 30 September 2013, and their financial performance and cash flows for the year then ended.

*PricewaterhouseCoopers, 188 Quay Street, Private Bag 92162, Auckland 1142, New Zealand*
T +64 9 355 8000, F +64 9 355 8001, www.pwc.com/nz

pwc

In our opinion, the supplementary information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order and included within the balance sheets and Notes 14, 32, 33, 35, 37 and 38:

(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 Bank and Banking Group; and
(iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

## Report on Other Legal and Regulatory Requirements (excluding Supplementary Information Relating to Capital Adequacy)

We also report in accordance with the requirements of Sections 16(1)(d) and 16(1)(e) of the Financial Reporting Act 1993 and Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements (excluding the supplementary information relating to capital adequacy disclosed in Notes 34 and 35) for the year ended 30 September 2013:

(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 Bank and the Banking Group as far as appears from an examination of those records.

## Report on the Supplementary Information Relating to Capital Adequacy

We have reviewed the supplementary information relating to capital adequacy required by Schedule 11 of the Order as disclosed in Notes 34 and 35 of the financial statements of the Bank and the Banking Group for the year ended 30 September 2013.

### *Directors' Responsibility for the Supplementary Information Relating to Capital Adequacy*

The Directors are responsible for the preparation of supplementary information relating to capital adequacy that is prepared in accordance with the Bank's conditions of registration and the Bank's internal models for credit risk and operational risk as accredited by the Reserve Bank of New Zealand and is disclosed in accordance with Schedule 11 of the Order.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the supplementary information relating to capital adequacy, disclosed in Notes 34 and 35, based on our review.

We are responsible for reviewing the disclosures in order to state whether, on the basis of the procedures described below, anything has come to our attention that would cause us to believe that the supplementary information is not, in all material respects:

(i) prepared in accordance with the Bank's conditions of registration;
(ii) prepared in accordance with the Bank's internal models for credit risk and operational risk as accredited by the Reserve Bank of New Zealand; and
(iii) disclosed in accordance with Schedule 11 of the Order

and for reporting our findings to you.

We conducted our review in accordance with review engagement standard RS-1 Statement of Review Engagement Standards issued in New Zealand. A review is limited primarily to enquiries of Bank and Banking Group personnel and analytical procedures applied to financial data, and thus provides less assurance than an audit. We have not performed an audit on the supplementary information relating to capital adequacy disclosed in Notes 34 and 35 and, accordingly, we do not express an audit opinion on that supplementary information.

### *Opinion*

Based on our review procedures, which are not an audit, nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy disclosed in Notes 34 and 35, as required by Schedule 11 of the Order, is not in all material respects:

(i) prepared in accordance with the Bank's conditions of registration;
(ii) prepared in accordance with the Bank's internal models for credit risk and operational risk as accredited by the Reserve Bank of New Zealand; and
(iii) disclosed in accordance with Schedule 11 of the Order.

## Restriction on Distribution or Use

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

PricewaterhouseCoopers

Chartered Accountants
21 November 2013

Auckland