Westpac Banking Corporation - New Zealand Banking Group

Disclosure Statement

For the year ended 30 September 2020

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Contents

Glossary of terms

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

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

- **Overseas Bank** – refers to Westpac Banking Corporation;
- **Overseas Banking Group** – refers to the Overseas Bank and all other entities included in the Overseas Bank’s group for the purposes of public reporting of the group financial statements in Australia;
- **NZ Branch** – refers to the New Zealand business (as defined in the Order) of the Overseas Bank;
- **Westpac New Zealand** – refers to Westpac New Zealand Limited; and
- **NZ Banking Group** – refers to the financial reporting group (as defined in the Order) of the Overseas Bank. Controlled entities of the NZ Banking Group as at 30 September 2020 are set out in Note 22 Related entities.

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

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

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

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

(b) is not false or misleading.

Each Director of the Overseas Bank and the Chief Executive Officer, NZ Branch, believe, after due enquiry, that, over the year ended 30 September 2020:

(a) the Overseas Bank has complied with all conditions of registration that applied during that period, except as noted on page 101; and

(b) the NZ Branch and other members of the NZ Banking Group had systems in place to monitor and control adequately the material risks of relevant members of the NZ Banking Group, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk and other business risks, and that those systems were being properly applied. For this purpose, a relevant member of the NZ Banking Group means a member of the NZ Banking Group that is not a member of Westpac New Zealand's banking group. Refer to Note 32 of the financial statements for further detail regarding the entities which had systems in place to monitor and control the material risks of relevant members of the NZ Banking Group.

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

David McLean

Simon Power

Dated this 24th day of November 2020

Income statement for the year ended 30 September 2020

		NZ BANKING GROUP	
$ millions	Note	**2020**	2019
Interest income:			
Calculated using the effective interest rate method	2	**3,546**	4,029
Other	2	**50**	90
Total Interest income	2	**3,596**	4,119
Interest expense	2	**(1,703)**	(2,121)
Net interest income		**1,893**	1,998
Net fees and commissions income	3	**157**	201
Net wealth management and insurance income	3	**169**	197
Trading income	3	**116**	115
Other income	3	**18**	49
Net operating income before operating expenses and impairment charges		**2,353**	2,560
Operating expenses	4	**(1,082)**	(1,018)
Impairment (charges)/benefits	6	**(320)**	10
Profit before income tax		**951**	1,552
Income tax expense	7	**(270)**	(423)
Net profit attributable to the owners of the NZ Banking Group		**681**	1,129

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

Statement of comprehensive income for the year ended 30 September 2020

	NZ BANKING GROUP	
$ millions	**2020**	2019
Net profit attributable to the owners of the NZ Banking Group	**681**	1,129
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss		
Gains/(losses) recognised in equity on:		
Investment securities	**74**	(8)
Cash flow hedging instruments	**(68)**	(86)
Transferred to income statement:		
Cash flow hedging instruments	**73**	74
Income tax on items taken to or transferred from equity:		
Investment securities	**(21)**	3
Cash flow hedging instruments	**(1)**	3
Items that will not be reclassified subsequently to profit or loss		
Remeasurement of defined benefit obligation recognised in equity (net of tax)	**(4)**	(10)
Other comprehensive income for the year (net of tax)	**53**	(24)
Total comprehensive income attributable to the owners of the NZ Banking Group	**734**	1,105

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

Balance sheet as at 30 September 2020

		NZ BANKING GROUP	
$ millions	Note	**2020**	2019
Assets			
Cash and balances with central banks	33	**4,488**	2,002
Collateral paid		**397**	417
Trading securities and financial assets measured at fair value through income statement ('**FVIS**')	9	**4,224**	4,871
Derivative financial instruments	23	**5,660**	6,257
Investment securities	10	**5,021**	4,469
Loans	11	**88,354**	84,626
Other financial assets	13	**555**	400
Life insurance assets	14	**375**	335
Due from related entities	22	**2,713**	2,367
Property and equipment		**398**	137
Deferred tax assets	15	**242**	138
Intangible assets	16	**696**	685
Other assets		**73**	58
Total assets		**113,196**	106,762
Liabilities			
Collateral received		**508**	623
Deposits and other borrowings	17	**73,970**	65,606
Other financial liabilities	18	**1,979**	1,748
Derivative financial instruments	23	**5,417**	5,825
Due to related entities	22	**2,560**	2,892
Debt issues	19	**15,799**	17,846
Current tax liabilities		**88**	91
Provisions	20	**210**	150
Other liabilities		**400**	139
Loan capital	21	**3,220**	3,185
Total liabilities		**104,151**	98,105
Net assets		**9,045**	8,657
Head office account			
Branch capital		**1,300**	1,300
Retained profits		**1,078**	989
Total head office account		**2,378**	2,289
NZ Banking Group equity			
Share capital		**143**	143
Reserves		**(12)**	(69)
Retained profits		**6,536**	6,294
Total NZ Banking Group equity		**6,667**	6,368
Total equity attributable to the owners of the NZ Banking Group		**9,045**	8,657

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

Signed on behalf of the Board of Directors.

Peter King

Director

24 November 2020

Director

24 November 2020

Statement of changes in equity for the year ended 30 September 2020

	NZ BANKING GROUP							
	NZ BRANCH		OTHER MEMBERS OF THE NZ BANKING GROUP					
	Head Office Account			Reserves				
$ millions	Branch Capital	Retained Profits	Share Capital	Available-for-sale Securities Reserve	Investment Securities Reserve	Cash Flow Hedge Reserve	Retained Profits	Total Equity
As at 30 September 2018	1,300	869	143	9	-	(64)	6,126	8,383
Impact on adoption of new accounting standards	-	-	-	(9)	9	-	(24)	(24)
As at 1 October 2018 (restated)	1,300	869	143	-	9	(64)	6,102	8,359
Year ended 30 September 2019								
Net profit attributable to the owners of the NZ Banking Group	-	120	-	-	-	-	1,009	1,129
Net gains/(losses) from changes in fair value	-	-	-	-	(8)	(86)	-	(94)
Income tax effect	-	-	-	-	3	24	-	27
Transferred to income statement	-	-	-	-	-	74	-	74
Income tax effect	-	-	-	-	-	(21)	-	(21)
Remeasurement of defined benefit obligations	-	-	-	-	-	-	(14)	(14)
Income tax effect	-	-	-	-	-	-	4	4
Total comprehensive income for the year ended 30 September 2019	-	120	-	-	(5)	(9)	999	1,105
Transactions with owners: Dividends paid on ordinary shares (refer to Note 22)	-	-	-	-	-	-	(807)	(807)
As at 30 September 2019	1,300	989	143	-	4	(73)	6,294	8,657
Year ended 30 September 2020								
Net profit attributable to the owners of the NZ Banking Group	**-**	**89**	**-**	**-**	**-**	**-**	**592**	**681**
Net gains/(losses) from changes in fair value	**-**	**-**	**-**	**-**	**74**	**(68)**	**-**	**6**
Income tax effect	**-**	**-**	**-**	**-**	**(21)**	**19**	**-**	**(2)**
Transferred to income statement	**-**	**-**	**-**	**-**	**-**	**73**	**-**	**73**
Income tax effect	**-**	**-**	**-**	**-**	**-**	**(20)**	**-**	**(20)**
Remeasurement of defined benefit obligations	**-**	**-**	**-**	**-**	**-**	**-**	**(5)**	**(5)**
Income tax effect	**-**	**-**	**-**	**-**	**-**	**-**	**1**	**1**
Total comprehensive income for the year ended 30 September 2020	**-**	**89**	**-**	**-**	**53**	**4**	**588**	**734**
Transactions with owners: Dividends paid on ordinary shares (refer to Note 22)	**-**	**-**	**-**	**-**	**-**	**-**	**(346)**	**(346)**
As at 30 September 2020	**1,300**	**1,078**	**143**	**-**	**57**	**(69)**	**6,536**	**9,045**

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

Statement of cash flows for the year ended 30 September 2020

		NZ BANKING GROUP	
$ millions	Note	**2020**	2019
Cash flows from operating activities			
Interest received		**3,571**	4,148
Interest paid		**(1,894)**	(2,140)
Non-interest income received[1]		**114**	711
Operating expenses paid		**(901)**	(868)
Income tax paid		**(398)**	(435)
Cash flows from operating activities before changes in operating assets and liabilities		**492**	1,416
Net (increase)/decrease in:			
Collateral paid		**20**	(237)
Trading securities and financial assets measured at FVIS		**450**	(1,841)
Loans		**(3,946)**	(3,687)
Other financial assets		**10**	(19)
Due from related entities		**(148)**	184
Other assets		**(7)**	-
Net increase/(decrease) in:			
Collateral received		**(115)**	32
Deposits and other borrowings		**8,364**	2,501
Other financial liabilities		**308**	237
Due to related entities		**(15)**	38
Other liabilities		**1**	1
Net movement in external and related entity derivative financial instruments[1]		**134**	(4)
Net cash provided by/(used in) operating activities	33	**5,548**	(1,379)
Cash flows from investing activities			
Purchase of investment securities		**(2,418)**	(2,009)
Proceeds from investment securities		**1,909**	1,387
Net movement in life insurance assets		**(40)**	(25)
Proceeds from disposal of associates		**-**	48
Purchase of capitalised computer software		**(83)**	(62)
Purchase of property and equipment		**(29)**	(35)
Net cash provided by/(used in) investing activities		**(661)**	(696)
Cash flows from financing activities			
Net movement in due to related entities		**(8)**	(279)
Proceeds from debt issues	19	**5,175**	8,707
Repayments of debt issues	19	**(7,193)**	(5,001)
Payments for the principal portion of lease liabilities		**(46)**	-
Dividends paid to ordinary shareholders	22	**(346)**	(807)
Net cash provided by/(used in) financing activities		**(2,418)**	2,620
Net increase/(decrease) in cash and cash equivalents		**2,469**	545
Cash and cash equivalents at the beginning of the year		**2,074**	1,529
Cash and cash equivalents at the end of the year	33	**4,543**	2,074

[1]Comparatives have been restated to correctly reflect cash flows of $233m in 'other cash items' relating to realised gains on FX trading derivatives which were previously presented in 'net movement in external and related entity derivative financial instruments'.

The above statement of cash flows should be read in conjunction with the accompanying notes. Details of the reconciliation of net cash provided by/(used in) operating activities to net profit are provided in Note 33.

Notes to the financial statements

Note 1 Financial statements preparation

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

- **Overseas Bank** – refers to Westpac Banking Corporation;
- **Overseas Banking Group** – refers to the Overseas Bank and all other entities included in the Overseas Bank's group for the purposes of public reporting of the group financial statements in Australia;
- **NZ Branch** – refers to the New Zealand business (as defined in the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) ('**Order**')) of the Overseas Bank;
- **Westpac New Zealand** – refers to Westpac New Zealand Limited; and
- **NZ Banking Group** – refers to the financial reporting group (as defined in the Order) of the Overseas Bank. Controlled entities of the NZ Banking Group as at 30 September 2020 are set out in Note 22.

The Overseas Bank is registered as a public company limited by shares under the Australian Corporations Act 2001 and is entered on the register maintained under the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**'). The Overseas Bank provides a broad range of banking and financial services, including consumer, business and institutional banking and wealth management services.

The NZ Branch's head office is situated at Westpac on Takutai Square, 16 Takutai Square, Auckland 1010, New Zealand and the address for service of process on the NZ Branch is Westpac on Takutai Square, 53 Galway Street, Auckland 1010, New Zealand.

The financial statements are for the NZ Banking Group.

These financial statements were authorised for issue by the Overseas Bank's Board of Directors (the '**Board**') on 24 November 2020. The Board has the power to amend and reissue the financial statements.

The principal accounting policies are set out below and in the relevant notes to the financial statements. These accounting policies provide details of the accounting treatments adopted for complex balances and where accounting standards provide policy choices. These policies have been consistently applied to all the years presented, unless otherwise stated.

a. Basis of preparation

(i) Basis of accounting

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

- the requirements of the Financial Markets Conduct Act 2013; and
- the requirements of the Order.

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

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

(ii) Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by applying fair value accounting to financial assets and financial liabilities (including derivative instruments) measured at FVIS, or in other comprehensive income ('**OCI**').

(iii) Comparative revisions

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

(iv) Standards adopted during the year ended 30 September 2020

NZ IFRS 16 Leases

NZ IFRS 16 *Leases* ('**NZ IFRS 16**') was adopted by the NZ Banking Group on 1 October 2019. NZ IFRS 16 requires all operating leases of greater than 12 months duration to be presented on balance sheet by the lessee as a right-of-use ('**ROU**') asset and lease liability. There are no significant changes to lessor accounting.

The NZ Banking Group adopted the standard using the simplified approach to transition with no restatement of comparative information and no effect on retained earnings.

The lease liabilities are measured at the present value of the remaining lease payments, discounted at the lessee's incremental borrowing rate at 1 October 2019. On transition to the new standard, the lease liability recognised in other liabilities was $292 million. The associated ROU assets were measured at an amount equal to the lease liability. The ROU assets are recognised in property and equipment.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

All leases on balance sheet give rise to a combination of interest expense on the lease liability and depreciation of the ROU asset. Interest expense is recognised in net interest income on an effective yield basis. Depreciation expense is recognised in operating expenses on a straight-line basis over the lease term.

Extension options are included in a number of lease contracts. The extension options are only included in the lease term if the lease is reasonably certain to be extended, which is assessed by the NZ Banking Group at the lease commencement date. The assessment is reviewed if a significant event or significant change in circumstances occurs which affects this assessment and is within the control of the NZ Banking Group. The NZ Banking Group considered the impact of COVID-19 on our assessment of extension options and concluded that they were unchanged. The NZ Banking Group also considered the impact of COVID-19 on the carrying value of the ROU asset and determined there was no impairment.

The NZ Banking Group used the incremental borrowing rate based on the remaining maturity of leases at the date of transition as the discount rate when determining present value. The weighted average incremental borrowing rate applied was 2.40%.

The table below shows the reconciliation of operating lease commitments disclosed as at 30 September 2019 to the lease liability recognised on 1 October 2019:

	NZ BANKING GROUP
$ millions	
Operating lease commitments at 30 September 2019	**306**
Recognition exemption for short-term leases	**(2)**
Adjustment for extension options reasonably certain to be exercised	**21**
Undiscounted lease payments as at 30 September 2019	**325**
Effect of discounting (weighted average incremental borrowing rate of 2.40%)	**(33)**
Lease liability as at 1 October 2019	**292**

NZ IFRIC Interpretation 23 Uncertainty over Income Tax Treatments

NZ IFRIC Interpretation 23 *Uncertainty over Income Tax Treatments* ('**NZ IFRIC 23**') was adopted by the NZ Banking Group on 1 October 2019 and clarifies the recognition and measurement criteria in NZ IAS 12 *Income Taxes* where there is uncertainty over income tax treatments, and requires an assessment of each uncertain tax position as to whether it is probable that a taxation authority will accept the position.

Where it is not considered probable, the effect of the uncertainty will be reflected in determining the relevant taxable profit or loss, tax bases, unused tax losses and unused tax credits or tax rates. The amount will be determined as either the single most likely amount or the sum of the probability weighted amounts in a range of possible outcomes, whichever better predicts the resolution of the uncertainty. Judgements will be reassessed as and when new facts and circumstances are presented.

NZ IFRIC 23 did not have a material impact on the NZ Banking Group.

Interest Rate Benchmark Reform

Interest Rate Benchmark Reform - amendments to NZ IFRS 9 *Financial Instruments* ('**NZ IFRS 9**'), NZ IAS 39 *Financial Instruments: Recognition and Measurement* ('**NZ IAS 39**') and NZ IFRS 7 *Financial Instruments: Disclosures* ('**NZ IFRS 7**') was early adopted, as permitted by the standard, by the NZ Banking Group on 1 October 2019. These amendments allow the NZ Banking Group to apply certain exceptions to the standard hedging requirements in respect of hedge relationships that are impacted by a market-wide interest rate benchmark reform. Specifically the exceptions allow the NZ Banking Group to:

- Assume that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the reform when determining whether a forecast transaction is highly probable;
- Assume that the interest rate benchmark of the hedged item/instrument is not altered for the life of the hedge when assessing whether a hedge is expected to continue to be highly effective;
- A hedge relationship impacted by uncertainty arising from benchmark interest rate reform is not required to pass the 80%-125% effectiveness test, however any actual ineffectiveness must be recorded in the income statement; and
- The determination of a designated component of an exposure in portfolio hedges is only required to be made the first time that component is designated, and not when the portfolio is de-designated and re-designated.

The exceptions allowed by the amendments are being applied to the NZ Banking Group's London Interbank Offered Rate ('**LIBOR**') linked hedge relationships that mature after the LIBOR discontinuance date of 31 December 2021. Last year the NZ Banking Group established an enterprise-wide Interbank Offered Rates ('**IBORs**') Transition Programme to manage the impacts of Interest Rate Benchmark Reform ('**IBOR reform**'). The scope of the programme is to address the impact of transition from IBORs to alternative reference rates ('**ARRs**') including business, compliance, customer and technology impacts. The Governance structure of the programme is well established to include a Steering Committee with its key responsibility being the governance of the programme. The Committee includes senior executives from Finance, Legal, Technology, Compliance, Risk and all impacted business units. The programme is executing against transition timelines with regulatory guidance in relation to COVID-19 indicating LIBOR is still expected to cease by end of December 2021. Significant activities underway include development of ARR product variations, changes required for adopting the International Swaps and Derivatives Association ('**ISDA**') Protocol, customer outreach including management of conduct risk in customer transition and technology .Changes required for both euro short-term rate ('**ESTR**') and secured overnight funding rate ('**SOFR**') LCH discounting have been implemented.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

A key assumption made when performing hedge accounting at the reporting date is that both the hedged item and instrument will be amended from existing LIBOR linked floating rates to new ARRs on the same date. Where actual differences between those dates arise hedge ineffectiveness will be recorded in the income statement.

Note 23 provides further information regarding the hedging relationships affected by the IBOR reform.

Refer to Note 1 (e) – Future developments in accounting standards for details of the accounting standard issued but not yet effective dealing with phase 2 of the IBOR reform.

b. Basis of aggregation

The NZ Banking Group as at 30 September 2020 has been aggregated by combining the sum of the capital and reserves of the NZ Branch, and the consolidated capital and reserves of Westpac New Zealand Group Limited, BT Financial Group (NZ) Limited, Westpac Financial Services Group-NZ-Limited, Westpac Group Investment-NZ-Limited, Capital Finance New Zealand Limited and their subsidiaries (including structured entities). For New Zealand entities acquired by the Overseas Banking Group, capital and reserves at acquisition are netted and recognised as capital contributed to the NZ Banking Group.

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

(i) Business combinations

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

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

(ii) Foreign currency translation

Functional and presentational currency

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

Transactions and balances

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

(iii) Head office account, share capital and reserves

Head office account - Branch capital

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

Ordinary shares

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

Investment securities reserve

This comprises the changes in the fair value of debt securities measured at fair value through other comprehensive income ('**FVOCI**') (except for interest income, impairment charges and FX gains and losses which are recognised in the income statement), net of any related hedge accounting adjustments and tax. These changes are transferred to non-interest income in the income statement when the asset is disposed.

Cash flow hedge reserve

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

Note 1 Financial statements preparation (continued)

c. Financial assets and financial liabilities

(i) Recognition

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

Financial liabilities are recognised when an obligation arises.

(ii) Derecognition

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

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

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

The terms are deemed to be substantially different if the discounted present value of the cashflows under the new terms (discounted using the original effective interest rate) is at least 10% different from the discounted present value of the remaining cash flows of the original financial liability. Qualitative factors such as a change in the currency the instrument is denominated in, a change in the interest rate from fixed to floating and conversion features are also considered.

(iii) Classification and measurement

Financial assets are grouped into the following classes: cash and balances with central banks, collateral paid, trading securities and financial assets measured at FVIS, derivative financial instruments, investment securities, loans, other financial assets, life insurance assets and due from related entities.

Financial assets

Financial assets are classified based on a) the business model within which the assets are managed, and b) whether the contractual cash flows of the instrument represent solely payments of principal and interest (‘**SPPI**’).

The NZ Banking Group determines the business model at the level that reflects how groups of financial assets are managed. When assessing the business model the NZ Banking Group considers factors including how performance and risks are managed, evaluated and reported and the frequency and volume of, and reason for, sales in previous periods and expectations of sales in future periods.

When assessing whether contractual cash flows are SPPI, interest is defined as consideration primarily for the time value of money and the credit risk of the principal outstanding. The time value of money is defined as the element of interest that provides consideration only for the passage of time and not consideration for other risks or costs associated with holding the financial asset. Terms that could change the contractual cash flows so that they may not meet the SPPI criteria include contingent and leverage features, non-recourse arrangements, and features that could modify the time value of money.

Debt instruments

If the debt instruments have contractual cash flows which represent SPPI on the principal balance outstanding they are classified at:

- amortised cost if they are held within a business model whose objective is achieved through holding the financial asset to collect these cash flows; or
- FVOCI if they are held within a business model whose objective is achieved both through collecting these cash flows or selling the financial asset; or
- FVIS if they are held within a business model whose objective is achieved through selling the financial asset.

Debt instruments are measured at FVIS where the contractual cash flows do not represent SPPI on the principal balance outstanding or where it is designated at FVIS to eliminate or reduce an accounting mismatch.

Debt instruments at amortised cost are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. They are presented net of provision for expected credit losses (‘**ECL**’) determined using the ECL model. Refer to Notes 6 and 12 for further details.

Debt instruments at FVOCI are measured at fair value with unrealised gains and losses recognised in OCI except for interest income, impairment charges and FX gains and losses, which are recognised in the income statement. Impairment on debt instruments at FVOCI is determined using the ECL model and is recognised in the income statement with a corresponding amount in OCI. There is no reduction of the carrying value of the debt security which remains at fair value.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

The cumulative gain or loss recognised in OCI is subsequently recognised in the income statement when the instrument is derecognised.

Debt instruments at FVIS are measured at fair value with subsequent changes in fair value recognised in the income statement.

Financial liabilities

Financial liabilities are grouped into the following classes: collateral received, deposits and other borrowings, other financial liabilities, derivative financial instruments, due to related entities, debt issues and loan capital.

Financial liabilities are measured at amortised cost if they are not held for trading or designated at FVIS, otherwise they are measured at FVIS.

Financial assets and financial liabilities measured at FVIS are recognised initially at fair value. All other financial assets and financial liabilities are recognised initially at fair value plus or minus directly attributable transaction costs respectively.

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

The NZ Banking Group's policies for determining the fair value of financial assets and financial liabilities are set out in Note 24.

d. Critical accounting assumptions and estimates

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

- Note 7 Income tax expense
- Note 12 Provision for expected credit losses
- Note 14 Life insurance assets
- Note 15 Deferred tax assets
- Note 16 Intangible assets
- Note 24 Fair value of financial assets and financial liabilities

Impact of COVID-19

The COVID-19 pandemic and the measures put in place domestically and globally to control the spread of the virus have had a significant impact on global economies and financial markets. As a result, this has increased the uncertainty and judgement required in relation to our critical accounting assumptions and estimates, primarily relating to:

- ECL; and
- recoverable amount assessments of intangible assets.

As there is a higher than usual degree of uncertainty associated with these assumptions and estimates, the actual economic conditions are likely to be different from those forecast which may significantly impact accounting estimates included in these financial statements. The impact of COVID-19 is discussed further in each of the related notes.

e. Future developments in accounting standards

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

NZ IFRS 17 *Insurance Contracts* ('**NZ IFRS 17**') was issued in August 2017 with an amendment issued in August 2020. The standard will be effective for the 30 September 2024 year end unless early adopted. This will replace NZ IFRS 4 *Insurance Contracts*. The main changes under the standard are:

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

Notes to the financial statements

Note 1 Financial statements preparation (continued)

- an election to recognise changes in the fair value of assets supporting policy liabilities in OCI rather than through the income statement;
- reinsurance contracts and the associated liability are to be determined separately to the gross contract liability and may have different contract boundaries; and
- additional disclosure requirements.

Amendments to NZ IFRS 17 issued in August 2020 include:

- deferral of acquisition costs for anticipated renewals outside of the initial contract boundary;
- further clarity on the contractual service margin;
- ability to recognise a gain in the income statement for reinsurance contracts, to offset losses from onerous contracts on initial recognition;
- additional transitional relief;
- simplified presentation requirements; and
- deferral of the initial effective date by 2 years (to annual reporting periods beginning on or after 1 January 2023).

Current project implementation efforts are focused on assessing the impact of the standard for the NZ Banking Group.

On 17 September 2020, the External Reporting Board issued *Interest Rate Benchmark Reform – Phase 2* which makes further amendments to NZ IFRS 9, NZ IAS 39, and NZ IFRS 7 resulting from IBOR reform. The standard is effective for the 30 September 2022 year end unless early adopted. The amendments:

- allow the NZ Banking Group to account for a change in contractual cash flows of a financial instrument that result specifically from IBOR reform by updating the effective interest rate rather than recognising a modification gain or loss;
- allow the NZ Banking Group to continue hedge accounting and not trigger a de-designation when the following occurs specific to IBOR reform:
  - changes to hedge documentation to update the hedged risk, item and instrument;
  - changes to the method of assessing hedge ineffectiveness;
  - once the hedge relationship has been converted from LIBOR to ARR the cumulative change in fair value for ineffectiveness testing could be reset to zero if this would improve the retrospective effectiveness test;
  - this amendment can apply to macro cash flow and fair value hedges where subgroups can be formed within the portfolio of hedges where some are under the existing LIBOR rate and others have already changed to the ARR;
- require additional disclosures including:
  - quantitative information regarding all financial instruments linked to LIBOR which have not been yet converted to ARR;
  - changes to the entity's risk management strategy arising from IBOR reform; and
  - the management of the NZ Banking Group's transition to ARR.

These amendments will impact the NZ Banking Group's financial instruments that reference a LIBOR rate as they transition to an ARR. The NZ Banking Group is currently assessing the impact of the standard and considering whether to early adopt the amendments as permitted by the standard.

A revised Conceptual Framework ('**Framework**') was issued on 10 May 2018. This will be effective for the NZ Banking Group for the 30 September 2021 financial year. The revised Framework includes new definitions and recognition criteria for assets, liabilities, income and expenses and other relevant financial reporting concepts. The changes are not expected to have a material impact on the NZ Banking Group.

Other amendments to existing standards that are not yet effective are not expected to have a material impact on the NZ Banking Group.

Notes to the financial statements

Note 2 Net interest income

Accounting policy

Interest income and interest expense for all interest earning financial assets and interest bearing financial liabilities at amortised cost or FVOCI, detailed within the following table, are recognised using the effective interest rate method. Net income from Treasury's interest rate and liquidity management activities is included in net interest income.

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

Interest income is calculated based on the gross carrying amount of financial assets in stages 1 and 2 of the NZ Banking Group's ECL model and on the carrying amount net of the provision for ECL for financial assets in stage 3. Refer to Note 12 for further details of the NZ Banking Group's ECL model.

		NZ BANKING GROUP	
$ millions	Note	**2020**	2019
Interest income			
Calculated using the effective interest rate method			
Cash and balances with central banks		**13**	21
Collateral paid		**3**	7
Investment securities		**102**	138
Loans		**3,408**	3,832
Due from related entities	22	**18**	27
Other interest income		**2**	4
Total interest income calculated using the effective interest rate method		**3,546**	4,029
Other			
Trading securities and financial assets measured at FVIS		**50**	90
Total other		**50**	90
Total interest income		**3,596**	4,119
Interest expense			
Calculated using the effective interest rate method			
Collateral received		**4**	8
Deposits and other borrowings		**918**	1,289
Due to related entities	22	**25**	46
Debt issues		**244**	285
Loan capital		**139**	147
Other interest expense		**9**	15
Total interest expense calculated using the effective interest rate method		**1,339**	1,790
Other			
Deposits and other borrowings		**18**	18
Debt issues		**33**	21
Other interest expense[1, 2]		**313**	292
Total other		**364**	331
Total interest expense		**1,703**	2,121
Net interest income		**1,893**	1,998

[1] Included in other interest expense for 30 September 2020 is $7 million relating to interest expense on lease liabilities due to the adoption of NZ IFRS 16 from 1 October 2019. Comparatives have not been restated. Refer to Notes 1 and 26 for further details.

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

Notes to the financial statements

Note 3 Non-interest income

Accounting policy

Non-interest income includes net fees and commissions income, net wealth management and insurance income, trading income and other income.

Net fees and commissions income

When another party is involved in providing goods or services to a NZ Banking Group customer, the NZ Banking Group assesses whether the nature of the arrangement with its customer is as a principal provider or an agent of another party. Where the NZ Banking Group is acting as an agent for another party, the income earned by the NZ Banking Group is the net consideration received (i.e. the gross amount received from the customer less amounts paid to a third party provider). As an agent, the net consideration represents fees and commissions income for facilitating the transaction between the customer and the third party provider with primary responsibility for fulfilling the contract.

Fees and commissions income

Fees and commissions income is recognised when the performance obligation is satisfied by transferring the promised good or service to the customer. Fees and commissions income includes facility fees, transaction fees and commissions and other non-risk fee income.

Facility fees include certain line fees, annual credit card fees and fees for providing customer bank accounts. They are recognised over the term of the facility/period of service on a straight line basis.

Transaction fees and commissions are earned for facilitating banking transactions such as FX fees, telegraphic transfers and issuing bank cheques. Fees and commissions for these one-off transactions are recognised once the transaction has been completed. Transaction fees and commissions are also recognised for credit card transactions including interchange fees net of scheme charges. These are recognised once the transaction has been completed, however, a component of interchange fees received is deferred as unearned income as the NZ Banking Group has a future service obligation to customers under the NZ Banking Group's credit card reward programmes.

Other non-risk fee income includes advisory and underwriting fees which are recognised when the related service is completed.

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

Fees and commissions expenses

Fees and commissions expenses include incremental external costs that vary directly with the provision of goods or services to customers. An incremental cost is one that would not have been incurred if a specific good or service had not been provided to a specific customer. Fees and commissions expenses which form an integral part of the effective interest rate of a financial instrument are recognised using the effective interest method and recorded in net interest income. Fees and commissions expenses include the costs associated with credit card loyalty programmes which are recognised as an expense when the services are provided on the redemption of points as well as merchant transaction costs.

Net wealth management and insurance income

Wealth management income

Wealth management fees earned for the ongoing management of customer funds and investments are recognised when the performance obligation is satisfied which is over the period of management.

Net life insurance income and change in policy liabilities

Net insurance policy assets relating to life insurance contracts are calculated by using the margin on service methodology in accordance with New Zealand Society of Actuaries Professional Standard 20 Determination of Life Insurance Policy Liabilities. Under this methodology, planned profit margins and an estimate of future liabilities are calculated separately for each major product line using applied assumptions at each reporting date. Profit margins are released in line with the service that has been provided.

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

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

Trading income

- realised and unrealised gains or losses from changes in the fair value of trading assets, liabilities and derivatives are recognised in the period in which they arise (except day one profits or losses which are deferred, refer to Note 24);
- net income related to Treasury's interest rate and liquidity management activities is included in net interest income.

Notes to the financial statements

Note 3 Non-interest income (continued)

	NZ BANKING GROUP	
$ millions	**2020**	2019
Net fees and commissions income		
Facility fees	**54**	50
Transaction fees and commissions	**135**	182
Other non-risk fee income	**27**	30
Fees and commissions income	**216**	262
Credit card loyalty programmes	**(33)**	(32)
Transaction fees and commissions related expenses	**(26)**	(29)
Fees and commissions expenses	**(59)**	(61)
Net fees and commissions income	**157**	201
Net wealth management and insurance income		
Wealth management income	**51**	59
Net life insurance income and change in policy liabilities	**118**	138
Net wealth management and insurance income	**169**	197
Trading income	**116**	115
Other income		
Net ineffectiveness on qualifying hedges	**10**	2
Other non-interest income	**8**	47
Total other income	**18**	49
Total non-interest income	**460**	562

Deferred income in relation to the credit card loyalty programmes for the NZ Banking Group was $31 million as at 30 September 2020 (30 September 2019: $31 million). This will be recognised as fees and commissions income as the credit card reward points are redeemed.

There were no other material contract assets or contract liabilities for the NZ Banking Group.

Non-interest income in scope of NZ IFRS 15 *Revenue from Contracts with Customers* can be further disaggregated into the following operating segments and is consistent with the segment descriptions detailed in Note 28.

	NZ BANKING GROUP					
$ millions	**Consumer Banking and Wealth**	**Commercial, Corporate and Institutional**	**Financial Markets, International Trade and Payments[1]**	**Investments and Insurance**	**Reconciling Items**	**Total**
Year ended 30 September 2020						
Fees and commissions income						
Facility fees	**33**	**16**	**-**	**-**	**5**	**54**
Transaction fees and commissions	**74**	**55**	**2**	**-**	**4**	**135**
Other non-risk fee income	**11**	**14**	**12**	**-**	**(10)**	**27**
Fees and commissions income	**118**	**85**	**14**	**-**	**(1)**	**216**
Fees and commissions expenses	**(59)**	**-**	**-**	**-**	**-**	**(59)**
Net fees and commissions income	**59**	**85**	**14**	**-**	**(1)**	**157**
Wealth management income	**14**	**-**	**-**	**37**	**-**	**51**
Year ended 30 September 2019 (restated)						
Fees and commissions income						
Facility fees	28	15	-	-	7	50
Transaction fees and commissions	117	61	3	-	1	182
Other non-risk fee income	13	14	13	-	(10)	30
Fees and commissions income	158	90	16	-	(2)	262
Fees and commissions expenses	(62)	-	-	-	1	(61)
Net fees and commissions income	96	90	16	-	(1)	201
Wealth management income	15	-	-	44	-	59

[1] In 2020, the NZ Banking Group has separately presented the Financial Markets, International Trade and Payments operating segment to more accurately reflect management's view of the operations. Previously, these amounts were included in the Commercial, Corporate and Institutional operating segment.

Notes to the financial statements

Note 4 Operating expenses

		NZ BANKING GROUP	
$ millions	Note	2020	2019
Staff expenses		**544**	523
Operating lease rentals		**26**	58
Depreciation[1]		**99**	39
Technology services and telecommunications		**71**	94
Purchased services		**134**	123
Software amortisation costs		**66**	59
Related entities - management fees	22	**14**	8
Other		**128**	114
Total operating expenses		**1,082**	1,018

[1] These balances include depreciation of ROU assets of $61 million due to the adoption of NZ IFRS 16 from 1 October 2019. Comparatives have not been restated. Refer to Notes 1 and 26 for further details.

Note 5 Auditor's remuneration

	NZ BANKING GROUP	
$'000s	**2020**	2019
Audit and audit related services		
Audit and review of financial statements[1]	**3,506**	3,146
Other audit related services[2]	**381**	241
Total remuneration for audit and other audit related services	**3,887**	3,387
Other services	**-**	-
Total remuneration for non-audit services	**-**	-
Total remuneration for audit, other audit related services and non-audit services	**3,887**	3,387

[1] Fees for the annual audit of the financial statements, the review or other procedures performed on the interim financial statements and Sarbanes-Oxley reporting undertaken in the role of auditor.
[2] Assurance or agreed upon procedures provided on certain financial information performed in the role of auditor (or where most appropriate to be performed by the auditor), being the issue of comfort letters and agreed procedures reports in relation to debt issuance programmes, solvency projections, net tangible assets return and solvency return.

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

The external auditor also provides audit and non-audit services to non-consolidated entities, including non-consolidated trusts and non-consolidated superannuation funds or pension funds of which a member of the NZ Banking Group is manager or responsible entity. During the year ended 30 September 2020, the fees in respect of these services were $ 449,025 (30 September 2019: $ 513,895).

Note 6 Impairment charges/(benefits)

Accounting policy

Impairment charges are based on an expected loss model which measures the difference between the current carrying amount and the present value of expected future cash flows taking into account past experience, current conditions and multiple probability-weighted macroeconomic scenarios for reasonably supportable future economic conditions. Further details of the calculation of ECL and the critical accounting assumptions and estimates relating to impairment charges are included in Note 12.

Impairment charges are recognised in the income statement, with a corresponding amount recognised as follows:

- Loans at amortised cost: as a reduction of the carrying value of the financial asset through an offsetting provision account (refer to Note 12);
- Investment securities: in reserves in OCI with no reduction of the carrying value of the debt security (refer to the statement of changes in equity); and
- Credit commitments: as a provision (refer to Note 20).

Uncollectable loans

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

Where loans are secured, amounts are generally written off after receiving the proceeds from the security, or in certain circumstances, where the net realisable value of the security has been determined and this indicates that there is no reasonable expectation of full recovery, write-off may be earlier. Unsecured consumer loans are generally written off after 180 days past due.

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Provisions raised/(released):		
Performing	**205**	(35)
Non-performing	**105**	(3)
Bad debts written-off/(recovered) directly to the income statement	**10**	28
Impairment charges/(benefits)	**320**	(10)
of which relates to:		
Loans and credit commitments	**320**	(10)
Impairment charges/(benefits)	**320**	(10)

Impairment charges/(benefits) on all other financial assets are not material to the NZ Banking Group. Refer to Note 12 for details on the impact of COVID-19 on the provision for ECL.

Notes to the financial statements

Note 7 Income tax expense

Accounting policy

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

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

Goods and services tax ('GST')

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

Critical accounting assumptions and estimates

Significant judgement is required in determining the current tax liability. There may be transactions with uncertain tax outcomes and provisions are determined based on the expected outcomes.

	NZ BANKING GROUP	
$ millions	**2020**	2019
Income tax expense		
Current tax:		
Current year	**374**	414
Prior year adjustments	**-**	4
Deferred tax (refer to Note 15):		
Current year	**(105)**	10
Prior year adjustments	**1**	(5)
Total income tax expense	**270**	423

Profit before income tax	**951**	1,552
Tax calculated at tax rate of 28%	**266**	435
Income not subject to tax	**-**	(11)
Expenses not deductible for tax purposes	**3**	-
Prior year adjustments	**1**	(1)
Total income tax expense	**270**	423

The effective tax rate for the year ended 30 September 2020 was 28.4% (30 September 2019: 27.3%).

Note 8 Imputation credit account

	NZ BANKING GROUP	
$ millions	**2020**	2019
Imputation credits available for use in subsequent reporting periods	**1,381**	1,235

Note 9 Trading securities and financial assets measured at FVIS

Accounting policy

Trading securities

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

Reverse repurchase agreements

Securities purchased under these agreements are not recognised in the balance sheet, as the NZ Banking Group has not obtained the risks and rewards of ownership. The cash consideration paid is recognised as a reverse repurchase agreement, which forms part of a trading portfolio that is measured at fair value.

Gains and losses on these financial assets are recognised in the income statement. Interest earned from debt securities is recognised in interest income (refer to Note 2).

	NZ BANKING GROUP	
$ millions	**2020**	2019
Government and semi-government securities	**2,684**	1,421
Other debt securities	**993**	2,409
Reverse repurchase agreements	**547**	1,041
Total trading securities and financial assets measured at FVIS	**4,224**	4,871

Note 10 Investment securities

Accounting policy

Investment securities include debt securities (government and other) that are measured at FVOCI. These instruments are classified based on the criteria disclosed under the heading "Financial assets and financial liabilities" in Note 1.

Debt securities measured at FVOCI

Include debt instruments that have contractual cash flows which represent SPPI on the principal balance outstanding and they are held within a business model whose objective is achieved both through collecting these cash flows or selling the financial asset.

These securities are measured at fair value with gains and losses recognised in OCI except for interest income, impairment charges and FX gains and losses which are recognised in the income statement.

Impairment is measured using the same ECL model applied to financial assets measured at amortised cost. Impairment is recognised in the income statement with a corresponding amount in OCI with no reduction of the carrying value of the debt security which remains at fair value. Refer to Note 12 for further details.

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Government and semi-government securities	**3,844**	2,599
Other debt securities	**1,177**	1,870
Total investment securities	**5,021**	4,469

Notes to the financial statements

Note 11 Loans

Accounting policy

Loans are financial assets initially recognised at fair value plus directly attributable transaction costs and fees.

Loans are subsequently measured at amortised cost using the effective interest rate method where they have contractual cash flows which represent SPPI on the principal balance outstanding and they are held within a business model whose objective is achieved through holding the loans to collect these cash flows. They are presented net of any provision for ECL.

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

The following table shows loans disaggregated by types of credit exposure:

	NZ BANKING GROUP	
$ millions	**2020**	2019
Residential mortgages	**55,230**	51,504
Other retail	**3,299**	3,753
Corporate	**30,340**	29,579
Other	**92**	111
Total gross loans	**88,961**	84,947
Provision for ECL on loans (refer to Note 12)	**(607)**	(321)
Total net loans	**88,354**	84,626

Notes to the financial statements

Note 12 Provision for expected credit losses

Accounting policy

Note 6 provides details of impairment charges.

Impairment under NZ IFRS 9 applies to all financial assets at amortised cost, investment securities and credit commitments.

The ECL determined under NZ IFRS 9 is recognised as follows:

- Loans at amortised cost: as a reduction of the carrying value of the financial asset through an offsetting provision account (refer to Note 11);
- Investment securities: in reserves in OCI with no reduction of the carrying value of the debt security itself (refer to the statement of changes in equity); and
- Credit commitments: as a provision (refer to Note 20).

Measurement

The NZ Banking Group calculates the provision for ECL based on a three stage approach. ECL are a probability-weighted estimate of the cash shortfalls expected to result from defaults over the relevant timeframe. They are determined by evaluating a range of possible outcomes and taking into account the time value of money, past events, current conditions and forecasts of future economic conditions.

The models use three main components to determine the ECL (as well as the time value of money) including:

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

Model stages
The three stages are as follows:

Stage 1: 12 months ECL - performing
For financial assets where there has been no significant increase in credit risk since origination a provision for 12 months ECL is recognised.

Stage 2: Lifetime ECL – performing
For financial assets where there has been a significant increase in credit risk since origination but where the asset is still performing a provision for lifetime ECL is recognised. The indicators of a significant increase in credit risk are described on the following page.

Stage 3: Lifetime ECL – non-performing
For financial assets that are non-performing a provision for lifetime ECL is recognised. Indicators include a breach of contract with the NZ Banking Group such as a default on interest or principal payments, a borrower experiencing significant financial difficulties or observable economic conditions that correlate to defaults on an individual basis.

Financial assets in Stage 3 are those that are in default. A default occurs when the NZ Banking Group considers that the customer is unable to repay its credit obligations in full, irrespective of recourse by the NZ Banking Group to actions such as realising security, or the customer is more than 90 days past due on any material credit obligation. This definition is aligned to the Reserve Bank regulatory definition of default.

Collective and individual assessment
Financial assets that are in Stages 1 and 2 are assessed on a collective basis. This means that they are grouped in pools of similar assets with similar credit risk characteristics including the type of product and the customer risk grade. Financial assets in Stage 3 are assessed on an individual basis and calculated collectively for those below a specified threshold.

Expected life

In considering the lifetime timeframe for ECL in Stages 2 and 3, the standard generally requires use of the remaining contractual life adjusted, where appropriate, for prepayments, extension and other options. For certain revolving credit facilities which include both a drawn and undrawn component (e.g. credit cards and revolving lines of credit), the NZ Banking Group's contractual ability to demand repayment and cancel the undrawn commitment does not limit the exposure to credit losses to the contractual notice period. For these facilities, lifetime is based on historical behaviour.

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

Note 12 Provision for expected credit losses (continued)

Accounting policy (continued)

Critical accounting assumptions and estimates
Key judgements include when a significant increase in credit risk has occurred and estimation of forward-looking macroeconomic information. Other factors which can impact the provision include the borrower's financial situation, the realisable value of collateral, the NZ Banking Group's position relative to other claimants, the reliability of customer information and the likely cost and duration of recovering the loan.

Significant increase in credit risk
Determining when a financial asset has experienced a significant increase in credit risk since origination is a critical accounting judgement which is primarily based on changes in internal customer risk grades since origination of the facility. A change in an internal customer risk grade is based on both quantitative and qualitative factors. The change in the internal customer risk grade that the NZ Banking Group uses to represent a significant increase in credit risk is based on a sliding scale. This means that a higher credit quality exposure at origination would require a more significant downgrade compared to a lower credit quality exposure before it is considered to have experienced a significant increase in credit risk.

The NZ Banking Group does not rebut the presumption that instruments that are 30 days past due have experienced a significant increase in risk but this is used as a backstop rather than the primary indicator.

The deferral of payments by customers in hardship arrangements is generally treated as an indication of a significant increase in credit risk ('**SICR**') but the deferral of payments under the current COVID-19 support packages for mortgages and business loans has not, in isolation, been treated as an indication of SICR.

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

Forward-looking macroeconomic information
The measurement of ECL for each stage and the assessment of significant increase in credit risk consider information about past events and current conditions as well as reasonable and supportable projections of future events and economic conditions. The estimation of forward-looking information is a critical accounting judgement. The NZ Banking Group considers three future macroeconomic scenarios including a base case scenario along with upside and downside scenarios.

The macroeconomic variables used in these scenarios, based on current economic forecasts, include (but are not limited to) unemployment rates, real gross domestic product growth rates, base interest rates and residential property price indices.

- Base case scenario
  This scenario utilises the internal Westpac economics forecast used for strategic decision making and forecasting.
- Upside scenario
  This scenario represents a modest improvement on the base case scenario.
- Downside scenario
  The downside scenario is a more severe scenario with ECL higher than those under the current base case scenario. The more severe loss outcome for the downside is generated under a recession scenario in which the combination of negative GDP growth, declines in residential property prices and an increase in the unemployment rate simultaneously impact ECL across all portfolios from the reporting date.

The macroeconomic scenarios are weighted based on the NZ Banking Group's best estimate of the relative likelihood of each scenario. The weighting applied to each of the three macroeconomic scenarios takes into account historical frequency, current trends, and forward-looking conditions.

The macroeconomic variables and probability weightings of the three macroeconomic scenarios are subject to the approval of the NZ Banking Group's Chief Financial Officer and Chief Risk Officer with oversight from the Board of Directors (and its Committees).

Where appropriate, adjustments will be made to modelled outcomes to reflect reasonable and supportable information not already incorporated in the models.

Judgements can change with time as new information becomes available which could result in changes to the provision for ECL.

Notes to the financial statements

Note 12 Provision for expected credit losses (continued)

Loans and credit commitments

The reconciliation of the provision for ECL tables for loans and credit commitments has been determined by an aggregation of monthly movements over the year. The key line items in the reconciliation represent the following:

- The "transfers between stages" lines represent transfers between Stage 1, Stage 2 and Stage 3 prior to remeasurement of the provision for ECL.
- The "other charges/(credits) to the income statement" line represents the impact on the provision for ECL due to changes in credit quality during the year (including transfers between stages), changes due to forward-looking economic scenarios, and partial repayments and additional drawdowns on existing facilities over the year.
- "Write-offs" represent a reduction in the provision for ECL as a result of derecognition of exposures where there is no reasonable expectation of full recovery.

The following table shows the collectively assessed provisions ('**CAP**') and individually assessed provisions ('**IAP**') for loans and credit commitments.

	NZ BANKING GROUP									
	2020					2019				
	Performing		Non-performing			Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3		Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total	CAP	CAP	CAP	IAP	Total
Provision for ECL on loans										
Residential mortgages	**44**	**121**	**70**	**6**	**241**	19	18	31	6	74
Other retail	**21**	**70**	**31**	**2**	**124**	37	51	19	-	107
Corporate	**31**	**140**	**6**	**65**	**242**	20	95	3	22	140
Total provision for ECL on loans (refer to Note 11)	**96**	**331**	**107**	**73**	**607**	76	164	53	28	321
Provision for ECL on credit commitments										
Residential mortgages	**5**	**2**	**-**	**-**	**7**	3	1	-	-	4
Other retail	**7**	**11**	**-**	**1**	**19**	9	4	-	-	13
Corporate	**8**	**16**	**-**	**-**	**24**	3	11	-	-	14
Total provision for ECL on credit commitments (refer to Note 20)	**20**	**29**	**-**	**1**	**50**	15	16	-	-	31
Total provision for ECL on loans and credit commitments	**116**	**360**	**107**	**74**	**657**	91	180	53	28	352
Gross carrying amount	**81,172**	**7,079**	**573**	**137**	**88,961**	80,435	4,064	379	69	84,947
Coverage ratio (%)[1]	**0.14**	**5.09**	**18.67**	**54.01**	**0.74**	0.11	4.43	13.98	40.58	0.41

[1] Coverage ratio is calculated using total provision for ECL on loans and credit commitments over gross carrying amount (excluding credit commitments).

Notes to the financial statements

Note 12 Provision for expected credit losses (continued)

Movements in components of loss allowance – total

The following table reconciles the provision for ECL on loans and credit commitments for the NZ Banking Group.

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	**CAP**	**CAP**	**CAP**	**IAP**	**Total**
Provision for ECL on loans and credit commitments as at 30 September 2019	**91**	**180**	**53**	**28**	**352**
Due to changes in credit quality:					
Transfers to Stage 1	**425**	**(400)**	**(25)**	**-**	**-**
Transfers to Stage 2	**(53)**	**143**	**(87)**	**(3)**	**-**
Transfers to Stage 3 CAP	**-**	**(85)**	**86**	**(1)**	**-**
Transfers to Stage 3 IAP	**-**	**(21)**	**(7)**	**28**	**-**
Reversals of previously recognised impairment charges	**-**	**-**	**-**	**(11)**	**(11)**
New financial assets originated	**23**	**-**	**-**	**-**	**23**
Financial assets derecognised during the year	**(14)**	**(40)**	**(19)**	**-**	**(73)**
Changes in CAP due to amounts written off	**-**	**-**	**(33)**	**-**	**(33)**
Other charges/(credits) to the income statement	**(356)**	**583**	**139**	**38**	**404**
Total charges/(credits) to the income statement for ECL	**25**	**180**	**54**	**51**	**310**
Amounts written off from IAP	**-**	**-**	**-**	**(5)**	**(5)**
Total provision for ECL on loans and credit commitments as at 30 September 2020	**116**	**360**	**107**	**74**	**657**

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total
Provision for ECL on loans and credit commitments as at 1 October 2018	103	203	53	36	395
Due to changes in credit quality:					
Transfers to Stage 1	261	(245)	(16)	-	-
Transfers to Stage 2	(16)	43	(26)	(1)	-
Transfers to Stage 3 CAP	-	(38)	42	(4)	-
Transfers to Stage 3 IAP	-	-	(8)	8	-
Reversals of previously recognised impairment charges	-	-	-	(15)	(15)
New financial assets originated	24	-	-	-	24
Financial assets derecognised during the year	(19)	(41)	(21)	-	(81)
Changes in CAP due to amounts written off	-	-	(53)	-	(53)
Other charges/(credits) to the income statement	(262)	258	82	9	87
Total charges/(credits) to the income statement for ECL	(12)	(23)	-	(3)	(38)
Amounts written off from IAP	-	-	-	(5)	(5)
Total provision for ECL on loans and credit commitments as at 30 September 2019	91	180	53	28	352

Notes to the financial statements

Note 12 Provision for expected credit losses (continued)

Movements in components of loss allowance – by types of credit exposure

The provision for ECL on loans and credit commitments can be further disaggregated into the following types of credit exposure:

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total
Residential mortgages					
Provision for ECL as at 30 September 2019	**22**	**19**	**31**	**6**	**78**
Due to changes in credit quality:					
Transfers to Stage 1	200	(186)	(14)	-	-
Transfers to Stage 2	(26)	86	(60)	-	-
Transfers to Stage 3 CAP	-	(46)	47	(1)	-
Transfers to Stage 3 IAP	-	-	(2)	2	-
Reversals of previously recognised impairment charges	-	-	-	(3)	(3)
New financial assets originated	11	-	-	-	11
Financial assets derecognised during the year	(4)	(10)	(14)	-	(28)
Changes in CAP due to amounts written off	-	-	(1)	-	(1)
Other charges/(credits) to the income statement	(154)	260	83	3	192
Total charges/(credits) to the income statement for ECL	**27**	**104**	**39**	**1**	**171**
Amounts written off from IAP	-	-	-	(1)	(1)
Total provision for ECL on loans and credit commitments as at 30 September 2020	**49**	**123**	**70**	**6**	**248**
Other retail					
Provision for ECL as at 30 September 2019	**46**	**55**	**19**	**-**	**120**
Due to changes in credit quality:					
Transfers to Stage 1	213	(202)	(11)	-	-
Transfers to Stage 2	(25)	49	(24)	-	-
Transfers to Stage 3 CAP	-	(32)	32	-	-
Transfers to Stage 3 IAP	-	-	-	-	-
Reversals of previously recognised impairment charges	-	-	-	(1)	(1)
New financial assets originated	6	-	-	-	6
Financial assets derecognised during the year	(6)	(19)	(5)	-	(30)
Changes in CAP due to amounts written off	-	-	(32)	-	(32)
Other charges/(credits) to the income statement	(206)	230	52	4	80
Total charges/(credits) to the income statement for ECL	**(18)**	**26**	**12**	**3**	**23**
Amounts written off from IAP	-	-	-	-	-
Total provision for ECL on loans and credit commitments as at 30 September 2020	**28**	**81**	**31**	**3**	**143**
Corporate					
Provision for ECL as at 30 September 2019	**23**	**106**	**3**	**22**	**154**
Due to changes in credit quality:					
Transfers to Stage 1	12	(12)	-	-	-
Transfers to Stage 2	(2)	8	(3)	(3)	-
Transfers to Stage 3 CAP	-	(7)	7	-	-
Transfers to Stage 3 IAP	-	(21)	(5)	26	-
Reversals of previously recognised impairment charges	-	-	-	(7)	(7)
New financial assets originated	6	-	-	-	6
Financial assets derecognised during the year	(4)	(11)	-	-	(15)
Changes in CAP due to amounts written off	-	-	-	-	-
Other charges/(credits) to the income statement	4	93	4	31	132
Total charges/(credits) to the income statement for ECL	**16**	**50**	**3**	**47**	**116**
Amounts written off from IAP	-	-	-	(4)	(4)
Total provision for ECL on loans and credit commitments as at 30 September 2020	**39**	**156**	**6**	**65**	**266**

The above movements in components of loss allowance table does not include 'Other' credit exposures on the basis that the provision for ECL is nil.

Note 12 Provision for expected credit losses (continued)

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total
Residential mortgages					
Provision for ECL as at 1 October 2018	33	25	25	7	90
Due to changes in credit quality:					
Transfers to Stage 1	22	(16)	(6)	-	-
Transfers to Stage 2	(3)	11	(8)	-	-
Transfers to Stage 3 CAP	-	(4)	5	(1)	-
Transfers to Stage 3 IAP	-	-	(3)	3	-
Reversals of previously recognised impairment charges	-	-	-	(3)	(3)
New financial assets originated	5	-	-	-	5
Financial assets derecognised during the year	(3)	(3)	(14)	-	(20)
Changes in CAP due to amounts written off	-	-	(2)	-	(2)
Other charges/(credits) to the income statement	(32)	6	34	2	10
Total charges/(credits) to the income statement for ECL	(11)	(6)	6	1	(10)
Amounts written off from IAP	-	-	-	(2)	(2)
Total provision for ECL on loans and credit commitments as at 30 September 2019	22	19	31	6	78
Other retail					
Provision for ECL as at 1 October 2018	50	64	18	3	135
Due to changes in credit quality:					
Transfers to Stage 1	232	(223)	(9)	-	-
Transfers to Stage 2	(10)	26	(16)	-	-
Transfers to Stage 3 CAP	-	(30)	31	(1)	-
Transfers to Stage 3 IAP	-	-	-	-	-
Reversals of previously recognised impairment charges	-	-	-	(4)	(4)
New financial assets originated	12	-	-	-	12
Financial assets derecognised during the year	(13)	(21)	(4)	-	(38)
Changes in CAP due to amounts written off	-	-	(51)	-	(51)
Other charges/(credits) to the income statement	(225)	239	50	5	69
Total charges/(credits) to the income statement for ECL	(4)	(9)	1	-	(12)
Amounts written off from IAP	-	-	-	(3)	(3)
Total provision for ECL on loans and credit commitments as at 30 September 2019	46	55	19	-	120
Corporate					
Provision for ECL as at 1 October 2018	20	114	10	26	170
Due to changes in credit quality:					
Transfers to Stage 1	7	(6)	(1)	-	-
Transfers to Stage 2	(3)	6	(2)	(1)	-
Transfers to Stage 3 CAP	-	(4)	6	(2)	-
Transfers to Stage 3 IAP	-	-	(5)	5	-
Reversals of previously recognised impairment charges	-	-	-	(8)	(8)
New financial assets originated	7	-	-	-	7
Financial assets derecognised during the year	(3)	(17)	(3)	-	(23)
Changes in CAP due to amounts written off	-	-	-	-	-
Other charges/(credits) to the income statement	(5)	13	(2)	2	8
Total charges/(credits) to the income statement for ECL	3	(8)	(7)	(4)	(16)
Amounts written off from IAP	-	-	-	-	-
Total provision for ECL on loans and credit commitments as at 30 September 2019	23	106	3	22	154

The above movements in components of loss allowance table does not include 'Other' credit exposures on the basis that the provision for ECL is nil.

Note 12 Provision for expected credit losses (continued)

Impact of Overlays on the provision for ECL

The following table attributes the breakup between modelled ECL and other economic overlays.

Where there is increased uncertainty regarding the required forward-looking economic conditions under NZ IFRS 9, or limitations of the historical data used to calibrate the models to current stressed environments, overlays are typically used to address areas of potential risk not captured in the underlying modelled ECL.

	NZ BANKING GROUP	
$ millions	**2020**	2019
Modelled provision for ECL	**522**	313
Overlays[1]	**135**	39
Total provision for ECL	**657**	352

[1] Included in 2020 is $128 million related to COVID-19.

Details of these changes, which are based on reasonable and supportable information up to the date of this disclosure statement are provided below.

Modelled provision for ECL

The modelled provision for ECL is a probability weighted estimate based on three scenarios which together are representative of the NZ Banking Group's view of the forward-looking distribution of potential loss outcomes. The increase in provisions as a result of changes in modelled ECL are reflected through the "Other charges/(credits) to the income statement" line in the "Movements in components of loss allowance" table.

The base case scenario uses current Westpac Economics forecasts and reflects the latest available macroeconomic view which shows a deterioration in the short term, with a subsequent recovery. The latest view considers both the economic and societal impacts of COVID-19 and the government stimulus measures implemented to cushion the impacts. The NZ Banking Group's economic forecast assumes the following:

Key macroeconomic assumptions for base case scenario	30 Sep 20	30 Sep 19
Annual GDP	Forecasted growth of 6.7% over the next 12 months	Forecasted growth of 3.2% over the next 12 months
Residential property prices	Forecasted growth of 6.8% over the next 12 months	Forecasted growth of 7% over the next 12 months
Cash rate	Reduction of 50 bps in the next 12 months	RBNZ bill rate of 1.1% in the next 12 months
Unemployment rate[1]	Forecast to peak at 7% (December 2020) and then fall to 6.6% at September 2021	N/A (not used in NZ IFRS 9 models)

[1] In this financial year, Credit Cards have moved from a Simplified approach to an Advanced model using Unemployment rate in the modelled ECL outcome.

The downside scenario is a more severe scenario with ECL higher than the base case scenario. The more severe loss outcome for the downside is generated under a recession scenario in which the combination of negative GDP growth, declines in residential property prices and an increase in the unemployment rate simultaneously impact ECL across all portfolios from the reporting date. The assumptions in this scenario and relativities to the base case scenario will be monitored having regard to the emerging economic conditions and updated where necessary. The upside scenario represents a modest improvement to the base case.

The following sensitivity table shows the reported provision for ECL based on the probability weighted scenarios and what the provision for ECL would be assuming a 100% weighting is applied to the base case scenario and to the downside scenario (with all other assumptions, including customer risk grades, held constant).

	NZ BANKING GROUP	
$ millions	**2020**	2019
Reported probability-weighted ECL	**657**	352
100% base case ECL	**492**	259
100% downside ECL	**902**	596

If 1% of the stage 1 gross exposure from loans and credit commitments (calculated on a 12 month ECL) was reflected in stage 2 (calculated on a lifetime ECL) the provision for ECL would increase by $33 million (2019: $26 million) based on applying the average provision coverage ratios by stage to the movement in the gross exposure by stage.

Notes to the financial statements

Note 12 Provision for expected credit losses (continued)

The following table indicates the weightings applied by the NZ Banking Group.

	NZ BANKING GROUP	
Macroeconomic scenario weightings (%)	**2020**	2019
Upside	**5**	10
Base	**55**	62.5
Downside	**40**	27.5

The increase in weighting to the downside scenario since 30 September 2019 reflects the continuing uncertainty around the economic assumptions used in the base case and the asymmetric impact of downside tail risk on ECL. In particular, the current base case economic forecast indicates a relatively short and sharp economic impact followed by a subsequent recovery. There is a risk that the economic impacts of COVID-19 could be deeper or more prolonged which would result in higher credit losses than those modelled under the base case.

The COVID-19 pandemic is leading to material structural shifts in the behaviour of the economy and customers, and unprecedented actions by banks, governments and regulators in response. ECL models are expected to be subject to a higher than usual level of uncertainty during this period. In this environment, there is a heightened need for the application of judgement in order to reflect these evolving relationships and risks.

This judgement has been applied in the form of the revision to scenario weightings and a COVID-19 overlay.

COVID-19 overlay

Where there is increased uncertainty regarding the required forward-looking economic conditions under NZ IFRS 9, or limitations of the historical data used to calibrate the models to current stressed environments, overlays are typically used to address areas of potential risk not captured in the underlying modelled ECL.

The COVID-19 pandemic has had, and continues to have, an impact on businesses around the world and the economic environments in which they operate. There also exists significant uncertainty regarding the duration and severity of COVID-19 impacts and the associated disruption to the economy and our customers. While the impacts on the broader economy are included in the assumptions used in the economic scenarios and the weightings applied to these scenarios, these general economy wide impacts may not fully reflect the specific impact on individual customers, and therefore the potential risk is not captured in the underlying modelled ECL. As overlays require the application of expert judgment, they are documented and subject to comprehensive internal governance and oversight. The NZ Banking Group's COVID-19 overlay as of September 2020 is $128 million, of which, $8 million relates to COVID-19 deferral packages.

The deferral of payments by customers in hardship arrangements is generally treated as an indication of a SICR but the deferral of payments under the current COVID-19 support packages for mortgages and business loans has not, in isolation, been treated as an indication of SICR. As highlighted by the IASB in its guidance document 'IFRS 9 and COVID-19' issued on 27 March 2020, in these changed circumstances it is not appropriate to apply previously established approaches to assessing SICR for payment holidays in a mechanistic manner.

These relief packages are available to customers who require assistance because of COVID-19 and who otherwise had up to date payment status prior to the onset of COVID-19. The earlier relief packages allow for a deferral of payments for up to 6 months. During this period, the deferred interest will be capitalised and the deferred principal along with the capitalised interest, will be repaid over the remaining term of the loan. These packages have been designed to provide short-term cash flow support while the most significant COVID-19 restrictions are in place. A further extension allowing for up to an additional 6 month deferral up to 31 March 2021 has been announced. The extension will not be automatic and will require up-to-date financial information on each borrower to confirm that there is a reasonable prospect to repay the loan.

As the situation has evolved since March 2020, the NZ Banking Group has classified the deferral packages into medium and high risk based on how these customers are expected to perform following the expiry of the relief packages. The NZ Banking Group has identified a proportion of deferral packages as higher credit risk and has identified a SICR event to have occurred on these customers. An overlay estimation has been done on this base of customers.

We continue to monitor our lending portfolios closely and reassess our provisioning levels as the situation around COVID-19 evolves. At the cessation of the COVID-19 support packages, it is likely that some customers will move into general hardship arrangements (Stage 2). Exposures allocated to Stage 3 relies only on individual evidence of default at September 2020.

Business lending (including institutional)

The business lending overlay relates to the increase in credit risk due to uncertainties including the effects of Government support to the business community, suggesting that credit deterioration is yet to be seen in the underlying portfolios.

Based on this judgement, we have identified $0.8 billion of business exposures on which a lifetime ECL overlay has been determined. This has resulted in a $58 million overlay which is included in stage 2 provisions. An additional overlay of $8 million has been calculated on a 12 month ECL and included in stage 1 provisions.

Retail lending

The retail lending overlay relates to SICR events given the expected medium-term structural change in unemployment rate by 2.6% along with the emerging credit risk from the residential mortgage and other retail customers who are currently on COVID-19 relief packages.

Note 12 Provision for expected credit losses (continued)

For customers not on relief packages, we have identified $1.3 billion of retail exposures on which a lifetime ECL overlay has been determined. This has resulted in a $53 million overlay which is included in stage 2 provisions.

Customers with packages have been segmented into medium and high risk based on how these customers are expected to perform following the expiry of the relief packages, on which a lifetime ECL overlay has been determined. We have identified $260 million of retail exposures on which a lifetime ECL overlay has been determined. This has resulted in an $8 million overlay which is included in stage 2 provisions.

The judgements and assumptions used in estimating the above overlays will be reviewed and refined as both the COVID-19 pandemic and portfolio evolves.

Impact of changes in credit exposures on the provision for ECL

Stage 1 exposures had a net increase of $0.8 billion (2019: net increase of $3.5 billion) for the NZ Banking Group primarily driven by residential mortgage and business segments. This increase is calculated after adjusting $2.3 billion transferred to Stage 2 to account for gross carrying amounts ('**GCA**') associated with COVID-19 overlays. Stage 1 ECL has increased mainly from impacts from revised macro-economic forecasts and weightings.

Stage 2 credit exposures increased by $3 billion (2019: increased by $0.3 billion) for the NZ Banking Group mainly driven by the residential mortgage segment and the impact of additional $2.3 billion transferred to Stage 2 to account for GCA associated with COVID-19 overlays. The Stage 2 underlying exposure increase has been driven by the residential mortgage segment resulting from increases from hardship segment. Stage 2 ECL has increased driven by the COVID-19 overlay, impacts from revised macro-economic forecasts/weightings and underlying increase in Stage 2 exposures.

Stage 3 credit exposures had a net increase of $253 million (2019: decrease $15 million) for the NZ Banking Group driven by net transfers to Stage 3 from Stage 1 and Stage 2 with the increase mainly driven by residential mortgage and business portfolios. The increase in Stage 3 exposures is in line with increase in 90 days past due for home loans, and business loans downgrades to impaired. Stage 3 ECL has increased in line with the increase in Stage 3 exposures.

Accordingly, as at 30 September 2020, the provision for ECL as a proportion of GCA has increased compared to 30 September 2019 for all types of credit exposures across all stages, except for Stage 1 and Stage 2 for other retail which has decreased, primarily due to the impact associated with the move from a Simplified approach to an Advanced model for Credit Cards.

Refer to Section iii. Asset quality of the Registered bank disclosures for further details on the impact of changes in gross financial assets on loss allowances.

COVID-19 deferral packages

The customers with deferral of payments under COVID-19 support packages for retail and business loans at 30 September 2020 is $4.7 billion. These loans and the related provision for ECL can be disaggregated as follows:

	NZ BANKING GROUP	
	2020	
$ millions	Gross loans	Provision for ECL on loans
Residential mortgages		
Stage 1	**3,188**	**7**
Stage 2	**1,353**	**49**
Stage 3	**53**	**9**
Total residential mortgages	**4,594**	**65**
Other retail		
Stage 1	**49**	**1**
Stage 2	**35**	**14**
Stage 3	**5**	**3**
Total other retail loans	**89**	**18**
Corporate		
Stage 1	**5**	**-**
Stage 2	**-**	**-**
Stage 3	**-**	**-**
Total corporate loans	**5**	**-**
Total loans		
Stage 1	**3,242**	**8**
Stage 2	**1,388**	**63**
Stage 3	**58**	**12**
Total loans	**4,688**	**83**

If the balance of COVID-19 support packages in Stage 1 moved to Stage 2 the NZ Banking Group estimates that the provision for ECL would increase by $126 million.

Considering all COVID-19 support packages provided to customers, $470 million were in Stage 2/3 at the time of the modification, of which $77 million have since moved to Stage 1.

Notes to the financial statements

Note 12 Provision for expected credit losses (continued)

Business Finance Guarantee Scheme

The Bank has entered into a deed of indemnity with the New Zealand Government to implement the New Zealand Government's business finance guarantee scheme ('**Scheme**'), whereby the New Zealand Government undertakes to indemnify the Bank for up to 80% of any loss incurred by the Bank on a loan it makes under the Scheme, after the Bank has exhausted its recoveries procedures. As at 30 September 2020, the Banking Group had advanced $15 million to customers under the Scheme.

Write-offs still under enforcement activity

The amount of current year write-offs which remain subject to enforcement activity was $27 million for the NZ Banking Group (30 September 2019: $43 million).

Note 13 Other financial assets

	NZ BANKING GROUP	
$ millions	**2020**	2019
Accrued interest receivable	**113**	137
Trade debtors	**4**	5
Securities sold not delivered	**288**	79
Interbank lending	**55**	72
Other	**95**	107
Total other financial assets	**555**	400

Note 14 Life insurance assets

Accounting policy

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

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

Investments held by the NZ Banking Group's life insurance company, including investments in funds managed by the NZ Banking Group and other debt securities, are designated at FVIS. Changes in the fair value are recognised in non-interest income. The determination of fair value involves the same judgements as other financial assets, which are described in the critical accounting assumptions and estimates in Note 24.

The value of net insurance policy assets is calculated using the margin on services methodology ('**MoS**'), in accordance with New Zealand Societies of Actuaries Professional Standard 20 *Determination of Life Insurance Policy Liabilities*.

MoS accounts for the associated risks and uncertainties of each type of life insurance contract written. At each reporting date, planned profit margins and an estimate of future liabilties are calculated. Profit margins are released to non-interest income over the period that life insurance is provided to the policyholders. The cost incurred in acquiring specific insurance contracts is deferred provided that these amounts are recoverable out of planned profit margins. The deferred amounts are recognised as a reduction in life insurance policy liabilties and are amortised to non-interest income over the same period as the planned profit margins.

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

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

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

Critical accounting assumptions and estimates

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

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

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Investment assets	**214**	193
Net insurance policy assets	**161**	142
Total life insurance assets	**375**	335

Note 15 Deferred tax assets

Accounting policy

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

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

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

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

Deferred tax is not recognised for the following temporary differences:

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

Critical accounting assumptions and estimates

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Deferred tax assets/(liabilities) comprise the following temporary differences:		
Provision for ECL on loans	**170**	90
Provision for ECL on credit commitments	**14**	9
Cash flow hedges	**28**	29
Provision for employee entitlements	**28**	22
Compliance, regulation and remediation provisions	**12**	13
Software, property and equipment	**(56)**	11
Lease liabilities[1]	**79**	-
Net insurance policy assets	**(47)**	(43)
Financial instruments	**13**	8
Other temporary differences	**1**	(1)
Net deferred tax assets	**242**	138
The deferred tax (charge)/credit in income tax expense comprises the following temporary differences:		
Provision for ECL on loans	**80**	(12)
Provision for ECL on credit commitments	**5**	(3)
Provision for employee entitlements	**5**	2
Compliance, regulation and remediation provisions	**(1)**	8
Software, property and equipment	**(67)**	1
Lease liabilities[1]	**79**	-
Net insurance policy assets	**(4)**	(8)
Financial instruments	**5**	4
Other temporary differences	**2**	3
Total deferred tax (charge)/credit in income tax expense	**104**	(5)
The deferred tax (charge)/credit in OCI comprises the following temporary differences:		
Cash flow hedges	**(1)**	3
Provision for employee entitlements	**1**	4
Total deferred tax (charge)/credit in OCI	**-**	7
The deferred tax adjustment to opening retained earnings comprises the following temporary differences:		
Provision for ECL on loans	**-**	8
Provision for ECL on credit commitments	**-**	2
Other temporary differences	**-**	(1)
Total deferred tax adjustment to opening retained earnings	**-**	9

[1] The NZ Banking Group adopted NZ IFRS 16 on 1 October 2019. Comparatives have not been restated. Refer to Note 1 for further details.

Notes to the financial statements

Note 16 Intangible assets

Accounting policy

Indefinite life intangible assets

Goodwill

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

i. the consideration paid; over

ii. the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

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

The NZ Banking Group's CGUs represent the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or group of assets. They reflect the level at which the NZ Banking Group monitors and manages its operations.

Finite life intangible assets

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

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

Critical accounting assumptions and estimates

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

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Goodwill	**525**	525
Computer software	**171**	160
Total intangible assets	**696**	685

Goodwill has been allocated to the following CGUs:

Consumer Banking and Wealth	**512**	512
BT New Zealand[1]	**13**	13
Net carrying amount of goodwill	**525**	525

[1] BT New Zealand forms part of the Investments and Insurance operating segment, as described in Note 28.

Impairment testing and results

Impairment testing is performed at least once a year, or whenever there is an indication of impairment, by comparing the recoverable amount of each CGU with the carrying amount. The primary test for the recoverable amount is determined based on value-in-use which refers to the present value of expected cash flows under its current use.

Impairment testing in the current year confirmed that the NZ Banking Group continues to have considerable headroom when determining whether goodwill is recoverable, and no impairment should be recognised.

Note 16 Intangible assets (continued)

Significant assumptions used in recoverable amount calculations

The assumptions made for goodwill impairment testing for each relevant significant CGU are provided in the following table and are based on past experience and management's expectations for the future. In the current year and given the present economic environment, the NZ Banking Group has reassessed these assumptions and revised them where necessary in order to provide a reasonable estimate of the value-in-use of the CGUs.

	Discount rate		Cash flows	
	Equity rate / adjusted pre-tax equity rate		Forecast period / terminal growth rate	
	2020	2019	**2020**	2019
Consumer Banking and Wealth	**11.0% / 14.5%**	11.0% / 15.3%	**3 years / 2%**	2 years / 0%
BT New Zealand	**11.0% / 14.5%**	11.0% / 15.3%	**3 years / 2%**	2 years / 0%

The NZ Banking Group discounts the projected cash flows by the adjusted pre-tax equity rate.

The cash flows used are based on management approved forecasts. These forecasts utilise information about current and future economic conditions, observable historical information and management expectations of future business performance. The terminal value growth rate represents the growth rate applied to extrapolate cash flows beyond the forecast period and reflects the midpoint of RBNZ's inflation target over the medium term.

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

Note 17 Deposits and other borrowings

Accounting policy

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

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

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

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

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Certificates of deposit	**2,996**	1,142
Non-interest bearing, repayable at call	**11,571**	6,871
Other interest bearing:		
At call	**28,412**	24,053
Term	**30,991**	33,540
Total deposits and other borrowings	**73,970**	65,606
Deposits at fair value	**2,996**	1,142
Deposits at amortised cost	**70,974**	64,464
Total deposits and other borrowings	**73,970**	65,606

Notes to the financial statements

Note 18 Other financial liabilities

Accounting policy

Other financial liabilities include liabilities measured at amortised cost as well as liabilities which are measured at FVIS. Financial liabilities measured at FVIS include:

- trading liabilities (i.e. securities sold short); and
- liabilities designated at fair value through income statement (i.e. certain repurchase agreements)

Repurchase agreements

Where securities are sold subject to an agreement to repurchase at a predetermined price, they remain recognised in the balance sheet in their original category (i.e. trading securities and financial assets measured at FVIS or investment securities).

The cash consideration received is recognised as a liability (repurchase agreements). Repurchase agreements are designated at fair value as they are managed as part of a trading portfolio and recognised as part of other financial liabilities.

Where a repurchase agreement is designated at fair value, subsequent to initial recognition, these liabilities are measured at fair value with changes in fair value (except credit risk) recognised through the income statement as they arise. The change in fair value that is attributable to credit risk is recognised in OCI except where it would create an accounting mismatch, in which case it is also recognised through the income statement.

	NZ BANKING GROUP	
$ millions	**2020**	2019
Accrued interest payable	**213**	337
Securities purchased not delivered	**133**	92
Trade creditors and other accrued expenses	**71**	65
Interbank placements	**1,194**	1,032
Securities sold short	**316**	188
Repurchase agreements	**33**	19
Other	**19**	15
Total other financial liabilities	**1,979**	1,748
Other financial liabilities at fair value	**349**	207
Other financial liabilities at amortised cost	**1,630**	1,541
Total other financial liabilities	**1,979**	1,748

Notes to the financial statements

Note 19 Debt issues

Accounting policy

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

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

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

The change in the fair value that is due to credit risk is recognised in OCI except where it would create an accounting mismatch, in which case it is also recognised in non-interest income.

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

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Short-term debt		
Commercial paper	**2,502**	2,312
Total short-term debt	**2,502**	2,312
Long-term debt		
Non-domestic medium-term notes	**5,329**	7,343
Covered bonds	**4,457**	5,263
Domestic medium-term notes	**3,511**	2,928
Total long-term debt	**13,297**	15,534
Total debt issues	**15,799**	17,846
Debt issues at fair value	**2,502**	2,312
Debt issues at amortised cost	**13,297**	15,534
Total debt issues	**15,799**	17,846

	NZ BANKING GROUP	
$ millions	**2020**	2019
Movement reconciliation		
Balance at beginning of the year	**17,846**	13,725
Issuances	**5,175**	8,707
Maturities, repayments, buy backs and reductions	**(7,193)**	(5,001)
Total cash movements	**(2,018)**	3,706
FX translation impact	**5**	273
Fair value hedge accounting adjustments	**(41)**	144
Other[1]	**7**	(2)
Total non-cash movements	**(29)**	415
Balance at end of the year	**15,799**	17,846

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

Notes to the financial statements

Note 20 Provisions

Accounting policy

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

Employee benefits – annual leave and other employee benefits

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

Provision for ECL on credit commitments

The NZ Banking Group is committed to provide facilities and guarantees as explained in Note 27. If it is probable that a facility will be drawn and the resulting asset will be less than the drawn amount then a provision for impairment is recognised. The provision for impairment is calculated using the same methodology as the provision for ECL (refer to Note 12).

Compliance, regulation and remediation provisions

The compliance, regulation and remediation provisions relate to matters pertaining to the provision of services to our customers identified both as a result of regulatory action and internal reviews. An assessment of the likely cost to the NZ Banking Group of these matters (including applicable customer refunds) is made on a case-by-case basis and specific provisions are made where appropriate.

	NZ BANKING GROUP	
$ millions	**2020**	2019
Annual leave and other employee benefits	**69**	69
Provision for ECL on credit commitments (refer to Note 12)	**50**	31
Compliance, regulation and remediation provisions[1]	**43**	48
Lease restoration obligations[2]	**31**	-
Other	**17**	2
Total provisions	**210**	150

[1] The NZ Banking Group has raised an additional provision of $16 million during the year ended 30 September 2020 (30 September 2019: $44 million). This reflects an increase in the identified number of instances where issues requiring remediation had occurred, together with associated interest and programme costs. $18 million has been paid to customers (30 September 2019: $11 million) and $3 million of unutilised provisions were reversed during the year ended 30 September 2020 (30 September 2019: $2 million).

[2] The addition to the lease restoration provision reflects a reassessment of the cost of making good leasehold premises at the end of the NZ Banking Group's property leases. The increase in the expected make-good cost has been treated as an addition to the cost of the ROU asset and is being depreciated over the remaining life of those assets.

Note 21 Loan capital

Accounting policy

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Additional Tier 1 loan capital - USD AT1 securities[1]	**2,097**	2,064
Tier 2 loan capital - Convertible subordinated notes[1]	**1,123**	1,121
Total loan capital	**3,220**	3,185

[1] Net of capitalised transaction costs.

	NZ BANKING GROUP	
$ millions	**2020**	2019
Movement reconciliation		
Balance at beginning of the year	**3,185**	2,866
Total cash movements	**-**	-
FX translation impact	**(97)**	89
Fair value hedge accounting adjustments	**129**	229
Other[1]	**3**	1
Total non-cash movements	**35**	319
Balance at end of the year	**3,220**	3,185

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

Note 21 Loan capital (continued)

Additional Tier 1 loan capital

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

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

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

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

Interest payable

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

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

Redemption

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

Conversion

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

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

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

Tier 2 loan capital

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

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

Interest payable

Interest payments on the Tier 2 notes are subject to Westpac New Zealand being solvent at the time of, and immediately following the interest payment. Refer to Note 22.

Early redemption

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

Conversion

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

Notes to the financial statements

Note 22 Related entities

Related entities

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

NZ Banking Group

The NZ Banking Group consists of the New Zealand operations of the Overseas Banking Group including the NZ Branch and the following controlled entities as at 30 September 2020 whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business:

Name of entity	Principal activity	Notes
BT Financial Group (NZ) Limited ('**BTFGNZL**')	Holding company	
BT Funds Management (NZ) Limited ('**BTNZ**')	Funds management company	
Capital Finance New Zealand Limited	Non-active company	
Sie-Lease (New Zealand) Pty Limited	Non-active company	
Westpac Financial Services Group-NZ-Limited ('**WFSGNZL**')	Holding company	
Westpac Life-NZ-Limited ('**Westpac Life**')	Life insurance company	
Westpac Nominees-NZ-Limited ('**WNNZL**')	Nominee company	
Westpac Superannuation Nominees-NZ-Limited ('**WSNNZL**')	Nominee company	
Westpac Group Investment-NZ-Limited ('**WGINZL**')	Holding company	
Westpac Holdings-NZ-Limited ('**WHNZL**')	Holding company	
Westpac Capital-NZ-Limited ('**WCNZL**')	Finance company	
Westpac Equity Investments NZ Limited	Non-active company	
Westpac New Zealand Group Limited ('**WNZGL**')	Holding company	
Westpac New Zealand Limited	Registered bank	
Westpac NZ Operations Limited ('**WNZOL**')	Holding company	
Aotearoa Financial Services Limited	Non-active company	
Number 120 Limited	Finance company	
Red Bird Ventures Limited	Corporate venture capital company	Established on 5 August 2020[1]
The Home Mortgage Company Limited	Residential mortgage company	
Westpac New Zealand Staff Superannuation Scheme Trustee Limited	Trustee company	
Westpac (NZ) Investments Limited ('**WNZIL**')	Property company	
Westpac Securities NZ Limited ('**WSNZL**')	Funding company	
Westpac NZ Covered Bond Holdings Limited ('**WNZCBHL**')	Holding company	19% owned[2]
Westpac NZ Covered Bond Limited ('**WNZCBL**')	Guarantor	19% owned[2]
Westpac NZ Securitisation Holdings Limited ('**WNZSHL**')	Holding company	19% owned[3]
Westpac NZ Securitisation Limited ('**WNZSL**')	Funding company	19% owned[3]
Westpac NZ Securitisation No.2 Limited ('**WNZSL2**')	Non-active company	19% owned[3]
Westpac Cash PIE Fund	Portfolio investment entity	Not owned[4]
Westpac Notice Saver PIE Fund	Portfolio investment entity	Not owned[4]
Westpac Term PIE Fund	Portfolio investment entity	Not owned[4]

[1] Red Bird Ventures Limited was incorporated on 5 August 2020 through the issue of 5,000 ordinary shares to WNZOL and is a wholly-owned subsidiary of WNZOL.
[2] The NZ Banking Group, through WNZOL (9.5%) and WHNZL (9.5%), has a total qualifying interest of 19% in WNZCBHL and its wholly-owned subsidiary company, WNZCBL. Westpac New Zealand is considered to control both WNZCBHL and WNZCBL based on contractual arrangements in place, and as such both WNZCBHL and WNZCBL are consolidated within the financial statements of the NZ Banking Group.
[3] The NZ Banking Group, through WNZOL (9.5%) and WHNZL (9.5%), has a total qualifying interest of 19% in WNZSHL and its wholly-owned subsidiaries, WNZSL and WNZSL2. Westpac New Zealand is considered to control WNZSHL, WNZSL and WNZSL2 based on contractual arrangements in place, and as such WNZSHL, WNZSL and WNZSL2 are consolidated within the financial statements of the NZ Banking Group.
[4] Westpac Term PIE Fund, Westpac Cash PIE Fund and Westpac Notice Saver PIE Fund (collectively referred to as the '**PIE Funds**') were established as unit trusts. The PIE Funds are Portfolio Investment Entities ('**PIE**'), where BTNZ is the manager and issuer. The manager has appointed Westpac New Zealand to perform all customer management and account administration for the PIE Funds. Westpac New Zealand is the PIE Funds' registrar and administration manager. Westpac New Zealand does not hold any units in the PIE Funds, however is considered to control them based on contractual arrangements in place, and as such the PIE Funds are consolidated in the financial statements of the NZ Banking Group.

There have been no changes in the ownership percentages since 30 September 2019.

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

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

Note 22 Related entities (continued)

Nature of transactions

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

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

The NZ Banking Group enters into derivative transactions with the Overseas Bank (refer to Note 23). They are accounted for as trading derivatives except for cross currency swaps in place with the Overseas Bank, which are designated in a cash flow hedge relationship to hedge the currency risk exposure of funding from the London Branch and Tier 2 notes issued to the London Branch (refer to Note 21).

Transactions with related entities

		NZ BANKING GROUP	
$ millions	**Note**	**2020**	2019
Overseas Bank			
Interest income	2	**18**	27
Interest expense:			
Loan capital[1]		**39**	51
Other[2]	2	**25**	46
Operating expenses - management fees	4	**14**	8
Funding repaid		**18**	263
Other controlled entities of the Overseas Bank			
WGINZL dividend paid to Westpac Overseas Holdings Pty Limited and Westpac Custodian Nominees Pty Limited		**2**	4
WFSGNZL dividend paid to Westpac Equity Holdings Pty Limited ('**WEHPL**')		**6**	38
BTFGNZL dividend paid to WEHPL		**23**	25
WNZGL dividend paid to Westpac Overseas Holdings No. 2 Pty Limited		**315**	735
Capital Finance New Zealand Limited dividend paid to Capital Finance Australia Limited		**-**	5

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

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

Due from and to related entities

	NZ BANKING GROUP	
$ millions	**2020**	2019
Due from related entities		
Overseas Bank	**2,713**	2,366
Other controlled entities of the Overseas Banking Group	**-**	1
Total due from related entities	**2,713**	2,367
Due from related entities at fair value[1]	**1,179**	985
Due from related entities at amortised cost	**1,534**	1,382
Total due from related entities	**2,713**	2,367
Due to related entities		
Overseas Bank	**2,560**	2,890
Other controlled entities of the Overseas Banking Group	**-**	2
Total due to related entities	**2,560**	2,892
Due to related entities at fair value[2]	**1,020**	1,334
Due to related entities at amortised cost	**1,540**	1,558
Total due to related entities	**2,560**	2,892

[1] Consists of derivative financial instruments of $1,179 million (30 September 2019: $981 million) (refer to Note 23) and nil trading securities (30 September 2019: $4 million).

[2] Consists of derivative financial instruments of $1,020 million (30 September 2019: $1,334 million) (refer to Note 23).

Note 22 Related entities (continued)

Key management personnel compensation

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

	NZ BANKING GROUP	
$'000s	**2020**	2019
Salaries and other short-term benefits	**6,536**	7,970
Post-employment benefits	**705**	521
Share-based payments	**2,923**	3,526
Total key management personnel compensation	**10,164**	12,017
Loans to key management personnel	**27,763**	26,876
Deposits from key management personnel	**12,492**	7,623
Interest income on amounts due from key management personnel	**930**	896
Interest expense on amounts due to key management personnel	**155**	67

Where the Directors of the Overseas Bank have received remuneration from the NZ Banking Group, the amounts are included above. Details of Directors' remuneration are disclosed in the Overseas Banking Group's 30 September 2020 Annual Financial Report.

Loans and deposits with key management personnel

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

As at 30 September 2020, no individual provision has been recognised in respect of loans given to key management personnel and their related parties (30 September 2019: nil). These loans have been included within the loan portfolio when determining collectively assessed provisions.

Other key management personnel transactions

All other transactions with key management personnel, their related entities and other related parties are conducted in the ordinary course of business. These transactions principally involve the provision of financial, investment and insurance services.

Notes to the financial statements

Note 23 Derivative financial instruments

Accounting policy

Derivative financial instruments are instruments whose values are derived from the value of an underlying asset, reference rate or index and include forwards, futures, swaps and options. Derivatives with related parties are included in due from/due to related entities.

The NZ Banking Group uses derivative financial instruments for meeting customers' needs; our asset and liability risk management ('**ALM**') activities, and undertaking market making and positioning activities.

Trading derivatives

Derivatives which are used in our ALM activities but are not designated into a hedge accounting relationship are considered economic hedges. These derivatives, along with derivatives used for meeting customers' needs and undertaking market making and positioning activities are measured at FVIS and are disclosed as trading derivatives.

Hedging derivatives

Hedging derivatives are those which are used in our ALM activities and have also been designated into one of two hedge accounting relationships: fair value hedge; or cash flow hedge. These derivatives are measured at fair value. These hedge designations and the associated accounting treatment are detailed below.

For more details regarding the NZ Banking Group's ALM activities, refer to Note 32.

Fair value hedges

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

Changes in the fair value of derivatives and the hedged asset or liability in fair value hedges are recognised in non-interest income. The carrying value of the hedged asset or liability is adjusted for the changes in fair value related to the hedged risk.

If a hedge is discontinued, any fair value adjustments to the carrying value of the asset or liability are amortised to net interest income over the period to maturity. If the asset or liability is sold, any unamortised adjustment is immediately recognised in net interest income.

Cash flow hedges

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

For effective hedges, changes in the fair value of derivatives are recognised in the cash flow hedge reserve through OCI and subsequently recognised in net interest income when the cash flows attributable to the asset or liability that was hedged impact the income statement.

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

If a hedge is discontinued, any cumulative gain or loss remains in OCI. It is amortised to net interest income over the period which the asset or liability that was hedged also impacts the income statement.

If a hedge of a forecast transaction is no longer expected to occur, any cumulative gain or loss in OCI is immediately recognised in net interest income.

Note 23 Derivative financial instruments (continued)

The carrying values of derivative instruments are set out in the tables below:

	NZ BANKING GROUP					
	2020					
	Trading		Hedging		Total derivatives carrying value	
$ millions	**Assets**	**Liabilities**	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate contracts						
Swap agreements	**10,108**	**(9,431)**	**383**	**(566)**	**10,491**	**(9,997)**
Total interest rate contracts	**10,108**	**(9,431)**	**383**	**(566)**	**10,491**	**(9,997)**
FX contracts						
Spot and forward contracts	**642**	**(640)**	**-**	**-**	**642**	**(640)**
Cross currency swap agreements (principal and interest)	**781**	**(1,261)**	**594**	**(208)**	**1,375**	**(1,469)**
Total FX contracts	**1,423**	**(1,901)**	**594**	**(208)**	**2,017**	**(2,109)**
Total of gross derivatives	**11,531**	**(11,332)**	**977**	**(774)**	**12,508**	**(12,106)**
Impact of netting arrangements	**(5,669)**	**5,669**	**-**	**-**	**(5,669)**	**5,669**
Total of net derivatives	**5,862**	**(5,663)**	**977**	**(774)**	**6,839**	**(6,437)**
Consisting of:						
Derivatives held with external counterparties	**4,683**	**(4,708)**	**977**	**(709)**	**5,660**	**(5,417)**
Derivatives held with related parties	**1,179**	**(955)**	**-**	**(65)**	**1,179**	**(1,020)**

	NZ BANKING GROUP					
	2019					
	Trading		Hedging		Total derivatives carrying value	
$ millions	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts						
Swap agreements	7,622	(7,242)	198	(594)	7,820	(7,836)
Total interest rate contracts	7,622	(7,242)	198	(594)	7,820	(7,836)
FX contracts						
Spot and forward contracts	730	(721)	-	-	730	(721)
Cross currency swap agreements (principal and interest)	2,015	(2,395)	604	(138)	2,619	(2,533)
Total FX contracts	2,745	(3,116)	604	(138)	3,349	(3,254)
Total of gross derivatives	10,367	(10,358)	802	(732)	11,169	(11,090)
Impact of netting arrangements	(3,931)	3,931	-	-	(3,931)	3,931
Total of net derivatives	6,436	(6,427)	802	(732)	7,238	(7,159)
Consisting of:						
Derivatives held with external counterparties	5,455	(5,163)	802	(662)	6,257	(5,825)
Derivatives held with related parties	981	(1,264)	-	(70)	981	(1,334)

Note 23 Derivative financial instruments (continued)

Hedge accounting

The NZ Banking Group designates derivatives into hedge accounting relationships in order to manage the volatility in earnings and capital that would otherwise arise from interest rate and FX risks that may result from differences in the accounting treatment of derivatives and underlying exposures. These hedge accounting relationships and the risks they are used to hedge are described below.

The NZ Banking Group enters into one-to-one hedge relationships to manage specific exposures where the terms of the hedged item significantly match the terms of the hedging instrument. The NZ Banking Group also uses dynamic hedge accounting where the hedged items are part of a portfolio of assets and/or liabilities that frequently change. In this hedging strategy, the exposure being hedged and the hedging instruments may change frequently rather than there being a one-to-one hedge accounting relationship for a specific exposure.

Fair value hedges

Interest rate risk

The NZ Banking Group hedges its interest rate risk to reduce exposure to changes in fair value due to interest rate fluctuations over the hedging period. Interest rate risk arising from fixed rate debt issuances and fixed rate bonds classified as investment securities at FVOCI is hedged with single currency fixed to floating interest rate derivatives. The NZ Banking Group also hedges its benchmark interest rate risk from fixed rate foreign currency denominated debt issuances using cross currency swaps. In applying fair value hedge accounting the NZ Banking Group primarily uses one-to-one hedge accounting to manage specific exposures.

The NZ Banking Group also uses a dynamic hedge accounting strategy for fair value portfolio hedge accounting of some fixed rate mortgages to reduce exposure to changes in fair value due to interest rate fluctuations over the hedging period. These fixed rate mortgages are allocated to time buckets based on their expected repricing dates and the fixed-to-floating interest rate derivatives are designated according to the capacity in the relevant time buckets.

The NZ Banking Group hedges the benchmark interest rate which generally represents the most significant component of the changes in fair value. The benchmark interest rate is a component of interest rate risk that is observable in the relevant financial markets, for example, LIBOR for USD interest rates and Bank Bill Benchmark Rate ('**BKBM**') for NZD interest rates. Ineffectiveness may arise from timing or discounting differences on repricing between the hedged item and the derivative. For portfolio hedge accounting, ineffectiveness also arises from prepayment risk (i.e. the difference between actual and expected prepayment of loans). In order to manage the ineffectiveness from early repayments and accommodate new originations the portfolio hedges are de-designated and redesignated periodically.

Cash flow hedges

Interest rate risk

The NZ Banking Group's exposure to the volatility of interest cash flows from customer deposits and loans is hedged with interest rate derivatives using a dynamic hedge accounting strategy called macro cash flow hedges. Customer deposits and loans are allocated to time buckets based on their expected repricing dates. The interest rate derivatives are designated according to the gross asset or gross liability positions for the relevant time buckets. The NZ Banking Group hedges the benchmark interest rate which generally represents the most significant component of the changes in fair value. The benchmark interest rate is a component of interest rate risk that is observable in the relevant financial markets, for example, Bank Bill Swap Rate for AUD interest rates, LIBOR for USD interest rates and BKBM for NZD interest rates. Ineffectiveness may arise from timing or discounting differences on repricing between the hedged item and the interest rate derivative. Ineffectiveness also arises if the notional values of the interest rate derivatives exceed the aggregate notional exposure for the relevant time buckets. The hedge accounting relationship is reviewed on a monthly basis and the hedging relationships are de-designated and redesignated if necessary.

FX risk

The NZ Banking Group's exposure to foreign currency principal and credit margin cash flows from fixed rate foreign currency debt issuances is hedged through the use of cross currency derivatives in a one-to-one hedging relationship to manage the changes between the foreign currency and NZD. In addition, for floating rate foreign currency debt issuances, the NZ Banking Group hedges from foreign floating to NZD floating interest rates. Ineffectiveness may arise from timing or discounting differences on repricing between the hedged item and the cross currency derivative.

Economic hedges

As part of the NZ Banking Group's ALM activities, economic hedges may be entered into to hedge long-term funding transactions.

Interest Rate Benchmark Reform

The NZ Banking Group's hedging relationships include hedged items and hedging instruments that are impacted by IBOR reform. As described in Note 1, the NZ Banking Group has early adopted *Interest Rate Benchmark Reform - amendments to NZ IFRS 9, NZ IAS 39 and NZ IFRS 7* which allows certain exceptions to the standard hedging requirements in respect of hedge relationships that are impacted by this benchmark reform.

The following table summarises the NZ Banking Group's current exposures in hedging relationships maturing after 31 December 2021 that will be impacted by the IBOR reform and the quantum of those risks expressed in NZD equivalent values. The extent of the risk exposure also reflects the notional amounts of related hedging instruments.

Notes to the financial statements

Note 23 Derivative financial instruments (continued)

$ millions	NZ BANKING GROUP 30 Sep 20 Notional hedged exposure
Benchmark	
USD LIBOR	**1,896**

Hedging instruments

The following tables show the carrying value of hedging instruments and a maturity analysis of the notional amounts of the hedging instruments in one-to-one hedge relationships categorised by the types of hedge relationships and the hedged risk.

			NZ BANKING GROUP 2020					
			Notional amounts				Carrying value	
$ millions	**Hedging instrument**	**Hedged risk**	**Within 1 year**	**Over 1 year to 5 years**	**Over 5 years**	**Total**	**Assets**	**Liabilities**
One-to-one hedge relationships								
Fair value hedges	Interest rate swap	Interest rate risk	**673**	**1,761**	**1,896**	**4,330**	**208**	**(179)**
	Cross currency swap	Interest rate risk	**1,823**	**4,426**	**356**	**6,605**	**111**	**19**
Cash flow hedges	Cross currency swap	FX risk	**3,128**	**7,162**	**356**	**10,646**	**483**	**(227)**
Total one-to-one hedge relationships			**5,624**	**13,349**	**2,608**	**21,581**	**802**	**(387)**
Macro hedge relationships								
Portfolio fair value hedges	Interest rate swap	Interest rate risk	**N/A**	**N/A**	**N/A**	**21,505**	**-**	**(202)**
Macro cash flow hedges	Interest rate swap	Interest rate risk	**N/A**	**N/A**	**N/A**	**13,587**	**175**	**(185)**
Total macro hedge relationships			**N/A**	**N/A**	**N/A**	**35,092**	**175**	**(387)**
Total of gross hedging derivatives			**N/A**	**N/A**	**N/A**	**56,673**	**977**	**(774)**
Impact of netting arrangements			**N/A**	**N/A**	**N/A**	**N/A**	**-**	**-**
Total of net hedging derivatives			**N/A**	**N/A**	**N/A**	**N/A**	**977**	**(774)**

			NZ BANKING GROUP 2019					
			Notional amounts				Carrying value	
$ millions	Hedging instrument	Hedged risk	Within 1 year	Over 1 year to 5 years	Over 5 years	Total	Assets	Liabilities
One-to-one hedge relationships								
Fair value hedges	Interest rate swap	Interest rate risk	2,157	2,013	2,416	6,586	84	(214)
	Cross currency swap	Interest rate risk	1,251	6,134	349	7,734	155	(100)
Cash flow hedges	Cross currency swap	FX risk	1,251	10,278	349	11,878	449	(38)
Total one-to-one hedge relationships			4,659	18,425	3,114	26,198	688	(352)
Macro hedge relationships								
Portfolio fair value hedges	Interest rate swap	Interest rate risk	N/A	N/A	N/A	20,301	-	(209)
Macro cash flow hedges	Interest rate swap	Interest rate risk	N/A	N/A	N/A	10,629	114	(171)
Total macro hedge relationships			N/A	N/A	N/A	30,930	114	(380)
Total of gross hedging derivatives			N/A	N/A	N/A	57,128	802	(732)
Impact of netting arrangements			N/A	N/A	N/A	N/A	-	-
Total of net hedging derivatives			N/A	N/A	N/A	N/A	802	(732)

Note 23 Derivative financial instruments (continued)

The following table shows the weighted average exchange rate related to significant hedging instruments in one-to-one hedge relationships:

				NZ BANKING GROUP	
			Currency /	Weighted average rate	
$ millions	Hedging instrument	Hedged risk	Currency pair	2020	2019
Cash flow hedges	Cross currency swap	FX risk	CHF:NZD	**0.6730**	0.7001
			EUR:NZD	**0.6160**	0.6079
			GBP:NZD	**0.4538**	0.4538
			NZD:AUD	**1.1272**	1.1272
			HKD:NZD	**4.9670**	4.9670

Impact of hedge accounting in the balance sheet and reserves

The following tables show the carrying amount of hedged items in a fair value hedge relationship and the component of the carrying amount related to accumulated fair value hedge accounting ('**FVHA**') adjustments.

	NZ BANKING GROUP			
	2020		2019	
$ millions	Carrying amount of hedged item	Accumulated FVHA adjustment included in carrying amount	Carrying amount of hedged item	Accumulated FVHA adjustment included in carrying amount
Interest rate risk				
Investment securities	**2,520**	**119**	4,469	120
Loans [1]	**21,647**	**142**	20,440	139
Debt issues and loan capital	**(8,923)**	**(342)**	(10,279)	(254)

[1] Comparatives have been restated to correctly present the carrying amount for loans in a fair value hedge relationship to include the accumulated FVHA adjustment. The revision increases the carrying amount of hedged item balance for loans by $139m from $20,301m to $20,440m.

There were no (30 September 2019: nil) accumulated FVHA adjustments included in the above carrying amounts relating to hedged items that have ceased to be adjusted for hedging gains and losses.

The pre-tax impact of cash flow hedges on reserves is detailed below:

	NZ BANKING GROUP					
	2020			2019		
$ millions	Interest rate risk	FX risk	Total	Interest rate risk	FX risk	Total
Cash flow hedge reserve						
Balance at beginning of the year	**(29)**	**(72)**	**(101)**	(48)	(41)	(89)
Net gains/(losses) from changes in fair value	**(18)**	**(50)**	**(68)**	(28)	(58)	(86)
Transferred to net interest income	**38**	**35**	**73**	47	27	74
Balance at end of year	**(9)**	**(87)**	**(96)**	(29)	(72)	(101)

There were no (30 September 2019: nil) balances remaining in the cash flow hedge reserve relating to hedge relationships for which hedge accounting is no longer applied.

Notes to the financial statements

Note 23 Derivative financial instruments (continued)

Hedge effectiveness

Hedge effectiveness is tested prospectively at inception and during the lifetime of hedge relationships. For one-to-one hedge relationships this testing uses a qualitative assessment of matched terms where the critical terms of the derivatives used as the hedging instrument match the terms of the hedged item. In addition, a quantitative effectiveness test is performed for all hedges which could include regression analysis, dollar offset and/or sensitivity analysis.

Retrospective testing is also performed to determine whether the hedge relationship remains highly effective so that hedge accounting can continue to be applied and also to determine any ineffectiveness. These tests are performed using regression analysis and the dollar offset method.

The following tables provide information regarding the determination of hedge effectiveness:

			NZ BANKING GROUP		
			2020		
$ millions	**Hedging instrument**	**Hedged risk**	**Change in fair value of hedging instrument used for calculating ineffectiveness**	**Change in value of the hedged item used for calculating ineffectiveness**	**Hedge ineffectiveness recognised in non-interest income**
Fair value hedges	Interest rate swap	Interest rate risk	**124**	**(124)**	**-**
	Cross currency swap	Interest rate risk	**(40)**	**39**	**(1)**
Cash flow hedges	Interest rate swap	Interest rate risk	**31**	**(20)**	**11**
	Cross currency swap	FX risk	**(15)**	**15**	**-**
Total			**100**	**(90)**	**10**

			NZ BANKING GROUP		
			2019		
$ millions	Hedging instrument	Hedged risk	Change in fair value of hedging instrument used for calculating ineffectiveness	Change in value of the hedged item used for calculating ineffectiveness	Hedge ineffectiveness recognised in non-interest income
Fair value hedges	Interest rate swap	Interest rate risk	67	(66)	1
	Cross currency swap	Interest rate risk	146	(143)	3
Cash flow hedges	Interest rate swap	Interest rate risk	17	(19)	(2)
	Cross currency swap	FX risk	(31)	31	-
Total			199	(197)	2

Notes to the financial statements

Note 24 Fair values of financial assets and financial liabilities

Accounting policy

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

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

Critical accounting assumptions and estimates

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

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

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

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

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

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

These adjustments incorporate bid/offer spreads, credit valuation adjustments ('**CVA**') and funding valuation adjustments ('**FVA**').

Fair Valuation Control Framework

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

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

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

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

Fair value hierarchy

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

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

Valuation techniques

The NZ Banking Group applies market accepted valuation techniques in determining the fair valuation of over-the-counter ('**OTC**') derivatives. This includes CVA and FVA, which incorporate credit risk and funding costs and benefits that arise in relation to uncollateralised derivative positions, respectively.

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

Note 24 Fair values of financial assets and financial liabilities (continued)

Financial instruments measured at fair value

Level 1 instruments

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

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

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

Level 2 instruments

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

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

Instrument	Balance sheet category	Includes:	Valuation
Interest rate products	Derivative financial instruments Due from related entities Due to related entities	Interest rate swaps, forwards and options – derivative financial instruments	Industry standard valuation models are used to calculate the expected future value of payments by product, which is discounted back to a present value. The model's interest rate inputs are benchmark interest rates and active broker quoted interest rates in the swap, bond and futures markets. Interest rate volatilities are sourced from brokers and consensus data providers. If consensus prices are not available, these are classified as Level 3 instruments.
FX products	Derivative financial instruments Due from related entities Due to related entities	FX swaps and FX forward contracts - derivative financial instruments	Derived from market observable inputs or consensus pricing providers using industry standard models.
Asset backed debt instruments	Trading securities and financial assets measured at FVIS Investment securities	Asset backed securities	Valued using an industry approach to value floating rate debt with prepayment features. The main inputs to the model are the trading margin and the weighted average life of the security. These inputs are sourced from a consensus data provider. If consensus prices are not available these are classified as Level 3 instruments.

Notes to the financial statements

Note 24 Fair values of financial assets and financial liabilities (continued)

Instrument	Balance sheet category	Includes:	Valuation
Non-asset backed debt instruments	Trading securities and financial assets measured at FVIS Investment securities Other financial liabilities	Local authority and NZ public securities, other bank issued certificates of deposit, commercial paper, other government securities, off-shore securities and corporate bonds Repurchase agreements and reverse repurchase agreements over non-asset backed debt securities	Valued using observable market prices which are sourced from independent pricing services, broker quotes or inter-dealer prices.
Deposits and other borrowings at fair value	Deposits and other borrowings	Certificates of deposit	Discounted cash flow using market rates offered for deposits of similar remaining maturities.
Debt issues at fair value	Debt issues	Commercial paper	Discounted cash flows, using a discount rate which reflects the terms of the instrument and the timing of cash flows adjusted for market observable changes in the applicable credit rating of the NZ Banking Group.
Life insurance assets	Life insurance assets	Local authority securities, investment grade corporate bonds, life insurance contract liabilities and units in unlisted unit trusts	Valued using observable market prices or other widely used and accepted valuation techniques utilising observable market inputs.

Level 3 instruments

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

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

Instrument	Balance sheet category	Includes:	Valuation
Interest rate derivatives	Derivative financial instruments	Non-vanilla interest rate (inflation indexed) derivatives and long dated NZD caps	Valued using industry standard valuation models utilising observable market inputs which are determined separately for each parameter. Where unobservable, inputs will be set with reference to an observable proxy.

Note 24 Fair values of financial assets and financial liabilities (continued)

The following table summarises the attribution of financial instruments measured at fair value to the fair value hierarchy:

	NZ BANKING GROUP							
	2020				2019			
$ millions	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3[1]	Total
Financial assets measured at fair value on a recurring basis								
Trading securities and financial assets measured at FVIS	**1,188**	**3,036**	**-**	**4,224**	29	4,842	-	4,871
Derivative financial instruments	**-**	**5,660**	**-**	**5,660**	-	6,256	1	6,257
Investment securities	**2,504**	**2,517**	**-**	**5,021**	1,049	3,420	-	4,469
Life insurance assets	**-**	**375**	**-**	**375**	-	335	-	335
Due from related entities	**3**	**1,176**	**-**	**1,179**	-	985	-	985
Total financial assets measured at fair value	**3,695**	**12,764**	**-**	**16,459**	1,078	15,838	1	16,917
Financial liabilities measured at fair value on a recurring basis								
Deposits and other borrowings at fair value	**-**	**2,996**	**-**	**2,996**	-	1,142	-	1,142
Other financial liabilities	**282**	**67**	**-**	**349**	180	27	-	207
Derivative financial instruments	**1**	**5,416**	**-**	**5,417**	-	5,807	18	5,825
Due to related entities	**4**	**1,016**	**-**	**1,020**	-	1,334	-	1,334
Debt issues at fair value	**-**	**2,502**	**-**	**2,502**	-	2,312	-	2,312
Total financial liabilities measured at fair value	**287**	**11,997**	**-**	**12,284**	180	10,622	18	10,820

[1] Balances within this category of the fair value hierarchy are not considered material to the total derivative financial instruments balances.

There were no material amounts of changes in fair value estimated using a valuation technique incorporating significant non-observable inputs that were recognised in the income statement or the statement of comprehensive income of the NZ Banking Group during the year ended 30 September 2020 (30 September 2019: no material changes in fair value).

Analysis of movements between fair value hierarchy levels

During the year, there were no material transfers between levels of the fair value hierarchy (30 September 2019: no material transfers between levels).

Note 24 Fair values of financial assets and financial liabilities (continued)

Financial instruments not measured at fair value

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

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

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

	NZ BANKING GROUP				
	2020				
	Carrying	Fair Value			
$ millions	Amount	Level 1	Level 2	Level 3	Total
Financial assets not measured at fair value					
Cash and balances with central banks	**4,488**	**4,488**	**-**	**-**	**4,488**
Collateral paid	**397**	**397**	**-**	**-**	**397**
Loans	**88,354**	**-**	**-**	**88,693**	**88,693**
Other financial assets	**555**	**-**	**55**	**500**	**555**
Due from related entities	**1,534**	**-**	**1,534**	**-**	**1,534**
Total financial assets not measured at fair value	**95,328**	**4,885**	**1,589**	**89,193**	**95,667**
Financial liabilities not measured at fair value					
Collateral received	**508**	**508**	**-**	**-**	**508**
Deposits and other borrowings	**70,974**	**-**	**69,937**	**1,179**	**71,116**
Other financial liabilities	**1,630**	**-**	**1,630**	**-**	**1,630**
Due to related entities	**1,540**	**-**	**1,542**	**-**	**1,542**
Debt issues[1]	**13,297**	**-**	**13,517**	**-**	**13,517**
Loan capital[1]	**3,220**	**-**	**1,928**	**1,137**	**3,065**
Total financial liabilities not measured at fair value	**91,169**	**508**	**88,554**	**2,316**	**91,378**

[1] The estimated fair value of debt issues and loan capital include the impact of changes in the NZ Banking Group's credit spreads since origination.

Notes to the financial statements

Note 24 Fair values of financial assets and financial liabilities (continued)

	NZ BANKING GROUP				
	2019				
	Carrying	Fair Value			
$ millions	Amount	Level 1	Level 2	Level 3	Total
Financial assets not measured at fair value					
Cash and balances with central banks	2,002	2,002	-	-	2,002
Collateral paid	417	417	-	-	417
Loans	84,626	-	-	84,880	84,880
Other financial assets[1]	400	-	72	328	400
Due from related entities	1,382	-	1,381	1	1,382
Total financial assets not measured at fair value	88,827	2,419	1,453	85,209	89,081
Financial liabilities not measured at fair value					
Collateral received	623	623	-	-	623
Deposits and other borrowings	64,464	-	63,974	563	64,537
Other financial liabilities	1,541	-	1,541	-	1,541
Due to related entities	1,558	-	1,565	-	1,565
Debt issues[2]	15,534	-	15,701	-	15,701
Loan capital[2]	3,185	-	1,954	1,158	3,112
Total financial liabilities not measured at fair value	86,905	623	84,735	1,721	87,079

[1] Comparatives have been restated to correctly reflect Other financial assets of $72m relating to Interbank lending in Level 2 of the fair value hierarchy (previously presented in Level 3).

[2] The estimated fair value of debt issues and loan capital include the impact of changes in the NZ Banking Group's credit spreads since origination.

Note 25 Offsetting financial assets and financial liabilities

Accounting policy

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

Some of the NZ Banking Group's offsetting arrangements are not enforceable in all circumstances. The amounts in the tables below may not tie back to the balance sheet if there are balances which are not subject to offsetting or enforceable netting arrangements. The amounts presented in this note do not represent the credit risk exposure of the NZ Banking Group. Refer to Note 32.2 for information on credit risk management. The offsetting and collateral arrangements and other credit risk mitigation strategies used by the NZ Banking Group are further explained in the 'Management of risk mitigation' section under Note 32.2.

Note 25 Offsetting financial assets and financial liabilities (continued)

	NZ BANKING GROUP 2020						
	Amounts Subject to Enforceable Netting Arrangements						
	Amounts Offset on the Balance Sheet			Amounts Not Offset on the Balance Sheet			
$ millions	**Gross Amounts**	**Amounts Offset**	**Net Amounts Reported in the Balance Sheet**	**Other Recognised Financial Instruments**	**Cash Collateral**	**Financial Instrument Collateral**	**Net Amount**
Assets							
Reverse repurchase agreements[1]	**547**	**-**	**547**	**-**	**-**	**(547)**	**-**
Derivative financial instruments[2]	**10,877**	**(5,669)**	**5,208**	**(3,106)**	**(472)**	**-**	**1,630**
Due from related entities - derivative financial instruments[3]	**1,179**	**-**	**1,179**	**(1,020)**	**-**	**-**	**159**
Total assets	**12,603**	**(5,669)**	**6,934**	**(4,126)**	**(472)**	**(547)**	**1,789**
Liabilities							
Repurchase agreements[4]	**33**	**-**	**33**	**-**	**-**	**(33)**	**-**
Derivative financial instruments[2]	**10,814**	**(5,669)**	**5,145**	**(3,106)**	**(359)**	**-**	**1,680**
Due to related entities - derivative financial instruments[5]	**1,020**	**-**	**1,020**	**(1,020)**	**-**	**-**	**-**
Total liabilities	**11,867**	**(5,669)**	**6,198**	**(4,126)**	**(359)**	**(33)**	**1,680**

	NZ BANKING GROUP 2019						
	Amounts Subject to Enforceable Netting Arrangements						
	Amounts Offset on the Balance Sheet			Amounts Not Offset on the Balance Sheet			
$ millions	Gross Amounts	Amounts Offset	Net Amounts Reported in the Balance Sheet	Other Recognised Financial Instruments	Cash Collateral	Financial Instrument Collateral	Net Amount
Assets							
Reverse repurchase agreements[1]	1,041	-	1,041	-	-	(1,041)	-
Derivative financial instruments[2]	9,390	(3,931)	5,459	(3,057)	(569)	-	1,833
Due from related entities - derivative financial instruments[3]	981	-	981	(981)	-	-	-
Total assets	11,412	(3,931)	7,481	(4,038)	(569)	(1,041)	1,833
Liabilities							
Repurchase agreements[4]	19	-	19	-	-	(19)	-
Derivative financial instruments[2]	9,360	(3,931)	5,429	(3,057)	(393)	-	1,979
Due to related entities - derivative financial instruments[5]	1,334	-	1,334	(981)	-	-	353
Total liabilities	10,713	(3,931)	6,782	(4,038)	(393)	(19)	2,332

[1] Forms part of trading securities and financial assets measured at FVIS (refer to Note 9).
[2] $452 million (2019: $798 million) of derivative financial assets and $272 million (2019: $396 million) of derivative financial liabilities are not subject to enforceable netting arrangements. 2019 gross amounts, net amounts reported on the balance sheet and net amount were restated to exclude amounts not subject to enforceable netting arrangements.
[3] Forms part of due from related entities in the balance sheet (refer to Note 22).
[4] Forms part of other financial liabilities in the balance sheet (refer to Note 18).
[5] Forms part of due to related entities in the balance sheet (refer to Note 22).

Note 25 Offsetting financial assets and financial liabilities (continued)

Other recognised financial instruments

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

Cash collateral and financial instrument collateral

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

Note 26 Lessee disclosures

Accounting policy

Accounting policy for 30 September 2020 under NZ IFRS 16

At the lease commencement date (or the inception date for certain leases), a right-of-use asset and a lease liability are recognised in the balance sheet for all leases with the exception of short term leases (12 months or less) and low value leases (underlying asset is less than $10,000).

ROU asset

The ROU asset is initially measured at cost being the amount of the initial measurement of the lease liability, plus any payments made at or before the commencement date, initial direct costs and estimated make-good costs, less any lease incentives received. It is subsequently measured at cost less accumulated depreciation and impairment losses. The asset is also adjusted for any subsequent remeasurement of the lease liability (refer below).

Depreciation expense is recognised in operating expenses on a straight-line basis over the lease term.

Lease liability

The lease liability is initially measured at the present value of the future lease payments using a discount rate based on the NZ Banking Group's incremental borrowing rate. It is subsequently increased by interest, reduced by principal payments and remeasured for any reassessment or lease modification.

The lease liability may be remeasured in certain circumstances. For the NZ Banking Group's leases, it is expected that the lease liability will only be required to be remeasured to reflect a change in the NZ Banking Group's assessment of the exercise of an extension option (refer below) or for a change in future lease payments for a change in rate or index.

Interest expense is recognised in net interest income on an effective yield basis.

Lease term

Extension options are included in a number of lease contracts. The extension options are only included in the lease term if the lease is reasonably certain to be extended, which is assessed by the NZ Banking Group at the lease commencement date. The assessment is reviewed if a significant event or significant change in circumstances occurs which affects this assessment and is within the control of the NZ Banking Group.

A reassessment of the lease term (to determine whether it has become 'reasonably certain' that an extension option will be exercised) must be undertaken for each of the NZ Banking Group's property and technology leases at a specific point prior to the lease expiry date.

Scope exemptions

For certain short-term and low value leases, lease payments are recognised in operating expenses on a straight-line basis over the lease term.

Accounting policy for 30 September 2019 under NZ IAS 17

An operating lease under NZ IAS 17 is a lease where substantially all of the risks and rewards of the leased assets remain with the lessor.

Where the NZ Banking Group is the lessee, lease rentals payable are recognised as an expense in the income statement on a straight-line basis over the lease term unless another systematic basis is more appropriate.

Notes to the financial statements

Note 26 Lessee disclosures (continued)

The NZ Banking Group leases various commercial and retail premises and related property and equipment. The ROU asset recognised as a result of these lease arrangements is included in property and equipment in the balance sheet and detailed in the following table:

ROU assets

	NZ BANKING GROUP		
$ millions	**Property**	**Other**	**Total**
Balance at 30 September 2019	**-**	**-**	**-**
Impact on adoption of NZ IFRS 16	**254**	**38**	**292**
Restated opening balance as at 1 October 2019	**254**	**38**	**292**
Additions	**41**	**-**	**41**
Depreciation	**(48)**	**(13)**	**(61)**
Other	**(5)**	**-**	**(5)**
Balance as at 30 September 2020	**242**	**25**	**267**

Lease liabilities

Lease liabilities included in other liabilities in the balance sheet were:

	NZ BANKING GROUP
$ millions	**2020**
Lease liabilities – property	**227**
Lease liabilities - other	**26**
Total lease liabilities as at 30 September 2020	**253**

The following table presents the future contractual undiscounted cash flows relating to lease liabilities by remaining contractual maturity based on the requirements of NZ IFRS 16 applicable for the current period:

	NZ BANKING GROUP
$ millions	**2020**
Due within 1 year	**52**
Due after 1 year but not later than 5 years	**121**
Due after 5 years	**107**
Total undiscounted lease liabilities as at 30 September 2020	**280**

As comparatives have not been restated on the adoption of NZ IFRS 16, the table below presents the operating lease commitments by remaining contractual maturity based on the requirements of NZ IAS 17 applicable for the prior year:

	NZ BANKING GROUP
$ millions	2019
Due within 1 year	52
Due after 1 year but not later than 5 years	130
Due after 5 years	124
Total undiscounted lease liabilities as at 30 September 2019	306

The total cash outflow for the year ended 30 September 2020 for leases was $114 million, of which $52 million relate to expenses recognised for variable lease payments not included in the measurement of lease liabilities.

Note 27 Credit related commitments, contingent assets and contingent liabilities

Accounting policy

Undrawn credit commitments

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

Contingent assets

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

Note 27 Credit related commitments, contingent assets and contingent liabilities (continued)

Contingent liabilities

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

Undrawn credit commitments

Undrawn credit commitments expose the NZ Banking Group to liquidity risk when called upon and also to credit risk if the customer fails to repay the amounts owed at the due date. The maximum exposure to credit loss is the contractual or notional amount of the instruments disclosed below. Some of the arrangements can be cancelled by the NZ Banking Group at any time. The actual liquidity and credit risk exposure varies in line with drawings and may be less than the amounts disclosed. The NZ Banking Group uses the same credit policies when entering into these arrangements as it does for on-balance sheet instruments. Refer to Note 32 for further details on liquidity risk and credit risk management.

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

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

(b) WNZCBL (pursuant to Westpac New Zealand's Global Covered Bond Programme ('**CB Programme**')) where:
   (i) it is discovered that there has been a material breach of a sale warranty (or any such sale warranty is materially untrue);
   (ii) the loan becomes materially impaired or is enforced prior to the second monthly covered bond payment date falling after the assignment of the loan; or
   (iii) at the cut-off date relating to the loan, there were arrears of interest and that loan subsequently becomes a delinquent loan prior to the second monthly covered bond payment date falling after the assignment of the loan.

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Letters of credit and guarantees[1]	**968**	964
Commitments to extend credit[2]	**27,897**	25,881
Total undrawn credit commitments	**28,865**	26,845

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

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

Contingent assets

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

Contingent liabilities

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

Compliance, regulation and remediation

The NZ Banking Group is subject to continued regulatory action and internal reviews relating to matters pertaining to the provision of services to our customers. Contingent liabilities may exist in respect of actual or potential claims, compensation payments and/or refunds identified as part of these reviews. An assessment of the NZ Banking Group's likely loss has been made on a case-by-case basis for the purpose of the Disclosure Statement but cannot always be reliably estimated. As at 30 September 2020, appropriate provision has been made in Note 20.

Notes to the financial statements

Note 28 Segment reporting

Accounting policy

Operating segments are presented on a basis that is consistent with information provided internally to the NZ Banking Group's chief operating decision-maker and reflects the management of the business, rather than the legal structure of the NZ Banking Group. The chief operating decision-maker is the person or group that allocates resources to and assesses the performance of the operating segments of an entity. The NZ Banking Group has determined that the NZ Banking Group executive team is its chief operating decision-maker.

Inter-segment revenue and costs are eliminated at head office. Income and expenses directly associated with each segment are included in determining business segment performance.

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

The operating segment results have been presented on a management reporting basis and consequently internal charges and transfer pricing adjustments have been reflected in the performance of each operating segment. Intersegment pricing is determined on a cost recovery basis.

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

In 2020, the NZ Banking Group has separately presented the Financial Markets, International Trade and Payments operating segment to more accurately reflect management's view of the operations. Previously, these amounts were included in the Commercial, Corporate and Institutional operating segment. Segment comparative information for the year 30 September 2019 has been restated to ensure consistent presentation with the current reporting period.

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

- Consumer Banking and Wealth provides financial services predominantly for individuals;
- Commercial, Corporate and Institutional Banking provides a broad range of financial services for commercial, corporate, property finance, agricultural, institutional and government customers;
- Financial Markets provides foreign exchange, interest rate derivatives, government and credit products, commodities, carbon and energy capabilities. International Trade and Payments provide international trade solutions, payments products and services to consumer, business and institutional customers; and
- Investments and Insurance provides funds management and insurance services.

Reconciling items primarily represent:

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

Notes to the financial statements

Note 28 Segment reporting (continued)

	NZ BANKING GROUP					
$ millions	Consumer Banking and Wealth	Commercial, Corporate and Institutional	Financial Markets, International Trade and Payments	Investments and Insurance	Reconciling Items	Total
Year ended 30 September 2020						
Net interest income	**1,002**	**908**	**33**	**1**	**(51)**	**1,893**
Non-interest income	**120**	**115**	**128**	**109**	**(12)**	**460**
Net operating income before operating expenses and impairment charges	**1,122**	**1,023**	**161**	**110**	**(63)**	**2,353**
Operating expenses	**(772)**	**(250)**	**(30)**	**(33)**	**3**	**(1,082)**
Impairment (charges)/benefits	**(165)**	**(155)**	**-**	**-**	**-**	**(320)**
Profit before income tax	**185**	**618**	**131**	**77**	**(60)**	**951**
Year ended 30 September 2019 (restated)						
Net interest income	1,032	887	46	-	33	1,998
Non-interest income	164	124	101	126	47	562
Net operating income before operating expenses and impairment charges	1,196	1,011	147	126	80	2,560
Operating expenses	(724)	(238)	(30)	(29)	3	(1,018)
Impairment (charges)/benefits	(17)	27	-	-	-	10
Profit before income tax	455	800	117	97	83	1,552
As at 30 September 2020						
Total gross loans	**48,979**	**39,457**	**383**	**-**	**142**	**88,961**
Total deposits and other borrowings	**38,637**	**32,337**	**-**	**-**	**2,996**	**73,970**
As at 30 September 2019 (restated)						
Total gross loans	45,730	38,624	455	-	138	84,947
Total deposits and other borrowings[1]	35,125	29,340	-	-	1,141	65,606

[1] Comparatives have been restated by $499m to correctly reflect the total deposits and other borrowings balance in the Commercial, Corporate and Institutional operating segment which were previously overstated. Total deposits and other borrowings have decreased from $29,839m to $29,340m and "reconciling items" have increased from $758m to $1,141m as a result of the restatement.

Note 29 Securitisation, covered bonds and other transferred assets

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

Securitisation

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

Own assets securitised

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

For securitisation structured entities which the NZ Banking Group controls, as defined in Note 30, the structured entities are classified as subsidiaries and consolidated. When assessing whether the NZ Banking Group controls a structured entity, it considers its exposure to and ability to affect variable returns. The NZ Banking Group may have variable returns from a structured entity through ongoing exposures to the risks and rewards associated with the assets, the provision of derivatives, liquidity facilities, trust management and operational services.

In October 2008, WNZSL was set up as part of Westpac New Zealand's internal residential mortgage-backed securitisation programme. Under this programme Westpac New Zealand sold the rights (but not the obligations) of a pool of housing loans to WNZSL. The purchase was funded by WNZSL's issuance of residential mortgage-backed securities ('**RMBS**'). The RMBS and an equivalent liability in the form of a deemed loan from Westpac New Zealand to WNZSL are fully eliminated in the NZ Banking Group's financial statements. Refer to Note 27 for a description of the NZ Banking Group's obligation to repurchase certain housing loans sold to WNZSL.

Covered bonds

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

The intercompany loan made by Westpac New Zealand to WNZCBL to fund the initial purchase (and subsequent further purchases which increased the cover pool) and the liability representing the deemed loan from WNZCBL to Westpac New Zealand are fully eliminated in the NZ Banking Group's financial statements. Refer to Note 27 for a description of the NZ Banking Group's obligation to repurchase certain housing loans sold to WNZCBL.

Repurchase agreements

Where securities are sold subject to an agreement to repurchase at a predetermined price, they remain recognised in the balance sheet in their original category (i.e. trading securities and financial assets measured at FVIS or investment securities).

The cash consideration received is recognised as a liability (repurchase agreements). Refer to Note 18 for further details.

Note 29 Securitisation, covered bonds and other transferred assets (continued)

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

	NZ BANKING GROUP				
			For those liabilities that only have recourse to the transferred assets:		
$ millions	Carrying amount of transferred assets	Carrying amount of associated liabilities	Fair value of transferred assets	Fair value of associated liabilities	Net fair value position
2020					
Securitisation - own assets[1]	**14,437**	**14,403**	**14,404**	**14,403**	**1**
Covered bonds[2]	**7,524**	**4,468**	**n/a**	**n/a**	**n/a**
Repurchase agreements	**33**	**33**	**n/a**	**n/a**	**n/a**
Total	**21,994**	**18,904**	**14,404**	**14,403**	**1**
2019					
Securitisation - own assets[1]	7,537	7,518	7,522	7,518	4
Covered bonds[2]	7,530	5,274	n/a	n/a	n/a
Repurchase agreements	19	19	n/a	n/a	n/a
Total	15,086	12,811	7,522	7,518	4

[1] The most senior rated securities at 30 September 2020 of $13,186 million (30 September 2019: $6,900 million) qualify as eligible collateral for repurchase agreements with the Reserve Bank. Westpac New Zealand complies with the Reserve Bank's guidelines for its overnight reverse repurchase agreement facility and open market operations, which allows banks in New Zealand to offer RMBS as collateral for the Reserve Bank's repurchase agreements.

[2] The difference between the carrying values of the covered bonds and the assets pledged allows for the immediate issuance of additional covered bonds if required. These additional assets can be repurchased by Westpac New Zealand at its discretion, subject to the conditions set out in the transaction documents. The cover pool is comprised of housing loans up to a value of $7,500 million as at 30 September 2020 (30 September 2019: $7,500 million). Over time, the composition of the cover pool will include, in addition to housing loans, accrued interest (representing accrued and unpaid interest on the outstanding housing loans) and cash (representing collections of principal and interest from the underlying housing loans).

Note 30 Structured entities

Accounting policy

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

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

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

Consolidated structured entities

Securitisation and covered bonds

The NZ Banking Group uses structured entities to securitise its financial assets through the CB Programme and Westpac New Zealand's internal residential mortgage-backed securitisation programme. Refer to Note 29 for further details.

NZ Banking Group managed funds

As disclosed in Note 22, the PIE Funds are consolidated within the financial statements of the NZ Banking Group.

Non-contractual financial support

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

Note 30 Structured entities (continued)

Unconsolidated structured entities

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

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

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

Loans and other credit commitments	The NZ Banking Group lends to unconsolidated structured entities, subject to the NZ Banking Group's collateral and credit approval processes, in order to earn interest and fees and commissions income. The structured entities are mainly securitisation entities.
Investment management agreements	The NZ Banking Group manages funds that provide customers with investment opportunities. The NZ Banking Group also manages superannuation funds for its employees. The NZ Banking Group earns management fee income which is recognised in non-interest income. The NZ Banking Group may also retain units in these investment management funds, primarily through its consolidated life insurance entity. The NZ Banking Group earns fund distribution income and recognises fair value movements through non-interest income.

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

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

	NZ BANKING GROUP					
	2020			2019		
$ millions	**Financing to Securitisation Vehicles**	**Group Managed Funds**	**Total**	Financing to Securitisation Vehicles	Group Managed Funds	Total
Assets						
Loans	**3,321**	**-**	**3,321**	2,784	-	2,784
Life insurance assets	**-**	**213**	**213**	-	188	188
Total on-balance sheet exposures	**3,321**	**213**	**3,534**	2,784	188	2,972
Total notional amounts of off-balance sheet exposures	**1,319**	**69**	**1,388**	1,104	87	1,191
Maximum exposure to loss	**4,640**	**282**	**4,922**	3,888	275	4,163
Size of structured entities[1]	**4,640**	**11,969**	**16,609**	3,888	11,251	15,139

[1] Represented by the total assets or market capitalisation of the entity, or if not available, the NZ Banking Group's total committed exposure (for lending arrangements and external debt holdings), funds under management (for Group managed funds).

Non-contractual financial support

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

Note 31 Capital Management

The Overseas Bank is a registered bank in New Zealand and conducts business in New Zealand through the NZ Banking Group. The capital held by the NZ Banking Group comprises of the head office account, NZ Banking Group equity and loan capital.

Most of the NZ Banking Group's capital is held in, and managed by Westpac New Zealand. Westpac New Zealand's Board is responsible for ensuring that capital adequacy of Westpac New Zealand is maintained and complies with the regulatory capital requirements prescribed by the Reserve Bank.

There are no regulatory capital requirements that apply specifically to the NZ Branch or the NZ Banking Group. NZ Banking Group capital is managed as part of the Overseas Banking Group's Internal Capital Adequacy Process ('**ICAAP**'). The Overseas Bank's Board is responsible for ensuring that capital adequacy of the Overseas Banking Group and the Overseas Bank is maintained.

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

The Overseas Banking Group (excluding entities specifically excluded by APRA regulations), and the Overseas Bank (Extended Licensed Entity as defined by APRA), exceeded the minimum capital adequacy requirements as specified by APRA as at 30 September 2020.

The Overseas Banking Group's approach to capital management seeks to ensure that it is adequately capitalised as an ADI.

The Overseas Banking Group evaluates its approach to capital management through an ICAAP, the key features of which include:

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

The table below represents the capital adequacy calculation for the Overseas Banking Group and Overseas Bank as at 30 September 2020 based on APRA's application of the Basel III capital adequacy framework.

%	**30 Sep 20 Unaudited**	30 Sep 19 Unaudited
Overseas Banking Group (excluding entities specifically excluded by APRA regulations)[1, 2]		
Common Equity Tier 1 capital ratio	**11.1**	10.7
Additional Tier 1 capital ratio	**2.1**	2.2
Tier 1 capital ratio	**13.2**	12.8
Tier 2 capital ratio	**3.2**	2.8
Total regulatory capital ratio	**16.4**	15.6
Overseas Bank (Extended Licensed Entity)[1, 3]		
Common Equity Tier 1 capital ratio	**11.4**	11.0
Additional Tier 1 capital ratio	**2.1**	2.2
Tier 1 capital ratio	**13.5**	13.2
Tier 2 capital ratio	**3.2**	2.9
Total regulatory capital ratio	**16.7**	16.1

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

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

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

Freeze on dividends and restrictions on the distributions of additional Tier 1 capital instruments by NZ Banks

On 2 April 2020, a decision was made by the Reserve Bank to freeze the distribution of dividends on ordinary shares and to restrict the extent to which distributions on additional Tier 1 capital instruments are permitted by all locally incorporated banks in New Zealand (including Westpac New Zealand) during the period of economic uncertainty caused by COVID-19. On 11 November 2020, the Reserve Bank announced that these restrictions will be retained until at least 31 March 2021. Non-payment of dividends from Westpac New Zealand only affects the Overseas Bank's Level 1 CET1 capital ratio.

The Overseas Bank is well capitalised and at 30 September 2020 had a Level 1 CET1 capital ratio of 11.40%.

Notes to the financial statements

Note 32 Financial risk

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

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

Principal risks	Note name	Note number
Overview	Risk management frameworks	32.1
Credit risk	Credit risk ratings system	32.2.1
The risk of financial loss where a customer or counterparty fails to meet their financial obligations.	Credit risk mitigation, collateral and other credit enhancements	32.2.2
	Credit risk concentrations	32.2.3
	Credit quality of financial assets	32.2.4
	Non-performing loans and credit commitments	32.2.5
	Collateral held	32.2.6
Funding and liquidity risk	Liquidity modelling	32.3.1
The risk that the NZ Banking Group cannot meet its payment obligations or that it does not have the appropriate amount, tenor and composition of funding and liquidity to support its assets.	Sources of funding	32.3.2
	Assets pledged as collateral	32.3.3
	Contractual maturity of financial liabilities	32.3.4
	Expected maturity	32.3.5
Market risk	Value-at-Risk ('**VaR**')	32.4.1
The risk of an adverse impact on earnings resulting from changes in market factors, such as FX rates, interest rates, commodity prices and equity prices.	Traded market risk	32.4.2
	Non-traded market risk	32.4.3

Note 32.1 Risk management frameworks

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

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

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

Notes to the financial statements

Note 32 Financial risk (continued)

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

Risk	Risk management framework and controls
Credit risk	– The Overseas Bank's Credit Risk Management Framework describes the principles, methodologies, systems, roles and responsibilities, reports and key controls for managing credit risk. Within the Credit Risk Management Framework, the NZ Banking Group has its own credit approval limits approved by Westpac New Zealand's Board as delegated by the Overseas Banking Group's Chief Risk Officer. – The Group BRCC and the WBC NZ Banking Group Executive Risk Committee ('**ERC**') monitor the risk profile, performance and management of the NZ Banking Group's credit portfolio and the development and review of key credit risk policies on at least a quarterly basis; other management reviews occur monthly or more frequently. – The NZ Banking Group's Credit Risk Rating System Policy describes the credit risk rating system philosophy, design, key features, IT systems and uses of rating outcomes. – All models materially impacting the risk rating process are periodically reviewed in accordance with the NZ Banking Group's model risk policies. – An annual review is performed of the Credit Risk Rating System by the Westpac New Zealand Board Risk and Compliance Committee ('**WNZL BRCC**') and ERC. – Specific credit risk estimates (including PD, LGD and EAD) are overseen, reviewed annually and supported by the Overseas Bank's Credit Risk Estimates Committee (a subcommittee of the Group BRCC). – In determining the provision for ECL, the macroeconomic variables and the probability weightings of the forward-looking scenarios as well as any adjustments made to the modelled outcomes are subject to the approval of the NZ Banking Group's Chief Financial Officer and Chief Risk Officer with oversight from the Board of Directors (and its Committees). – Policies for delegating credit approval authorities and formal limits for the extension of credit are established throughout the NZ Banking Group. These include those for the approval and management of all credit risk arising from other banks and related entities. – Credit policies are established throughout the NZ Banking Group including policies governing the origination, evaluation, approval, documentation, settlement and ongoing management of credit risks. – Sector policies guide credit extension where industry-specific guidelines are considered necessary (e.g. acceptable financial ratios or permitted collateral). – The Related Entity Risk Management Framework and supporting policies govern credit exposures to related entities to minimise the spread of credit risk between Overseas Banking Group entities and to comply with prudential requirements prescribed by APRA.
Funding and liquidity risk	– Funding and liquidity risk is measured and managed in accordance with the policies and processes defined in the Board-approved Liquidity Risk Management Framework which is part of the Overseas Banking Group's Board-approved Risk Management Strategy. – Responsibility for managing the NZ Banking Group's liquidity and funding positions in accordance with the Liquidity Risk Management Framework is delegated to Treasury, both under the oversight of the Overseas Banking Group's Asset and Liability Committee ('**Group ALCO**') as regards APRA APS 210 obligations and under Westpac New Zealand's Asset and Liability Committee ('**WNZL ALCO**') as regards Reserve Bank's BS13 prudential standard. Group BRCC oversees Group ALCO with regard to APRA APS 210 obligations and WNZL BRCC oversees WNZL ALCO's reporting and monitoring of BS13 liquidity measures. – Treasury undertakes an annual funding review that outlines the NZ Banking Group's balance sheet funding strategy over a three year period. This review encompasses trends in global markets, peer analysis, wholesale funding capacity, expected funding requirements and a funding risk analysis. This strategy is continuously reviewed to take account of changing market conditions, investor sentiment and estimations of asset and liability growth rates. This review is subsequently submitted to WNZL BRCC for approval. – The Overseas Banking Group monitors the composition and stability of its funding so that it remains within its funding risk appetite. This includes compliance with both the Liquidity Coverage Ratio ('**LCR**') and Net Stable Funding Ratio ('**NSFR**'). – Treasury also maintains a contingent funding plan that outlines the steps that should be taken by the NZ Banking Group in the event of an emerging 'funding crisis'. The plan is aligned with the Overseas Banking Group's broader Liquidity Crisis Management Policy and is submitted annually to WNZL BRCC for approval. – Daily liquidity risk reports are reviewed by Treasury and the Overseas Banking Group's Liquidity Risk teams. Liquidity reports are presented to Group ALCO monthly and to the Group BRCC quarterly, as well as WNZL ALCO and WNZL BRCC on a similar schedule.

Note 32 Financial risk (continued)

Risk	Risk management framework and controls
Market risk	– The Market Risk Framework describes the Overseas Banking Group's approach to managing traded and non-traded market risk and is approved by the Group BRCC. Westpac New Zealand operates its own Market Risk Management Framework that is closely aligned with that of the Overseas Banking Group. The Westpac New Zealand Framework is approved by the WNZL BRCC. – Traded market risk includes interest rate, FX, commodity, equity price, credit spread and volatility risks. Non-traded market risk includes interest rate and FX risks. – Market risk is managed using VaR limits, Net interest income at risk ('**NaR**') and structural risk limits (including credit spread and interest rate basis point value limits) as well as scenario analysis and stress testing. – The Group BRCC approves the risk appetite for traded and non-traded risks through the use of VaR, NaR and specific structural risk limits. – The Overseas Banking Group's RISKCO ('**Group RISKCO**') has approved separate VaR sub-limits for the trading activities of the Overseas Banking Group's Financial Markets and Treasury units. – Market risk limits are assigned to business management based upon the Overseas Banking Group's risk appetite and business strategies in addition to the consideration of market liquidity and concentration of risks. – Market risk positions are managed by the trading desks and ALM unit consistent with their delegated authorities and the nature and scale of the market risks involved. – Daily monitoring of current exposure and limit utilisation is conducted independently by the Overseas Banking Group's Market Risk unit, which monitors market risk exposures against VaR and structural risk limits. Oversight of risk specific to the NZ Banking Group is monitored by the NZ Branch's Trading Risk Management Unit. Daily VaR position reports are produced by risk type, by product lines and by geographic region. Quarterly reports are produced for the Overseas Banking Group's Market Risk Committee ('**Group MARCO**'), Group RISKCO and Group BRCC. – Daily stress testing and backtesting of VaR results are performed to support model integrity and to analyse extreme or unexpected movements. A review of the potential profit and loss outcomes is also undertaken to monitor any skew created by the historical data. – The Group BRCC has approved a framework for profit or loss escalation which considers both single day and 20 day cumulative results. – Treasury's ALM unit is responsible for managing the non-traded interest rate risk including risk mitigation through hedging using derivatives. This is overseen by the Market Risk unit and reviewed by the Group MARCO, Group RISKCO and Group BRCC.

Notes to the financial statements

Note 32 Financial risk (continued)

32.2 Credit risk

32.2.1 Credit risk ratings system

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

Transaction-managed customers

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

The following table shows the NZ Banking Group's high level CRG's for transaction-managed portfolios mapped to the NZ Banking Group's credit quality disclosure categories and to their corresponding external rating.

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

Program-managed portfolio

The program-managed portfolio generally includes retail products including mortgages, personal lending (including credit cards) as well as Small and Medium-sized Enterprises ('**SME**') lending. These customers are grouped into pools of similar risk. Pools are created by analysing similar risk characteristics that have historically predicted that an account is likely to go into default. Customers grouped according to these predictive characteristics are assigned a PD and LGD relative to their pool. The credit quality of these pools is based on a combination of behavioural factors, delinquency trends, PD estimates and loan to valuation ratio (housing loans only).

	Program-managed	
Financial Statement Disclosure	**Advanced PM Model[1]**	**Simplified PM Approach[2]**
Strong	Stage 1 facilities with PM Risk Grade between 13 and 10	-
Good/satisfactory	Stage 1 facilities with PM Risk Grade between 9 and 6	Stage 1
	Stage 2 facilities with PM Risk Grade between 13 and 6	Stage 2 and 0 - 29 days past due
Weak	All facilities with PM Risk Grade between 5 and 1	Stage 2 and 30 or more days past due
Weak/default/non-performing	All facilities with PM Risk Grade equal to 0	Stage 3

[1] Used for Residential Mortgages, Credit Cards & SME.
[2] Used for Personal Lending.

32.2.2 Credit risk mitigation, collateral and other credit enhancements

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

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

Note 32 Financial risk (continued)

Collateral

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

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

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

Management of risk mitigation

The NZ Banking Group mitigates credit risk through controls covering:

Collateral and valuation management	The Overseas Bank manages collateral under collateralisation agreements centrally for all branches of the Overseas Bank and Westpac New Zealand. The estimated realisable value of collateral held in support of loans is based on a combination of: • formal valuations currently held for such collateral; and • management's assessment of the estimated realisable value of all collateral held. This analysis also takes into consideration any other relevant knowledge available to management at the time. Updated valuations are obtained when appropriate. The NZ Banking Group revalues collateral related to financial markets positions on a daily basis and has formal processes in place to promptly call for collateral top-ups, if required. These processes include margining for non-centrally cleared customer derivatives where required under APRA's Prudential Standard CPS226. The collateralisation arrangements are documented via the Credit Support Annex of the ISDA dealing agreements and Global Master Repurchase Agreements for repurchase transactions.
Other credit enhancements	The NZ Banking Group only recognises guarantees, standby letters of credit, or credit derivative protection from the following entities (provided they are not related to the entity with which the NZ Banking Group has a credit exposure): • Sovereign; • Australia and New Zealand public sector; • Authorised deposit-taking institutions and overseas banks with a minimum risk grade equivalent of A3 / A-; and • Other entities with a minimum risk grade equivalent of A3 / A-.
Offsetting	Creditworthy customers domiciled in New Zealand may enter into formal agreements with the NZ Banking Group, permitting the NZ Banking Group to set-off gross credit and debit balances in their nominated accounts. Cross-border set-offs are not permitted. Close-out netting is undertaken with counterparties with whom the NZ Banking Group has entered into a legally enforceable master netting agreement for their off-balance sheet financial market transactions in the event of default. Further details of offsetting are provided in Note 25.
Central clearing	The NZ Banking Group increasingly executes derivative transactions through central clearing counterparties. Central clearing counterparties mitigate risk through stringent membership requirements, the collection of margin against all trades placed, the default fund, and an explicitly defined order of priority of payments in the event of default.

Notes to the financial statements

Note 32 Financial risk (continued)

32.2.3 Credit risk concentrations

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

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

Individual customers or groups of related customers

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

Specific industries

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

Individual countries

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

Maximum exposure to credit risk

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Financial assets		
Cash and balances with central banks	**4,488**	2,002
Collateral paid	**397**	417
Trading securities and financial assets measured at FVIS	**4,224**	4,871
Derivative financial instruments	**5,660**	6,257
Investment securities	**5,021**	4,469
Loans	**88,354**	84,626
Other financial assets	**555**	400
Life insurance assets	**-**	4
Due from related entities	**2,713**	2,367
Total financial assets	**111,412**	105,413
Undrawn credit commitments		
Letters of credit and guarantees	**968**	964
Commitments to extend credit	**27,897**	25,881
Total undrawn credit commitments	**28,865**	26,845
Total maximum credit risk exposure	**140,277**	132,258

Note 32 Financial risk (continued)

Concentration of credit exposures

	NZ BANKING GROUP	
$ millions	**2020**	2019
On-balance sheet credit exposures		
Analysis of on-balance sheet credit exposures by geographical areas		
New Zealand	**103,335**	97,283
Australia	**3,857**	3,685
United Kingdom	**2,520**	2,459
United States of America	**135**	154
China	**874**	936
Other	**691**	896
Total on-balance sheet credit exposures	**111,412**	105,413
Analysis of on-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**480**	465
Agriculture	**9,379**	8,836
Construction	**604**	572
Finance and insurance	**9,541**	10,687
Forestry and fishing	**513**	444
Government, administration and defence	**12,629**	9,044
Manufacturing	**1,947**	2,229
Mining	**226**	311
Property	**8,072**	7,512
Property services and business services	**1,170**	1,451
Services	**2,283**	2,125
Trade	**2,121**	2,554
Transport and storage	**1,321**	1,280
Utilities	**2,130**	2,297
Retail lending	**56,790**	53,446
Other	**1**	2
Subtotal	**109,207**	103,255
Provision for ECL on loans	**(607)**	(321)
Due from related entities	**2,713**	2,367
Other financial assets	**99**	112
Total on-balance sheet credit exposures	**111,412**	105,413
Off-balance sheet credit exposures consists of		
Credit risk-related instruments	**28,865**	26,845
Total off-balance sheet credit exposures	**28,865**	26,845
Analysis of off-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**104**	116
Agriculture	**837**	624
Construction	**554**	502
Finance and insurance	**1,926**	1,636
Forestry and fishing	**235**	204
Government, administration and defence	**905**	891
Manufacturing	**1,932**	1,870
Mining	**111**	35
Property	**1,215**	1,986
Property services and business services	**930**	705
Services	**861**	592
Trade	**2,086**	1,682
Transport and storage	**955**	812
Utilities	**1,987**	1,720
Retail lending	**14,227**	13,470
Total off-balance sheet credit exposures	**28,865**	26,845

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

Notes to the financial statements

Note 32 Financial risk (continued)

32.2.4 Credit quality of financial assets

The following table shows the credit quality of gross credit risk exposures measured at amortised cost or at FVOCI to which the impairment requirements of NZ IFRS 9 apply. The credit quality is determined by reference to the credit risk ratings system (refer to Note 32.2.1) and expectations of future economic conditions under multiple scenarios:

	NZ BANKING GROUP							
	2020				2019			
$ millions	**Stage 1**	**Stage 2**	**Stage 3**	**Total[1]**	Stage 1	Stage 2	Stage 3	Total[1]
Loans - Residential Mortgages								
Strong	**42,916**	**-**	**-**	**42,916**	42,096	-	-	42,096
Good/satisfactory	**7,713**	**3,578**	**-**	**11,291**	7,629	1,201	-	8,830
Weak	**49**	**501**	**473**	**1,023**	28	248	302	578
Total Loans - Residential Mortgages	**50,678**	**4,079**	**473**	**55,230**	49,753	1,449	302	51,504
Loans - Other retail[2]								
Strong	**1,206**	**-**	**-**	**1,206**	610	-	-	610
Good/satisfactory	**1,646**	**203**	**-**	**1,849**	2,881	56	-	2,937
Weak	**18**	**152**	**74**	**244**	19	134	53	206
Total Loans - Other retail	**2,870**	**355**	**74**	**3,299**	3,510	190	53	3,753
Loans - Corporate								
Strong	**11,613**	**-**	**-**	**11,613**	11,437	-	-	11,437
Good/satisfactory	**15,919**	**993**	**-**	**16,912**	15,624	1,126	-	16,750
Weak	**-**	**1,652**	**163**	**1,815**	-	1,299	93	1,392
Total Loans - Corporate	**27,532**	**2,645**	**163**	**30,340**	27,061	2,425	93	29,579
Loans - Other								
Strong	**92**	**-**	**-**	**92**	111	-	-	111
Good/satisfactory	**-**	**-**	**-**	**-**	-	-	-	-
Weak	**-**	**-**	**-**	**-**	-	-	-	-
Total Loans - Other	**92**	**-**	**-**	**92**	111	-	-	111
Investment Securities								
Strong	**5,021**	**-**	**-**	**5,021**	4,469	-	-	4,469
Good/satisfactory	**-**	**-**	**-**	**-**	-	-	-	-
Weak	**-**	**-**	**-**	**-**	-	-	-	-
Total Investment Securities	**5,021**	**-**	**-**	**5,021**	4,469	-	-	4,469
All other financial assets								
Strong	**6,927**	**-**	**-**	**6,927**	4,151	-	-	4,151
Good/satisfactory	**37**	**6**	**-**	**43**	42	4	-	46
Weak	**-**	**3**	**1**	**4**	-	3	1	4
Total all other financial assets	**6,964**	**9**	**1**	**6,974**	4,193	7	1	4,201
Undrawn credit commitments								
Strong	**21,900**	**-**	**-**	**21,900**	18,567	-	-	18,567
Good/Satisfactory	**6,482**	**281**	**-**	**6,763**	7,832	237	-	8,069
Weak	**12**	**146**	**44**	**202**	10	179	20	209
Total undrawn credit commitments	**28,394**	**427**	**44**	**28,865**	26,409	416	20	26,845
Total strong	**89,675**	**-**	**-**	**89,675**	81,441	-	-	81,441
Total good/satisfactory	**31,797**	**5,061**	**-**	**36,858**	34,008	2,624	-	36,632
Total weak	**79**	**2,454**	**755**	**3,288**	57	1,863	469	2,389
Total on and off balance sheet	**121,551**	**7,515**	**755**	**129,821**	115,506	4,487	469	120,462

[1] This credit quality disclosure differs to that of credit risk concentration as it relates only to financial assets measured at amortised costs or at FVOCI and therefore excludes trading securities and financial assets measured at FVIS, and derivative financial instruments.

[2] Comparatives have been restated to correctly classify Stage 2 credit exposures of $116m related to 'Loans – Other retail' from 'Good/satisfactory' to 'Weak'.

Details of collateral held in support of these balances are provided in Note 32.2.6.

Note 32 Financial risk (continued)

32.2.5 Non-performing loans and credit commitments

The loans and credit commitments balance in stage 3 (non-performing) is represented by those loans and credit commitments which are in default. A default occurs when the NZ Banking Group considers that the customer is unlikely to repay its credit obligations in full, irrespective of recourse by the NZ Banking Group to actions such as realising security, or the customer is more than 90 days past due on any material credit obligation. This definition of default is aligned to the Reserve Bank regulatory definition of default except for customers' exposures availing COVID-19 assistance, which follow the supplementary guidelines provided by the Reserve Bank for regulatory capital and the IASB guidance for provisioning.

The determination of the provision for ECL is one of the NZ Banking Group's critical accounting assumptions and estimates. Details of this and the NZ Banking Group's accounting policy for the provision for ECL are discussed in Notes 6 and 12 along with the total provision for ECL on loans and credit commitments and the total for those loans and credit commitments that are considered non-performing (i.e. stage 3).

32.2.6 Collateral held

Loans

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

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

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

	NZ BANKING GROUP									
	2020					2019				
%	Residential Mortgages[1]	Other Retail	Corporate	Other	Total	Residential Mortgages[1]	Other Retail	Corporate	Other	Total
Performing Loans										
Fully secured	**100**	**44**	**63**	**44**	**85**	100	39	61	37	84
Partially secured	**-**	**4**	**19**	**1**	**7**	-	4	20	11	7
Unsecured	**-**	**52**	**18**	**55**	**8**	-	57	19	52	9
Total	**100**	**100**	**100**	**100**	**100**	100	100	100	100	100
Non-performing loans										
Fully secured	**96**	**39**	**13**	**-**	**70**	94	53	10	-	72
Partially secured	**4**	**7**	**13**	**-**	**7**	6	4	50	-	15
Unsecured	**-**	**54**	**74**	**-**	**23**	-	43	40	-	13
Total	**100**	**100**	**100**	**-**	**100**	100	100	100	-	100

[1] For the purposes of collateral classifications, residential mortgages are classified as fully secured, unless they are non-performing in which case they may be classified as partially secured. Refer to Section iv 'Additional mortgage information' of the Registered bank disclosures for loan-to-value ratio ('**LVR**') analysis of residential mortgages.

Details of the carrying value and associated provision for ECL are disclosed in Note 11, Section iii. of the Registered bank disclosures and Note 12 respectively. The credit quality of loans is disclosed in Note 32.2.4.

Collateral held against financial assets other than loans

	NZ BANKING GROUP	
$ millions	2020	2019
Cash, primarily for derivatives	**508**	623
Securities under reverse repurchase agreements[1]	**547**	1,041
Total other collateral held	**1,055**	1,664

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

Note 32 Financial risk (continued)

32.3 Funding and liquidity risk

32.3.1 Liquidity modelling

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

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

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

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

32.3.2 Sources of funding

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

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

Liquid assets

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

The following table shows the NZ Banking Group's holding of liquid assets and represents the key liquidity information provided to management. Liquid assets include high quality assets readily convertible to cash to meet the NZ Banking Group's liquidity requirements. In management's opinion, liquidity is sufficient to meet the NZ Banking Group's present requirements.

	NZ BANKING GROUP	
$ millions	**2020**	2019
Cash and balances with central banks	**4,488**	2,002
Interbank lending	**55**	72
Supranational securities	**1,020**	1,712
NZ Government securities	**3,856**	2,022
NZ public securities	**2,563**	2,614
NZ corporate securities	**1,060**	2,220
Residential mortgage-backed securities	**11,081**	5,798
Total liquid assets	**24,123**	16,440

Notes to the financial statements

Note 32 Financial risk (continued)

Concentration of funding

	NZ BANKING GROUP	
$ millions	**2020**	2019
Funding consists of		
Collateral received	**508**	623
Deposits and other borrowings	**73,970**	65,606
Other financial liabilities[1]	**1,543**	1,239
Due to related entities[2]	**1,518**	1,539
Debt issues[3]	**15,799**	17,846
Loan capital	**3,220**	3,185
Total funding	**96,558**	90,038
Analysis of funding by geographical areas[3]		
New Zealand	**74,122**	65,038
Australia	**2,664**	2,963
United Kingdom	**8,014**	9,076
United States of America	**5,770**	5,126
China	**3,248**	4,575
Other	**2,740**	3,260
Total funding	**96,558**	90,038
Analysis of funding by industry sector		
Accommodation, cafes and restaurants	**493**	421
Agriculture	**1,579**	1,425
Construction	**2,212**	1,918
Finance and insurance	**35,291**	36,302
Forestry and fishing	**192**	193
Government, administration and defence	**3,303**	2,626
Manufacturing	**2,083**	1,589
Mining	**82**	65
Property services and business services	**6,865**	5,790
Services	**4,729**	4,112
Trade	**2,062**	1,533
Transport and storage	**787**	386
Utilities	**754**	450
Households	**30,256**	27,229
Other[4]	**4,352**	4,460
Subtotal	**95,040**	88,499
Due to related entities[2]	**1,518**	1,539
Total funding	**96,558**	90,038

[1] Other financial liabilities, as presented above, are in respect of repurchase agreements, securities sold short and interbank placements.

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

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

[4] Includes deposits from non-residents.

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

Notes to the financial statements

Note 32 Financial risk (continued)

32.3.3 Assets pledged as collateral

The NZ Banking Group is required to provide collateral (predominantly to other financial institutions), as part of standard terms, to secure liabilities. In addition to assets supporting Westpac New Zealand's CB Programme disclosed in Note 29, the carrying value of these financial assets pledged as collateral is:

	NZ BANKING GROUP	
$ millions	**2020**	2019
Cash	**397**	417
Securities pledged under repurchase agreements:		
Trading securities and financial assets measured at FVIS	**33**	19
Total amount pledged to secure liabilities (excluding CB Programme)	**430**	436

32.3.4 Contractual maturity of financial liabilities

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

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

Derivatives held for trading and certain liabilities classified in "Other financial liabilities" which are measured at FVIS are not managed for liquidity purposes on the basis of their contractual maturity, and accordingly these liabilities are presented in either the on demand or up to 1 month columns. Only the liabilities that the NZ Banking Group manages based on their contractual maturity are presented on a contractual undiscounted basis in the following table.

Note 32 Financial risk (continued)

$ millions	On Demand	Up to 1 Month	Over 1 Month and Up to 3 Months	Over 3 Months and Up to 1 Year	Over 1 and Up to 5 Years	Over 5 Years	Total
	NZ BANKING GROUP						
	2020						
Financial liabilities							
Collateral received	-	508	-	-	-	-	508
Deposits and other borrowings	38,558	6,446	11,193	16,091	2,098	-	74,386
Other financial liabilities	1,102	658	6	-	-	-	1,766
Derivative financial instruments:							
Held for trading	4,708	-	-	-	-	-	4,708
Held for hedging purposes (net settled)	-	37	75	198	252	4	566
Held for hedging purposes (gross settled):							
Cash outflow	-	3	9	1,919	1,349	-	3,280
Cash inflow	-	-	(6)	(1,824)	(1,312)	-	(3,142)
Due to related entities:							
Non-derivative balances	1,232	-	2	308	-	-	1,542
Derivative financial instruments:							
Held for trading	954	-	-	-	-	-	954
Held for hedging purposes (gross settled):							
Cash outflow	-	-	12	1,504	-	-	1,516
Cash inflow	-	-	(10)	(1,440)	-	-	(1,450)
Debt issues	-	166	25	6,565	8,950	395	16,101
Loan capital	-	-	8	24	130	3,035	3,197
Total undiscounted financial liabilities	46,554	7,818	11,314	23,345	11,467	3,434	103,932
Total contingent liabilities and commitments							
Letters of credit and guarantees	968	-	-	-	-	-	968
Commitments to extend credit	27,897	-	-	-	-	-	27,897
Total undiscounted contingent liabilities and commitments	28,865	-	-	-	-	-	28,865

Notes to the financial statements

Note 32 Financial risk (continued)

	NZ BANKING GROUP						
	2019						
$ millions	On Demand	Up to 1 Month	Over 1 Month and Up to 3 Months	Over 3 Months and Up to 1 Year	Over 1 Year and Up to 5 Years	Over 5 Years	Total
Financial liabilities							
Collateral received	-	623	-	-	-	-	623
Deposits and other borrowings	29,664	6,853	13,531	14,420	1,788	-	66,256
Other financial liabilities	760	643	8	-	-	-	1,411
Derivative financial instruments:							
Held for trading	5,163	-	-	-	-	-	5,163
Held for hedging purposes (net settled)	-	38	82	197	273	8	598
Held for hedging purposes (gross settled):							
Cash outflow	-	5	5	911	558	-	1,479
Cash inflow	-	-	-	(889)	(503)	-	(1,392)
Due to related entities:							
Non-derivative balances	1,250	-	2	5	311	-	1,568
Derivative financial instruments:							
Held for trading	1,263	-	-	-	-	-	1,263
Held for hedging purposes (gross settled):							
Cash outflow	-	-	15	42	1,520	-	1,577
Cash inflow	-	-	(13)	(37)	(1,452)	-	(1,502)
Debt issues	-	122	947	4,309	12,746	393	18,517
Loan capital	-	-	11	31	159	3,176	3,377
Total undiscounted financial liabilities	38,100	8,284	14,588	18,989	15,400	3,577	98,938
Total contingent liabilities and commitments							
Letters of credit and guarantees	964	-	-	-	-	-	964
Commitments to extend credit	25,881	-	-	-	-	-	25,881
Total undiscounted contingent liabilities and commitments	26,845	-	-	-	-	-	26,845

Note 32 Financial risk (continued)

32.3.5 Expected maturity

The following table presents the balance sheet based on expected maturity dates, except for deposits, based on historical behaviours. The liability balances in the following table will not agree to the contractual maturity tables due to the analysis below being based on expected rather than contractual maturities, the impact of discounting and the exclusion of interest accruals beyond the reporting period. Deposits are presented in the following table on a contractual basis, however as part of our normal banking operations, the NZ Banking Group would expect a large proportion of these balances to be retained.

	NZ BANKING GROUP					
	2020			2019		
$ millions	Due within 12 months	Greater 12 months	Total	Due within 12 months	Greater than 12 months	Total
Assets						
Cash and balances with central banks	**4,488**	**-**	**4,488**	2,002	-	2,002
Collateral paid	**397**	**-**	**397**	417	-	417
Trading securities and financial assets measured at FVIS	**3,814**	**410**	**4,224**	4,730	141	4,871
Derivative financial instruments	**4,405**	**1,255**	**5,660**	4,742	1,515	6,257
Investment securities	**694**	**4,327**	**5,021**	1,948	2,521	4,469
Loans	**12,571**	**75,783**	**88,354**	12,325	72,301	84,626
Life insurance assets	**214**	**161**	**375**	193	142	335
Due from related entities	**2,648**	**65**	**2,713**	2,288	79	2,367
All other assets	**819**	**1,145**	**1,964**	606	812	1,418
Total assets	**30,050**	**83,146**	**113,196**	29,251	77,511	106,762
Liabilities						
Collateral received	**508**	**-**	**508**	623	-	623
Deposits and other borrowings	**71,947**	**2,023**	**73,970**	63,920	1,686	65,606
Derivative financial instruments	**4,503**	**914**	**5,417**	4,455	1,370	5,825
Due to related entities	**2,491**	**69**	**2,560**	2,247	645	2,892
Debt issues	**6,592**	**9,207**	**15,799**	5,113	12,733	17,846
Loan capital	**1,123**	**2,097**	**3,220**	-	3,185	3,185
All other liabilities	**2,306**	**371**	**2,677**	2,001	127	2,128
Total liabilities	**89,470**	**14,681**	**104,151**	78,359	19,746	98,105

32.4 Market risk

32.4.1 Value-at-Risk

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

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

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

The key parameters of VaR are:

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

Note 32 Financial risk (continued)

32.4.2 Traded market risk

The NZ Banking Group's exposure to traded market risk arises out of its Financial Markets ('**FM**') and Treasury trading activities. The FM trading book activity represents dealings that encompass book running and distribution activity. The types of market risk arising from FM trading activity include interest rate risk, FX risk, credit spread risk and volatility risk.

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

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

	NZ BANKING GROUP							
	2020				2019			
$ millions	As at	Maximum Exposure	Minimum Exposure	Average Exposure	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	**4.2**	**9.3**	**1.0**	**3.6**	1.2	2.0	0.7	1.2
FX risk	**0.3**	**1.5**	**0.1**	**0.4**	0.3	2.6	-	0.8
Price risk	**1.0**	**2.8**	**0.1**	**0.8**	0.4	0.6	0.2	0.3
Volatility risk	**-**	**-**	**-**	**-**	-	-	-	-
Net market risk	**4.7**	**11.8**	**1.0**	**4.4**	1.2	2.5	0.7	1.5

32.4.3 Non-traded market risk

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

Net interest income ('**NII**') sensitivity is managed in terms of the NaR. A simulation model is used to calculate the NZ Banking Group's potential NaR. This combines the underlying balance sheet data with assumptions about run off and new business, expected repricing behaviour and changes in wholesale market interest rates.

Simulations using a range of interest rate scenarios are used to provide a series of potential future NII outcomes. The interest rate scenarios modelled are 25, 50, 75, 100 and 200 basis point shifts up and down to the static and the implied forward current yield curve rates in Australia and New Zealand.

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

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

The following table depicts NaR assuming a 100 basis point shock (with a floor of zero for falling interest rates) over the 12 months as a percentage of reported NII:

	NZ BANKING GROUP							
	2020				2019			
% (increase)/ decrease in NII	As at	Maximum Exposure	Minimum Exposure	Average Exposure	As at	Maximum Exposure	Minimum Exposure	Average Exposure
NaR	**1.28**	**8.2**	**0.98**	**3.76**	7.95	7.95	3.17	5.43

Value at Risk – IRRBB[1]

The table below depicts VaR for IRRBB:

	NZ BANKING GROUP							
	2020				2019			
$ millions	As at	Maximum Exposure	Minimum Exposure	Average Exposure	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	**0.5**	**1.3**	**0.1**	**0.5**	1.2	1.3	0.2	0.5

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

Note 32 Financial risk (continued)

Risk mitigation

IRRBB stems from the ordinary course of banking activities, including structural interest rate risk (the mismatch between the duration of assets and liabilities) and capital management.

The NZ Banking Group hedges its exposure to such interest rate risk using derivatives. Further details on the NZ Banking Group's use of hedge accounting are discussed in Note 23.

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

Foreign currency exposures

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Receivable/(payable)		
Australian dollar	**3**	-
Euro	**4**	-
British pound	**(1)**	-
US dollar	**16**	8
Japanese yen	**-**	1
Others	**4**	3

Notes to the financial statements

Note 33 Notes to the statement of cash flows

Accounting policy

Cash and cash equivalents include cash held at branches and in ATMs, balances with overseas banks in their local currency, balances with central banks and balances with other financial institutions.

Cash and cash equivalents

	NZ BANKING GROUP	
$ millions	**2020**	2019
Cash and cash equivalents comprise:		
Cash and balances with central banks:		
Cash on hand	**321**	318
Balances with central banks	**4,167**	1,684
Interbank lending classified as cash and cash equivalents[1]	**55**	72
Cash and cash equivalents at end of the year	**4,543**	2,074

[1] Included in other financial assets in the balance sheet.

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Net profit attributable to the owners of the NZ Banking Group	**681**	1,129
Adjustments:		
Impairment charges/(benefits) on loans	**320**	(10)
Computer software amortisation costs	**66**	59
Depreciation	**99**	39
(Gain)/loss from hedging ineffectiveness	**(10)**	(2)
Movement in accrued interest receivable	**23**	10
Movement in accrued interest payable	**(156)**	(6)
Movement in current and deferred tax	**(128)**	(12)
Gain on disposal of associate	**-**	(40)
Share-based payments	**5**	6
Other non-cash items[1,2]	**(408)**	243
Cash flows from operating activities before changes in operating assets and liabilities	**492**	1,416
Movement in collateral paid	**20**	(237)
Movement in trading securities and financial assets measured at FVIS	**450**	(1,841)
Movement in loans	**(3,946)**	(3,687)
Movement in other financial assets	**10**	(19)
Movement in due from related entities	**(148)**	184
Movement in other assets	**(7)**	-
Movement in collateral received	**(115)**	32
Movement in deposits and other borrowings	**8,364**	2,501
Movement in other financial liabilities	**308**	237
Movement in due to related entities	**(15)**	38
Movement in other liabilities	**1**	1
Net movement in external and related entity derivative financial instruments[2]	**134**	(4)
Net cash flows provided by/(used in) operating activities	**5,548**	(1,379)

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

[2] Comparatives have been restated to correctly reflect cash flows of $233m in other cash items relating to realised gains on FX trading derivatives which were previously presented in 'net movement in external and related entity derivative financial instruments'.

Registered bank disclosures

This section contains the additional disclosures required by the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended).

i. General information (Unaudited)

Overseas Bank

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

Limits on material financial support by the Overseas Bank

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

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

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

While the limit and associated conditions do not apply to the ELE's non-equity exposures to the NZ Branch (which is within the ELE), the limit and associated conditions do apply to the NZ Branch's non-equity exposures to the rest of the NZ Banking Group other than Westpac New Zealand Group Limited. As at 30 September 2020, the ELE's non-equity exposures to New Zealand banking subsidiaries affected by the limit were below 5% of Level 1 Tier 1 capital of the Overseas Bank.

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

Ranking of local creditors in liquidation

There are material legislative restrictions in Australia (being the Overseas Bank's country of incorporation) which subordinate the claims of certain classes of unsecured creditors of the NZ Branch on the assets of the Overseas Bank (including a claim made or proved in an insolvent winding-up or liquidation of the Overseas Bank) to those of other classes of unsecured creditors of the Overseas Bank.

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

Section 13A(3) of the Banking Act 1959 of Australia ('**Australian Banking Act**') provides that if an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to satisfy the liabilities of the ADI in the following order:

- first, certain obligations of the ADI to APRA (if any) arising under Division 2AA of Part II of the Australian Banking Act in respect of amounts payable by APRA to holders of 'protected accounts' (as defined in the Australian Banking Act) as part of the Financial Claims Scheme ('**FCS**') for the Australian government guarantee of 'protected accounts' (including most deposits) up to A$250,000 in the winding-up of the ADI;
- second, APRA's costs (if any) in exercising its powers and performing its functions relating to the ADI in connection with the FCS;
- third, the ADI's liabilities (if any) in Australia in relation to 'protected accounts' that account-holders keep with the ADI;
- fourth, the ADI's debts (if any) to the Reserve Bank of Australia;
- fifth, the ADI's liabilities (if any) under an emergency financial 'industry support contract' that is certified by APRA in accordance with the Australian Banking Act; and
- sixth, the ADI's other liabilities (if any) in the order of their priority apart from the above.

Section 13A(3) of the Australian Banking Act affects all unsecured liabilities of the NZ Branch, which, as at 30 September 2020, amounted to $14,484 million (30 September 2019: $9,911 million).

Section 13A(4) of the Australian Banking Act also provides that it is an offence for an ADI not to hold assets (other than goodwill and any assets or other amount excluded by the prudential standards) in Australia of a value that is equal to or greater than the total amount of its deposit liabilities in Australia, unless APRA has authorised the ADI to hold assets of a lesser value. During the year ended 30 September 2020, the Overseas Bank has at all times held assets (other than goodwill) in Australia of not less than the value of the Overseas Bank's total deposit liabilities in Australia.

i. General information (Unaudited) (continued)

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

The requirements of the above provisions have the potential to impact on the management of the liquidity of the New Zealand business of the Overseas Bank.

Guarantee arrangements

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

Directorate

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

Name: John McFarlane, MA, MBA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Unibail-Rodamco-Westfield SE and Old Oak Holdings Ltd.
Name: Peter King, BEc, FCA **Non-executive:** No **Country of Residence:** Australia **Primary Occupation:** Managing Director & Chief Executive Officer **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** No	**External Directorships:** Director of Australian Banking Association Incorporated and Institute of International Finance.
Name: Nerida Caesar, BCom, MBA, GAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of Workplace Giving Australia Limited and Director of Spark Investment Holdco Pty Ltd.
Name: Catriona Alison Deans, BA, MBA, GAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Cochlear Limited, Ramsay Health Care Limited, SCEGGS Darlinghurst Limited, The Observership Program Limited and Deputy Group Pty Ltd.
Name: Craig Dunn, BCom, FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of The Australian Ballet. Director of Telstra Corporation Limited.

Registered bank disclosures

i. General information (Unaudited) (continued)

Directorate (continued)

Name: Steven Harker, BEc (Hons.), LLB **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of ASX Refinitiv Charity Foundation, New South Wales Golf Club Foundation Limited, The Banking and Finance Oath Limited and The Hunger Project Australia.
Name: Peter Marriott, BEc (Hons.), FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of Austraclear Limited, ASX Limited, ASX Settlement Corporation Limited and ASX Clearing Corporation Limited.
Name: Peter Nash, BCom, FCA, F Fin **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes, Chairman **Independent Director:** Yes	**External Directorships:** Chairman of Johns Lyng Group Limited. Director of ASX Limited, Mirvac Group, Reconciliation Australia Limited and Golf Victoria Limited.
Name: Margaret Seale, BA, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Scentre Group Limited and Telstra Corporation Limited.
Name: Christopher Lynch, BCom. MBA. FCPA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of Business for Millennium Development Ltd.

Changes to Directorate

On 23 September 2020, the Overseas Bank announced that Michael (Mike) Hawker AM will be appointed as a Non-executive Director effective in November 2020 and also announced that Alison Deans a Non-executive Director of the Overseas Bank would retire from the Board at the conclusion of the 2020 Annual General Meeting, to be held on 11 December 2020.

Registered bank disclosures

i. General information (Unaudited) (continued)

Chief Executive Officer, NZ Branch

Name: Simon James Power QSO, BA, LLB, MA (Dist.), AMP (Harvard), CMinstD, INFINZ (Fellow)
Country of Residence: New Zealand
Primary Occupation: Chief Executive Officer, NZ Branch
Secondary Occupations: GM, Institutional & Business Banking (previously Commercial, Corporate and Institutional), Westpac New Zealand
External Directorships: Director of Westpac Chopper Appeal Charitable Trust Board, Chair of King's College Board of Governors, Trustee of King's College Foundation, Board Member of New Zealand International Business Forum and Honorary Adviser to the Asia New Zealand Foundation.

Responsible person

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

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

Address for communications

All communications may be sent to the Directors, the Chief Executive Officer, NZ Branch and the Responsible Person at the head office of the NZ Branch at Westpac on Takutai Square, 16 Takutai Square, Auckland 1010, New Zealand.

Board Audit Committee

There is a Board Audit Committee that covers audit matters, comprising of four directors, all of whom are independent directors.

Conflicts of interest policy

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

i. give notice to the Board of any direct or indirect interest in any contract, proposed contract or other matter with the Overseas Bank as soon as practicable after the relevant facts have come to that Director's knowledge. Alternatively, a Director may give to the Board a general notice to the effect that the Director is to be regarded as interested in any present or prospective contract or other matter between the Overseas Bank and a person or persons specified in that notice; and
ii. in relation to any matter that is to be considered at a Directors' meeting in which that Director has a material personal interest, not vote on the matter nor be present while the matter is being considered at the meeting (unless the remaining Directors have previously resolved to the contrary).

Auditor

PricewaterhouseCoopers

PwC Tower, Level 27

15 Customs Street West

Auckland, New Zealand

Registered bank disclosures

i. General information (Unaudited) (continued)

Credit ratings

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

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

On 9 July 2019, S&P Global Ratings affirmed the Overseas Bank's long-term issuer default rating at AA- and revised the outlook to stable from negative. On 8 April 2020, S&P Global Ratings affirmed the Overseas Bank's long-term issuer default rating of AA- and revised the outlook to negative from stable.

On 17 July 2019, Fitch affirmed the Overseas Bank's long-term rating at AA- but revised its outlook to negative from stable, in line with its outlook for all the major Australian banks. On 7 April 2020, Fitch downgraded the long-term credit ratings for the major Australian banks (including the Overseas Bank) by one notch, to A+ (from AA-) and the outlook remained negative. This change in rating reflected the major downgrade risk to Fitch's economic outlook in light of the evolving global situation.

The rating for Moody's has remained unchanged during the two years immediately preceding the signing date.

Descriptions of credit rating scales[1]

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

[1] This is a general description of the rating categories based on information published by Fitch Ratings, Moody's and S&P Global Ratings.

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

The Overseas Bank's current position is indicated in bold.

i. General information (Unaudited) (continued)

Historical summary of financial statements

	NZ BANKING GROUP				
$ millions	**2020**	2019	2018	2017	2016
Income statement					
Interest income	**3,596**	4,119	4,067	3,981	4,172
Interest expense	**(1,703)**	(2,121)	(2,155)	(2,193)	(2,398)
Net interest income	**1,893**	1,998	1,912	1,788	1,774
Non-interest income	**460**	562	573	625	588
Net operating income before operating expenses and impairment charges	**2,353**	2,560	2,485	2,413	2,362
Operating expenses	**(1,082)**	(1,018)	(940)	(1,006)	(953)
Impairment (charges)/benefits	**(320)**	10	3	76	(73)
Profit before income tax	**951**	1,552	1,548	1,483	1,336
Income tax expense	**(270)**	(423)	(431)	(424)	(373)
Net profit for the year	**681**	1,129	1,117	1,059	963
Net profit for the year attributable to:					
Head office account and owners of the NZ Banking Group	**681**	1,129	1,117	1,059	963
Dividends paid on ordinary share capital	**(346)**	(807)	(572)	(316)	(111)
Balance sheet					
Total assets	**113,196**	106,762	96,656	95,666	93,358
Total individually impaired assets	**137**	69	145	173	222
Total liabilities	**104,151**	98,105	88,273	87,835	86,321
Total head office account	**2,378**	2,289	2,169	2,040	1,913
Total equity	**9,045**	8,657	8,383	7,831	7,037

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

Other material matters

Reserve Bank Capital Review

On 5 December 2019, the Reserve Bank announced changes to the capital adequacy framework in New Zealand. The new framework includes the following key components:

- Setting a Tier 1 capital requirement of 16% of risk-weighted assets ('**RWA**') for systemically important banks (including Westpac New Zealand) and 14% for all other banks;
- Additional Tier 1 capital ('**AT1**') can comprise no more than 2.5% of the 16% Tier 1 capital requirement;
- Eligible Tier 1 capital will comprise common equity and redeemable perpetual preference shares. Existing AT1 instruments will be phased out over a seven-year period;
- Maintaining the existing Tier 2 capital requirement of 2% of RWA; and
- Recalibrating RWA for internal rating based banks, such as Westpac New Zealand, such that aggregate RWA will increase to approximately 90% of standardised RWA.

Westpac New Zealand is already strongly capitalised with a Tier 1 capital ratio of 15% as at 30 September 2020 based on the current Reserve Bank rules. On a pro forma basis, (including the new RWA and capital requirements) as at 30 September 2020 and assuming a Tier 1 capital ratio of 16-17%, Westpac New Zealand would require a further NZ$1.6-$2.2 billion of Tier 1 capital to meet the new requirements that are fully effective in 2028.

In response to the impacts of COVID-19, and to support credit availability, the Reserve Bank has delayed the start date of the new capital regime until 1 July 2022. Banks will be given up to seven years to comply.

Registered bank disclosures

i. General information (Unaudited) (continued)

AUSTRAC proceedings issued against the Overseas Bank

On 20 November 2019, the Australian Transaction Reports and Analysis Centre ('**AUSTRAC**'), the Australian financial crime regulator, commenced civil proceedings in the Federal Court of Australia ('**Federal Court**') against the Overseas Bank in relation to alleged contraventions of the Australian Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth) ('**AML/CTF Act**'). These proceedings related to non-reporting of a large number of international fund transfer instructions ('**IFTIs**') and a failure to include in a number of IFTIs required information about the payer, failings in relation to record keeping and the passing on of certain data required in IFTIs, failure to comply with correspondent banking obligations, AML/CTF Program failures and contraventions of the Overseas Bank's ongoing customer due diligence obligations. AUSTRAC alleged over 23 million contraventions of the AML/CTF Act.

On 24 September 2020, the Overseas Bank reached an agreement with AUSTRAC to resolve the proceedings, subject to Federal Court approval. Under the agreement, the parties agreed to file with the Federal Court a Statement of Agreed Facts and Admissions ('**SAFA**'), and to recommend to the Federal Court that the Overseas Bank pay a civil penalty of $1.3 billion in relation to in excess of 23 million admitted contraventions of the AML/CTF Act. The Overseas Bank also agreed to pay AUSTRAC's legal costs of $3.75 million. The settlement was approved by the Federal Court on 21 October 2020.

As part of the SAFA, the Overseas Bank admitted to additional contraventions of the AML/CTF Act to those in its Defence of May 2020 and to the new allegations in the Amended Statement of Claim that AUSTRAC filed with the Federal Court on 24 September 2020. Those additional admitted contraventions relate to the reporting of 76,144 IFTIs that did not contain the required information about the payer, two additional failures to comply with correspondent banking due diligence obligations, a failure to conduct appropriate ongoing customer due diligence in relation to a number of additional customers, and aspects of Part A of the Overseas Bank's AML/CTF Program not fully complying with the requirements under the AML/CTF Act and the Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No.1).

On 17 December 2019, APRA commenced an investigation examining potential contraventions by the Overseas Bank, its directors and/or senior managers of the Australian Banking Act (including the Banking Executive Accountability Regime) and/or APRA's Prudential Standards by engaging in, and the way it responded to, the conduct the subject of the AUSTRAC proceedings. On 17 June 2020, APRA delegated certain of its enforcement powers under the Australian Banking Act to the Australian Securities and Investments Commission ('**ASIC**'). Following that delegation, ASIC will examine potential contraventions under the Australian Banking Act by the Overseas Bank, its directors and/or senior managers. APRA has retained its power to administratively disqualify certain individuals under the Australian Banking Act. ASIC has commenced an extensive investigation into matters related to the AUSTRAC proceedings.

The Overseas Bank is also defending a class action proceeding which was commenced in December 2019 in the Federal Court by law firm Phi Finney McDonald, on behalf of certain investors in the Overseas Bank's securities between 16 December 2013 and 19 November 2019. The proceeding involves allegations relating to market disclosure issues connected to the Overseas Bank's monitoring of financial crime over the relevant period and matters the subject of the AUSTRAC proceedings. The claims do not identify the amount of any damages sought. However, given the time period in question and the nature of the claims, it is likely that the damages which will be alleged will be significant.

Business Finance Guarantee Scheme

On 13 April 2020 Westpac New Zealand entered into a deed of indemnity with the New Zealand Government to implement the New Zealand Government's business finance guarantee scheme ('**Scheme**'). The key terms of the Scheme, which were amended on 20 August 2020, are as follows:

- the Scheme permits banks to lend up to $5,000,000 to qualifying borrowers for a maximum of five years; and
- the New Zealand Government will pay 80% of any loss incurred by Westpac New Zealand on a loan it makes under the Scheme, after Westpac New Zealand has exhausted its recoveries procedures,

in each case, subject to the terms of the Scheme.

Freeze on dividends and restrictions on the distributions of additional Tier 1 capital instruments by NZ Banks

On 2 April 2020, a decision was made by the Reserve Bank to freeze the distribution of dividends on ordinary shares and to restrict the extent to which distributions on additional Tier 1 capital instruments are permitted by all locally incorporated banks in New Zealand (including Westpac New Zealand) during the period of economic uncertainty caused by COVID-19. On 11 November 2020, the Reserve Bank announced that these restrictions will be retained until at least 31 March 2021. Non-payment of dividends from Westpac New Zealand only affects the Overseas Bank's Level 1 CET1 capital ratio.

The Overseas Bank is well capitalised and at 30 September had a Level 1 CET1 capital ratio of 11.40%.

Reserve Bank steps to support liquidity and customer lending

On 16 March 2020 the Reserve Bank announced that it would provide term funding through a Term Auction Facility ('**TAF**') to give banks (including Westpac New Zealand) the ability to access term funding, with collateralised loans out to a term of twelve months, in order to alleviate pressures in funding markets as a result of COVID-19.

On 2 April 2020, the Reserve Bank reduced the minimum core funding ratio for banks (including Westpac New Zealand) to 50% from 75%.

From 26 May 2020, for a period of six months, the Reserve Bank will make available a Term Lending Facility ('**TLF**'), to offer loans for a fixed term of three years at the rate of the Official Cash Rate, with access to the funds linked to banks' lending under the Scheme. On 20 August 2020, the Reserve Bank announced it would extend the availability of the TLF to 1 February 2021 with terms of five years.

i. General information (Unaudited) (continued)

On 11 November 2020, the Reserve Bank announced that additional stimulus would be provided through a Funding for Lending Programme ('**FLP**'), commencing in December 2020. The FLP will provide funding to banks at the prevailing OCR for a term of three years, secured by high quality collateral. The size of funding available under the FLP will include an initial allocation of 4% of each bank's total loans and advances to New Zealand households, private non-financial businesses, and non-profit institutions serving households (eligible loans). A conditional additional allocation of up to 2% of eligible loans will also be made available, subject to growth in eligible loans, for a total size of up to 6% of eligible loans. Terms and conditions of the FLP are yet to be made available by the Reserve Bank.

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

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

The most recently published financial statements of the Overseas Bank and the Overseas Banking Group are for the year ended 30 September 2020 and for the six months ended 31 March 2020, respectively, and can be accessed at the internet address www.westpac.com.au.

ii. Additional financial disclosures

Additional information on balance sheet

	NZ BANKING GROUP	
$ millions	**2020**	2019
Interest earning and discount bearing assets	**104,034**	97,740
Interest and discount bearing liabilities	**84,775**	83,028
Total liabilities of the NZ Branch, net of amounts due to related entities	**9,020**	9,098
Total retail deposits of the NZ Branch	**-**	-

Additional information on concentrations of credit risk

Refer to Note 32.2.3 Credit risk concentrations for additional Information on concentration of credit exposure, in terms of customer and industry sector and material credit risk exposure to the agricultural sector, using the Australian and New Zealand Industrial Classification 2006.

Additional information on interest rate sensitivity

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

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the NZ Banking Group's net asset position as at 30 September 2020. The NZ Banking Group uses this contractual repricing information as a base, which is then altered to take account of customer behaviour, to manage its interest rate risk.

Registered bank disclosures

ii. Additional financial disclosures (continued)

	NZ BANKING GROUP						
	2020						
$ millions	Up to 3 Months	Over 3 Months Up to 6 Months	Over 6 Months 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	4,167	-	-	-	-	321	4,488
Collateral paid	397	-	-	-	-	-	397
Trading securities and financial assets measured at FVIS	2,741	464	605	33	381	-	4,224
Derivative financial instruments	-	-	-	-	-	5,660	5,660
Investment securities	-	172	521	331	3,997	-	5,021
Loans	44,877	7,119	18,425	14,777	3,441	(285)	88,354
Other financial assets	55	-	-	-	-	500	555
Life insurance assets	-	-	-	-	-	375	375
Due from related entities	1,531	-	-	-	-	1,182	2,713
Total financial assets	53,768	7,755	19,551	15,141	7,819	7,753	111,787
Non-financial assets							1,409
Total assets							113,196
Financial liabilities							
Collateral received	508	-	-	-	-	-	508
Deposits and other borrowings	44,484	10,178	5,714	1,440	583	11,571	73,970
Other financial liabilities	1,507	-	-	-	-	472	1,979
Derivative financial instruments	-	-	-	-	-	5,417	5,417
Due to related entities	1,470	-	-	-	-	1,090	2,560
Debt issues	4,925	1,510	2,147	2,371	4,718	128	15,799
Loan capital	1,123	-	-	-	2,097	-	3,220
Total financial liabilities	54,017	11,688	7,861	3,811	7,398	18,678	103,453
Non-financial liabilities							698
Total liabilities							104,151
On-balance sheet interest rate repricing	(249)	(3,933)	11,690	11,330	421		
Net derivative notional principals							
Net interest rate contracts (notional):							
Receivable/(payable)	14,405	(12,321)	1,183	(5,790)	2,523		
Net interest rate repricing gap	14,156	(16,254)	12,873	5,540	2,944		

Additional information on liquidity risk

Refer to Note 32.3.4 Contractual maturity of financial liabilities which shows the maturity analyses of financial liabilities.

ii. Additional financial disclosures (continued)

Overseas Banking Group profitability and size

Information on the Overseas Banking Group is from the most recently published financial statements of the Overseas Banking Group for the year ended 30 September 2020.

Profitability	30 Sep 20
Net profit after tax for the year ended 30 September 2020 (A$ millions)[1]	**2,292**
Net profit after tax for the year ended 30 September 2020 as a percentage of average total assets	**0.3%**

Total assets and equity	30 Sep 20
Total assets (A$ millions)	**911,946**
Percentage change in total assets over the year ended 30 September 2020	**0.6%**
Total equity (A$ millions)	**68,074**

[1] Net profit after tax represents the amount before deductions for net profit attributable to non-controlling interests.

Reconciliation of mortgage-related amounts

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

	NZ BANKING GROUP
$ millions	**30 Sep 20**
Residential mortgages - total gross loans (as disclosed in Note 11 and Note 32.2.4)	**55,230**
Reconciling items:	
Unamortised deferred fees and expenses	**(199)**
Fair value hedge adjustments	**(141)**
Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages	**11,074**
Undrawn at default[1]	**(2,829)**
Residential mortgages by LVR (as disclosed in Additional mortgage information in Section iv.)	**63,135**

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

Registered bank disclosures

iii. Asset quality

Past due assets

	NZ BANKING GROUP	
$ millions	**30 Sep 20**	30 Sep 19
Past due but not individually impaired assets		
Less than 30 days past due	**3,142**	1,288
At least 30 days but less than 60 days past due	**328**	151
At least 60 days but less than 90 days past due	**73**	69
At least 90 days past due	**343**	113
Total past due but not individually impaired assets	**3,886**	1,621

Movements in components of loss allowance

Refer to Note 12 Provision for expected credit losses for the movements in the NZ Banking Group's loss allowance components, as required by NZ IFRS 9.

Impacts of changes in gross financial assets on loss allowances - total

The following table explains how changes in gross carrying amounts of loans during the year have contributed to changes in the provision for ECL on loans.

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total
Total gross carrying amount as at 30 September 2019	**80,435**	**4,064**	**379**	**69**	**84,947**
Transfers:					
Transfers to Stage 1	**7,406**	**(7,273)**	**(132)**	**(1)**	**-**
Transfers to Stage 2	**(11,305)**	**11,765**	**(446)**	**(14)**	**-**
Transfers to Stage 3 CAP	**(101)**	**(864)**	**971**	**(6)**	**-**
Transfers to Stage 3 IAP	**(1)**	**(75)**	**(32)**	**108**	**-**
Net further lending/(repayment)	**(3,994)**	**117**	**(10)**	**(6)**	**(3,893)**
New financial assets originated	**20,715**	**-**	**-**	**-**	**20,715**
Financial assets derecognised during the year	**(11,983)**	**(655)**	**(124)**	**(8)**	**(12,770)**
Amounts written-off	**-**	**-**	**(33)**	**(5)**	**(38)**
Total gross carrying amount as at 30 September 2020	**81,172**	**7,079**	**573**	**137**	**88,961**
Provision for ECL as at 30 September 2020	**(96)**	**(331)**	**(107)**	**(73)**	**(607)**
Total net carrying amount as at 30 September 2020	**81,076**	**6,748**	**466**	**64**	**88,354**

iii. Asset quality

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total
Total gross carrying amount as at 1 October 2018	76,946	3,775	383	80	81,184
Transfers:					
Transfers to Stage 1	4,205	(4,108)	(92)	(5)	-
Transfers to Stage 2	(5,058)	5,176	(115)	(3)	-
Transfers to Stage 3 CAP	(158)	(347)	519	(14)	-
Transfers to Stage 3 IAP	(6)	(2)	(40)	48	-
Net further lending/(repayment)	(2,475)	228	(76)	(24)	(2,347)
New financial assets originated	17,749	-	-	-	17,749
Financial assets derecognised during the year	(10,768)	(658)	(147)	(8)	(11,581)
Amounts written-off	-	-	(53)	(5)	(58)
Total gross carrying amount as at 30 September 2019	80,435	4,064	379	69	84,947
Provision for ECL as at 30 September 2019	(76)	(164)	(53)	(28)	(321)
Total net carrying amount as at 30 September 2019	80,359	3,900	326	41	84,626

Other asset quality information

	NZ BANKING GROUP	
$ millions	**30 Sep 20**	30 Sep 19
Undrawn commitments with individually impaired counterparties	**5**	6
Other assets under administration	**-**	-

Overseas Banking Group asset quality

Information on the Overseas Banking Group is from the most recently published financial statements of the Overseas Banking Group for the year ended 30 September 2020.

	2020
Total individually impaired assets[1, 2] (A$ millions)	**2,779**
Total individually impaired assets expressed as a percentage of total assets	**0.3%**
Total individually assessed provision for ECL[3] (A$ millions)	**1,152**
Total individually assessed provision for ECL expressed as a percentage of total individually impaired assets	**41.5%**
Total collectively assessed provision for ECL[3] (A$ millions)	**5,548**

[1] Total individually impaired assets are before provision for ECL and net of interest held in suspense. Total individually impaired assets includes A$1,607 million of assets which are determined to be impaired, but which are not individually significant, and therefore have been grouped into pools of assets for the purpose of collectively calculating an impairment provision.

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

[3] Total individual provision for ECL and total collective provision for ECL both include A$541 million of provision for ECL that has been calculated collectively on groups of assets which have been determined to be impaired, but which are not individually significant.

iv. Credit and market risk exposures and capital adequacy (Unaudited)

Additional mortgage information

Residential mortgages by loan-to-value ratio ('LVR') as at 30 September 2020

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

The NZ Banking Group utilises data from its loan system to obtain origination valuations. For loans originated prior to 1 January 2008, or those originated outside of the loan system, the origination valuation is not recorded in the system and is therefore, due to system limitations, not available for disclosure. For these loans, the NZ Banking Group utilises the earliest valuation recorded as the closest available alternative to estimate an origination valuation.

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

	NZ BANKING GROUP					
	2020					
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	**23,648**	**13,126**	**13,755**	**3,088**	**1,273**	**54,890**
Undrawn commitments and other off-balance sheet exposures	**5,859**	**1,224**	**834**	**129**	**199**	**8,245**
Value of exposures	**29,507**	**14,350**	**14,589**	**3,217**	**1,472**	**63,135**

Market risk

Market risk notional capital charges

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

For each category of market risk, the NZ Banking Group's peak end-of-day aggregate capital charge is derived by determining the maximum over the six months ended 30 September 2020 of the aggregate capital charge for that category of market risk at the close of each business day derived in accordance with BS2A.

The following table provides a summary of the NZ Banking Group's notional capital charges by risk type as at the reporting date and the peak end-of-day notional capital charges by risk type for the six months ended 30 September 2020.

	NZ BANKING GROUP	
	2020	
$ millions	**Implied Risk-weighted Exposure**	**Notional Capital Charge**
End-of-period		
Interest rate risk	**5,516**	**441**
Foreign currency risk	**28**	**2**
Equity risk	**-**	**-**
Peak end-of-day		
Interest rate risk	**10,622**	**850**
Foreign currency risk	**113**	**9**
Equity risk	**-**	**-**

Overseas Bank and Overseas Banking Group capital ratios

Refer to Note 31 for information on the Overseas Bank and Overseas Banking Group capital ratios.

v. Insurance, securitisation, funds management, other fiduciary activities, and marketing and distribution of insurance products

Insurance business

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

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Total assets of insurance business	**238**	213
As a percentage of total consolidated assets of the NZ Banking Group	**0.21%**	0.20%

Non-consolidated insurance and non-financial activities

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

The NZ Banking Group's involvement in securitisation, funds management, other fiduciary activities, and marketing and distribution of insurance products

Securitisation

The NZ Banking Group uses structured entities to securitise its financial assets through the CB Programme and Westpac New Zealand's internal residential mortgage-backed securitisation programme. Refer to Note 29 Securitisation, covered bonds and other transferred assets for further information and amounts of outstanding securitised assets.

Funds management and other fiduciary activities

The NZ Banking Group conducts investment and other fiduciary activities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. These assets are not the property of the NZ Banking Group and accordingly are not included in these financial statements, with the exception of the PIE Funds which are treated as controlled entities of Westpac New Zealand (refer to Note 22 for further details) and life insurance assets owned by Westpac Life which are included in wholesale client portfolios. Where controlled entities incur certain liabilities in respect of these activities, a right of indemnity exists against the assets of the applicable trusts. As these assets are sufficient to cover liabilities, and it is not probable that the controlled entities will be required to settle them, the liabilities are not included in the consolidated financial statements.

The PIE Funds are managed by a member of the NZ Banking Group (refer to Note 22 for further details) and invest in deposits with Westpac New Zealand. Westpac New Zealand is considered to control the PIE Funds, and as such they are consolidated within the financial statements of the NZ Banking Group.

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

	NZ BANKING GROUP	
$ millions	**2020**	2019
Private and priority	**633**	688
Retirement plans	**8,210**	7,229
Retail unit trusts	**2,366**	2,615
Wholesale client portfolios	**759**	719
Term PIE	**1,944**	2,091
Cash PIE	**711**	687
Notice Saver PIE	**623**	639
Total funds under management	**15,246**	14,668

Other than funds under management disclosed above, there are no funds held in trust, funds under custodial arrangements or other funds held or managed subject to fiduciary responsibilities by any member of the NZ Banking Group (30 September 2019: nil).

Registered bank disclosures

v. Insurance, securitisation, funds management, other fiduciary activities, and marketing and distribution of insurance products (continued)

Marketing and distribution of insurance products

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

Arrangements to ensure no adverse impacts arising from the above activities

The NZ Banking Group's risk management strategy (refer to Note 32) will help minimise the possibility that any difficulties arising from the above activities would adversely impact the NZ Banking Group.

vi. Risk management policies

Information about risk

Risk management framework

The NZ Banking Group regards the management of risk to be a fundamental management activity performed at all levels of its business. The NZ Banking Group's risk management framework is designed to achieve our vision. This includes a sound risk culture and sets out minimum standards for risk management across all risk types ('**Risk Management Framework**'). The NZ Banking Group adopts a 'Three Lines of Defence' approach to risk management to ensure holistic end-to-end management of risk, where all employees play an active role in identifying and managing risk and operating within the NZ Banking Group's desired risk profile.

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

Business units are responsible for identifying, evaluating and managing the risks that they originate within approved risk appetite and policies. They are required to establish and maintain appropriate governance structures, risk management controls, resources and self-assessment processes, including issue identification recording and escalation procedures.

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

The 2nd Line of Defence comprises separate risk and compliance advisory, control, assurance and monitoring functions, which establish frameworks, controls, policies, limits and standards for the management, monitoring and reporting of risk. The 2nd Line of Defence may approve risks outside the business' risk appetite and also evaluate and provide assurance over the effectiveness of 1st Line controls, monitoring, compliance and assess progress towards mitigating risks. 2nd Line of Defence provide insight to 1st Line, assisting in developing, maintaining and enhancing the business' approach to risk management.

The 3rd Line of Defence – Independent assurance

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

Risk management frameworks

Further to the Directors' Statement on page 5:

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

vi. Risk management policies (continued)

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

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

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

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

Financial risks

Refer to Note 32 Financial risk management for a discussion of the financial risks faced by the NZ Banking Group.

Other key material risks

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The definition is aligned to the regulatory (Basel II) definition including legal and regulatory risk but excluding strategic and reputation risk.

Operational risk has the potential, as a result of the way business objectives are pursued, to negatively impact the NZ Banking Group's financial performance, customer service and/or reputation in the community or cause other damage to the business.

The NZ Banking Group applies the Overseas Bank's Operational Risk Management Framework ('**ORMF**') which outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management, and reporting and monitoring. The ORMF is approved by the Group BRCC. Westpac New Zealand has its own ORMF that is closely aligned with that of the Overseas Bank. The Westpac New Zealand ORMF is approved by the WNZL BRCC.

Compliance and conduct risk

Compliance and conduct risk is the risk of failing to abide by compliance obligations required of the Banking Group or otherwise failing to have behaviours and practices that deliver suitable, fair and clear outcomes for customers and that support market integrity.

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

The NZ Banking Group applies the Overseas Bank's Compliance and Conduct Risk Management Framework to assist the business in managing its compliance risks. The Framework is approved by the Group BRCC. Westpac New Zealand operates its own Compliance Risk Management Framework that is closely aligned with that of the Overseas Bank. The Westpac New Zealand Framework is approved by the WNZL BRCC.

Other risk classes include:

- Financial Crime: the risk that the NZ Banking Group fails to prevent financial crime and comply with applicable global financial crime regulatory obligations;
- Cyber Risk: the risk that the NZ Banking Group or its third parties' data or technology are inappropriately accessed, manipulated or damaged from cybersecurity threats or vulnerabilities;
- Strategic risk: the risk that the NZ Banking Group makes inappropriate strategic choices, does not implement its strategies successfully, or does not respond effectively to changes in the operating environment; and
- Reputation and Sustainability risk: the risk that an action, inaction, transaction, investment or event will reduce trust in the NZ Banking Groups' integrity and competence by clients, counterparties, investors, regulators, employees or the public.

vi. Risk management policies (continued)

Reviews of the NZ Banking Group's risk management systems

Group Audit's Credit Portfolio Review function has a rolling programme of credit and model risk reviews throughout the financial year. New Zealand Audit, with support from Group Audit, also periodically reviews the NZ Banking Group's Operational, Compliance, Market, Funding and Liquidity Risk Frameworks. The rolling and periodic reviews follow the audit methodology which aims at achieving a review of the very high risk areas annually and the high risk areas bi-annually, medium risk areas every three years and low risk areas every four years.

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

Various external reviews of the NZ Banking Group's risk management system have been conducted during the year ended 30 September 2020 as part of ongoing compliance with regulatory requirements.

Internal audit function of the NZ Banking Group

Group Audit for the Overseas Banking Group ('**Group Audit**') comprises the Group Audit and Credit Portfolio Review (including Model Risk) functions. Group Audit provides the Board and Senior Executives with independent and objective evaluation of the adequacy and effectiveness of the Overseas Banking Group and NZ Banking Group's governance, risk management and internal controls. The New Zealand Audit function comprises a New Zealand based Audit team, supported by the Overseas Banking Group's Credit Portfolio Review (including Model Risk) functions. Group Audit reports on a quarterly basis, or more often as deemed appropriate, to the Overseas Bank's Board Audit Committee ('**Group BAC**'), to agree the budget and the annual audit plan and to report its findings. In addition, the Group BAC has private sessions with the General Manager Group Audit. Furthermore, the General Manager Group Audit reports to the Chair of the Group BAC, and for administrative purposes to the Overseas Bank's Chief Financial Officer, a member of the Overseas Bank's Executive Team.

As independent functions, New Zealand Audit and Group Audit have no direct authority over the activities of management. They have unlimited access to all of the NZ Banking Group's activities, records, property and employees. The scope of responsibility of New Zealand Audit covers systems of management control across all business activities and support functions at all levels of management within the NZ Banking Group. The level of risk across all material risk classes determines the scope and frequency of individual audits. The audit methodology aims at achieving a review of the very high risk areas annually and the high risk areas bi-annually, medium risk areas every 3 years and low risk areas every 4 years.

As set out in its Charter, the Group BAC assists the Board in fulfilling its responsibilities in relation to:

- overseeing the integrity of the financial statements and financial reporting systems of the Overseas Banking Group and its related bodies corporate;
- overseeing the external audit engagement, including the external auditor's qualifications, performance, independence and fees;
- oversight of the performance of the internal audit function;
- overseeing the integrity of the Overseas Banking Group and NZ Banking Group's corporate reporting, including the financial reporting and compliance with prudential regulatory reporting and professional accounting requirements; and
- reviewing, discussing with management and the external auditor, and assessing any significant financial reporting issues and judgements made in connection with the preparation of the financial reports and the processes used to monitor and comply with laws and regulations over financial information, reporting and disclosure.

Access to the Overseas Bank disclosures

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

Conditions of registration

Conditions of registration

The registration of Westpac Banking Corporation ("the registered bank") in New Zealand is subject to the following conditions, which applied from 1 May 2020:

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

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

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

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

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

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

   For the purposes of this condition of registration,:

   "insurance business" means the undertaking or assumption of liability as an insurer under a contract of insurance:

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

3. That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.

4. That no appointment to the position of the New Zealand chief executive officer of the registered bank shall be made unless:

   (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and

   (b) the Reserve Bank has advised that it has no objection to that appointment.

5. That Westpac Banking Corporation complies with the requirements imposed on it by the Australian Prudential Regulation Authority.

6. That Westpac Banking Corporation complies with the following minimum capital adequacy requirements, as administered by the Australian Prudential Regulation Authority:

   (a) Common Equity Tier 1 capital of Westpac Banking Corporation is not less than 4.5% of risk weighted exposures;

   (b) Tier 1 capital of Westpac Banking Corporation is not less than 6% of risk weighted exposures; and

   (c) Total capital of Westpac Banking Corporation is not less than 8% of risk weighted exposures.

7. That liabilities of the registered bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed $15 billion.

8. That the retail deposits of the registered bank in New Zealand do not exceed $200 million. For the purposes of this condition retail deposits are defined as deposits by natural persons, excluding deposits with an outstanding balance which exceeds $250,000.

In these conditions of registration,:

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

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

"generally accepted accounting practice" has the same meaning as in section 8 of the Financial Reporting Act 2013.

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

Non-compliance with conditions of registration

On 19 March 2020, the Overseas Bank was not compliant with condition of registration 7, which requires that the liabilities of the NZ Branch, net of amounts due to related parties, ('**NZ Liabilities**') do not exceed $15bn. Due to significant exchange rate and interest rate fluctuations resulting from the impact of the COVID-19 pandemic, liability under interest rate and cross currency swaps increased sharply, resulting in the NZ Liabilities increasing to $16.025bn on 19 March 2020. The NZ Liabilities fell back below $15bn the following day. The Overseas Bank continues to closely monitor its NZ Liabilities.

Conditions of registration

Westpac New Zealand conditions of registration

In February 2017 the Reserve Bank required Westpac New Zealand to obtain an independent review of its compliance with advanced internal rating-based aspects of the Reserve Bank's 'Capital Adequacy Framework (Internal Models Based Approach) (BS2B)' ('BS2B'). In June 2019, Westpac New Zealand presented the Reserve Bank with a submission providing an overview of its credit risk rating system and activities undertaken to address compliance issues and enhance risk management practices.

On 30 October 2019, the Reserve Bank informed Westpac New Zealand that it had accepted the submission and measures undertaken by Westpac New Zealand to achieve satisfactory compliance with BS2B, and that Westpac New Zealand would retain its accreditation to use internal models for credit risk in the calculation of its regulatory capital requirements. With effect from 31 December 2019, the Reserve Bank removed the requirement imposed on Westpac New Zealand since 31 December 2017 to maintain minimum regulatory capital ratios which were two percentage points higher than the ratios applying to other locally incorporated banks.

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

Westpac New Zealand has also disclosed in its disclosure statement for the year ended 30 September 2020 non-compliance with:

(i) condition of registration 22 relating to the Reserve Bank's BS11: Outsourcing Policy; and
(ii) condition of registration 14 relating to the Reserve Bank's BS13: Liquidity Policy.

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

Changes to conditions of registration

The Reserve Bank amended the Overseas Bank's conditions of registration with effect from 1 May 2020, to remove restrictions on the Overseas Bank's new residential mortgage lending at high loan-to-valuation ('**LVR**') ratios.

Independent auditor's report

To the Directors of Westpac Banking Corporation (the 'Directors')

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

This report includes our:

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

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

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

- the balance sheet as at 30 September 2020;
- the income statement for the year then ended;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended;
- the notes to the financial statements, which include the principal accounting policies; and
- the supplementary information required by Schedules 4, 7, 11 and 13 of the Order.

Our opinion

In our opinion:

- the NZ Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 11 and 13 of the Order and included within notes ii to vi of the registered bank disclosures):
  - i. comply with generally accepted accounting practice in New Zealand;
  - ii. comply with NZ IFRS and IFRS; and
  - iii. give a true and fair view of the financial position of the NZ Banking Group as at 30 September 2020, and its financial performance and cash flows for the year then ended.
- the supplementary information disclosed in accordance with Schedules 4, 7, 11 and 13 of the Order and included within notes ii, iii, v and vi of the registered bank disclosures:
  - i. has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
  - ii. is in accordance with the books and records of the NZ Banking Group; and
  - iii. fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

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Basis for opinion

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

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

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

Our firm carries out other services for the NZ Banking Group in the areas of other audit related services, which relate to assurance or agreed upon procedures on certain financial information performed in the role of auditor (or where most appropriate to be performed by the auditor), being the issue of comfort letters and agreed procedures reports in relation to debt issuance programmes, solvency projections, net tangible assets returns and solvency returns. These services also include audit and assurance services in respect of funds managed by the NZ Banking Group. In addition, certain partners and employees of our firm may deal with the NZ Banking Group on normal terms within the ordinary course of trading activities of the NZ Banking Group. These matters have not impaired our independence as auditor of the NZ Banking Group.

Key audit matters

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

Key Audit Matter

Provision for expected credit losses on loans and credit commitments

(Refer to Notes 6 and 12 of the financial statements)

The provision for expected credit losses (ECL) on loans and credit commitments was $657 million for the NZ Banking Group at 30 September 2020.

ECL is a probability-weighted estimate of the cash shortfalls expected to result from defaults over the relevant timeframe determined by evaluating a range of possible outcomes and taking into account the time value of money, past events, current conditions and forecasts of future economic conditions. The model to determine the ECL includes significant judgement in assumptions used in:

- determining when a significant increase in credit risk (SICR) has occurred;
- estimating forward-looking macroeconomic scenarios (MES) and applying a probability weighting to different scenarios;
- identifying and calculating adjustments to model output (overlays); and
- determining the completeness of stage 3 corporate individually assessed provisions.

There is also a significant volume of data used in the ECL model, which is sourced from relevant IT systems.

The economic uncertainty due to COVID-19 has also impacted certain judgements made by the NZ Banking Group, specifically relating to forward-looking assumptions applied to the probability of default of individual customers and the associated macroeconomic scenarios that are applied. In addition, with the increased uncertainties in the economic environment and limitations of historical data used to calibrate the models to the current stressed economic environment, overlays are required to address areas of potential risk not captured in the underlying ECL model. The NZ Banking Group has applied additional judgements through overlays related to the likelihood that changes in borrowers' circumstances have resulted in a SICR.

The principal considerations for our determination that the provision for ECL on loans and credit commitments is a key audit matter are:

How our audit addressed the Key Audit Matter

Our audit procedures included testing the effectiveness of controls relating to the NZ Banking Group's ECL estimation process, which included controls over the data, models and assumptions used in determining the provision for ECL on loans and credit commitments, as well as IT general controls related to the relevant IT systems.

Other significant audit procedures included:

- consideration of the methodology inherent within the models for SICR and MES against the requirements of NZ IFRS 9;
- the involvement of our credit risk modelling experts to evaluate the appropriateness of the models and the reasonableness of the assumptions applied within the models, including evaluating the results of management's model monitoring undertaken during the year;
- the involvement of our economics experts to assist in evaluating the reasonableness of the assumptions, economic variables and data applied in determining MES;
- the involvement of our credit risk modelling experts to challenge and assess the appropriateness of overlay adjustments due to COVID-19, including using challenger overlay approaches to provide evidence that the overlays recorded are reasonable;
- testing the completeness and accuracy of critical data elements used to calculate the overlays;
- observing the review, challenge and approval by an internal governance committee of MES, probability weightings and overlay adjustments used in the ECL model and assessing the reasonableness of decisions;
- controls and substantive testing on a sample basis of the input of critical data elements into source systems, and the flow and transformation of those critical data elements from source systems to the ECL model;
- for a sample of loans not identified as impaired, considering the latest financial information provided to the NZ Banking Group, to test the credit risk grade that has been allocated to the borrower and inspecting the valuation of collateral (where applicable) to test the loss given default factor, two critical data elements which involve significant management judgement;

(i) there was significant judgement and effort in evaluating audit evidence related to the model and assumptions used to determine the provision for ECL on loans and credit commitments;

(ii) there was significant judgement and effort in evaluating audit evidence related to the identification and calculation of overlay adjustments to the ECL due to the impacts of current conditions and forecasts of future economic conditions;

(iii) the nature and extent of audit testing related to critical data elements used in the model;

(iv) the audit effort involved the use of professionals with specialised skill and knowledge; and

(v) the nature and extent of audit testing related to IT general controls for the relevant IT systems used in determining the provision for ECL on loans and credit commitments.

- considering the impacts of events occurring subsequent to balance date on the ECL for loans and credit commitments; and
- assessing the appropriateness of the NZ Banking Group's disclosures against the requirements of NZ IFRS.

Operation of IT systems and controls

We focused on this area because the NZ Banking Group is heavily dependent on complex IT systems for the capture, processing, storage and extraction of significant volumes of transactions.

There are some areas of the audit where we seek to place reliance on system functionality including certain automated controls, system calculations and reports. Our reliance on these is dependent on the NZ Banking Group's IT General Control (ITGC) environment, in particular, user access maintenance and that changes to IT systems are authorised and made in an appropriate manner.

For significant financial statement line items, we gained an understanding of the business processes, key controls and IT systems used to generate and support those line items. Where relevant to our planned audit approach, we assessed the design and tested the operating effectiveness of the key ITGCs which support the continued integrity of the in-scope IT systems.

Our procedures over ITGCs focused on user access and change management and we also carried out tests, on a sample basis, of system functionality that was key to our audit approach.

Where we identified design or operating effectiveness matters relating to ITGCs and system functionality relevant to our audit, we performed alternative or additional audit procedures.

Our audit approach

Overview

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

The overall NZ Banking Group materiality: $62.5 million, which represents approximately 5% of a weighted average profit before income tax for the years ended 30 September 2018, 30 September 2019 and 30 September 2020.

We chose profit before income tax as the basis for our benchmark because, in our view, it is the benchmark against which the performance of the NZ Banking Group is most commonly measured by users, and is a generally accepted benchmark. We averaged the last three years' profit before taxation due to the significant impact of COVID-19 in the year ended 30 September 2020, with higher weighting applied to the current year.

As reported above, we have two key audit matters, being:

- Provision for expected credit losses on loans and credit commitments
- Operation of IT systems and controls

Materiality

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

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

Audit scope

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

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the NZ Banking Group, the accounting processes and controls, and the industry in which the NZ Banking Group operates. Certain operational processes which are critical to financial reporting for the NZ Banking Group are undertaken outside of New Zealand. We worked with a PwC member firm engaged in the Westpac Banking Corporation group audit to understand certain processes that supported material balances, classes of transactions and disclosures within the NZ Banking Group's financial statements. This enabled us to evaluate the effectiveness of the controls over those processes and consider the implications for the remainder of our audit work.

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

The Directors are responsible for the other information included in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 5, 84 to 91 and 101 to 102. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

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

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

The Directors are responsible, on behalf of Westpac Banking Corporation, for the preparation of the financial statements in accordance with Clause 25 of the Order, NZ IFRS and IFRS and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 11 and 13 of the Order.

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

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

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

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

This description forms part of our auditor's report.

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

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in note iv of the registered bank disclosures) for the year ended 30 September 2020:

i. we have obtained all the information and explanations that we have required; and

ii. in our opinion, proper accounting records have been kept by the NZ Banking Group as far as appears from an examination of those records.

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

We have examined the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in note iv of the registered bank disclosures for the year ended 30 September 2020.

Our conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in note iv of the registered bank disclosures, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

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

Basis for our conclusion

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

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

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

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

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

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

Who we report to

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

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants
24 November 2020

Auckland