Westpac New Zealand Limited

Annual Report and 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 (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (‘**Order**’).

In this Disclosure Statement, reference is made to:

- Westpac New Zealand Limited (otherwise referred to as the ‘**Bank**’);
- Westpac New Zealand Limited and its controlled entities (otherwise referred to as the ‘**Banking Group**’). Controlled entities of the Bank as at 30 September 2020 are set out in Note 22;
- Westpac Banking Corporation (otherwise referred to as the ‘**Ultimate Parent Bank**’); and
- Ultimate Parent Bank and its controlled entities (otherwise referred to as the ‘**Ultimate Parent Bank Group**’).

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.

Westpac New Zealand sustainability performance

Igniting financial possibilities

We are taking action to create a better future for the people who bank with us, work with us, invest in us or are part of our broader communities. We do this through our core business, and more widely by using our financial and economic expertise to generate positive economic, social and environmental outcomes for our customers and New Zealand.

Our three year 2018-2020 sustainability strategy has come to an end, and our 2025 Strategy will be launched early 2021.

Our commitment is Manaaki te ao, manaaki te tāngata, e tipu pūtea ora, and we will continue to help Aotearoa take action on climate change, support people and communities and help lift financial wellbeing.

For more information on our approach to sustainability visit www.westpacsustainability.co.nz.

Sustainability Strategy results for financial year 2020

Grow financial wellbeing – E tipu pūtea ora

Increased economic participation and inclusive prosperity is beneficial to all. We want all New Zealanders to be financially secure and independent, enabling them to reach their full potential. We aim to grow the financial capability of our communities and increase financial independence by helping Kiwis participate in the economy and grow their wealth.

	2020 targets	Progress
1.	20,000 financial education workshop participants	20,434 participants
2.	Introduce a new product or service to tackle financial exclusion[1]	1 complete, 1 in progress
3.	Provide $300m in lending to social and affordable housing[2]	$280m

Highlights for the year ended 30 September 2020 include:

- Partnered with MyMahi (an app to help young people become work-ready) on financial wellbeing.
- New Start initiative to ensure that when prisoners are released they have a valid ID, a bank account, a debit card, and can access online banking.
- Collaborated with New Zealand Housing Foundation to enable Waikato-Tainui to create a shared equity scheme helping their tribal members buy their own homes.
- SeniorNet partnership to support seniors throughout New Zealand to be digitally confident and engage with online banking safely.

Take action on climate change – Manaaki te ao

We want to lead New Zealand's transition to a resilient, low-emissions economy that continues to grow to the benefit of future generations.

	Targets	Progress
1.	Reduce our operational emissions by 30% by 2025 (2019 baseline)[3]	19%
2.	Convert 100% of our car fleet to electric vehicles or PHEV[4] by 2025	34%
3.	Provide $2 billion in lending to business customers to climate change solutions as at 30 September 2020	$1.6b

Climate change is a major threat to our environment, economy and wellbeing. It also presents opportunities for new products and services, technologies and jobs. We believe business and the financial sector has a major role to play.

Our strategy is to address climate change with urgency by disclosing, reducing and offsetting our own emissions, better understanding our exposure to climate risk and helping our customers manage their transition to a net zero economy through innovative sustainable finance structures. We want to ensure capital flows to those parts of the economy where it is needed most to facilitate that transition efficiently and effectively.

Highlights for the year ended 30 September 2020 include:

- Becoming the first New Zealand bank to be Toitū carbonzero certified. To achieve this, we are reducing our Carbon emissions by a further 30% by 2025, and offsetting the remainder by purchasing New Zealand native permanent forestry carbon credits.
- 'Westpac Warm Up', offering our home loan customers an interest-free loan of up to $10,000 to improve their homes' energy-efficiency by installing heat pumps, solar panels, ventilation, double glazing and insulation. To date, we have received 2,531 applications and had $14.45m drawn down.
- Entering into a $50 million, four-year sustainability-linked loan facility with Contact Energy, the first such loan issued by Westpac NZ and one of the first of its kind in New Zealand.
- Enabling Meridian Energy to launch its Green Finance Programme converting Meridian's existing retail bonds to green bonds as certified by the Climate Bonds Standard.
- Publishing the Bank's inaugural Climate Risk Report in line with the recommendations of the Taskforce for Climate-Related Financial Disclosure (TCFD).
- Co-chairing the Aotearoa Circle's Sustainable Finance Forum, which published its Report on making Aotearoa's financial system more sustainable. www.theaotearoacircle.nz/sustainablefinance.

Care for people & communities – Manaaki te tāngata

We want to help create thriving New Zealand communities and a workforce and society where everyone feels valued.

	2020 targets	Progress
1.	Raise $3 million for Westpac Rescue Choppers	$3.13m
2.	50% Women in Leadership	50.4%

Highlights for the year ended 30 September 2020 include:

- Receiving the Gender Tick, for initiatives including a gender inclusive culture, parental leave, safe workplace, flexible work, equal pay and leadership representation.

We're all in this together – supporting our communities through COVID-19

We have all been impacted by COVID-19 in different ways. Westpac has donated an extra $1 million to support New Zealand's rescue helicopters, which are facing a serious fundraising shortfall. We know that lockdown increased stress and so we partnered with Kiwibank to assist Sir John Kirwan to release his Mentemia mental health app free of charge to all New Zealanders.

[1] One initiative has been completed – Bank accounts for prisoners, and one initiative is in progress.
[2] Does not include Kiwibuild or shared equity.
[3] Environmental year runs 1 July to 30 June. CO_2e results include all Westpac business units based in New Zealand. In 2019, we changed the way we measure and report carbon emissions, to align with the Greenhouse Gas Protocol (2004) and ISO 14064-1:2006 Specification as required by Toitū Envirocare, our carbonzero programme certifier, which also resulted in setting a new 2025 target.
[4] Plug-in hybrid electric vehicles. In March 2020 we announced a revised target of 100% conversion by 2025, replacing the prior target of 30% by 2020 which was achieved in FY2019.

Annual report

Pursuant to section 211(3) of the Companies Act 1993, the shareholder of Westpac New Zealand Limited has agreed that the Annual Report of Westpac New Zealand Limited need not comply with the requirements of paragraphs (a), and (e) to (j) of subsection (1) and subsection (2) of section 211.

Accordingly, there is no information to be included in the Annual Report other than the financial statements for the year ended 30 September 2020 and the independent auditor's report on those financial statements.

For and on behalf of the Board of Directors:

J.A. Dawson

Chair

20 November 2020

D.A. McLean

Chief Executive

20 November 2020

Directors' statement

Each Director of the Bank believes, after due enquiry, that, as at the date on which this Disclosure Statement is signed, the Disclosure Statement:

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

(b) is not false or misleading.

Each Director of the Bank believes, after due enquiry, that over the year ended 30 September 2020:

(a) the Bank has complied with all conditions of registration that applied during that period, except as noted on pages 113 to 114;

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

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

This Disclosure Statement has been signed by all the Directors:

Janice Dawson

David McLean

Malcolm Bailey

Philippa Greenwood

Jonathan Mason

Mary Quin

Dated this 20th day of November 2020

Income statement for the year ended 30 September 2020

		THE BANKING GROUP	
$ millions	Note	**2020**	2019
Interest income:			
Calculated using the effective interest rate method	2	**3,511**	3,976
Other	2	**29**	35
Total Interest income	2	**3,540**	4,011
Interest expense	2	**(1,665)**	(2,068)
Net interest income		**1,875**	1,943
Net fees and commissions income	3	**228**	281
Other income	3	**15**	48
Net operating income before operating expenses and impairment charges		**2,118**	2,272
Operating expenses	4	**(1,030)**	(961)
Impairment (charges)/benefits	6	**(320)**	10
Profit before income tax		**768**	1,321
Income tax expense	7	**(218)**	(357)
Net profit attributable to the owners of the Banking Group		**550**	964

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

Statement of comprehensive income for the year ended 30 September 2020

	THE BANKING GROUP	
$ millions	**2020**	2019
Net profit attributable to the owners of the Banking Group	**550**	964
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	**(81)**	(106)
Transferred to income statement:		
Cash flow hedging instruments	**80**	77
Income tax on items taken to or transferred from equity:		
Investment securities	**(21)**	3
Cash flow hedging instruments	**-**	8
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)	**48**	(36)
Total comprehensive income attributable to the owners of the Banking Group	**598**	928

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

Balance sheet as at 30 September 2020

		THE BANKING GROUP	
$ millions	Note	**2020**	2019
Assets			
Cash and balances with central banks	33	**4,360**	1,864
Collateral paid		**148**	168
Trading securities and financial assets measured at fair value through income statement ('**FVIS**')	9	**2,437**	1,661
Derivative financial instruments	23	**599**	616
Investment securities	10	**5,021**	4,469
Loans	11	**87,959**	84,160
Other financial assets	13	**196**	178
Due from related entities	22	**1,094**	2,502
Property and equipment		**398**	137
Deferred tax assets	14	**280**	174
Intangible assets	15	**647**	636
Other assets		**53**	42
Total assets		**103,192**	96,607
Liabilities			
Collateral received		**419**	473
Deposits and other borrowings	16	**73,970**	65,606
Other financial liabilities	17	**287**	455
Derivative financial instruments	23	**293**	257
Debt issues	18	**15,799**	17,846
Current tax liabilities		**73**	72
Provisions	19	**206**	144
Other liabilities		**356**	96
Total liabilities excluding related entities liabilities		**91,403**	84,949
Due to related entities	22	**1,487**	1,632
Loan capital	20	**2,612**	2,609
Total related entities liabilities		**4,099**	4,241
Total liabilities		**95,502**	89,190
Net assets		**7,690**	7,417
Shareholder's equity			
Share capital	21	**7,300**	7,300
Reserves		**(25)**	(77)
Retained profits		**415**	194
Total shareholder's equity		**7,690**	7,417

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

Signed on behalf of the Board of Directors.

J.A. Dawson

20 November 2020

J.P. Mason

20 November 2020

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

	THE BANKING GROUP					
		Reserves				
$ millions	Share Capital	Available-for-sale Securities Reserve	Investment Securities Reserve	Cash Flow Hedge Reserve	Retained Profits	Total
As at 30 September 2018	5,100	9	-	(60)	2,229	7,278
Impact on adoption of new accounting standards	-	(9)	9	-	(24)	(24)
As at 1 October 2018 (restated)	5,100	-	9	(60)	2,205	7,254
Year ended 30 September 2019						
Net profit attributable to the owners of the Banking Group	-	-	-	-	964	964
Net gains/(losses) from changes in fair value	-	-	(8)	(106)	-	(114)
Income tax effect	-	-	3	30	-	33
Transferred to income statement	-	-	-	77	-	77
Income tax effect	-	-	-	(22)	-	(22)
Remeasurement of defined benefit obligations	-	-	-	-	(14)	(14)
Income tax effect	-	-	-	-	4	4
Total comprehensive income for the year ended 30 September 2019	-	-	(5)	(21)	954	928
Transactions with owners:						
Ordinary share capital issued (refer to Note 21)	2,200	-	-	-	-	2,200
Dividends paid on ordinary shares	-	-	-	-	(2,965)	(2,965)
As at 30 September 2019	7,300	-	4	(81)	194	7,417
Year ended 30 September 2020						
Net profit attributable to the owners of the Banking Group	**-**	**-**	**-**	**-**	**550**	**550**
Net gains/(losses) from changes in fair value	**-**	**-**	**74**	**(81)**	**-**	**(7)**
Income tax effect	**-**	**-**	**(21)**	**22**	**-**	**1**
Transferred to income statement	**-**	**-**	**-**	**80**	**-**	**80**
Income tax effect	**-**	**-**	**-**	**(22)**	**-**	**(22)**
Remeasurement of defined benefit obligations	**-**	**-**	**-**	**-**	**(5)**	**(5)**
Income tax effect	**-**	**-**	**-**	**-**	**1**	**1**
Total comprehensive income for the year ended 30 September 2020	**-**	**-**	**53**	**(1)**	**546**	**598**
Transactions with owners:						
Ordinary share capital issued (refer to Note 21)	**-**	**-**	**-**	**-**	**-**	**-**
Dividends paid on ordinary shares (refer to Note 21)	**-**	**-**	**-**	**-**	**(325)**	**(325)**
As at 30 September 2020	**7,300**	**-**	**57**	**(82)**	**415**	**7,690**

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

		THE BANKING GROUP	
$ millions	Note	**2020**	2019
Cash flows from operating activities			
Interest received		**3,511**	4,042
Interest paid		**(1,836)**	(2,095)
Non-interest income received		**241**	289
Operating expenses paid		**(850)**	(817)
Income tax paid		**(342)**	(373)
Cash flows from operating activities before changes in operating assets and liabilities		**724**	1,046
Net (increase)/decrease in:			
Collateral paid		**20**	(98)
Trading securities and financial assets measured at FVIS		**(773)**	(510)
Loans		**(4,018)**	(3,714)
Other financial assets		**(39)**	21
Due from related entities		**760**	(747)
Other assets		**(5)**	-
Net increase/(decrease) in:			
Collateral received		**(54)**	(3)
Deposits and other borrowings		**8,364**	2,504
Other financial liabilities		**(49)**	(83)
Due to related entities		**293**	33
Other liabilities		**1**	-
Net movement in external and related entity derivative financial instruments		**382**	417
Net cash provided by/(used in) operating activities	33	**5,606**	(1,134)
Cash flows from investing activities			
Purchase of investment securities		**(2,418)**	(2,009)
Proceeds from investment securities		**1,909**	1,387
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		**(621)**	(671)
Cash flows from financing activities			
Issue of ordinary share capital	21	**-**	2,200
Net movement in due to related entities		**(100)**	(625)
Proceeds from debt issues	18	**5,175**	8,707
Repayments of debt issues	18	**(7,193)**	(5,001)
Payments for the principal portion of lease liabilities		**(46)**	-
Dividends paid to ordinary shareholders	21	**(325)**	(2,965)
Net cash provided by/(used in) financing activities		**(2,489)**	2,316
Net increase/(decrease) in cash and cash equivalents		**2,496**	511
Cash and cash equivalents at the beginning of the year		**1,864**	1,353
Cash and cash equivalents at the end of the year	33	**4,360**	1,864

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:

- Westpac New Zealand Limited (otherwise referred to as the '**Bank**');
- Westpac New Zealand Limited and its controlled entities (otherwise referred to as the '**Banking Group**'). Controlled entities of the Bank as at 30 September 2020 are set out in Note 22;
- Westpac Banking Corporation (otherwise referred to as the '**Ultimate Parent Bank**'); and
- Ultimate Parent Bank and its controlled entities (otherwise referred to as the '**Ultimate Parent Bank Group**').

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

The Bank is a locally incorporated subsidiary of the Ultimate Parent Bank undertaking the Ultimate Parent Bank's New Zealand consumer and business banking operations.

The consolidated financial statements are for the Banking Group.

These financial statements were authorised for issue by the Board of Directors of the Bank (the '**Board**') on 20 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 Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) ('**Order**').

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

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

(ii) Historical cost convention

These financial statements have been prepared under the historical cost convention, as modified by applying fair value accounting to 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 or below.

Restatement of related party balances

Comparative information for the year ended 30 September 2019 has been restated to correctly reflect exposures to the overseas bank in relation to customer foreign currency deposits which were overstated. The impact of the restatement is a decrease of $69m in due from related entities and an equivalent decrease in due to related entities.

(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 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 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 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 Banking Group. The Banking Group considered the impact of COVID-19 on our assessment of extension options and concluded that they were unchanged. The Banking Group also considered the impact of COVID-19 on the carrying value of the ROU asset and determined there was no impairment.

The 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:

	THE 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 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 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 Banking Group on 1 October 2019. These amendments allow the 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.

The exceptions allowed by the amendments are being applied to the Banking Group's London Interbank Offered Rate ('**LIBOR**') linked hedge Relationships that mature after the LIBOR discontinuance date of 31 December 2021. 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.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

(v) 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 Banking Group's equity interest in the acquiree, over the fair value of the identifiable net assets acquired.

(vi) Foreign currency translation

Functional and presentational currency

The consolidated financial statements are presented in New Zealand dollars which is the 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.

(vii) Reserves

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.

b. Principles of consolidation

The Banking Group subsidiaries are entities which the Bank controls and consolidates as it is exposed to, or has rights to, variable returns from the entities, and can affect those returns through its power over the entities.

All transactions between entities within the 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.

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 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 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 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 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 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 Banking Group determines the business model at the level that reflects how groups of financial assets are managed. When assessing the business model the 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.

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, debt issues, due to related entities 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 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 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 Deferred tax assets
- Note 15 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

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 Banking Group to account for a change in contractual cash flows of a financial instrument or lease liability that result specifically from IBOR reform by updating the effective interest rate rather than recognising a modification gain or loss;
- allow the Banking Group to continue hedge accounting and not trigger a de-designation for certain changes arising specifically from IBOR reform; and
- require additional disclosures for financial instruments linked to LIBOR not yet converted to ARR, changes to risk management strategies arising from IBOR reform, and management of transition to ARR.

These amendments will impact the Banking Group's financial instruments that reference a LIBOR rate. The 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 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 Banking Group.

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

		THE 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		**1**	4
Investment securities		**102**	138
Loans		**3,393**	3,809
Due from related entities	22	**2**	3
Other interest income		**-**	1
Total interest income calculated using the effective interest rate method		**3,511**	3,976
Other			
Trading securities and financial assets measured at FVIS		**22**	29
Due from related entities	22	**7**	6
Total other		**29**	35
Total interest income		**3,540**	4,011

Interest expense			
Calculated using the effective interest rate method			
Collateral received		**3**	7
Deposits and other borrowings		**918**	1,289
Debt issues		**244**	285
Due to related entities	22	**18**	31
Loan capital	22	**110**	137
Other interest expense		**5**	4
Total interest expense calculated using the effective interest rate method		**1,298**	1,753
Other			
Deposits and other borrowings		**18**	18
Debt issues		**33**	22
Due to related entities	22	**-**	1
Other interest expense[1, 2]		**316**	274
Total other		**367**	315
Total interest expense		**1,665**	2,068
Net interest income		**1,875**	1,943

[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 and other income.

Net fees and commissions income

When another party is involved in providing goods or services to a Banking Group customer, the 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 Banking Group is acting as an agent for another party, the income earned by the 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 Banking Group has a future service obligation to customers under the 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.

	THE BANKING GROUP	
$ millions	**2020**	2019
Net fees and commissions income		
Facility fees	**54**	50
Transaction fees and commissions[1]	**212**	268
Other non-risk fee income[2]	**21**	24
Fees and commissions income	**287**	342
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	**228**	281
Other income		
Net ineffectiveness on qualifying hedges	**8**	2
Other non-interest income	**7**	46
Total other income	**15**	48
Total non-interest income	**243**	329

[1] Includes transaction fees and commissions due from related entities. Refer to Note 22.

[2] Includes management fees due from related entities. Refer to Note 22.

Deferred income in relation to the credit card loyalty programmes for the 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 Banking Group.

Notes to the financial statements

Note 3 Non-interest income (continued)

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.

	THE BANKING GROUP				
$ millions	Consumer Banking and Wealth	Commercial, Corporate and Institutional	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	**133**	**85**	**-**	**(6)**	**212**
Other non-risk fee income	**13**	**14**	**-**	**(6)**	**21**
Fees and commissions income	**179**	**115**	**-**	**(7)**	**287**
Fees and commissions expenses	**(59)**	**-**	**-**	**-**	**(59)**
Net fees and commissions income	**120**	**115**	**-**	**(7)**	**228**
Year ended 30 September 2019 (restated)					
Fees and commissions income					
Facility fees	28	15	-	7	50
Transaction fees and commissions	183	95	-	(10)	268
Other non-risk fee income	15	14	-	(5)	24
Fees and commissions income	226	124	-	(8)	342
Fees and commissions expenses	(62)	-	-	1	(61)
Net fees and commissions income	164	124	-	(7)	281

Note 4 Operating expenses

		THE BANKING GROUP	
$ millions	Note	**2020**	2019
Staff expenses		**514**	491
Operating lease rentals		**25**	58
Depreciation[1]		**99**	39
Technology services and telecommunications		**70**	92
Purchased services		**119**	111
Software amortisation costs		**66**	55
Related entities - management fees	22	**9**	4
Other		**128**	111
Total operating expenses		**1,030**	961

[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.

Notes to the financial statements

Note 5 Auditor's remuneration

	THE BANKING GROUP	
$'000s	**2020**	2019
Audit and audit related services		
Audit and review of financial statements[1]	**2,711**	2,295
Other audit related services[2]	**361**	224
Total remuneration for audit and other audit related services	**3,072**	2,519
Other services	**-**	-
Total remuneration for non-audit services	**-**	-
Total remuneration for audit, other audit related services and non-audit services	**3,072**	2,519

[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.

It is the 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 Banking Group is important.

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 19).

Uncollectable loans

A loan may become uncollectable in full or part if, after following the Banking Group's loan recovery procedures, the 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 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.

	THE 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 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.

	THE BANKING GROUP	
$ millions	**2020**	2019
Income tax expense		
Current tax:		
Current year	**324**	350
Prior year adjustments	**(1)**	4
Deferred tax (refer to Note 14)		
Current year	**(106)**	8
Prior year adjustments	**1**	(5)
Total income tax expense	**218**	357
Profit before income tax	**768**	1,321
Tax calculated at tax rate of 28%	**215**	370
Income not subject to tax	**-**	(12)
Expenses not deductible for tax purposes	**3**	-
Prior year adjustments	**-**	(1)
Total income tax expense	**218**	357

The effective tax rate for the year ended 30 September 2020 was 28.4% (30 September 2019: 27.0%).

Note 8 Imputation credit account

	THE BANKING GROUP	
$ millions	**2020**	2019
Imputation credits available for use in subsequent reporting periods	**1,244**	1,109

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 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).

	THE BANKING GROUP	
$ millions	**2020**	2019
Government and semi-government securities	**2,296**	1,064
Other debt securities	**141**	486
Reverse repurchase agreements	**-**	111
Total trading securities and financial assets measured at FVIS	**2,437**	1,661

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.

	THE 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

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:

	THE BANKING GROUP	
$ millions	**2020**	2019
Residential mortgages	**55,212**	51,487
Other retail	**3,299**	3,753
Corporate	**29,957**	29,124
Other	**92**	111
Total gross loans	**88,560**	84,475
Provision for ECL on loans (refer to Note 12)	**(601)**	(315)
Total net loans	**87,959**	84,160

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 19).

Measurement

The 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 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 Banking Group considers that the customer is unable to repay its credit obligations in full, irrespective of recourse by the 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 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.

Notes to the financial statements

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 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 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 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 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 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 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 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.

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.

	THE 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	**30**	**135**	**6**	**65**	**236**	20	89	3	22	134
Total provision for ECL on loans (refer to Note 11)	**95**	**326**	**107**	**73**	**601**	76	158	53	28	315
Provision for ECL on credit commitments										
Residential mortgages	**5**	**2**	**-**	**-**	**7**	3	1	-	-	4
Other retail	**7**	**11**	**-**	**1**	**19**	9	4	-	-	13
Corporate	**9**	**21**	**-**	**-**	**30**	3	17	-	-	20
Total provision for ECL on credit commitments (refer to Note 19)	**21**	**34**	**-**	**1**	**56**	15	22	-	-	37
Total provision for ECL on loans and credit commitments	**116**	**360**	**107**	**74**	**657**	91	180	53	28	352
Gross carrying amount	**80,836**	**7,023**	**572**	**129**	**88,560**	80,055	3,972	379	69	84,475
Coverage ratio (%)[1]	**0.14**	**5.13**	**18.71**	**57.36**	**0.74**	0.11	4.53	13.98	40.58	0.42

[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 Banking Group.

	THE 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**

	THE 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

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:

	THE 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)

	THE 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.

	THE 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 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 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).

	THE 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.

Note 12 Provision for expected credit losses (continued)

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

	THE 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 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 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 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.

Note 12 Provision for expected credit losses (continued)

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.

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 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 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 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:

	THE 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**

Notes to the financial statements

Note 12 Provision for expected credit losses (continued)

If the balance of COVID-19 support packages in Stage 1 moved to Stage 2 the 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.

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 Banking Group (30 September 2019: $43 million).

Note 13 Other financial assets

	THE BANKING GROUP	
$ millions	**2020**	2019
Accrued interest receivable	**109**	129
Trade debtors	**2**	2
Other	**85**	47
Total other financial assets	**196**	178

Note 14 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 Banking Group's critical accounting assumptions and estimates.

Note 14 Deferred tax assets (continued)

	THE BANKING GROUP	
$ millions	**2020**	2019
Deferred tax assets/(liabilities) comprise the following temporary differences:		
Provision for ECL on loans	**168**	88
Provision for ECL on credit commitments	**16**	10
Cash flow hedges	**31**	31
Provision for employee entitlements	**27**	20
Compliance, regulation and remediation provisions	**12**	12
Software, property and equipment	**(56)**	9
Lease liabilities[1]	**79**	-
Other temporary differences	**3**	4
Net deferred tax assets	**280**	174
The deferred tax (charge)/credit in income tax expense comprises the following temporary differences:		
Provision for ECL on loans	**80**	(14)
Provision for ECL on credit commitments	**6**	(2)
Provision for employee entitlements	**6**	2
Compliance, regulation and remediation provisions	**-**	9
Software, property and equipment	**(65)**	(1)
Lease liabilities[1]	**79**	-
Other temporary differences	**(1)**	3
Total deferred tax (charge)/credit in income tax expense	**105**	(3)
The deferred tax (charge)/credit in OCI comprises the following temporary differences:		
Cash flow hedges	**-**	8
Provision for employee entitlements	**1**	4
Total deferred tax (charge)/credit in OCI	**1**	12
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 Banking Group adopted NZ IFRS 16 on 1 October 2019. Comparatives have not been restated. Refer to Note 1 for further details.

Note 15 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 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 Banking Group monitors and manages its operations.

Note 15 Intangible assets (continued)

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.

	THE BANKING GROUP	
$ millions	**2020**	2019
Goodwill	**477**	477
Computer software	**170**	159
Total intangible assets	**647**	636

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 Banking Group continues to have considerable headroom when determining whether goodwill is recoverable, and no impairment should be recognised.

Significant assumptions used in recoverable amount calculations

The assumptions made for goodwill impairment testing for the Consumer Banking and Wealth 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 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 CGU.

	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%

The 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 Consumer Banking and Wealth CGU that would result in an indication of impairment or have a material impact on the Banking Group's reported results.

Notes to the financial statements

Note 16 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.

	THE 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

Note 17 Other financial liabilities

Accounting policy

Other financial liabilities include liabilities measured at amortised cost. Repurchase agreements are financial liabilities measured at FVIS and are included in due to related entities (refer to Note 22).

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.

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.

	THE BANKING GROUP	
$ millions	**2020**	2019
Accrued interest payable	**208**	331
Trade creditors and other accrued expenses	**61**	57
Interbank placements	**-**	54
Other	**18**	13
Total other financial liabilities	**287**	455
Other financial liabilities at fair value	**-**	-
Other financial liabilities at amortised cost	**287**	455
Total other financial liabilities	**287**	455

Note 18 Debt issues

Accounting policy

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

	THE 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

	THE 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 19 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 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 Banking Group of these matters (including applicable customer refunds) is made on a case-by-case basis and specific provisions are made where appropriate.

	THE BANKING GROUP	
$ millions	**2020**	2019
Annual leave and other employee benefits	**61**	61
Provision for ECL on credit commitments (refer to Note 12)	**56**	37
Compliance, regulation and remediation provisions[1]	**42**	44
Lease restoration obligations[2]	**31**	-
Other	**16**	2
Total provisions	**206**	144

[1] The Banking Group has raised an additional provision of $15 million during the year ended 30 September 2020 (30 September 2019: $42 million), This reflects an increase in the identified number of instances where issues requiring remediation had occurred, together with associated interest and programme costs. $16 million has been paid to customers (30 September 2019: $10 million) and $1 million of unutilised provisions were reversed during the year ended 30 September 2020 (30 September 2019: nil).

[2] The addition to the lease restoration provision reflects a reassessment of the cost of making good leasehold premises at the end of the 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 20 Loan capital

Accounting policy

Loan capital are instruments which qualify for inclusion as regulatory capital under the Reserve Bank Capital Adequacy Framework. 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.

	THE BANKING GROUP	
$ millions	**2020**	2019
Additional Tier 1 loan capital - Convertible subordinated perpetual notes[1]	**1,489**	1,488
Tier 2 loan capital - Convertible subordinated notes[1]	**1,123**	1,121
Total loan capital	**2,612**	2,609

[1] Net of capitalised transaction costs.

	THE BANKING GROUP	
$ millions	**2020**	2019
Movement reconciliation		
Balance at beginning of the year	**2,609**	2,622
Total cash movements	**-**	-
FX translation impact	**2**	(14)
Other[1]	**1**	1
Total non-cash movements	**3**	(13)
Balance at end of the year	**2,612**	2,609

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

Note 20 Loan capital (continued)

Additional Tier 1 loan capital

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

$	Issue date	Counterparty	Interest rate	Optional redemption date
NZ$1,500 million notes [1]	22 September 2017	New Zealand Branch of the Ultimate Parent Bank ('**NZ Branch**')	NZ 90 day bank bill rate + 3.9594% p.a.	21 September 2027 and every fifth anniversary thereafter

[1] The AT1 notes were issued by the Bank and rank equally amongst themselves and are subordinated to the claims of depositors and senior or less subordinated creditors of the Bank.

Interest payable

Quarterly interest payments on the AT1 notes are at the absolute discretion of the Bank and will only be paid if the payment conditions are satisfied, including that the interest payment will not result in the Bank becoming insolvent immediately following the interest payment; not result in a breach of the Reserve Bank Prudential Standards; and the payment date not falling on the date of a capital trigger event or non-viability trigger event. Interest payments are non-cumulative. If interest is not paid in full, the Bank may not determine or pay any dividends on its ordinary shares or undertake a discretionary buy back or capital reduction of the Bank's ordinary shares (except in limited circumstances).

Redemption

The Bank may elect to redeem all or some of the AT1 notes for their face value on 21 September 2027 and every fifth anniversary thereafter, subject to the Reserve Bank's prior written approval. Early redemption of all of the AT1 notes for certain tax or regulatory reasons is permitted subject to the Reserve Bank's prior written approval.

Conversion

If a capital trigger event or non-viability trigger event occurs, the Bank must convert some or all of the AT1 notes into a variable number of ordinary shares issued by the Bank (calculated with reference to the net assets of the Bank and the total number of ordinary shares on issue at the conversion date) that is sufficient, in the case of a capital trigger event, to return the Bank's Common Equity Tier 1 capital ratio to above 5.125% as determined by the Bank in consultation with the Reserve Bank; or, in the case of a non-viability trigger event, to satisfy the direction of the Reserve Bank or the decision of the statutory manager of the Bank. A capital trigger event occurs when the Bank determines, or the Reserve Bank notifies in writing that it believes, the Bank's Common Equity Tier 1 Capital ratio is equal to or less than 5.125%. A non-viability trigger event occurs when the Reserve Bank or the statutory manager (appointed pursuant to section 117 of the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act'**)) directs the Bank to convert or write off all or some of its AT1 notes.

If conversion of the AT1 notes does not occur within five business days of a capital trigger event or a non-viability trigger event, holders' rights in relation to the AT1 notes will be immediately and irrevocably terminated.

The Bank is able to elect to convert all the AT1 notes for certain tax or regulatory reasons (or in certain other circumstances).

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 [1]	8 September 2015	London Branch of the Ultimate Parent Bank	Australian 90 day bank bill rate + 2.87% p.a.	22 March 2026	22 March 2021 and every interest payment date thereafter

[1] The Tier 2 notes were issued by the Bank and rank equally amongst themselves and are subordinated to the claims of depositors and senior or less subordinated creditors of the Bank.

Interest payable

Interest payments on the Tier 2 notes are subject to the Bank being solvent at the time of, and immediately following the interest payment.

Early redemption

The Bank 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, the Bank must convert such number of the Tier 2 notes into a variable number of ordinary shares issued by the Bank (calculated with reference to the net assets of the Bank 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 the Bank to convert or write off all or some of its 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 21 Share capital

Accounting policy

Share capital

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

Ordinary shares fully paid

	THE BANKING GROUP	
	2020 Number of Shares Issued and Authorised	2019 Number of Shares Issued and Authorised
Balance at beginning of the year	**7,300,001,000**	5,100,001,000
Share capital issued	**-**	2,200,000,000
Balance at end of the year	**7,300,001,000**	7,300,001,000

In accordance with the Reserve Bank document BS2B ordinary share capital is classified as Common Equity Tier 1 capital.

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

On 13 February 2020, the Bank declared and paid a dividend of $325 million to its immediate parent company, Westpac New Zealand Group Limited ('**WNZGL**').

Note 22 Related entities

Related entities

The 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.

Banking Group

The Bank is a controlled entity of WNZGL. The ultimate parent bank of the Bank is Westpac Banking Corporation.

The Banking Group consists of the Bank and all its controlled entities. As at 30 September 2020, the Bank had the following controlled entities:

Name of entity	Principal activity	Notes
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	9.5% owned[2]
Westpac NZ Covered Bond Limited ('**WNZCBL**')	Guarantor	9.5% owned[2]
Westpac NZ Securitisation Holdings Limited ('**WNZSHL**')	Holding company	9.5% owned[3]
Westpac NZ Securitisation Limited ('**WNZSL**')	Funding company	9.5% owned[3]
Westpac NZ Securitisation No.2 Limited ('**WNZSL2**')	Non-active company	9.5% 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 Banking Group, through its subsidiary, WNZOL, has a qualifying interest of 9.5% in WNZCBHL and its wholly-owned subsidiary company, WNZCBL. The Bank 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 Banking Group.

[3] The Banking Group, through its subsidiary WNZOL, has a qualifying interest of 9.5% in WNZSHL and its wholly-owned subsidiary companies, WNZSL and WNZSL2. The Bank 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 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 BT Funds Management (NZ) Limited ('**BTNZ**') (an indirectly wholly-owned subsidiary of the Ultimate Parent Bank) is the manager and issuer. The manager has appointed the Bank to perform all customer management and account administration for the PIE Funds. The Bank is the PIE Funds' registrar and administration manager. The Bank 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 Banking Group.

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

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

Nature of transactions

The Banking Group has transactions with members of the Ultimate Parent Bank Group on commercial terms, including the provision of management, distribution and administrative services.

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

The NZ Branch provides financial market services, foreign currency, trade and interest rate risk products to the Banking Group and its customers, which includes derivative transactions (refer to Note 23).

Effective 1 October 2014, the Bank and the NZ Branch entered into an agreement whereby the Bank will reimburse the NZ Branch for any credit losses incurred by it due to certain customers of the Bank defaulting on certain financial market and international products. The Banking Group receives commission from the sale of these products to customers for providing this guarantee.

This is treated as a financial guarantee for accounting purposes. Financial guarantee contracts are recognised as financial liabilities (recorded within provisions) when a payment under a contract has become probable. The liability is initially measured at fair value and subsequently at the higher of the amount of the loss allowance determined in accordance with NZ IFRS 9 and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

Refer to Note 20 for details of the loan capital transactions undertaken by the Banking Group with related entities.

Notes to the financial statements

Note 22 Related entities (continued)

Transactions with related entities

$ millions	Note	THE BANKING GROUP 2020	2019
Ultimate Parent Bank			
Interest income[1]	2	**9**	9
Interest expense:			
Loan capital	2	**110**	137
Other[2]	2	**18**	31
Non-interest income:			
Commissions received		**45**	55
Management fees received		**3**	3
Operating expenses - management fees	4	**9**	4
Funding repaid		**-**	710
Immediate Parent Company			
Dividends paid	21	**325**	2,965
Other controlled entities of the Ultimate Parent Bank			
Interest expense:			
Interest expense - other	2	**-**	1
Non-interest income:			
Distribution fees received on managed fund products		**14**	15
Distribution fees received on life and general insurance products		**31**	31
Management fees received		**4**	4
Associate			
Dividends received		**-**	3

[1] Includes interest income on reverse repurchase agreements and cash held with the NZ Branch.

[2] Includes interest expense on other funding provided by and repurchase agreements with the NZ Branch.

Due from and to related entities

$ millions	THE BANKING GROUP 2020	2019
Due from related entities		
Ultimate Parent Bank	**1,085**	2,492
Other controlled entities of the Ultimate Parent Bank	**9**	10
Total due from related entities	**1,094**	2,502
Due from related entities at fair value[1]	**252**	1,703
Due from related entities at amortised cost	**842**	799
Total due from related entities	**1,094**	2,502
Due to related entities		
Ultimate Parent Bank	**1,432**	1,596
Other controlled entities of the Ultimate Parent Bank	**55**	36
Total due to related entities	**1,487**	1,632
Due to related entities at fair value[2]	**671**	820
Due to related entities at amortised cost	**816**	812
Total due to related entities	**1,487**	1,632

[1] Consists of reverse repurchase agreements of $69 million (30 September 2019: $872 million) and derivative financial instruments of $183 million (30 September 2019: $831 million) (refer to Note 23).

[2] Consists of repurchase agreements of $204 million (30 September 2019 : $10 million) and derivative financial instruments of $467 million (30 September 2019: $810 million) (refer to Note 23).

Notes to the financial statements

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 Banking Group. This includes all Executive/Non-Executive Directors and members of the executive team.

	THE BANKING GROUP	
$'000s	**2020**	2019
Salaries and other short-term benefits	**6,277**	7,590
Post-employment benefits	**667**	497
Share-based payments	**2,725**	3,330
Total key management personnel compensation	**9,669**	11,417
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

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

Loans and deposits with key management personnel

All loans and deposits are made in the ordinary course of business of the 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 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.

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 Banking Group uses derivative financial instruments for our asset and liability risk management ('**ALM**') 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 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 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.

Note 23 Derivative financial instruments (continued)

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.

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

	THE BANKING GROUP					
	2020					
	Trading		Hedging		Total derivatives carrying value	
$ millions	**Assets**	**Liabilities**	**Assets**	**Liabilities**	**Assets**	**Liabilities**
Interest rate contracts						
Swap agreements	**-**	**-**	**165**	**(553)**	**165**	**(553)**
Total interest rate contracts	**-**	**-**	**165**	**(553)**	**165**	**(553)**
FX contracts						
Cross currency swap agreements (principal and interest)	**10**	**(13)**	**607**	**(194)**	**617**	**(207)**
Total FX contracts	**10**	**(13)**	**607**	**(194)**	**617**	**(207)**
Total of gross derivatives	**10**	**(13)**	**772**	**(747)**	**782**	**(760)**
Impact of netting arrangements	**-**	**-**	**-**	**-**	**-**	**-**
Total of net derivatives	**10**	**(13)**	**772**	**(747)**	**782**	**(760)**
Consisting of:						
Derivatives held with external counterparties	**-**	**-**	**599**	**(293)**	**599**	**(293)**
Derivatives held with related parties	**10**	**(13)**	**173**	**(454)**	**183**	**(467)**

	THE BANKING GROUP					
	2019					
	Trading		Hedging		Total derivatives carrying value	
$ millions	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts						
Swap agreements	3	-	120	(565)	123	(565)
Total interest rate contracts	3	-	120	(565)	123	(565)
FX contracts						
Cross currency swap agreements (principal and interest)	498	(378)	826	(124)	1,324	(502)
Total FX contracts	498	(378)	826	(124)	1,324	(502)
Total of gross derivatives	501	(378)	946	(689)	1,447	(1,067)
Impact of netting arrangements	-	-	-	-	-	-
Total of net derivatives	501	(378)	946	(689)	1,447	(1,067)
Consisting of:						
Derivatives held with external counterparties	-	-	616	(257)	616	(257)
Derivatives held with related parties	501	(378)	330	(432)	831	(810)

Notes to the financial statements

Note 23 Derivative financial instruments (continued)

Hedge accounting

The 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 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 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 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 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 Banking Group primarily uses one-to-one hedge accounting to manage specific exposures.

The 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 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 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 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 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 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 Banking Group's ALM activities, economic hedges may be entered into to hedge long-term funding transactions.

Note 23 Derivative financial instruments (continued)

Interest Rate Benchmark Reform

The Banking Group's hedging relationships include hedged items and hedging instruments that are impacted by IBOR reform. As described in Note 1, the 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 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.

	THE BANKING GROUP
	30 Sep 20
$ millions	Notional hedged exposure
Benchmark	
USD LIBOR	**91**

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.

			THE 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**	**-**	**2,434**	**5**	**(180)**
	Cross currency swap	Interest rate risk	**1,823**	**4,426**	**356**	**6,605**	**111**	**(57)**
Cash flow hedges	Cross currency swap	FX risk	**4,509**	**5,823**	**356**	**10,688**	**496**	**(137)**
Total one-to-one hedge relationships			**7,005**	**12,010**	**712**	**19,727**	**612**	**(374)**
Macro hedge relationships								
Portfolio fair value hedges	Interest rate swap	Interest rate risk	**N/A**	**N/A**	**N/A**	**18,875**	**-**	**(180)**
Macro cash flow hedges	Interest rate swap	Interest rate risk	**N/A**	**N/A**	**N/A**	**12,741**	**160**	**(193)**
Total macro hedge relationships			**N/A**	**N/A**	**N/A**	**31,616**	**160**	**(373)**
Total of gross hedging derivatives			**N/A**	**N/A**	**N/A**	**51,343**	**772**	**(747)**
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**	**772**	**(747)**

			THE 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	421	4,591	13	(213)
	Cross currency swap	Interest rate risk	1,251	6,134	349	7,734	155	(100)
Cash flow hedges	Cross currency swap	FX risk	2,558	10,338	349	13,245	671	(24)
Total one-to-one hedge relationships			5,966	18,485	1,119	25,570	839	(337)
Macro hedge relationships								
Portfolio fair value hedges	Interest rate swap	Interest rate risk	N/A	N/A	N/A	16,375	-	(178)
Macro cash flow hedges	Interest rate swap	Interest rate risk	N/A	N/A	N/A	10,220	107	(174)
Total macro hedge relationships			N/A	N/A	N/A	26,595	107	(352)
Total of gross hedging derivatives			N/A	N/A	N/A	52,165	946	(689)
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	946	(689)

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:

				THE 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
			USD:NZD	**0.6855**	0.7230

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.

	THE 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]	**18,998**	**123**	16,496	121
Debt issues and loan capital	**(6,825)**	**(128)**	(8,215)	(169)

[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 $121m from $16,375m to $16,496m.

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:

	THE 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	**(39)**	**(73)**	**(112)**	(46)	(37)	(83)
Net gains/(losses) from changes in fair value	**(30)**	**(51)**	**(81)**	(40)	(66)	(106)
Transferred to net interest income	**45**	**35**	**80**	47	30	77
Balance at end of year	**(24)**	**(89)**	**(113)**	(39)	(73)	(112)

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:

			THE 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	**(5)**	**4**	**(1)**
	Cross currency swap	Interest rate risk	**(40)**	**39**	**(1)**
Cash flow hedges	Interest rate swap	Interest rate risk	**24**	**(14)**	**10**
	Cross currency swap	FX risk	**(16)**	**16**	**-**
Total			**(37)**	**45**	**8**

			THE 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	(146)	147	1
	Cross currency swap	Interest rate risk	150	(147)	3
Cash flow hedges	Interest rate swap	Interest rate risk	4	(6)	(2)
	Cross currency swap	FX risk	(35)	35	-
Total			(27)	29	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 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 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 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 Ultimate Parent Bank 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 Banking Group categorises all fair value instruments according to the hierarchy described below.

Valuation techniques

The 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.

Instrument	Balance sheet category	Includes:	Valuation
Non-asset backed debt instruments	Trading securities and financial assets measured at FVIS Investment securities	New Zealand Government bonds	These instruments are traded in liquid, active markets where prices are readily observable. No modelling or assumptions are used in the valuation.

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 – derivative financial instruments	Derived from market observable inputs or consensus pricing providers using industry standard models.
Non-asset backed debt instruments	Trading securities and financial assets measured at FVIS Investment securities Due from related entities Due to related entities	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 Bank's implied credit worthiness.

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

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.

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

	THE BANKING GROUP							
	2020				2019			
$ millions	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value on a recurring basis								
Trading securities and financial assets measured at FVIS	**1,064**	**1,373**	**-**	**2,437**	-	1,661	-	1,661
Derivative financial instruments	**-**	**599**	**-**	**599**	-	616	-	616
Investment securities	**2,504**	**2,517**	**-**	**5,021**	1,049	3,420	-	4,469
Due from related entities	**-**	**252**	**-**	**252**	-	1,703	-	1,703
Total financial assets measured at fair value	**3,568**	**4,741**	**-**	**8,309**	1,049	7,400	-	8,449
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
Derivative financial instruments	**-**	**293**	**-**	**293**	-	257	-	257
Debt issues at fair value	**-**	**2,502**	**-**	**2,502**	-	2,312	-	2,312
Due to related entities	**-**	**671**	**-**	**671**	-	820	-	820
Total financial liabilities measured at fair value	**-**	**6,462**	**-**	**6,462**	-	4,531	-	4,531

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).

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 Banking Group's credit spreads.
Due to related entities	The fair value of the loan due to related entities is estimated 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.

Notes to the financial statements

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

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

	THE BANKING GROUP				
	2020				
		Fair Value			
$ millions	**Carrying Amount**	**Level 1**	**Level 2**	**Level 3**	**Total**
Financial assets not measured at fair value					
Cash and balances with central banks	**4,360**	**4,360**	**-**	**-**	**4,360**
Collateral paid	**148**	**148**	**-**	**-**	**148**
Loans	**87,959**	**-**	**-**	**88,298**	**88,298**
Other financial assets	**196**	**-**	**-**	**196**	**196**
Due from related entities	**842**	**-**	**833**	**9**	**842**
Total financial assets not measured at fair value	**93,505**	**4,508**	**833**	**88,503**	**93,844**
Financial liabilities not measured at fair value					
Collateral received	**419**	**419**	**-**	**-**	**419**
Deposits and other borrowings	**70,974**	**-**	**69,937**	**1,179**	**71,116**
Other financial liabilities	**287**	**-**	**287**	**-**	**287**
Debt issues[1]	**13,297**	**-**	**13,517**	**-**	**13,517**
Due to related entities	**816**	**-**	**816**	**-**	**816**
Loan capital[1]	**2,612**	**-**	**-**	**2,737**	**2,737**
Total financial liabilities not measured at fair value	**88,405**	**419**	**84,557**	**3,916**	**88,892**

	THE BANKING GROUP				
	2019				
		Fair Value			
$ millions	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets not measured at fair value					
Cash and balances with central banks	1,864	1,864	-	-	1,864
Collateral paid	168	168	-	-	168
Loans	84,160	-	-	84,412	84,412
Other financial assets	178	-	-	178	178
Due from related entities	799	-	789	10	799
Total financial assets not measured at fair value	87,169	2,032	789	84,600	87,421
Financial liabilities not measured at fair value					
Collateral received	473	473	-	-	473
Deposits and other borrowings	64,464	-	63,974	564	64,538
Other financial liabilities	455	-	455	-	455
Debt issues[1]	15,534	-	15,701	-	15,701
Due to related entities	812	-	812	-	812
Loan capital[1]	2,609	-	-	2,703	2,703
Total financial liabilities not measured at fair value	84,347	473	80,942	3,267	84,682

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

Notes to the financial statements

Note 25 Offsetting financial assets and financial liabilities

Accounting policy

Financial assets and financial liabilities are presented net in the balance sheet when the 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 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 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 Banking Group are further explained in the 'Management of risk mitigation' section under Note 32.2.

	THE 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							
Derivative financial instruments	**599**	**-**	**599**	**(144)**	**(408)**	**-**	**47**
Due from related entities - reverse repurchase agreements[1]	**69**	**-**	**69**	**-**	**-**	**(69)**	**-**
Due from related entities - derivative financial instruments[1]	**183**	**-**	**183**	**(183)**	**-**	**-**	**-**
Total assets	**851**	**-**	**851**	**(327)**	**(408)**	**(69)**	**47**
Liabilities							
Derivative financial instruments	**293**	**-**	**293**	**(144)**	**(148)**	**-**	**1**
Due to related entities - repurchase agreements[2]	**204**	**-**	**204**	**-**	**-**	**(204)**	**-**
Due to related entities - derivative financial instruments[2]	**467**	**-**	**467**	**(183)**	**-**	**-**	**284**
Total liabilities	**964**	**-**	**964**	**(327)**	**(148)**	**(204)**	**285**

[1] Forms part of due from related entities on the balance sheet (refer to Note 22).
[2] Forms part of due to related entities in the balance sheet (refer to Note 22).

Notes to the financial statements

Note 25 Offsetting financial assets and financial liabilities (continued)

	THE 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]	111	-	111	-	-	(111)	-
Derivative financial instruments	616	-	616	(89)	(473)	-	54
Due from related entities - reverse repurchase agreements[2]	872	-	872	-	-	(872)	-
Due from related entities - derivative financial instruments[2]	831	-	831	(810)	-	-	21
Total assets	2,430	-	2,430	(899)	(473)	(983)	75
Liabilities							
Derivative financial instruments	257	-	257	(89)	(166)	-	2
Due to related entities - repurchase agreements[3]	10	-	10	-	-	(10)	-
Due to related entities - derivative financial instruments[3]	810	-	810	(810)	-	-	-
Total liabilities	1,077	-	1,077	(899)	(166)	(10)	2

[1] Forms part of trading securities and financial assets measured at FVIS (refer to Note 9).
[2] Forms part of due from related entities in the balance sheet (refer to Note 22).
[3] Forms part of due to related entities on the balance sheet (refer to Note 22).

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 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 Banking Group's leases, it is expected that the lease liability will only be required to be remeasured to reflect a change in the 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 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 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 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 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.

The 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

	THE 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

Note 26 Lessee disclosures (continued)

Lease liabilities

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

	THE 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:

	THE 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:

	THE 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 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.

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.

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

Undrawn credit commitments

Undrawn credit commitments expose the 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 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 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.

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

(a) WNZSL (pursuant to its securitisation programme) where the loan does not meet certain terms and conditions of the WNZSL securitisation programme;
(b) WNZCBL (pursuant to the Bank'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 Banking Group will arise from these obligations.

	THE BANKING GROUP	
$ millions	**2020**	2019
Letters of credit and guarantees[1]	**833**	828
Commitments to extend credit[2]	**27,891**	25,858
Total undrawn credit commitments	**28,724**	26,686

[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 Banking Group may hold cash as collateral for certain guarantees issued.

[2] Commitments to extend credit include all obligations on the part of the 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 Banking Group is exposed to contingent liabilities in respect of actual and potential claims and proceedings. An assessment of the Banking Group's likely loss in respect of these matters has been made on a case-by-case basis and provision has been made in these financial statements where appropriate and is probable.

Compliance, regulation and remediation

The 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 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 19.

Guarantees

As disclosed in Note 22, the Bank has an agreement with the NZ Branch whereby the Bank will reimburse the NZ Branch for any credit losses incurred by it due to certain customers of the Bank defaulting on certain financial market and international products.

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 Banking Group's chief operating decision-maker and reflects the management of the business, rather than the legal structure of the 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 Banking Group has determined that the Bank's 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 Banking Group's segment reporting incorporates 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 Banking Group does not rely on any single major customer for its revenue base.

Segment comparative information for the year 30 September 2019 has been restated to ensure consistent presentation with the current reporting period.

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

- Consumer Banking and Wealth provides financial services predominantly for individuals;
- Commercial, Corporate and Institutional Banking provides a broad range of financial services for commercial, corporate, property finance, agricultural, institutional and government customers; and
- 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 of the results, assets and liabilities of the Banking Group's controlled entities in the preparation of the consolidated financial statements of the Banking Group;
- results of certain entities included for management reporting purposes including insurance and investments, but excluded from the consolidated financial statements of the Banking Group for statutory financial reporting purposes; and
- results of certain business units excluded for management reporting purposes but included within the consolidated financial statements of the Banking Group for statutory financial reporting purposes.

Notes to the financial statements

Note 28 Segment reporting (continued)

	THE BANKING GROUP				
$ millions	**Consumer Banking and Wealth**	**Commercial, Corporate and Institutional**	**Investments and Insurance**	**Reconciling Items**	**Total**
Year ended 30 September 2020					
Net interest income	**1,002**	**908**	**1**	**(36)**	**1,875**
Non-interest income	**120**	**115**	**109**	**(101)**	**243**
Net operating income before operating expenses and impairment charges	**1,122**	**1,023**	**110**	**(137)**	**2,118**
Operating expenses	**(772)**	**(250)**	**(33)**	**25**	**(1,030)**
Impairment (charges)/benefits	**(165)**	**(155)**	**-**	**-**	**(320)**
Profit before income tax	**185**	**618**	**77**	**(112)**	**768**
Year ended 30 September 2019 (restated)					
Net interest income	1,032	887	-	24	1,943
Non-interest income	164	124	126	(85)	329
Net operating income before operating expenses and impairment charges	1,196	1,011	126	(61)	2,272
Operating expenses	(724)	(238)	(29)	30	(961)
Impairment (charges)/benefits	(17)	27	-	-	10
Profit before income tax	455	800	97	(31)	1,321
As at 30 September 2020					
Total gross loans	**48,979**	**39,457**	**-**	**124**	**88,560**
Total deposits and other borrowings	**38,637**	**32,337**	**-**	**2,996**	**73,970**
As at 30 September 2019					
Total gross loans	45,730	38,624	-	121	84,475
Total deposits and other borrowings	35,125	29,340	-	1,141	65,606

Note 29 Securitisation, covered bonds and other transferred assets

The 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 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 Banking Group as a funding and liquidity tool.

For securitisation structured entities which the Banking Group controls, as defined in Note 30, the structured entities are classified as subsidiaries and consolidated. When assessing whether the Banking Group controls a structured entity, it considers its exposure to and ability to affect variable returns. The 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 the Bank's internal residential mortgage-backed securitisation programme. Under this programme the Bank 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 the Bank to WNZSL are fully eliminated in the Banking Group's financial statements. Refer to Note 27 for a description of the Banking Group's obligation to repurchase certain housing loans sold to WNZSL.

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

Covered bonds

The 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 the Bank) in respect of obligations under the covered bonds issued from time to time by WSNZL under the CB Programme. That financial guarantee is supported by WNZCBL granting security in favour of the covered bondholders over the cover pool.

The intercompany loan made by the Bank 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 the Bank are fully eliminated in the Banking Group's financial statements. Refer to Note 27 for a description of the 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 17 for further details.

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

	THE 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	**204**	**204**	**n/a**	**n/a**	**n/a**
Total	**22,165**	**19,075**	**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	10	10	n/a	n/a	n/a
Total	15,077	12,802	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. The Bank 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 the Bank 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 Banking Group does not control a structured entity then it will not be consolidated.

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

Funds managed by a member of the Ultimate Parent Bank Group

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

Non-contractual financial support

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

Unconsolidated structured entities

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

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 Banking Group's main interests in unconsolidated structured entities, which arise in the normal course of business, are loans and other credit commitments. The Banking Group lends to unconsolidated structured entities, subject to the 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.

The following table shows the 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, the maximum exposure to loss is the notional amounts.

	THE BANKING GROUP	
	2020	2019
$ millions	**Financing to Securitisation Vehicles**	Financing to Securitisation Vehicles
Assets		
Loans	**3,321**	2,784
Total on-balance sheet exposures	**3,321**	2,784
Total notional amounts of off-balance sheet exposures	**1,319**	1,104
Maximum exposure to loss	**4,640**	3,888
Size of structured entities[1]	**4,640**	3,888

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

Non-contractual financial support

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

Note 31 Capital management

The primary objectives of the Banking Group's capital management are to ensure that the Banking Group complies with the regulatory capital requirements prescribed by the Reserve Bank, maintains strong credit ratings and holds a strong capital position in order to support its business objectives and maximise shareholders' value.

The Banking Group manages its capital structure and makes adjustments to this in light of changing economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Banking Group may adjust the amount of dividend payments to shareholders, reduce discretionary expenditure, return/issue capital to shareholders or issue capital securities.

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

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

The following tables show the Banking Group's capital summary and capital ratios.

	THE BANKING GROUP	
$ millions	**2020 Unaudited**	2019 Unaudited
Tier 1 capital		
Common Equity Tier 1 capital		
Total shareholder's equity	**7,690**	7,417
Less deductions from Common Equity Tier 1 capital	**(858)**	(1,009)
Total Common Equity Tier 1 capital	**6,832**	6,408
Additional Tier 1 capital instruments[1]	**1,500**	1,500
Total Tier 1 capital	**8,332**	7,908
Tier 2 capital instruments[1]	**1,123**	1,122
Eligible impairment allowance in excess of expected loss	**43**	-
Total Tier 2 capital	**1,166**	1,122
Total capital	**9,498**	9,030

[1] Classified as a liability and excludes capitalised transaction costs. Additional Tier 1 capital instruments and Tier 2 capital instruments are itemised in Note 20. Further details on convertibility for Additional Tier 1 and Tier 2 capital instruments are noted in Note 20.

		THE BANKING GROUP	
%	**Reserve Bank Minimum Ratios[1]**	**2020 Unaudited**	2019[1] Unaudited
Capital ratios			
Common Equity Tier 1 capital ratio	4.5	**12.3**	11.3
Tier 1 capital ratio	6.0	**15.0**	13.9
Total capital ratio	8.0	**17.1**	15.9
Buffer ratio	2.5	**7.8**	4.8

[1] Changes to the Bank's conditions of registration, effective from 31 December 2017, increased the Common Equity Tier 1 capital ratio, Tier 1 capital ratio and Total capital ratio ('**minimum capital ratios**') by 2% compared to the minimum capital ratios as at 30 September 2017. The increased minimum capital ratios were to remain in place until the Bank had satisfied the Reserve Bank that all existing issues in relation to the matters of non-compliance had been resolved. Effective from 31 December 2019, the Reserve Bank amended the Bank's conditions of registration to remove the two percentage point overlay applying to its minimum capital requirements. Refer to the 'Non-compliance with conditions of registration' section on page 113 for further details.

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 the Bank) 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.

Note 31 Capital management (continued)

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 the Bank) 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 the Bank, such that aggregate RWA will increase to approximately 90% of standardised RWA.

The Bank 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%, the Bank would require a further NZ$1.6-$2.2 billion (Unaudited) 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.

Note 32 Financial risk

Financial instruments are fundamental to the 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 Banking Group.

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

Principal risks	Note name	Note number
Overview	Risk management frameworks	32.1
Credit risk The risk of financial loss where a customer or counterparty fails to meet their financial obligations.	Credit risk ratings system	32.2.1
	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 The risk that the 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.	Liquidity modelling	32.3.1
	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 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.	Value-at-Risk ('**VaR**')	32.4.1
	Non-traded market risk	32.4.2

32.1 Risk management frameworks

The Board is responsible for approving the Banking Group's Risk Management Framework and Risk Appetite Statement and monitoring the effectiveness of risk management by the Banking Group. The Bank is wholly owned by the Ultimate Parent Bank and, therefore, a member of the group of companies comprising the Ultimate Parent Bank Group. Accordingly, the Banking Group's Risk Management Framework is closely aligned with the Ultimate Parent Bank's Risk Management Framework.

Notes to the financial statements

Note 32 Financial risk (continued)

The Board has delegated to the BRCC to:

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

For each of its primary financial risks, the 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 Banking Group'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 Banking Group has its own credit approval limits approved by the Banking Group's Board as delegated by the Ultimate Parent Bank Group Chief Risk Officer. - The BRCC, Executive Risk Committee ('**RISKCO**') and Credit Risk Committee ('**CREDCO**') monitor the risk profile, performance and management of the 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 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 Banking Group's model risk policies. - An annual review is performed of the Credit Risk Rating System for approval by the BRCC. - Specific credit risk estimates (including PD, LGD and EAD) are reviewed by CREDCO, overseen, reviewed annually and approved by the Chief Risk Officer and by the Ultimate Parent Bank's Credit Risk Estimates Committee (a subcommittee of the Ultimate Parent Bank's 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 Chief Financial Officer and the 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 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 Banking Group. They include 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 Ultimate Parent Bank's Related Entity Risk Management Framework and supporting policies govern credit exposures to related entities to minimise the spread of credit risk between the Ultimate Parent Bank Group.
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 Banking Group's Board-approved Risk Management Framework. - Responsibility for managing the Banking Group's liquidity and funding positions in accordance with the Liquidity Risk Management Framework is delegated to Treasury, under the oversight of the Banking Group's Asset and Liability Committee ('**ALCO**') and Banking Group Liquidity Risk. - The Banking Group's Liquidity Risk Management Framework sets out the Banking Group's funding and liquidity risk appetite, roles and responsibilities of key people managing funding and liquidity risk within the Banking Group, risk reporting and control processes and limits and targets used to manage the Banking Group's balance sheet. - Treasury undertakes an annual funding review that outlines the 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.	- The Banking Group monitors the composition and stability of its funding so that it remains within the Banking Group's funding risk appetite. This includes compliance with both the Liquidity Coverage Ratio ('**LCR**') and Net Stable Funding Ratio ('**NSFR**'). - The Banking Group holds a portfolio of liquid assets for several purposes, including as a buffer against unforeseen funding requirements. The level of liquid assets held takes into account the liquidity requirements of the Banking Group's balance sheet under normal and stress conditions. - Treasury also maintains a contingent funding plan that outlines the steps that should be taken by the Banking Group in the event of an emerging 'funding crisis'. The plan is aligned with the Banking Group's broader Liquidity Crisis Management Policy which is approved annually by the Board. - Daily liquidity risk reports are reviewed by Treasury and the Banking Group's Liquidity Risk teams. Liquidity reports are presented to ALCO monthly and to the BRCC quarterly.

Note 32 Financial risk (continued)

Risk	Risk management framework and controls
Market risk	- The Market Risk Framework describes the Banking Group's approach to managing non-traded market risk. - As the Ultimate Parent Bank's financial markets business in New Zealand is conducted by the NZ Branch, the market risks faced by the Banking Group are only of a non-traded nature. Non-traded market risk includes interest rate and FX risks. The Banking Group does not carry material foreign currency or equity price risk due to the risks being hedged. - 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 BRCC approves the VaR and NaR limits for non-traded risk. - Market risk limits are assigned to business management based upon the 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 Banking Group's Market Risk unit, which monitors market risk exposures against VaR and structural risk limits. Daily VaR position reports are produced by risk type, by product lines and by geographic region. Monthly and quarterly reports are produced for the Banking Group's and Ultimate Parent Bank's risk forums and Ultimate Parent Bank's BRCC, respectively, to ensure transparency of material market risks and issues. - 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. RISKCO has ratified an approved escalation framework. - 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 Ultimate Parent Bank's Market Risk Committee, RISKCO and BRCC.

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

		Transaction-managed	
Financial Statement Disclosure	**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+
		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).

Note 32 Financial risk (continued)

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

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

The Banking Group includes the effect of credit risk mitigation through eligible guarantees within the calculation applied to LGD. Due to system limitations, the value of the guarantee is not always separately recorded, and therefore, neither this value nor a close alternative is available for disclosure under Clause 7 of Schedule 11 to the Order.

Collateral

The following table 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, due from related entities 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.

Note 32 Financial risk (continued)

Management of risk mitigation

The Banking Group mitigates credit risk through controls covering:

Collateral and valuation management	The Ultimate Parent Bank manages collateral under collateralisation agreements centrally for all branches of the Ultimate Parent Bank and the Bank. 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 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 Australian Prudential Regulation Authority's ('**APRA**') 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 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 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	Close-out netting is undertaken with counterparties with whom the 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 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.

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

Individual customers or groups of related customers

The 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 Banking Group's industry risk appetite limits.

Note 32 Financial risk (continued)

Individual countries

The 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 Banking Group, or the 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.

	THE BANKING GROUP	
$ millions	**2020**	2019
Financial assets		
Cash and balances with central banks	**4,360**	1,864
Collateral paid	**148**	168
Trading securities and financial assets measured at FVIS	**2,437**	1,661
Derivative financial instruments	**599**	616
Investment securities	**5,021**	4,469
Loans	**87,959**	84,160
Other financial assets	**196**	178
Due from related entities	**1,094**	2,502
Total financial assets	**101,814**	95,618
Undrawn credit commitments		
Letters of credit and guarantees	**833**	828
Commitments to extend credit	**27,891**	25,858
Total undrawn credit commitments	**28,724**	26,686
Total maximum credit risk exposure	**130,538**	122,304

Note 32 Financial risk (continued)

Concentration of credit exposures

	THE BANKING GROUP	
$ millions	2020	2019
On-balance sheet credit exposures		
Analysis of on-balance sheet credit exposures by geographical areas		
New Zealand	**99,239**	92,871
Australia	**695**	857
United Kingdom	**603**	603
United States of America	**67**	58
China	**730**	684
Other	**480**	545
Total on-balance sheet credit exposures	**101,814**	95,618
Analysis of on-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**480**	465
Agriculture	**9,330**	8,773
Construction	**581**	557
Finance and insurance	**5,116**	4,970
Forestry and fishing	**505**	434
Government, administration and defence	**10,602**	6,681
Manufacturing	**1,738**	1,937
Mining	**220**	300
Property	**7,975**	7,387
Property services and business services	**1,076**	1,319
Services	**2,226**	2,056
Trade	**1,767**	2,131
Transport and storage	**1,244**	1,198
Utilities	**1,605**	1,751
Retail lending	**56,769**	53,423
Subtotal	**101,234**	93,382
Provision for ECL on loans	**(601)**	(315)
Due from related entities	**1,094**	2,502
Other financial assets	**87**	49
Total on-balance sheet credit exposures	**101,814**	95,618
Off-balance sheet credit exposures consists of		
Credit risk-related instruments	**28,724**	26,686
Total off-balance sheet credit exposures	**28,724**	26,686
Analysis of off-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**104**	116
Agriculture	**837**	624
Construction	**543**	492
Finance and insurance	**1,916**	1,625
Forestry and fishing	**233**	204
Government, administration and defence	**899**	884
Manufacturing	**1,920**	1,840
Mining	**111**	35
Property	**1,215**	1,986
Property services and business services	**928**	700
Services	**861**	592
Trade	**2,077**	1,672
Transport and storage	**944**	801
Utilities	**1,909**	1,646
Retail lending	**14,227**	13,469
Total off-balance sheet credit exposures	**28,724**	26,686

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

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:

	THE 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	7,695	3,578	-	11,273	7,612	1,201	-	8,813
Weak	49	501	473	1,023	28	248	302	578
Total Loans - Residential Mortgages	50,660	4,079	473	55,212	49,736	1,449	302	51,487
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	11,571	-	-	11,571	11,368	-	-	11,368
Good/satisfactory	15,643	979	-	16,622	15,330	1,104	-	16,434
Weak	-	1,610	154	1,764	-	1,229	93	1,322
Total Loans - Corporate	27,214	2,589	154	29,957	26,698	2,333	93	29,124
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	5,505	-	-	5,505	2,963	-	-	2,963
Good/satisfactory	31	6	-	37	39	4	-	43
Weak	-	3	1	4	-	2	1	3
Total all other financial assets	5,536	9	1	5,546	3,002	6	1	3,009
Undrawn credit commitments								
Strong	21,774	-	-	21,774	18,435	-	-	18,435
Good/Satisfactory	6,469	279	-	6,748	7,812	230	-	8,042
Weak	12	146	44	202	10	179	20	209
Total undrawn credit commitments	28,255	425	44	28,724	26,257	409	20	26,686
Total strong	88,085	-	-	88,085	80,052	-	-	80,052
Total good/satisfactory	31,484	5,045	-	36,529	33,674	2,595	-	36,269
Total weak	79	2,412	746	3,237	57	1,792	469	2,318
Total on and off balance sheet	119,648	7,457	746	127,851	113,783	4,387	469	118,639

[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.

Notes to the financial statements

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 Banking Group considers that the customer is unlikely to repay its credit obligations in full, irrespective of recourse by the 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 Banking Group's critical accounting assumptions and estimates. Details of this and the 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 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 Banking Group's loan portfolio has the following coverage from collateral held:

	THE 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**	**-**	**71**	94	53	10	-	72
Partially secured	**4**	**7**	**14**	**-**	**7**	6	4	50	-	15
Unsecured	**-**	**54**	**73**	**-**	**22**	-	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

	THE BANKING GROUP	
$ millions	2020	2019
Cash, primarily for derivatives	**419**	473
Securities under reverse repurchase agreements [1]	**69**	983
Total other collateral held	**488**	1,456

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

Note 32 Financial risk (continued)

32.3 Funding and liquidity risk

The Bank aims to maintain a mix of retail and wholesale funding, with emphasis on the value of core funding consistent with the principles inherent in the Reserve Bank's document entitled 'Liquidity Policy' ('**BS13**').

32.3.1 Liquidity modelling

The Bank is subject to the conditions of BS13. The following metrics are calculated and reported on a daily basis in accordance with BS13:

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

In addition, the Bank calculates the following liquidity ratios in accordance with the Ultimate Parent Bank's liquidity risk framework under 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 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 Banking Group's holding of liquid assets and represents the key liquidity information provided to management. Liquid assets include high quality assets readily convertible to cash to meet the Banking Group's liquidity requirements. In management's opinion, liquidity is sufficient to meet the Banking Group's present requirements.

	THE BANKING GROUP	
$ millions	**2020**	2019
Cash and balances with central banks	**4,360**	1,864
Receivables due from the Ultimate Parent Bank	**86**	122
Supranational securities	**1,020**	1,712
NZ Government securities	**3,441**	2,022
NZ public securities	**2,563**	2,614
NZ corporate securities	**300**	645
Residential mortgage-backed securities	**11,081**	5,798
Total liquid assets	**22,851**	14,777

Note 32 Financial risk (continued)

Concentration of funding

	THE BANKING GROUP	
$ millions	**2020**	2019
Funding consists of		
Collateral received	**419**	473
Deposits and other borrowings	**73,970**	65,606
Other financial liabilities[1]	**-**	54
Debt issues[2]	**15,799**	17,846
Due to related entities[3]	**998**	801
Loan capital	**2,612**	2,609
Total funding	**93,798**	87,389
Analysis of funding by geographical areas[2]		
New Zealand	**76,023**	66,730
Australia	**1,007**	1,397
United Kingdom	**7,677**	8,714
United States of America	**3,270**	2,961
China	**3,178**	4,455
Other	**2,643**	3,132
Total funding	**93,798**	87,389
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	**33,051**	34,390
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**	4,461
Subtotal	**92,800**	86,588
Due to related entities[3]	**998**	801
Total funding	**93,798**	87,389

[1] Other financial liabilities, as presented above, are in respect of interbank placements.

[2] 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.

[3] 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.

[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 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 the CB Programme disclosed in Note 29, the carrying value of these financial assets pledged as collateral is:

	THE BANKING GROUP	
$ millions	**2020**	2019
Cash	**148**	168
Securities pledged under repurchase agreements:[1]		
Investment securities	**204**	1
Trading securities and financial assets measured at FVIS	**-**	9
Total amount pledged to secure liabilities (excluding CB Programme)	**352**	178

[1] Securities were pledged as collateral to the NZ Branch which is recorded within due to related entities in the balance sheet.

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 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 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
	THE BANKING GROUP						
	2020						
Financial liabilities							
Collateral received	-	419	-	-	-	-	419
Deposits and other borrowings	38,558	6,446	11,193	16,091	2,098	-	74,386
Other financial liabilities	-	73	6	-	-	-	79
Derivative financial instruments:							
Held for hedging purposes (net settled)	-	8	15	39	87	-	149
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)
Debt issues	-	166	25	6,565	8,950	395	16,101
Due to related entities:							
Non-derivative balances	752	205	52	1	10	-	1,020
Derivative financial instruments:							
Held for trading	13	-	-	-	-	-	13
Held for hedging purposes (net settled)	-	26	66	146	163	4	405
Held for hedging purposes (gross settled):							
Cash outflow	-	-	10	1,182	-	-	1,192
Cash inflow	-	-	(8)	(1,131)	-	-	(1,139)
Loan capital	-	-	8	24	130	2,639	2,801
Total undiscounted financial liabilities	39,323	7,346	11,370	23,012	11,475	3,038	95,564
Total contingent liabilities and commitments							
Letters of credit and guarantees	833	-	-	-	-	-	833
Commitments to extend credit	27,891	-	-	-	-	-	27,891
Total undiscounted contingent liabilities and commitments	28,724	-	-	-	-	-	28,724

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 Year and Up to 5 Years	Over 5 Years	Total
	THE BANKING GROUP						
	2019						
Financial liabilities							
Collateral received	-	473	-	-	-	-	473
Deposits and other borrowings	29,664	6,853	13,531	14,420	1,788	-	66,256
Other financial liabilities	-	116	8	-	-	-	124
Derivative financial instruments:							
Held for hedging purposes (net settled)	-	17	14	51	105	3	190
Held for hedging purposes (gross settled):							
Cash outflow	-	5	5	911	558	-	1,479
Cash inflow	-	-	-	(889)	(503)	-	(1,392)
Debt issues	-	122	947	4,309	12,746	393	18,517
Due to related entities:							
Non-derivative balances	656	11	36	3	76	52	834
Derivative financial instruments:							
Held for trading	377	-	-	-	-	-	377
Held for hedging purposes (net settled)	-	13	66	135	165	5	384
Held for hedging purposes (gross settled):							
Cash outflow	-	-	12	35	1,195	-	1,242
Cash inflow	-	-	(11)	(31)	(1,142)	-	(1,184)
Loan capital	-	-	11	31	159	2,681	2,882
Total undiscounted financial liabilities	30,697	7,610	14,619	18,975	15,147	3,134	90,182
Total contingent liabilities and commitments							
Letters of credit and guarantees	828	-	-	-	-	-	828
Commitments to extend credit	25,858	-	-	-	-	-	25,858
Total undiscounted contingent liabilities and commitments	26,686	-	-	-	-	-	26,686

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 Banking Group would expect a large proportion of these balances to be retained.

	THE 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	**4,360**	**-**	**4,360**	1,864	-	1,864
Collateral paid	**148**	**-**	**148**	168	-	168
Trading securities and financial assets measured at FVIS	**2,027**	**410**	**2,437**	1,520	141	1,661
Derivative financial instruments	**108**	**491**	**599**	84	532	616
Investment securities	**694**	**4,327**	**5,021**	1,948	2,521	4,469
Loans	**12,195**	**75,764**	**87,959**	11,871	72,289	84,160
Due from related entities	**949**	**145**	**1,094**	2,367	135	2,502
All other assets	**461**	**1,113**	**1,574**	351	816	1,167
Total assets	**20,942**	**82,250**	**103,192**	20,173	76,434	96,607
Liabilities						
Collateral received	**419**	**-**	**419**	473	-	473
Deposits and other borrowings	**71,947**	**2,023**	**73,970**	63,920	1,686	65,606
Derivative financial instruments	**123**	**170**	**293**	49	208	257
Debt issues	**6,592**	**9,207**	**15,799**	5,113	12,733	17,846
Due to related entities	**1,199**	**288**	**1,487**	1,190	442	1,632
Loan capital	**1,123**	**1,489**	**2,612**	-	2,609	2,609
All other liabilities	**547**	**375**	**922**	635	132	767
Total liabilities	**81,950**	**13,552**	**95,502**	71,380	17,810	89,190

32.4 Market risk

32.4.1 Value-at-Risk

The Banking Group uses VaR as one of the mechanisms for controlling 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 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 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:

	THE 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	**1.16**	**7.08**	**0.98**	**3.62**	6.97	6.97	2.24	4.51

Value at Risk – IRRBB[1]

The table below depicts VaR for IRRBB:

	THE BANKING GROUP							
	2020				2019			
$ millions	As at	Maximum Exposure	Minimum Exposure	Average Exposure	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	**1.9**	**3.0**	**0.8**	**1.8**	1.4	2.0	0.6	1.1

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

The Banking Group does not carry material foreign currency or equity risk.

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

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 and balances with central banks.

Cash and cash equivalents

	THE BANKING GROUP	
$ millions	**2020**	2019
Cash and cash equivalents comprise:		
Cash and balances with central banks:		
Cash on hand	**193**	180
Balances with central banks	**4,167**	1,684
Cash and cash equivalents at end of the year	**4,360**	1,864

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

	THE BANKING GROUP	
$ millions	**2020**	2019
Net profit attributable to the owners of the Banking Group	**550**	964
Adjustments:		
Impairment charges/(benefits) on loans	**320**	(10)
Computer software amortisation costs	**66**	55
Depreciation	**99**	39
(Gain)/loss from hedging ineffectiveness	**(8)**	(2)
Movement in accrued interest receivable	**19**	12
Movement in accrued interest payable	**(146)**	(8)
Movement in current and deferred tax	**(124)**	(16)
Gain on disposal of associate	**-**	(40)
Share-based payments	**4**	5
Other non-cash items	**(56)**	47
Cash flows from operating activities before changes in operating assets and liabilities	**724**	1,046
Movement in collateral paid	**20**	(98)
Movement in trading securities and financial assets measured at FVIS	**(773)**	(510)
Movement in loans	**(4,018)**	(3,714)
Movement in other financial assets	**(39)**	21
Movement in due from related entities	**760**	(747)
Movement in other assets	**(5)**	-
Movement in collateral received	**(54)**	(3)
Movement in deposits and other borrowings	**8,364**	2,504
Movement in other financial liabilities	**(49)**	(83)
Movement in due to related entities	**293**	33
Movement in other liabilities	**1**	-
Net movement in external and related entity derivative financial instruments	**382**	417
Net cash flows provided by/(used in) operating activities	**5,606**	(1,134)

Registered bank disclosures

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

i. General information (Unaudited)

Ultimate Parent Bank

The Ultimate Parent Bank is incorporated in Australia under the Australian Corporations Act 2001 and its address for service of process is Level 18, Westpac Place, 275 Kent Street, Sydney, New South Wales 2000, Australia.

Limits on material financial support by the Ultimate Parent Bank

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

- the Ultimate Parent Bank's exposure to the Bank (being a related ADI as defined in APS 222) must not exceed 50% of the Ultimate Parent Bank's Level 1 capital base (as defined in APS 222);
- the Ultimate Parent Bank's aggregate exposure to all related ADI's must not exceed 150% of the Ultimate Parent Bank's Level 1 capital base (as defined in APS 222);
- the Ultimate Parent Bank must not hold unlimited exposures to the Bank (such as a general guarantee covering any of the Bank's obligations);
- the Ultimate Parent Bank must not enter into cross-default clauses whereby a default by the Bank on an obligation (whether financial or otherwise) is deemed to trigger a default of the Ultimate Parent Bank in its obligations;
- when determining limits on acceptable levels of exposure to the Bank, the Board of Directors of the Ultimate Parent Bank must have regard to:
    - the level of exposures that would be approved to third parties of broadly equivalent credit status; and
    - the impact on the Ultimate Parent Bank's stand-alone capital and liquidity positions, and its ability to continue operating, in the event of a failure by the Bank or any other related entity to which it is exposed.

In January 2013, a provision in APS 222 took effect which allows APRA to set specific limits on the Ultimate Parent Bank's exposures to related entities, which include the Bank.

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

On 20 August 2019, APRA released the finalised prudential standard APS 222: Associations with Related Entities. The revised standard is intended to strengthen the ability of ADIs to monitor, limit and control risks arising from transactions and other associations with related entities. Key changes include revisions to the limit for exposure to ADIs from 50% of Total Capital to 25% of Tier 1 capital. The revised standard is effective from 1 January 2022.

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

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

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

On 19 November 2015, APRA informed the Ultimate Parent 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 Ultimate Parent 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 Ultimate Parent Bank and its subsidiary entities that have been approved by APRA to be included in the ELE for the purposes of measuring capital adequacy.

Registered bank disclosures

i. General information (Unaudited) (continued)

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. 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 Ultimate Parent Bank.

APRA has also confirmed the terms on which the Ultimate Parent 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.

Voting securities and power to appoint directors

The Bank is a wholly-owned subsidiary of WNZGL, a New Zealand company, which in turn is a wholly-owned subsidiary of Westpac Overseas Holdings No. 2 Pty Limited ('**WOHL**'), an Australian company. WOHL is, in turn, a wholly-owned subsidiary of the Ultimate Parent Bank.

At 30 September 2020, WNZGL has a direct qualifying interest in 100% of the voting securities of the Bank. WOHL and the Ultimate Parent Bank have an indirect qualifying interest in 100% of the voting securities of the Bank.

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

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

Priority of financial liabilities in the event of liquidation

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

Guarantee arrangements

No material obligations of the Bank are guaranteed as at the date the Directors signed this Disclosure Statement.

WNZGL does not guarantee any of the obligations of the Bank or any member of the Banking Group.

Directorate

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

Name: Janice Amelia Dawson, B.Com, FCA **Non-executive:** Yes **Country of Residence:** New Zealand **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Deputy Chair of Air New Zealand Limited. Director of each of AIG Insurance New Zealand Limited, Erua Limited, Jan Dawson Limited, Meridian Energy Limited, Meridian LTI Trustee Limited, MP Dillion No 4 Trustee Limited, and Pokaka Trustee Limited. Member of each of the Capital Investment Committee of the National Health Board, the Council of the University of Auckland, Audit Committee of the World Sailing Federation and World Sailing Council Vice President and Director. Member of HR Committee of BECA Group Limited.
Name: David Alexander McLean, LLB (Hons) **Non-executive:** No **Country of Residence:** New Zealand **Primary Occupation:** Chief Executive, Westpac New Zealand Limited **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** No	**External Directorships:** Member of the New Zealand Bankers' Association. Co-Chair of Champions for Change. Director of Bibi McLean Trustees Limited. Member of each of the Capital Markets 2029 Steering Committee, Mastercard Asia/Pacific Advisory Board, New Zealand National Advisory Council on the Employment of Woman, and the New Zealand Prime Minister's Business Advisory Council.
Name: Malcolm Guy Bailey, B.Ag.Econ. **Non-executive:** Yes **Country of Residence:** New Zealand **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Chair of each of the Dairy Companies Association of New Zealand, Red Meat Profit Partnership General Partner Limited, New Zealand International Business Forum and Central Economic Development Agency Limited. Director of each of Bailey Agriculture Limited, Bailey Family Properties Limited, BBD Industrial Properties Limited, Etech Engineering Services Limited, Etech NZ Limited, Frogparking Limited, Gleneig Holdings Limited, Greentech NZ Limited, RMI NZ Limited, and Tadpole NZ Limited.

Registered bank disclosures

i. General information (Unaudited) (continued)

Name: Philippa Mary Greenwood, LLB **Non-executive:** Yes **Country of Residence:** New Zealand **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of each of Fisher & Paykel Healthcare Corporation Limited, Spark New Zealand Limited, The A2 Milk Company Limited and Vulcan Steel Limited.
Name: Jonathan Parker Mason, MBA, MA, BA **Non-executive:** Yes **Country of Residence:** New Zealand **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes, Chair **Independent Director:** Yes	**External Directorships:** Chair of Vector Limited. Director of each of Air New Zealand Limited, Advanced Metering Assets Limited, Advanced Metering Services Limited, Allagash Limited, Alvarium (NZ) Wealth Management Holdings Limited, Alvarium Wealth (NZ) Limited, Arc Innovations Limited, NGC Holdings Limited, On Gas Limited, Vector Advanced Metering Assets (Australia) Limited, Vector Communications Limited, Vector Gas Trading Limited, Vector Metering Data Services Limited, Zespri Group Limited, and Zespri International Limited. Board Member of the American Chamber of Commerce in New Zealand and World Wildlife Fund New Zealand.
Name: Mary Patricia Leonie Quin, PhD, MBA, BSc (Hons) **Non-executive:** Yes **Country of Residence:** New Zealand **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of Frogparking Limited.

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

Board Audit Committee

There is a Board Audit Committee ('**BAC**') that covers audit matters, comprising five directors, all of whom are non-executive 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 Bank and their personal, professional or business interests are avoided or dealt with.

Each Director must give notice to the Board of any direct or indirect interest in a matter relating to the affairs of the Bank as soon as practicable after the relevant facts have come to that Director's knowledge. Where a matter is to be considered at a Directors' meeting in which one or more Directors have an interest, the Board's practice is to manage any conflict of interest on a case-by-case basis, depending on the circumstances.

Auditor

PricewaterhouseCoopers
PwC Tower, Level 27
15 Customs Street West
Auckland, New Zealand

Registered bank disclosures

i. General information (Unaudited) (continued)

Credit ratings

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

Rating Agency	Current Credit Rating	Rating Outlook
Fitch Ratings (**'Fitch'**)	A+	Negative
Moody's Investors Service (**'Moody's'**)	A1	Stable
S&P Global Ratings	AA-	Negative

On 9 July 2019, S&P Global Ratings affirmed the Ultimate Parent Bank's long-term issuer default rating at AA- and revised the outlook to stable from negative. As a consequence, the Bank's outlook was aligned with the Ultimate Parent Bank's and revised to stable from negative. On 8 April 2020, S&P Global Ratings affirmed the Ultimate Parent Bank's long-term issuer default rating of AA- and revised the outlook to negative from stable. As a consequence, the Bank's outlook was aligned with the Ultimate Parent Bank's and revised to negative from stable.

On 17 July 2019, Fitch affirmed the Ultimate Parent 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. As a consequence, the Bank's outlook was aligned with the Ultimate Parent Bank's and revised to negative from stable. On 7 April 2020, Fitch downgraded the long-term credit ratings for the major Australian banks (including the Ultimate Parent Bank) and their subsidiaries 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. As a consequence of this action, Fitch also downgraded the long-term rating for the Bank to A+ and maintained the outlook as negative.

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 Bank's current position is indicated in bold.

i. General Information (Unaudited) (continued)

Historical summary of financial statements

	THE BANKING GROUP				
$ millions	**2020**	2019	2018	2017	2016
Income statement					
Interest income	**3,540**	4,011	3,989	3,917	4,113
Interest expense	**(1,665)**	(2,068)	(2,145)	(2,176)	(2,369)
Net interest income	**1,875**	1,943	1,844	1,741	1,744
Non-interest income	**243**	329	344	405	400
Net operating income before operating expenses and impairment charges	**2,118**	2,272	2,188	2,146	2,144
Operating expenses	**(1,030)**	(961)	(886)	(954)	(907)
Impairment (charges)/benefits	**(320)**	10	(3)	76	(59)
Profit before income tax	**768**	1,321	1,299	1,268	1,178
Income tax expense	**(218)**	(357)	(363)	(359)	(327)
Net profit for the year	**550**	964	936	909	851
Net profit for the year attributable to:					
Owners of the Banking Group	**550**	964	936	909	851
Dividends paid or provided	**(325)**	(2,965)	(1,870)	(640)	(660)
Balance sheet					
Total assets	**103,192**	96,607	89,871	88,627	86,307
Total individually impaired assets	**129**	69	145	173	222
Total liabilities	**95,502**	89,190	82,593	81,777	79,747
Total shareholder's equity	**7,690**	7,417	7,278	6,850	6,560

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

Other material matters

AUSTRAC proceedings issued against the Ultimate Parent 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 Ultimate Parent Bank in relation to alleged contraventions of the 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 Funds 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 ongoing customer due diligence obligations. AUSTRAC alleged over 23 million contraventions of the AML/CTF Act.

On 24 September 2020, the Ultimate Parent 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 Ultimate Parent 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 Ultimate Parent 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 Ultimate Parent 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 its 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).

Registered bank disclosures

i. General information (Unaudited) (continued)

On 17 December 2019, APRA commenced an investigation examining potential contraventions by the Ultimate Parent 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 Ultimate Parent 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 Ultimate Parent 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 Ultimate Parent Bank securities between 16 December 2013 and 19 November 2019. The proceeding involves allegations relating to market disclosure issues connected to the Ultimate Parent 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 the Bank 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 and restated on 20 August 2020, are as follows:

- The Scheme permits banks to lend up to $500,000 to qualifying borrowers for a maximum of five years; and.
- The New Zealand Government will pay 80% of any loss incurred by the Bank on a loan it makes under the Scheme, after the Bank has exhausted its recoveries procedures,

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

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 the Bank) 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 the Bank) from 75% to 50%.

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.

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.

ii. Additional financial disclosures

Additional information on balance sheet

	THE BANKING GROUP	
$ millions	**2020**	2019
Interest earning and discount bearing assets	**100,915**	94,076
Interest and discount bearing liabilities	**82,099**	80,586

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 Banking Group's policy guidelines.

ii. Additional financial disclosures (continued)

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the Banking Group's net asset position as at 30 September 2020. The 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.

	THE 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	-	-	-	-	193	4,360
Collateral paid	148	-	-	-	-	-	148
Trading securities and financial assets measured at FVIS	1,397	464	576	-	-	-	2,437
Derivative financial instruments	-	-	-	-	-	599	599
Investment securities	-	172	521	331	3,997	-	5,021
Loans	44,604	7,015	18,419	14,777	3,441	(297)	87,959
Other financial assets	-	-	-	-	-	196	196
Due from related entities	886	-	-	-	-	208	1,094
Total financial assets	51,202	7,651	19,516	15,108	7,438	899	101,814
Non-financial assets							1,378
Total assets							103,192
Financial liabilities							
Collateral received	419	-	-	-	-	-	419
Deposits and other borrowings	44,484	10,178	5,714	1,440	583	11,571	73,970
Other financial liabilities	-	-	-	-	-	287	287
Derivative financial instruments	-	-	-	-	-	293	293
Debt issues	4,925	1,510	2,147	2,371	4,718	128	15,799
Due to related entities	998	-	-	-	-	489	1,487
Loan capital	2,612	-	-	-	-	-	2,612
Total financial liabilities	53,438	11,688	7,861	3,811	5,301	12,768	94,867
Non-financial liabilities							635
Total liabilities							95,502
On-balance sheet interest rate repricing	(2,236)	(4,037)	11,655	11,297	2,137		
Net derivative notional principals							
Net interest rate contracts (notional):							
Receivable/(payable)	13,437	(1,430)	(6,909)	(6,089)	991		
Net interest rate repricing gap	11,201	(5,467)	4,746	5,208	3,128		

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)

Reconciliation of mortgage-related amounts

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

	THE BANKING GROUP
$ millions	**30 Sep 20**
Residential mortgages - total gross loans (as disclosed in Note 11, Note 32.2.4 and Section iii. Asset quality)	**55,212**
Reconciling items:	
Unamortised deferred fees and expenses	**(199)**
Fair value hedge adjustments	**(123)**
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**
Accrued interest receivable	**55**
Partial write-offs	**3**
Residential mortgages - EAD (as disclosed in Credit risk exposures by asset class in Section iv.)	**63,193**

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

iii. Asset quality

Past due assets

	THE BANKING GROUP				
	30 Sep 20				
$ millions	**Residential Mortgages**	**Other Retail**	**Corporate**	**Other**	**Total**
Past due but not individually impaired assets					
Less than 30 days past due	**2,743**	**112**	**287**	**-**	**3,142**
At least 30 days but less than 60 days past due	**291**	**23**	**14**	**-**	**328**
At least 60 days but less than 90 days past due	**63**	**10**	**-**	**-**	**73**
At least 90 days past due	**277**	**39**	**27**	**-**	**343**
Total past due but not individually impaired assets	**3,374**	**184**	**328**	**-**	**3,886**

	THE BANKING GROUP				
	30 Sep 19				
$ millions	Residential Mortgages	Other Retail	Corporate	Other	Total
Past due but not individually impaired assets					
Less than 30 days past due	873	137	263	15	1,288
At least 30 days but less than 60 days past due	119	24	8	-	151
At least 60 days but less than 90 days past due	46	14	9	-	69
At least 90 days past due	61	23	29	-	113
Total past due but not individually impaired assets	1,099	198	309	15	1,621

Movements in components of loss allowance

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

iii. Asset quality (continued)

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.

	THE 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	**80,055**	**3,972**	**379**	**69**	**84,475**
Transfers:					
Transfers to Stage 1	**7,398**	**(7,265)**	**(132)**	**(1)**	**-**
Transfers to Stage 2	**(11,297)**	**11,757**	**(446)**	**(14)**	**-**
Transfers to Stage 3 CAP	**(101)**	**(863)**	**970**	**(6)**	**-**
Transfers to Stage 3 IAP	**(1)**	**(65)**	**(32)**	**98**	**-**
Net further lending/(repayment)	**(3,935)**	**135**	**(10)**	**(6)**	**(3,816)**
New financial assets originated	**20,676**	**-**	**-**	**-**	**20,676**
Financial assets derecognised during the year	**(11,959)**	**(648)**	**(124)**	**(6)**	**(12,737)**
Amounts written-off	**-**	**-**	**(33)**	**(5)**	**(38)**
Total gross carrying amount as at 30 September 2020	**80,836**	**7,023**	**572**	**129**	**88,560**
Provision for ECL as at 30 September 2020	**(95)**	**(326)**	**(107)**	**(73)**	**(601)**
Total net carrying amount as at 30 September 2020	**80,741**	**6,697**	**465**	**56**	**87,959**

	THE 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	76,532	3,707	383	80	80,702
Transfers:					
Transfers to Stage 1	4,202	(4,105)	(92)	(5)	-
Transfers to Stage 2	(5,005)	5,123	(115)	(3)	-
Transfers to Stage 3 CAP	(158)	(346)	518	(14)	-
Transfers to Stage 3 IAP	(6)	(2)	(40)	48	-
Net further lending/(repayment)	(2,456)	228	(75)	(24)	(2,327)
New financial assets originated	17,693	-	-	-	17,693
Financial assets derecognised during the year	(10,747)	(633)	(147)	(8)	(11,535)
Amounts written-off	-	-	(53)	(5)	(58)
Total gross carrying amount as at 30 September 2019	80,055	3,972	379	69	84,475
Provision for ECL as at 30 September 2019	(76)	(158)	(53)	(28)	(315)
Total net carrying amount as at 30 September 2019	79,979	3,814	326	41	84,160

iii. Asset quality (continued)

Impacts of changes in gross financial assets on loss allowances – by types of credit exposure

The impacts of changes in gross carrying amounts of loans on expected loss allowance can be further disaggregated into the following types of credit exposure:

	THE BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	Total
$ millions	CAP	CAP	CAP	IAP	
Residential mortgages					
Total gross carrying amount as at 30 September 2019	49,736	1,449	285	17	51,487
Transfers:					
Transfers to Stage 1	4,646	(4,533)	(112)	(1)	-
Transfers to Stage 2	(7,829)	8,222	(392)	(1)	-
Transfers to Stage 3 CAP	(76)	(716)	797	(5)	-
Transfers to Stage 3 IAP	(1)	(1)	(13)	15	-
Net further lending/(repayment)	(2,265)	(36)	(5)	(2)	(2,308)
New financial assets originated	11,818	-	-	-	11,818
Financial assets derecognised during the year	(5,369)	(306)	(104)	(4)	(5,783)
Amounts written-off	-	-	(1)	(1)	(2)
Total gross carrying amount as at 30 September 2020	50,660	4,079	455	18	55,212
Provision for ECL as at 30 September 2020	(44)	(121)	(70)	(6)	(241)
Total net carrying amount as at 30 September 2020	50,616	3,958	385	12	54,971
Other retail					
Total gross carrying amount as at 30 September 2019	3,510	190	51	2	3,753
Transfers:					
Transfers to Stage 1	912	(893)	(19)	-	-
Transfers to Stage 2	(1,125)	1,153	(28)	-	-
Transfers to Stage 3 CAP	(20)	(102)	123	(1)	-
Transfers to Stage 3 IAP	-	-	(3)	3	-
Net further lending/(repayment)	(530)	64	(1)	(1)	(468)
New financial assets originated	656	-	-	-	656
Financial assets derecognised during the year	(533)	(57)	(20)	-	(610)
Amounts written-off	-	-	(32)	-	(32)
Total gross carrying amount as at 30 September 2020	2,870	355	71	3	3,299
Provision for ECL as at 30 September 2020	(21)	(70)	(31)	(2)	(124)
Total net carrying amount as at 30 September 2020	2,849	285	40	1	3,175
Corporate					
Total gross carrying amount as at 30 September 2019	26,698	2,333	43	50	29,124
Transfers:					
Transfers to Stage 1	1,737	(1,736)	(1)	-	-
Transfers to Stage 2	(2,264)	2,303	(26)	(13)	-
Transfers to Stage 3 CAP	(5)	(45)	50	-	-
Transfers to Stage 3 IAP	-	(64)	(16)	80	-
Net further lending/(repayment)	(1,131)	83	(4)	(3)	(1,055)
New financial assets originated	7,967	-	-	-	7,967
Financial assets derecognised during the year	(5,788)	(285)	-	(2)	(6,075)
Amounts written-off	-	-	-	(4)	(4)
Total gross carrying amount as at 30 September 2020	27,214	2,589	46	108	29,957
Provision for ECL as at 30 September 2020	(30)	(135)	(6)	(65)	(236)
Total net carrying amount as at 30 September 2020	27,184	2,454	40	43	29,721

The above gross carrying amount table does not include 'Other' credit exposures (refer to Note 11) on the basis that the provision for ECL is nil.

iii. Asset quality (continued)

	THE BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	Total
$ millions	CAP	CAP	CAP	IAP	
Residential mortgages					
Total gross carrying amount as at 1 October 2018	47,254	1,364	264	11	48,893
Transfers:					
Transfers to Stage 1	1,670	(1,598)	(67)	(5)	-
Transfers to Stage 2	(2,068)	2,144	(74)	(2)	-
Transfers to Stage 3 CAP	(125)	(182)	311	(4)	-
Transfers to Stage 3 IAP	(6)	(2)	(21)	29	-
Net further lending/(repayment)	(1,842)	(51)	(15)	(3)	(1,911)
New financial assets originated	10,307	-	-	-	10,307
Financial assets derecognised during the year	(5,454)	(226)	(111)	(7)	(5,798)
Amounts written-off	-	-	(2)	(2)	(4)
Total gross carrying amount as at 30 September 2019	49,736	1,449	285	17	51,487
Provision for ECL as at 30 September 2019	(19)	(18)	(31)	(6)	(74)
Total net carrying amount as at 30 September 2019	49,717	1,431	254	11	51,413
Other retail					
Total gross carrying amount as at 1 October 2018	3,668	208	48	4	3,928
Transfers:					
Transfers to Stage 1	918	(903)	(15)	-	-
Transfers to Stage 2	(900)	919	(19)	-	-
Transfers to Stage 3 CAP	(19)	(101)	122	(2)	-
Transfers to Stage 3 IAP	-	-	(4)	4	-
Net further lending/(repayment)	(371)	119	(11)	-	(263)
New financial assets originated	832	-	-	-	832
Financial assets derecognised during the year	(618)	(52)	(19)	(1)	(690)
Amounts written-off	-	-	(51)	(3)	(54)
Total gross carrying amount as at 30 September 2019	3,510	190	51	2	3,753
Provision for ECL as at 30 September 2019	(37)	(51)	(19)	-	(107)
Total net carrying amount as at 30 September 2019	3,473	139	32	2	3,646
Corporate					
Total gross carrying amount as at 1 October 2018	25,334	2,133	71	65	27,603
Transfers:					
Transfers to Stage 1	1,614	(1,604)	(10)	-	-
Transfers to Stage 2	(2,037)	2,060	(22)	(1)	-
Transfers to Stage 3 CAP	(14)	(63)	85	(8)	-
Transfers to Stage 3 IAP	-	-	(15)	15	-
Net further lending/(repayment)	(17)	128	(49)	(21)	41
New financial assets originated	6,279	-	-	-	6,279
Financial assets derecognised during the year	(4,461)	(321)	(17)	-	(4,799)
Amounts written-off	-	-	-	-	-
Total gross carrying amount as at 30 September 2019	26,698	2,333	43	50	29,124
Provision for ECL as at 30 September 2019	(20)	(89)	(3)	(22)	(134)
Total net carrying amount as at 30 September 2019	26,678	2,244	40	28	28,990

The above gross carrying amount table does not include 'Other' credit exposures (refer to Note 11) on the basis that the provision for ECL is nil.

iii. Asset quality (continued)

Other asset quality information

	THE BANKING GROUP				
	30 Sep 20				
$ millions	**Residential Mortgages**	**Other Retail**	**Corporate**	**Other**	**Total**
Undrawn commitments with individually impaired counterparties	**-**	**2**	**3**	**-**	**5**
Other assets under administration	**-**	**-**	**-**	**-**	**-**

	THE BANKING GROUP				
	30 Sep 19				
$ millions	Residential Mortgages	Other Retail	Corporate	Other	Total
Undrawn commitments with individually impaired counterparties	-	-	6	-	6
Other assets under administration	-	-	-	-	-

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited)

The information contained in this note has been derived in accordance with the Banking Group's conditions of registration which relate to capital adequacy and the Reserve Bank BS2B, except for the matters of non-compliance issued by BS2B with condition of registration 1B disclosed on page 113. The Bank considers its internal credit model methodologies result in the retention of an appropriate amount of capital to reflect its credit risk and any effect of the non-compliance with its conditions of registration 1B on the information relating to capital adequacy is not considered by the Bank to be material.

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

The Banking Group's capital summary as at 30 September 2020

		THE BANKING GROUP
$ millions	Note	**2020**
Tier 1 capital		
Common Equity Tier 1 capital		
Paid-up ordinary shares issued by the Bank plus related share premium	21	**7,300**
Retained earnings (net of appropriations)		**415**
Accumulated OCI and other disclosed reserves[1]		**(25)**
Less deductions from Common Equity Tier 1 capital		
Goodwill		**(477)**
Other intangible assets[2]		**(183)**
Cash flow hedge reserve		**82**
Deferred tax asset deduction		**(280)**
Expected loss excess over eligible allowance		**-**
Total Common Equity Tier 1 capital		**6,832**
Additional Tier 1 capital		
Additional Tier 1 capital instruments[3]	20	**1,500**
Total additional Tier 1 capital		**1,500**
Total Tier 1 capital		**8,332**
Tier 2 capital		
Tier 2 capital instruments[3]	20	**1,123**
Revaluation reserves		**-**
Eligible impairment allowance in excess of expected loss		**43**
Total Tier 2 capital		**1,166**
Total capital		**9,498**

[1] Accumulated OCI and other disclosed reserves consist of investment securities and cash flow hedge reserve as disclosed as reserves in the balance sheet.

[2] Includes capitalised transaction costs on loan capital and debt issues.

[3] Classified as a liability and excludes capitalised transaction costs. Additional Tier 1 capital instruments and Tier 2 capital instruments are itemised in Note 20. Further details on convertibility for Additional Tier 1 and Tier 2 capital instruments are noted in Note 20.

Capital Structure

Refer to Note 20 Loan capital and Note 21 Share capital for information on the Banking Group's capital structure.

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Credit risk subject to the Internal Rating Based ('IRB') approach

Credit risk exposures by asset class

The Banking Group's credit risk exposures by asset class as at 30 September 2020

Exposure-weighted PD Grade (%)	Weighted Average PD %	EAD $ millions	Exposure-weighted LGD %	Exposure-weighted Risk Weight %	Risk-weighted Assets[1] $ millions	Minimum Pillar 1 Capital Requirement $ millions
Residential mortgages						
Up to and including 0.10	-	-	-	-	-	-
Over 0.10 up to and including 0.50	0.47	26,185	14.94	12.11	3,362	269
Over 0.50 up to and including 1.0	0.70	23,296	21.71	23.57	5,820	466
Over 1.0 up to and including 2.5	1.52	12,175	22.73	43.56	5,621	450
Over 2.5 up to and including 10.0	3.95	1,062	27.17	99.37	1,118	89
Over 10.0 up to and including 99.99	-	-	-	-	-	-
Default	100.00	475	22.23	104.05	524	42
Total	1.56	63,193	19.19	24.55	16,445	1,316
Other retail						
Up to and including 0.10	0.05	772	46.39	6.83	56	4
Over 0.10 up to and including 0.50	0.19	861	54.63	21.40	196	16
Over 0.50 up to and including 1.0	0.54	293	55.80	41.89	130	10
Over 1.0 up to and including 2.5	1.86	692	70.12	86.76	637	51
Over 2.5 up to and including 10.0	5.60	506	71.74	107.57	577	46
Over 10.0 up to and including 99.99	21.90	148	82.03	176.35	276	22
Default	100.00	35	85.05	49.34	18	1
Total	3.39	3,307	60.21	53.90	1,890	150
Small business						
Up to and including 0.10	0.10	16	22.76	5.65	1	-
Over 0.10 up to and including 0.50	0.36	1,093	25.65	14.77	172	14
Over 0.50 up to and including 1.0	0.91	774	31.34	30.59	252	20
Over 1.0 up to and including 2.5	1.83	441	27.06	34.14	159	13
Over 2.5 up to and including 10.0	4.66	187	28.72	42.16	83	7
Over 10.0 up to and including 99.99	15.08	24	32.13	61.66	15	1
Default	100.00	47	33.03	286.61	141	11
Total	3.02	2,582	28.00	30.08	823	66

[1] The value of the scalar used in determining the risk weighted assets is 1.06 as required by the conditions of registration.

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Exposure-weighted PD Grade (%)	Weighted Average PD %	EAD $ millions	Exposure-weighted LGD %	Exposure-weighted Risk Weight %	Risk-weighted Assets[1] $ millions	Minimum Pillar 1 Capital Requirement $ millions
Corporate/Business lending						
Up to and including 0.04	0.03	4,723	44.68	20.67	1,035	83
Over 0.04 up to and including 0.10	0.07	4,125	49.59	28.75	1,257	101
Over 0.10 up to and including 0.40	0.21	8,232	46.10	42.11	3,675	294
Over 0.40 up to and including 3.0	1.31	15,931	33.85	67.13	11,336	907
Over 3.0 up to and including 10.0	4.78	700	33.88	102.96	764	61
Over 10.0 up to and including 99.0	24.85	1,073	37.09	187.84	2,136	171
Default	100.00	176	55.46	303.36	566	45
Total	2.02	34,960	40.26	56.04	20,769	1,662
Sovereign						
Up to and including 0.04	0.01	8,810	7.08	1.39	130	11
Over 0.04 up to and including 0.10	-	-	-	-	-	-
Over 0.10 up to and including 0.40	-	-	-	-	-	-
Over 0.40 up to and including 3.0	-	-	-	-	-	-
Over 3.0 up to and including 10.0	-	-	-	-	-	-
Over 10.0 up to and including 99.0	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	0.01	8,810	7.08	1.39	130	11
Bank						
Up to and including 0.04	0.03	2,666	17.34	5.22	148	12
Over 0.04 up to and including 0.10	0.05	498	48.61	19.58	103	8
Over 0.10 up to and including 0.40	0.17	75	60.00	36.46	29	2
Over 0.40 up to and including 3.0	0.74	30	57.72	106.61	34	3
Over 3.0 up to and including 10.0	-	-	-	-	-	-
Over 10.0 up to and including 99.0	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	0.04	3,269	23.46	9.05	314	25
Total credit risk exposures subject to the internal ratings based approach		116,121			40,371	3,230

[1] The value of the scalar used in determining the risk weighted assets is 1.06 as required by the conditions of registration

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

The following table summarises the Banking Group's credit risk exposures by asset class arising from undrawn commitments and other off-balance sheet exposures. These unaudited amounts are included in the previous tables.

	Undrawn Commitments and Other Off-balance Sheet Amounts		Market Related Contracts	
$ millions	**Value**	**EAD**	**Value**	**EAD**
Residential mortgages	**11,074**	**8,245**	-	-
Other retail	**3,154**	**1,799**	-	-
Small business	**937**	**775**	-	-
Corporate/Business lending	**11,437**	**11,554**	-	-
Sovereign	**80**	**80**	-	-
Bank	**975**	**1,084**	-	-
Total	**27,657**	**23,537**	-	-

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 Banking Group's valuation of the residential security at origination.

The 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 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.

	THE 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**

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Specialised lending subject to the slotting approach

The Banking Group's specialised lending: Project and property finance credit risk exposures as at 30 September 2020

	Total Exposures After Credit Risk Mitigation $ millions	Risk Weight %	Risk-weighted Assets[1] $ millions	Minimum Pillar 1 Capital Requirement $ millions
Supervisory slotting grade				
Strong	5,074	70.00	3,765	301
Good	2,184	90.00	2,084	166
Satisfactory	159	115.00	194	16
Weak	198	250.00	524	42
Default	16	-	-	-
Total on-balance sheet exposures	7,631	81.18	6,567	525
Undrawn commitments and other off-balance sheet exposures	1,163	81.13	1,000	80
Total specialised lending exposures (on and off-balance sheet)	8,794	81.17	7,567	605

[1] The value of the scalar used in determining the risk weighted assets is 1.06 as required by the conditions of registration.

Credit risk exposures subject to the standardised approach

The Banking Group's credit risk exposures subject to the standardised approach as at 30 September 2020

Calculation of on-balance sheet exposures

	Total Exposure After Credit Risk Mitigation $ millions	Average Risk Weight %	Risk-weighted Exposure[1] $ millions	Minimum Pillar 1 Capital Requirement $ millions
Other assets[2]	1,460	50.47	781	63
Total on-balance sheet exposures	1,460		781	63

[1] The value of the scalar used in determining the risk weighted assets is 1.06 as required by the conditions of registration.

[2] Relate to property and equipment, other assets and related parties.

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Calculation of off-balance sheet exposures

	Total Exposure or Principal Amount $ millions	Average Credit Conversion Factor %	Credit Equivalent Amount $ millions	Average Risk Weight %	Risk-weighted Exposure[1] $ millions	Minimum Pillar 1 Capital Requirement $ millions
Market related contracts subject to the standardised approach						
FX contracts	14,311	N/A	960	20.00	204	16
Interest rate contracts	34,400	N/A	47	20.00	10	1
Credit value adjustment	-	N/A	-	-	204	16
Total market related contracts subject to the standardised approach	48,711		1,007		418	33
Standardised subtotal (on and off-balance sheet)			2,467		1,199	96

[1] The value of the scalar used in determining the risk weighted assets is 1.06 as required by the conditions of registration.

Credit risk mitigation

The Banking Group uses a variety of techniques to reduce the credit risk arising from its lending activities. This includes the Banking Group establishing that it has direct, irrevocable and unconditional recourse to collateral and other credit enhancements through obtaining legally enforceable documentation.

The Banking Group includes the effect of credit risk mitigation through eligible guarantees within the calculation applied to LGD. Due to system limitations, the value of the guarantee is not always separately recorded, and therefore, neither this value nor a close alternative is available for disclosure, under Clause 7 of Schedule 11 to the Order.

Equity risk

The Banking Group's equity exposures as at 30 September 2020

Equity	Total Exposure $ millions	Risk Weight %	Risk-weighted Exposure[1] $ millions	Minimum Pillar 1 Capital Requirement $ millions
Equity holdings (not deducted from capital) that are publicly traded	-	300	-	-
All other equity holdings (not deducted from capital)	-	400	2	-

[1] The value of the scalar used in determining the risk weighted assets is 1.06 as required by the conditions of registration.

Operational risk

Operational risk capital requirement

The following table sets out the Banking Group's unaudited implied risk-weighted exposures under the Advanced Measurement Approach ('**AMA**') methodology and the operational risk capital requirement.

	THE BANKING GROUP	
	2020	
$ millions	Implied Risk-weighted Exposure	Total Operational Risk Capital Requirement
Advanced Measurement Approach		
Operational risk	4,834	387

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Market risk

Market risk notional capital charges

The Banking Group's aggregate market risk exposure is derived in accordance with BS2B and is calculated on a six monthly basis. The end-of-period aggregate market risk exposure is calculated from the period end balance sheet information.

For each category of market risk, the Banking Group's peak end-of-day aggregate capital charge is derived by determining the maximum over the six 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 BS2B.

The following table provides a summary of the 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:

	THE BANKING GROUP	
	2020	
$ millions	Implied Risk-weighted Exposure	Aggregate Capital Charge
End-of-period		
Interest rate risk	1,589	127
Foreign currency risk	-	-
Equity risk	-	-
Peak end-of-day		
Interest rate risk	2,773	222
Foreign currency risk	-	-
Equity risk	-	-

Total capital requirements
Banking Group Pillar I Total Capital Requirement

	THE BANKING GROUP		
	2020		
$ millions	Total Exposure After Credit Risk Mitigation	Risk-weighted Exposure or Implied Risk-weighted Exposure	Total Capital Requirement
Credit risk			
Exposures subject to the internal ratings based approach	116,121	40,371	3,230
Equity exposures	-	2	-
Specialised lending subject to the slotting approach	8,794	7,567	605
Exposures subject to the standardised approach	2,467	1,199	96
Total credit risk (scaled)[1]	127,382	49,139	3,931
Operational risk	N/A	4,834	387
Market risk	N/A	1,589	127
Total	127,382	55,562	4,445

[1] The value of the scalar used in determining the credit risk weighted exposure is 1.06 as required by the conditions of registration.

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Capital ratios

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

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

The following table is disclosed under the Reserve Bank's Basel III framework in accordance with Clauses 15 and 16 of Schedule 11 to the Order and represents the capital adequacy calculation based on BS2B.

	THE BANKING GROUP			THE BANK	
%	Reserve Bank Minimum Ratios[1]	30 Sep 20	30 Sep 19[1]	30 Sep 20	30 Sep 19
Common Equity Tier 1 capital ratio	4.5	**12.3**	11.3	**11.4**	10.6
Tier 1 capital ratio	6.0	**15.0**	13.9	**13.9**	13.0
Total capital ratio	8.0	**17.1**	15.9	**15.8**	14.9
Buffer ratio	2.5	**7.8**	4.8	**N/A**	N/A

[1] Changes to the Bank's conditions of registration, effective from 31 December 2017, increased the minimum capital ratios by 2% compared to the minimum capital ratios as at 30 September 2017. The increased minimum capital ratios were to remain in place until the Bank had satisfied the Reserve Bank that all existing issues in relation to the matters of non-compliance had been resolved. Effective from 31 December 2019, the Reserve Bank amended the Bank's conditions of registration to remove the two percentage point overlay applying to its minimum capital requirements. Refer to the 'Non-compliance with conditions of registration' section on page 113 for further details.

Capital for other material risks

Summary of ICAAP

The Banking Group's ICAAP outlines the Banking Group's approach to meeting minimum capital requirements and confirming that capital held by the Bank is commensurate with its risk profile. The Banking Group's ICAAP complies with the requirements set out in the Reserve Bank document 'Guidelines on a Bank's Internal Capital Adequacy Assessment Process (ICAAP)' (BS12) in accordance with the Bank's Conditions of Registration.

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

The Banking Group's ICAAP identifies, reviews and measures additional material risks that must be captured within the Banking Group's capital adequacy assessment process. The additional material risks considered are those not captured by Pillar 1 regulatory capital requirements and include compliance risk, conduct risk, liquidity risk, reputational risk, environmental, social and governance risk, business/strategic risk, other assets risk, model risk, deferred acquisition cost risk and subsidiary risk.

The Banking Group's internal capital allocation for 'other material risks' is $268 million as at 30 September 2020 (30 September 2019: $254 million).

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Ultimate Parent Bank Group Basel III capital adequacy ratios

The following table represents the capital adequacy calculation for the Ultimate Parent Bank and the Ultimate Parent Bank Group based on APRA's application of the Basel III capital adequacy framework.

%	30 Sep 20	30 Sep 19
Ultimate Parent Bank 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
Ultimate Parent 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 Ultimate Parent Bank Group are publicly available in the Ultimate Parent Bank Group's Pillar 3 report. This information is made available to users via the Ultimate Parent Bank's website (www.westpac.com.au).

[2] Ultimate Parent Bank Group (excluding entities specifically excluded by APRA regulations) comprises the consolidation of the Ultimate Parent 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 Ultimate Parent Bank.

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

Under APRA's Prudential Standards, ADIs, including the Ultimate Parent Bank Group and the Ultimate Parent 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 Ultimate Parent Bank Group is accredited by APRA to apply advanced models permitted by the Basel III global capital adequacy regime. The Ultimate Parent Bank Group uses the Advanced Internal Ratings Based ('**Advanced IRB**') approach for credit risk, the AMA for operational risk and the internal model approach for IRRBB 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 BCBS, except where APRA has exercised certain discretions.

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

iv. Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited) (continued)

Regulatory liquidity ratios

The Bank calculates liquidity ratios in accordance with the BS13. Ratios are calculated daily and are part of the Bank's management of liquidity risk. Quarterly, average ratios are produced in line with the Reserve Bank rules and guidance.

	THE BANKING GOUP	
%	**30 Sep 20**	30 Jun 20
Average for the three months ended		
One-week mismatch ratio	**4.4**	5.0
One-month mismatch ratio	**3.4**	4.6
Core funding ratio	**82.9**	82.8

In the current reporting period, the Banking Group has restated the one-week and one-month mismatch ratios for the three months ended 30 June 2020 as presented in the table above. The restatement was due to the Banking Group having amended the methodology used to determine the cash inflows of certain revolving credit products and cash outflows of its 32 day constant maturity deposit product for the purpose of calculating the one-week and one-month mismatch ratios, as the previous methodology was non-compliant with BS13. Refer to page 113 "non-compliance with conditions of registration" for further information. The one-week and one-month mismatch ratios for the three months ended 30 September 2020 and three months ended 30 June 2020 have been calculated in accordance with the amended methodology. As at 30 September 2020, the Banking Group held sufficient liquid assets to maintain mismatch ratios above the regulatory minimums when calculated in accordance with the amended compliant methodology. This methodology change has had no impact on the Banking Group's core funding ratio for current or prior periods.

v. Concentration of credit exposures to individual counterparties

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

The number of individual bank and non-bank counterparties to which the Banking Group has an aggregate credit exposure or peak end-of-day aggregate credit exposure that equals or exceeds 10% of the Banking Group's Common Equity Tier 1 capital:

	THE BANKING GROUP	
	2020	
% of Banking Group's Common Equity Tier 1 Capital	Bank Counterparties[1] Long-term credit rating A- or A3 and above	Non-bank Counterparties[2] Long-term credit rating A- or A3 and above
As at 30 September 2020[3]		
Exceeds 10% and not 15%	-	-
Exceeds 15% and not 20%	-	2
Peak end-of-day aggregate credit exposure for the six months ended 30 September 2020[3]		
Exceeds 10% and not 15%	2	3
Exceeds 15% and not 20%	-	2

[1] A counterparty is a bank counterparty if it is a bank that is not a member of a group of closely related counterparties or it is a group of closely related counterparties of which a bank is the parent.

[2] A counterparty is a non-bank counterparty if it is a non-bank that is not a member of a group of closely related counterparties or it is a group of closely related counterparties of which a bank is not the parent.

[3] There were no individual bank or non-bank counterparties with aggregate credit exposure that equals or exceeds 10% of the Banking Group's Common Equity Tier 1 capital and with a long-term credit rating of less than A- or A3, or its equivalent, or unrated.

The peak end-of-day aggregate credit exposure to each individual counterparty (which are not members of a group of closely related counterparties) or a group of closely related counterparties has been calculated by determining the maximum end-of-day aggregate amount of actual credit exposure over the six-month period ending 30 September 2020, and then dividing that amount by the Banking Group's Common Equity Tier 1 capital as at 30 September 2020.

Credit exposures to individual counterparties (not being members of a group of closely related counterparties) and to groups of closely related counterparties exclude exposures to connected persons, to the central government or central bank of any country with a long-term credit rating of A- or A3 or above, or its equivalent, or to any supranational or quasi-sovereign agency with a long-term credit rating of A- or A3 or above, or its equivalent. These calculations relate only to exposures held in the financial records of the Banking Group and were calculated net of individually assessed provisions.

vi. Credit exposures to connected persons

The Banking Group's credit exposure to connected persons is derived in accordance with the Bank's conditions of registration and the Reserve Bank document 'Connected Exposures Policy' (BS8), is net of individual credit impairment allowances and excludes advances to connected persons of a capital nature.

The Reserve Bank defines connected persons to be other members of the Ultimate Parent Bank Group and Directors of the Bank. Controlled entities of the Bank are not connected persons. Credit exposures to connected persons are based on actual credit exposures rather than internal limits. Peak end-of-day aggregate credit exposures to connected persons expressed as a percentage of Tier 1 capital of the Banking Group have been derived by determining the maximum end-of-day aggregate amount of credit exposure over the year ended 30 September 2020 and then dividing that amount by the Banking Group's Tier 1 capital as at 30 September 2020.

Credit exposures to connected persons reported in the following table have been calculated on a bilateral net basis. Netting has occurred in respect of certain transactions which are the subject of a bilateral netting agreement. On this basis, there is a limit of 125% of the Banking Group's Tier 1 capital in respect of the gross amount of aggregate credit exposure to connected persons that can be netted off in determining the net exposure.

	THE BANKING GROUP	
$ millions	**As at 30 Sep 20**	**Peak End-of-day for the Year Ended 30 Sep 20**
Credit exposures to connected persons:		
On gross basis, before netting	**1,251**	**5,262**
As a percentage of Tier 1 capital of the Banking Group at end of the year	**15.0%**	**63.2%**
Amount that has been netted off in determining the net exposure	**330**	**3,213**
As a percentage of Tier 1 capital of the Banking Group at end of the year	**4.0%**	**38.6%**
On partial bilateral net basis	**921**	**2,049**
As a percentage of Tier 1 capital of the Banking Group at end of the year	**11.1%**	**24.6%**
Credit exposures to non-bank connected persons	**20**	**22**
As a percentage of Tier 1 capital of the Banking Group at end of the year	**0.2%**	**0.3%**

As at 30 September 2020, the rating-contingent limit applicable to the Banking Group was 60% of Tier 1 capital on a bilateral net basis. There have been no changes to this rating-contingent limit over the year ended 30 September 2020. Within the overall rating-contingent limit there is a sub-limit of 15% of Tier 1 capital which applies to the aggregate credit exposure to non-bank connected persons.

Where a bank is funding a large loan it is common practice to share the risk of a customer default through risk transfer to an acceptable entity. These arrangements are called risk lay-off arrangements. As at 30 September 2020, the Banking Group had $17 million of aggregate contingent exposures to connected persons arising from risk lay-off arrangements in respect of credit exposures to counterparties (excluding counterparties that are connected persons).

The aggregate amount of the Banking Group's loss allowance for credit exposures to connected persons that are credit impaired was nil as at 30 September 2020.

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

Insurance business

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

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

Securitisation

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

Funds management and other fiduciary activities

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

The PIE Funds are administered by the Banking Group (refer to Note 22 for further details) and invest in deposits with the Bank. The Bank is considered to control the PIE Funds, and as such they are consolidated within the financial statements of the Banking Group. As at 30 September 2020, $3,278 million (30 September 2019: $3,418 million) of funds under management were invested by the PIE Funds in the Bank's deposits.

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 Banking Group (30 September 2019: nil).

Marketing and distribution of insurance products

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

Arrangements to ensure no adverse impacts arising from the above activities

The 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 Banking Group.

Financial services provided to entities conducting the above activities

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

Assets purchased from entities conducting the above activities

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

Funding provided to entities in aggregate and individually

During the year ended 30 September 2020, the Banking Group did not provide any funding to entities conducting funds management and other fiduciary activities, securitisation activities or insurance product marketing and distribution activities described in this note (30 September 2019: nil).

Registered bank disclosures

viii. Risk management policies

Information about risk

Risk management framework

The Banking Group regards the management of risk to be a fundamental management activity performed at all levels of its business. The 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 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 Banking Group's desired risk profile.

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

Business units and corporate core functions are responsible for identifying, evaluating and managing the risks that 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, and opines on, the adequacy and effectiveness of the overall risk management framework and controls to the Board and senior executives.

Financial risks

Refer to Note 32 Financial risk management for a discussion of the financial risks faced by the 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 Banking Group's financial performance, customer service and/or reputation in the community or cause other damage to the business.

The Banking Group has an Operational Risk Management Framework, which is aligned to the Ultimate Parent Bank's Operational Risk Framework and outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management, and reporting and monitoring. This Framework is approved by the BRCC.

The AMA methodology for calculating operational risk capital has been implemented which takes into account internal and external factors and scenario analysis. An allocation methodology is in place for the economic capital calculated.

The Bank's RISKCO, chaired by the Bank's Chief Risk Officer, is responsible for overseeing the effectiveness and implementation of the Operational Risk and Compliance Frameworks. RISKCO monitors the operational risk profiles and the action plans, and has the discretion to escalate material matters to the Bank's BRCC and/or the relevant Ultimate Parent Bank Group Risk Committee.

Compliance and conduct risk

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

Compliance and conduct risk management is a cornerstone of the way the Banking Group conducts business as it ensures the protection of the entity and its stakeholders. Effective compliance and conduct risk management enables the Bank to identify emerging issues and, where necessary, put in place preventative measures. The Bank has Compliance Management and Conduct Frameworks in place and a dedicated compliance function to assist the business in managing its compliance and conducts risks.

The Bank's RISKCO, chaired by the Bank's Chief Risk Officer, is responsible for overseeing the effectiveness and implementation of the Compliance Management and Conduct Frameworks. RISKCO oversees compliance and conduct risks across the Banking Group within the context of risk appetite determined by the Board, and has the discretion to escalate material matters to the Bank's BRCC and/or the relevant Ultimate Parent Bank Group Risk Committee.

viii. Risk management policies (continued)

Other risk classes include:

- Financial Crime: the risk that the Banking Group fails to prevent financial crime and comply with applicable global financial crime regulatory obligations;
- Cyber Risk: the risk that the 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 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 Banking Groups' integrity and competence by clients, counterparties, investors, regulators, employees or the public.

Capital adequacy

Refer to Note 31 Capital management for the Banking Group's approach to assessing the adequacy of its capital to support current and future activities and the role that directors and senior management take in the capital management process.

Reviews of the Banking Group's risk management systems

The Ultimate Parent Bank Group Audit's Credit Portfolio Review function has a rolling programme of credit and model risk reviews throughout the financial year. The Banking Group's independent assurance unit ('**New Zealand Audit**'), with support from the Ultimate Parent Bank's Group Audit unit, also periodically reviews the Bank'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 Banking Group or the Ultimate Parent Bank, though they are independent and have no direct authority over the activities of management.

Various external reviews of the Bank'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 Banking Group

New Zealand Audit comprises a New Zealand based audit team, supported by the Ultimate Parent Bank Credit Portfolio Review (including Model Risk) functions, which report to the Bank's BAC, as well as to the Ultimate Parent Bank.

New Zealand Audit, as an independent function, has no direct authority over the activities of management. It has unlimited access to all of the 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 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. The Head of New Zealand Audit reports on a quarterly basis, or more often as deemed appropriate, to the Bank's BAC, to agree the budget and the annual audit plan and to report its findings. In addition, the Bank's BAC has private sessions with the Head of New Zealand Audit. Furthermore, the Head of New Zealand Audit reports to the Chair of the Bank's BAC, and for administrative purposes to the Bank's Chief Financial Officer and the Ultimate Parent Bank's General Manager Group Audit.

The Bank's BAC assists the Board in fulfilling its responsibilities in relation to:

- external reporting of financial information, internal control of operational risk, the efficiency and effectiveness of audit and compliance with regulatory and statutory reporting requirements; and
- the review of the interim and annual financial statements, the activities of the Banking Group's internal auditors and monitoring of the relationship between management and the external auditors.

viii. Risk management policies (continued)

Measurement of impaired assets

Impaired assets are measured on a monthly basis. Refer to Note 6 Impairment charges/(benefits) and Note 12 Provision for expected credit losses which describe the approaches the Banking Group follows for assessing asset impairment.

Recoverable amounts are represented by net loans, which are calculated as gross loans less provisions for impairment.

Credit risk mitigation

Refer to Note 32.2.2 Credit risk mitigation, collateral and other credit enhancements and Note 25 Offsetting financial assets and financial liabilities for the policies and processes the Banking Group follows to mitigate credit risk.

Where the effect of credit risk mitigation through eligible collateral is used to reduce our measure of risk, the Banking Group, as an Advanced Internal Ratings Based ('**AIRB**') Bank, uses the comprehensive method to measure the mitigating effects of the collateral or eligible guarantees.

Additional information about credit risk

Classification of Banking Group exposures according to rating approach

The Banking Group reports capital adequacy under BS2B. Under the IRB approach for the measurement of credit risk, banks use their own tools to calculate both expected and unexpected loss probabilities for their customers and exposures. For exposures classified under specialised lending, the Banking Group uses slotting tables supplied by the Reserve Bank rather than internal estimates. The Banking Group has some minor portfolios that, due to system or other constraints, are not assessed under an IRB approach. Risk weights for these exposures are assessed for capital adequacy under the standardised approach as set out in the Reserve Bank document Capital Adequacy Framework (Standardised Approach) ('**BS2A**').

Asset Class	Banking Group Category	Segmentation Criteria	Rating Approach
Corporate	Corporate	All transaction-managed customers not elsewhere classified where annual turnover exceeds $50 million.	IRB
	Business lending	All transaction-managed customers not elsewhere classified where annual turnover is $50 million or less.	IRB
	Specialised lending - property finance	Applied to transaction-managed customers where the primary source of debt service, security and repayment is derived from either the sale of a property development or income produced by one or more investment properties.	IRB - Slotting
	Specialised lending - project finance	Applied to transaction-managed customers where the primary source of debt service, repayment and security is revenues generated by a project.	IRB - Slotting
Sovereign	Sovereign	Applied to transaction-managed customers identified by ANZSIC code.	IRB
Bank	Bank	Applied to transaction-managed customers identified by ANZSIC code and public sector entities.	IRB
Residential mortgages	Residential mortgages	All program-managed exposures secured by residential mortgages defined as housing lending.	IRB
Other retail	Small business	Program-managed business lending.	IRB
	Other retail	All other program-managed lending to retail customers, including credit cards, personal loans and personal overdrafts.	IRB
Equity	Equity	All equity items that have not been deducted from capital and meet the definition of equity exposures in paragraph 4.8 of BS2B.	IRB
Other assets	Other assets	All other assets not falling within the above classes.	Standardised

viii. Risk management policies (continued)

Overview of the internal credit risk ratings process by portfolio

(a) Transaction-managed approach (including business lending, corporate, Sovereign and bank)

The process for assignment and approval of individual PDs and LGDs involves business unit representatives recommending the CRGs and LGDs under criteria guidelines. Credit Officers then independently evaluate the recommendations and approve the final outcomes. An expert judgement decision-making process is employed to evaluate the CRG. The following represent the types of business lending, corporate, sovereign and banking exposures included within the transaction-managed portfolio approach:

- direct lending exposures;
- contingent lending exposures;
- pre-settlement exposures;
- FX settlement exposures; and
- transaction exposures.

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

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

PD

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

LGD

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

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

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

EAD and Credit Conversion Factor ('CCF')

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

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

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

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

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

viii. Risk management policies (continued)

PD

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

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

LGD

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

EAD

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

Additional information about operational risk

Calculating operational risk capital

Operational risk regulatory capital is calculated on a quarterly basis.

The Banking Group operational risk capital is based on three data sources:

- Internal Loss Data – operational risk losses experienced by the Banking Group;
- External Loss Data – operational risk losses experienced by other financial institutions; and
- Scenario Data – potential losses from severe but plausible events relevant to the Banking Group.

These data sources together represent the internal and external operational risk profile, across the spectrum of operational risk losses, from both historical and forward-looking perspectives. The model combines these data sources to produce a loss distribution.

No adjustments or deductions are currently made to the Banking Group's measurement of operational risk regulatory capital for the mitigating impacts of insurance or expected operational risk losses.

Controls surrounding credit risk rating systems

Refer to Note 32.1 Risk management frameworks and Note 32.2.1 Credit risk ratings system for a discussion of the control mechanisms for the rating systems the Banking Group uses to measure credit risk.

Conditions of registration

Conditions of registration for Westpac New Zealand Limited

The registration of the Bank in New Zealand is subject to the following conditions, which applied on and after 1 May 2020:

The registration of the Bank as a registered bank is subject to the following conditions:

1. That:
   (a) the Total capital ratio of the Banking Group is not less than 8%;
   (b) the Tier 1 capital ratio of the Banking Group is not less than 6%;
   (c) the Common Equity Tier 1 capital ratio of the Banking Group is not less than 4.5%;
   (d) the Total capital of the Banking Group is not less than $30 million;
   (e) the bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and
   (f) the bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document 'Application requirements for capital recognition or repayment and notification requirements in respect of capital' ('**BS16**') dated November 2015 in respect of regulatory capital instruments.

   For the purposes of this condition of registration:

   the scalar referred to in the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' ('**BS2B**') dated November 2015 is 1.06;

   'Total capital ratio', 'Tier 1 capital ratio', and 'Common Equity Tier 1 capital ratio' have the same meaning as in Part 3 of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015;

   'Total capital' has the same meaning as in Part 2 of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015;

   an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 2.13(a) or (c) of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015;

   a Tier 2 capital instrument is an instrument that meets the requirements of subsection 2.16(a) or (c) of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015.

1A. That:
   (a) the bank has an internal capital adequacy assessment process ('**ICAAP**') that accords with the requirements set out in the document 'Guidelines on a bank's internal capital adequacy assessment process ('ICAAP')' ('**BS12**') dated December 2007;
   (b) under its ICAAP the bank identifies and measures its 'other material risks' defined as all material risks of the Banking Group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015; and

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

1B. That the bank complies with the minimum requirements set out in the following sections of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015:
   (a) the model approval requirements in section 1.3A;
   (b) the compendium requirements in section 1.3B;
   (c) the minimum requirements for the IRB approach in sections 4.217 to 4.324 (that is, Subpart 4C of BS2B); and
   (d) the minimum requirements for using the AMA approach for operational risk set out in sections 8.4 to 8.34.

1C. That, if the buffer ratio of the Banking Group is 2.5% or less, the bank must:
   (a) according to the following table, limit any distributions of the bank's earnings payable to holders of Additional Tier 1 capital instruments to the percentage limit on distributions that corresponds to the Banking Group's buffer ratio:

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

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

   For the purposes of this condition of registration:

   an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 2.13(a) or (c) of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015;

   'buffer ratio', 'distributions', and 'earnings' have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015.

   the scalar referred to in the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015 is 1.06.

1D. That the bank must make no distributions, whether paid out of earnings, or out of accumulated previous years' retained earnings or other reserves included within the banking group's total capital, other than discretionary payments payable to holders of Additional Tier 1 capital instruments to the extent permitted by condition 1C.

   For the purposes of this condition of registration:

   an Additional Tier 1 capital instrument is an instrument that meets the requirements of subsection 2.13(a) or (c) of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015;

   'total capital' has the same meaning as in Part 2 of the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015;

Conditions of registration

'distributions' and 'earnings' have the same meaning as in Part 3 of the Reserve Bank of New Zealand document: 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015.

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

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

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

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

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

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

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

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

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

   For the purposes of this condition of registration:

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

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

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

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

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

   Within the rating-contingent limit, credit exposures (of a non-capital nature and net of any allowances for impairment) to non-bank connected persons shall not exceed 15% of the Banking Group's Tier 1 capital.

   For the purposes of this condition of registration, compliance with the rating-contingent connected exposure limit is determined in accordance with the Reserve Bank of New Zealand document entitled 'Connected exposures policy' (BS8) dated November 2015.

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

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

   (a) the board of the bank must have at least five directors;

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

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

   (d) an alternate director:

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

   (ii) for an independent director must be independent;

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

   (f) the chairperson of the board of the bank must be independent; and

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

   For the purposes of this condition of registration, 'non-executive' and 'independent' have the same meaning as in the Reserve Bank of New Zealand document entitled 'Corporate Governance' (BS14) dated July 2014.

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:

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

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

8. That a person must not be appointed as chairperson of the board of the bank unless:

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

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

9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:

   (a) the mandate of the committee must include: ensuring the integrity of the bank's financial controls, reporting systems and internal audit standards;

   (b) the committee must have at least three members;

   (c) every member of the committee must be a non-executive director of the bank;

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(d) the majority of the members of the committee must be independent; and

(e) the chairperson of the committee must be independent and must not be the chairperson of the bank.

For the purposes of this condition of registration, 'non-executive' and 'independent' have the same meaning as in the Reserve Bank of New Zealand document entitled 'Corporate Governance' (BS14) dated July 2014.

10. That a substantial proportion of the bank's business is conducted in and from New Zealand.

11. That the bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the bank that are carried on by a person other than the bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the bank or of a service provider to the bank, the following outcomes:

(a) that the bank's clearing and settlement obligations due on a day can be met on that day;

(b) that the bank's financial risk positions on a day can be identified on that day;

(c) that the bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and

(d) that the bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

This condition ceases to apply in respect of an existing outsourcing arrangement on the earlier of either 1 October 2023 or when the existing outsourcing arrangement becomes compliant with condition 25, from which point in time condition 25 will apply to that outsourcing arrangement.

For the purpose of this condition of registration:

(a) the term 'legal and practical ability to control and execute' is explained in the Reserve Bank of New Zealand document entitled 'Outsourcing Policy' (BS11) dated January 2006; and

(b) the term 'existing outsourcing arrangement' is defined in the Reserve Bank of New Zealand document entitled 'Outsourcing Policy' (BS11) dated April 2020.

12. That:

(a) the business and affairs of the bank are managed by, or under the direction or supervision of, the board of the bank;

(b) the employment contract of the chief executive officer of the bank or person in an equivalent position (together '**CEO**') is with the bank, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the bank; and

(c) all staff employed by the bank have their remuneration determined by (or under the delegated authority of) the board or the CEO of the bank and are accountable (directly or indirectly) to the CEO of the bank.

13. That, for the purposes of calculating the bank's capital ratios on a solo basis, a credit conversion factor of zero is only applied to a guarantee of a financing subsidiary's financial obligations if, in substance, the guarantee does not create a risk of loss for the bank.

14. That the Banking Group complies with the following quantitative requirements for liquidity-risk management:

(a) the one-week mismatch ratio of the Banking Group is not less than zero per cent at the end of each business day;

(b) the one-month mismatch ratio of the Banking Group is not less than zero per cent at the end of each business day; and

(c) the one-year core funding ratio of the Banking Group is not less than 50 per cent at the end of each business day.

For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled 'Liquidity Policy' (BS13) dated January 2018 and 'Liquidity Policy Annex: Liquid Assets' (BS13A) dated October 2018.

15. That the bank has an internal framework for liquidity risk management that is adequate in the bank's view for managing the bank's liquidity risk at a prudent level, and that, in particular:

(a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;

(b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;

(c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and

(d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.

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

For the purposes of this condition,:

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

'SPV' means a person:

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

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

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

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

17. That:

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

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

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

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

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

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

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

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

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

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

(i) all liabilities are frozen in full; and

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

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

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

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

(e) maintain a full freeze on liabilities not pre-positioned for open bank resolution; and

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

For the purposes of this condition of registration, 'de minimis', 'partial freeze', 'customer liability account', and 'frozen and unfrozen funds' have the same meaning as in the Reserve Bank of New Zealand document 'Open Bank Resolution (OBR) Pre-positioning Requirements Policy' (BS17) dated September 2013.

19. That the bank has an Implementation Plan that:

(a) is up-to-date; and

(b) demonstrates that the bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: 'Open Bank Resolution Pre-positioning Requirements Policy' (BS 17) dated September 2013.

For the purposes of this condition of registration, 'Implementation Plan' has the same meaning as in the Reserve Bank of New Zealand document 'Open Bank Resolution (OBR) Pre-positioning Requirements Policy' (BS17) dated September 2013.

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

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

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

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

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

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

For the purposes of this condition of registration, 'compendium of liabilities', and 'pre-positioned and non pre-positioned liabilities' have the same meaning as in the Reserve Bank of New Zealand document 'Open Bank Resolution (OBR) Pre-positioning Requirements Policy' (BS17) dated September 2013.

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

For the purposes of this condition of registration, 'Implementation Plan' has the same meaning as in the Reserve Bank of New Zealand document 'Open Bank Resolution (OBR) Pre-positioning Requirements Policy' (BS17) dated September 2013.

22. That the bank must comply with the Reserve Bank of New Zealand document 'Outsourcing Policy' (BS11) dated April 2020.

In these conditions of registration,:

'Banking Group' means Westpac New Zealand Limited (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

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

Conditions of registration

Non-compliance with conditions of registration

In June 2019, in response to a review under section 95 of the Reserve Bank Act of the Bank's compliance with advanced internal rating based aspects of the Reserve Bank's 'Capital Adequacy Framework (Internal Models Based Approach)' ('BS2B'), the Bank presented the Reserve Bank with a submission providing an overview of its credit risk rating system and activities undertaken since FY17 to address compliance issues and enhance risk management practices.

On 30 October 2019, the Reserve Bank informed the Bank that it had accepted the submission and measures undertaken by the Bank to achieve satisfactory compliance with BS2B, and that the Bank 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 the Bank 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.

During the reporting period, the Bank was non-compliant with condition of registration 1B (which requires the Bank to comply with aspects of BS2B) in relation to the matters disclosed below.

- It operated versions of various capital models which were not approved by the Reserve Bank, in some cases since December 2008, and it failed to meet the Reserve Bank's requirements in relation to model documentation and associated model documentation policies. On 30 October 2019, the Reserve Bank confirmed its approval of all unapproved models, other than a PD model for a small number of corporate exposures. Work is underway to address this issue.
- The Model Compendium required under 1.3B of BS2B ('Compendium') was not accurate. Further to the Reserve Bank's determination, an updated Compendium has been submitted to the Reserve Bank for review and was subsequently approved on 24 January 2020.
- It is not fully compliant with paragraph 4.246 of BS2B in that, with the exception of wholesale property development and investment customers, non-retail risk grade credit policy overrides are not captured and monitored. A new system to capture relevant non-retail customer credit data has been built, is in use and will address this issue.
- It is not fully compliant with paragraph 4.248 of BS2B in that not all historical origination data for non-retail customers is maintained in a format that allows easy accessibility to key data used to derive the original risk rating. A new system to capture relevant non-retail customer credit data has been built, is in use and will address this issue.

During the reporting period, the Bank was also non-compliant with condition of registration 1B that was in effect prior to 1 January 2019 in relation to the matters below. These matters do not result in non-compliance with the current version of condition of registration 1B in effect from 1 January 2019.

- It was not fully compliant with paragraph 4.4 of BS2B in that a small number of Corporate asset class exposures were incorrectly classified as Retail SME asset class exposures. The amount is not assessed to be material.
- It was not fully compliant with paragraph 4.61A of BS2B in that, in respect of a small number of agricultural customers, it used the customer limit rather than the current balance for calculating loan-to-value ratio ('LVR'). This resulted in an understatement of Risk Weighted Assets ('RWA'). The amount is not assessed to be material.
- For less than one percent of its residential mortgages by loan value, its use of total committed exposure rather than EAD for calculating LVR for capital adequacy purposes does not meet the minimum LGD requirements of paragraph 4.150 A of BS2B. Additionally, for less than 5% of accounts by number, the security value utilised within the calculation of LVR is an updated valuation and not the origination value as required by that paragraph. These issues were addressed by the Mortgage LGD model approved by the Reserve Bank on 30 October 2019.
- It is not fully compliant with paragraphs 4.86-4.97 of BS2B in that for some exposures where the maturity measure is missing, the default maturity applied is not a conservative measure. The amount is not assessed to be material.

As disclosed in Note iv. of the Registered bank disclosures, the Bank considers its current internal credit model methodologies result in the retention of an appropriate amount of capital to reflect its credit risk. Any effect of the non-compliance with condition of registration 1B on the information relating to capital adequacy disclosed in Note iv. of the Registered bank disclosures was not considered by the Bank to be material.

The Bank was non-compliant with Condition of Registration 14 (requiring compliance with three quantitative ratios for liquidity risk management) in that:

- the methodology used by the Bank since 2017 to determine the cash inflows of certain revolving credit products for the purpose of calculating the mismatch ratios was not in compliance with paragraph 29 of the Reserve Bank's 'Liquidity Policy' ('BS13') which requires any simplifying assumptions adopted by the Bank in any of the quantitative ratios to have the effect of decreasing the value of the ratio; and
- the methodology used by the Bank since 2012 to determine the cash outflows of its 32 day constant maturity deposit product for the purpose of calculating the mismatch ratios was not in compliance with BS13 as it did not take into account a product feature not included in the product terms and conditions which had the effect of allowing the product to be withdrawn prior to the 32 day notice period.

Following recalculation of the mismatch ratios for the relevant revolving credit products and its 32 day constant maturity deposit product (together, the Products) in accordance with the compliant methodology (and, for the purposes of the recalculation, assuming no mitigating action had been taken by the Bank), the Bank's mismatch ratios would have fallen below the regulatory minimum specified in Condition of Registration 14, on a number of occasions in prior periods. The Bank has corrected the methodology for calculating its mismatch ratios for the Products and the impact of the past non-compliance is presented in the restated table in Note iv Capital adequacy under the internal models based approach, and regulatory liquidity ratios (Unaudited).

The Bank considers that, had it applied BS13 compliant treatment to the Products, it would have taken corrective action to ensure it was holding sufficient liquid assets to maintain mismatch ratios above the regulatory minimums.

Conditions of registration

The Bank identified the following non-compliances with condition of registration 22, which requires compliance with the Reserve Bank Outsourcing Policy ('BS11'):

– The Bank renewed three existing outsourcing arrangements (as defined in BS11) for licensing and support of software applications (and related dedicated hardware for one application) and did not have in place the required risk mitigants for the arrangements as required by BS11. The outsourcing arrangements have been amended to include the requisite risk mitigants.

– The Bank did not renew nine outsourcing arrangements (as defined in BS11) by the contract expiry dates, including for courier services, test resourcing, monitoring services and the licensing and/or support of various software applications, but it continued to receive services from the relevant vendors and make payment. The outsourcing arrangements have either been terminated or amended to include the required risk mitigants for the arrangements as required by BS11.

– The Bank's compendium of outsourcing arrangements ('Compendium') did not include the upfront costs for sixteen outsourcing arrangements as is required to be included for each outsourcing arrangement by BS11. The Compendium has been amended to include such costs.

– The Bank did not include one existing outsourcing arrangement (as defined in BS11) in its Compendium by 1 October 2019 and did not include one new outsourcing arrangement with the requisite 20 working days of it becoming effective, both as required by BS11. The Compendium has been amended to include the arrangements.

Changes to conditions of registration

The Reserve Bank amended the Bank's conditions of registration:

– with effect from 2 April 2020:

  – to ban distributions and to restrict the extent to which distributions on Additional Tier 1 capital instruments are permitted;
  – to reduce the minimum core funding ratio from 75% to 50%; and
  – to extend the transition period for the Reserve Bank Outsourcing Policy ('BS11') by 12 months; and

– with effect from 1 May 2020 the Reserve Bank amended the Bank's conditions of registration to remove restrictions on the Bank's new residential mortgage lending at high loan-to-valuation ('LVR') ratios.

Independent auditor's report

To the shareholder of Westpac New Zealand Limited

This report is for the Banking Group, comprising Westpac New Zealand Limited (the 'Bank') and the entities it controlled at 30 September 2020 or from time to time during the financial year.

This report includes our:

- audit opinion on the financial statements prepared in accordance with Clause 24 of the Registered Bank Disclosure Statements (New Zealand 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, 13, 14, 15 and 17 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 capital adequacy and regulatory liquidity requirements prepared in accordance with Schedule 11 of the Order.

Report on the audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

We have audited the Banking Group's financial statements required by Clause 24 of the Order and the supplementary information required by Schedules 4, 7, 13, 14, 15 and 17 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, 13, 14, 15 and 17 of the Order.

Our opinion

In our opinion:

- the Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 11, 13, 14, 15 and 17 of the Order and included within notes ii to viii of the registered bank disclosures):
  1. comply with generally accepted accounting practice in New Zealand;
  2. comply with NZ IFRS and IFRS; and
  3. give a true and fair view of the financial position of the 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, 13, 14, 15 and 17 of the Order and included within notes ii, iii and v to viii of the registered bank disclosures:
  1. 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;
  2. is in accordance with the books and records of the Banking Group; and
  3. 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 capital adequacy and regulatory liquidity requirements)* 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 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 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. In addition, certain partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the Banking Group. These matters have not impaired our independence as auditor of the 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	How our audit addressed the 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 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 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.	Our audit procedures included testing the effectiveness of controls relating to the 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;

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 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:

(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.

- 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 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;
- considering the impacts of events occurring subsequent to balance date on the ECL for loans and credit commitments; and
- assessing the appropriateness of the Banking Group's disclosures against the requirements of NZ IFRS.

Operation of IT systems and controls

We focused on this area because the 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 Banking Group's IT General Controls (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 Banking Group materiality: $52.0 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 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 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 Banking Group, the accounting processes and controls, and the industry in which the Banking Group operates. Certain operational processes which are critical to financial reporting for the 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 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 of the Bank (the 'Directors') are responsible, on behalf of the Bank, for the other information included in the Annual Report and Disclosure Statement. The other information includes the Annual Report and information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 5 to 7, 80 to 85 and 109 to 114. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

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

Responsibilities of the Directors for the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

The Directors are responsible, on behalf of the Bank, for the preparation of the financial statements in accordance with Clause 24 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 the supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order.

In preparing the financial statements, the Directors are responsible for assessing the 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 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 capital adequacy and regulatory liquidity requirements)

Our objectives are to obtain reasonable assurance about whether the financial statements, as a whole, and the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in note iv of the registered bank disclosures) disclosed in accordance with Clause 24 and Schedules 4, 7, 13, 14, 15 and 17 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 capital adequacy and regulatory liquidity requirements)

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 capital adequacy and regulatory liquidity requirements 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 Banking Group as far as appears from an examination of those records.

Report on the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements

We have examined the supplementary information relating to capital adequacy and regulatory liquidity requirements required by Schedule 11 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 capital adequacy and regulatory liquidity requirements disclosed in note iv of the registered bank disclosures, is not, in all material respects, disclosed in accordance with Schedule 11 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 capital adequacy and regulatory liquidity requirements* section of our report.

Responsibilities of the Directors for the supplementary information relating to capital adequacy and regulatory liquidity requirements

The Directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 11 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 capital adequacy and regulatory liquidity requirements that is free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the review of the supplementary information relating to capital adequacy and regulatory liquidity requirements

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in note iv of the registered bank disclosures, is not, in all material respects, disclosed in accordance with Schedule 11 of the Order.

A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements 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 capital adequacy and regulatory liquidity requirements disclosed in note iv of the registered bank disclosures.

Who we report to

This report is made solely to the Bank's shareholder. 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 the Bank and the Bank's shareholder, for our work, for this report or for the opinions and conclusion we have formed.

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants

Auckland

20 November 2020