Westpac Banking Corporation - New Zealand Banking Group

Disclosure Statement

For the year ended 30 September 2019

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Glossary of terms

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

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

- **Overseas Bank** – refers to Westpac Banking Corporation;
- **Overseas Banking Group** – refers to the Overseas Bank and all other entities included in the Overseas Bank's group for the purposes of public reporting of the group financial statements in Australia;
- **NZ Branch** – refers to the New Zealand business (as defined in the Order) of the Overseas Bank;
- **Westpac New Zealand** – refers to Westpac New Zealand Limited; and
- **NZ Banking Group** – refers to the financial reporting group (as defined in the Order) of the Overseas Bank. Controlled entities of the NZ Banking Group as at 30 September 2019 are set out in Note 22 Related entities.

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

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

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

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

(b) is not false or misleading.

Each Director of the Overseas Bank and the Chief Executive Officer, NZ Branch, believe, after due enquiry, that, over the year ended 30 September 2019:

(a) the Overseas Bank has complied with all conditions of registration that applied during that period; and

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

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

David McLean

Karen Silk

Dated this 28th day of November 2019

Income statement for the year ended 30 September 2019

$ millions	Note	NZ BANKING GROUP 2019[1]	2018[1]
Interest income:			
Calculated using the effective interest rate method	2	**4,029**	3,980
Other	2	**90**	87
Total Interest income	2	**4,119**	4,067
Interest expense	2	**(2,121)**	(2,155)
Net interest income		**1,998**	1,912
Net fees and commissions income	3	**201**	268
Net wealth management and insurance income	3	**197**	152
Trading income	3	**115**	139
Other income	3	**49**	14
Net operating income before operating expenses and impairment charges		**2,560**	2,485
Operating expenses	4	**(1,018)**	(940)
Impairment (charges)/benefits	6	**10**	3
Profit before income tax		**1,552**	1,548
Income tax expense	7	**(423)**	(431)
Net profit attributable to the owners of the NZ Banking Group		**1,129**	1,117

[1] The NZ Banking Group has adopted NZ IFRS 9 *Financial Instruments* ('**NZ IFRS 9**') and NZ IFRS 15 *Revenue from Contracts with Customers* ('**NZ IFRS 15**') from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

Statement of comprehensive income for the year ended 30 September 2019

$ millions	NZ BANKING GROUP 2019[1]	2018[1]
Net profit attributable to the owners of the NZ Banking Group	**1,129**	1,117
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss		
Gains/(losses) recognised in equity on:		
Investment securities	**(8)**	-
Cash flow hedging instruments	**(86)**	(34)
Transferred to income statement:		
Cash flow hedging instruments	**74**	46
Income tax on items taken to or transferred from equity:		
Investment securities reserve	**3**	-
Cash flow hedge reserve	**3**	(3)
Items that will not be reclassified subsequently to profit or loss (net of tax)		
Remeasurement of defined benefit obligation	**(10)**	(2)
Other comprehensive income for the year (net of tax)	**(24)**	7
Total comprehensive income attributable to the owners of the NZ Banking Group	**1,105**	**1,124**

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

Balance sheet as at 30 September 2019

$ millions	Note	NZ BANKING GROUP 2019[1]	2018[1]
Assets			
Cash and balances with central banks	33	**2,002**	1,472
Collateral paid		**417**	180
Trading securities and financial assets measured at fair value through income statement ('**FVIS**')	9	**4,871**	3,016
Derivative financial instruments	23	**6,257**	3,509
Available-for-sale securities	10	**-**	3,810
Investment securities	10	**4,469**	-
Loans	11	**84,626**	80,860
Other financial assets	13	**400**	468
Life insurance assets		**335**	310
Due from related entities	22	**2,367**	2,023
Property and equipment		**137**	144
Deferred tax assets	15	**138**	127
Intangible assets	16	**685**	683
Other assets		**58**	54
Total assets		**106,762**	96,656
Liabilities			
Collateral received		**623**	591
Deposits and other borrowings	17	**65,606**	63,105
Other financial liabilities	18	**1,748**	1,622
Derivative financial instruments	23	**5,825**	3,569
Due to related entities	22	**2,892**	2,440
Debt issues	19	**17,846**	13,725
Current tax liabilities		**91**	111
Provisions	20	**150**	120
Other liabilities		**139**	124
Loan capital	21	**3,185**	2,866
Total liabilities		**98,105**	88,273
Net assets		**8,657**	8,383
Head office account			
Branch capital		**1,300**	1,300
Retained profits		**989**	869
Total head office account		**2,289**	2,169
NZ Banking Group equity			
Share capital		**143**	143
Reserves		**(69)**	(55)
Retained profits		**6,294**	6,126
Total NZ Banking Group equity		**6,368**	6,214
Total equity attributable to the owners of the NZ Banking Group		**8,657**	8,383

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

Signed on behalf of the Board of Directors.

Director

28 November 2019

Director

28 November 2019

Statement of changes in equity for the year ended 30 September 2019

	NZ BANKING GROUP							
	NZ BRANCH		OTHER MEMBERS OF THE NZ BANKING GROUP					
	Head Office Account			Reserves				
$ millions	Branch Capital	Retained Profits	Share Capital	Available-for-sale Securities Reserve	Investment Securities Reserve	Cash Flow Hedge Reserve	Retained Profits	Total Equity
As at 1 October 2017	1,300	740	143	9	-	(73)	5,712	7,831
Year ended 30 September 2018								
Net profit attributable to the owners of the NZ Banking Group	-	129	-	-	-	-	988	1,117
Net gains/(losses) from changes in fair value	-	-	-	-	-	(34)	-	(34)
Income tax effect	-	-	-	-	-	10	-	10
Transferred to income statement	-	-	-	-	-	46	-	46
Income tax effect	-	-	-	-	-	(13)	-	(13)
Remeasurement of defined benefit obligations	-	-	-	-	-	-	(3)	(3)
Income tax effect	-	-	-	-	-	-	1	1
Total comprehensive income for the year ended 30 September 2018	-	129	-	-	-	9	986	1,124
Transactions with owners:								
Dividends paid on ordinary shares (refer to Note 22)	-	-	-	-	-	-	(572)	(572)
As at 30 September 2018	1,300	869	143	9	-	(64)	6,126	8,383
Impact on adoption of new accounting standards[1]	**-**	**-**	**-**	**(9)**	**9**	**-**	**(24)**	**(24)**
As at 1 October 2018 (restated)	**1,300**	**869**	**143**	**-**	**9**	**(64)**	**6,102**	**8,359**
Year ended 30 September 2019								
Net profit attributable to the owners of the NZ Banking Group	**-**	**120**	**-**	**-**	**-**	**-**	**1,009**	**1,129**
Net gains/(losses) from changes in fair value	**-**	**-**	**-**	**-**	**(8)**	**(86)**	**-**	**(94)**
Income tax effect	**-**	**-**	**-**	**-**	**3**	**24**	**-**	**27**
Transferred to income statement	**-**	**-**	**-**	**-**	**-**	**74**	**-**	**74**
Income tax effect	**-**	**-**	**-**	**-**	**-**	**(21)**	**-**	**(21)**
Remeasurement of defined benefit obligations	**-**	**-**	**-**	**-**	**-**	**-**	**(14)**	**(14)**
Income tax effect	**-**	**-**	**-**	**-**	**-**	**-**	**4**	**4**
Total comprehensive income for the year ended 30 September 2019	**-**	**120**	**-**	**-**	**(5)**	**(9)**	**999**	**1,105**
Transactions with owners:								
Dividends paid on ordinary shares (refer to Note 22)	**-**	**-**	**-**	**-**	**-**	**-**	**(807)**	**(807)**
As at 30 September 2019	**1,300**	**989**	**143**	**-**	**4**	**(73)**	**6,294**	**8,657**

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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 2019

$ millions	Note	NZ BANKING GROUP 2019[1]	2018[1]
Cash flows from operating activities			
Interest received		**4,148**	4,062
Interest paid		**(2,140)**	(2,175)
Non-interest income received		**478**	485
Operating expenses paid		**(868)**	(838)
Income tax paid		**(435)**	(402)
Cash flows from operating activities before changes in operating assets and liabilities		**1,183**	1,132
Net (increase)/decrease in:			
Collateral paid		**(237)**	251
Trading securities and financial assets measured at FVIS		**(1,841)**	1,052
Loans		**(3,687)**	(3,172)
Other financial assets		**(19)**	(7)
Due from related entities		**184**	643
Net increase/(decrease) in:			
Collateral received		**32**	400
Deposits and other borrowings		**2,501**	4,107
Other financial liabilities		**237**	(172)
Due to related entities		**38**	(880)
Other liabilities		**1**	1
Net movement in external and related entity derivative financial instruments		**229**	1,143
Net cash provided by/(used in) operating activities	33	**(1,379)**	4,498
Cash flows from investing activities			
Purchase of available-for-sale securities		**-**	(268)
Proceeds from available-for-sale securities		**-**	499
Purchase of investment securities		**(2,009)**	-
Proceeds from investment securities		**1,387**	-
Net movement in life insurance assets		**(25)**	(6)
Proceeds from disposal of associates		**48**	-
Purchase of capitalised computer software		**(62)**	(64)
Purchase of property and equipment		**(35)**	(44)
Net cash provided by/(used in) investing activities		**(696)**	117
Cash flows from financing activities			
Net movement in due to related entities		**(279)**	(401)
Proceeds from debt issues	19	**8,707**	550
Repayments of debt issues	19	**(5,001)**	(4,464)
Dividends paid to ordinary shareholders	22	**(807)**	(572)
Net cash provided by/(used in) financing activities		**2,620**	(4,887)
Net increase/(decrease) in cash and cash equivalents		**545**	(272)
Cash and cash equivalents at the beginning of the year		**1,529**	1,801
Cash and cash equivalents at the end of the year	33	**2,074**	1,529

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

Notes to the financial statements

Note 1 Financial statements preparation

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

- **Overseas Bank** – refers to Westpac Banking Corporation;
- **Overseas Banking Group** – refers to the Overseas Bank and all other entities included in the Overseas Bank's group for the purposes of public reporting of the group financial statements in Australia;
- **NZ Branch** – refers to the New Zealand business (as defined in the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) ('**Order**')) of the Overseas Bank;
- **Westpac New Zealand** – refers to Westpac New Zealand Limited; and
- **NZ Banking Group** – refers to the financial reporting group (as defined in the Order) of the Overseas Bank. Controlled entities of the NZ Banking Group as at 30 September 2019 are set out in Note 22 Related entities.

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

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

The financial statements are for the NZ Banking Group.

These financial statements were authorised for issue by the Overseas Bank's Board of Directors (the '**Board**') on 28 November 2019. The Board has the power to amend the financial statements after they are authorised for issue.

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

a. Basis of preparation

(i) Basis of accounting

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

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

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

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

(ii) Historical cost convention

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

(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 'Changes in accounting policies' section below or the relevant note.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

(iv) Changes in accounting policies

Voluntary presentation changes

Balance sheet

The following voluntary presentation changes to the balance sheet (and related notes) have been made to improve consistency and provide more relevant information to the users of the financial statements by reporting balances of a similar nature together in the same place in the balance sheet. These changes have no effect on the measurement of these items and therefore had no impact on retained earnings or net profit.

These changes are:

- the addition of new balance sheet lines for 'collateral paid', 'other financial assets', 'collateral received' and 'other financial liabilities';
- removal of the balance sheet line 'receivables due from other financial institutions' and reclassification to 'collateral paid' and 'other financial assets';
- removal of the balance sheet line 'payables due to other financial institutions' and reclassification to 'collateral received' and 'other financial liabilities';
- removal of the balance sheet line 'other financial liabilities at fair value through income statement' and reclassification to 'other financial liabilities'; and
- reclassification of financial assets or financial liabilities included in other assets or other liabilities, respectively, to other financial assets and other financial liabilities, respectively.

Collateral paid/collateral received relates to cash provided to/received from counterparties as collateral over financial liabilities/assets arising from derivative contracts. It includes initial and variation margin placed as security for derivative transactions.

Comparatives have been restated for these voluntary presentation changes and are detailed as follows:

	NZ BANKING GROUP		
	2018		
$ millions	Reported	Presentation changes	Restated
Assets			
Receivables due from other financial institutions	**237**	**(237)**	**-**
Collateral paid	**-**	**180**	**180**
Other financial assets	**-**	**468**	**468**
Other assets	**465**	**(411)**	**54**
All other assets	**95,954**	**-**	**95,954**
Total assets	**96,656**	**-**	**96,656**
Liabilities			
Payables due to other financial institutions	**1,253**	**(1,253)**	**-**
Collateral received	**-**	**591**	**591**
Other financial liabilities at fair value through income statement	**223**	**(223)**	**-**
Other financial liabilities	**-**	**1,622**	**1,622**
Other liabilities	**861**	**(737)**	**124**
All other liabilities	**85,936**	**-**	**85,936**
Total liabilities	**88,273**	**-**	**88,273**

Income statement

The following voluntary presentation changes to the income statement (and related notes) have been made to provide more relevant information to the users of the financial statements. These changes have no effect on the measurement of these items and therefore had no impact on retained earnings or net profit.

Net interest income

- the components of interest income and interest expense relating to the balance sheet reclassifications have been restated accordingly. Note that there was no net impact to total interest income, total interest expense or to net interest income. Comparatives have been restated for these voluntary presentation changes. Refer to Note 2.
- in addition, to comply with disclosure requirements, interest income calculated using the effective interest rate method has been presented separately from other interest income. For consistency, within Note 2, interest expense is presented in the same way. The details are provided in Note 2.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

Non-interest income and operating expenses

- disaggregating the non-interest income line on the income statement into four separate lines for net fees and commissions income, net wealth management and insurance income, trading income and other income.
- separating net fees and commissions income in the non-interest income note into fees and commissions income and fees and commissions expenses.
- reclassifying credit card loyalty program expense included in purchased services from operating expenses to the new fees and commissions expenses category in the non-interest income note.

Fees and commissions expenses include those expenses that are incremental external costs that vary directly with the provision of goods or services to customers (excluding expenses which would qualify as transaction costs relating to the issue, acquisition or disposal of a financial asset or a financial liability which are deferred and included in the effective interest rate and recognised in net interest income).

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.

Comparatives have been restated for these voluntary presentation changes and are detailed in the table below.

	NZ BANKING GROUP		
	2018		
$ millions	Reported	Presentation changes	Restated
Income statement			
Net interest income	1,912	-	1,912
Non-interest income	602	(602)	-
Net fees and commissions income	-	268	268
Net wealth management and insurance income	-	152	152
Trading income	-	139	139
Other income	-	14	14
Net operating income before operating expenses and impairment charges	2,514	(29)	2,485
Operating expenses	(969)	29	(940)
Impairment (charges)/benefits	3	-	3
Profit before income tax	1,548	-	1,548
Income tax expense	(431)	-	(431)
Net profit attributable to the owners of the NZ Banking Group	1,117	-	1,117
Note 3: Non-interest income (extract)			
Net fees and commissions income			
Facility fees	61	-	61
Transaction fees and commissions	187	28	215
Other non-risk fee income	49	-	49
Fees and commissions income	297	28	325
Credit card loyalty programs	-	(29)	(29)
Transaction fees and commissions related expenses	-	(28)	(28)
Fees and commissions expenses	-	(57)	(57)
Net fees and commissions income	297	(29)	268
Note 4: Operating expenses (extract)			
Purchased services	129	(29)	100
Total operating expenses	969	(29)	940

Notes to the financial statements

Note 1 Financial statements preparation (continued)

(v) Standards adopted during the year ended 30 September 2019

NZ IFRS 9 Financial Instruments (September 2014) (NZ IFRS 9)

The NZ Banking Group adopted NZ IFRS 9 on 1 October 2018. The adoption of NZ IFRS 9 has been applied by adjusting the opening balance sheet at 1 October 2018, with no restatement of comparatives as permitted by the standard. The adoption of NZ IFRS 9 reduced retained earnings at 1 October 2018 by $27 million (net of tax), primarily due to the increase in impairment provisions under the new standard.

Impairment

NZ IFRS 9 introduces a revised impairment model which requires entities to recognise expected credit losses ('**ECL**') based on unbiased forward looking information, replacing the incurred loss model under NZ IAS 39 *Financial instruments: Recognition and Measurement* ('**NZ IAS 39**') which only recognised impairment if there was objective evidence that a loss had been incurred. The revised impairment model applies to all financial assets at amortised cost, investment securities, and credit commitments.

The accounting policy for the provision for ECL under NZ IFRS 9 is detailed in Notes 6 and 12.

Classification and measurement

NZ IFRS 9 replaced the classification and measurement model in NZ IAS 39 with a new model that categorises financial assets based on: a) the business model within which the assets are managed and b) whether the contractual cash flows under the instrument represent solely payments of principal and interest ('**SPPI**').

The accounting policies for the classification and measurement of financial assets and financial liabilities are detailed in Note 1c and in the relevant notes to the financial statements for financial assets and financial liabilities.

In the 2014 financial year, the NZ Banking Group early adopted part of NZ IFRS 9 which relates to the recognition of the changes in fair value of financial liabilities designated at fair value attributable to the NZ Banking Group's own credit risk in other comprehensive income (except where it would create an accounting mismatch, in which case all changes in fair value are recognised in the income statement). As a result, the accounting for this remains unchanged for the NZ Banking Group.

Hedging

NZ IFRS 9 changes hedge accounting by increasing the eligibility of both hedged items and hedging instruments and introducing a more principles based approach to assessing hedge effectiveness. Adoption of the new hedge accounting model is optional until the IASB completes its accounting for dynamic risk management project. Until this time, current hedge accounting under NZ IAS 39 can continue to be applied. The NZ Banking Group has applied the option to continue hedge accounting under NZ IAS 39, however the NZ Banking Group has adopted the amended NZ IFRS 7 *Financial Instruments: Disclosures* ('**NZ IFRS 7**') hedge accounting disclosures as required.

NZ IFRS 15 Revenue from Contracts with Customers (NZ IFRS 15)

The NZ Banking Group adopted NZ IFRS 15 on 1 October 2018. It replaced NZ IAS 18 *Revenue* and related interpretations and applies to all contracts with customers, except leases, financial instruments and insurance contracts. The standard provides a systematic approach to revenue recognition by introducing a five-step model governing revenue measurement and recognition. This includes:

- identifying the contract with customer;
- identifying each of the performance obligations included in the contract;
- determining the amount of consideration in the contract;
- allocating the consideration to each of the identified performance obligations; and
- recognising revenue as each performance obligation is satisfied.

The NZ Banking Group has applied NZ IFRS 15 by increasing the opening balance of retained earnings at the date of initial application, 1 October 2018, by $3 million (net of tax) with no comparative restatement.

In addition, the NZ Banking Group identified certain income and expenses which were previously reported on a net basis primarily within fees and commissions income which are now being presented on a gross basis. This resulted in an increase of $21 million in net fees and commissions income and a corresponding increase in operating expenses for the current year.

Finally, certain facility fees have been reclassified from non-interest income to interest income. This resulted in a decrease of $56 million in net fees and commissions income and a corresponding increase in interest income for the current year.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

Transition (NZ IFRS 9 and NZ IFRS 15)

Impact of the adoption of NZ IFRS 9 – impairment

The following table shows the impact of the adoption of NZ IFRS 9 on impairment balances.

	NZ BANKING GROUP				
$ millions	Provisions on loans	Provisions for credit commitments	Loss allowance on investment securities	Provisions on all other financial assets at amortised cost	Total
30 September 2018 - carrying amount	324	34	-	-	358
Increase in provision for impairment	28	9	-	-	37
1 October 2018 - NZ IFRS 9 carrying amount	352	43	-	-	395

Impact of the adoption of NZ IFRS 9 – loss allowance on loans and credit commitments

The following table shows the impact of the adoption of NZ IFRS 9 on collectively assessed provisions ('**CAP**') and individually assessed provisions ('**IAP**') for loans and credit commitments.

	NZ BANKING GROUP						
	NZ IFRS 9				NZ IAS 39		
	Performing		Non-performing				
	CAP	CAP	CAP	IAP	CAP	IAP	Total
$ millions	Stage 1	Stage 2	Stage 3	Stage 3			
Provision for impairment charges as at 30 September 2018	-	-	-	-	322	36	358
Restatement for adoption of NZ IFRS 9	103	203	53	36	(322)	(36)	37
Restated provision for ECL as at 1 October 2018	103	203	53	36	-	-	395

Impact of the adoption of NZ IFRS 9 - classification and measurement

Available-for-sale securities / Investment securities

The balance sheet line item previously named Available-for-sale securities has been renamed to Investment securities. Investment securities consist of debt securities at FVOCI as the business model is achieved by both collecting the contractual cash flows and selling the instruments and the contractual cash flows represent SPPI.

Basis of measurement

There has been no change in the basis of measurement of financial assets and financial liabilities under NZ IFRS 9 as shown in the 'Reconciliation of the opening balance sheet' section.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

Reconciliation of the opening balance sheet

The table below reconciles the restated 30 September 2018 balance sheet to the 1 October 2018 opening balance sheet on adoption of NZ IFRS 9 and NZ IFRS 15 showing separately the impact of adjustments relating to reclassification and remeasurement, including the related tax impacts.

	NZ BANKING GROUP						
	30 Sep 2018	1 Oct 2018	30 Sep 2018	1 Oct 2018			
				NZ IFRS 9 changes			
$ millions	NZ IAS 39 measurement basis	NZ IFRS 9 measurement basis	Restated carrying amount	Reclass-ification	Remeas-urement	NZ IFRS 15 changes	Opening carrying amount
Assets							
Cash and balances with central banks	Amortised cost	Amortised cost	1,472	-	-	-	1,472
Collateral paid	Amortised cost	Amortised cost	180	-	-	-	180
Trading securities and financial assets measured at FVIS	FVIS	FVIS	3,016	-	-	-	3,016
Derivative financial instruments	FVIS	FVIS	3,509	-	-	-	3,509
Available-for-sale securities	FVOCI	FVOCI	3,810	(3,810)	-	-	-
Investment securities	FVOCI	FVOCI	-	3,810	-	-	3,810
Loans	Amortised cost	Amortised cost	80,860	-	(28)	-	80,832
Other financial assets	Amortised cost	Amortised cost	468	-	-	-	468
Life insurance assets	FVIS	FVIS	310	-	-	-	310
Due from related entities	Amortised cost	Amortised cost	1,564	-	-	-	1,564
	FVIS	FVIS	459	-	-	-	459
Property and equipment	N/A	N/A	144	-	-	-	144
Deferred tax assets	N/A	N/A	127	-	10	(1)	136
Intangible assets	N/A	N/A	683	-	-	-	683
Other assets	N/A	N/A	54	-	-	-	54
Total assets			96,656	-	(18)	(1)	96,637
Liabilities							
Collateral received	Amortised cost	Amortised cost	591	-	-	-	591
Deposits and other borrowings	Amortised cost	Amortised cost	61,884	-	-	-	61,884
	FVIS	FVIS	1,221	-	-	-	1,221
Other financial liabilities	Amortised cost	Amortised cost	1,399	-	-	(4)	1,395
	FVIS	FVIS	223	-	-	-	223
Derivative financial instruments	FVIS	FVIS	3,569	-	-	-	3,569
Due to related entities	Amortised cost	Amortised cost	1,796	-	-	-	1,796
	FVIS	FVIS	644	-	-	-	644
Debt issues	Amortised cost	Amortised cost	13,725	-	-	-	13,725
Current tax liabilities	N/A	N/A	111	-	-	-	111
Provisions	N/A	N/A	120	-	9	-	129
Other liabilities	N/A	N/A	124	-	-	-	124
Loan capital	Amortised cost	Amortised cost	2,866	-	-	-	2,866
Total liabilities			88,273	-	9	(4)	88,278
Net assets			8,383	-	(27)	3	8,359
Head office account							
Branch capital	N/A	N/A	1,300	-	-	-	1,300
Retained profits	N/A	N/A	869	-	-	-	869
Total head office account			2,169	-	-	-	2,169
NZ Banking Group equity							
Share capital	N/A	N/A	143	-	-	-	143
Reserves	N/A	N/A	(55)	-	-	-	(55)
Retained profits	N/A	N/A	6,126	-	(27)	3	6,102
Total NZ Banking Group equity			6,214	-	(27)	3	6,190
Total equity attributable to the owners of the NZ Banking Group			8,383	-	(27)	3	8,359

As permitted by NZ IFRS 9 and NZ IFRS 15, comparatives have not been restated. Comparatives have been restated for voluntary presentation changes as detailed in the section 'Changes in accounting policies' on page 10.

Notes to the financial statements

Note 1 Financial statements preparation (continued)

b. Basis of aggregation

The NZ Banking Group as at 30 September 2019 has been aggregated by combining the sum of the capital and reserves of the NZ Branch, and the consolidated capital and reserves of Westpac New Zealand Group Limited, BT Financial Group (NZ) Limited, Westpac Financial Services Group-NZ-Limited, Westpac Group Investment-NZ-Limited, Capital Finance New Zealand Limited and their subsidiaries (including structured entities). For New Zealand entities acquired by the Overseas Banking Group, capital and reserves at acquisition are netted and recognised as capital contributed to the NZ Banking Group.

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

(i) Business combinations

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

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

(ii) Foreign currency translation

Functional and presentational currency

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

Transactions and balances

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

(iii) Head office account, share capital and reserves

Head office account - Branch capital

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

Ordinary shares

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

Investment securities reserve

This comprises the changes in the fair value of debt securities measured at FVOCI (except for interest income, impairment charges and foreign exchange 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.

c. Financial assets and financial liabilities

(i) Recognition

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

Financial liabilities are recognised when an obligation arises.

(ii) Classification and measurement

As comparatives have not been restated upon the adoption of NZ IFRS 9 the accounting policy applied in 2019 differs to that applied in comparative periods. The accounting policy applied in comparative periods is discussed in Note 35. The accounting policy applied in 2019 is as follows.

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

Notes to the financial statements

Note 1 Financial statements preparation (continued)

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 SPPI.

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

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

Debt instruments

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

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

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

Debt instruments at amortised cost are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. They are presented net of provisions for expected credit losses 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 other comprehensive income except for interest income, impairment charges and foreign exchange 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 other comprehensive income. There is no reduction of the carrying value of the debt security which remains at fair value.

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

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

Financial liabilities

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

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

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

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

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

(iii) Derecognition

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

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

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

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.

Note 1 Financial statements preparation (continued)

d. Critical accounting assumptions and estimates

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

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

e. Future developments in accounting standards

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

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

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

The NZ IFRS 16 implementation and governance program is led by Finance with representatives from the impacted areas of the business with oversight from the Chief Financial Officer. The project has identified the portfolios impacted by that standard which are predominantly property leases. In addition, the project has updated finance systems and processes, established a governance framework, updated relevant policies and addressed key judgements including the transition option that will be applied in order to determine the expected impact to the NZ Banking Group.

The NZ Banking Group will adopt the standard using the simplified approach of transition with no restatement of comparative information. The expected impact on adoption of the standard will be to recognise a ROU asset of approximately $292 million and an equivalent lease liability with no impact on retained earnings.

The NZ Banking Group has determined that it will use the incremental borrowing rate as the discount rate when determining present value. This discount rate will be based on the remaining maturity of the lease at the date of transition. The NZ Banking Group will also apply the practical exemptions for low-value assets and short-term leases.

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

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

Notes to the financial statements

Note 1 Financial statements preparation (continued)

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

On 26 June 2019, the IASB issued an exposure draft proposing a number of amendments to the insurance contracts standard. If approved, these amendments would allow entities to:

- defer acquisition costs for anticipated renewals outside of the initial contract boundary; and
- recognise a gain in the P&L for reinsurance contracts, to offset losses from onerous contracts on initial recognition (to the extent the reinsurance contracts held covers the losses of each contract on a proportionate basis).

In addition, the effective date of the standard would be deferred by one year to be applicable to the NZ Banking Group for the 30 September 2023 financial year.

NZ IFRIC 23 *Uncertainty over Income Tax Treatments* ('**NZ IFRIC 23**') was issued in August 2017 and will be effective for the 30 September 2020 financial year. NZ IFRIC 23 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.

The interpretation is not expected to have a material impact on the NZ Banking Group.

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

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

Interbank-offered rates ('IBOR') reform

IBORs are interest rate benchmarks used in financial markets for pricing, valuing and hedging a wide variety of financial instruments such as derivatives, loans and bonds. Examples of IBOR include the London Interbank Offered Rate ('**LIBOR**') and the Euro Interbank Offered Rate ('**EURIBOR**').

A review of the global major IBORs is being conducted to reform or replace existing IBORs with more suitable alternative reference rates ('**ARRs**'). This IBOR reform will impact the accounting for financial instruments that reference IBORs including hedge accounting, fair value methodologies and existing financial instruments that reference IBORs at transition. This replacement process is at different stages and is progressing at different speeds in different jurisdictions. Therefore, there is uncertainty as to the basis, method, timing and implications of transition to the ARRs.

In November 2019, the External Reporting Board issued amendments to NZ IFRS 9, NZ IAS 39 and NZ IFRS 7 which enable hedge accounting to continue for certain hedges that might otherwise need to be discontinued due to uncertainties arising from IBOR reform and requires certain disclosures. These amendments are effective for the NZ Banking Group for the 30 September 2021 financial year with early application permitted.

As a result of these developments, the NZ Banking Group has applied judgement in the current reporting period to determine that hedge relationships that include IBORs as a hedged risk continue to qualify for hedge accounting. The NZ Banking Group continues to monitor these developments and the expected impact.

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 table below, are recognised using the effective interest rate method. Net income from treasury's interest rate and liquidity management activities is included in net interest income.

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

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

		NZ BANKING GROUP	
$ millions	Note	**2019[1]**	2018[1]
Interest income			
Calculated using the effective interest rate method			
Cash and balances with central banks		**21**	24
Collateral paid		**7**	5
Available-for-sale securities		**-**	148
Investment securities		**138**	-
Loans		**3,832**	3,774
Due from related entities	22	**27**	27
Other interest income		**4**	2
Total interest income calculated using the effective interest rate method		**4,029**	3,980
Other			
Trading securities and financial assets measured at FVIS		**90**	87
Total other		**90**	87
Total interest income		**4,119**	4,067
Interest expense			
Calculated using the effective interest rate method			
Collateral received		**8**	6
Deposits and other borrowings		**1,289**	1,290
Due to related entities	22	**46**	53
Debt issues		**285**	306
Loan capital		**147**	146
Other interest expense		**15**	17
Total interest expense calculated using the effective interest rate method		**1,790**	1,818
Other			
Deposits and other borrowings		**18**	13
Debt issues		**21**	11
Other interest expense[2]		**292**	313
Total other		**331**	337
Total interest expense		**2,121**	2,155
Net interest income		**1,998**	1,912

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

Notes to the financial statements

Note 3 Non-interest income

Accounting policy

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

Net fees and commissions income

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

Fees and commissions income

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

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

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

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 programs which are recognised as an expense when the services are provided on the redemption of points as well as merchant transaction costs.

Net wealth management and insurance income

Wealth management income

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

Net life insurance income and change in policy liabilities

Net insurance policy assets relating to life insurance contracts are calculated by using the margin on service methodology in accordance with New Zealand Society of Actuaries Professional Standard 3 Determination of Life Insurance Policy Liabilities. Under this methodology, planned profit margins and an estimate of future liabilities are calculated separately for each major product line using applied assumptions at each reporting date. Profit margins are released in line with the service that has been provided.

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

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

Trading income

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

Notes to the financial statements

Note 3 Non-interest income (continued)

	NZ BANKING GROUP	
$ millions	**2019[1]**	2018[1]
Net fees and commissions income		
Facility fees	**50**	61
Transaction fees and commissions	**182**	215
Other non-risk fee income	**30**	49
Fees and commissions income	**262**	325
Credit card loyalty programs	**(32)**	(29)
Transaction fees and commissions related expenses	**(29)**	(28)
Fees and commissions expenses	**(61)**	(57)
Net fees and commissions income	**201**	268
Net wealth management and insurance income		
Wealth management income	**59**	55
Net life insurance income and change in policy liabilities	**138**	97
Net wealth management and insurance income	**197**	152
Trading income	**115**	139
Other income		
Net ineffectiveness on qualifying hedges	**2**	4
Other non-interest income[2]	**47**	10
Total other income	**49**	14
Total non-interest income	**562**	573

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

[2] Westpac NZ Operations Limited ('**WNZOL**') sold its 25% shareholding in Paymark Limited to Ingenico Group S.A, resulting in a gain on sale of $40 million for the year ended 30 September 2019. Refer to Note 22 for details.

Deferred income in relation to the credit card loyalty programs for the NZ Banking Group was $31 million as at 30 September 2019 (30 September 2018: $29 million). This will be recognised as fees and commissions income as the credit card reward points are redeemed.

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

Notes to the financial statements

Note 3 Non-interest income (continued)

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

	NZ BANKING GROUP					
$ millions	**Consumer Banking and Wealth**	**Commercial, Corporate and Institutional**	**Investments and Insurance**	**NZ IFRS 9 and NZ IFRS 15 changes**	**Reconciling Items**	**Total**
Year ended 30 September 2019						
Fees and commissions income						
Facility fees	**30**	**15**	**-**	**N/A**	**5**	**50**
Transaction fees and commissions	**100**	**64**	**-**	**N/A**	**18**	**182**
Other non-risk fee income	**5**	**27**	**-**	**N/A**	**(2)**	**30**
Fees and commissions income	**135**	**106**	**-**	**N/A**	**21**	**262**
Fees and commissions expenses	**(56)**	**-**	**-**	**N/A**	**(5)**	**(61)**
Net fees and commissions income	**79**	**106**	**-**	**N/A**	**16**	**201**
Wealth management income	**-**	**-**	**65**	**N/A**	**(6)**	**59**
Year ended 30 September 2018						
Fees and commissions income						
Facility fees	36	14	-	10	1	61
Transaction fees and commissions	88	60	-	16	51	215
Other non-risk fee income	9	28	-	16	(4)	49
Fees and commissions income	133	102	-	42	48	325
Fees and commissions expenses	(49)	-	-	-	(8)	(57)
Net fees and commissions income	84	102	-	42	40	268
Wealth management income	-	-	62	-	(7)	55

Notes to the financial statements

Note 4 Operating expenses

		NZ BANKING GROUP	
$ millions	Note	**2019[1]**	2018[1]
Staff expenses		**523**	484
Operating lease rentals		**58**	63
Depreciation		**39**	44
Technology services and telecommunications		**94**	100
Purchased services		**123**	100
Software amortisation costs		**59**	46
Related entities - management fees	22	**8**	7
Other		**114**	96
Total operating expenses		**1,018**	940

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

Note 5 Auditor's remuneration

	NZ BANKING GROUP	
$'000s	**2019**	2018
Audit and audit related services		
Audit and review of financial statements[1]	**3,146**	2,674
Other audit related services[2]	**241**	192
Total remuneration for audit and other audit related services	**3,387**	2,866
Other services	**-**	-
Total remuneration for non-audit services	**-**	-
Total remuneration for audit, other audit related services and non-audit services	**3,387**	2,866

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

[2] Primarily assurance provided on certain financial information performed in the role of auditor (or where most appropriate to be performed by the auditor) including the issue of comfort letters and agreed procedures reports in relation to debt issuance programmes.

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

The external auditor also provides audit and non-audit services to non-consolidated entities, including non-consolidated trusts of which a member of the NZ Banking Group is manager or responsible entity and non-consolidated superannuation funds or pension funds. During the year ended 30 September 2019, the fees in respect of these services were approximately $ 513,895 (30 September 2018: $ 483,425).

Notes to the financial statements

Note 6 Impairment charges/(benefits)

Accounting policy

As comparatives have not been restated upon the adoption of NZ IFRS 9, the accounting policy applied in 2019 differs to that applied in comparative periods. The accounting policy applied in comparative periods is discussed in Note 35. The accounting policy applied in 2019 is as follows.

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 expected credit losses 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 other comprehensive income with no reduction of the carrying value of the debt security (refer to the statement of changes in equity); and
- Credit commitments: as a provision (refer to Note 20).

Uncollectable loans

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

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

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

The following table details impairment charges for the year ended 30 September 2019 based on the requirements of NZ IFRS 9.

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

Impairment losses on other financial assets are not material to the NZ Banking Group.

As comparatives have not been restated for the adoption of NZ IFRS 9, the following table details impairment charges for the year ended 30 September 2018 based on the requirements of NZ IAS 39. In subsequent reporting periods, as NZ IFRS 9 will have been effective for this disclosure for all periods presented in the Disclosure Statement, this table will no longer be required.

	NZ BANKING GROUP
$ millions	2018
Individually assessed provisions raised	28
Reversal of previously recognised impairment charges	(18)
Collectively assessed provisions raised/(released)	(34)
Bad debts written-off/(recovered) directly to the income statement	21
Total impairment charges/(benefits)	(3)

Notes to the financial statements

Note 7 Income tax expense

Accounting policy

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

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

Goods and services tax ('GST')

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

Critical accounting assumptions and estimates

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Income tax expense		
Current tax:		
Current year	**414**	424
Prior year adjustments	**4**	-
Deferred tax (refer to Note 15):		
Current year	**10**	10
Prior year adjustments	**(5)**	(3)
Total income tax expense	**423**	431
Profit before income tax	**1,552**	1,548
Tax calculated at tax rate of 28%	**435**	433
Income not subject to tax	**(11)**	-
Expenses not deductible for tax purposes	**-**	2
Prior year adjustments	**(1)**	(3)
Other items	**-**	(1)
Total income tax expense	**423**	431

The effective tax rate for the year ended 30 September 2019 was 27.3% (30 September 2018: 27.8%).

Note 8 Imputation credit account

	NZ BANKING GROUP	
$ millions	**2019**	2018
Imputation credits available for use in subsequent reporting periods	**1,235**	1,072

Notes to the financial statements

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Government and semi-government securities	**1,421**	1,143
Other debt securities	**2,409**	1,657
Reverse repurchase agreements	**1,041**	216
Total trading securities and financial assets measured at FVIS	**4,871**	3,016

Note 10 Investment securities/Available-for-sale securities

Accounting policy

As comparatives have not been restated upon the adoption of NZ IFRS 9 the accounting policy applied in 2019 differs to that applied in comparative years. The accounting policy applied in comparative years is discussed in Note 35. The accounting policy applied in 2019 is as follows.

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

Includes 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 other comprehensive income except for interest income, impairment charges and foreign exchange 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 other comprehensive income 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 other comprehensive income is subsequently recognised in the income statement when the instrument is disposed.

Balances recognised under NZ IFRS 9

	NZ BANKING GROUP
$ millions	**2019**[1]
Government and semi-government securities	**2,599**
Other debt securities	**1,870**
Total investment securities	**4,469**

Balances recognised under NZ IAS 39

	NZ BANKING GROUP
$ millions	2018[1]
Government and semi-government securities	2,155
Other debt securities	1,655
Total available-for-sale securities	3,810

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated.

Notes to the financial statements

Note 11 Loans

Accounting policy

As comparatives have not been restated upon the adoption of NZ IFRS 9 the accounting policy applied in 2019 differs to that applied in comparative years. The accounting policy applied in comparative years is discussed in Note 35. The accounting policy applied in 2019 is as follows.

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 provisions for ECL.

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

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

	NZ BANKING GROUP	
$ millions	**2019[1,2]**	2018[1,2]
Residential mortgages	**51,504**	48,893
Other retail	**3,753**	3,928
Corporate	**29,579**	28,085
Other	**111**	278
Total gross loans	**84,947**	81,184
Provisions for ECL/impairment charges on loans (refer to Note 12)	**(321)**	(324)
Total net loans	**84,626**	80,860

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

[2] The NZ Banking Group has changed the presentation of loan categories for consistency with the types of credit exposures defined in the Reserve Bank of New Zealand ('**Reserve Bank**') Capital Adequacy Framework (Internal Models Based Approach) ('**BS2B**'). This has no effect on the balance sheet or income statement. Comparatives have been restated.

Note 12 Provisions for expected credit losses/impairment charges

Accounting policy

As comparatives have not been restated upon the adoption of NZ IFRS 9 the accounting policy applied in 2019 differs to that applied in comparative years. The accounting policy applied in comparative years is discussed in Note 35. The accounting policy applied in 2019 is as follows.

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 other comprehensive income with no reduction of the carrying value of the debt security itself (refer to the statement of changes in equity); and
- Credit commitments: as a provision (refer to Note 20).

Measurement

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

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

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

Model stages
The three stages are as follows:

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

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

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

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

Collective and individual assessment
Financial assets that are in stages 1 and 2 are assessed on a collective basis as are financial assets in stage 3 below specified thresholds. Financial assets that are collectively assessed are grouped in pools of similar assets with similar credit risk characteristics including the type of product and the customer risk grade. Those financial assets in stage 3 above the specified thresholds are assessed on an individual basis.

Expected life

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

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

Note 12 Provisions for expected credit losses/impairment charges (continued)

Accounting policy (continued)

Critical accounting assumptions and estimates

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

Significant increase in credit risk

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

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

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

Forward looking macroeconomic information

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

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

- Base case scenario
  This scenario utilises the internal NZ Banking Group economics forecast used for strategic decision making and forecasting.
- Upside scenario
  This scenario represents a modest improvement on the base case scenario.
- Downside scenario
  This scenario represents a moderate recession.

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

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

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

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

Notes to the financial statements

Note 12 Provisions for expected credit losses/impairment charges (continued)

Loans and credit commitments

The reconciliation of the provision for ECL tables for loans and credit commitments as at 30 September 2019 below are based on the requirements of NZ IFRS 9. They have 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 period (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.

Movements in components of loss allowance - total

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total
Restated provision for ECL 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**
Presented as:					
Provision for ECL on loans (refer to Note 11)	76	164	53	28	321
Provision for ECL on credit commitments (refer to Note 20)	15	16	-	-	31
Total provision for ECL on loans and credit commitments as at 30 September 2019	**91**	**180**	**53**	**28**	**352**

Note 12 Provisions for expected credit losses/impairment charges (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 provisions for ECL on loans.

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

Sensitivity of the provision for ECL

As noted in the accounting policy, the critical accounting assumptions in determining the provision for ECL are the determination of a significant increase in credit risk and the use of probability weighted forward looking macroeconomic scenarios.

Staging sensitivity

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 $26 million for the NZ Banking Group based on applying the average provision coverage ratios by stage to the movement in the gross exposure by stage.

Weighting of macroeconomic scenarios

The NZ Banking Group uses three macro-economic scenarios which are probability weighted based on the NZ Banking Group's best estimate of the relative likelihood of each scenario.

The NZ Banking Group assigned a weighting of 62.5% to the base case scenario, 27.5% to the downside scenario and 10% to the upside scenario as at 30 September 2019. During September 2019 there was a 2.5% reduction in the weighting on the base case scenario from 65% and a corresponding 2.5% increase in the weighting on the downside scenario from 25%. The increase in weighting to the downside scenario was primarily driven by global economic uncertainties.

The base case scenario utilises the NZ Banking Group's economic forecasts and assumes the following one-year outlook: GDP growth of 3.2%, an increase in the rate of growth in commercial property prices and residential property prices to 7% and Reserve Bank bill rate of 1.15%.

The downside scenario represents a moderate recession. In this scenario there is negative GDP growth, declines in commercial and residential property prices and lower interest rates.

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

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

Write-offs still under enforcement activity

The amount of current year write-offs which remain subject to enforcement activity was $43 million for the NZ Banking Group.

Note 12 Provisions for expected credit losses/impairment charges (continued)

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

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

	NZ BANKING GROUP				
	Performing		Non-performing		
	Stage 1	Stage 2	Stage 3	Stage 3	
$ millions	CAP	CAP	CAP	IAP	Total
Residential mortgages					
Restated 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 as at 30 September 2019	22	19	31	6	78
Other retail					
Restated 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 as at 30 September 2019	46	55	19	-	120
Corporate					
Restated 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 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 Provisions for expected credit losses/impairment charges (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:

	NZ 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 at the beginning of the year	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)	(1,825)	(51)	(15)	(3)	(1,894)
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	49,753	1,449	285	17	51,504
Provision for ECL as at 30 September 2019	(19)	(18)	(31)	(6)	(74)
Total net carrying amount as at 30 September 2019	49,734	1,431	254	11	51,430
Other retail					
Total gross carrying amount at the beginning of the year	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)	(102)	123	(2)	-
Transfers to Stage 3 IAP	-	-	(4)	4	-
Net further lending/(repayment)	(371)	120	(12)	-	(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 at the beginning of the year	25,748	2,201	71	65	28,085
Transfers:					
Transfers to Stage 1	1,617	(1,607)	(10)	-	-
Transfers to Stage 2	(2,090)	2,113	(22)	(1)	-
Transfers to Stage 3 CAP	(14)	(63)	85	(8)	-
Transfers to Stage 3 IAP	-	-	(15)	15	-
Net further lending/(repayment)	(53)	127	(49)	(21)	4
New financial assets originated	6,335	-	-	-	6,335
Financial assets derecognised during the year	(4,482)	(346)	(17)	-	(4,845)
Amounts written-off	-	-	-	-	-
Total gross carrying amount as at 30 September 2019	27,061	2,425	43	50	29,579
Provision for ECL as at 30 September 2019	(20)	(95)	(3)	(22)	(140)
Total net carrying amount as at 30 September 2019	27,041	2,330	40	28	29,439

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.

Note 12 Provisions for expected credit losses/impairment charges (continued)

Comparative year information under NZ IAS 39

As comparatives have not been restated for the adoption of NZ IFRS 9, the following table reconciles the 30 September 2018 provision for impairment charges on loans and credit commitments based on the requirements of NZ IAS 39. In subsequent reporting periods, as NZ IFRS 9 will have been effective for this disclosure for all periods presented in the Disclosure Statement, this table will no longer be required.

	NZ BANKING GROUP				
	2018				
$ millions	Residential Mortgages	Other Retail	Corporate	Other	Total
Neither past due nor impaired	47,974	3,726	27,775	278	79,753
Past due but not impaired assets					
Less than 30 days past due	739	143	162	-	1,044
At least 30 days but less than 60 days past due	80	25	6	-	111
At least 60 days but less than 90 days past due	33	10	2	-	45
At least 90 days past due	43	18	25	-	86
Total past due assets not impaired	895	196	195	-	1,286
Individually impaired assets					
Balance at beginning of the year	32	5	136	-	173
Additions	31	8	40	-	79
Amounts written off	(6)	(2)	(14)	-	(22)
Returned to performing or repaid	(33)	(5)	(47)	-	(85)
Balance at end of the year	24	6	115	-	145
Total gross loans	48,893	3,928	28,085	278	81,184
Individually assessed provisions					
Balance at beginning of the year	7	5	36	-	48
Impairment charges/(benefits):					
New provisions	9	2	17	-	28
Reversal of previously recognised impairment charges	(3)	(2)	(13)	-	(18)
Amounts written off	(6)	(2)	(14)	-	(22)
Balance at end of the year	7	3	26	-	36
Collectively assessed provisions					
Balance at beginning of the year	54	97	181	-	332
Impairment charges/(benefits)	(2)	(10)	(22)	-	(34)
Interest adjustments	2	12	10	-	24
Balance at end of the year	54	99	169	-	322
Total provisions for impairment charges on loans and credit commitments	61	102	195	-	358
Provision for credit commitments (refer to Note 20)	-	(4)	(30)	-	(34)
Total provisions for impairment charges on loans	61	98	165	-	324
Total net loans[1]	48,832	3,830	27,920	278	80,860

[1] Total net loans represent the estimated recoverable amounts which are net of provisions for impairment.

Note 13 Other financial assets

	NZ BANKING GROUP	
$ millions	**2019**[1]	2018[1]
Accrued interest receivable	**137**	160
Trade debtors	**5**	6
Securities sold not delivered	**79**	159
Interbank lending	**72**	57
Other	**107**	86
Total other financial assets	**400**	468

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

Notes to the financial statements

Note 14 Life insurance assets

Accounting policy

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

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

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

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

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

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

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

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

Critical accounting assumptions and estimates

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

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

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

Notes to the financial statements

Note 15 Deferred tax assets

Accounting policy

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

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

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

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

Deferred tax is not recognised for the following temporary differences:

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

Critical accounting assumptions and estimates

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Deferred tax assets/(liabilities) comprise the following temporary differences:		
Provisions for ECL/impairment charges on loans[1]	**90**	94
Provisions for ECL/impairment charges on credit commitments[1]	**9**	10
Cash flow hedges	**29**	26
Provision for employee entitlements	**22**	16
Compliance, regulation and remediation provisions	**13**	5
Software, property and equipment	**11**	10
Life insurance policy liabilities	**(43)**	(35)
Financial instruments	**8**	4
Other temporary differences	**(1)**	(3)
Net deferred tax assets	**138**	127
The deferred tax (charge)/credit in income tax expense comprises the following temporary differences:		
Provisions for ECL/impairment charges on loans[1]	**(12)**	(7)
Provisions for ECL/impairment charges on credit commitments[1]	**(3)**	2
Provision for employee entitlements	**2**	2
Compliance, regulation and remediation provisions	**8**	5
Software, property and equipment	**1**	1
Life insurance policy liabilities	**(8)**	(2)
Financial instruments	**4**	(2)
Other temporary differences	**3**	(6)
Total deferred tax (charge)/credit in income tax expense	**(5)**	(7)
The deferred tax (charge)/credit in other comprehensive income comprises the following temporary differences:		
Cash flow hedges	**3**	(3)
Provision for employee entitlements	**4**	1
Total deferred tax (charge)/credit in other comprehensive income	**7**	(2)
The deferred tax adjustment to opening retained earnings comprises the following temporary differences:		
Provisions for ECL/impairment charges on loans[1]	**8**	-
Provisions for ECL/impairment charges on credit commitments[1]	**2**	-
Other temporary differences[1]	**(1)**	-
Total deferred tax adjustment to opening retained earnings	**9**	-

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. Refer to Note 1 for further details.

Notes to the financial statements

Note 16 Intangible assets

Accounting policy

Indefinite life intangible assets

Goodwill

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

i. the consideration paid; over

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

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

Finite life intangible assets

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

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

Critical accounting assumptions and estimates

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Goodwill	**525**	525
Computer software	**160**	158
Total intangible assets	**685**	683

Significant assumptions used in recoverable amount calculations

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

- NZ Banking Group's equity rate was 11.0% (2018: 11.0%)
- NZ Banking Group's adjusted pre-tax equity rate was 15.3% (2018: 15.3%)

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

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

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

Goodwill has been allocated to the following CGUs:

	NZ BANKING GROUP	
$ millions	**2019**	2018
Consumer Banking and Wealth	**512**	512
BT New Zealand[1]	**13**	13
Net carrying amount of goodwill	**525**	525

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

Notes to the financial statements

Note 17 Deposits and other borrowings

Accounting policy

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

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

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

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Certificates of deposit	**1,142**	1,218
Non-interest bearing, repayable at call	**6,871**	5,903
Other interest bearing:		
At call	**24,053**	23,335
Term	**33,540**	32,649
Total deposits and other borrowings	**65,606**	63,105
Deposits at fair value	**1,142**	1,221
Deposits at amortised cost	**64,464**	61,884
Total deposits and other borrowings	**65,606**	63,105

Note 18 Other financial liabilities

Accounting policy

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

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

Repurchase agreements

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

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

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

Notes to the financial statements

Note 18 Other financial liabilities (continued)

	NZ BANKING GROUP	
$ millions	**2019[1]**	2018[1]
Accrued interest payable	**337**	361
Securities purchased not delivered	**92**	184
Trade creditors and other accrued expenses	**65**	56
Interbank placements	**1,032**	662
Securities sold short	**188**	182
Repurchase agreements	**19**	41
Other	**15**	136
Total other financial liabilities	**1,748**	1,622
Other financial liabilities at fair value	**207**	223
Other financial liabilities at amortised cost	**1,541**	1,399
Total other financial liabilities	**1,748**	1,622

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

Notes to the financial statements

Note 19 Debt issues

Accounting policy

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

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

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

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

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Short-term debt		
Commercial paper	**2,312**	-
Total short-term debt	**2,312**	-
Long-term debt		
Non-domestic medium-term notes	**7,343**	6,100
Covered bonds	**5,263**	5,640
Domestic medium-term notes	**2,928**	1,985
Total long-term debt	**15,534**	13,725
Total debt issues	**17,846**	13,725
Debt issues at fair value	**2,312**	-
Debt issues at amortised cost	**15,534**	13,725
Total debt issues	**17,846**	13,725

	NZ BANKING GROUP	
$ millions	**2019**	2018
Movement reconciliation		
Balance at beginning of the year	**13,725**	16,729
Issuances	**8,707**	550
Maturities, repayments, buy backs and reductions	**(5,001)**	(4,464)
Total cash movements	**3,706**	(3,914)
Foreign exchange translation impact	**273**	933
Fair value adjustments	**-**	(1)
Fair value hedge accounting adjustments	**144**	(27)
Other[1]	**(2)**	5
Total non-cash movements	**415**	910
Balance at end of the year	**17,846**	13,725

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

Notes to the financial statements

Note 20 Provisions

Accounting policy

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

Employee benefits – annual leave and other employee benefits

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

Provision for impairment on credit commitments

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

Compliance, regulation and remediation provisions

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Annual leave and other employee benefits	**69**	66
Provision for impairment on credit commitments (refer to Note 12)	**31**	34
Compliance, regulation and remediation provisions[1]	**48**	17
Other	**2**	3
Total provisions	**150**	120

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

Note 21 Loan capital

Accounting policy

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

		NZ BANKING GROUP	
$ millions	**Note**	**2019**	2018
Additional Tier 1 loan capital - USD AT1 securities[1]		**2,064**	1,731
Tier 2 loan capital - Convertible subordinated notes[1]	22	**1,121**	1,135
Total loan capital		**3,185**	2,866

[1] Net of capitalised transaction costs.

	NZ BANKING GROUP	
$ millions	**2019**	2018
Movement reconciliation		
Balance at beginning of the year	**2,866**	2,822
Total cash movements	**-**	-
Foreign exchange translation impact	**89**	163
Fair value hedge accounting adjustments	**229**	(120)
Other[1]	**1**	1
Total non-cash movements	**319**	44
Balance at end of the year	**3,185**	2,866

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

Notes to the financial statements

Note 21 Loan capital (continued)

Additional Tier 1 loan capital

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

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

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

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

Interest payable

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

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

Redemption

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

Conversion

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

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

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

Tier 2 loan capital

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

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

Interest payable

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

Early redemption

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

Conversion

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

Notes to the financial statements

Note 22 Related entities

Related entities

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

NZ Banking Group

The NZ Banking Group consists of the New Zealand operations of the Overseas Banking Group including the NZ Branch and the following controlled entities as at 30 September 2019 whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business:

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

[1] On 11 January 2019, WNZOL sold its 25% shareholding in Paymark Limited to Ingenico Group S.A, resulting in a gain on sale of $40 million which is recognised in other non-interest income. Refer to Note 3.

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

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

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

There have been no changes in the ownership percentages since 30 September 2018.

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

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

Note 22 Related entities (continued)

Nature of transactions

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

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

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

Transactions with related entities

		NZ BANKING GROUP	
$ millions	**Note**	**2019**	2018
Overseas Bank			
Interest income	2	**27**	27
Interest expense:			
Loan capital[1]		**51**	55
Other[2]	2	**46**	53
Operating expenses - management fees		**8**	7
Funding repaid		**263**	400
Other controlled entities of the Overseas Bank			
WGINZL dividend paid to Westpac Overseas Holdings Pty Limited and Westpac Custodian Nominees Pty Limited		**4**	4
WFSGNZL dividend paid to Westpac Equity Holdings Pty Limited ('**WEHPL**')		**38**	58
BTFGNZL dividend paid to WEHPL		**25**	10
WNZGL dividend paid to Westpac Overseas Holdings No. 2 Pty Limited		**735**	500
Capital Finance New Zealand Limited dividend paid to Capital Finance Australia Limited		**5**	-

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

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

Due from and to related entities

	NZ BANKING GROUP	
$ millions	**2019**	2018
Due from related entities		
Overseas Bank	**2,366**	2,017
Other controlled entities of the Overseas Banking Group	**1**	6
Total due from related entities	**2,367**	2,023
Due from related entities at fair value[1]	**985**	459
Due from related entities at amortised cost	**1,382**	1,564
Total due from related entities	**2,367**	2,023
Due to related entities		
Overseas Bank	**2,890**	2,436
Other controlled entities of the Overseas Banking Group	**2**	4
Total due to related entities	**2,892**	2,440
Due to related entities at fair value[2]	**1,334**	644
Due to related entities at amortised cost	**1,558**	1,796
Total due to related entities	**2,892**	2,440

[1] Consists of derivative financial instruments of $981 million (2018: $453 million) (refer to Note 23) and trading securities of $4 million (2018: $6 million).

[2] Consists of derivative financial instruments of $1,334 million (2018: $644 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 NZ Banking Group. This includes all Executive/Non-Executive Directors and members of the executive team.

	NZ BANKING GROUP	
$'000s	**2019**	2018
Salaries and other short-term benefits	**7,970**	8,441
Post-employment benefits	**846**	653
Other termination benefits	**-**	615
Share-based payments	**3,526**	2,711
Total key management personnel compensation	**12,342**	12,420
Loans to key management personnel	**26,876**	22,349
Deposits from key management personnel	**7,623**	6,006
Interest income on amounts due from key management personnel	**896**	819
Interest expense on amounts due to key management personnel	**67**	107

Where the Directors of the Overseas Bank have received remuneration from the NZ Banking Group, the amounts are included above. Details of Directors' remuneration are disclosed in the Overseas Banking Group's 30 September 2019 Annual Financial Report.

Loans and deposits with key management personnel

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

As at 30 September 2019, no individual provision has been recognised in respect of loans given to key management personnel and their related parties (30 September 2018: nil). These loans have been included within the loan portfolio when determining collectively assessed provisions.

Other key management personnel transactions

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

Notes to the financial statements

Note 23 Derivative financial instruments

Accounting policy

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

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

Trading derivatives

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

Hedging derivatives

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

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

Fair value hedges

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

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

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

Cash flow hedges

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

For effective hedges, changes in the fair value of derivatives are recognised in the cash flow hedge reserve through other comprehensive income 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 other comprehensive income. It is amortised to net interest income over the period which the asset or liability that was hedged also impacts the income statement.

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

Notes to the financial statements

Note 23 Derivative financial instruments (continued)

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

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

	NZ BANKING GROUP					
	2018					
	Trading		Hedging		Total derivatives carrying value	
$ millions	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts						
Swap agreements	3,119	(2,989)	54	(480)	3,173	(3,469)
Options	1	(1)	-	-	1	(1)
Total interest rate contracts	3,120	(2,990)	54	(480)	3,174	(3,470)
Foreign exchange contracts						
Spot and forward contracts	291	(291)	-	-	291	(291)
Cross currency swap agreements (principal and interest)	983	(1,390)	568	(116)	1,551	(1,506)
Total foreign exchange contracts	1,274	(1,681)	568	(116)	1,842	(1,797)
Total of gross derivatives	4,394	(4,671)	622	(596)	5,016	(5,267)
Impact of netting arrangements	(1,054)	1,054	-	-	(1,054)	1,054
Total of net derivatives	3,340	(3,617)	622	(596)	3,962	(4,213)
Consisting of:						
Derivatives held with external counterparties	2,887	(3,026)	622	(543)	3,509	(3,569)
Derivatives held with related parties	453	(591)	-	(53)	453	(644)

Note 23 Derivative financial instruments (continued)

Hedge accounting

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

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

Fair value hedges

Interest rate risk

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

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

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

Cash flow hedges

Interest rate risk

The NZ Banking Group's exposure to the volatility of interest cash flows from customer deposits and loans is hedged with interest rate derivatives using a dynamic hedge accounting strategy called macro cash flow hedges. Customer deposits and loans are allocated to time buckets based on their expected repricing dates. The interest rate derivatives are designated according to the gross asset or gross liability positions for the relevant time buckets. The NZ Banking Group hedges the benchmark interest rate which generally represents the most significant component of the changes in fair value. The benchmark interest rate is a component of interest rate risk that is observable in the relevant financial markets, for example, Bank Bill Swap Rate for AUD interest rates, LIBOR for USD interest rates and BKBM for NZD interest rates. Ineffectiveness arises from timing 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.

Foreign exchange risk

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

Economic hedges

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

Notes to the financial statements

Note 23 Derivative financial instruments (continued)

Hedging instruments

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

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

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

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

Notes to the financial statements

Note 23 Derivative financial instruments (continued)

Impact of hedge accounting on the balance sheet and reserves

The following table shows the carrying amount of hedged items in a fair value hedge relationship and the component of the carrying amount related to accumulated hedge accounting adjustments.

	NZ BANKING GROUP	
	2019	
$ millions	Carrying amount of hedged item	Accumulated fair value hedge adjustment included in carrying amount
Interest rate risk		
Investment securities	4,469	120
Loans	20,301	139
Debt issues and loan capital	(10,279)	(254)

There were no accumulated fair value hedge adjustments included in the above carrying amounts relating to hedged items that have ceased to be adjusted for hedging gains and losses.

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

	NZ BANKING GROUP		
	2019		
$ millions	Interest rate risk	Foreign exchange risk	Total
Cash flow hedge reserve			
Balance at beginning of the year	(48)	(41)	(89)
Net gains/(losses) from changes in fair value	(28)	(58)	(86)
Transferred to net interest income	47	27	74
Balance at end of year	(29)	(72)	(101)

There were no 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 table provides information regarding the determination of hedge effectiveness:

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

Comparative year information under prior NZ IFRS 7 disclosure requirements

Ineffectiveness of hedge relationships

Fair value hedges

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

Cash flow hedges

	NZ BANKING GROUP
$ millions	2018
Cash flow hedge ineffectiveness	4

Hedging instruments

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

	NZ BANKING GROUP							
	2018							
	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 2 Years	2 Years to 3 Years	3 Years to 4 Years	4 Years to 5 Years	Over 5 Years
Cash inflows	0%	0%	19%	18%	24%	22%	3%	14%
Cash outflows	1%	1%	18%	19%	24%	20%	3%	14%

Notes to the financial statements

Note 24 Fair values of financial assets and financial liabilities

Accounting policy

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

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

Critical accounting assumptions and estimates

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

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

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

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

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

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

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

Fair Valuation Control Framework

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

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

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

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

Fair value hierarchy

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

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

Valuation techniques

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

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

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

Financial instruments measured at fair value

Level 1 instruments

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

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

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

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 technique
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.
Foreign exchange products	Derivative financial instruments Due from related entities Due to related entities	FX swaps and FX forward contracts - derivative financial instruments	Derived from market observable inputs or consensus pricing providers using industry standard models.
Asset backed debt instruments	Trading securities and financial assets measured at FVIS Available-for-sale securities/Investment securities	Asset backed securities	Valued using an industry approach to value floating rate debt with prepayment features. The main inputs to the model are the trading margin and the weighted average life of the security. These inputs are sourced from a consensus data provider. If consensus prices are not available these are classified as Level 3 instruments.

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

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

Level 3 instruments

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

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

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

Notes to the financial statements

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

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

	NZ BANKING GROUP							
	2019[1]				2018[1]			
$ millions	**Level 1**	**Level 2**	**Level 3[2]**	**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	**29**	**4,842**	**-**	**4,871**	159	2,857	-	3,016
Derivative financial instruments	**-**	**6,256**	**1**	**6,257**	-	3,509	-	3,509
Investment securities/Available-for-sale securities	**1,049**	**3,420**	**-**	**4,469**	1,167	2,643	-	3,810
Life insurance assets	**-**	**335**	**-**	**335**	-	310	-	310
Due from related entities	**-**	**985**	**-**	**985**	1	458	-	459
Total financial assets measured at fair value	**1,078**	**15,838**	**1**	**16,917**	1,327	9,777	-	11,104
Financial liabilities measured at fair value on a recurring basis								
Deposits and other borrowings at fair value	**-**	**1,142**	**-**	**1,142**	-	1,221	-	1,221
Other financial liabilities	**180**	**27**	**-**	**207**	145	78	-	223
Derivative financial instruments	**-**	**5,807**	**18**	**5,825**	-	3,569	-	3,569
Due to related entities	**-**	**1,334**	**-**	**1,334**	2	642	-	644
Debt issues at fair value	**-**	**2,312**	**-**	**2,312**	-	-	-	-
Total financial liabilities measured at fair value	**180**	**10,622**	**18**	**10,820**	147	5,510	-	5,657

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

There were no material amounts of changes in fair value estimated using a valuation technique incorporating significant non-observable inputs that were recognised in the income statement or the statement of comprehensive income of the NZ Banking Group during the year ended 30 September 2019 (30 September 2018: no material changes in fair value).

Analysis of movements between fair value hierarchy levels

During the year, there were no material transfers between levels of the fair value hierarchy (30 September 2018: no material transfers between levels).

Notes to the financial statements

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

Financial instruments not measured at fair value

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

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

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

	NZ BANKING GROUP				
	2019[1]				
	Carrying	Fair Value			
$ millions	Amount	Level 1	Level 2	Level 3	Total
Financial assets not measured at fair value					
Cash and balances with central banks	**2,002**	**2,002**	**-**	**-**	**2,002**
Collateral paid	**417**	**417**	**-**	**-**	**417**
Loans	**84,626**	**-**	**-**	**84,880**	**84,880**
Other financial assets	**400**	**-**	**-**	**400**	**400**
Due from related entities	**1,382**	**-**	**1,381**	**1**	**1,382**
Total financial assets not measured at fair value	**88,827**	**2,419**	**1,381**	**85,281**	**89,081**
Financial liabilities not measured at fair value					
Collateral received	**623**	**623**	**-**	**-**	**623**
Deposits and other borrowings	**64,464**	**-**	**63,974**	**563**	**64,537**
Other financial liabilities	**1,541**	**-**	**1,541**	**-**	**1,541**
Due to related entities	**1,558**	**-**	**1,565**	**-**	**1,565**
Debt issues[2]	**15,534**	**-**	**15,701**	**-**	**15,701**
Loan capital[2]	**3,185**	**-**	**1,954**	**1,158**	**3,112**
Total financial liabilities not measured at fair value	**86,905**	**623**	**84,735**	**1,721**	**87,079**

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

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

	NZ BANKING GROUP				
	2018[1]				
	Carrying	Fair Value			
$ millions	Amount	Level 1	Level 2	Level 3	Total
Financial assets not measured at fair value					
Cash and balances with central banks	1,472	1,472	-	-	1,472
Collateral paid	180	180	-	-	180
Loans	80,860	-	-	80,989	80,989
Other financial assets	468	-	57	411	468
Due from related entities	1,564	-	1,558	6	1,564
Total financial assets not measured at fair value	84,544	1,652	1,615	81,406	84,673
Financial liabilities not measured at fair value					
Collateral received	591	591	-	-	591
Deposits and other borrowings	61,884	-	61,276	647	61,923
Other financial liabilities	1,399	-	1,399	-	1,399
Due to related entities	1,796	-	1,806	-	1,806
Debt issues[2]	13,725	-	13,845	-	13,845
Loan capital[2]	2,866	-	1,692	1,180	2,872
Total financial liabilities not measured at fair value	82,261	591	80,018	1,827	82,436

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

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

Note 25 Offsetting financial assets and financial liabilities

Accounting policy

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

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

Notes to the financial statements

Note 25 Offsetting financial assets and financial liabilities (continued)

	NZ BANKING GROUP 2019[1]						
	Effects of Offsetting on Balance Sheet			Amounts Subject to Enforceable Netting Arrangements But Not Offset			
$ millions	Gross Amounts	Amounts Offset	Net Amounts Reported on the Balance Sheet	Other Recognised Financial Instruments	Cash Collateral	Financial Instrument Collateral	Net Amount
Assets							
Reverse repurchase agreements[2]	**1,041**	**-**	**1,041**	**-**	**-**	**(1,041)**	**-**
Derivative financial instruments	**10,188**	**(3,931)**	**6,257**	**(3,057)**	**(569)**	**-**	**2,631**
Due from related entities - derivative financial instruments[3]	**981**	**-**	**981**	**(981)**	**-**	**-**	**-**
Total assets	**12,210**	**(3,931)**	**8,279**	**(4,038)**	**(569)**	**(1,041)**	**2,631**
Liabilities							
Repurchase agreements[4]	**19**	**-**	**19**	**-**	**-**	**(19)**	**-**
Derivative financial instruments	**9,756**	**(3,931)**	**5,825**	**(3,057)**	**(393)**	**-**	**2,375**
Due to related entities - derivative financial instruments[5]	**1,334**	**-**	**1,334**	**(981)**	**-**	**-**	**353**
Total liabilities	**11,109**	**(3,931)**	**7,178**	**(4,038)**	**(393)**	**(19)**	**2,728**

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

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

[2] Forms part of trading securities and financial assets measured at FVIS (refer to Note 9).

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

[4] Forms part of other financial liabilities on the balance sheet (refer to Note 18).

[5] Forms part of due to related entities on the balance sheet (refer to Note 22).

Notes to the financial statements

Note 25 Offsetting financial assets and financial liabilities (continued)

Other recognised financial instruments

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

Cash collateral and financial instrument collateral

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

Note 26 Operating lease commitments

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

	NZ BANKING GROUP	
$ millions	**2019**	2018[1]
Due within one year	**52**	54
Due after one year but not later than five years	**130**	122
Due after five years	**124**	141
Total lease commitments	**306**	317

[1] Comparative information for the year ended 30 September 2018 has been restated to ensure consistent presentation with the current reporting period. This has no effect on the balance sheet or income statement.

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

Note 27 Credit related commitments, contingent assets and contingent liabilities

Accounting policy

Undrawn credit commitments

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

Contingent assets

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

Contingent liabilities

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

Undrawn credit commitments

Undrawn credit commitments expose the NZ Banking Group to liquidity risk when called upon and also to credit risk if the customer fails to repay the amounts owed at the due date. The maximum exposure to credit loss is the contractual or notional amount of the instruments disclosed below. Some of the arrangements can be cancelled by the NZ Banking Group at any time and a significant portion is expected to expire without being drawn. The actual required liquidity and credit risk exposure is therefore less than the amounts disclosed. The NZ Banking Group uses the same credit policies when entering into these arrangements as it does for on-balance sheet instruments. Refer to Note 32 for further details on liquidity risk and credit risk management.

Notes to the financial statements

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

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

(a) WNZSL (pursuant to its securitisation programme) where the loan does not meet certain terms and conditions of the WNZSL securitisation programme;
(b) WNZCBL (pursuant to Westpac New Zealand's Global Covered Bond Programme ('**CB Programme**')) where:
  (i) it is discovered that there has been a material breach of a sale warranty (or any such sale warranty is materially untrue);
  (ii) the loan becomes materially impaired or is enforced prior to the second monthly covered bond payment date falling after the assignment of the loan; or
  (iii) at the cut-off date relating to the loan, there were arrears of interest and that loan subsequently becomes a delinquent loan prior to the second monthly covered bond payment date falling after the assignment of the loan.

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Letters of credit and guarantees[1]	**964**	1,104
Commitments to extend credit[2]	**25,881**	24,722
Other	**-**	60
Total undrawn credit commitments	**26,845**	25,886

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

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

Contingent assets

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

Contingent liabilities

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

Compliance, regulation and remediation

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

Notes to the financial statements

Note 28 Segment reporting

Accounting policy

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

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

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

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

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

Segment comparative information for the year ended 30 September 2018 has been restated to ensure consistent presentation with the current reporting period. This includes adjustments for:

- changes in the segmentation classification for small business customers;
- changes to expense allocations and the Overseas Bank's capital allocation framework; and
- NZ IFRS 9 and NZ IFRS 15 that were adopted on 1 October 2018. Segment comparatives have been restated as though the standards were adopted on 1 October 2017, except for ECL provisioning. This resulted in comparative reclassifications between individual line items that do not impact total results. These adjustments are comprised of:
  - facility fees: The NZ Banking Group has reclassified facility fees (mostly business) from non-interest income to net interest income to more appropriately reflect the relationship with drawn lines of credit;
  - other fees and expenses: The NZ Banking Group has restated the classification of a number of fees and expenses which has resulted in the grossing up of non-interest income and operating expenses;
  - card scheme: Support payments received from Mastercard have been reclassified to non-interest income and related expenses have been reclassified to operating expenses; and
  - interest carrying adjustments: Interest on performing loans (stage 1 and stage 2 loans) is now measured on the gross loan value. Previously, interest on performing loans was recognised on the loan balance net of provisions. This adjustment increases interest income and impairment charges.

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

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

Reconciling items primarily represent:

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

Notes to the financial statements

Note 28 Segment reporting (continued)

	NZ BANKING GROUP					
$ millions	Consumer Banking and Wealth	Commercial, Corporate Institutional	Investments and Insurance	NZ IFRS 9 and NZ IFRS 15 changes	Reconciling Items	Total
Year ended 30 September 2019						
Net interest income	**1,042**	**933**	**-**	**N/A**	**23**	**1,998**
Non-interest income	**131**	**225**	**147**	**N/A**	**59**	**562**
Net operating income before operating expenses and impairment charges	**1,173**	**1,158**	**147**	**N/A**	**82**	**2,560**
Operating expenses	**(721)**	**(269)**	**(29)**	**N/A**	**1**	**(1,018)**
Impairment (charges)/benefits	**(17)**	**33**	**-**	**N/A**	**(6)**	**10**
Profit before income tax	**435**	**922**	**118**	**N/A**	**77**	**1,552**
Year ended 30 September 2018 (restated)						
Net interest income	1,074	900	1	(85)	22	1,912
Non-interest income	140	229	138	42	24	573
Net operating income before operating expenses and impairment charges	1,214	1,129	139	(43)	46	2,485
Operating expenses	(672)	(250)	(29)	21	(10)	(940)
Impairment (charges)/benefits	(45)	3	-	22	23	3
Profit before income tax	497	882	110	-	59	1,548
As at 30 September 2019						
Total gross loans	**45,730**	**39,079**	**-**	**N/A**	**138**	**84,947**
Total deposits and other borrowings	**35,125**	**29,839**	**-**	**N/A**	**642**	**65,606**
As at 30 September 2018						
Total gross loans	43,266	37,890	-	N/A	28	81,184
Total deposits and other borrowings	33,840	28,507	-	N/A	758	63,105

Notes to the financial statements

Note 29 Securitisation, covered bonds and other transferred assets

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

Securitisation

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

Own assets securitised

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

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

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

Covered bonds

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

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

Repurchase agreements

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

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

Notes to the financial statements

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

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

	NZ BANKING GROUP				
			For those liabilities that only have recourse to the transferred assets:		
$ millions	Carrying amount of transferred assets	Carrying amount of associated liabilities	Fair value of transferred assets	Fair value of associated liabilities	Net fair value position
2019					
Securitisation - own assets[1]	**7,537**	**7,518**	**7,522**	**7,518**	**4**
Covered bonds[2]	**7,530**	**5,274**	**n/a**	**n/a**	**n/a**
Repurchase agreements	**19**	**19**	**n/a**	**n/a**	**n/a**
Total	**15,086**	**12,811**	**7,522**	**7,518**	**4**
2018					
Securitisation - own assets[1]	5,033	5,015	5,021	5,015	6
Covered bonds[2]	7,533	5,656	n/a	n/a	n/a
Repurchase agreements	41	41	n/a	n/a	n/a
Total	12,607	10,712	5,021	5,015	6

[1] The most senior rated securities at 30 September 2019 of $6,900 million (30 September 2018: $4,700 million) qualify as eligible collateral for repurchase agreements with the Reserve Bank. Westpac New Zealand complies with the Reserve Bank's guidelines for its overnight reverse repurchase agreement facility and open market operations, which allows banks in New Zealand to offer RMBS as collateral for the Reserve Bank's repurchase agreements.

[2] The difference between the carrying values of the covered bonds and the assets pledged allows for the immediate issuance of additional covered bonds if required. These additional assets can be repurchased by Westpac New Zealand at its discretion, subject to the conditions set out in the transaction documents. The cover pool is comprised of housing loans up to a value of $7,500 million as at 30 September 2019 (30 September 2018: $7,500 million). Over time, the composition of the cover pool will include, in addition to housing loans, accrued interest (representing accrued and unpaid interest on the outstanding housing loans) and cash (representing collections of principal and interest from the underlying housing loans).

Note 30 Structured entities

Accounting policy

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

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

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

Consolidated structured entities

Securitisation and covered bonds

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

NZ Banking Group managed funds

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

Non-contractual financial support

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

Note 30 Structured entities (continued)

Unconsolidated structured entities

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

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

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

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

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

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

	NZ BANKING GROUP							
	2019				2018			
$ millions	Investment in Third Party Mortgage and other Asset-Backed Securities[1]	Financing to Securitisation Vehicles	Group Managed Funds	Total	Investment in Third Party Mortgage and other Asset-Backed Securities[1]	Financing to Securitisation Vehicles	Group Managed Funds	Total
Assets								
Trading securities and financial assets measured at FVIS	-	-	-	-	50	-	-	50
Loans	-	2,784	-	2,784	-	2,632	-	2,632
Life insurance assets	-	-	188	188	-	-	191	191
Total on-balance sheet exposures	-	2,784	188	2,972	50	2,632	191	2,873
Total notional amounts of off-balance sheet exposures	-	1,104	87	1,191	-	765	87	852
Maximum exposure to loss	-	3,888	275	4,163	50	3,397	278	3,725
Size of structured entities[2]	-	3,888	11,251	15,139	813	3,397	10,219	14,429

[1] The NZ Banking Group's interests in third party mortgage and other asset-backed securities are senior tranches of notes and are investment grade rated.

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

Non-contractual financial support

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

Notes to the financial statements

Note 31 Capital Management

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

The Overseas Banking Group (excluding entities specifically excluded by APRA regulations), and the Overseas Bank (Extended Licensed Entity as defined by APRA), exceeded the minimum capital adequacy requirements as specified by APRA as at 30 September 2019.

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

The Overseas Banking Group evaluates its approach to capital management through an Internal Capital Adequacy Assessment Process ('**ICAAP**'), the key features of which include:

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

The table below represents the capital adequacy calculation for the Overseas Banking Group and Overseas Bank as at 30 September 2019 based on APRA's application of the Basel III capital adequacy framework.

%	30 Sep 19 Unaudited	30 Sep 18 Unaudited
Overseas Banking Group (excluding entities specifically excluded by APRA regulations)[1, 2]		
Common Equity Tier 1 capital ratio	**10.7**	10.6
Additional Tier 1 capital ratio	**2.2**	2.2
Tier 1 capital ratio	**12.8**	12.8
Tier 2 capital ratio	**2.8**	1.9
Total regulatory capital ratio	**15.6**	14.7
Overseas Bank (Extended Licensed Entity)[1, 3]		
Common Equity Tier 1 capital ratio	**11.0**	10.5
Additional Tier 1 capital ratio	**2.2**	2.3
Tier 1 capital ratio	**13.2**	12.8
Tier 2 capital ratio	**2.9**	2.0
Total regulatory capital ratio	**16.1**	14.8

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

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

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

Notes to the financial statements

Note 32 Financial risk

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

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

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

Note 32.1 Risk management frameworks

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

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

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

Notes to the financial statements

Note 32 Financial risk (continued)

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

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

Notes to the financial statements

Note 32 Financial risk (continued)

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

Notes to the financial statements

Note 32 Financial risk (continued)

32.2 Credit risk

32.2.1 Credit risk ratings system

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

Transaction-managed customers

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

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

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

Program-managed portfolio

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

32.2.2 Credit risk mitigation, collateral and other credit enhancements

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

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

Notes to the financial statements

Note 32 Financial risk (continued)

Collateral

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

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

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

Management of risk mitigation

The NZ Banking Group mitigates credit risk through controls covering:

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

Notes to the financial statements

Note 32 Financial risk (continued)

32.2.3 Credit risk concentrations

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

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

Individual customers or groups of related customers

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

Specific industries

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

Individual countries

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

Maximum exposure to credit risk

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Financial assets		
Cash and balances with central banks	**2,002**	1,472
Collateral paid	**417**	180
Trading securities and financial assets measured at FVIS	**4,871**	3,016
Derivative financial instruments	**6,257**	3,509
Investment securities/Available-for-sale securities	**4,469**	3,810
Loans	**84,626**	80,860
Other financial assets	**400**	468
Life insurance assets	**4**	9
Due from related entities	**2,367**	2,023
Total financial assets	**105,413**	95,347
Undrawn credit commitments		
Letters of credit and guarantees	**964**	1,104
Commitments to extend credit	**25,881**	24,722
Other commitments	**-**	60
Total undrawn credit commitments	**26,845**	25,886
Total maximum credit risk exposure	**132,258**	121,233

Notes to the financial statements

Note 32 Financial risk (continued)

Concentration of credit exposures

	NZ BANKING GROUP	
$ millions	**2019**	2018
On-balance sheet credit exposures		
Analysis of on-balance sheet credit exposures by geographical areas		
New Zealand	**97,283**	89,199
Australia	**3,685**	2,572
United Kingdom	**2,459**	1,726
United States of America	**154**	173
Other	**1,832**	1,677
Total on-balance sheet credit exposures	**105,413**	95,347
Analysis of on-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**465**	443
Agriculture	**8,836**	8,498
Construction	**572**	551
Finance and insurance	**10,687**	8,135
Forestry and fishing	**444**	464
Government, administration and defence	**9,044**	6,381
Manufacturing	**2,229**	2,443
Mining	**311**	243
Property	**7,512**	6,851
Property services and business services	**1,451**	1,321
Services	**2,125**	1,858
Trade	**2,554**	2,564
Transport and storage	**1,280**	1,194
Utilities	**2,297**	1,804
Retail lending	**53,446**	50,805
Other	**2**	1
Subtotal	**103,255**	93,556
Provisions for impairment charges on loans	**(321)**	(324)
Due from related entities	**2,367**	2,023
Other financial assets	**112**	92
Total on-balance sheet credit exposures	**105,413**	95,347
Off-balance sheet credit exposures consists of		
Credit risk-related instruments	**26,845**	25,886
Total off-balance sheet credit exposures	**26,845**	25,886
Analysis of off-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**116**	93
Agriculture	**624**	606
Construction	**502**	528
Finance and insurance	**1,636**	1,608
Forestry and fishing	**204**	143
Government, administration and defence	**891**	756
Manufacturing	**1,870**	1,776
Mining	**35**	175
Property	**1,986**	1,544
Property services and business services	**705**	529
Services	**592**	600
Trade	**1,682**	1,750
Transport and storage	**812**	879
Utilities	**1,720**	1,779
Retail lending	**13,470**	13,120
Total off-balance sheet credit exposures	**26,845**	25,886

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

Notes to the financial statements

Note 32 Financial risk (continued)

32.2.4 Credit quality of financial assets

Credit quality disclosures (NZ IFRS 9)

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

	NZ BANKING GROUP			
$ millions	**Stage 1**	**Stage 2**	**Stage 3**	**Total[1]**
Loans - Residential Mortgages				
Strong	42,096	-	-	42,096
Good/satisfactory	7,629	1,201	-	8,830
Weak	28	248	302	578
Total Loans - Residential Mortgages	49,753	1,449	302	51,504
Loans - Other retail				
Strong	610	-	-	610
Good/satisfactory	2,881	172	-	3,053
Weak	19	18	53	90
Total Loans - Other retail	3,510	190	53	3,753
Loans - Corporate				
Strong	11,437	-	-	11,437
Good/satisfactory	15,624	1,126	-	16,750
Weak	-	1,299	93	1,392
Total Loans - Corporate	27,061	2,425	93	29,579
Loans - Other				
Strong	111	-	-	111
Good/satisfactory	-	-	-	-
Weak	-	-	-	-
Total Loans - Other	111	-	-	111
Investment Securities				
Strong	4,469	-	-	4,469
Good/satisfactory	-	-	-	-
Weak	-	-	-	-
Total Investment Securities	4,469	-	-	4,469
All other financial assets				
Strong	4,151	-	-	4,151
Good/satisfactory	42	4	-	46
Weak	-	3	1	4
Total all other financial assets	4,193	7	1	4,201
Undrawn credit commitments				
Strong	18,567	-	-	18,567
Good/Satisfactory	7,832	237	-	8,069
Weak	10	179	20	209
Total undrawn credit commitments	26,409	416	20	26,845
Total strong	81,441	-	-	81,441
Total good/satisfactory	34,008	2,740	-	36,748
Total weak	57	1,747	469	2,273
Total on and off balance sheet	115,506	4,487	469	120,462

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

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

Note 32 Financial risk (continued)

Credit quality disclosures (NZ IAS 39)

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

As comparatives have not been restated for the adoption of NZ IFRS 9, the following table presents the credit quality of financial assets of the NZ Banking Group that are neither past due nor impaired as determined by reference to the credit risk ratings system under NZ IAS 39. As these tables do not reflect the adoption of NZ IFRS 9 they are not directly comparable to the credit quality disclosures under NZ IFRS 9.

All the financial assets of the NZ Banking Group as at 30 September 2018, other than loans, are neither past due nor impaired.

All the financial assets of the NZ Banking Group that are neither past due nor impaired fall into the 'Strong' category in their entirety except those financial assets disclosed below:

	NZ BANKING GROUP			
	2018			
$ millions	Strong	Good/ Satisfactory	Weak	Total
Accrued interest receivable (refer to Note 13)	70	87	3	160
Trading securities and financial assets measured at FVIS (refer to Note 9)	3,015	1	-	3,016
Derivative financial instruments (refer to Note 23)	3,342	167	-	3,509
Loans (refer to Note 12)	35,119	43,202	1,432	79,753

32.2.5 Non-performing loans and credit commitments

The loans and credit commitments balance in stage 3 (non-performing) is represented by those loans and credit commitments which are in default. A default occurs when the NZ Banking Group considers that the customer is unlikely to repay its credit obligations in full, irrespective of recourse by the NZ Banking Group to actions such as realising security, or the customer is more than 90 days past due on any material credit obligation. This definition of default is aligned to the Reserve Bank regulatory definition of default.

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

Note 32 Financial risk (continued)

32.2.6 Collateral held

Loans

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

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

The NZ Banking Group's loan portfolio has the following coverage from collateral held based on the requirements of NZ IFRS 9:

Performing Loans

%	Residential Mortgages[1]	Other Retail	Corporate	Other	Total
Fully secured	**100**	**39**	**61**	**37**	**84**
Partially secured	**-**	**4**	**20**	**11**	**7**
Unsecured	**-**	**57**	**19**	**52**	**9**
Total	**100**	**100**	**100**	**100**	**100**

Non-performing loans

%	Residential Mortgages[1]	Other Retail	Corporate	Other	Total
Fully secured	**94**	**53**	**10**	**-**	**72**
Partially secured	**6**	**4**	**50**	**-**	**15**
Unsecured	**-**	**43**	**40**	**-**	**13**
Total	**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' for loan-to-value ratio ('**LVR**') analysis of residential mortgages.

Details of the carrying value and associated provisions for ECL are disclosed in Notes 11 and 12 respectively. The credit quality of loans is disclosed in Note 32.2.4.

As the comparatives have not been restated for the adoption of NZ IFRS 9, the NZ Banking Group's loan portfolio has the following coverage from collateral held based on the requirements of NZ IAS 39 for prior years. Once NZ IFRS 9 has been effective for the comparative year end, these tables will no longer be presented.

	NZ BANKING GROUP
%	2018[1]
Fully secured	84
Partially secured	6
Unsecured	10
Total net loans	100

[1] Comparative information for the year ended 30 September 2018 has been restated. Certain exposures have been re-classified between 'fully secured' and 'partially secured'. The impact of the restatement is an increase in 'fully secured' loans from 78% to 84% and a corresponding decrease in 'partially secured' loans from 12% to 6%.

Collateral held against financial assets other than loans

	NZ BANKING GROUP	
$ millions	**2019**	2018
Cash, primarily for derivatives	**623**	591
Securities under reverse repurchase agreements[1]	**1,041**	216
Total other collateral held	**1,664**	807

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

Note 32 Financial risk (continued)

32.3 Funding and liquidity risk

32.3.1 Liquidity modelling

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

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

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

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

32.3.2 Sources of funding

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

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

Liquid assets

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Cash and balances with central banks	**2,002**	1,472
Interbank lending	**72**	57
Supranational securities	**1,712**	1,502
NZ Government securities	**2,022**	1,322
NZ public securities	**2,614**	1,809
NZ corporate securities	**2,220**	1,522
Residential mortgage-backed securities	**5,798**	3,950
Total liquid assets	**16,440**	11,634

Notes to the financial statements

Note 32 Financial risk (continued)

Concentration of funding

	NZ BANKING GROUP	
$ millions	**2019**	2018
Funding consists of		
Collateral received	**623**	591
Deposits and other borrowings	**65,606**	63,105
Other financial liabilities[1]	**1,239**	885
Due to related entities[2]	**1,539**	1,778
Debt issues[3]	**17,846**	13,725
Loan capital	**3,185**	2,866
Total funding	**90,038**	82,950
Analysis of funding by geographical areas[3]		
New Zealand	**65,038**	61,572
Australia	**2,963**	2,811
United Kingdom	**9,076**	8,589
United States of America	**5,126**	2,442
Other	**7,835**	7,536
Total funding	**90,038**	82,950
Analysis of funding by industry sector		
Accommodation, cafes and restaurants	**421**	405
Agriculture	**1,425**	1,373
Construction	**1,918**	1,739
Finance and insurance	**36,302**	30,742
Forestry and fishing	**193**	222
Government, administration and defence	**2,626**	2,068
Manufacturing	**1,589**	1,530
Mining	**65**	67
Property services and business services	**5,790**	5,809
Services	**4,112**	4,152
Trade	**1,533**	1,444
Transport and storage	**386**	593
Utilities	**450**	485
Households	**27,229**	26,141
Other[4]	**4,460**	4,402
Subtotal	**88,499**	81,172
Due to related entities[2]	**1,539**	1,778
Total funding	**90,038**	82,950

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

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

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

[4] Includes deposits from non-residents.

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

Notes to the financial statements

Note 32 Financial risk (continued)

32.3.3 Assets pledged as collateral

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Cash	**417**	180
Securities pledged under repurchase agreements:		
Trading securities and financial assets measured at FVIS	**19**	41
Total amount pledged to secure liabilities (excluding CB Programme)	**436**	221

32.3.4 Contractual maturity of financial liabilities

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

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

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

Note 32 Financial risk (continued)

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

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

Notes to the financial statements

Note 32 Financial risk (continued)

	NZ BANKING GROUP						
	2018[1]						
$ millions	On Demand	Up to 1 Month	Over 1 Month and Up to 3 Months	Over 3 Months and Up to 1 Year	Over 1 Year and Up to 5 Years	Over 5 Years	Total
Financial liabilities							
Collateral received	-	591	-	-	-	-	591
Deposits and other borrowings	28,083	6,488	12,166	14,759	2,363	-	63,859
Other financial liabilities	718	543	-	-	-	-	1,261
Derivative financial instruments:							
Held for trading	3,026	-	-	-	-	-	3,026
Held for hedging purposes (net settled)	-	18	69	105	229	84	505
Held for hedging purposes (gross settled):							
Cash outflow	-	5	5	32	682	581	1,305
Cash inflow	-	-	-	(15)	(529)	(584)	(1,128)
Due to related entities:							
Non-derivative balances	1,475	-	-	9	340	-	1,824
Derivative financial instruments:							
Held for trading	591	-	-	-	-	-	591
Held for hedging purposes (gross settled):							
Cash outflow	-	-	18	54	1,605	-	1,677
Cash inflow	-	-	(17)	(50)	(1,551)	-	(1,618)
Debt issues	-	10	52	1,772	11,595	1,017	14,446
Loan capital	-	-	14	41	232	3,174	3,461
Total undiscounted financial liabilities	33,893	7,655	12,307	16,707	14,966	4,272	89,800
Total contingent liabilities and commitments							
Letters of credit and guarantees	1,104	-	-	-	-	-	1,104
Commitments to extend credit	24,722	-	-	-	-	-	24,722
Other commitments	60	-	-	-	-	-	60
Total undiscounted contingent liabilities and commitments	25,886	-	-	-	-	-	25,886

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

Notes to the financial statements

Note 32 Financial risk (continued)

32.3.5 Expected maturity

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

	NZ BANKING GROUP					
	2019[1]			2018[1]		
$ 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	**2,002**	**-**	**2,002**	1,472	-	1,472
Collateral paid	**417**	**-**	**417**	180	-	180
Trading securities and financial assets measured at FVIS	**4,730**	**141**	**4,871**	2,506	510	3,016
Derivative financial instruments	**4,742**	**1,515**	**6,257**	2,771	738	3,509
Investment securities/Available-for-sale securities	**1,948**	**2,521**	**4,469**	1,386	2,424	3,810
Loans	**12,325**	**72,301**	**84,626**	11,467	69,393	80,860
Life insurance assets	**193**	**142**	**335**	201	109	310
Due from related entities	**2,288**	**79**	**2,367**	1,976	47	2,023
All other assets	**606**	**812**	**1,418**	633	843	1,476
Total assets	**29,251**	**77,511**	**106,762**	22,592	74,064	96,656
Liabilities						
Collateral received	**623**	**-**	**623**	591	-	591
Deposits and other borrowings	**63,920**	**1,686**	**65,606**	60,881	2,224	63,105
Derivative financial instruments	**4,455**	**1,370**	**5,825**	2,715	854	3,569
Due to related entities	**2,247**	**645**	**2,892**	2,024	416	2,440
Debt issues	**5,113**	**12,733**	**17,846**	1,567	12,158	13,725
Loan capital	**-**	**3,185**	**3,185**	-	2,866	2,866
All other liabilities	**2,001**	**127**	**2,128**	1,890	87	1,977
Total liabilities	**78,359**	**19,746**	**98,105**	69,668	18,605	88,273

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated. Refer to Note 1 for further detail.

32.4 Market risk

32.4.1 Value-at-Risk

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

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

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

The key parameters of VaR are:

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

Note 32 Financial risk (continued)

32.4.2 Traded market risk

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

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

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

	NZ BANKING GROUP							
	2019				2018			
$ millions	**As at**	**Maximum Exposure**	**Minimum Exposure**	**Average Exposure**	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	**1.2**	**2.0**	**0.7**	**1.2**	1.5	1.9	0.6	1.1
Foreign exchange risk	**0.3**	**2.6**	**-**	**0.8**	0.5	2.6	-	0.7
Price risk	**0.4**	**0.6**	**0.2**	**0.3**	0.3	0.6	0.1	0.2
Volatility risk	**-**	**-**	**-**	**-**	-	-	-	-
Net market risk	**1.2**	**2.5**	**0.7**	**1.5**	1.7	2.6	0.7	1.4

32.4.3 Non-traded market risk

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

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

Simulations using a range of interest rate scenarios are used to provide a series of potential future NII outcomes. The interest rate scenarios modelled, over a three year time horizon using a 99% confidence interval, include those projected using historical market interest rate volatility as well as 100 and 200 basis point shifts up and down from the current market yield curves in Australia and New Zealand. Additional stressed interest rate scenarios are also considered and modelled.

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

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

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

	NZ BANKING GROUP							
	2019				2018[1]			
% (increase)/ decrease in net interest income	**As at**	**Maximum Exposure**	**Minimum Exposure**	**Average Exposure**	As at	Maximum Exposure	Minimum Exposure	Average Exposure
NaR	**7.95**	**7.95**	**3.17**	**5.43**	3.02	3.59	2.30	3.14

[1] Comparative information for the year ended 30 September 2018 has been restated to correctly depict NaR assuming a 100 basis point shock on a 12 months basis. Previously reported percentages were calculated on a 1 month basis. The impact of the restatement is an increase for: 'As at' from 0.37% to 3.02%, 'Maximum Exposure' from 0.58% to 3.59%, 'Minimum Exposure' from 0.28% to 2.30% and 'Average Exposure' from 0.39% to 3.14%.

Value at Risk – IRRBB[1]

The table below depicts VaR for IRRBB:

	NZ BANKING GROUP							
	2019				2018			
$ millions	**As at**	**Maximum Exposure**	**Minimum Exposure**	**Average Exposure**	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	**1.2**	**1.3**	**0.2**	**0.5**	0.5	0.7	0.1	0.4

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

Note 32 Financial risk (continued)

Risk mitigation

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

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

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

Foreign currency exposures

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Receivable/(payable)		
Australian dollar	**-**	(6)
Euro	**-**	(1)
British pound	**-**	2
US dollar	**8**	9
Japanese yen	**1**	-
Others	**3**	2

Notes to the financial statements

Note 33 Notes to the statement of cash flows

Accounting policy

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

Cash and cash equivalents

	NZ BANKING GROUP	
$ millions	**2019**	2018
Cash and cash equivalents comprise:		
Cash and balances with central banks:		
Cash on hand	**318**	**288**
Balances with central banks	**1,684**	**1,184**
Interbank lending classified as cash and cash equivalents[1]	**72**	**57**
Cash and cash equivalents at end of the year	**2,074**	**1,529**

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Net profit attributable to the owners of the NZ Banking Group	**1,129**	1,117
Adjustments:		
Impairment charges/(benefits) on loans	**(10)**	(3)
Computer software amortisation costs	**59**	46
Depreciation	**39**	44
(Gain)/loss from hedging ineffectiveness	**(2)**	(4)
Movement in accrued interest receivable	**10**	(5)
Movement in accrued interest payable	**(6)**	(9)
Movement in current and deferred tax	**(12)**	29
Gain on disposal of associate	**(40)**	-
Share of associate's net profit	**-**	1
Share-based payments	**6**	5
Other non-cash items[1]	**10**	(89)
Cash flows from operating activities before changes in operating assets and liabilities	**1,183**	1,132
Movement in collateral paid	**(237)**	251
Movement in trading securities and financial assets measured at FVIS	**(1,841)**	1,052
Movement in loans	**(3,687)**	(3,172)
Movement in other financial assets	**(19)**	(7)
Movement in due from related entities	**184**	643
Movement in collateral received	**32**	400
Movement in deposits and other borrowings	**2,501**	4,107
Movement in other financial liabilities	**237**	(172)
Movement in due to related entities	**38**	(880)
Movement in other liabilities	**1**	1
Net movement in external and related entity derivative financial instruments	**229**	1,143
Net cash flows provided by/(used in) operating activities	**(1,379)**	4,498

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

Note 34 Subsequent events

On 5 November 2019, the Overseas Bank announced that it had successfully completed an underwritten placement of fully paid ordinary shares in the Overseas Bank to institutional investors to raise A$2 billion. As further announced, following the placement, the Overseas Bank has made a share purchase plan available to shareholders to raise approximately A$500 million, subject to scaleback, and with the ability to raise less or more. The additional capital raised by the Overseas Bank will have no impact on the balance sheet of the NZ Banking Group. Refer to Note 31 for further information on the NZ Banking Group's capital management.

Notes to the financial statements

Note 35 Accounting policies relating to prior years

Due to the adoption of NZ IFRS 9, the accounting policies relating to the accounting for some financial instruments and related balances have changed. The policies applicable to the current year are provided in the relevant note to the financial statements above. As prior comparative years have not been restated, the accounting policies detailed below reflect the policies applicable to financial years prior to 2019 based on NZ IAS 39. Refer to Note 1 for further information.

Accounting policy relating to impairment (Note 6 and Note 12)

Impairment charges/(benefits) (Note 6)

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

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

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

The impairment charge is recognised in the income statement with a corresponding reduction of the carrying value of the loan through an offsetting provision account (refer to Note 12).

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

Uncollectable loans

The policy for uncollectable loans is consistent with that applicable to 2019 based on NZ IFRS 9.

Provisions for impairment charges (Note 12)

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

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

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

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

Critical accounting assumptions and estimates

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

Individual component

Key judgements include the business prospects for the customer, the realisable value of collateral, the NZ Banking Group's position relative to other claimants, the reliability of customer information and the likely cost and duration of recovering the loan.

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

Collective component

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

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

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

Notes to the financial statements

Note 35 Accounting policies relating to prior years (continued)

Accounting policy relating to classification and measurement of financial instruments

Classification and measurement of financial assets and financial liabilities (Note 1)

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

The NZ Banking Group classifies its significant financial liabilities in the following categories: collateral received, deposits and other borrowings, other financial liabilities, derivative financial instruments, due to related entities, debt issues and loan capital.

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

Reverse repurchase agreements (Note 9)

Reverse repurchase agreements which are part of a trading portfolio are designated at fair value.

Available-for-sale securities (Note 10)

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

- Interest on debt securities; and
- Impairment charges.

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

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

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

Available-for-sale securities reserve (Note 1)

This comprises the changes in the fair value of available-for-sale debt securities, net of any related hedge accounting adjustments and tax. These changes were transferred to non-interest income in the income statement when the asset is either disposed or impaired. This reserve was closed on the adoption of NZ IFRS 9 and the closing balance was allocated to investment securities reserve.

Loans (Note 11)

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 and are presented net of any provisions for impairment.

Registered bank disclosures

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

i. General information (Unaudited)

Overseas Bank

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

Limits on material financial support by the Overseas Bank

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

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

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

While the limit and associated conditions do not apply to the ELE's non-equity exposures to the NZ Branch (which is within the ELE), the limit and associated conditions do apply to the NZ Branch's non-equity exposures to the rest of the NZ Banking Group other than Westpac New Zealand Group Limited. As at 30 September 2019, the ELE's non-equity exposures to New Zealand banking subsidiaries affected by the limit were below 5% of Level 1 Tier 1 capital of the Overseas Bank.

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

Ranking of local creditors in liquidation

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

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

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

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

Section 13A(3) of the Australian Banking Act affects all unsecured liabilities of the NZ Branch, which, as at 30 September 2019, amounted to $14,484 million (30 September 2018: $9,911 million).

Section 13A(4) of the Australian Banking Act also provides that it is an offence for an ADI not to hold assets (other than goodwill and any assets or other amount excluded by the prudential standards) in Australia of a value that is equal to or greater than the total amount of its deposit liabilities in Australia, unless APRA has authorised the ADI to hold assets of a lesser value. During the year ended 30 September 2019, the Overseas Bank has at all times held assets (other than goodwill) in Australia of not less than the value of the Overseas Bank's total deposit liabilities in Australia.

Registered bank disclosures

i. General information (Unaudited) (continued)

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

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

Guarantee arrangements

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

Directorate

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

Name: Lindsay Philip Maxsted, DipBus (Gordon), FCA, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Chairman of Transurban Group. Managing Director of Align Capital Pty Ltd. Director of BHP Group Limited, BHP Group plc and Baker Heart and Diabetes Institute.
Name: Brian Charles Hartzer, BA, CFA **Non-executive:** No **Country of Residence:** Australia **Primary Occupation:** Managing Director & Chief Executive Officer, Westpac Banking Corporation **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** No	**External Directorships:** Director of Australian Banking Association Incorporated and The Financial Markets Foundation for Children, Chairman of The Australian National University Business and Industry Advisory Board.
Name: Nerida Frances Caesar, BCom, MBA, GAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of Workplace Giving Australia Limited, Director of Spark Investment Holdco Pty Ltd.
Name: Ewen Graham Wolseley Crouch AM, BEc (Hons.), LLB, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of BlueScope Steel Limited, Sydney Symphony Orchestra Holdings Pty Limited and Jawun Chairman of Corporate Travel Management Limited.
Name: Catriona Alison Deans, BA, MBA, GAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Cochlear Limited, Ramsay Health Care Limited, The Observership Program Limited, SCEGGS Darlinghurst Limited and Deputy Group Pty Ltd.

Registered bank disclosures

i. General information (Unaudited) (continued)

Directorate (continued)

Name: Craig William Dunn, BCom, FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of The Australian Ballet. Director of Telstra Corporation Limited.
Name: Yuen Mei Anita Fung, BSocSc, MAppFin **Non-executive:** Yes **Country of Residence:** Hong Kong **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Hong Kong Exchanges and Clearing Limited, China Construction Bank Corporation and Hang Lung Properties Limited. Board member of the Airport Authority Hong Kong.
Name: Steven John Harker, BEc (Hons.), LLB **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of Ascham School Ltd, ASX Refinitiv Charity Foundation, NSW Golf Club Foundation Limited, The Banking and Finance Oath Limited and The Hunger Project Australia.
Name: Peter Ralph Marriott, BEc (Hons.), FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes, Chairman **Independent Director:** Yes	**External Directorships:** Director of Austraclear Limited, ASX Limited, ASX Settlement Corporation Limited and ASX Clearing Corporation Limited.
Name: Peter Stanley Nash, BCom, FCA, F Fin **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Chairman of Johns Lyng Group Limited. Director of ASX Limited, Mirvac Group. Reconciliation Australia Limited and Golf Victoria Limited.
Name: Margaret Leone Seale, BA, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Scentre Group Limited, Telstra Corporation Limited and Australian Pacific (Holdings) Pty Limited.

Changes to Directorate

On 26 November 2019 the Overseas Bank announced a number of changes to its Board as follows. Brian Charles Hartzer will cease to be a Director and Peter Francis King will be appointed as a Director, both effective 2 December 2019. In addition, Ewen Graham Wolseley Crouch has decided he will not seek re-election as a Director at the upcoming Westpac Annual General Meeting and Lindsay Philip Maxsted has confirmed he will bring forward his retirement as Chairman and as a Director to the first half of 2020.

Registered bank disclosures

i. General information (Unaudited) (continued)

Chief Executive Officer, NZ Branch

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

Responsible person

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

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

Address for communications

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

Board Audit Committee

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

Conflicts of interest policy

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

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

Auditor

PricewaterhouseCoopers

PricewaterhouseCoopers Tower

188 Quay Street

Auckland, New Zealand

i. General information (Unaudited) (continued)

Pending proceedings or arbitration

On 20 November 2019, the Overseas Bank received a statement of claim from AUSTRAC (the Australian money-laundering regulator) commencing civil proceedings in relation to alleged contraventions of the Overseas Bank's obligations under Australia's Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth). The proceedings relate to the alleged failure to report a large number of international fund transfer instructions and alleged failings in relation to correspondent banking, risk assessments, customer due diligence, transaction monitoring, record keeping and the passing on of certain data in funds transfer instructions. No similar proceedings have been commenced against any member of the NZ Banking Group in New Zealand.

Credit ratings

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

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

On 17 July 2019, Fitch affirmed the Overseas Bank's long term rating at AA- but revised its outlook to "Negative" from "Stable", in line with its outlook for all of the major Australian banks. Fitch's change in outlook follows APRA's announcement on 11 July 2019 that it was applying additional operational risk capital requirements on the Overseas Bank due to the findings in its culture, governance and accountability self-assessment.

On 9 July 2019, S&P affirmed the Overseas Bank's long term rating at AA- and revised its outlook to "Stable" from "Negative". This outlook change reflects S&P's view that the Australian Government remains highly supportive of Australia's systemically important banks based on APRA's release on loss absorbing capacity, also dated 9 July 2019.

Descriptions of credit rating scales[1]

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

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

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

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

Registered bank disclosures

i. General information (Unaudited) (continued)

Historical summary of financial statements

	NZ BANKING GROUP				
$ millions	**2019[1]**	2018[1]	2017	2016	2015
Income statement					
Interest income	**4,119**	4,067	3,981	4,172	4,451
Interest expense	**(2,121)**	(2,155)	(2,193)	(2,398)	(2,670)
Net interest income	**1,998**	1,912	1,788	1,774	1,781
Non-interest income	**562**	573	625	588	590
Net operating income before operating expenses and impairment charges	**2,560**	2,485	2,413	2,362	2,371
Operating expenses	**(1,018)**	(940)	(1,006)	(953)	(943)
Impairment (charges)/benefits	**10**	3	76	(73)	(47)
Profit before income tax	**1,552**	1,548	1,483	1,336	1,381
Income tax expense	**(423)**	(431)	(424)	(373)	(375)
Net profit for the year	**1,129**	1,117	1,059	963	1,006
Net profit for the year attributable to:					
Head office account and owners of the NZ Banking Group	**1,129**	1,117	1,059	963	1,003
Non-controlling interests	**-**	-	-	-	3
	1,129	1,117	1,059	963	1,006
Dividends paid on ordinary share capital	**(807)**	(572)	(316)	(111)	(159)
Balance sheet					
Total assets	**106,762**	96,656	95,666	93,358	88,861
Total individually impaired assets	**69**	145	173	222	282
Total liabilities	**98,105**	88,273	87,835	86,321	82,668
Total head office account	**2,289**	2,169	2,040	1,913	1,824
Total equity	**8,657**	8,383	7,831	7,037	6,193

[1] The NZ Banking Group has adopted NZ IFRS 9 and NZ IFRS 15 from 1 October 2018. Comparatives have not been restated. In addition, the NZ Banking Group has made a number of presentational changes to the balance sheet and income statement. Comparatives have been restated for 2018. Refer to Note 1 for further detail.

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

i. General information (Unaudited) (continued)

Other material matters

In addition to those specific matters identified below, certain additional material matters relating to the business and affairs of the Overseas Bank and the NZ Banking Group have been disclosed in the annual report for the Overseas Banking Group published on 4 November 2019 ('**Group Annual Report**'). These matters relate to, amongst other things, customer remediations, regulatory and compliance matters and litigation to which members of the Overseas Banking Group are a party. A copy of the Group Annual Report can be found at https://www.westpac.com.au/about-westpac/investor-centre/annual-report/.

More detail regarding these matters is set out in the section entitled "Significant developments" in Section 1 of the Group Annual Report on pages 15-22, Note 27 Provisions, contingent liabilities, contingent assets and credit commitments on pages 252-257 and Note 38 Subsequent events on page 277 of the Group Annual Report.

Additionally, further material matters relating to the business and affairs of the Overseas Bank and the NZ Banking Group arising after 4 November 2019 have been disclosed on the New Zealand and/or Australian stock exchanges under the ticker "WBC".

Thematic review of Bank Conduct and Culture

In May 2018, the Reserve Bank and Financial Markets Authority commenced a review in respect of New Zealand's 10 major banks and 15 life insurers, including Westpac New Zealand, to explain why conduct issues highlighted by the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry are not present in New Zealand. An industry thematic review report for the banks was released on 5 November 2018. Westpac New Zealand submitted a plan responding to recommendations in the review report and in Westpac New Zealand's individual feedback letters to the regulators on 29 March 2019. The regulators have subsequently confirmed that the plan comprehensively addresses the regulators' requirements. Westpac New Zealand provided its first update to the regulators on 31 October 2019 and will continue its work to execute and embed the plan.

The industry thematic review report into life insurers, including Westpac Life, was released on 29 January 2019. The report identified extensive weaknesses in life insurers' systems and controls, governance and management of conduct risks. Westpac Life provided its plan to address the findings to the regulators in June 2019.

Following the developments and findings of the Financial Services Conduct and Culture Review and the Australian Royal Commission, the Minister of Commerce announced a proposal to introduce a conduct licensing regime for banks, insurers and non-bank deposit takers in respect of their conduct in relation to retail customers. The regime will require licensed institutions to meet a fair treatment standard, and implement effective policies, processes, systems and controls to meet this standard. The regime will also create obligations relating to remuneration and sales incentives. Legislation is expected to be introduced to parliament by the end of 2019.

In addition to those matters identified above, the NZ Banking Group remains subject to continued regulatory engagement in the nature of ongoing investigations and reviews which may result in further regulatory change or requirements for customer remediation. The NZ Banking Group continues to identify and remediate conduct issues and risks as they arise.

Reserve Bank Capital Review

On 14 December 2018, the Reserve Bank released a consultation paper to seek the public's view on a proposal to set a Tier 1 capital requirement equal to 16% of risk weighted assets for banks deemed systemically important, such as Westpac New Zealand. The proposal of a Tier 1 ratio of 6% of risk weighted assets as a regulatory minimum is unchanged, and of this no more than 1.5% of risk weighted assets can be contributed by Additional Tier 1 capital or redeemable preference shares. The Reserve Bank has proposed a five year transition period.

The proposed changes aim to further strengthen the New Zealand banking system to protect the economy and depositors from bank failure. Westpac New Zealand would be required to hold a further estimated NZ$2.3 – 2.9 billion of Tier 1 capital (assuming a Tier 1 capital ratio of 16-17%) if the proposals were applied at 30 September 2019. Westpac New Zealand is already strongly capitalised with a Tier 1 capital ratio of 13.9% at 30 September 2019.

Further clarity on the proposals is expected from the Reserve Bank in December 2019 with implementation of any new rules starting from April 2020.

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

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

The most recently published financial statements of the Overseas Bank and the Overseas Banking Group are for the year ended 30 September 2019 and can be accessed at the internet address www.westpac.com.au.

ii. Additional financial disclosures

Additional information on balance sheet

	NZ BANKING GROUP	
$ millions	**2019**	2018
Interest earning and discount bearing assets	**97,740**	91,003
Interest and discount bearing liabilities	**83,028**	76,948
Total liabilities of the NZ Branch, net of amounts due to related entities	**9,098**	6,311
Total retail deposits of the NZ Branch	**-**	3

Additional information on concentrations of credit risk

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

Additional information on interest rate sensitivity

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

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the NZ Banking Group's net asset position as at 30 September 2019. The NZ Banking Group uses this contractual repricing information as a base, which is then altered to take account of consumer behaviour, to manage its interest rate risk.

ii. Additional financial disclosures (continued)

	NZ BANKING GROUP						
	2019						
$ 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	1,684	-	-	-	-	318	2,002
Collateral paid	417	-	-	-	-	-	417
Trading securities and financial assets measured at FVIS	3,580	729	28	46	488	-	4,871
Derivative financial instruments	-	-	-	-	-	6,257	6,257
Investment securities	88	633	1,226	719	1,803	-	4,469
Loans	44,564	6,443	13,829	14,399	5,631	(240)	84,626
Other financial assets	72	-	-	-	-	328	400
Life insurance assets	-	5	-	-	-	330	335
Due from related entities	1,352	-	-	4	-	1,011	2,367
Total financial assets	51,757	7,810	15,083	15,168	7,922	8,004	105,744
Non-financial assets							1,018
Total assets							106,762
Financial liabilities							
Collateral received	623	-	-	-	-	-	623
Deposits and other borrowings	42,934	9,014	5,102	1,044	641	6,871	65,606
Other financial liabilities	1,166	-	-	-	-	582	1,748
Derivative financial instruments	-	-	-	-	-	5,825	5,825
Due to related entities	1,473	-	-	-	-	1,419	2,892
Debt issues	7,203	-	1,388	2,461	6,794	-	17,846
Loan capital	1,121	-	-	-	2,064	-	3,185
Total financial liabilities	54,520	9,014	6,490	3,505	9,499	14,697	97,725
Non-financial liabilities							380
Total liabilities							98,105
On-balance sheet interest rate repricing	(2,763)	(1,204)	8,593	11,663	(1,577)		
Net derivative notional principals							
Net interest rate contracts (notional):							
Receivable/(payable)	10,123	(3,596)	(2,586)	(8,439)	4,498		
Net interest rate repricing gap	7,360	(4,800)	6,007	3,224	2,921		

Additional information on liquidity risk

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

Registered bank disclosures

ii. Additional financial disclosures (continued)

Overseas Banking Group profitability and size

Information on the Overseas Banking Group is from the most recently published financial statements of the Overseas Banking Group for the year ended 30 September 2019.

Profitability	30 Sep 19
Net profit after tax for the year ended 30 September 2019 (A$ millions)[1]	**6,790**
Net profit after tax for the year ended 30 September 2019 as a percentage of average total assets	**0.8%**

Total assets and equity	30 Sep 19
Total assets (A$ millions)	**906,626**
Percentage change in total assets over the year ended 30 September 2019	**3.1%**
Total equity (A$ millions)	**65,507**

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

Reconciliation of mortgage-related amounts

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

	NZ BANKING GROUP
$ millions	**30 Sep 19**
Residential mortgages - total gross loans (as disclosed in Note 11 and Note 12)	**51,504**
Reconciling items:	
Unamortised deferred fees and expenses	**(181)**
Fair value hedge adjustments	**(138)**
Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages	**10,337**
Undrawn at default[1]	**(2,635)**
Residential mortgages by LVR (as disclosed in Additional mortgage information in Section iv.)	**58,887**

[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

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

Refer to Note 12 Provisions for expected credit losses/impairment charges for the NZ Banking Group's comparative information on past due assets.

Movements in individually impaired assets

Refer to Note 12 Provisions for expected credit losses/impairment charges for the NZ Banking Group's comparative information on movements in individually impaired assets.

Movements in balances of total individual credit impairment allowances

Refer to Note 12 Provisions for expected credit losses/impairment charges for the NZ Banking Group's comparative information on movements in balances of total individual credit impairment allowances.

Movements in balance of collective credit impairment allowance

Refer to Note 12 Provisions for expected credit losses/impairment charges for the NZ Banking Group's comparative information on movements in balance of collective credit impairment allowance.

Movements in components of loss allowance (NZ IFRS 9)

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

Impacts of changes in gross financial assets on loss allowances (NZ IFRS 9)

Refer to Note 12 Provisions for expected credit losses/impairment charges for the impacts of changes in gross financial assets on loss allowances, as required by NZ IFRS 9.

Other asset quality information

The NZ Banking Group had undrawn commitments of $6 million (30 September 2018: $4 million) to counterparties for whom drawn balances are classified as individually impaired assets under corporate loans as at 30 September 2019.

The NZ Banking Group does not have other assets under administration as at 30 September 2019 (30 September 2018: nil).

Registered bank disclosures

iii. Asset quality (continued)

Overseas Banking Group asset quality

Information on the Overseas Banking Group is from the most recently published financial statements of the Overseas Banking Group for the year ended 30 September 2019.

	2019
Total individually impaired assets[1, 2] (A$ millions)	**1,763**
Total individually impaired assets expressed as a percentage of total assets	**0.2%**
Total individually assessed provision for ECL[3] (A$ millions)	**792**
Total individually assessed provision for ECL expressed as a percentage of total individually impaired assets	**44.9%**
Total collectively assessed provision for ECL[3] (A$ millions)	**3,510**

[1] Total individually impaired assets are before provision for ECL and net of interest held in suspense. Total individually impaired assets includes A$1,060 million of assets which are determined to be impaired, but which are not individually significant, and therefore have been grouped into pools of assets for the purpose of collectively calculating an impairment provision.

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

[3] Total individual provision for ECL and total collective provision for ECL both include A$380 million of provision for ECL that has been calculated collectively on groups of assets which have been determined to be impaired, but which are not individually significant.

Registered bank disclosures

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

Additional mortgage information

Residential mortgages by loan-to-value ratio ('LVR') as at 30 September 2019

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

For loans originated from 1 January 2008, the NZ Banking Group utilises data from its loan system. Due to system limitations, for loans originated prior to 1 January 2008, the origination valuation is not separately recorded and is therefore not available for disclosure. For these loans, the NZ Banking Group utilises its dynamic LVR process to estimate an origination valuation. Refer also to the disclosures in relation to Westpac New Zealand's conditions of registration on page 108.

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

	NZ BANKING GROUP					
	2019					
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	**21,819**	**12,262**	**12,759**	**2,770**	**1,575**	**51,185**
Undrawn commitments and other off-balance sheet exposures	**5,401**	**1,192**	**809**	**134**	**166**	**7,702**
Value of exposures	**27,220**	**13,454**	**13,568**	**2,904**	**1,741**	**58,887**

Market risk

Market risk notional capital charges

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

For each category of market risk, the NZ Banking Group's peak end-of-day aggregate capital charge is derived by determining the maximum over the six months ended 30 September 2019 of the aggregate capital charge for that category of market risk at the close of each business day derived in accordance with BS2A.

The following table provides a summary of the NZ Banking Group's notional capital charges by risk type as at the reporting date and the peak end-of-day notional capital charges by risk type for the six months ended 30 September 2019.

	NZ BANKING GROUP	
	2019	
$ millions	**Implied Risk-weighted Exposure**	**Notional Capital Charge**
End-of-period		
Interest rate risk	**4,228**	**338**
Foreign currency risk	**13**	**1**
Equity risk	**-**	**-**
Peak end-of-day		
Interest rate risk	**6,594**	**528**
Foreign currency risk	**50**	**4**
Equity risk	**-**	**-**

Overseas Bank and Overseas Banking Group capital ratios

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

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

Insurance business

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Total assets of insurance business	**213**	219
As a percentage of total consolidated assets of the NZ Banking Group	**0.20%**	0.23%

Non-consolidated insurance and non-financial activities

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

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

Securitisation

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

Funds management and other fiduciary activities

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

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

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

	NZ BANKING GROUP	
$ millions	**2019**	2018
Private and priority	**688**	637
Retirement plans	**7,229**	6,312
Retail unit trusts	**2,615**	2,546
Wholesale client portfolios	**719**	724
Term PIE	**2,091**	2,031
Cash PIE	**687**	762
Notice Saver PIE	**639**	456
Total funds under management	**14,668**	13,468

Other than funds under management disclosed above, there are no funds held in trust, funds under custodial arrangements or other funds held or managed subject to fiduciary responsibilities by any member of the NZ Banking Group (30 September 2018: nil).

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

Marketing and distribution of insurance products

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

Arrangements to ensure no adverse impacts arising from the above activities

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

Registered bank disclosures

vi. Risk management policies

Information about risk

Risk management strategy

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

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

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

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

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

The 3rd Line of Defence – Independent assurance

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

Risk management frameworks

Further to the Directors' Statement on page 5:

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

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

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

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

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

Financial risks

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

vi. Risk management policies (continued)

Other key material risks

Operational risk

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

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

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

Compliance risk

Compliance risk is the risk of legal or regulatory sanction, financial loss or reputation loss arising from the NZ Banking Group's failure to abide by the compliance obligations required of the NZ Banking Group.

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

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

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

Other risk classes include:

- Conduct risk: the risk that the NZ Banking Group's services and products do not deliver clear, fair and suitable outcomes for the NZ Banking Group's customers or undermines market integrity;
- Business risk: the risk associated with the vulnerability of a line of business to changes in the business environment;
- Equity risk: the potential for financial loss arising from movements in equity values. Equity risk may be direct, indirect or contingent;
- Insurance risk: the risk of mis-estimation of the expected cost of insured events, volatility in the number or severity of insured events, and mis-estimation of the cost of incurred claims;
- Related entity (contagion) risk: the risk that problems arising in other members of the Overseas Banking Group may compromise the financial and operational position of the ADIs in the NZ Banking Group;
- Reputation risk: the risk of the loss of reputation, stakeholder confidence, or public trust and standing; and
- Sustainability risk: the risk of reputation or financial loss due to failure to recognise or address material existing or emerging sustainability related environmental, social or governance issues.

Reviews of the NZ Banking Group's risk management systems

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

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

Various external reviews of the NZ Banking Group's risk management system have been conducted during the year ended 30 September 2019 as part of ongoing compliance with regulatory requirements.

vi. Risk management policies (continued)

Internal audit function of the NZ Banking Group

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

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

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

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

Access to the Overseas Bank disclosures

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

Conditions of registration

Conditions of registration

The registration of Westpac Banking Corporation ("the registered bank") in New Zealand is subject to the following conditions, which applied from 1 January 2019:

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

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

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

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

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

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

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

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

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

   For the purposes of this condition of registration,:

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

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

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

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

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

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

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

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

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

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

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

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

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

9. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 70%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.

10. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 20% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-value measurement period.

11. That the business of the registered bank in New Zealand must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

In these conditions of registration,:

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

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

Conditions of registration

Conditions of registration (continued)

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

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

In conditions of registration 9 to 11:

"loan-to-valuation ratio", "non property-investment residential mortgage loans", property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of property-investment residential mortgage loans", "qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans", and "residential mortgage loan" have the same meaning as in the Reserve Bank document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" ('**BS19**') dated January 2019, and where the version of the Reserve Bank document "Capital Adequacy Framework (Standardised Approach)" ('**BS2A**') referred to in BS19 for the purpose of defining these terms is that dated November 2015.

"loan-to-valuation measurement period" means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of June 2019.

Changes to conditions of registration

There have been no changes to the conditions of registration imposed on the Overseas Bank in New Zealand since 31 March 2019.

Westpac New Zealand conditions of registration

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

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

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

Westpac New Zealand has also disclosed non-compliance with its condition of registration 25 relating to the Reserve Bank's BS11: Outsourcing Policy in its disclosure statement for the year ended 30 September 2019.

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

Independent auditor's report

To the Directors of Westpac Banking Corporation

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

This report includes our:

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

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

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

- the balance sheet as at 30 September 2019;
- the income statement for the year then ended;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended;
- the notes to the financial statements, which include the principal accounting policies; and
- the supplementary information required by Schedules 4, 7, 11 and 13 of the Order.

Our opinion

In our opinion:

- the NZ Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 11 and 13 of the Order and included within notes ii to vi of the registered bank disclosures):
  i. comply with generally accepted accounting practice in New Zealand;
  ii. comply with NZ IFRS and IFRS; and
  iii. give a true and fair view of the financial position of the NZ Banking Group as at 30 September 2019, and its financial performance and cash flows for the year then ended.
- the supplementary information disclosed in accordance with Schedules 4, 7, 11 and 13 of the Order and included within notes ii, iii, v and vi of the registered bank disclosures:
  i. has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
  ii. is in accordance with the books and records of the NZ Banking Group; and
  iii. fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

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Basis for opinion

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

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

Our audit approach

Overview

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

The overall NZ Banking Group materiality: $77.6 million, which represents approximately 5% of profit before income tax.

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

We have determined that there are two key audit matters:

- Provision for expected credit losses
- Operation of IT systems and controls

Materiality

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

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

Audit scope

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

We tailored the scope of our audit in order to perform sufficient work to enable us to provide an opinion on the financial statements as a whole, taking into account the structure of the NZ Banking Group, the accounting processes and controls, and the industry in which the NZ Banking Group operates. Certain operational processes which are critical to financial reporting for the NZ Banking Group are undertaken outside of New Zealand. We worked with a PwC member firm engaged in the Westpac Banking Corporation group audit to understand certain processes that supported material balances, classes of transactions and disclosures within the NZ Banking Group's financial statements. This enabled us to evaluate the effectiveness of the controls over those processes and consider the implications for the remainder of our audit work.

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 *(Refer to Notes 6 and 12 of the financial statements)* The provision for expected credit losses (ECL) on loans and credit commitments was $352m for the NZ Banking Group at 30 September 2019. ECL are 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 to determine when a significant increase in credit risk (SICR) has occurred, and in estimating forward looking multiple economic scenarios (MES) and applying a probability weighting to different scenarios. There is also a significant volume of data used in the ECL model, which is sourced from relevant IT systems. The principal considerations for our determination that performing procedures relating to the provision for ECL on loans and credit commitments is a key audit matter are: (i) there was significant judgement by the NZ Banking Group in determining the ECL, which in turn led to a high degree of auditor subjectivity in performing procedures related to the ECL model and assumptions used to estimate the ECL; (ii) 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; (iii) the audit effort involved the use of professionals with specialised skill and knowledge; (iv) the nature and extent of audit testing involved in evaluating audit evidence related to critical data elements used in the model; 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.	Our audit procedures included performing tests of the effectiveness of controls relating to the ECL estimation process, which included controls over the data, model 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: • the involvement of our credit risk modelling specialists to assess the reasonableness of the models and the assumptions applied within SICR and MES, and to evaluate management's model monitoring controls 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; • consideration of the methodology inherent within the models for SICR and MES against the requirements of NZ IFRS 9; • observing the review, challenge and approval by an internal governance committee of MES and of critical data elements 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; and • for a sample of loans not identified as impaired, we considered the latest financial information provided to the NZ Banking Group, to test the Credit Risk grade rating that has been allocated to the borrower and inspected the valuation of collateral (where applicable) to test the loss given default factor, two critical data elements which involve significant management judgement.

Key Audit Matter	How our audit addressed the Key Audit Matter
Operation of IT systems and controls We focused on this area because the NZ Banking Group is heavily dependent on complex IT systems for the capture, processing, storage and extraction of significant volumes of transactions. There are some areas of the audit where we seek to place reliance on system functionality including certain automated controls, system calculations and reports. Our reliance on these is dependent on the NZ Banking Group's IT General Control (ITGC) environment, in particular, user access maintenance and that changes to IT systems are authorised and made in an appropriate manner.	For significant financial statement line items, we gained an understanding of the business processes, key controls and IT systems used to generate and support those line items. Where relevant to our planned audit approach, we assessed the design and tested the operating effectiveness of the key ITGCs which support the continued integrity of the in-scope IT systems. Our procedures over ITGCs focused on user access and change management and we also carried out tests, on a sample basis, of system functionality that was key to our audit approach. Where we identified design or operating effectiveness matters relating to ITGCs and system functionality relevant to our audit, we performed alternative or additional audit procedures.

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

The Directors of Westpac Banking Corporation (the 'Directors') are responsible for the other information included in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 5, 89 to 95 and 107 to 108. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

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

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

The Directors are responsible, on behalf of Westpac Banking Corporation, for the preparation of the financial statements in accordance with Clause 25 of the Order, NZ IFRS and IFRS and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 11 and 13 of the Order.

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

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

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

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

This description forms part of our auditor's report.

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

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in note iv of the registered bank disclosures) for the year ended 30 September 2019:

i. we have obtained all the information and explanations that we have required; and

ii. in our opinion, proper accounting records have been kept by the NZ Banking Group as far as appears from an examination of those records.

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

We have examined the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in note iv of the registered bank disclosures for the year ended 30 September 2019.

Our conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in note iv of the registered bank disclosures, is not, in all material respects, disclosed in accordance with Schedule 9 of the Order.

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

Basis for our conclusion

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

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

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

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

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

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

Auditor independence

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

Our firm carries out other services for the NZ Banking Group in the areas of other audit related services, which relate to assurance on certain financial information performed in the role of auditor (or where most appropriate to be performed by the auditor) including 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 NZ Banking Group on normal terms within the ordinary course of trading activities of the NZ Banking Group. These matters have not impaired our independence as auditor of the NZ Banking Group.

Who we report to

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

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants Auckland
28 November 2019