
Westpac New Zealand Limited

Annual Report and
Disclosure Statement

For the year ended 30 September 2018



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Annual report for the year ended 30 September 2018

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

Accordingly, there is no information to be included in the Annual Report other than the financial statements for the year ended 30 September 2018 and the independent auditor's report on those financial statements.

For and on behalf of the Board of Directors:



JA Dawson

Chair

19 November 2018



DA McLean

Chief Executive

19 November 2018

General information

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

In this Disclosure Statement, reference is made to:

- Westpac New Zealand Limited (otherwise referred to as the '**Bank**');
- Westpac New Zealand Limited and its controlled entities (otherwise referred to as the '**Banking Group**'). Controlled entities of the Bank as at 30 September 2018 are set out in Note 24;
- Westpac Banking Corporation (otherwise referred to as the '**Ultimate Parent Bank**'); and
- Ultimate Parent Bank and its controlled entities (otherwise referred to as the '**Ultimate Parent Bank Group**').

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

Corporate information

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

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

Ultimate Parent Bank

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

Voting securities and power to appoint directors

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

At 30 September 2018, WNZGL has a direct qualifying interest in 100% of the voting securities of the Bank. The Ultimate Parent Bank has an indirect qualifying interest in 100% of the voting securities of the Bank.

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

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

No director may be appointed unless the Reserve Bank of New Zealand ('**Reserve Bank**') has advised it has no objection to that appointment.

Limits on material financial support by the Ultimate Parent Bank

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

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

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

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

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

General information (continued)

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

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

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

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

APRA has allowed a period of five years commencing on 1 January 2016 to transition to be less than the 5% limit. Exposures for the purposes of this limit include all committed, non-intraday, non-equity exposures including derivatives and off-balance sheet exposures. For the purposes of assessing this exposure, the 5% limit excludes equity investments and holdings of capital instruments in New Zealand banking subsidiaries. As at 30 September 2018, the ELE’s non-equity exposures to New Zealand banking subsidiaries affected by the limit were below 5% of Level 1 Tier 1 capital of the Ultimate Parent Bank.

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

General information (continued)

Directorate

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

Name: Janice Amelia Dawson, B.Com, FCA Non-executive: Yes Country of Residence: New Zealand Primary Occupation: Director Secondary Occupations: None Board Audit Committee Member: Yes Independent Director: Yes	External Directorships: Deputy Chair of Air New Zealand Limited. Director of each of AIG Insurance New Zealand Limited, Beca Group Limited, Meridian Energy Limited, Erua Limited, Fulbright New Zealand and Jan Dawson Limited. Member of each of the Capital Investment Committee of the National Health Board, the Council of the University of Auckland and World Sailing Council Vice President and Director.
Name: David Alexander McLean, LL.B (Hons) Non-executive: No Country of Residence: New Zealand Primary Occupation: Chief Executive, Westpac New Zealand Limited Secondary Occupations: None Board Audit Committee Member: No Independent Director: No	External Directorships: Member of Mastercard Asia/Pacific Advisory Board. Chair of the New Zealand Bankers' Association. Member of the New Zealand Prime Minister's Business Advisory Council. Co-Chair of Champions for Change.
Name: Malcolm Guy Bailey, B.Ag,Econ. Non-executive: Yes Country of Residence: New Zealand Primary Occupation: Director Secondary Occupations: None Board Audit Committee Member: Yes Independent Director: Yes	External Directorships: Chairman of each of the Dairy Companies Association of New Zealand, Red Meat Profit Partnership General Partner Limited and New Zealand International Business Forum and Central Economic Development Agency Limited. Director of each of RMI NZ Limited, Bailey Agriculture Limited, Bailey Family Properties Limited, BBD Industrial Properties Limited, Embryo Technologies Limited, Etech Engineering Services Limited, Etech NZ Limited, Gleneig Holdings Limited, Tadpole NZ Limited and Greentech NZ Limited.
Name: Peter Francis King, BEc, FCA Non-executive: Yes Country of Residence: Australia Primary Occupation: Chief Financial Officer, Westpac Banking Corporation (April 2014 to June 2018, and October 2018 to date) / Acting Chief Risk Officer, Westpac Banking Corporation (June 2018 to September 2018) Secondary Occupations: None Board Audit Committee Member: Yes Independent Director: No	External Directorships: None
Name: Jonathan Parker Mason, MBA, MA, BA Non-executive: Yes Country of Residence: New Zealand Primary Occupation: Director Secondary Occupations: None Board Audit Committee Member: Yes, Chair Independent Director: Yes	External Directorships: Director of each of Air New Zealand Limited, Advanced Metering Assets Limited, Advanced Metering Services Limited, Arc Innovations Limited, Allagash Limited, New Zealand Assets Management Limited, NGC Holdings Limited, On Gas Limited, Vector Advanced Metering Assets (Australia) Limited, Vector Communications Limited, Vector Gas Trading Limited, Vector Limited, Vector Metering Data Services Limited, Zespri Group Limited, and Zespri International Limited. Board Member of the American Chamber of Commerce in New Zealand and World Wildlife Fund New Zealand.
Name: Christopher John David Moller, BCA, Dip Accounting, FCA Non-executive: Yes Country of Residence: New Zealand Primary Occupation: Director Secondary Occupations: None Board Audit Committee Member: Yes Independent Director: Yes	External Directorships: Chairman of Meridian Energy Limited. Director of Urenui Consultants Limited.
Name: Mary Patricia Leonie Quin, PhD, MBA, BSc (Hons) Non-executive: Yes Country of Residence: New Zealand Primary Occupation: Director Secondary Occupations: None Board Audit Committee Member: Yes Independent Director: Yes	External Directorships: None

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

Changes to Directorate

There have been no changes in the composition of the Board of Directors of the Bank since 30 September 2017.

Conflicts of interest policy

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

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

General information (continued)

Interested transactions

There have been no transactions entered into by any Director, or any immediate relative or close business associate of any Director, with the Bank, or any member of the Banking Group:

- on terms other than on those which would, in the ordinary course of business of the Bank or any member of the Banking Group, be given to any other person of like circumstances or means; or
- which could otherwise be reasonably likely to influence materially the exercise of that Director's duties.

Credit ratings

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

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

On 19 June 2017, Moody's downgraded the Bank's credit rating to A1. The downgrade follows Moody's revision of the Australian Macro Profile to "Strong +" from "Very Strong -", which resulted in a downgrade for the Ultimate Parent Bank to 'Aa3' from 'Aa2'. At the same time, Moody's revised the outlook to 'stable' from 'negative'.

Descriptions of credit rating scales¹

	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 Bank's current position is indicated in bold.

Guarantee arrangements

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

Auditor

PricewaterhouseCoopers

PricewaterhouseCoopers Tower
188 Quay Street
Auckland, New Zealand

General information (continued)

Other matters

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

Historical summary of financial statements

\$ millions	THE BANKING GROUP				
	Year Ended 30-Sep-18	Year Ended 30-Sep-17	Year Ended 30-Sep-16	Year Ended 30-Sep-15	Year Ended 30-Sep-14
Income statement					
Interest income	3,989	3,917	4,113	4,397	3,979
Interest expense	(2,145)	(2,176)	(2,369)	(2,607)	(2,339)
Net interest income	1,844	1,741	1,744	1,790	1,640
Non-interest income	373	405	400	399	481
Net operating income before operating expenses and impairment charges	2,217	2,146	2,144	2,189	2,121
Operating expenses	(915)	(954)	(907)	(888)	(817)
Impairment (charges)/benefits	(3)	76	(59)	(47)	(26)
Profit before income tax	1,299	1,268	1,178	1,254	1,278
Income tax expense	(363)	(359)	(327)	(343)	(337)
Net profit for the year	936	909	851	911	941
Net profit for the year attributable to:					
Owners of the Banking Group	936	909	851	908	938
Non-controlling interests	-	-	-	3	3
	936	909	851	911	941
Dividends paid or provided	(1,870)	(640)	(660)	(608)	(378)
Balance sheet					
Total assets	89,871	88,627	86,307	79,925	74,449
Total individually impaired assets	145	173	222	282	346
Total liabilities	82,593	81,777	79,747	73,534	67,844
Total shareholder's equity	7,278	6,850	6,560	6,391	6,605

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

Directors' statement

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

- a. contains all the information that is required by the Order; and
- b. is not false or misleading.

Each Director of the Bank believes, after due enquiry, that, over the year ended 30 September 2018:

- a. the Bank has complied with all conditions of registration imposed on it pursuant to section 74 of the Reserve Bank of New Zealand Act 1989 (**Reserve Bank Act**) except as noted on pages 77 and 78 and Note 34 to the financial statements;
- b. credit exposures to connected persons were not contrary to the interests of the Banking Group; and
- c. the Bank had systems in place to monitor and control adequately the Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

This Disclosure Statement has been signed by all the Directors:



Janice Amelia Dawson



David Alexander McLean



Malcolm Guy Bailey



Peter Francis King



Jonathan Parker Mason



Christopher John David Moller



Mary Patricia Leonie Quin

Dated this 19th day of November 2018

Income statement

for the years ended 30 September

\$ millions	Note	THE BANKING GROUP	
		Year Ended 30-Sep-18	Year Ended 30-Sep-17
Interest income	2	3,989	3,917
Interest expense	2	(2,145)	(2,176)
Net interest income		1,844	1,741
Non-interest income	3	373	405
Net operating income before operating expenses and impairment charges		2,217	2,146
Operating expenses	4	(915)	(954)
Impairment (charges)/benefits	6	(3)	76
Profit before income tax		1,299	1,268
Income tax expense	7	(363)	(359)
Net profit attributable to the owners of the Banking Group		936	909

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

Statement of comprehensive income

for the years ended 30 September

\$ millions	THE BANKING GROUP	
	Year Ended 30-Sep-18	Year Ended 30-Sep-17
Net profit attributable to the owners of the Banking Group	936	909
Other comprehensive income		
Items that may be reclassified subsequently to profit and loss		
Gains/(losses) on available-for-sale securities:		
Recognised in equity	-	11
Gains/(losses) on cash flow hedging instruments:		
Recognised in equity	(20)	(76)
Transferred to income statement	39	79
Income tax on items taken to or transferred from equity:		
Available-for-sale securities reserve	-	(3)
Cash flow hedge reserve	(5)	-
Items that will not be reclassified subsequently to profit or loss		
Remeasurement of defined benefit obligation recognised in equity (net of tax)	(2)	10
Other comprehensive income for the year (net of tax)	12	21
Total comprehensive income attributable to the owners of the Banking Group	948	930

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

Balance sheet as at 30 September

THE BANKING GROUP

\$ millions	Note	2018	2017
Assets			
Cash and balances with central banks	39	1,353	1,659
Receivables due from other financial institutions	9	70	407
Other assets	10	276	264
Trading securities	11	1,151	1,797
Derivative financial instruments	25	585	220
Available-for-sale securities	12	3,810	4,087
Loans	13, 14	80,378	77,261
Due from related entities	24	1,319	2,017
Property and equipment		144	146
Deferred tax assets	15	156	162
Intangible assets	16	629	607
Total assets		89,871	88,627
Liabilities			
Payables due to other financial institutions		497	143
Other liabilities	18	621	502
Deposits and other borrowings	19	63,102	58,998
Other financial liabilities at fair value through income statement		-	19
Derivative financial instruments	25	181	484
Debt issues	20	13,725	16,729
Current tax liabilities		96	75
Provisions	21	106	85
Total liabilities excluding related entities liabilities		78,328	77,035
Due to related entities	24	1,643	2,126
Loan capital	22	2,622	2,616
Total related entities liabilities		4,265	4,742
Total liabilities		82,593	81,777
Net assets		7,278	6,850
Shareholder's equity			
Share capital	23	5,100	3,750
Reserves		(51)	(65)
Retained profits		2,229	3,165
Total shareholder's equity		7,278	6,850
Interest earning and discount bearing assets		87,810	87,294
Interest and discount bearing liabilities		75,409	74,996

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

Signed on behalf of the Board of Directors.



J.A. Dawson

19 November 2018



J.P. Mason

19 November 2018

Statement of changes in equity for the years ended 30 September

THE BANKING GROUP

	Reserves				Total
	Share Capital	Available-for-sale Securities Reserve	Cash Flow Hedge Reserve	Retained Profits	
\$ millions					
As at 1 October 2016	3,750	1	(77)	2,886	6,560
Year ended 30 September 2017					
Net profit attributable to the owners of the Banking Group	-	-	-	909	909
Net gains/(losses) from changes in fair value	-	11	(76)	-	(65)
Income tax effect	-	(3)	22	-	19
Transferred to income statement	-	-	79	-	79
Income tax effect	-	-	(22)	-	(22)
Remeasurement of defined benefit obligations	-	-	-	14	14
Income tax effect	-	-	-	(4)	(4)
Total comprehensive income for the year ended 30 September 2017	-	8	3	919	930
Transactions with owners:					
Dividends paid on ordinary shares (refer to Note 23)	-	-	-	(640)	(640)
As at 30 September 2017	3,750	9	(74)	3,165	6,850
For the year ended 30 September 2018					
Net profit attributable to the owners of the Banking Group	-	-	-	936	936
Net gains/(losses) from changes in fair value	-	-	(20)	-	(20)
Income tax effect	-	-	6	-	6
Transferred to income statement	-	-	39	-	39
Income tax effect	-	-	(11)	-	(11)
Remeasurement of defined benefit obligations	-	-	-	(3)	(3)
Income tax effect	-	-	-	1	1
Total comprehensive income for the year ended 30 September 2018	-	-	14	934	948
Transactions with owners:					
Share capital issued (refer to Note 23)	1,350	-	-	-	1,350
Dividends paid on ordinary shares (refer to Note 23)	-	-	-	(1,870)	(1,870)
As at 30 September 2018	5,100	9	(60)	2,229	7,278

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

Statement of cash flows

for the years ended 30 September

THE BANKING GROUP

\$ millions	Note	Year Ended 30-Sep-18	Year Ended 30-Sep-17
Cash flows from operating activities			
Interest received		3,985	3,902
Interest paid		(2,161)	(2,158)
Non-interest income received		362	422
Operating expenses paid		(820)	(844)
Income tax paid		(336)	(334)
Cash flows from operating activities before changes in operating assets and liabilities		1,030	988
Net (increase)/decrease in:			
Receivables due from other financial institutions		337	313
Other assets		(9)	(14)
Trading securities		666	312
Loans		(3,121)	(2,103)
Due from related entities		1,025	(281)
Net increase/(decrease) in:			
Payables due to other financial institutions		354	128
Other liabilities		96	9
Deposits and other borrowings		4,104	207
Other financial liabilities at fair value through income statement		(19)	(381)
Due to related entities ¹		(7)	(197)
Net movement in external and related entity derivative financial instruments		(63)	(627)
Net cash provided by/(used in) operating activities	39	4,393	(1,646)
Cash flows from investing activities			
Purchase of available-for-sale securities		(268)	(533)
Proceeds from available-for-sale securities		499	162
Purchase of capitalised computer software		(64)	(61)
Purchase of property and equipment		(44)	(31)
Net cash provided by/(used in) investing activities		123	(463)
Cash flows from financing activities			
Net movement in due to related entities ¹		(388)	(287)
Proceeds from debt issues	20	550	7,490
Repayments of debt issues	20	(4,464)	(5,698)
Issue of loan capital (net of transaction fees)	22	-	1,485
Issue of ordinary share capital	23	1,350	-
Dividends paid to ordinary shareholders	23	(1,870)	(640)
Net cash provided by/(used in) financing activities		(4,822)	2,350
Net increase/(decrease) in cash and cash equivalents		(306)	241
Cash and cash equivalents at beginning of the year		1,659	1,418
Cash and cash equivalents at end of the year	39	1,353	1,659

¹ Certain comparatives have been revised for consistency. The reclassification was made to better reflect the Banking Group's cash flows from operating and financing activities and has no effect on the balance sheet or income statement.

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 39.

Notes to the financial statements

Note 1 Financial statement preparation

In these financial statements, reference is made to:

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

The consolidated financial statements are for the Banking Group.

These financial statements were authorised for issue by the Board of Directors of the Bank (the '**Board**') on 19 November 2018. The Board has the power to amend and reissue the financial statements.

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

a. Basis of preparation

i. Basis of accounting

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

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

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

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

ii. Historical cost convention

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

iii. Comparative revisions

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

iv. Changes in accounting standards

The Banking Group adopted the requirements of Disclosure Initiative: Amendments to NZ IAS 7 *Statement of Cash Flows* which require additional disclosures regarding both cash and non-cash changes in liabilities arising from financing activities. These disclosures have been made in Note 20 and Note 22. As permitted by the standard, comparatives are not required on first application.

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

v. Business combinations

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

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

vi. Foreign currency translation

Functional and presentational currency

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

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date 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.

vii. Reserves

Available-for-sale securities reserve

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

Cash flow hedge reserve

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

b. Principles of consolidation

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

All transactions between entities within the Banking Group are eliminated. Subsidiaries are fully consolidated from the date on which control commences and are de-consolidated from the date that control ceases.

c. Financial assets and financial liabilities

i. Recognition

Purchases and sales of regular way financial assets, except for loans and receivables, are recognised on trade-date; the date on which the 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.

Notes to the financial statements

Note 1 Financial statement preparation (continued)

ii. Classification and measurement

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

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

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

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

The Banking Group's policies for determining the fair value of financial assets and financial liabilities are set out in Note 26.

iii. Derecognition

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

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

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

d. Critical accounting assumptions and estimates

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

- Note 7 Income tax expense
- Note 14 Asset quality
- Note 15 Deferred tax assets
- Note 16 Intangible assets
- Note 26 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 Banking Group have been issued but are not yet effective, and unless otherwise stated, have not been early adopted by the Banking Group:

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

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

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

Impairment

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

Key elements of the new impairment model are:

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

Implementation

Measurement

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

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

Notes to the financial statements

Note 1 Financial statement preparation (continued)

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

Significant increase in credit risk and movement between stages

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

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

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

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

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

Forward looking information

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

Governance

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

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

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

Classification and measurement

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

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

The accounting for financial liabilities is largely unchanged.

Implementation

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

Hedging

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

Implementation

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

Transition

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

Notes to the financial statements

Note 1 Financial statement preparation (continued)

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

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

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

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

- all operating leases of greater than 12 months duration will be required to be presented on balance sheet by the lessee as a right-of-use asset and lease liability. The asset and liability will initially be measured at the present value of non-cancellable lease payments and payments to be made in optional periods where it is reasonably certain that the option will be exercised. Details of the Banking Group's lease obligations are included in Note 28; and
- all leases on balance sheet will give rise to a combination of interest expense on the lease liability and depreciation of the right-of-use asset.

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

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

Notes to the financial statements

Note 2 Net interest income

Accounting policy

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

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

\$ millions	Note	THE BANKING GROUP	
		Year Ended 30-Sep-18	Year Ended 30-Sep-17
Interest income			
Cash and balances with central banks		28	30
Trading securities		46	57
Available-for-sale securities		148	157
Loans		3,751	3,656
Due from related entities	24	16	17
Total interest income		3,989	3,917
Interest expense			
Deposits and other borrowings		1,303	1,250
Debt issues		317	314
Loan capital	24	144	54
Due to related entities	24	43	56
Other ¹		338	502
Total interest expense		2,145	2,176
Net interest income		1,844	1,741

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

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

\$ millions	THE BANKING GROUP	
	Year Ended 30-Sep-18	Year Ended 30-Sep-17
Interest income	3,938	3,854
Interest expense	2,119	2,122

Notes to the financial statements

Note 3 Non-interest income

Accounting policy

Fees and commissions

Fees and commission income are recognised as follows:

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

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

\$ millions	Note	THE BANKING GROUP	
		Year Ended 30-Sep-18	Year Ended 30-Sep-17
Fees and commissions			
Transaction fees and commissions ¹		252	287
Lending fees		57	57
Management fees received from related entities	24	7	10
Other non-risk fee income		43	46
Total fees and commissions		359	400
Net ineffectiveness on qualifying hedges		4	(12)
Other non-interest income			
Share of associate's net profit		5	5
Other		5	12
Total other non-interest income		10	17
Total non-interest income		373	405

¹ Includes transaction fees and commissions due from related entities (refer to Note 24).

Note 4 Operating Expenses

\$ millions	Note	THE BANKING GROUP	
		Year Ended 30-Sep-18	Year Ended 30-Sep-17
Staff expenses		455	447
Operating lease rentals		62	67
Depreciation		44	46
Technology services and telecommunications		98	102
Purchased services		120	157
Software amortisation costs		42	44
Related entities - management fees	24	4	3
Other		90	88
Total operating expenses		915	954

Notes to the financial statements

Note 5 Auditor's remuneration

\$'000s	THE BANKING GROUP	
	Year Ended 30-Sep-18	Year Ended 30-Sep-17
Audit and audit related services		
Audit and review of financial statements ¹	1,770	1,392
Other audit related services ²	49	47
Total remuneration for audit and other audit related services	1,819	1,439
Other services ³	126	125
Total remuneration for non-audit services	126	125
Total remuneration for audit, other audit related services and non-audit services	1,945	1,564

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

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

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

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

Note 6 Impairment charges/(benefits)

Accounting policy

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

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

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

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

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

Uncollectable loans

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

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

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

\$ millions	THE BANKING GROUP				
	For the year ended 30 September 2018				
	Residential Mortgages	Other Retail	Corporate	Other	Total
Individually assessed provisions raised	9	2	17	-	28
Reversal of previously recognised impairment charges	(3)	(2)	(13)	-	(18)
Collectively assessed provisions released	(2)	(10)	(22)	-	(34)
Bad debts written-off/(recovered) directly to the income statement	(2)	41	(12)	-	27
Total impairment charges/(benefits)	2	31	(30)	-	3

Notes to the financial statements

Note 6 Impairment charges/(benefits) (continued)

THE BANKING GROUP					
For the year ended 30 September 2017					
\$ millions	Residential Mortgages	Other Retail	Corporate	Other	Total
Individually assessed provisions raised	8	4	6	-	18
Reversal of previously recognised impairment charges	(4)	(1)	(62)	-	(67)
Collectively assessed provisions raised/(released)	5	(10)	(51)	-	(56)
Bad debts written-off/(recovered) directly to the income statement	-	31	(2)	-	29
Total impairment charges/(benefits)	9	24	(109)	-	(76)

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

Note 7 Income tax expense

Accounting policy

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

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

Goods and services tax ('GST')

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

Critical accounting assumptions and estimates

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

THE BANKING GROUP		
\$ millions	Year Ended 30-Sep-18	Year Ended 30-Sep-17
Income tax expense		
Current tax:		
Current year	361	335
Prior year adjustments	-	(1)
Deferred tax (refer to Note 15):		
Current year	2	20
Prior year adjustments	-	5
Total income tax expense	363	359
Profit before income tax	1,299	1,268
Tax calculated at tax rate of 28%	364	355
Income not subject to tax	(1)	(1)
Expenses not deductible for tax purposes	2	1
Prior year adjustments	-	4
Other items	(2)	-
Total income tax expense	363	359

The effective tax rate for the year ended 30 September 2018 was 27.9% (30 September 2017: 28.3%).

Notes to the financial statements

Note 8 Imputation credit account

\$ millions	THE BANKING GROUP	
	2018	2017
Imputation credits available for use in subsequent reporting periods	775	618

Note 9 Receivables due from other financial institutions

Accounting policy

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

\$ millions	Note	THE BANKING GROUP	
		2018	2017
Cash collateral	17	70	407
Total receivables due from other financial institutions		70	407

Note 10 Other assets

\$ millions	THE BANKING GROUP	
	2018	2017
Accrued interest receivable	154	144
Trade debtors and prepayments	46	37
Other	76	83
Total other assets	276	264

Note 11 Trading securities

Accounting policy

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

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

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

Reverse repos are not recognised on the balance sheet as the Banking Group has not obtained the risks and rewards of ownership. The cash consideration paid is recognised as an asset. Reverse repos which are part of a trading portfolio are designated at fair value and recognised as part of due from related entities (refer to Note 24). Gains and losses on these financial assets are recognised in non-interest income. Interest received under these agreements is recognised in interest income.

\$ millions	THE BANKING GROUP	
	2018	2017
Government and semi-government securities	828	903
Other debt securities	323	894
Total trading securities	1,151	1,797

Notes to the financial statements

Note 12 Available-for-sale securities

Accounting policy

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

- Interest on debt securities; and
- Impairment charges.

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

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

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

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

Note 13 Loans

Accounting policy

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

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

The following table shows loans disaggregated by type of product:

\$ millions	THE BANKING GROUP	
	2018	2017
Overdrafts	1,117	1,296
Credit card outstandings	1,499	1,518
Money market loans	1,361	1,250
Term loans:		
Housing	48,893	46,947
Non-housing	27,031	25,778
Other	801	822
Total gross loans	80,702	77,611
Provisions for impairment charges on loans	(324)	(350)
Total net loans	80,378	77,261

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

Notes to the financial statements

Note 14 Asset quality

Accounting policy

The 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 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 Banking Group to reduce differences between impairment provisions and actual loss experience.

Individual component

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

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

Collective component

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

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

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

Notes to the financial statements

Note 14 Asset quality (continued)

\$ millions	THE BANKING GROUP 2018					THE BANKING GROUP 2017				
	Residential Mortgages	Other Retail	Corporate	Other	Total	Residential Mortgages	Other Retail	Corporate	Other	Total
Neither past due nor impaired	47,974	3,726	27,293	278	79,271	46,023	3,767	26,189	225	76,204
Past due but not impaired assets										
Less than 30 days past due	739	143	162	-	1,044	752	132	107	-	991
At least 30 days but less than 60 days past due	80	25	6	-	111	67	22	10	-	99
At least 60 days but less than 90 days past due	33	10	2	-	45	27	13	24	-	64
At least 90 days past due	43	18	25	-	86	46	19	15	-	80
Total past due assets not impaired	895	196	195	-	1,286	892	186	156	-	1,234
Individually impaired assets¹										
Balance at beginning of the year	32	5	136	-	173	25	4	193	-	222
Additions	31	8	40	-	79	40	5	39	-	84
Amounts written off	(6)	(2)	(14)	-	(22)	(4)	(1)	(3)	-	(8)
Returned to performing or repaid	(33)	(5)	(47)	-	(85)	(29)	(3)	(93)	-	(125)
Balance at end of the year	24	6	115	-	145	32	5	136	-	173
Total gross loans²	48,893	3,928	27,603	278	80,702	46,947	3,958	26,481	225	77,611
Individually assessed provisions										
Balance at beginning of the year	7	5	36	-	48	7	3	95	-	105
Impairment charges/(benefits):										
New provisions	9	2	17	-	28	8	4	6	-	18
Reversal of previously recognised impairment charges	(3)	(2)	(13)	-	(18)	(4)	(1)	(62)	-	(67)
Amounts written off	(6)	(2)	(14)	-	(22)	(4)	(1)	(3)	-	(8)
Balance at end of the year	7	3	26	-	36	7	5	36	-	48
Collectively assessed provisions										
Balance at beginning of the year	54	97	181	-	332	46	95	220	-	361
Impairment charges/(benefits)	(2)	(10)	(22)	-	(34)	5	(10)	(51)	-	(56)
Interest adjustments	2	12	10	-	24	3	12	12	-	27
Balance at end of the year	54	99	169	-	322	54	97	181	-	332
Total provisions for impairment charges on loans and credit commitments	61	102	195	-	358	61	102	217	-	380
Provision for credit commitments (refer to Note 21)	-	(4)	(30)	-	(34)	-	(4)	(26)	-	(30)
Total provisions for impairment charges on loans	61	98	165	-	324	61	98	191	-	350
Total net loans³	48,832	3,830	27,438	278	80,378	46,886	3,860	26,290	225	77,261

¹ The Banking Group had undrawn commitments of \$4 million (30 September 2017: \$4 million) to counterparties for whom drawn balances are classified as individually impaired assets under corporate loans as at 30 September 2018.

² The Banking Group does not have other assets under administration as at 30 September 2018.

³ Total net loans represent the estimated recoverable amounts which are net of provisions for impairment.

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.

Notes to the financial statements

Note 15 Deferred tax assets (continued)

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

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

Deferred tax is not recognised for the following temporary differences:

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

Critical accounting assumptions and estimates

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

\$ millions	THE BANKING GROUP	
	2018	2017
Deferred tax assets/(liabilities) comprise the following temporary differences:		
Provision for impairment charges on loans	94	101
Cash flow hedges	23	28
Provision for employee entitlements	14	12
Software, property and equipment	10	11
Other temporary differences	15	10
Net deferred tax assets	156	162
The deferred tax (charge)/credit in income tax expense comprises the following temporary differences:		
Provision for impairment charges on loans	(7)	(24)
Provision for employee entitlements	1	(1)
Software, property and equipment	(1)	2
Other temporary differences	5	(2)
Total deferred tax charge in income tax expense	(2)	(25)
The deferred tax (charge)/credit in other comprehensive income comprises the following temporary differences:		
Provision for employee entitlements	1	(4)
Cash flow hedges	(5)	-
Total deferred tax charge in other comprehensive income	(4)	(4)

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)

Notes to the financial statements

Note 16 Intangible assets (continued)

Critical accounting assumptions and estimates

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

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

\$ millions	THE BANKING GROUP	
	2018	2017
Goodwill	477	477
Computer software	152	130
Total intangible assets	629	607

Significant assumptions used in recoverable amount calculations

Goodwill has been allocated to the Consumer Banking and Wealth operating segment. 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 Banking Group discounts the projected cash flows by its adjusted pre-tax equity rate.

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

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

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

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

Note 17 Financial assets pledged as collateral

Accounting policy

Security repurchase agreements

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

The cash consideration received is recognised as a liability ('security repurchase agreements'). Security repurchase agreements are designated at fair value and recognised as part of other financial liabilities at fair value through income statement or due to related entities (refer to Note 24) as they are managed as part of a trading portfolio.

The Banking Group is required to provide collateral to other financial institutions, as part of standard terms, to secure liabilities. In addition to assets supporting the Bank's Global Covered Bond Programme ('CB Programme') disclosed in Note 31, the carrying value of these financial assets pledged as collateral is:

\$ millions	THE BANKING GROUP	
	2018	2017
Cash ¹	70	407
Securities pledged under repurchase agreements:		
Available-for-sale securities ²	15	41
Total amount pledged to secure liabilities (excluding CB Programme)	85	448

¹ Comprises receivables due from other financial institutions.

² As at 30 September 2018, \$15 million of available-for-sale securities were pledged as collateral to the New Zealand Branch of the Ultimate Parent Bank ('NZ Branch') (30 September 2017: \$22 million) which is recorded within due to related entities and nil available-for-sale securities were pledged to third parties (30 September 2017: \$19 million) which is recorded within other financial liabilities at fair value through income statement.

Notes to the financial statements

Note 18 Other liabilities

\$ millions	THE BANKING GROUP	
	2018	2017
Accrued interest payable	356	328
Retirement benefit obligations	18	14
Trade creditors and other accrued expenses	66	71
Other	181	89
Total other liabilities	621	502

Note 19 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.

\$ millions	THE BANKING GROUP	
	2018	2017
Certificates of deposit	1,218	593
Non-interest bearing, repayable at call	5,903	5,274
Other interest bearing:		
At call	23,335	23,117
Term	32,646	30,014
Total deposits and other borrowings	63,102	58,998
Deposits at fair value	1,218	593
Deposits at amortised cost	61,884	58,405
Total deposits and other borrowings	63,102	58,998

Priority of financial liabilities in the event of liquidation

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

Note 20 Debt issues

Accounting policy

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

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

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

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

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

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

Notes to the financial statements

Note 20 Debt issues (continued)

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

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

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

¹ Includes items such as amortisation of issue costs.

Note 21 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 Banking Group is committed to provide facilities and guarantees as explained in Note 29. If it is probable that a facility will be drawn and the resulting asset will be less than the drawn amount then a provision for impairment is recognised. The provision for impairment is calculated using the same methodology as the provision for impairment charges on loans (refer to Note 6).

Notes to the financial statements

Note 21 Provisions (continued)

\$ millions	THE BANKING GROUP	
	2018	2017
Annual leave and other employee benefits	58	54
Provision for impairment on credit commitments	34	30
Other	14	1
Total provisions	106	85

Note 22 Loan Capital

Accounting policy

Loan capital are instruments which qualify for inclusion as regulatory capital under the Reserve Bank of New Zealand ("Reserve Bank") Capital Adequacy Framework. Loan capital is initially measured at fair value and subsequently measured at amortised cost using the effective interest rate method. Interest expense incurred is recognised in net interest income.

\$ millions	THE BANKING GROUP	
	2018	2017
Additional Tier 1 loan capital - Convertible subordinated perpetual notes ¹	1,487	1,485
Tier 2 loan capital - Convertible subordinated notes ¹	1,135	1,131
Total loan capital	2,622	2,616

¹ Net of capitalised transaction costs.

\$ millions	THE BANKING GROUP	
	2018	
Movement reconciliation		
Balance as at 1 October 2017	2,616	
Total cash movements	-	
Foreign exchange translation impact	4	
Other ¹	2	
Total non-cash movements	6	
Balance as at 30 September 2018	2,622	

¹ Includes items such as amortisation of issue costs.

Additional Tier 1 loan capital

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

\$	Issue date	Counterparty	Interest rate	Optional redemption date
NZ\$1,500 million notes ¹	22 September 2017	NZ Branch	NZ 90 day bank bill rate + 3.9594% p.a.	21 September 2027 and every fifth anniversary thereafter

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

Interest payable

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

Redemption

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

Notes to the financial statements

Note 22 Loan Capital (continued)

Conversion

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

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

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

Tier 2 loan capital

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

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

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

Interest payable

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

Early redemption

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

Conversion

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

Note 23 Share capital

Accounting policy

Share capital

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

Ordinary shares fully paid

	THE BANKING GROUP	
	2018 Number of Shares Issued and Authorised	2017 Number of Shares Issued and Authorised
Balance at beginning of the year	3,750,001,000	3,750,001,000
Share capital issued	1,350,000,000	-
Balance at end of the year	5,100,001,000	3,750,001,000

In accordance with the Reserve Bank document 'Capital Adequacy Framework (Internal Models Based Approach) (BS2B)' ('BS2B') ordinary share capital is classified as Common Equity Tier 1 capital.

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

Notes to the financial statements

Note 23 Share capital (continued)

The Directors of the Bank paid a dividend of \$520 million on 16 August 2018, on the ordinary shares on issue to Westpac New Zealand Group Limited ('WNZGL').

On 15 February 2018, the Directors of the Bank paid a dividend of \$1,350 million on the ordinary shares on issue to WNZGL. Immediately after this payment the Bank issued 1,350 million ordinary shares to WNZGL for \$1 per share.

Note 24 Related entities

Related entities

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

Banking Group

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

The Banking Group consists of the Bank and all of its controlled entities. As at 30 September 2018, the Bank had the following controlled entities:

Name of Entity	Principal Activity	Notes
Westpac NZ Operations Limited ('WNZOL') ¹	Holding company	
Aotearoa Financial Services Limited	Non-active company	
Number 120 Limited	Finance company	
The Home Mortgage Company Limited	Residential mortgage company	
Westpac New Zealand Staff Superannuation Scheme Trustee Limited ('WNZSSSTL')	Trustee company	
Westpac (NZ) Investments Limited ('WNZIL')	Property company	
Westpac Securities NZ Limited ('WSNZL')	Funding company	
Westpac NZ Covered Bond Holdings Limited ('WNZCBHL')	Holding company	9.5% owned ²
Westpac NZ Covered Bond Limited ('WNZCBL')	Guarantor	9.5% owned ²
Westpac NZ Securitisation Holdings Limited ('WNZSHL')	Holding company	9.5% owned ³
Westpac NZ Securitisation Limited ('WNZSL')	Funding company	9.5% owned ³
Westpac NZ Securitisation No.2 Limited ('WNZSL2')	Non-active company	9.5% owned ³
Westpac Cash PIE Fund	Portfolio investment entity	Not owned ⁴
Westpac Notice Saver PIE Fund	Portfolio investment entity	Not owned ⁴
Westpac Term PIE Fund	Portfolio investment entity	Not owned ⁴

¹ As at 30 September 2018, WNZOL held 25% equity in Paymark Limited, an associate, which was not a controlled entity. See Note 40 Subsequent events.

² The Banking Group, through its subsidiary, WNZOL, has a qualifying interest of 9.5% in WNZCBHL and its wholly-owned subsidiary company, WNZCBL. The Bank is considered to control both WNZCBHL and WNZCBL based on contractual arrangements in place, and as such both WNZCBHL and WNZCBL are consolidated within the financial statements of the Banking Group.

³ The Banking Group, through its subsidiary WNZOL, has a qualifying interest of 9.5% in WNZSHL and its wholly-owned subsidiary companies, WNZSL and WNZSL2. The Bank is considered to control WNZSHL, WNZSL and WNZSL2 based on contractual arrangements in place, and as such WNZSHL, WNZSL and WNZSL2 are consolidated within the financial statements of the Banking Group.

⁴ Westpac Term PIE Fund, Westpac Cash PIE Fund and Westpac Notice Saver PIE Fund (collectively referred to as the 'PIE Funds') were established as unit trusts. The PIE Funds are Portfolio Investment Entities ('PIE'), where BT Funds Management (NZ) Limited ('BTNZ') (an indirectly wholly-owned subsidiary of the Ultimate Parent Bank) is the manager and issuer. The manager has appointed the Bank to perform all customer management and account administration for the PIE Funds. The Bank is the PIE Funds' registrar and administration manager. The Bank does not hold any units in the PIE Funds, however is considered to control them based on contractual arrangements in place, and as such the PIE Funds are consolidated in the financial statements of the Banking Group.

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

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

Notes to the financial statements

Note 24 Related entities (continued)

Nature of transactions

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

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

The NZ Branch provides financial market services, foreign currency, trade and interest rate risk products to the Banking Group and its customers, which includes derivative transactions (refer to Note 25).

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

This is treated as a financial guarantee for accounting purposes. Financial guarantee contracts are recognised as financial liabilities (recorded within provisions) when a payment under a contract has become probable. The liability is initially measured at fair value and subsequently at the higher of the amount determined in accordance with NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less cumulative amortisation, where appropriate.

Refer to Note 22 for details of the loan capital transactions undertaken by the Banking Group with related entities.

Transactions with related entities

\$ millions	Note	THE BANKING GROUP	
		Year Ended 30-Sep-18	Year Ended 30-Sep-17
Ultimate Parent Bank			
Interest income ¹	2	16	17
Interest expense:			
Loan capital	2	144	54
Other ²	2	42	55
Non-interest income:			
Commissions received		54	54
Management fees received	3	3	3
Operating expenses - management fees	4	4	3
Funding received	22	-	1,485
Funding repaid		400	200
Immediate Parent Company			
Dividends paid	23	1,870	640
Other controlled entities of the Ultimate Parent Bank			
Interest expense:			
Interest expense - other	2	1	1
Non-interest income:			
Distribution fees received on managed fund products		14	13
Distribution fees received on life and general insurance products		36	40
Management fees received	3	4	7
Associate			
Dividends received		6	5

¹ Includes interest income on reverse repos and cash held with the NZ Branch.

² Includes interest expense on other funding provided by and repos with the NZ Branch.

Notes to the financial statements

Note 24 Related entities (continued)

Due from and to related entities

\$ millions	THE BANKING GROUP	
	2018	2017
Due from related entities		
Ultimate Parent Bank	1,309	2,006
Other controlled entities of the Ultimate Parent Bank	10	11
Total due from related entities	1,319	2,017
Due from related entities at fair value ¹	558	587
Due from related entities at amortised cost	761	1,430
Total due from related entities	1,319	2,017
Due to related entities		
Ultimate Parent Bank	1,588	2,089
Other controlled entities of the Ultimate Parent Bank	55	37
Total due to related entities	1,643	2,126
Due to related entities at fair value ²	251	355
Due to related entities at amortised cost	1,392	1,771
Total due to related entities	1,643	2,126

¹ Includes reverse repos of \$163 million (2017: \$519 million).

² Includes repos of \$15 million (2017: \$22 million).

Key management personnel compensation

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

\$'000s	THE BANKING GROUP	
	Year Ended 30-Sep-18	Year Ended 30-Sep-17
Salaries and other short-term benefits	8,019	8,143
Post-employment benefits	613	455
Other termination benefits	615	-
Share-based payments	2,559	2,651
Total key management personnel compensation	11,806	11,249
Loans to key management personnel	22,349	22,769
Deposits from key management personnel	6,006	1,229
Interest income on amounts due from key management personnel	819	842
Interest expense on amounts due to key management personnel	107	19

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

Loans and deposits with key management personnel

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

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

Other key management personnel transactions

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

Notes to the financial statements

Note 25 Derivative financial instruments

Accounting policy

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

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

The Banking Group uses derivative instruments as part of its asset and liability risk management activities, which are discussed in Note 35. Derivatives used for risk management activities include designating derivatives into one of two types of hedge accounting relationships: fair value hedge or cash flow hedge, where permitted under NZ IAS 39. These hedge designations and associated accounting treatment are as follows:

Fair value hedges

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

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

Cash flow hedges

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

- For effective hedges, changes in the fair value of derivatives are recognised in the cash flow hedge reserve through other comprehensive income and subsequently recognised in net interest income when the asset or liability that was hedged impacts the income statement.
- For hedges with some ineffectiveness, the changes in the fair value of the derivatives relating to the ineffective portion are immediately recognised in the income statement.
- If a hedge is discontinued, any cumulative gain or loss remains in other comprehensive income. It is amortised to net interest income over the period which the asset or liability that was hedged also impacts the income statement.
- If a hedge of a forecast transaction is no longer expected to occur, any cumulative gain or loss in other comprehensive income is immediately recognised in the income statement.

Fair value hedges

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

\$ millions	THE BANKING GROUP	
	2018	2017
Change in fair value of hedging instruments	10	32
Change in fair value of hedged items attributed to hedged risk	(10)	(39)
Ineffectiveness in non-interest income	-	(7)

Cash flow hedges

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

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

	THE 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%	23%	3%	13%
Cash outflows	0%	0%	17%	18%	25%	22%	3%	15%

Notes to the financial statements

Note 25 Derivative financial instruments (continued)

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	2017							
	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 2 Years	2 Years to 3 Years	3 Years to 4 Years	4 Years to 5 Years	Over 5 Years
Cash inflows	12%	0%	3%	17%	6%	24%	23%	15%
Cash outflows	12%	0%	4%	17%	6%	25%	21%	15%

THE BANKING GROUP

\$ millions	2018	2017
Cash flow hedge ineffectiveness	4	(5)

Dual fair value and cash flow hedges

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

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

Derivatives held with external counterparties

THE BANKING GROUP

\$ millions	Notional Amount	2018							
		FAIR VALUE							
		Trading		Hedging				Total Fair Value	
		Assets	Liabilities	Fair Value		Cash Flow		Assets	Liabilities
		Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts									
Swap agreements	4,232	-	-	18	(119)	-	-	18	(119)
Total interest rate contracts	4,232	-	-	18	(119)	-	-	18	(119)
Foreign exchange contracts									
Cross currency swap agreements	7,314	-	-	25	(7)	542	(55)	567	(62)
Total foreign exchange contracts	7,314	-	-	25	(7)	542	(55)	567	(62)
Total of gross derivatives	11,546	-	-	43	(126)	542	(55)	585	(181)
Impact of netting arrangements	-	-	-	-	-	-	-	-	-
Total of net derivatives	11,546	-	-	43	(126)	542	(55)	585	(181)

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\$ millions	Notional Amount	2017							
		FAIR VALUE							
		Trading		Hedging				Total Fair Value	
		Assets	Liabilities	Fair Value		Cash Flow		Assets	Liabilities
		Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts									
Swap agreements	4,488	-	-	20	(164)	-	-	20	(164)
Total interest rate contracts	4,488	-	-	20	(164)	-	-	20	(164)
Foreign exchange contracts									
Cross currency swap agreements	7,538	-	-	30	(5)	170	(315)	200	(320)
Total foreign exchange contracts	7,538	-	-	30	(5)	170	(315)	200	(320)
Total of gross derivatives	12,026	-	-	50	(169)	170	(315)	220	(484)
Impact of netting arrangements	-	-	-	-	-	-	-	-	-
Total of net derivatives	12,026	-	-	50	(169)	170	(315)	220	(484)

Notes to the financial statements

Note 25 Derivative financial instruments (continued)

Derivatives held with related parties

THE BANKING GROUP									
2018									
\$ millions	Notional Amount	FAIR VALUE							
		Trading		Hedging				Total Fair Value	
		Assets	Liabilities	Fair Value		Cash Flow		Assets	Liabilities
				Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts									
Swap agreements	50,500	-	(1)	-	(84)	40	(110)	40	(195)
Total interest rate contracts	50,500	-	(1)	-	(84)	40	(110)	40	(195)
Foreign exchange contracts									
Cross currency swap agreements	6,490	-	-	-	-	355	(41)	355	(41)
Total foreign exchange contracts	6,490	-	-	-	-	355	(41)	355	(41)
Total of gross derivatives	56,990	-	(1)	-	(84)	395	(151)	395	(236)
Impact of netting arrangements	-	-	-	-	-	-	-	-	-
Total of net derivatives	56,990	-	(1)	-	(84)	395	(151)	395	(236)

THE BANKING GROUP									
2017									
\$ millions	Notional Amount	FAIR VALUE							
		Trading		Hedging				Total Fair Value	
		Assets	Liabilities	Fair Value		Cash Flow		Assets	Liabilities
				Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Interest rate contracts									
Forward rate agreements	1,000	-	-	-	-	-	-	-	-
Swap agreements	46,085	-	-	1	(103)	51	(129)	52	(232)
Total interest rate contracts	47,085	-	-	1	(103)	51	(129)	52	(232)
Foreign exchange contracts									
Cross currency swap agreements	6,909	16	(26)	-	-	-	(75)	16	(101)
Total foreign exchange contracts	6,909	16	(26)	-	-	-	(75)	16	(101)
Total of gross derivatives	53,994	16	(26)	1	(103)	51	(204)	68	(333)
Impact of netting arrangements	-	-	-	-	-	-	-	-	-
Total of net derivatives	53,994	16	(26)	1	(103)	51	(204)	68	(333)

Notes to the financial statements

Note 26 Fair value of financial assets and financial liabilities

Accounting policy

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

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

Critical accounting assumptions and estimates

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

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

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

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

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

In order to determine a reliable fair value for a financial instrument, management may apply adjustments to the techniques previously described.

These adjustments reflect the Banking Group's assessment of factors that market participants would consider in setting the fair value.

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

Fair Valuation Control Framework

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

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

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

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

Fair value hierarchy

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

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

Valuation techniques

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

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

Notes to the financial statements

Note 26 Fair value 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 based on recent unadjusted quoted prices. These prices are based on actual arm's length basis transactions.

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

Instrument	Balance sheet category	Includes:	Valuation technique
Non-asset backed debt instruments	Trading securities Available-for-sale securities	New Zealand Government bonds	These instruments are traded in liquid, active markets where prices are readily observable. No modelling or assumptions are used in the valuation.

Level 2 instruments

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

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

Instrument	Balance sheet category	Includes:	Valuation technique
Interest rate products	Derivative financial instruments	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.
	Due from related entities		
	Due to related entities		
Foreign exchange products	Derivative financial instruments	FX swaps – derivative financial instruments	Derived from market observable inputs or consensus pricing providers using industry standard models.
	Due from related entities		
	Due to related entities		
Non-asset backed debt instruments	Trading securities	Local authority and NZ public securities, other bank issued certificates of deposit, commercial paper, other government securities and corporate bonds	Valued using observable market prices which are sourced from consensus pricing services, broker quotes or inter-dealer prices.
	Available-for-sale securities		
	Due from related entities		
	Other financial liabilities at fair value through income statement	Security repurchase agreements and reverse repurchase agreements over non-asset backed debt securities	
Due to related entities			
	Deposits and other borrowings at fair value	Certificates of deposit	Discounted cash flow using market rates offered for deposits of similar remaining maturities.
Debt issues at fair value	Debt issues	Commercial paper	Discounted cash flows, using a discount rate which reflects the terms of the instrument and the timing of cash flows adjusted for market observable changes in the Bank's implied credit worthiness.

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.

Notes to the financial statements

Note 26 Fair value of financial assets and financial liabilities (continued)

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

THE BANKING GROUP								
\$ millions	2018				2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets measured at fair value								
Trading securities	6	1,145	-	1,151	20	1,777	-	1,797
Derivative financial instruments	-	585	-	585	-	220	-	220
Available-for-sale securities	1,167	2,643	-	3,810	1,556	2,531	-	4,087
Due from related entities	-	558	-	558	-	587	-	587
Total financial assets measured at fair value	1,173	4,931	-	6,104	1,576	5,115	-	6,691
Financial liabilities measured at fair value								
Deposits and other borrowings at fair value	-	1,218	-	1,218	-	593	-	593
Other financial liabilities at fair value through income statement	-	-	-	-	-	19	-	19
Derivative financial instruments	-	181	-	181	-	484	-	484
Debt issues at fair value	-	-	-	-	-	1,642	-	1,642
Due to related entities	-	251	-	251	-	355	-	355
Total financial liabilities measured at fair value	-	1,650	-	1,650	-	3,093	-	3,093

Analysis of movements between Fair Value Hierarchy Levels

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

Financial instruments not measured at fair value

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

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

Notes to the financial statements

Note 26 Fair value of financial assets and financial liabilities (continued)

The following tables summarise the estimated fair value and fair value hierarchy of financial instruments not measured at fair value:

THE BANKING GROUP					
2018					
\$ millions	Carrying Amount	Level 1	Fair Value		Total
			Level 2	Level 3	
Financial assets not measured at fair value					
Cash and balances with central banks	1,353	1,353	-	-	1,353
Receivables due from other financial institutions	70	70	-	-	70
Other assets	225	-	-	225	225
Loans	80,378	-	-	80,503	80,503
Due from related entities	761	-	751	10	761
Total financial assets not measured at fair value	82,787	1,423	751	80,738	82,912
Financial liabilities not measured at fair value					
Payables due to other financial institutions	497	476	21	-	497
Other liabilities	539	-	539	-	539
Deposits and other borrowings	61,884	-	61,276	647	61,923
Debt issues	13,725	-	13,845	-	13,845
Due to related entities	1,392	-	1,399	-	1,399
Loan capital	2,622	-	-	2,645	2,645
Total financial liabilities not measured at fair value	80,659	476	77,080	3,292	80,848

THE BANKING GROUP					
2017					
\$ millions	Carrying Amount	Level 1	Fair Value		Total
			Level 2	Level 3	
Financial assets not measured at fair value					
Cash and balances with central banks	1,659	1,659	-	-	1,659
Receivables due from other financial institutions	407	407	-	-	407
Other assets	221	-	-	221	221
Loans	77,261	-	-	77,292	77,292
Due from related entities	1,430	-	1,419	11	1,430
Total financial assets not measured at fair value	80,978	2,066	1,419	77,524	81,009
Financial liabilities not measured at fair value					
Payables due to other financial institutions	143	143	-	-	143
Other liabilities	423	-	423	-	423
Deposits and other borrowings	58,405	-	57,849	601	58,450
Debt issues	15,087	-	15,259	-	15,259
Due to related entities	1,771	-	1,786	-	1,786
Loan capital	2,616	-	1,500	1,188	2,688
Total financial liabilities not measured at fair value	78,445	143	76,817	1,789	78,749

Note 27 Offsetting financial assets and financial liabilities

Accounting policy

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

Some of the Banking Group's offsetting arrangements are not enforceable in all circumstances. The assets and liabilities under such agreements are also disclosed in the table below, to illustrate the net balance sheet amount if these future events should occur. The amounts in the tables below may not tie back to the balance sheet if there are balances which are not subject to offsetting arrangements. The amounts presented in this note do not represent the credit risk exposure of the Banking Group. Refer to Note 35.2 for information on credit risk management. The offsetting and collateral arrangements and other credit risk mitigation strategies used by the Banking Group are further explained in the 'Management of risk mitigation' section under Note 35.2.

Notes to the financial statements

Note 27 Offsetting financial assets and financial liabilities (continued)

THE BANKING GROUP							
2018							
\$ millions	Effects of Offsetting on Balance Sheet			Amounts Subject to Enforceable Netting Arrangements But Not Offset			Net amount
	Gross Amounts	Amounts Offset	Net Amounts Reported on the Balance Sheet	Other Recognised Financial Instruments	Cash Collateral	Financial Instrument Collateral	
Assets							
Derivative financial instruments	585	-	585	(109)	(471)	-	5
Due from related entities - securities purchased under agreement to resell ¹	163	-	163	-	-	(163)	-
Due from related entities - derivative financial instruments ¹	395	-	395	(236)	-	-	159
Total assets	1,143	-	1,143	(345)	(471)	(163)	164
Liabilities							
Derivative financial instruments	181	-	181	(109)	(70)	-	2
Due to related entities - security repurchase agreements ³	15	-	15	-	-	(15)	-
Due to related entities - derivative financial instruments ³	236	-	236	(236)	-	-	-
Total liabilities	432	-	432	(345)	(70)	(15)	2

THE BANKING GROUP							
2017							
\$ millions	Effects of Offsetting on Balance Sheet			Amounts Subject to Enforceable Netting Arrangements But Not Offset			Net amount
	Gross Amounts	Amounts Offset	Net Amounts Reported on the Balance Sheet	Other Recognised Financial Instruments	Cash Collateral	Financial Instrument Collateral	
Assets							
Derivative financial instruments	220	-	220	(168)	(52)	-	-
Due from related entities - securities purchased under agreement to resell ¹	519	-	519	-	-	(519)	-
Due from related entities - derivative financial instruments ¹	68	-	68	(68)	-	-	-
Total assets	807	-	807	(236)	(52)	(519)	-
Liabilities							
Security repurchase agreements ²	19	-	19	-	-	(19)	-
Derivative financial instruments	484	-	484	(168)	(314)	-	2
Due to related entities - security repurchase agreements ³	22	-	22	-	-	(22)	-
Due to related entities - derivative financial instruments ³	333	-	333	(68)	-	-	265
Total liabilities	858	-	858	(236)	(314)	(41)	267

¹ Forms part of due from related entities on the balance sheet (refer to Note 24).

² Forms part of other financial liabilities at fair value through income statement on the balance sheet.

³ Forms part of due to related entities on the balance sheet (refer to Note 24).

Other recognised financial instruments

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

Notes to the financial statements

Note 27 Offsetting financial assets and financial liabilities (continued)

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 28 Operating lease commitments

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

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

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

Note 29 Credit related commitments, contingent assets and contingent liabilities

Accounting policy

Undrawn credit commitments

The Banking Group enters into various arrangements with customers which are only recognised in the balance sheet when called upon.

These arrangements include commitments to extend credit, bill endorsements, financial guarantees, standby letters of credit and underwriting facilities.

Contingent assets

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

Contingent liabilities

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

Undrawn credit commitments

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

They expose the Banking Group to liquidity risk when called upon and also to credit risk if the customer fails to repay the amounts owed at the due date. The maximum exposure to credit loss is the contractual or notional amount of the instruments disclosed below. Some of the arrangements can be cancelled by the Banking Group at any time 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 Banking Group uses the same credit policies when entering into these arrangements as it does for on-balance sheet instruments. Refer to Note 35 for further details on liquidity risk and credit risk management.

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

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

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

Notes to the financial statements

Note 29 Credit related commitments, contingent assets and contingent liabilities (continued)

\$ millions	THE BANKING GROUP	
	2018	2017
Letters of credit and guarantees ¹	863	772
Commitments to extend credit ²	24,650	25,081
Other	60	10
Total undrawn credit commitments	25,573	25,863

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

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

Contingent assets

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

Contingent liabilities

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

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

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

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

Guarantees

As disclosed in Note 24, the Bank has an agreement with the NZ Branch whereby the Bank will reimburse the NZ Branch for any credit losses incurred by it due to certain customers of the Bank defaulting on certain financial market and international products.

Note 30 Segment reporting

Accounting policy

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

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

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

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

- Consumer Banking and Wealth provides financial services predominantly for individuals;
- Commercial, Corporate and Institutional Banking provides a broad range of financial services for commercial, corporate, property finance, agricultural, institutional and government customers; and
- Investments and Insurance provides funds management and insurance services.

Notes to the financial statements

Note 30 Segment reporting (continued)

Reconciling items primarily represent:

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

\$ millions	THE BANKING GROUP				Total
	Consumer Banking and Wealth	Commercial, Corporate and Institutional	Investments and Insurance	Reconciling Items	
Year ended 30 September 2018					
Net interest income	1,145	705	1	(7)	1,844
Non-interest income	177	153	138	(95)	373
Net operating income before operating expenses and impairment charges	1,322	858	139	(102)	2,217
Operating expenses	(679)	(221)	(32)	17	(915)
Impairment (charges)/benefits	(33)	9	-	21	(3)
Profit before income tax	610	646	107	(64)	1,299
Total gross loans	46,605	34,068	-	29	80,702
Total deposits and other borrowings	36,147	25,737	-	1,218	63,102
Year ended 30 September 2017 (restated)					
Net interest income	1,053	683	1	4	1,741
Non-interest income	219	153	131	(98)	405
Net operating income before operating expenses and impairment charges	1,272	836	132	(94)	2,146
Operating expenses	(708)	(221)	(29)	4	(954)
Impairment (charges)/benefits	(34)	97	-	13	76
Profit before income tax	530	712	103	(77)	1,268
Total gross loans	44,707	32,870	-	34	77,611
Total deposits and other borrowings	34,044	24,361	-	593	58,998

Note 31 Securitisation, covered bonds and other transferred assets

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

Securitisation

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

Own assets securitised

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

For securitisation structured entities which the Banking Group controls, as defined in Note 32, the structured entities are classified as subsidiaries and consolidated. When assessing whether the Banking Group controls a structured entity, it considers its exposure to and ability to affect variable returns. The Banking Group may have variable returns from a structured entity through ongoing exposures to the risks and rewards associated with the assets, the provision of derivatives, liquidity facilities, trust management and operational services.

In October 2008, WNZSL was set up as part of the Bank's internal residential mortgage-backed securitisation programme. Under this programme the Bank sold the rights (but not the obligations) of a pool of housing loans to WNZSL. The purchase was funded by WNZSL's issuance of residential mortgage-backed securities ('RMBS'). The RMBS and an equivalent liability in the form of a deemed loan from the Bank to WNZSL are fully eliminated in the Banking Group's financial statements. Refer to Note 29 for a description of the Banking Group's obligation to repurchase certain housing loans sold to WNZSL.

Notes to the financial statements

Note 31 Securitisation, covered bonds and other transferred assets (continued)

Covered bonds

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

The intercompany loan made by the Bank to WNZCBL to fund the initial purchase (and subsequent further purchases which increased the cover pool) and the liability representing the deemed loan from WNZCBL to the Bank are fully eliminated in the Banking Group's financial statements. Refer to Note 29 for a description of the Banking Group's obligation to repurchase certain housing loans sold to WNZCBL.

Security repurchase agreements

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

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

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

THE BANKING GROUP					
For those liabilities that only have recourse to the transferred assets:					
\$ millions	Carrying amount of transferred assets	Carrying amount of associated liabilities	Fair value of transferred assets	Fair value of associated liabilities	Net fair value position
2018					
Securitisation - own assets ¹	5,033	5,015	5,021	5,015	6
Covered bonds ²	7,533	5,656	n/a	n/a	n/a
Security repurchase agreements	15	15	n/a	n/a	n/a
Total	12,581	10,686	5,021	5,015	6
2017					
Securitisation - own assets ¹	5,034	5,013	5,018	5,013	5
Covered bonds ²	7,535	5,246	n/a	n/a	n/a
Security repurchase agreements	41	41	n/a	n/a	n/a
Total	12,610	10,300	5,018	5,013	5

¹ The most senior rated securities at 30 September 2018 of \$4,700 million (30 September 2017: \$4,700 million) qualify as eligible collateral for repurchase agreements with the Reserve Bank. The Bank takes advantage of the Reserve Bank's guidelines for its overnight reverse repo facility and open market operations, which allows banks in New Zealand to offer RMBS as collateral for the Reserve Bank's repurchase agreements.

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

Note 32 Structured entities

Accounting policy

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

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

The Banking Group engages in various transactions with both consolidated and unconsolidated structured entities that are mainly involved in securitisations.

Consolidated structured entities

Securitisation and covered bonds

The Banking Group uses structured entities to securitise its financial assets through the CB Programme and the Bank's internal residential mortgage-backed securitisation programme. Refer to Note 31 for further details.

Notes to the financial statements

Note 32 Structured entities (continued)

Funds managed by a member of the Ultimate Parent Bank Group

As disclosed in Note 24 and the 'Funds management and other fiduciary activities' section below, the PIE Funds are consolidated within the financial statements of the Banking Group.

Non-contractual financial support

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

Unconsolidated structured entities

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

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

The Banking Group's main interests in unconsolidated structured entities, which arise in the normal course of business, are loans and other credit commitments. The Banking Group lends to unconsolidated structured entities, subject to the Banking Group's collateral and credit approval processes, in order to earn interest and fee income. The structured entities are mainly securitisation entities.

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

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

\$ millions	THE BANKING GROUP	
	2018	2017
	Financing to Securitisation Vehicles	Financing to Securitisation Vehicles
Assets		
Loans	2,632	2,297
Total on-balance sheet exposures	2,632	2,297
Total notional amounts of off-balance sheet exposures	765	1,052
Maximum exposure to loss	3,397	3,349
Size of structured entities ¹	3,397	3,349

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

Non-contractual financial support

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

Funds management and other fiduciary activities

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

The PIE Funds are administered by the Banking Group (refer to Note 24 for further details) and invest in deposits with the Bank. The Bank is considered to control the PIE Funds, and as such they are consolidated within the financial statements of the Banking Group. As at 30 September 2018, \$3,249 million (30 September 2017: \$2,870 million) of funds under management were invested by the PIE Funds in the Bank's deposits.

Marketing and distribution of insurance products

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

Notes to the financial statements

Note 32 Structured entities (continued)

Risk management

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

Furthermore, during the year ended 30 September 2018:

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

Peak aggregate funding provided to entities

During the year ended 30 September 2018, the Banking Group did not provide any funding to entities conducting funds management and other fiduciary activities, securitisation activities or insurance product marketing and distribution activities described in this note (30 September 2017: nil).

Note 33 Insurance business

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

Note 34 Capital adequacy

The information contained in this note has been derived in accordance with the Banking Group's conditions of registration which relate to capital adequacy and BS2B issued by the Reserve Bank, except for the matters of non-compliance with condition of registration 1B disclosed on pages 77 and 78. The Bank considers its internal credit model methodologies result in the retention of an appropriate amount of capital to reflect its credit risk and any effect of the non-compliance with its conditions of registration 1B on the information relating to capital adequacy is not considered by the Bank to be material.

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

Capital management

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

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

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

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

Notes to the financial statements

Note 34 Capital adequacy (continued)

The Banking Group's capital summary (unaudited)

\$ millions	THE BANKING GROUP	
	Note	2018
Tier 1 capital		
Common Equity Tier 1 capital		
Paid-up ordinary shares issued by the Bank plus related share premium	23	5,100
Retained earnings (net of appropriations)		2,229
Accumulated other comprehensive income and other disclosed reserves ¹		(51)
Less deductions from Common Equity Tier 1 capital		
Goodwill		(477)
Other intangible assets ²		(168)
Cash flow hedging reserve		60
Deferred tax asset deduction		(156)
Expected loss excess over eligible allowance		(247)
Total Common Equity Tier 1 capital		6,290
Additional Tier 1 capital		
Additional Tier 1 capital instruments ³	22	1,500
Total additional Tier 1 capital		1,500
Total Tier 1 capital		7,790
Tier 2 capital		
Tier 2 capital instruments ³	22	1,135
Revaluation reserves		-
Eligible impairment allowance in excess of expected loss		-
Total Tier 2 capital		1,135
Total capital		8,925

¹ Accumulated other comprehensive income and other disclosed reserves consist of available-for-sale securities reserve and cash flow hedge reserve as disclosed on the balance sheet.

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

³ Excludes capitalised transaction costs.

Capital ratios (unaudited)

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

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

Notes to the financial statements

Note 34 Capital adequacy (continued)

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

%	THE BANKING GROUP			The Bank ²	
	Reserve Bank Minimum Ratios ¹	2018	2017	2018	2017
Common Equity Tier 1 capital ratio	6.5	11.7	11.1	11.0	8.8
Tier 1 capital ratio	8.0	14.5	14.0	13.6	11.1
Total capital ratio	10.0	16.6	16.1	15.6	12.8
Buffer ratio	2.5	5.2	6.6	N/A	N/A

¹ Changes to the Bank's conditions of registration, effective from 31 December 2017, have increased the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and Total capital ratio ('minimum capital ratios') by 2% compared to the minimum capital ratios as at 30 September 2017. The increased minimum capital ratios will remain in place until the Bank has satisfied the Reserve Bank that all existing issues in relation to the matters of non-compliance on pages 77 and 78 have been resolved.

² On 26 September 2018 the Reserve Bank confirmed it has no objection to the Bank using the Internal Ratings Based ('IRB') approach to assess the risk weighting of two solo-deconsolidated entities for the purposes of calculating the Bank's solo capital ratios. On a comparable basis, the Bank's solo capital ratios as at 30 September 2017 would be Common Equity Tier 1 of 10.5%, Tier 1 capital of 13.1% and Total capital of 15.1%.

Banking Group Pillar 1 total capital requirement (unaudited)

\$ millions	THE BANKING GROUP		
	2018		
	Total Exposure After Credit Risk Mitigation	Risk-weighted Exposure or Implied Risk-weighted Exposure	Total Capital Requirement
Credit risk			
Exposures subject to the internal ratings based approach	100,688	39,931	3,195
Equity exposures	-	-	-
Specialised lending subject to the slotting approach	8,040	7,292	583
Exposures subject to the standardised approach	2,516	1,027	82
Total credit risk (scaled)¹	111,244	48,250	3,860
Operational risk	N/A	4,532	363
Market risk	N/A	1,038	83
Total	111,244	53,820	4,306

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

Capital for other material risk

Summary of ICAAP (unaudited)

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

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

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

The Banking Group's internal capital allocation for 'other material risks' is \$245 million as at 30 September 2018 (30 September 2017: \$256 million).

Notes to the financial statements

Note 34 Capital adequacy (continued)

Ultimate Parent Bank Group Basel III capital adequacy ratios (unaudited)

The table below represents the capital adequacy calculation for the Ultimate Parent Bank and the Ultimate Parent Bank Group as at 30 September 2018 based on Australian Prudential Regulation Authority's ('APRA') application of the Basel III capital adequacy framework.

%	THE BANKING GROUP	
	2018	2017
Ultimate Parent Bank Group (excluding entities specifically excluded by APRA regulations)^{1,2}		
Common Equity Tier 1 capital ratio	10.6	10.6
Additional Tier 1 capital ratio	2.2	2.1
Tier 1 capital ratio	12.8	12.7
Tier 2 capital ratio	1.9	2.1
Total regulatory capital ratio	14.7	14.8
Ultimate Parent Bank (Extended Licensed Entity)^{1,3}		
Common Equity Tier 1 capital ratio	10.5	10.4
Additional Tier 1 capital ratio	2.3	2.2
Tier 1 capital ratio	12.8	12.6
Tier 2 capital ratio	2.0	2.4
Total regulatory capital ratio	14.8	15.0

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

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

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

Under APRA's Prudential Standards, Australian authorised deposit-taking institutions ('ADI'), including the Ultimate Parent Bank Group are required to maintain minimum ratios of capital to risk weighted assets ('RWA'), as determined by APRA. For the calculation of RWAs, the Ultimate Parent Bank Group is accredited by APRA to apply advanced models permitted by the Basel III global capital adequacy regime. The Ultimate Parent Bank Group uses the Advanced Internal Ratings Based ('Advanced IRB') approach for credit risk, the 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 Ultimate Parent Bank 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 Ultimate Parent Bank's website (www.westpac.com.au).

The Ultimate Parent Bank Group (excluding entities specifically excluded by APRA regulations), and the Ultimate Parent Bank (Extended Licensed Entity as defined by APRA), exceeded the minimum capital adequacy requirements as specified by APRA as at 30 September 2018.

Note 35 Risk management

The Banking Group regards the management of risk to be a fundamental management activity performed at all levels of its business. The Banking Group's risk management strategy includes a sound risk culture and sets out minimum standards for risk management across all risk types ('Risk Management Strategy'). The 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 Banking Group's desired risk profile.

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

Divisional business units and corporate core functions are responsible for identifying, evaluating and managing the risks that originate within approved risk appetite and policies. They are required to establish and maintain appropriate 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 provide assurance over 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, and opines on, the adequacy and effectiveness of the overall risk management framework and controls to the Board and senior executives.

Notes to the financial statements

Note 35 Risk management (continued)

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

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

Principal risks	Note name	Note number
Overview	Risk management frameworks	35.1.1
	Independent New Zealand Audit unit	35.1.2
	Reviews in respect of risk management systems	35.1.3
Credit risk The risk of financial loss where a customer or counterparty fails to meet their financial obligations to the Banking Group.	Credit risk ratings system	35.2.1
	Credit risk mitigation, collateral and other credit enhancements	35.2.2
	Credit risk concentrations	35.2.3
	Regulatory capital	35.2.4
	Residential mortgages by loan-to-value ratio ('LVR')	35.2.5
	Credit quality of financial assets	35.2.6
	Collateral held	35.2.7
Operational risk and compliance risk Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The definition is aligned to the regulatory (Basel II) definition, including legal and regulatory risk but excluding strategic and reputation risk. Compliance risk is the risk of legal or regulatory sanction, financial loss or reputation loss arising from the Banking Group's failure to abide by the compliance obligations required of the Banking Group.	Operational risk and compliance risk	35.3
Funding and liquidity risk The risk that the Banking Group will be unable to fund assets and meet obligations as they become due.	Liquidity modelling	35.4.1
	Sources of liquidity	35.4.2
	Regulatory liquidity ratios	35.4.3
	Contractual maturity of financial instruments	35.4.4
	Expected maturity	35.4.5
Market risk The risk of an adverse impact on earnings resulting from changes in market factors, such as foreign exchange rates, interest rates, commodity prices and equity prices.	Value-at-Risk ('VaR')	35.5.1
	Non-traded market risk	35.5.2
	Market risk notional capital charges	35.5.3
	Interest rate sensitivity	35.5.4

35.1 Overview

35.1.1 Risk management frameworks

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

The Board has delegated authority to the BRCC to:

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

The Board is also supported by the Bank's BAC which assists the Board in fulfilling its responsibilities in relation to:

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

Notes to the financial statements

Note 35 Risk management (continued)

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

Risk	Risk management framework and controls
Credit risk	<ul style="list-style-type: none"> - The Banking Group's Credit Risk Management Framework describes the principles, methodologies, systems, roles and responsibilities, reports and key controls for managing credit risk. Within the Credit Risk Management Framework, the Banking Group has its own credit approval limits approved by the Banking Group's Board as delegated by the Ultimate Parent Bank Group Chief Risk Officer. - The BRCC, Executive Risk Committee ('RISKO') and Credit Risk Committee ('CREDCO') monitor the risk profile, performance and management of the Banking Group's credit portfolio and the development and review of key credit risk policies. - The Banking Group's Credit Risk Rating System Policy describes the credit risk rating system philosophy, design, key features and uses of rating outcomes. - All models materially impacting the risk rating process are periodically reviewed in accordance with the Banking Group's model risk policies. - An annual review is performed of the Credit Risk Rating System for approval by the BRCC. - Specific credit risk estimates (including PD, LGD and EAD) are reviewed by CREDCO, overseen, reviewed annually and approved by the Chief Risk Officer and by the Ultimate Parent Bank's Credit Risk Estimates Committee (a subcommittee of the Ultimate Parent Bank's BRCC). - Policies for delegating credit approval authorities and formal limits for the extension of credit are established throughout the Banking Group. These include those for the approval and management of all credit risk arising from other banks and related entities. - Credit manuals are established throughout the Banking Group. They include policies governing the origination, evaluation, approval, documentation, settlement and ongoing management of credit risks. - Sector policies guide credit extension where industry-specific guidelines are considered necessary (e.g. acceptable financial ratios or permitted collateral). - The Ultimate Parent Bank's Related Entity Risk Management Framework and supporting policies govern credit exposures to related entities to minimise the spread of credit risk between the Ultimate Parent Bank Group.
Operational risk and compliance risk	<ul style="list-style-type: none"> - The Banking Group has an Operational Risk Management Framework, which is aligned to the Ultimate Parent Bank's Operational Risk Framework and outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management, and reporting and monitoring. This Framework is approved by the BRCC. - The Advanced Measurement Approach ('AMA') methodology for calculating operational risk capital has been implemented which takes into account both internal and external factors. An allocation methodology is in place for the economic capital calculated. - The Bank has a Compliance Risk Management Framework and a dedicated compliance function to assist the business in managing its compliance risks. - The Bank's RISKO, chaired by the Bank's Chief Risk Officer, is responsible for overseeing the effectiveness and implementation of the Operational Risk and Compliance Frameworks. RISKO monitors the operational risk profiles and the action plans, and has the discretion to escalate material matters to the Bank's BRCC and/or the relevant Ultimate Parent Bank Group Risk Committee.
Funding and liquidity risk	<ul style="list-style-type: none"> - The Liquidity Risk Management Framework sets out the liquidity risk appetite, roles and responsibilities, tools for measuring and managing liquidity risk, reporting procedures and supporting policies. It also documents the limits and targets for minimum liquid asset holdings, cash flow mismatch levels and wholesale funding and balance sheet ratios. It is reviewed by the Banking Group's Asset and Liability Committee ('ALCO') prior to approval by the BRCC. - The Banking Group's Treasury function is responsible for managing funding and liquidity including managing the balance sheet against approved limits and targets and managing the Banking Group's funding base so that it is appropriately maintained, stable and diversified. - Daily liquidity risk reports are reviewed by Treasury and the Liquidity risk teams. Liquidity reports are presented to ALCO monthly and to the BRCC quarterly. - An annual funding strategy is established by Treasury which includes consideration of trends in global markets, peer analysis, wholesale funding capacity, expected funding requirements and funding risk analysis. The strategy is regularly reviewed to take into account current market conditions. - A contingency funding plan is also maintained, which details actions to be taken in response to severe disruptions in the Banking Group's ability to conduct its activities in a timely manner and at a reasonable cost. The plan identifies the committee of senior executives to manage any crisis and their responsibilities. The plan is aligned with the Banking Group's broader Liquidity Crisis Management Policy.
Market risk	<ul style="list-style-type: none"> - The Market Risk Framework describes the Banking Group's approach to managing non-traded market risk. - As the Ultimate Parent Bank's financial markets business in New Zealand is conducted by the NZ Branch, the market risks faced by the Banking Group are only of a non-traded nature. Non-traded market risk includes interest rate and foreign exchange risks. The Banking Group does not carry material foreign currency or equity price risk due to the risks being hedged. - Market risk is managed using VaR limits, Net interest income at risk ('NaR') and structural risk limits (including credit spread and interest rate basis point value limits) as well as scenario analysis and stress testing. - The BRCC approves the VaR and NaR limits for non-traded risk. - Market risk limits are assigned to business managers based upon business strategies, experience, and the consideration of market liquidity and the concentration of risks. - Market risk positions are managed by the trading desks and Asset and Liability Management ('ALM') unit consistent with their delegated authorities and the nature and scale of the market risks involved. - Daily monitoring of current exposure and limit utilisation is conducted independently by the Banking Group's Market Risk Management unit, which monitors market risk exposures against VaR and structural risk limits. Daily VaR position reports are produced by risk type, by product lines and by geographic region. Monthly and quarterly reports are produced for both the Banking Group's and Ultimate Parent Bank's risk forums and Ultimate Parent Bank's BRCC, respectively, to ensure transparency of material market risks and issues. - Daily stress testing and backtesting of VaR results is performed to support model integrity and to analyse extreme or unexpected movements. A review of both the potential profit and loss outcomes is also undertaken to monitor any skew created by the historical data. RISKO has ratified an approved escalation framework. - The 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 Ultimate Parent Bank's Market Risk Committee, RISKO and BRCC.

Notes to the financial statements

Note 35 Risk management (continued)

Other risk classes include:

- Conduct risk: the risk that the Banking Group's provision of services and products results in unsuitable or unfair outcomes for the 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;
- Reputation risk: the risk of 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.

35.1.2 Independent New Zealand Audit unit

The Banking Group has an independent assurance unit ('**New Zealand Audit**') comprised of a New Zealand based audit team, supported by the Ultimate Parent Bank Credit Portfolio Review (including Model Risk) functions, which report to the Bank's BAC, as well as to the Ultimate Parent Bank.

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

35.1.3 Reviews in respect of risk management systems

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

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

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

35.2 Credit risk

35.2.1 Credit risk ratings system

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

Transaction-managed customers

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

Program-managed portfolio

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

Notes to the financial statements

Note 35 Risk management (continued)

Customer risk grades

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

Financial Statement Disclosure	The 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+
Weak	E	Banking Group Rating Watchlist	
	F	Special Mention	
Weak/default	G	Substandard/Default	
	H	Default	

35.2.2 Credit risk mitigation, collateral and other credit enhancements

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

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

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

Collateral

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

Financial assets	Nature of collateral
Loans – housing and personal ¹	Housing loans are secured by a mortgage over property and additional security may take the form of guarantees and deposits. Personal lending (including credit cards and overdrafts) is predominantly unsecured. Where security is taken, it is restricted to eligible motor vehicles, caravans, campers, motor homes and boats.
Loans – business ¹	Business loans may be secured, partially secured or unsecured. Security is typically taken by way of a mortgage over property and/or a general security agreement over business assets or other assets. Other security such as guarantees or standby letters of credit may also be taken as collateral, if appropriate.
Financial assets designated at fair value within due from related entities and derivative financial instruments	These exposures are carried at fair value which reflects the credit risk. Master netting agreements are typically used to enable the effects of derivative assets and derivative liabilities with the same counterparty to be offset when measuring these exposures. Additionally, collateralisation agreements are also typically entered into with major institutional counterparties to avoid the potential build-up of excessive mark-to-market positions. Derivative transactions are increasingly being cleared through central clearers.

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

Notes to the financial statements

Note 35 Risk management (continued)

Management of risk mitigation

The Banking Group mitigates credit risk through controls covering:

Collateral and valuation management	<p>The Ultimate Parent Bank manages collateral under collateralisation agreements centrally for all branches of the Ultimate Parent Bank and the Bank.</p> <p>The estimated realisable value of collateral held in support of loans is based on a combination of:</p> <ul style="list-style-type: none">– formal valuations currently held for such collateral; and– management’s assessment of the estimated realisable value of all collateral held. <p>This analysis also takes into consideration any other relevant knowledge available to management at the time. Updated valuations are obtained when appropriate.</p> <p>The Banking Group revalues collateral related to financial markets positions on a daily basis and has formal processes in place to promptly call for collateral top-ups, if required. These processes include margining for non-centrally cleared customer derivatives where required under APRA’s Prudential Standard CPS226. The collateralisation arrangements are documented via the Credit Support Annex of the International Swaps and Derivatives Association dealing agreements.</p>
Other credit enhancements	<p>The Banking Group only recognises guarantees, standby letters of credit, or credit derivative protection from the following entities (provided they are not related to the entity with which the Banking Group has a credit exposure):</p> <ul style="list-style-type: none">– 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	<p>Creditworthy customers domiciled in New Zealand may enter into formal agreements with the Banking Group, permitting the Banking Group to set-off gross credit and debit balances in their nominated accounts. Cross-border set-offs are not permitted.</p> <p>Close-out netting is undertaken with counterparties with whom the Banking Group has entered into a legally enforceable master netting agreement for their off-balance sheet financial market transactions in the event of default.</p> <p>Further details of offsetting are provided in Note 27.</p>
Central clearing (ASX/LCH)	<p>The Banking Group increasingly executes derivative transactions through central clearing counterparties. Central clearing counterparties mitigate risk through stringent membership requirements, the collection of margin against all trades placed, the default fund, and an explicitly defined order of priority of payments in the event of default.</p>

35.2.3 Credit risk concentrations

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

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

Individual customers or groups of related customers

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

Specific industries

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

Individual countries

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

Notes to the financial statements

Note 35 Risk management (continued)

Maximum exposure to credit risk

The carrying amount of on-balance sheet financial assets and undrawn credit commitments, represents the maximum exposure to credit risk (excluding any collateral received) as set out in the following table.

	THE BANKING GROUP	
\$ millions	2018	2017
Financial assests		
Cash and balances with central banks	1,353	1,659
Receivables due from other financial institutions	70	407
Other assets	225	221
Trading securities	1,151	1,797
Derivative financial instruments	585	220
Available-for-sale securities	3,810	4,087
Loans	80,378	77,261
Due from related entities	1,319	2,017
Total financial assets	88,891	87,669
Undrawn credit commitments		
Letters of credit and guarantees	863	772
Commitments to extend credit	24,650	25,081
Other commitments	60	10
Total undrawn credit commitments	25,573	25,863
Total maximum credit risk exposure	114,464	113,532

35.2.4 Regulatory capital

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

Overview of the internal credit risk ratings process by portfolio

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

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

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

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

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

PD

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

Notes to the financial statements

Note 35 Risk management (continued)

LGD

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

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

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

EAD and Credit Conversion Factor ('CCF')

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

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

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

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

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

PD

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

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

LGD

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

EAD

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

Classification of Banking Group exposures according to rating approach

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

Notes to the financial statements

Note 35 Risk management (continued)

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

Credit risk exposures by asset class

The Banking Group's credit risk exposures by asset class as at 30 September 2018 (Unaudited)

Exposure-weighted PD Grade (%)	Weighted Average PD %	EAD \$ millions	Exposure-weighted LGD %	Exposure-weighted Risk Weight %	Risk-weighted Assets ¹ \$ millions	Minimum Pillar 1 Capital Requirement \$ millions
Residential mortgages						
0.00 to 0.10	-	-	-	-	-	-
0.10 to 0.25	0.18	2,811	19.10	7.28	217	17
0.25 to 1.0	0.49	27,557	20.59	16.86	4,926	395
1.0 to 2.5	1.42	21,681	19.94	33.78	7,763	621
2.5 to 10.0	4.42	3,892	22.17	73.45	3,030	242
10.0 to 99.99	-	-	-	-	-	-
Default	100.00	278	21.57	212.43	626	50
Total	1.60	56,219	20.38	27.79	16,562	1,325
Other retail						
0.00 to 0.10	-	-	-	-	-	-
0.10 to 0.25	0.14	565	40.57	12.86	77	6
0.25 to 1.0	0.36	1,534	62.87	37.45	609	49
1.0 to 2.5	2.22	1,311	68.57	89.88	1,249	100
2.5 to 10.0	5.54	308	84.72	126.81	414	33
10.0 to 99.99	20.74	220	72.12	150.94	352	28
Default	100.00	16	73.40	94.34	16	1
Total	2.89	3,954	63.83	64.83	2,717	217
Small business						
0.00 to 0.10	0.03	162	73.76	7.57	13	1
0.10 to 0.25	-	-	-	-	-	-
0.25 to 1.0	0.31	637	20.93	17.33	117	9
1.0 to 2.5	1.84	1,501	20.72	26.21	417	34
2.5 to 10.0	4.83	291	19.59	28.85	89	7
10.0 to 99.99	16.12	30	22.47	44.03	14	1
Default	100.00	40	21.29	238.21	101	8
Total	3.33	2,661	23.91	26.62	751	60

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

Notes to the financial statements

Note 35 Risk management (continued)

Exposure-weighted PD Grade (%)	Weighted Average PD %	EAD \$ millions	Exposure-weighted LGD %	Exposure-weighted Risk Weight %	Risk-weighted Assets ¹ \$ millions	Minimum Pillar 1 Capital Requirement \$ millions
Corporate/Business lending						
0.00 to 0.02	-	-	-	-	-	-
0.02 to 0.04	0.03	2,671	38.95	17.20	487	39
0.04 to 0.10	0.08	3,920	52.29	30.90	1,284	103
0.10 to 0.50	0.21	8,163	43.69	39.87	3,450	276
0.50 to 3.0	1.52	13,872	34.72	72.20	10,616	850
3.0 to 10.0	3.70	923	35.86	103.23	1,010	81
10.0 to 99.0	29.48	1,169	39.42	198.12	2,455	196
Default	100.00	73	40.09	223.57	173	14
Total	2.22	30,791	39.93	59.67	19,475	1,559
Sovereign						
0.00 to 0.02	0.01	1,481	16.04	1.91	30	2
0.02 to 0.04	0.02	2,557	8.86	1.59	43	4
0.04 to 0.10	0.06	1	60.00	-	-	-
0.10 to 0.50	0.30	4	59.94	0.47	2	-
0.50 to 3.0	1.82	19	38.80	0.79	16	1
3.0 to 10.0	-	-	-	-	-	-
10.0 to 99.0	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	0.02	4,062	11.68	2.11	91	7
Bank						
0.00 to 0.02	-	-	-	-	-	-
0.02 to 0.04	0.03	2,047	15.28	3.78	82	7
0.04 to 0.10	0.05	915	49.02	24.44	237	19
0.10 to 0.50	0.13	34	60.00	27.75	10	1
0.50 to 3.0	1.29	5	55.71	113.21	6	-
3.0 to 10.0	-	-	-	-	-	-
10.0 to 99.0	-	-	-	-	-	-
Default	-	-	-	-	-	-
Total	0.04	3,001	26.14	10.53	335	27
Total credit risk exposures subject to the internal ratings based approach		100,688			39,931	3,195

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

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

\$ millions	Undrawn Commitments and Other Off-balance Sheet Amounts		Market Related Contracts	
	Value	EAD	Value	EAD
Residential mortgages	9,983	7,438	-	-
Other retail	3,213	1,865	-	-
Small business	866	769	-	-
Corporate/Business lending	9,299	9,211	-	-
Sovereign	179	179	-	-
Bank	792	826	-	-
Total	24,332	20,288	-	-

Notes to the financial statements

Note 35 Risk management (continued)

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

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

The Banking Group's specialised lending: Project and property finance credit risk exposures as at 30 September 2018 (Unaudited)

Supervisory slotting grade	Total Exposures After Credit Risk Mitigation \$ millions	Risk Weight %	Risk-weighted Assets ¹ \$ millions	Minimum Pillar 1 Capital Requirement \$ millions
Strong	3,336	70.00	2,475	198
Good	3,823	90.00	3,648	292
Satisfactory	650	115.00	792	63
Weak	142	250.00	377	30
Default	89	-	-	-
Total	8,040	85.56	7,292	583

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

The following table summarises the Banking Group's specialised lending: Project and property finance credit risk exposures arising from undrawn commitments and other off-balance sheet exposures. These amounts are included in the above table.

	EAD \$ millions	Average Risk Weight %	Risk-weighted Assets ¹ \$ millions	Minimum Pillar 1 Capital Requirement \$ millions
Undrawn commitments and other off-balance sheet exposures	1,247	86.32	1,141	91

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

The Banking Group's credit risk exposures subject to the standardised approach as at 30 September 2018 (Unaudited) Calculation of on-balance sheet exposures

	Total Exposure After Credit Risk Mitigation \$ millions	Average Risk Weight %	Risk-weighted Exposure ¹ \$ millions	Minimum Pillar 1 Capital Requirement \$ millions
Other assets ²	1,192	40.44	511	41
Total on-balance sheet exposures	1,192		511	41

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

² Other assets relate to property and equipment, other assets and related parties.

Notes to the financial statements

Note 35 Risk management (continued)

Calculation of off-balance sheet exposures

	Total Exposure or Principal Amount \$ millions	Average Credit Conversion Factor %	Credit Equivalent Amount \$ millions	Average Risk Weight %	Risk-weighted Exposure ¹ \$ millions	Minimum Pillar 1 Capital Requirement \$ millions
Market related contracts subject to the standardised approach						
Foreign exchange contracts	15,016	N/A	1,215	20.00	257	20
Interest rate contracts	54,732	N/A	109	20.00	23	2
Credit value adjustment	-	N/A	-	-	236	19
Total market related contracts subject to the standardised approach	69,748		1,324		516	41
Standardised subtotal (on and off-balance sheet)			2,516		1,027	82

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

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

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

For loans originated from 1 January 2008, the Banking Group utilises data from its loan system. For loans originated prior to 1 January 2008, the origination valuation is not separately recorded and is therefore not available for disclosure. For these loans, the Banking Group utilises its dynamic LVR process to estimate an origination valuation.

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

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

Reconciliation of residential mortgage-related amounts

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

	THE BANKING GROUP
\$ millions	30-Sep-18
Term loans - Housing (as disclosed in Note 13) and Residential mortgages - total gross loans (as disclosed in Note 14)	48,893
<i>Reconciling items:</i>	
Unamortised deferred fees and expenses	(166)
Fair value hedge adjustments	(29)
Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages	9,983
Undrawn at default ¹	(2,545)
Residential mortgages by LVR	56,136
Accrued interest receivable	78
Partial write-offs	5
Residential mortgages - EAD (as disclosed in Credit risk exposures by asset class)	56,219

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

35.2.6 Credit quality of financial assets

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

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

Notes to the financial statements

Note 35 Risk management (continued)

The credit quality of financial assets of the Banking Group that are neither past due nor impaired is determined by reference to the credit risk ratings system (refer to Note 35.2.1). All the financial assets of the Banking Group that are neither past due nor impaired fall into the 'Strong' category in their entirety except those financial assets disclosed below:

\$ millions	THE BANKING GROUP							
	2018				2017			
	Strong	Good/ Satisfactory	Weak	Total	Strong	Good/ Satisfactory	Weak	Total
Accrued interest receivable (refer to Note 10)	68	83	3	154	61	80	3	144
Trading securities (refer to Note 11)	1,151	-	-	1,151	1,779	18	-	1,797
Loans (refer to Note 14)	35,027	42,860	1,384	79,271	32,073	42,303	1,828	76,204

35.2.7 Collateral held

Loans

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

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

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

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

Collateral held against financial assets other than loans

\$ millions	THE BANKING GROUP	
	2018	2017
Cash, primarily for derivatives	476	136
Securities under reverse repurchase agreements ¹	163	519
Total other collateral held	639	655

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

35.3 Operational risk and compliance risk

Operational risk

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

Calculating operational risk capital (Unaudited)

Operational risk regulatory capital is calculated on a quarterly basis. The Operational Risk Capital Model ("ORCM") is reviewed annually to reassess the appropriateness of the model framework, methodology, assumptions and parameters in light of changes in the operational risk profile and industry developments.

Notes to the financial statements

Note 35 Risk management (continued)

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

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

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

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

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

THE BANKING GROUP		
2018		
\$ millions	Implied Risk-weighted Exposure	Total Operational Risk Capital Requirement
Methodology implemented		
Advanced Measurement Approach		
Operational risk	4,532	363

Compliance risk

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

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

35.4 Funding and liquidity risk

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

35.4.1 Liquidity modelling

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

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

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

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

35.4.2 Sources of liquidity

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

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

Notes to the financial statements

Note 35 Risk management (continued)

Wholesale funding

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

THE BANKING GROUP						
2018			2017			
Markets	Issuer	Programme Type	Programme Limit	Issuer	Programme Type	Programme Limit
Euro market	Ultimate Parent Bank / WSNZL ¹	Euro Commercial Paper and Certificate of Deposit Programme	US\$20 billion	Ultimate Parent Bank / WSNZL ¹	Euro Commercial Paper and Certificate of Deposit Programme	US\$20 billion
Euro market	WSNZL ¹	Programme for Issuance of Debt Instruments	US\$10 billion	WSNZL ¹	Programme for Issuance of Debt Instruments	US\$10 billion
Euro market	WSNZL ¹	Global Covered Bond Programme	€5.0 billion	WSNZL ¹	Global Covered Bond Programme	€5.0 billion
United States	WSNZL ¹	US Commercial Paper Programme	US\$10 billion	WSNZL ¹	US Commercial Paper Programme	US\$10 billion
New Zealand	The Bank	Medium-term Note Programme and Registered Certificate of Deposit Programme	No limit	The Bank	Medium-term Note Programme and Registered Certificate of Deposit Programme	No limit

¹ Notes issued by WSNZL are guaranteed by the Bank.

Liquid assets

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

\$ millions	THE BANKING GROUP	
	2018	2017
Cash and balances with central banks	1,353	1,659
Receivables due from Ultimate Parent Bank	134	799
Supranational securities	1,502	1,484
NZ Government securities	1,322	2,240
NZ public securities	1,809	1,609
NZ corporate securities	476	1,029
Residential mortgage-backed securities	3,950	3,950
Total liquid assets	10,546	12,770

35.4.3 Regulatory Liquidity Ratios (unaudited)

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

\$ millions	THE BANKING GROUP	
	30-Sep-18	30-Jun-18
Average for the three months ended		
One-week mismatch ratio	6.01	4.87
One-month mismatch ratio	9.21	9.75
Core funding ratio	83.79	84.73

Notes to the financial statements

Note 35 Risk management (continued)

35.4.4 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 Banking Group manages inherent liquidity risk based on expected cash flows.

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

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

THE BANKING GROUP							
2018							
\$ millions	On Demand	Up to 1 Month	Over 1 Month and Up to 3 Months	Over 3 Months and Up to 1 Year	Over 1 Year and Up to 5 Years	Over 5 Years	Total
Financial liabilities							
Payables due to other financial institutions	20	477	-	-	-	-	497
Other liabilities	-	183	-	-	-	-	183
Deposits and other borrowings	28,083	6,488	12,166	14,759	2,363	-	63,859
Other financial liabilities at fair value through income statement	-	-	-	-	-	-	-
Derivative financial instruments:							
Held for hedging purposes (net settled)	-	6	4	51	60	-	121
Held for hedging purposes (gross settled):							
Cash outflow	-	5	5	32	682	581	1,305
Cash inflow	-	-	-	(15)	(529)	(584)	(1,128)
Debt issues	-	10	52	1,772	11,595	1,017	14,446
Due to related entities:							
Non-derivative balances	609	15	60	720	11	-	1,415
Derivative financial instruments:							
Held for trading	2	-	-	-	-	-	2
Held for hedging purposes (net settled)	-	9	42	63	84	-	198
Held for hedging purposes (gross settled):							
Cash outflow	-	-	14	44	1,264	-	1,322
Cash inflow	-	-	(14)	(41)	(1,221)	-	(1,276)
Loan capital	-	-	14	41	232	2,782	3,069
Total undiscounted financial liabilities	28,714	7,193	12,343	17,426	14,541	3,796	84,013
Total contingent liabilities and commitments							
Letters of credit and guarantees	863	-	-	-	-	-	863
Commitments to extend credit	24,650	-	-	-	-	-	24,650
Other commitments	60	-	-	-	-	-	60
Total undiscounted contingent liabilities and commitments	25,573	-	-	-	-	-	25,573

Notes to the financial statements

Note 35 Risk management (continued)

THE BANKING GROUP

\$ millions	2017						Total
	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	
Financial liabilities							
Payables due to other financial institutions	5	138	-	-	-	-	143
Other liabilities	-	95	-	-	-	-	95
Deposits and other borrowings	28,454	4,455	12,404	12,205	2,158	-	59,676
Other financial liabilities at fair value through income statement	-	19	-	-	-	-	19
Derivative financial instruments:							
Held for hedging purposes (net settled)	-	4	15	65	82	3	169
Held for hedging purposes (gross settled):							
Cash outflow	-	929	23	238	3,065	830	5,085
Cash inflow	-	(800)	-	(153)	(2,453)	(753)	(4,159)
Debt issues	-	910	692	3,090	11,640	1,189	17,521
Due to related entities:							
Non-derivative balances	611	22	245	222	732	-	1,832
Derivative financial instruments:							
Held for trading	26	-	-	-	-	-	26
Held for hedging purposes (net settled)	-	17	54	91	78	-	240
Held for hedging purposes (gross settled):							
Cash outflow	-	-	42	2,606	7,428	62	10,138
Cash inflow	-	-	(31)	(2,556)	(7,216)	(57)	(9,860)
Loan capital	-	-	13	40	244	2,851	3,148
Total undiscounted financial liabilities	29,096	5,789	13,457	15,848	15,758	4,125	84,073
Total contingent liabilities and commitments							
Letters of credit and guarantees	772	-	-	-	-	-	772
Commitments to extend credit	25,081	-	-	-	-	-	25,081
Other commitments	10	-	-	-	-	-	10
Total undiscounted contingent liabilities and commitments	25,863	-	-	-	-	-	25,863

Notes to the financial statements

Note 35 Risk management (continued)

35.4.5 Expected maturity

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

\$ millions	THE BANKING GROUP					
	2018			2017		
	Due within 12 months	Greater than 12 months	Total	Due within 12 months	Greater than 12 months	Total
Assets						
Cash and balances with central banks	1,353	-	1,353	1,659	-	1,659
Receivables due from other financial institutions	70	-	70	407	-	407
Trading securities	641	510	1,151	1,438	359	1,797
Derivative financial instruments	163	422	585	-	220	220
Available-for-sale securities	1,386	2,424	3,810	511	3,576	4,087
Loans	11,057	69,321	80,378	10,052	67,209	77,261
Due from related entities	1,026	293	1,319	1,993	24	2,017
All other assets	376	829	1,205	368	811	1,179
Total assets	16,072	73,799	89,871	16,428	72,199	88,627
Liabilities						
Payables due to other financial institutions	497	-	497	143	-	143
Deposits and other borrowings	60,878	2,224	63,102	56,965	2,033	58,998
Derivative financial instruments	19	162	181	104	380	484
Debt issues	1,567	12,158	13,725	4,406	12,323	16,729
Due to related entities	1,455	188	1,643	1,204	922	2,126
Loan capital	-	2,622	2,622	-	2,616	2,616
All other liabilities	741	82	823	608	73	681
Total liabilities	65,157	17,436	82,593	63,430	18,347	81,777

35.5 Market risk

35.5.1 Value-at-Risk

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

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

VaR seeks to take account of all material market variables that may cause a change in the value of the portfolio, including interest rates, 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

35.5.2 Non-traded market risk

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

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

Notes to the financial statements

Note 35 Risk management (continued)

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

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

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

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

THE BANKING GROUP								
%	2018				2017			
	As at	Maximum Exposure	Minimum Exposure	Average Exposure	As at	Maximum Exposure	Minimum Exposure	Average Exposure
NaR	0.27	0.35	0.22	0.27	0.32	0.46	0.18	0.30

Value at Risk – IRRBB¹

The table below depicts VaR for IRRBB:

THE BANKING GROUP								
\$ millions	2018				2017			
	As at	Maximum Exposure	Minimum Exposure	Average Exposure	As at	Maximum Exposure	Minimum Exposure	Average Exposure
Interest rate risk	0.9	1.2	0.3	0.8	0.8	1.8	0.7	1.3

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

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

Risk mitigation

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

The Banking Group hedges its exposure to such interest rate risk using derivatives. Further details on the Banking Group's use of hedge accounting are discussed in Note 25.

35.5.3 Market risk notional capital charges (Unaudited)

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

For each category of market risk, the Banking Group's peak end-of-day aggregate capital charge is derived by determining the maximum over the six months ended 30 September 2018 of the aggregate capital charge for that category of market risk at the close of each business day derived in accordance with BS2B.

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

THE BANKING GROUP		
\$ millions	2018	
	Implied Risk-weighted Exposure	Aggregate capital charge
End-of-period		
Interest rate risk	1,038	83
Foreign currency risk	-	-
Equity risk	-	-
	1,038	83
Peak end-of-day		
Interest rate risk	1,273	102
Foreign currency risk	-	-
Equity risk	-	-

Notes to the financial statements

Note 35 Risk management (continued)

35.5.4 Interest rate sensitivity

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

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the Banking Group's net asset position as at 30 September 2018. The Banking Group uses this contractual repricing information as a base, which is then altered to take account of consumer behaviour, to manage its interest rate risk.

THE BANKING GROUP							
2018							
\$ millions	Up to 3 Months	Over 3 Months and Up to 6 Months	Over 6 Months and Up to 1 Year	Over 1 Year and Up to 2 Years	Over 2 Years	Non- interest Bearing	Total
Financial assets							
Cash and balances with central banks	1,184	-	-	-	-	169	1,353
Receivables due from other financial institutions	70	-	-	-	-	-	70
Other assets	-	-	-	-	-	225	225
Trading securities	1,032	70	49	-	-	-	1,151
Derivative financial instruments	-	-	-	-	-	585	585
Available-for-sale securities	43	1,343	-	1,186	1,238	-	3,810
Loans	43,474	5,296	12,469	14,743	4,720	(324)	80,378
Due from related entities	893	-	-	-	-	426	1,319
Total financial assets	46,696	6,709	12,518	15,929	5,958	1,081	88,891
Non-financial assets							980
Total assets							89,871
Financial liabilities							
Payables due to other financial institutions	477	-	-	-	-	20	497
Other liabilities	-	-	-	-	-	539	539
Deposits and other borrowings	40,587	9,167	5,221	1,541	683	5,903	63,102
Other financial liabilities at fair value through income statement	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	-	-	181	181
Debt issues	4,102	-	1,567	602	7,454	-	13,725
Due to related entities	1,375	-	-	-	11	257	1,643
Loan capital	2,622	-	-	-	-	-	2,622
Total financial liabilities	49,163	9,167	6,788	2,143	8,148	6,900	82,309
Non-financial liabilities							284
Total liabilities							82,593
On-balance sheet interest rate repricing gap	(2,467)	(2,458)	5,730	13,786	(2,190)		
Net derivative notional principals							
Net interest rate contracts (notional):							
Receivable/(payable)	14,457	(4,269)	(3,463)	(9,808)	3,083		
Net interest rate repricing gap	11,990	(6,727)	2,267	3,978	893		

Notes to the financial statements

Note 36 Concentration of funding

\$ millions	THE BANKING GROUP	
	2018	2017
Funding consists of		
Payables due to other financial institutions	497	143
Deposits and other borrowings	63,102	58,998
Other financial liabilities at fair value through income statement	-	19
Debt issues ¹	13,725	16,729
Due to related entities ²	1,386	1,770
Loan capital	2,622	2,616
Total funding	81,332	80,275
Analysis of funding by geographical areas¹		
New Zealand	63,962	61,742
Australia	1,250	1,189
United Kingdom	8,186	8,561
United States of America	581	2,021
Other	7,353	6,762
Total funding	81,332	80,275
Analysis of funding by industry sector		
Accommodation, cafes and restaurants	405	282
Agriculture	1,373	1,260
Construction	1,739	1,713
Finance and insurance	29,520	30,126
Forestry and fishing	222	398
Government, administration and defence	2,068	2,312
Manufacturing	1,530	1,573
Mining	67	57
Property services and business services	5,809	5,868
Services	4,152	4,334
Trade	1,444	1,542
Transport and storage	593	628
Utilities	485	630
Households	26,141	24,184
Other	4,398	3,598
Subtotal	79,946	78,505
Due to related entities ²	1,386	1,770
Total funding	81,332	80,275

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

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

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

Notes to the financial statements

Note 37 Concentration of credit exposures

	THE BANKING GROUP	
\$ millions	2018	2017
On-balance sheet credit exposures (refer to Note 35.2.3 Maximum exposure to credit risk)		
Analysis of on-balance sheet credit exposures by geographical areas		
New Zealand	86,125	85,216
Australia	656	597
United Kingdom	669	296
United States of America	47	258
Other	1,394	1,302
Total on-balance sheet credit exposures	88,891	87,669
Analysis of on-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	443	408
Agriculture	8,446	8,025
Construction	540	512
Finance and insurance	4,861	5,235
Forestry and fishing	458	414
Government, administration and defence	5,304	6,024
Manufacturing	2,146	2,008
Mining	235	153
Property	6,766	6,406
Property services and business services	1,274	1,120
Services	1,822	1,717
Trade	2,213	1,968
Transport and storage	1,115	1,254
Utilities	1,397	1,739
Retail lending	50,805	48,942
Subtotal	87,825	85,925
Provisions for impairment charges on loans	(324)	(350)
Due from related entities	1,319	2,017
Other assets	71	77
Total on-balance sheet credit exposures	88,891	87,669
Off-balance sheet credit exposures (refer to Note 35.2.3 Maximum exposure to credit risk)		
Credit risk-related instruments	25,573	25,863
Total off-balance sheet credit exposures	25,573	25,863
Analysis of off-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	93	81
Agriculture	606	614
Construction	508	484
Finance and insurance	1,597	2,128
Forestry and fishing	143	133
Government, administration and defence	753	617
Manufacturing	1,744	1,554
Mining	175	210
Property	1,540	1,524
Property services and business services	516	389
Services	596	596
Trade	1,704	2,210
Transport and storage	828	900
Utilities	1,651	1,407
Retail lending	13,119	13,016
Total off-balance sheet credit exposures	25,573	25,863

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

Notes to the financial statements

Note 37 Concentration of credit exposures (continued)

Concentration of credit exposures to individual counterparties

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

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

% of Banking Group's Common Equity Tier 1 Capital	THE BANKING GROUP	
	2018	
	Bank Counterparties ¹ Long-term credit rating A- or A3 and above	Non-bank Counterparties ² Long-term credit rating A- or A3 and above
As at 30 September 2018³		
Exceeds 10% and not 15%	-	1
Exceeds 15% and not 20%	-	-
Exceeds 20% and not 25%	-	1
Peak end-of-day aggregate credit exposure for the six months ended 30 September 2018³		
Exceeds 10% and not 15%	1	1
Exceeds 15% and not 20%	1	-
Exceeds 20% and not 25%	1	1

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

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

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

The peak end-of-day aggregate credit exposure to each individual counterparty (which are not members of a group of closely related counterparties) or a group of closely related counterparties has been calculated by determining the maximum end-of-day aggregate amount of actual credit exposure over the relevant six-month period, and then dividing that amount by the Banking Group's Common Equity Tier 1 capital as at 30 September 2018.

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

Notes to the financial statements

Note 38 Credit exposures to connected persons and non-bank connected persons

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

The Reserve Bank defines connected persons to be other members of the Ultimate Parent Bank Group and Directors of the Bank. Controlled entities of the Bank are not connected persons. Credit exposures to connected persons are based on actual credit exposures rather than internal limits. Peak end-of-day aggregate credit exposures to connected persons expressed as a percentage of Tier 1 capital of the Banking Group have been derived by determining the maximum end-of-day aggregate amount of credit exposure over the year ended 30 September 2018 and then dividing that amount by the Banking Group's Tier 1 capital as at 30 September 2018.

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

\$ millions	THE BANKING GROUP	
	As at 30-Sep-18	Peak End-of-day for the Year Ended 30-Sep-18
Credit exposures to connected persons:		
On gross basis, before netting	1,692	3,044
As a percentage of Tier 1 capital of the Banking Group at end of the year	21.7%	39.1%
Amount that has been netted off in determining the net exposure	519	1,200
As a percentage of Tier 1 capital of the Banking Group at end of the year	6.7%	15.4%
On partial bilateral net basis	1,173	1,844
As a percentage of Tier 1 capital of the Banking Group at end of the year	15.1%	23.7%
Credit exposures to non-bank connected persons	16	16
As a percentage of Tier 1 capital of the Banking Group at end of the year	0.2%	0.2%

As at 30 September 2018, the rating-contingent limit applicable to the Banking Group was 60% of Tier 1 capital on a partial bilateral net basis. Within this overall rating-contingent limit there is a sub-limit of 15% of Tier 1 capital which applies to the aggregate credit exposure to non-bank connected persons.

The limits on aggregate credit exposures to all connected persons and to non-bank connected persons in the Bank's conditions of registration have been complied with at all times during the year ended 30 September 2018.

Where a bank is funding a large loan it is common practice to share the risk of a customer default through risk transfer to an acceptable entity. These arrangements are called risk lay-off arrangements. As at 30 September 2018, the Banking Group had \$3 million of aggregate contingent exposures to connected persons arising from risk lay-off arrangements in respect of credit exposures to counterparties (excluding counterparties that are connected persons).

The aggregate amount of the Banking Group's individual credit provisions provided against credit exposures to connected persons was nil as at 30 September 2018.

Notes to the financial statements

Note 39 Notes to the statement of cash flows

Accounting policy

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

Cash and cash equivalents

\$ millions	THE BANKING GROUP	
	2018	2017
Cash and cash equivalents comprise:		
Cash and balances with central banks:		
Cash on hand	169	179
Balances with central banks	1,184	1,480
Cash and cash equivalents at end of the year	1,353	1,659

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

\$ millions	THE BANKING GROUP	
	Year Ended 30-Sep-18	Year Ended 30-Sep-17
Net profit attributable to the owners of the Banking Group	936	909
Adjustments:		
Impairment charges/(benefits) on loans	3	(76)
Computer software amortisation costs	42	44
Depreciation	44	46
(Gain)/loss from hedging ineffectiveness	(4)	12
Movement in accrued interest receivable	(4)	(15)
Movement in accrued interest payable	(16)	19
Movement in current and deferred tax	27	25
Share of associate's net profit	1	-
Share-based payments	4	3
Other non-cash items	(3)	21
Cash flows from operating activities before changes in operating assets and liabilities	1,030	988
Movement in receivables due from other financial institutions	337	313
Movement in other assets	(9)	(14)
Movement in trading securities	666	312
Movement in loans	(3,121)	(2,103)
Movement in due from related entities	1,025	(281)
Movement in payables due to other financial institutions	354	128
Movement in other liabilities	96	9
Movement in deposits and other borrowings	4,104	207
Movement in other financial liabilities at fair value through income statement	(19)	(381)
Movement in due to related entities	(7)	(197)
Net movement in external and related entity derivative financial instruments	(63)	(627)
Net cash provided by/(used in) operating activities	4,393	(1,646)

Notes to the financial statements

Note 40 Subsequent events

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

Conditions of registration

The registration of the Bank in New Zealand is subject to the following conditions, which applied on and after 1 January 2018:

1. That:
 - a. the Total capital ratio of the Banking Group is not less than 10 percent;
 - b. the Tier 1 capital ratio of the Banking Group is not less than 8 percent;
 - c. the Common Equity Tier 1 capital ratio of the Banking Group is not less than 6.5 percent;
 - d. the Total capital of the Banking Group is not less than \$30 million;
 - e. the Bank must not include the amount of an Additional Tier 1 capital instrument or Tier 2 capital instrument issued after 1 January 2013 in the calculation of its capital ratios unless it has received a notice of non-objection to the instrument from the Reserve Bank; and
 - f. the Bank meets the requirements of Part 3 of the Reserve Bank of New Zealand document 'Application requirements for capital recognition or repayment and notification requirements in respect of capital' (BS16) dated November 2015 in respect of regulatory capital instruments.

For the purposes of this condition of registration,—

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

'Total capital ratio', 'Tier 1 capital ratio', 'Common Equity Tier 1 capital ratio', and 'Total capital' must be calculated in accordance with the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015 an Additional Tier1 capital instrument is an instrument that meets the requirements of subsection 2.13(a) or (c) of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Internal Models Based Approach)" (BS2B) dated November 2015.

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

- 1A. That:
 - a. the Bank has an internal capital adequacy assessment process ('ICAAP') that accords with the requirements set out in the document 'Guidelines on a Bank's Internal Capital Adequacy Assessment Process ('ICAAP')' (BS12) dated December 2007;
 - b. under its ICAAP the Bank identifies and measures its 'other material risks' defined as all material risks of the Banking Group that are not explicitly captured in the calculation of Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and Total capital ratio under the requirements set out in the document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015; and
 - c. the Bank determines an internal capital allocation for each identified and measured 'other material risk'.
- 1B. That the Banking Group complies with all requirements set out in the Reserve Bank of New Zealand document 'Capital Adequacy Framework (Internal Models Based Approach)' (BS2B) dated November 2015.
- 1C. That, if the buffer ratio of the Banking Group is 2.5% or less, the Bank must:
 - a. according to the following table, limit the aggregate distributions of the Bank's earnings to the percentage limit to distributions that corresponds to the Banking Group's buffer ratio:

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

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

For the purposes of this condition of registration,—

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

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

2. That the Banking Group does not conduct any non-financial activities that in aggregate are material relative to its total activities. In this condition of registration, the meaning of 'material' is based on generally accepted accounting practice.
3. That the Banking Group's insurance business is not greater than 1% of its total consolidated assets.

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

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

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

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

For the purposes of this condition of registration, —

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

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

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

Conditions of registration

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

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

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

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

5. That exposures to connected persons are not on more favourable terms (for example, as relates to such matters as credit assessment, tenor, interest rates, amortisation schedules and requirement for collateral) than corresponding exposures to non-connected persons.
6. That the Bank complies with the following corporate governance requirements:
 - a. the Board of the Bank must have at least five directors;
 - b. the majority of the Board members must be non-executive directors;
 - c. at least half of the Board members must be independent directors;
 - d. an alternate director:
 - i. for a non-executive director must be non-executive; and
 - ii. for an independent director must be independent;
 - e. at least half of the independent directors of the Bank must be ordinarily resident in New Zealand;
 - f. the chairperson of the Board of the Bank must be independent; and
 - g. the Bank's constitution must not include any provision permitting a director, when exercising powers or performing duties as a director, to act other than in what he or she believes is the best interests of the company (i.e. the Bank).

For the purposes of this condition of registration, 'non-executive' and 'independent' have the same meaning as in the Reserve Bank of New Zealand document entitled 'Corporate Governance' (BS14) dated July 2014.
7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the Bank unless:
 - a. the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - b. the Reserve Bank has advised that it has no objection to that appointment.
8. That a person must not be appointed as chairperson of the Board of the Bank unless:
 - a. the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - b. the Reserve Bank has advised that it has no objection to that appointment.
9. That the Bank has a Board audit committee, or other separate board committee covering audit matters, that meets the following requirements:

- a. the mandate of the committee must include: ensuring the integrity of the Bank's financial controls, reporting systems and internal audit standards;
- b. the committee must have at least three members;
- c. every member of the committee must be a non-executive director of the Bank;
- d. the majority of the members of the committee must be independent; and
- e. the chairperson of the committee must be independent and must not be the chairperson of the Bank.

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

10. That a substantial proportion of the Bank's business is conducted in and from New Zealand.
11. That the Bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the Bank that are carried on by a person other than the Bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the Bank or of a service provider to the Bank, the following outcomes:
 - a. that the Bank's clearing and settlement obligations due on a day can be met on that day;
 - b. that the Bank's financial risk positions on a day can be identified on that day;
 - c. that the Bank's financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
 - d. that the Bank's existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

This condition ceases to apply in respect of an existing outsourcing arrangement on the earlier of either 1 October 2022 or when the existing outsourcing arrangement becomes compliant with condition 25, from which point in time condition 25 will apply to that outsourcing arrangement.

For the purposes of this condition of registration:

- a. the term 'legal and practical ability to control and execute' is explained in the Reserve Bank of New Zealand document entitled 'Outsourcing Policy' (BS11) dated January 2006; and
- b. the term "existing outsourcing arrangement" is defined in the Reserve Bank of New Zealand document entitled "Outsourcing Policy" (BS11) dated September 2017.
12. That:
 - a. the business and affairs of the Bank are managed by, or under the direction or supervision of, the Board of the Bank;
 - b. the employment contract of the chief executive officer of the Bank or person in an equivalent position (together 'CEO') is with the Bank, and the terms and conditions of the CEO's employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the Board of the Bank; and
 - c. all staff employed by the Bank have their remuneration determined by (or under the delegated authority of) the Board or the CEO of the Bank and are accountable (directly or indirectly) to the CEO of the Bank.
13. That, for the purposes of calculating the Bank's capital ratios on a solo basis, a credit conversion factor of zero is only applied to a guarantee of a financing subsidiary's financial obligations if, in substance, the guarantee does not create a risk of loss for the Bank.

Conditions of registration

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

- a. the one-week mismatch ratio of the Banking Group is not less than 0% at the end of each business day;
- b. the one-month mismatch ratio of the Banking Group is not less than 0% at the end of each business day; and
- c. the one-year core funding ratio of the Banking Group is not less than 75% at the end of each business day.

For the purposes of this condition of registration, the ratios identified must be calculated in accordance with the Reserve Bank of New Zealand documents entitled 'Liquidity Policy' (BS13) dated July 2014 and 'Liquidity Policy Annex: Liquid Assets' (BS13A) dated December 2011.

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

- a. is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
- b. identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
- c. identifies the principal methods that the Bank will use for measuring, monitoring and controlling liquidity risk; and
- d. considers the material sources of stress that the Bank might face, and prepares the Bank to manage stress through a contingency funding plan.

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

For the purposes of this condition, —

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

'SPV' means a person—

- a. to whom any member of the Banking Group has sold, assigned, or otherwise transferred any asset;
- b. who has granted, or may grant, a security interest in its assets for the benefit of any holder of any covered bond; and
- c. who carries on no other business except for that necessary or incidental to guarantee the obligations of any member of the Banking Group under a covered bond:

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

17. That:

- a. no member of the Banking Group may give effect to a qualifying acquisition or business combination that meets the notification threshold, and does not meet the non-objection threshold, unless:
 - i. the Bank has notified the Reserve Bank in writing of the intended acquisition or business combination and at least 10 working days have passed; and
 - ii. at the time of notifying the Reserve Bank of the intended acquisition or business combination, the Bank provided the Reserve Bank with the information required under the Reserve Bank Banking Supervision Handbook document 'Significant Acquisitions Policy' (BS15) dated December 2011; and
- b. no member of the Banking Group may give effect to a qualifying acquisition or business combination that meets the non-objection threshold unless:
 - i. the Bank has notified the Reserve Bank in writing of the intended acquisition or business combination;

- ii. at the time of notifying the Reserve Bank of the intended acquisition or business combination, the Bank provided the Reserve Bank with the information required under the Reserve Bank Banking Supervision Handbook document 'Significant Acquisitions Policy' (BS15) dated December 2011; and
- iii. the Reserve Bank has given the Bank a notice of non-objection to the significant acquisition or business combination.

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

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

- a. close promptly at any time of the day and on any day of the week and that effective upon the appointment of the statutory manager:
 - i. all liabilities are frozen in full; and
 - ii. no further access by customers and counterparties to their accounts (deposits, liabilities or other obligations) is possible;
- b. apply a *de minimis* to relevant customer liability accounts;
- c. apply a partial freeze to the customer liability account balances;
- d. reopen by no later than 9am the next business day following the appointment of a statutory manager and provide customers access to their unfrozen funds;
- e. maintain a full freeze on liabilities not pre-positioned for open bank resolution; and
- f. reinstate customers' access to some or all of their residual frozen funds.

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

19. That the Bank has an Implementation Plan that—

- a. is up-to-date; and
- b. demonstrates that the Bank's prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank of New Zealand document: 'Open Bank Resolution Pre-positioning Requirements Policy' (BS 17) dated September 2013.

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

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

- a. at the product-class level lists all liabilities, indicating which are—
 - i. pre-positioned for Open Bank Resolution; and
 - ii. not pre-positioned for Open Bank Resolution;
- b. is agreed to by the Reserve Bank; and
- c. if the Reserve Bank's agreement is conditional, meets the Reserve Bank's conditions.

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

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

Conditions of registration

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

22. That, for a loan-to-valuation measurement period, the total of the Bank's qualifying new mortgage lending amount in respect of property-investment residential mortgage loans with a loan-to-valuation ratio of more than 65%, must not exceed 5% of the total of the qualifying new mortgage lending amounts in respect of property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
23. That, for a loan-to-valuation measurement period, the total of the bank's qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans with a loan-to-valuation ratio of more than 80%, must not exceed 15% of the total of the qualifying new mortgage lending amount in respect of non property-investment residential mortgage loans arising in the loan-to-valuation measurement period.
24. That the Bank 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.
25. That the bank must comply with the Reserve Bank of New Zealand document "Outsourcing Policy" (BS11) dated September 2017.

In these conditions of registration:

- 'Banking Group'—
means Westpac New Zealand Limited (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.
- 'generally accepted accounting practice'—
has the same meaning as in section 8 of the Financial Reporting Act 2013.
- In conditions of registration 22 to 24,—
"loan-to-valuation ratio", "non property-investment residential mortgage loan", "property-investment residential mortgage loan", "qualifying new mortgage lending amount in respect of property-investment residential mortgage loans" and 'residential mortgage loan' have the same meaning as in the Reserve Bank of New Zealand document entitled 'Framework for Restrictions on High-LVR Residential Mortgage Lending' (BS19) dated January 2018:
- 'loan-to-valuation measurement period' means—
 - a. the three calendar month period ending on the last day of March 2018; and
 - b. thereafter a period of three calendar months ending on the last day of the third calendar month, the first of which ends on the last day of April 2018.

Non-compliance with conditions of registration

The Bank underwent a review of compliance with certain aspects of condition of registration 1B in response to a notice issued by the Reserve Bank under section 95 of the Reserve Bank Act during the reporting period ('Section 95 Review'). Condition of registration 1B requires the Bank to comply with the Reserve Bank Capital Adequacy Framework (Internal Models Based Approach) ('BS2B').

The Section 95 Review considered the Bank's compliance with aspects of BS2B since accreditation in 2008. It found that the Bank had not complied with aspects of BS2B over that period, and in particular it used a number of capital models not approved by the RBNZ and failed to meet requirements around model governance, process and documentation.

The Bank accepts the findings of the Section 95 Review and is committed to addressing the issues raised. The Bank addressed a number of issues during the reporting period, and is progressing remediation of the remaining issues. As disclosed in Note 34 to the financial statements, the Bank considers its current internal credit model methodologies result in the retention of an appropriate amount of capital to reflect its credit risk. Any effect of the non-compliance with condition of registration 1B on the information relating to capital adequacy disclosed in the financial statements is not considered by the Bank to be material.

During the reporting period, the Bank was non-compliant with condition of registration 1B in relation to the following matters:

- It has continued to operate versions of the following capital models which were not approved by the Reserve Bank, in some cases since December 2008:
 - > Probability of Default ('PD') models for small business and agriculture.
 - > Loss Given Default ('LGD') and Exposure at Default ('EAD') models for credit card exposures.
 - > PD and LGD models for:
 - Banks;
 - Sovereigns;
 - Corporates; and
 - SME Corporates.
 - > Risk Grade model utilised within expert judgement evaluation for wholesale property development and investment customers.
 - > For one obligor, the slotting rule utilised, applied within the Specialised Lending Income Producing Real Estate asset class, was not approved by the Reserve Bank. This has been corrected and capital calculations adjusted accordingly.
- In some instances, changes to expert judgement policies, compositional changes and an asset class segmentation rule within the Bank's loan book were not notified to the Reserve Bank as required under paragraph 1.3A(a) of BS2B.
- The Bank's Model Compendium required under 1.3B of BS2B is not accurate as it does not include all models, has unapproved models and has not been updated to include changes in models.
- It is not fully compliant with paragraph 4.246 of BS2B in that, with the exception of wholesale property development and investment customers, non-retail risk grade credit policy overrides are not captured and monitored.
- It is not fully compliant with paragraph 4.248 of BS2B in that not all historical origination data for non-retail customers is maintained in a format that allows easy accessibility to key data used to derive the original risk rating.
- It is not fully compliant with 4.256 of BS2B in that WNZL management accountabilities and authorities are not specified in the relevant framework policies published by the Ultimate Parent Bank. This issue has been addressed. The relevant framework policies by the Ultimate Parent Bank have been updated to reflect WNZL management accountabilities and authorities
- For less than one percent of its residential mortgages by loan value, its use of total committed exposure rather than EAD for calculating loan-to-value ratio ('LVR') for capital adequacy purposes does not meet the minimum LGD requirements of paragraph 4.150 of BS2B. Additionally, for less than 5% of accounts by number, the security value utilised within the calculation of LVR is an updated valuation and not the origination value as required by that paragraph.

Conditions of registration

- For credit risk capital purposes, off-balance sheet exposures include amounts that have been approved but not yet drawn by the customer. The Bank has identified that, for some loans to commercial and corporate customers, amounts approved but not yet drawn are not accurately included in its capital estimates. The aggregate amount is not assessed to be material.
- The Banking Group has some minor portfolios where risk weights for these exposures are assessed for capital adequacy under a standardised approach rather than under BS2B without the Reserve Bank's approval. The Reserve Bank has now approved WNZL's use of the standardised approach for these portfolios.
- For a small number of corporate customers, certain committed credit facilities have been incorrectly recorded as uncommitted. This has been corrected and capital calculations adjusted accordingly. The aggregate amount is not assessed to be material.
- It is not fully compliant with 4.205 and 4.324 of BS2B in that the Bank has not risk-weighted the residual value of operating leases at 100%. This has been corrected and the capital calculations adjusted accordingly. The aggregate amount is not assessed to be material.
- It is not fully compliant with 4.93 of BS2B in that the Bank has not applied the appropriate facility maturity for drawn amounts for the lease portfolio (less than 0.4% of total exposure). This has been corrected and the capital calculations adjusted accordingly. The aggregate amount is not assessed to be material.
- It is not fully compliant with 4.136A(b) of BS2B in that an asset value correlation multiplier of 1.25 has not been applied to the correlation parameter R for exposures to unregulated financial institutions. This has been corrected and the capital calculations adjusted accordingly.
- It is not fully compliant with 4.65, 4.84 and 4.152 of BS2B in that the Bank has not included partial write-offs in EAD calculations. This has been corrected and the capital calculations adjusted accordingly. The aggregate amount is not assessed to be material.
- A small number of sovereign customers were incorrectly classified as corporate customers. This resulted in an over-statement of risk-weighted assets ('RWA'). This has been corrected and the capital calculations adjusted accordingly.
- It is not fully compliant with 4.156 of BS2B in that an incorrect EAD factor of 100% (rather than the approved 20%) is used within the EAD calculations for the retail SME portfolio. This results in an over-statement of RWA.
- It is not fully compliant with 4.93 of BS2B in that for some exposures, where amounts have been drawn under a committed facility and there are varying maturities, the more conservative measure of maturity has not been used. The amount is not assessed to be material. The capital calculations will be adjusted during the next reporting period.

In addition to the non-compliance described above, the Section 95 Review noted that the Bank had failed to meet the Reserve Bank's requirements in relation to:

- model documentation and associated model documentation policies;
- internal processes for changes to the Bank's rating system;
- data maintenance; and
- policies or processes to support incorporating conservatism into models and estimates.

The Bank accepts the findings of the Section 95 Review and is committed to addressing the issues raised.

Changes to conditions of registration

The conditions of registration were amended on 29 August 2018 with effect on and after 1 October 2018 to account for some minor and technical changes to the Liquidity Policy Annex (BS13A).



Independent auditor's report

To the shareholder of Westpac New Zealand Limited

This report is for the Banking Group, comprising Westpac New Zealand Limited (the 'Bank') and the entities it controlled at 30 September 2018 or from time to time during the financial year.

This report includes our:

- audit opinion on the financial statements prepared in accordance with Clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'), New Zealand Equivalents to International Financial Reporting Standards ('NZ IFRS') and International Financial Reporting Standards ('IFRS');
- audit opinion on the supplementary information prepared in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order;
- audit opinion on other legal and regulatory requirements in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order; and
- review conclusion on the supplementary information relating to capital adequacy and regulatory liquidity requirements prepared in accordance with Schedule 11 of the Order.

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

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

- the balance sheet as at 30 September 2018;
- the income statement for the year then ended;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended;
- the notes to the financial statements, which include the principal accounting policies; and
- the supplementary information required by Schedules 4, 7, 13, 14, 15 and 17 of the Order.

Our opinion

In our opinion:

- the Banking Group's financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 11, 13, 14, 15 and 17 of the Order and included within the balance sheet and Notes 14, 32, 33, 34, 35, 37 and 38):
 - 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 Banking Group as at 30 September 2018, and its financial performance and cash flows for the year then ended.
- the supplementary information disclosed in accordance with Schedules 4, 7, 13, 14, 15 and 17 of the Order and included within the balance sheet and Notes 14, 32, 33, 35, 37 and 38:
 - i. has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
 - ii. is in accordance with the books and records of the Banking Group; and
 - iii. fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

Basis for opinion

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

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

Our audit approach

Overview



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

The overall Banking Group materiality: \$64.4 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 Banking Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% based on our professional judgement, noting that it is also within the range of commonly accepted profit-related thresholds.

We have determined that there are three key audit matters:

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

Materiality

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

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

Audit scope

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

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

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
<p><i>Provisions for impairment charges on loans</i> <i>(Refer to Notes 6 and 14 of the financial statements)</i></p> <p>We focused on provisions for impairment charges on loans because of the subjective and complex judgements made by the Banking Group in determining the necessity for, and then estimating the size of, provisions for impairment charges on loans.</p> <p>Provisions for impairment charges on loans that exceed specific thresholds are individually assessed by management with reference to the estimated future cash repayments and proceeds from the realisation of collateral held by the Banking Group in respect of those loans.</p> <p>If an individually assessed loan is not impaired, it is then included in a group of loans with similar risk characteristics and, along with those loans below the specific thresholds noted above, is collectively assessed on a portfolio basis using models developed by the Banking Group.</p> <p>Key elements in the provisioning for impairment charges on loans include:</p> <ul style="list-style-type: none"> the identification of impaired loans and the cash flow forecasts (including the expected realisable value of any collateral held) supporting the calculation of individually assessed provisions; and the application of impairment models used in the collectively assessed provision calculations, the appropriateness of the key assumptions used in the impairment models, the probability of default (PD) and the loss given default (LGD) factors. 	<p>We assessed the design and tested the operating effectiveness of key controls over the provisioning for impairment charges on loans. The key controls included:</p> <ul style="list-style-type: none"> governance oversight, including the continuous re-assessment by the Banking Group that the impairment models are operating in a way which is appropriate for the credit risks in the Banking Group's loan portfolios; controls over timely identification of deterioration in the credit quality of individual loans; controls inherent in the IT systems that manage and transfer the data between underlying source systems and the impairment models; and the review and approval process for the outputs of the impairment models, and the adjustments and economic overlays that are applied to the modelled outputs. <p>Our work over the provisions for impairment charges on loans included:</p> <ul style="list-style-type: none"> for all portfolios, recalculated the collective provision using the key assumptions in the model, such as PDs and LGDs; considered whether the calculations and underlying assumptions are consistent with those applied in the previous year, or that any changes are appropriate in the circumstances; performed analyses on key assumptions related to the collective provision; for a sample of individually assessed loans not identified as impaired, considered the latest financial information provided to the Banking Group, to test the Credit Risk Grade rating that has been allocated to the borrower. We also inspected the valuation of collateral (where applicable) to test the LGD factor applied; and for a sample of individually assessed loans identified as impaired, considered the latest financial information, valuation of collateral, and independent expert advice (where available) provided to the Banking Group, to test the basis of measuring the individually assessed provision.

Key Audit Matter	How our audit addressed the Key Audit Matter
<p><i>NZ IFRS 9 Financial Instruments</i> (Refer to Note 1 of the financial statements)</p> <p>On 1 October 2018 the Banking Group transitioned to financial instruments accounting standard NZ IFRS 9 <i>Financial Instruments</i> which replaced NZ IAS 39 <i>Financial Instruments: Recognition and Measurement</i>. The estimated transition impact, net of deferred tax, in the period of initial application is disclosed in Note 1 to the financial statements in accordance with NZ IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>.</p> <p>NZ IFRS 9 introduces an expected credit loss ('ECL') model which takes into account forward-looking information reflecting the Banking Group's view on potential future economic events. Given this is a new and complex accounting standard which requires considerable judgement to estimate ECL provisions against financial instruments, we considered the transition impact disclosure to be a key audit matter.</p> <p>Key elements in the provisioning for impairment charges on loans under NZ IFRS 9 include:</p> <ul style="list-style-type: none"> • the judgements applied in determining exposures that have a significant increase in credit risk; • judgements in setting the assumptions used in the ECL models, such as estimating forward looking probability of default (PD), loss given default (LGD) of financial instruments and macro-economic scenarios and their weightings; • judgements over the use of data inputs required by the models; and • overlays added to reflect emerging trends or particular situations which are not otherwise captured by the impairment models. 	<p>We assessed the design and tested the operating effectiveness of key controls over the Banking Group's estimate of the transition impact.</p> <p>The key controls included:</p> <ul style="list-style-type: none"> • governance over the development, validation and approval of the Banking Group's ECL models to assess compliance with NZ IFRS 9; • review and approval of key judgements, assumptions and forward looking information used in the ECL models; • interfaces and reconciliations over transfer of data inputs from source systems to the models; and • review and approval of ECL model outputs, overlays and disclosures of the transition impact. <p>Our work over a sample of ECL models included:</p> <ul style="list-style-type: none"> • consideration of the methodology inherent within the models against the requirements of NZ IFRS 9; • assessment of key assumptions in the ECL models, including staging, PD and LGD. This included using our credit modelling specialists in our assessment; • consideration of economic information used within, and weightings applied to, forward looking scenarios; • testing the accuracy and completeness of data inputs by testing reconciliations between source systems and the ECL models; • recalculation of the ECL; and • consideration of the potential for the ECL provision to be affected by events not captured by the Banking Group's ECL models, and assessing whether the overlays were appropriate. <p>We assessed the appropriateness of the Banking Group's transition disclosure in the financial statements.</p>

Key Audit Matter	How our audit addressed the Key Audit Matter
<p><i>Operation of IT systems and controls</i></p> <p>We focused on this area because the Banking Group is heavily dependent on complex IT systems for the processing and recording of significant volumes of transactions.</p> <p>In considering the complexity of the Banking Group’s processes and the design of the internal control environment, there are some areas of the audit where we seek to place reliance on automated controls or reports. The effective operation of these areas is dependent on the Banking Group’s IT General Control (ITGC) environment. For example:</p> <ul style="list-style-type: none"> • change management internal controls are important because they help ensure that changes to systems and data are authorised and made appropriately; • IT operations are important as they help ensure errors in processing are resolved in a timely manner; and • user access controls are important to help ensure staff have appropriate access to IT systems and that access is monitored. 	<p>For significant financial statement balances, we gained an understanding of the business processes, key controls and IT systems used to generate and support those balances. Where relevant to our planned audit approach, we assessed the design and tested the operating effectiveness of the key controls which support the continued integrity of the in-scope IT systems. This involved considering, and where appropriate, testing the following elements of the ITGC environment:</p> <ul style="list-style-type: none"> • governance controls used to monitor and enforce internal control consciousness throughout the Banking Group’s technology teams and third party suppliers; • program change management controls, where applicable, to help ensure changes to systems and data are tested, authorised and reviewed; • IT operations controls that help ensure any significant IT issues or incidents are escalated and resolved in a timely manner; and • user access security controls that help make sure that access to IT systems is adequately restricted to appropriate personnel, periodically reviewed and promptly removed when access is no longer required. <p>For in-scope IT systems where technology services are provided by a third party, we:</p> <ul style="list-style-type: none"> • obtained assurance from the third party’s auditors on the design and operating effectiveness of controls; and/or • tested control design and operating effectiveness ourselves. <p>In performing our procedures over in-scope IT systems, we identified certain deficiencies in IT internal controls which have impacted the level of reliance we can directly place on the Banking Group’s IT internal control environment.</p> <p>In response, we carried out further direct tests of the operation of key programs to establish the accuracy of calculations, the reliability of reports, and to assess the operation of automated controls and technology-dependent manual controls across the financial year.</p> <p>We also performed additional compensating control tests and/or substantive audit procedures over key financial balances where required to support our audit.</p>



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

The Directors of the Bank (the 'Directors') are responsible for the other information included in the Annual Report and Disclosure Statement. The other information comprises the Annual Report and information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 1 to 6 and 74 to 78. Our opinion on the financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon.

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

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

The Directors are responsible, on behalf of the Bank, for the preparation of the financial statements in accordance with Clause 24 of the Order, NZ IFRS and IFRS and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of the supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 13, 14, 15 and 17 of the Order.

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

Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

Our objectives are to obtain reasonable assurance about whether the financial statements and the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in Notes 34 and 35) disclosed in accordance with Clause 24 and Schedules 4, 7, 13, 14, 15 and 17 of the Order, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (NZ) and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at:

<https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/>

This description forms part of our auditor's report.

Report on other legal and regulatory requirements (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in Notes 34 and 35) for the year ended 30 September 2018:

- i. we have obtained all the information and explanations that we have required; and
- ii. in our opinion, proper accounting records have been kept by the Banking Group as far as appears from an examination of those records.

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

We have examined the supplementary information relating to capital adequacy and regulatory liquidity requirements required by Schedule 11 of the Order as disclosed in Notes 34 and 35 of the financial statements of the Banking Group for the year ended 30 September 2018.

Our conclusion

Based on our review, nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in Notes 34 and 35, is not, in all material respects, disclosed in accordance with Schedule 11 of the Order.

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

Emphasis of matter

Without modifying our conclusion, we draw attention to the other information on pages 77 and 78 of the Annual Report and Disclosure Statement and to Note 34 of the financial statements, which disclose certain matters of non-compliance with condition of registration 1B by the Bank. This includes the fact that the Bank continues to operate versions of certain internal models for credit risk that have not been approved by the Reserve Bank of New Zealand. However, as disclosed in the other information on pages 77 and 78 of the Annual Report and Disclosure Statement and in Note 34 of the financial statements, the Bank considers its current internal credit model methodologies result in the retention of an appropriate amount of capital to reflect its credit risk and any effect of the non-compliance with condition of registration 1B on the information relating to capital adequacy disclosed in the financial statements is not considered to be material.

Basis for our conclusion

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

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

The Directors are responsible, on behalf of the Bank, for the preparation of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in accordance with Schedule 11 of the Order. The Directors are also responsible for such internal control as the Directors determine is necessary to enable the preparation of the supplementary information relating to capital adequacy and regulatory liquidity requirements that is free from material misstatement, whether due to fraud or error.



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

Our responsibility is to express a conclusion, whether, based on our review, the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in Notes 34 and 35, is not, in all material respects, disclosed in accordance with Schedule 11 of the Order.

A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in Notes 34 and 35 in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with ISAs (NZ) and ISAs. Accordingly we do not express an audit opinion on the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in Notes 34 and 35.

Auditor independence

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

Who we report to

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

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

For and on behalf of:

Chartered Accountants
19 November 2018

Auckland

