# Westpac New Zealand Limited
## Disclosure Statement

For the six months ended 31 March 2017

# Contents

## General information and definitions

Certain information contained in this Disclosure Statement is required by section 81 of the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**') and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 ('**Order**').

In this Disclosure Statement, reference is made to:

- Westpac New Zealand Limited (otherwise referred to as the '**Bank**'); and
- Westpac New Zealand Limited and its controlled entities (otherwise referred to as the '**Banking 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. All amounts referred to in this Disclosure Statement are in New Zealand dollars unless otherwise stated.

## Limits on material financial support by the ultimate parent bank

In late 2014, the Australian Prudential Regulation Authority ('**APRA**') initiated a process to reduce Australian bank non-equity exposures to their respective New Zealand banking subsidiaries and branches, so that these non-equity exposures are minimised during ordinary times. On 19 November 2015, APRA informed Westpac Banking Corporation (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 five percent of the Ultimate Parent Bank's Level 1 Tier 1 capital.

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 five percent limit. Exposures for the purposes of this limit include all committed, non-intraday, non-equity exposures including derivatives and off-balance sheet exposures. Further, APRA imposed two conditions over the transition period – the percentage excess above the five percent limit as at 30 June 2015, is to reduce by at least one fifth by the end of each calendar year over the transition period, and the absolute amount of routine New Zealand non-equity exposure is not to increase from the 30 June 2015 level until the Ultimate Parent Bank is, and expects to remain, below the five percent limit. For the purposes of assessing this exposure, the five percent limit excludes equity investments and holdings of capital instruments in New Zealand banking subsidiaries. As at 31 March 2017, the ELE's non-equity exposures to New Zealand banking subsidiaries affected by the limit were approximately 6.8% of Level 1 Tier 1 capital of the Ultimate Parent Bank. Non-equity exposures would need to reduce by approximately $0.9 billion from the 31 March 2017 position to comply with the 5% limit. The Ultimate Parent Bank expects to achieve compliance with the 5% limit within the transition period.

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.

## Directors

There have been no changes in the composition of the Board of Directors of the Bank since 30 September 2016.

## Credit ratings

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

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

On 7 July 2016, S&P Global Ratings ('**S&P**') affirmed the Bank's credit rating at AA-, however, it revised the Bank's outlook to 'negative' from 'stable'. The revision in outlook was as a result of S&P revising the outlook for the Australian sovereign rating to 'negative' from 'stable', which resulted in a revision of the outlook for the Ultimate Parent Bank's to 'negative' from 'stable'. On 19 August 2016, Moody's Investors Service ('**Moody's**') affirmed the Bank's credit rating at Aa3, however, it revised the Bank's outlook to 'negative' from 'stable'. The revision in outlook was as a result of Moody's revising the Australian Macro Profile to "Very Strong –" from "Very Strong", which resulted in a revision of the outlook for the Ultimate Parent Bank to 'negative' from 'stable'. There have been no changes to the Bank's credit rating in the two years prior to 31 March 2017.

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

## Guarantee arrangements

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

## Conditions of registration

**Non-compliance with conditions of registration**

The Bank is currently undergoing a review of compliance with certain aspects of condition of registration 1B, which requires the Bank to comply with the Reserve Bank's Capital Adequacy Framework (Internal Models Based Approach) (**BS2B**). On 10 February 2017 the Reserve Bank issued a notice under section 95 of the Reserve Bank Act, requiring the Bank to obtain an independent review of its compliance with advanced internal rating-based aspects of BS2B.

The Bank has identified the following matters in respect of which it was non-compliant with condition of registration 1B:

- It has been operating versions of the following capital models without obtaining the Reserve Bank's prior approval as required under paragraph 1.3A of the revised version of BS2B that came into effect on 1 July 2014:
  - Probability of Default ('**PD**') masterscale, Loss Given Default ('**LGD**') masterscale and expert judgment evaluation policies for transaction managed customers.
  - LGD and Exposure at Default ('**EAD**') models for credit card exposures.
  - Risk Grade model utilised within expert judgment evaluation for wholesale property development and investment customers.
  - Small business and corporate asset class definitions.
- In some instances compositional changes within the Bank's loan book were not notified to the Reserve Bank as required under paragraph 1.3A(a) of BS2B.
- For less than one percent of its residential mortgages by loan value, its use of total committed exposure rather than EAD for calculating LVR for capital adequacy purposes does not meet the minimum LGD requirements of paragraph 4.150 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.
- It is not fully compliant with paragraph 4.246 of BS2B, as not all risk grade credit policy overrides are captured and monitored.

As disclosed in Note 15 to the financial statements, 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 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. Any further consequences arising from the review will be appropriately disclosed in subsequent Disclosure Statements.

**Changes to conditions of registration**

There have been no changes to the conditions of registration imposed on the Bank since 31 December 2016.

## Auditor

**PricewaterhouseCoopers**
PricewaterhouseCoopers Tower
188 Quay Street
Auckland, New Zealand

## 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 six months ended 31 March 2017:

(a) the Bank has complied with all conditions of registration imposed on it pursuant to section 74 of the Reserve Bank Act except as noted on page 2 and Note 15 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 23rd day of May 2017

## **Income statement** for the six months ended 31 March 2017

| | | The Banking Group | | |
|---|---|---|---|---|
| **$ millions** | Note | **Six Months Ended 31-Mar-17 Unaudited** | Six Months Ended 31-Mar-16 Unaudited | Year Ended 30-Sep-16 Audited |
| Interest income | | **1,947** | 2,088 | 4,113 |
| Interest expense | | **(1,112)** | (1,222) | (2,369) |
| **Net interest income** | | **835** | 866 | 1,744 |
| Non-interest income | 2 | **188** | 198 | 400 |
| **Net operating income** | | **1,023** | 1,064 | 2,144 |
| Operating expenses | | **(465)** | (447) | (907) |
| Impairment recoveries/(charges) on loans | 3 | **36** | (9) | (59) |
| **Profit before income tax expense** | | **594** | 608 | 1,178 |
| Income tax expense | | **(168)** | (168) | (327) |
| **Profit after income tax expense** | | **426** | 440 | 851 |

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

## Statement of comprehensive income for the six months ended 31 March 2017

| $ millions | The Banking Group<br>Six Months Ended 31-Mar-17 Unaudited | The Banking Group<br>Six Months Ended 31-Mar-16 Unaudited | The Banking Group<br>Year Ended 30-Sep-16 Audited |
|---|---|---|---|
| **Profit after income tax expense** | **426** | 440 | 851 |
| **Other comprehensive income/(expense) which may be reclassified subsequently to the income statement:** | | | |
| Available-for-sale securities: | | | |
| Net unrealised gains/(losses) from changes in fair value of available-for-sale securities | **9** | (15) | (21) |
| Income tax effect | **(3)** | 4 | 6 |
| Cash flow hedges: | | | |
| Net losses from changes in fair value of cash flow hedges | **(20)** | (63) | (91) |
| Transferred to the income statement | **42** | 48 | 90 |
| Income tax effect | **(6)** | 4 | (1) |
| **Total other comprehensive income/(expense) which may be reclassified subsequently to the income statement** | **22** | (22) | (17) |
| **Other comprehensive income/(expense) which will not be reclassified subsequently to the income statement:** | | | |
| Remeasurement of employee defined benefit obligations | **13** | (2) | (7) |
| Income tax effect | **(3)** | 1 | 2 |
| **Total other comprehensive income/(expense) which will not be reclassified subsequently to the income statement** | **10** | (1) | (5) |
| **Total other comprehensive income/(expense), net of tax** | **32** | (23) | (22) |
| **Total comprehensive income** | **458** | 417 | 829 |

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

## **Balance sheet** as at 31 March 2017

| $ millions | Note | The Banking Group<br>31-Mar-17<br>Unaudited | <br>31-Mar-16<br>Unaudited | <br>30-Sep-16<br>Audited |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and balances with central banks | | **1,495** | 1,523 | 1,418 |
| Due from other financial institutions | | **753** | 172 | 720 |
| Trading securities and other financial assets designated at fair value | 4 | **1,708** | 1,788 | 2,128 |
| Derivative financial instruments | | **63** | 253 | 130 |
| Available-for-sale securities | | **3,818** | 3,713 | 3,790 |
| Loans | 5, 6 | **76,542** | 71,723 | 75,172 |
| Due from related entities | | **1,349** | 2,149 | 1,760 |
| Investment in associate | | **11** | 8 | 9 |
| Property and equipment | | **145** | 149 | 161 |
| Current tax assets | | **-** | 20 | - |
| Deferred tax assets | | **171** | 184 | 191 |
| Intangible assets | | **589** | 591 | 590 |
| Other assets | | **224** | 242 | 238 |
| **Total assets** | | **86,868** | 82,515 | 86,307 |
| **Liabilities** | | | | |
| Due to other financial institutions | | **410** | 78 | 15 |
| Deposits and other borrowings | 8 | **58,429** | 55,965 | 58,791 |
| Other financial liabilities at fair value through income statement | | **10** | 157 | 400 |
| Derivative financial instruments | | **799** | 461 | 884 |
| Debt issues | 9 | **15,803** | 14,748 | 14,727 |
| Current tax liabilities | | **16** | - | 71 |
| Provisions | | **75** | 68 | 90 |
| Other liabilities | | **434** | 511 | 508 |
| **Total liabilities excluding related entities liabilities** | | **75,976** | 71,988 | 75,486 |
| Due to related entities | | **3,066** | 2,897 | 3,170 |
| Subordinated notes | | **1,138** | 1,152 | 1,091 |
| **Total related entities liabilities** | | **4,204** | 4,049 | 4,261 |
| **Total liabilities** | | **80,180** | 76,037 | 79,747 |
| **Net assets** | | **6,688** | 6,478 | 6,560 |
| **Equity** | | | | |
| Share capital | | **3,750** | 3,750 | 3,750 |
| Retained profits | | **2,992** | 2,809 | 2,886 |
| Available-for-sale securities reserve | | **7** | 5 | 1 |
| Cash flow hedge reserve | | **(61)** | (86) | (77) |
| **Total equity** | | **6,688** | 6,478 | 6,560 |
| Interest earning and discount bearing assets | | **85,611** | 81,168 | 85,088 |
| Interest and discount bearing liabilities | | **73,441** | 69,745 | 72,569 |

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

## **Statement of changes in equity** for the six months ended 31 March 2017

| $ millions | The Banking Group Share Capital | Retained Profits | Available-for-sale Securities Reserve | Cash Flow Hedge Reserve | Total |
|---|---|---|---|---|---|
| **As at 1 October 2015 (Audited)** | 3,750 | 2,700 | 16 | (75) | 6,391 |
| **Six months ended 31 March 2016 (Unaudited)** | | | | | |
| Profit after income tax expense | - | 440 | - | - | 440 |
| Net losses from changes in fair value | - | - | (15) | (63) | (78) |
| Income tax effect | - | - | 4 | 17 | 21 |
| Transferred to the income statement | - | - | - | 48 | 48 |
| Income tax effect | - | - | - | (13) | (13) |
| Remeasurement of employee defined benefit obligations | - | (2) | - | - | (2) |
| Income tax effect | - | 1 | - | - | 1 |
| **Total comprehensive income for the six months ended 31 March 2016** | - | 439 | (11) | (11) | 417 |
| Transactions with owners: | | | | | |
| Dividends paid on ordinary shares | - | (330) | - | - | (330) |
| **As at 31 March 2016 (Unaudited)** | 3,750 | 2,809 | 5 | (86) | 6,478 |
| **Year ended 30 September 2016 (Audited)** | | | | | |
| Profit after income tax expense | - | 851 | - | - | 851 |
| Net losses from changes in fair value | - | - | (21) | (91) | (112) |
| Income tax effect | - | - | 6 | 25 | 31 |
| Transferred to the income statement | - | - | - | 90 | 90 |
| Income tax effect | - | - | - | (26) | (26) |
| Remeasurement of employee defined benefit obligations | - | (7) | - | - | (7) |
| Income tax effect | - | 2 | - | - | 2 |
| **Total comprehensive income for the year ended 30 September 2016** | - | 846 | (15) | (2) | 829 |
| Transactions with owners: | | | | | |
| Dividends paid on ordinary shares | - | (660) | - | - | (660) |
| **As at 30 September 2016 (Audited)** | 3,750 | 2,886 | 1 | (77) | 6,560 |
| **Six months ended 31 March 2017 (Unaudited)** | | | | | |
| Profit after income tax expense | **-** | **426** | **-** | **-** | **426** |
| Net gains/(losses) from changes in fair value | **-** | **-** | **9** | **(20)** | **(11)** |
| Income tax effect | **-** | **-** | **(3)** | **6** | **3** |
| Transferred to the income statement | **-** | **-** | **-** | **42** | **42** |
| Income tax effect | **-** | **-** | **-** | **(12)** | **(12)** |
| Remeasurement of employee defined benefit obligations | **-** | **13** | **-** | **-** | **13** |
| Income tax effect | **-** | **(3)** | **-** | **-** | **(3)** |
| **Total comprehensive income for the six months ended 31 March 2017** | **-** | **436** | **6** | **16** | **458** |
| Transactions with owner: | | | | | |
| Dividends paid on ordinary shares (refer to Note 10) | **-** | **(330)** | **-** | **-** | **(330)** |
| **As at 31 March 2017 (Unaudited)** | **3,750** | **2,992** | **7** | **(61)** | **6,688** |

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

## **Statement of cash flows** for the six months ended 31 March 2017

| $ millions | The Banking Group<br>Six Months Ended 31-Mar-17 Unaudited | Six Months Ended 31-Mar-16 Unaudited | Year Ended 30-Sep-16 Audited |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Interest income received | **1,953** | 2,109 | 4,136 |
| Interest expense paid | **(1,138)** | (1,225) | (2,365) |
| Non-interest income received | **182** | 168 | 380 |
| Operating expenses paid | **(414)** | (423) | (797) |
| Income tax paid | **(216)** | (207) | (287) |
| Cash flows from operating activities before changes in operating assets and liabilities | **367** | 422 | 1,067 |
| Net (increase)/decrease in: | | | |
| Due from other financial institutions | **(33)** | (154) | (702) |
| Trading securities and other financial assets designated at fair value | **421** | 293 | (47) |
| Loans | **(1,409)** | (2,542) | (6,108) |
| Due from related entities | **572** | 165 | 543 |
| Other assets | **1** | 4 | - |
| Net increase/(decrease) in: | | | |
| Due to other financial institutions | **395** | (412) | (475) |
| Deposits and other borrowings | **(362)** | 2,979 | 5,805 |
| Other financial liabilities at fair value through income statement | **(390)** | 157 | 400 |
| Other liabilities | **(6)** | 17 | (5) |
| Net movement in external and related entity derivative financial instruments | **(489)** | 136 | (82) |
| **Net cash (used in)/provided by operating activities** | **(933)** | 1,065 | 396 |
| **Cash flows from investing activities** | | | |
| Purchase of available-for-sale securities | **(128)** | (275) | (652) |
| Proceeds from maturities/sale of available-for-sale securities | **30** | - | 300 |
| Purchase of capitalised computer software | **(25)** | (14) | (46) |
| Purchase of property and equipment | **(7)** | (4) | (25) |
| **Net cash used in investing activities** | **(130)** | (293) | (423) |
| **Cash flows from financing activities** | | | |
| Proceeds from debt issues | **5,644** | 3,181 | 7,840 |
| Repayments of debt issues | **(4,650)** | (2,233) | (6,018) |
| Net movement in due to related entities | **476** | (724) | (574) |
| Dividends paid to ordinary shareholders | **(330)** | (330) | (660) |
| **Net cash provided by/(used in) financing activities** | **1,140** | (106) | 588 |
| **Net increase in cash and cash equivalents** | **77** | 666 | 561 |
| Cash and cash equivalents at beginning of the period/year | **1,418** | 857 | 857 |
| **Cash and cash equivalents at end of the period/year** | **1,495** | 1,523 | 1,418 |
| **Cash and cash equivalents at end of the period/year comprise:** | | | |
| Cash on hand | **179** | 180 | 204 |
| Cash and balances with central banks | **1,316** | 1,343 | 1,214 |
| **Cash and cash equivalents at end of the period/year** | **1,495** | 1,523 | 1,418 |

The above statement of cash flows should be read in conjunction with the accompanying notes.

## Note 1 Statement of accounting policies

### Statutory base

In these condensed consolidated interim financial statements ('**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**'); and
- Westpac Banking Corporation (otherwise referred to as the '**Ultimate Parent Bank**').

These financial statements have been prepared and presented in accordance with the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**') and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 ('**Order**').

These financial statements have also been prepared in accordance with Generally Accepted Accounting Practice in New Zealand, as appropriate for profit-oriented entities, and the New Zealand equivalent to International Accounting Standard 34 *Interim Financial Reporting* and should be read in conjunction with the Disclosure Statement for the year ended 30 September 2016. These financial statements comply with International Accounting Standard 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board.

These financial statements were authorised for issue by the Board of Directors of the Bank (the '**Board**') on 23 May 2017. The Board has the power to amend the financial statements after they are authorised for issue.

### Basis of preparation

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 financial liabilities (including derivative instruments) measured at fair value through income statement or in other comprehensive income. The going concern concept and the accrual basis of accounting have been applied.

All amounts in these financial statements have been rounded in millions of New Zealand dollars unless otherwise stated.

There were no amendments to the New Zealand Accounting Standards adopted during the reporting period that had a material impact on the Banking Group.

The same accounting policies and methods of computation have been followed in preparing these financial statements as were used in preparing the financial statements for the year ended 30 September 2016.

The areas of judgment, estimates and assumptions in these financial statements, including the key sources of estimation uncertainty, are consistent with those in the financial statements for the year ended 30 September 2016.

Certain comparative information has been restated to ensure consistent treatment with the current reporting period. Where there has been a material restatement of comparative information the nature of, and the reason for, the restatement is disclosed in the relevant note.

## Note 2 Non-interest income

| | The Banking Group | | |
|---|---|---|---|
| $ millions | **Six Months Ended 31-Mar-17 Unaudited** | Six Months Ended 31-Mar-16 Unaudited | Year Ended 30-Sep-16 Audited |
| **Fees and commissions** | | | |
| Transaction fees and commissions | **131** | 124 | 254 |
| Lending fees | **30** | 30 | 60 |
| Management fees received from related entities | **4** | 6 | 12 |
| Other non-risk fee income | **24** | 23 | 43 |
| **Total fees and commissions** | **189** | 183 | 369 |
| **Net ineffectiveness on qualifying hedges** | **(9)** | 2 | 5 |
| **Other non-interest income** | | | |
| Share of profit of associate accounted for using the equity method | **3** | 8 | 11 |
| Other | **5** | 5 | 15 |
| **Total other non-interest income** | **8** | 13 | 26 |
| **Total non-interest income** | **188** | 198 | 400 |

## Note 3 Impairment charges on loans

| $ millions | Residential Mortgages | Other Retail | Corporate | Other | Total |
|---|---|---|---|---|---|
| | The Banking Group | | | | |
| **Six months ended 31 March 2017 (Unaudited)** | | | | | |
| Collectively assessed provisions | **7** | **(3)** | **(12)** | **-** | **(8)** |
| Individually assessed provisions | **1** | **1** | **(41)** | **-** | **(39)** |
| Bad debts (recovered)/written-off directly to the income statement | **(1)** | **13** | **(1)** | **-** | **11** |
| **Total impairment charges/(recoveries) on loans** | **7** | **11** | **(54)** | **-** | **(36)** |
| **Six months ended 31 March 2016 (Unaudited)** | | | | | |
| Collectively assessed provisions | (8) | 1 | (9) | - | (16) |
| Individually assessed provisions | (1) | 1 | 2 | - | 2 |
| Bad debts written-off directly to the income statement | 1 | 22 | - | - | 23 |
| **Total impairment (recoveries)/charges on loans** | (8) | 24 | (7) | - | 9 |
| **Year ended 30 September 2016 (Audited)** | | | | | |
| Collectively assessed provisions | (12) | (8) | 28 | - | 8 |
| Individually assessed provisions | - | 2 | 4 | - | 6 |
| Bad debts written-off directly to the income statement | 1 | 43 | 1 | - | 45 |
| **Total impairment (recoveries)/charges on loans** | (11) | 37 | 33 | - | 59 |

## Note 4 Trading securities and other financial assets designated at fair value

| $ millions | **31-Mar-17 Unaudited** | 31-Mar-16 Unaudited | 30-Sep-16 Audited |
|---|---|---|---|
| | The Banking Group | | |
| Government and semi-government securities | **1,336** | 538 | 1,058 |
| Other debt securities | **266** | 1,250 | 1,070 |
| Securities purchased under agreement to resell | **106** | - | - |
| **Total trading securities and other financial assets designated at fair value** | **1,708** | 1,788 | 2,128 |

## Note 5 Loans

| $ millions | **31-Mar-17 Unaudited** | 31-Mar-16 Unaudited | 30-Sep-16 Audited |
|---|---|---|---|
| | The Banking Group | | |
| Overdrafts | **1,184** | 1,292 | 1,313 |
| Credit card outstandings | **1,492** | 1,547 | 1,503 |
| Money market loans | **1,362** | 1,375 | 1,362 |
| Term loans: | | | |
| Housing | **46,252** | 43,464 | 45,153 |
| Non-housing | **25,718** | 23,579 | 25,425 |
| Other | **932** | 875 | 851 |
| **Total gross loans** | **76,940** | 72,132 | 75,607 |
| Provisions for impairment charges on loans | **(398)** | (409) | (435) |
| **Total net loans** | **76,542** | 71,723 | 75,172 |

As at 31 March 2017, $6,812 million of housing loans were used by the Banking Group to secure the obligations of Westpac Securities NZ Limited ('**WSNZL**') under the Bank's Global Covered Bond Programme ('**CB Programme**') (31 March 2016: $4,303 million, 30 September 2016: $6,591 million). These housing loans were not derecognised from the Banking Group's balance sheet in accordance with the accounting policies outlined in Note 1 to the financial statements included in the Disclosure Statement for the year ended 30 September 2016. As at 31 March 2017, the New Zealand dollar equivalent of bonds issued by WSNZL under the CB Programme was $3,386 million (31 March 2016: $4,090 million, 30 September 2016: $3,480 million).

## Note 6 Credit quality, impaired assets and provisions for impairment charges on loans

| $ millions | The Banking Group 31-Mar-17 (Unaudited) Residential Mortgages | Other Retail | Corporate | Other | Total |
|---|---|---|---|---|---|
| **Neither past due nor impaired** | **45,255** | **3,653** | **26,187** | **250** | **75,345** |
| **Past due but not impaired assets** | | | | | |
| Less than 30 days past due | **791** | **140** | **191** | **-** | **1,122** |
| At least 30 days but less than 60 days past due | **93** | **27** | **25** | **-** | **145** |
| At least 60 days but less than 90 days past due | **37** | **12** | **6** | **-** | **55** |
| At least 90 days past due | **53** | **19** | **26** | **-** | **98** |
| **Total past due assets not impaired** | **974** | **198** | **248** | **-** | **1,420** |
| **Individually impaired assets**[1] | | | | | |
| Balance at beginning of the period | **25** | **4** | **193** | **-** | **222** |
| Additions | **16** | **2** | **37** | **-** | **55** |
| Amounts written off | **(2)** | **-** | **-** | **-** | **(2)** |
| Returned to performing or repaid | **(16)** | **(2)** | **(82)** | **-** | **(100)** |
| **Balance at end of the period** | **23** | **4** | **148** | **-** | **175** |
| **Total gross loans**[2] | **46,252** | **3,855** | **26,583** | **250** | **76,940** |
| **Individually assessed provisions** | | | | | |
| Balance at beginning of the period | **7** | **3** | **95** | **-** | **105** |
| Impairment charges on loans: | | | | | |
| New provisions | **3** | **1** | **5** | **-** | **9** |
| Reversal of previously recognised impairment charges on loans | **(2)** | **-** | **(46)** | **-** | **(48)** |
| Amounts written off | **(1)** | **(2)** | **(1)** | **-** | **(4)** |
| **Balance at end of the period** | **7** | **2** | **53** | **-** | **62** |
| **Collectively assessed provisions** | | | | | |
| Balance at beginning of the period | **46** | **95** | **220** | **-** | **361** |
| Impairment charges/(reversals) on loans | **7** | **(3)** | **(12)** | **-** | **(8)** |
| Interest adjustments | **1** | **6** | **7** | **-** | **14** |
| **Balance at end of the period** | **54** | **98** | **215** | **-** | **367** |
| **Total provisions for impairment charges on loans and credit commitments** | **61** | **100** | **268** | **-** | **429** |
| Provision for credit commitments | **-** | **(4)** | **(27)** | **-** | **(31)** |
| **Total provisions for impairment charges on loans** | **61** | **96** | **241** | **-** | **398** |
| **Total net loans** | **46,191** | **3,759** | **26,342** | **250** | **76,542** |

1 The Banking Group had undrawn commitments of $8 million to counterparties for whom drawn balances are classified as individually impaired assets under corporate loans as at 31 March 2017.

2 The Banking Group did not have other assets under administration as at 31 March 2017.

## Note 7 Financial assets pledged as collateral

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 CB Programme (refer to Note 5), the carrying value of these financial assets pledged as collateral is:

| $ millions | The Banking Group 31-Mar-17 Unaudited | 31-Mar-16 Unaudited | 30-Sep-16 Audited |
|---|---|---|---|
| Cash | **753** | 172 | 720 |
| Securities pledged under repurchase agreements | | | |
| Available-for-sale securities[1] | **603** | 5 | 483 |
| **Total amount pledged to secure liabilities (excluding CB Programme)** | **1,356** | 177 | 1,203 |

1 As at 31 March 2017, $603 million of available-for-sale securities were pledged as collateral to the New Zealand Branch of the Ultimate Parent Bank (31 March 2016: $5 million, 30 September 2016: $83 million) which is recorded within due to related entities and nil was pledged to third parties (31 March 2016: nil, 30 September 2016: $400 million) which is recorded as other financial liabilities at fair value through income statement.

# Notes to the financial statements

## Note 8 Deposits and other borrowings

| $ millions | The Banking Group 31-Mar-17 Unaudited | 31-Mar-16 Unaudited | 30-Sep-16 Audited |
|---|---|---|---|
| **Deposits and other borrowings at fair value** | | | |
| Certificates of deposit | **1,617** | 1,045 | 1,250 |
| **Total deposits and other borrowings at fair value** | **1,617** | 1,045 | 1,250 |
| **Deposits and other borrowings at amortised cost** | | | |
| Non-interest bearing, repayable at call | **5,081** | 4,467 | 4,621 |
| Other interest bearing: | | | |
| At call | **23,894** | 25,311 | 23,741 |
| Term | **27,837** | 25,142 | 29,179 |
| **Total deposits and other borrowings at amortised cost** | **56,812** | 54,920 | 57,541 |
| **Total deposits and other borrowings** | **58,429** | 55,965 | 58,791 |

## Note 9 Debt issues

| $ millions | The Banking Group 31-Mar-17 Unaudited | 31-Mar-16 Unaudited | 30-Sep-16 Audited |
|---|---|---|---|
| **Short-term debt** | | | |
| Commercial paper | **2,398** | 1,630 | 2,410 |
| **Total short-term debt** | **2,398** | 1,630 | 2,410 |
| **Long-term debt** | | | |
| Non-domestic medium-term notes | **6,908** | 6,115 | 5,616 |
| Covered bonds | **3,386** | 4,090 | 3,480 |
| Domestic medium-term notes | **3,111** | 2,913 | 3,221 |
| **Total long-term debt** | **13,405** | 13,118 | 12,317 |
| **Total debt issues** | **15,803** | 14,748 | 14,727 |
| Debt issues at amortised cost | **13,405** | 13,118 | 12,317 |
| Debt issues at fair value | **2,398** | 1,630 | 2,410 |
| **Total debt issues** | **15,803** | 14,748 | 14,727 |
| **Movement in debt issues** | | | |
| Balance at beginning of the period/year | **14,727** | 14,685 | 14,685 |
| Issuance during the period/year | **5,644** | 3,181 | 7,840 |
| Repayments during the period/year | **(4,650)** | (2,233) | (6,018) |
| Effect of foreign exchange movements during the period/year | **189** | (923) | (1,824) |
| Effect of fair value movements and amortisation adjustments during the period/year | **(107)** | 38 | 44 |
| **Balance at end of the period/year** | **15,803** | 14,748 | 14,727 |

## Note 10 Related entities

Controlled entities of the Bank as at 30 September 2016 are set out in Note 25 to the financial statements included in the Disclosure Statement for the year ended 30 September 2016.

On 17 February 2017, the Bank declared and paid a dividend of $330 million to its immediate parent company, Westpac New Zealand Group Limited.

## Note 11 Fair value of financial instruments

**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 originator 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 together with its controlled entities ('**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 incorporate credit risk and funding costs and benefits that arise in relation to uncollateralised derivative positions, respectively.

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

**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 |
|---|---|---|---|
| Non-asset backed debt instruments | Trading securities and other financial assets designated at fair value<br>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 inputs. Valuation techniques include:

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

## Note 11 Fair value of financial instruments (continued)

| Instrument | Balance sheet category | Includes: | Valuation |
|---|---|---|---|
| Interest rate products | Derivative financial instruments<br>Due from related entities<br>Due to related entities | Interest rate swaps | 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. |
| Foreign exchange products | Derivative financial instruments<br>Due from related entities<br>Due to related entities | FX swaps, FX forward contracts and FX options | Derived from market observable inputs or consensus pricing providers using industry standard models. |
| Non-asset backed debt instruments | Trading securities and other financial assets designated at fair value<br>Available-for-sale securities<br>Other financial liabilities at fair value through income statement | Local authority and NZ public securities, other bank issued certificates of deposit, commercial paper, other government securities and corporate bonds<br>Security repurchase agreements and reverse repurchase agreements over non-asset backed debt securities with related and third parties | Valued using observable market prices which are sourced from consensus pricing services, broker quotes or inter-dealer prices. |
| Certificates of deposit | Deposits and other borrowings | Certificates of deposit | Discounted cash flow using market rates offered for deposits of similar remaining maturities. |
| Debt issues at fair value | Debt issues | Debt issues | 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.

There are no financial instruments included in the Level 3 category (31 March 2016: nil, 30 September 2016: nil).

All financial assets and financial liabilities measured at fair value are included in Level 2 of the fair value hierarchy except for certain available-for-sale securities and trading securities and other financial assets designated at fair value. The following table summarises the attribution of available-for-sale securities and trading securities and other financial assets designated at fair value to the fair value hierarchy based on the measurement basis after initial recognition:

| | The Banking Group | | |
|---|---|---|---|
| **$ millions** | **31-Mar-17 Unaudited** | 31-Mar-16 Unaudited | 30-Sep-16 Audited |
| **Trading securities and other financial assets designated at fair value** | | | |
| Level 1 | **593** | - | 478 |
| Level 2 | **1,115** | 1,788 | 1,650 |
| **Total trading securities and other financial assets designated at fair value** | **1,708** | 1,788 | 2,128 |
| **Available-for-sale securities** | | | |
| Level 1 | **1,573** | 1,623 | 1,608 |
| Level 2 | **2,245** | 2,090 | 2,182 |
| **Total available-for-sale securities** | **3,818** | 3,713 | 3,790 |
| **Total** | **5,526** | 5,501 | 5,918 |

**Analysis of movements between fair value hierarchy levels**

During the period, there were no material transfers between levels of the fair value hierarchy (31 March 2016: no material transfers between levels, 30 September 2016: no material transfers between levels).

## Note 11 Fair value of financial instruments (continued)

### Financial instruments not measured at fair value

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

| | The Banking Group | | | | | |
|---|---|---|---|---|---|---|
| | 31-Mar-17 (Unaudited) | | 31-Mar-16 (Unaudited) | | 30-Sep-16 (Audited) | |
| $ millions | Total Carrying Amount | Estimated Fair Value | Total Carrying Amount | Estimated Fair Value | Total Carrying Amount | Estimated Fair Value |
| **Financial assets** | | | | | | |
| Loans | **76,542** | **76,558** | 71,723 | 71,909 | 75,172 | 75,417 |
| **Total** | **76,542** | **76,558** | 71,723 | 71,909 | 75,172 | 75,417 |
| **Financial liabilities** | | | | | | |
| Deposits and other borrowings | **56,812** | **56,850** | 54,920 | 54,997 | 57,541 | 57,597 |
| Debt issues | **13,405** | **13,554** | 13,118 | 13,203 | 12,317 | 12,473 |
| Due to related entities | **2,149** | **2,167** | 2,123 | 2,137 | 2,191 | 2,210 |
| Subordinated notes | **1,138** | **1,187** | 1,152 | 1,141 | 1,091 | 1,111 |
| **Total** | **73,504** | **73,758** | 71,313 | 71,478 | 73,140 | 73,391 |

For cash and balances with central banks, due from and due to other financial institutions and non-derivative balances due from related entities which are carried at amortised cost and other types of short-term financial instruments recognised in the balance sheet under other assets and other liabilities, the carrying amount is equivalent to fair value. These items are either short-term in nature or reprice frequently, and are of a high credit rating.

A detailed description of how fair value is derived for financial instruments not measured at fair value is set out in Note 27 to the financial statements included in the Disclosure Statement for the year ended 30 September 2016.

## Note 12 Contingent liabilities, contingent assets and credit commitments

| | The Banking Group | | |
|---|---|---|---|
| $ millions | 31-Mar-17 Unaudited | 31-Mar-16 Unaudited | 30-Sep-16 Audited |
| **Commitments for capital expenditure** | **12** | 1 | 3 |
| **Lease commitments**[1] | | | |
| One year or less | **59** | 53 | 57 |
| Between one and five years | **138** | 136 | 141 |
| Over five years | **21** | 21 | 16 |
| **Total lease commitments** | **218** | 210 | 214 |
| **Undrawn credit commitments** | | | |
| Letters of credit and guarantees | **764** | 833 | 818 |
| Commitments to extend credit | **24,215** | 25,007 | 23,932 |
| Other commitments | **25** | - | - |
| **Total Undrawn credit commitments** | **25,004** | 25,840 | 24,750 |

1 The Banking Group mainly leases commercial and retail premises and related property and equipment.

In March 2013, litigation funder, Litigation Lending Services (NZ) Limited, announced potential representative actions against five New Zealand banks in relation to certain fees. The Bank is the defendant in proceedings filed on 20 August 2014 by the plaintiff group. At this stage the impact of the proceedings cannot be determined with any certainty.

As disclosed on page 2, on 10 February 2017 the Reserve Bank issued a notice under section 95 of the Reserve Bank Act, requiring the Bank to obtain an independent review of its compliance with advanced internal rating-based aspects of BS2B. The review has commenced and the Bank considers its internal credit model methodologies result in the retention of an appropriate amount of capital at 31 March 2017. Any further consequences arising from the section 95 review will be appropriately disclosed in subsequent Disclosure Statements.

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

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.

## Note 13 Segment information

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 information 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 six months ended 31 March 2016 and the year ended 30 September 2016 has been restated following customer segmentation changes, as well as changes to the net interest income in the operating segments, as a result of the Ultimate Parent Bank updating its capital allocation framework. Comparative information has been restated to ensure consistent presentation with the current reporting period.

## Note 13 Segment information (continued)

The revised presentation has no impact on total profit before income tax expense for the six months ended 31 March 2016 and the year ended 30 September 2016.

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.

Reconciling items primarily represent:

- business units that do not meet the definition of operating segments under New Zealand equivalents to International Financial Reporting Standards 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.

| | The Banking Group | | | | |
|---|---|---|---|---|---|
| $ millions | Consumer Banking and Wealth | Commercial, Corporate and Institutional | Investments and Insurance | Reconciling Items | Total |
| **Six months ended 31 March 2017 (Unaudited)** | | | | | |
| Net interest income | **519** | **336** | **1** | **(21)** | **835** |
| Non-interest income | **97** | **78** | **61** | **(48)** | **188** |
| **Net operating income** | **616** | **414** | **62** | **(69)** | **1,023** |
| Net operating income from external customers | **852** | **564** | **64** | **(457)** | **1,023** |
| Net internal interest expense | **(236)** | **(150)** | **(2)** | **388** | **-** |
| **Net operating income** | **616** | **414** | **62** | **(69)** | **1,023** |
| Operating expenses | **(343)** | **(111)** | **(14)** | **3** | **(465)** |
| Impairment (charges)/recoveries on loans | **(20)** | **56** | **-** | **-** | **36** |
| **Profit before income tax expense** | **253** | **359** | **48** | **(66)** | **594** |
| **Total gross loans** | **43,824** | **33,067** | **-** | **49** | **76,940** |
| **Total deposits and other borrowings** | **33,670** | **23,142** | **-** | **1,617** | **58,429** |
| **Six months ended 31 March 2016 (Unaudited)** | | | | | |
| Net interest income/(expense) | 507 | 343 | (2) | 18 | 866 |
| Non-interest income | 95 | 69 | 66 | (32) | 198 |
| **Net operating income** | 602 | 412 | 64 | (14) | 1,064 |
| Net operating income from external customers | 840 | 597 | 67 | (440) | 1,064 |
| Net internal interest expense | (238) | (185) | (3) | 426 | - |
| **Net operating income** | 602 | 412 | 64 | (14) | 1,064 |
| Operating expenses | (337) | (107) | (12) | 9 | (447) |
| Impairment (charges)/recoveries on loans | (22) | 14 | - | (1) | (9) |
| **Profit before income tax expense** | 243 | 319 | 52 | (6) | 608 |
| **Total gross loans** | 41,043 | 30,990 | - | 99 | 72,132 |
| **Total deposits and other borrowings** | 32,242 | 22,678 | - | 1,045 | 55,965 |
| **Year ended 30 September 2016 (Unaudited)** | | | | | |
| Net interest income/(expense) | 1,032 | 700 | (4) | 16 | 1,744 |
| Non-interest income | 195 | 142 | 128 | (65) | 400 |
| **Net operating income** | 1,227 | 842 | 124 | (49) | 2,144 |
| Net operating income from external customers | 1,718 | 1,186 | 129 | (889) | 2,144 |
| Net internal interest expense | (491) | (344) | (5) | 840 | - |
| **Net operating income** | 1,227 | 842 | 124 | (49) | 2,144 |
| Operating expenses | (672) | (219) | (26) | 10 | (907) |
| Impairment charges on loans | (32) | (15) | - | (12) | (59) |
| **Profit before income tax expense** | 523 | 608 | 98 | (51) | 1,178 |
| **Total gross loans** | 42,695 | 32,851 | - | 61 | 75,607 |
| **Total deposits and other borrowings** | 32,830 | 24,711 | - | 1,250 | 58,791 |

## Note 14 Insurance business

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

## Note 15 Capital adequacy

The information contained in this note has been derived in accordance with the Bank's conditions of registration which relate to capital adequacy and the document 'Capital Adequacy Framework (Internal Models Based Approach) (BS2B)' ('**BS2B**') issued by the Reserve Bank of New Zealand ('**Reserve Bank**'), except for the matters of non-compliance with condition of registration 1B disclosed on page 2. 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's capital summary (Unaudited)**

| $ millions | The Banking Group 31-Mar-17 |
|---|---|
| **Tier 1 capital** | |
| **Common Equity Tier 1 capital** | |
| Paid-up ordinary shares issued by the Bank plus related share premium | **3,750** |
| Retained earnings (net of appropriations) | **2,992** |
| Accumulated other comprehensive income and other disclosed reserves[1] | **(54)** |
| ***Less deductions from Common Equity Tier 1 capital*** | |
| Goodwill | **(477)** |
| Other intangible assets[2] | **(114)** |
| Cash flow hedge reserve | **61** |
| Deferred tax asset deduction | **(171)** |
| Expected loss excess over eligible allowance | **(222)** |
| **Total Common Equity Tier 1 capital** | **5,765** |
| **Additional Tier 1 capital** | |
| Interests arising from ordinary shares issued by fully consolidated subsidiaries and held by third parties | **-** |
| **Total Tier 1 capital** | **5,765** |
| **Tier 2 capital** | |
| Tier 2 capital instruments[3] | **1,138** |
| Revaluation reserves | **-** |
| Eligible impairment allowance in excess of expected loss | **-** |
| **Total Tier 2 capital** | **1,138** |
| **Total capital** | **6,903** |

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

2 Includes capitalised transaction costs on subordinated notes and debt issues.

3 Excludes capitalised transaction costs.

### Capital structure

***Ordinary shares***

In accordance with 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.

***Tier Two Notes***

On 8 September 2015, the Bank issued 1,040,000 subordinated notes at a face value of A$1,000 each ('**Tier Two Notes**') to the London Branch of the Ultimate Parent Bank ('**London Branch**'). The Tier Two Notes are convertible, redeemable, subordinated and unsecured debt securities of the Bank. The Tier Two Notes rank equally amongst themselves and are subordinated to the claims of depositors and other unsubordinated creditors of the Bank. The Tier Two Notes mature on 22 March 2026. The Tier Two Notes qualify for Tier 2 regulatory capital recognition under BS2B.

*Interest payable*

Interest is payable quarterly in arrears at a rate based on the Australian 90 day bank bill rate plus a margin of 2.87% per annum. Interest payments on the Tier Two Notes are subject to the Bank being solvent at the time of the interest payment and immediately following the interest payment.

*Conversion*

If a non-viability trigger event occurs, the Bank must convert such number of the Tier Two Notes into a variable number of ordinary shares issued by the Bank (calculated by reference to the net assets of the Bank and the total number of ordinary shares) 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 directs the Bank to convert or write-off all or some of the Bank's capital instruments that qualify for Tier 1 or Tier 2 regulatory capital recognition under the BS2B ('**Capital Instruments**') or the Bank is declared subject to statutory management pursuant to section 117 of the Reserve Bank Act and the statutory manager decides the Bank must convert or write-off all or some of the Capital Instruments.

If conversion of the Tier Two Notes fails to take effect within five business days, holders' rights in relation to the Tier Two Notes will be terminated.

## Note 15 Capital adequacy (continued)

*Redemption*

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

***Reserves***

*Available-for-sale securities reserve*

This comprises the changes in the fair value of available-for-sale financial securities, net of tax as well as fair value changes relating to movements in respect of derivatives when fair value hedge accounting is applied. 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.

**Capital ratios (unaudited)**

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

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

| | The Banking Group | |
|---|---|---|
| % | 31-Mar-17 | 31-Mar-16 |
| **Capital adequacy ratios** | | |
| Common Equity Tier 1 capital ratio | **10.7** | 10.8 |
| Tier 1 capital ratio | **10.7** | 10.8 |
| Total capital ratio | **12.8** | 13.1 |
| **Reserve Bank minimum ratios** | | |
| Common Equity Tier 1 capital ratio | **4.5** | 4.5 |
| Tier 1 capital ratio | **6.0** | 6.0 |
| Total capital ratio | **8.0** | 8.0 |
| **Buffer ratios** | | |
| Buffer ratio | **4.7** | 4.8 |
| Buffer requirement | **2.5** | 2.5 |

**Banking Group Pillar 1 total capital requirement (Unaudited)**

| | The Banking Group 31-Mar-17 | | |
|---|---|---|---|
| $ millions | Total Exposure After Credit Risk Mitigation | Risk-weighted Exposure or Implied Risk-weighted Exposure | Total Capital Requirement |
| **Credit risk** | | | |
| Exposures subject to the internal ratings based approach | **97,559** | **40,832** | **3,267** |
| Equity exposures | **-** | **-** | **-** |
| Specialised lending subject to the slotting approach | **7,542** | **6,789** | **543** |
| Exposures subject to the standardised approach | **1,974** | **806** | **65** |
| **Total credit risk** [1] | **107,075** | **48,427** | **3,875** |
| **Operational risk** | **N/A** | **4,613** | **369** |
| **Market risk** | **N/A** | **868** | **69** |
| **Supervisory adjustment** | **N/A** | **-** | **-** |
| **Total** | **107,075** | **53,908** | **4,313** |

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

**Solo capital adequacy (unaudited)**

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

## Note 15 Capital adequacy (continued)

The table below represents the solo capital adequacy calculation based on the Reserve Bank's Basel III framework as contained in BS2B.

| % | The Bank | |
|---|---|---|
| | **31-Mar-17** | 31-Mar-16 |
| **Capital adequacy ratios** | | |
| Common Equity Tier 1 capital ratio | **8.5** | 8.8 |
| Tier 1 capital ratio | **8.5** | 8.8 |
| Total capital ratio | **10.2** | 10.7 |

### Capital for other material risks (unaudited)

The Banking Group's internal capital adequacy assessment process 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 and subsidiary risk.

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

| $ millions | The Banking Group | |
|---|---|---|
| | **31-Mar-17** | 31-Mar-16 |
| **Internal capital allocation** | | |
| Other material risks | **83** | 67 |

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

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

| % | **31-Mar-17** | 31-Mar-16 |
|---|---|---|
| **Ultimate Parent Bank Group (excluding entities specifically excluded by APRA regulations)**[1, 2] | | |
| Common Equity Tier 1 capital ratio | **10.0** | 10.5 |
| Additional Tier 1 capital ratio | **1.7** | 1.6 |
| Tier 1 capital ratio | **11.7** | 12.1 |
| Tier 2 capital ratio | **2.3** | 1.9 |
| Total regulatory capital ratio | **14.0** | 14.0 |
| **Ultimate Parent Bank (Extended Licensed Entity)**[1, 3] | | |
| Common Equity Tier 1 capital ratio | **10.2** | 10.8 |
| Additional Tier 1 capital ratio | **1.8** | 1.8 |
| Tier 1 capital ratio | **12.0** | 12.6 |
| Tier 2 capital ratio | **2.6** | 2.2 |
| Total regulatory capital ratio | **14.6** | 14.8 |

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).

The Ultimate Parent Bank Group is accredited by APRA to apply the Advanced Internal Ratings Based ('**Advanced IRB**') approach for credit risk, the Advanced Measurement Approach ('**AMA**') for operational risk and the internal model approach for interest rate risk in the banking book for calculating regulatory capital (known as 'Advanced Accreditation') and is required by APRA to hold minimum capital at least equal to that specified under the Advanced IRB and AMA methodologies. Under BS2B this methodology is referred to as the Basel III (internal models based approach). With this accreditation the Ultimate Parent Bank Group is required to disclose additional detailed information on its risk management practices and capital adequacy on a quarterly basis. This information is made available to users via the Ultimate Parent Bank's website (www.westpac.com.au). The aim is to allow the market to better assess the Ultimate Parent Bank Group's risk and reward assessment process and hence increase the scrutiny of this process.

The Ultimate Parent Bank Group (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 31 March 2017.

## Note 16 Risk management

### 16.1 Credit risk

**Credit risk mitigation**

The Banking Group uses a variety of techniques to reduce the credit risk arising from its lending activities (refer to Note 36.1 to the financial statements included in the Disclosure Statement for the year ended 30 September 2016 for further details). Enforceable legal documentation establishes the Banking Group's direct, irrevocable and unconditional recourse to any collateral, security or other credit enhancements provided.

The Banking Group includes the effect of credit risk mitigation through eligible guarantees within calculation applied to Loss Given Default ('**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.

***Definitions of PD, LGD and EAD***

**(i) Probability of Default ('PD')**

PD is a through-the-cycle assessment of the likelihood of a customer defaulting on its financial obligations within one year.

**(ii) LGD**

LGD represents an estimate of the expected severity of a loss to the Banking Group should a customer default occur during an economic downturn.

**(iii) Exposure at Default ('EAD')**

EAD represents an estimate of the amount of committed exposure expected to be drawn by the customer at the time of default.

**The Banking Group's credit risk exposures by asset class as at 31 March 2017 (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 | 2,497 | 19.17 | 7.33 | 194 | 16 |
| 0.25 to 1.0 | 0.50 | 25,148 | 21.09 | 17.69 | 4,715 | 377 |
| 1.0 to 2.5 | 1.40 | 21,373 | 20.84 | 35.43 | 8,027 | 642 |
| 2.5 to 10.0 | 4.50 | 4,109 | 22.84 | 77.17 | 3,361 | 269 |
| 10.0 to 99.99 | - | - | - | - | - | - |
| Default | 100.00 | 217 | 22.40 | 216.50 | 498 | 40 |
| **Total** | 1.56 | 53,344 | 21.04 | 29.70 | 16,795 | 1,344 |
| **Other retail (Credit cards, personal loans, personal overdrafts)** | | | | | | |
| 0.00 to 0.10 | - | - | - | - | - | - |
| 0.10 to 0.25 | 0.14 | 544 | 40.69 | 12.83 | 74 | 6 |
| 0.25 to 1.0 | 0.36 | 1,492 | 63.02 | 37.50 | 593 | 47 |
| 1.0 to 2.5 | 2.22 | 1,359 | 67.96 | 89.13 | 1,284 | 104 |
| 2.5 to 10.0 | 5.39 | 366 | 84.55 | 126.30 | 490 | 39 |
| 10.0 to 99.99 | 19.72 | 240 | 69.95 | 144.65 | 368 | 29 |
| Default | 100.00 | 14 | 72.41 | 107.82 | 16 | 1 |
| **Total** | 2.92 | 4,015 | 64.08 | 66.38 | 2,825 | 226 |
| **Small business** | | | | | | |
| 0.00 to 0.10 | 0.03 | 144 | 73.76 | 7.21 | 11 | 1 |
| 0.10 to 0.25 | - | - | - | - | - | - |
| 0.25 to 1.0 | 0.33 | 633 | 21.55 | 17.59 | 118 | 9 |
| 1.0 to 2.5 | 1.84 | 1,444 | 21.04 | 26.72 | 409 | 33 |
| 2.5 to 10.0 | 4.92 | 231 | 20.11 | 29.81 | 73 | 6 |
| 10.0 to 99.99 | 16.98 | 31 | 23.20 | 45.65 | 15 | 1 |
| Default | 100.00 | 38 | 20.61 | 223.44 | 90 | 7 |
| **Total** | 3.31 | 2,521 | 24.12 | 26.79 | 716 | 57 |

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

## Note 16 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 | 2,509 | 37.45 | 13.39 | 356 | 28 |
| 0.04 to 0.10 | 0.08 | 4,495 | 51.92 | 27.41 | 1,306 | 104 |
| 0.10 to 0.50 | 0.21 | 7,431 | 44.75 | 41.11 | 3,238 | 259 |
| 0.50 to 3.0 | 1.58 | 12,580 | 35.32 | 73.54 | 9,807 | 786 |
| 3.0 to 10.0 | 3.70 | 1,007 | 36.27 | 105.96 | 1,131 | 90 |
| 10.0 to 99.0 | 22.06 | 2,073 | 39.90 | 192.27 | 4,225 | 338 |
| Default | 100.00 | 96 | 49.70 | 120.87 | 123 | 10 |
| **Total** | 2.68 | 30,191 | 40.68 | 63.08 | 20,186 | 1,615 |
| **Sovereign** | | | | | | |
| 0.00 to 0.02 | 0.01 | 1,302 | 60.00 | 3.19 | 44 | 4 |
| 0.02 to 0.04 | 0.02 | 4,270 | 14.84 | 1.68 | 76 | 6 |
| 0.04 to 0.10 | 0.05 | 4 | 25.00 | - | - | - |
| 0.10 to 0.50 | - | - | - | - | - | - |
| 0.50 to 3.0 | 1.99 | 1 | 27.86 | 94.34 | 1 | - |
| 3.0 to 10.0 | - | - | - | - | - | - |
| 10.0 to 99.0 | - | - | - | - | - | - |
| Default | - | - | - | - | - | - |
| **Total** | 0.02 | 5,577 | 25.39 | 2.05 | 121 | 10 |
| **Bank** | | | | | | |
| 0.00 to 0.02 | - | - | - | - | - | - |
| 0.02 to 0.04 | 0.03 | 1,489 | 23.14 | 8.11 | 128 | 10 |
| 0.04 to 0.10 | 0.06 | 386 | 26.85 | 11.00 | 45 | 4 |
| 0.10 to 0.50 | 0.13 | 31 | 60.00 | 30.43 | 10 | 1 |
| 0.50 to 3.0 | 2.71 | 4 | 35.00 | 117.92 | 5 | - |
| 3.0 to 10.0 | 3.70 | 1 | 45.00 | 94.34 | 1 | - |
| 10.0 to 99.0 | - | - | - | - | - | - |
| Default | - | - | - | - | - | - |
| **Total** | 0.05 | 1,911 | 24.52 | 9.33 | 189 | 15 |
| **Total credit risk exposures subject to the internal ratings based approach** | | 97,559 | | | 40,832 | 3,267 |

[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 | 9,565 | 7,265 | - | - |
| Other retail (Credit cards, personal loans, personal overdrafts) | 3,251 | 1,907 | - | - |
| Small business | 814 | 727 | - | - |
| Corporate/Business lending | 9,340 | 9,459 | - | - |
| Sovereign | 98 | 91 | - | - |
| Bank | 627 | 648 | - | - |
| **Total** | 23,695 | 20,097 | - | - |

## Note 16 Risk management (continued)

### The Banking Group's equity exposures as at 31 March 2017 (Unaudited)

| 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 31 March 2017 (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 | 2,695 | 70.00 | 1,999 | 160 |
| Good | 3,764 | 90.00 | 3,592 | 287 |
| Satisfactory | 870 | 115.00 | 1,060 | 85 |
| Weak | 52 | 250.00 | 138 | 11 |
| Default | 161 | - | - | - |
| **Total** | 7,542 | 84.92 | 6,789 | 543 |

[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 | 1,318 | 82.89 | 1,158 | 93 |

[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 31 March 2017 (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] | 1,357 | 38.05 | 547 | 44 |
| **Total on-balance sheet exposures** | 1,357 | | 547 | 44 |

[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.

### 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 | 15,384 | N/A | 544 | 20.00 | 115 | 9 |
| Interest rate contracts | 37,320 | N/A | 73 | 20.00 | 16 | 1 |
| Credit value adjustment | - | N/A | - | - | 128 | 11 |
| **Total market related contracts subject to the standardised approach** | 52,704 | | 617 | | 259 | 21 |
| **Standardised subtotal (on and off-balance sheet)** | | | 1,974 | | 806 | 65 |

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

## Note 16 Risk management (continued)

### The Banking Group's residential mortgages by loan-to-value ratio ('LVR') as at 31 March 2017 (Unaudited)

The Banking Group identified during the preparation of the Disclosure Statement for the three months ended 31 December 2016 that the LVRs had not been calculated in compliance with the Order. The Banking Group had been calculating the ratios by reference to the value of loans at origination rather than the current values as required by the Order. The information below as at 31 March 2017 has been calculated in compliance with the Order and the Banking Group has re-stated the ratios as at 30 September 2016 and 31 December 2016.

For loans originated from 1 January 2008, the Banking Group utilises data from its loan origination 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 calculate an origination valuation.

For loans approved but not yet drawn prior to 28 February 2017, exposures were not separately recorded and are therefore not available for disclosure. As at 31 March 2017, loans approved but not yet drawn utilise the proposed loan limit to calculate LVR and are included in the relevant LVR range.

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

| | The Banking Group 31-Mar-17 | | | | | |
|---|---|---|---|---|---|---|
| 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 | **17,812** | **11,173** | **12,662** | **2,707** | **1,667** | **46,021** |
| Undrawn commitments and other off-balance sheet exposures | **4,638** | **1,249** | **1,058** | **139** | **181** | **7,265** |
| **Value of exposures** | **22,450** | **12,422** | **13,720** | **2,846** | **1,848** | **53,286** |

| | The Banking Group 30-Sep-16 (Restated) | | | | | |
|---|---|---|---|---|---|---|
| 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 | 16,321 | 10,855 | 13,177 | 2,675 | 1,808 | 44,836 |
| Undrawn commitments and other off-balance sheet exposures | 4,260 | 1,146 | 925 | 120 | 191 | 6,642 |
| **Value of exposures** | 20,581 | 12,001 | 14,102 | 2,795 | 1,999 | 51,478 |

| | The Banking Group 31-Dec-16 (Restated) | | | | | |
|---|---|---|---|---|---|---|
| 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 | 17,038 | 10,886 | 12,903 | 2,797 | 1,718 | 45,342 |
| Undrawn commitments and other off-balance sheet exposures | 4,411 | 1,139 | 891 | 117 | 181 | 6,739 |
| **Value of exposures** | 21,449 | 12,025 | 13,794 | 2,914 | 1,899 | 52,081 |

### The Banking Group's reconciliation of residential mortgage-related amounts (Unaudited)

The tables below provide the Banking Group's reconciliation between any amounts disclosed in the Disclosure Statement that relate to mortgages on residential property. The Banking Group has re-stated the reconciliation as at 30 September 2016 as a consequence of the previously mentioned restatement of the Banking Group's residential mortgages LVR range disclosures.

| $ millions | The Banking Group 31-Mar-17 |
|---|---|
| **Term loans - Housing (as disclosed in Note 5) and Residential mortgages - total gross loans (as disclosed in Note 6)** | **46,252** |
| *Reconciling items:* | |
| Unamortised deferred fees and expenses | **(183)** |
| Fair value hedge adjustments | **(48)** |
| Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages | **9,565** |
| Undrawn at default[1] | **(2,300)** |
| **Residential mortgages by LVR** | **53,286** |
| Accrued interest receivable | **58** |
| **Residential mortgages by EAD (as disclosed in Credit risk exposures by asset class)** | **53,344** |

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

## Note 16 Risk management (continued)

| $ millions | The Banking Group 30-Sep-16 Restated |
|---|---|
| **Term loans - Housing (as disclosed in Note 12 of the financial statements included in the Disclosure Statement for the year ended 30 September 2016) and Residential mortgages - total gross loans (as disclosed in Note 13 of the financial statements included in the Disclosure Statement for the year ended 30 September 2016)** | 45,153 |
| *Reconciling items:* | |
| Unamortised deferred fees and expenses | (194) |
| Fair value hedge adjustments | (123) |
| Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages | 8,864 |
| Undrawn at default[1] | (2,222) |
| **Residential mortgages by LVR** | 51,478 |
| Accrued interest receivable | 60 |
| **Residential mortgages by EAD (as disclosed in Credit risk exposures by asset class)** | 51,538 |

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

### 16.2 Operational risk

**The Banking Group's operational risk capital requirement (Unaudited)**

| $ millions | The Banking Group 31-Mar-17 Implied Risk-weighted Exposure | The Banking Group 31-Mar-17 Total Operational Risk Capital Requirement |
|---|---|---|
| **Methodology implemented** | | |
| **Advanced Measurement Approach** | | |
| Operational risk | **4,613** | **369** |

### 16.3 Market risk

**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 31 March 2017 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 31 March 2017:

| $ millions | The Banking Group 31-Mar-17 Implied Risk-weighted Exposure | The Banking Group 31-Mar-17 Aggregate Capital Charge |
|---|---|---|
| **End-of-period** | | |
| Interest rate risk | **868** | **69** |
| Foreign currency risk | **-** | **-** |
| Equity risk | **-** | **-** |
| | **868** | **69** |
| **Peak end-of-day** | | |
| Interest rate risk | **1,093** | **87** |
| Foreign currency risk | **-** | **-** |
| Equity risk | **-** | **-** |

## Note 16 Risk management (continued)

### Interest rate sensitivity (Unaudited)

The following table presents a breakdown of the earlier of the contractual repricing date or maturity date of the Banking Group's net asset position as at 31 March 2017. 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 31-Mar-17 | | | | | | |
|---|---|---|---|---|---|---|---|
| $ 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 | 1,317 | - | - | - | - | 178 | 1,495 |
| Due from other financial institutions | 753 | - | - | - | - | - | 753 |
| Trading securities and other financial assets designated at fair value | 1,457 | 202 | 49 | - | - | - | 1,708 |
| Derivative financial instruments | - | - | - | - | - | 63 | 63 |
| Available-for-sale securities | 23 | 86 | 523 | 1,340 | 1,846 | - | 3,818 |
| Loans | 41,319 | 5,380 | 9,899 | 13,633 | 6,709 | (398) | 76,542 |
| Due from related entities | 1,075 | - | - | - | - | 274 | 1,349 |
| Other assets | - | - | - | - | - | 177 | 177 |
| **Total financial assets** | 45,944 | 5,668 | 10,471 | 14,973 | 8,555 | 294 | 85,905 |
| Non-financial assets | | | | | | | 963 |
| **Total assets** | | | | | | | 86,868 |
| **Financial liabilities** | | | | | | | |
| Due to other financial institutions | 403 | - | - | - | - | 7 | 410 |
| Deposits and other borrowings | 39,504 | 7,185 | 4,821 | 1,307 | 531 | 5,081 | 58,429 |
| Other financial liabilties at fair value through income statement | 10 | - | - | - | - | - | 10 |
| Derivative financial instruments | - | - | - | - | - | 799 | 799 |
| Debt issues | 8,217 | 320 | - | 1,367 | 5,899 | - | 15,803 |
| Other liabilities | - | - | - | - | - | 358 | 358 |
| Due to related entities | 2,734 | - | - | 3 | 2 | 327 | 3,066 |
| Subordinated notes | 1,138 | - | - | - | - | - | 1,138 |
| **Total financial liabilities** | 52,006 | 7,505 | 4,821 | 2,677 | 6,432 | 6,572 | 80,013 |
| Non-financial liabilities | | | | | | | 167 |
| **Total liabilities** | | | | | | | 80,180 |
| **On-balance sheet interest rate repricing gap** | (6,062) | (1,837) | 5,650 | 12,296 | 2,123 | | |
| **Net derivative notional principals** | | | | | | | |
| Net interest rate contracts (notional): | | | | | | | |
| Receivable/(payable) | 18,135 | (2,351) | (5,375) | (10,355) | (54) | | |
| **Net interest rate repricing gap** | 12,073 | (4,188) | 275 | 1,941 | 2,069 | | |

## 16.4 Liquidity risk

### Liquid assets (Unaudited)

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 31-Mar-17 |
|---|---|
| Cash and balances with central banks | 1,495 |
| Supranational securities | 1,382 |
| NZ Government securities | 2,093 |
| NZ public securities | 1,469 |
| NZ corporate securities | 340 |
| Residential mortgage-backed securities | 3,950 |
| **Total liquid assets** | 10,729 |

## Note 16 Risk management (continued)

### Contractual maturity of financial instruments (unaudited)

The following table presents cash flows associated with financial instruments receivable or 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 instruments 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. Derivatives designed for hedging purposes are expected to be held for their remaining contractual lives, and reflect gross cash flows derived as the fixed rate and/or the expected variable rate applied to the notional amount over the remaining contractual term and where relevant includes the receipt and payment of the notional amount under the contract. Foreign exchange obligations have been translated to New Zealand dollars using the closing spot rates at the end of the period.

The balances in the table below will not necessarily agree to amounts presented on the face of the balance sheet as amounts in the table incorporate cash flows on an undiscounted basis and include both principal and associated future interest payments.

Derivatives held for trading and other financial instruments at fair value through income statement are not managed for liquidity purposes on the basis of their contractual maturity, and accordingly these instruments are presented in both the on demand and up to 1 month columns.

The financial instruments that are managed based on their contractual maturity are presented on a contractual undiscounted basis in the table below:

| | The Banking Group 31-Mar-17 | | | | | | |
|---|---|---|---|---|---|---|---|
| $ 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 assets** | | | | | | | |
| Cash and balances with central banks | 1,495 | - | - | - | - | - | 1,495 |
| Due from other financial institutions | - | 753 | - | - | - | - | 753 |
| Trading securities and other financial assets designated at fair value | - | 494 | 503 | 289 | 462 | - | 1,748 |
| Derivative financial instruments: | | | | | | | |
| Held for hedging purposes (net settled) | - | 3 | - | 6 | 14 | - | 23 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | (2) | (7) | (335) | - | (344) |
| Cash inflow | - | - | - | 2 | 342 | - | 344 |
| Available-for-sale securities | - | 29 | 28 | 714 | 3,235 | 63 | 4,069 |
| Loans | 5,191 | 8,467 | 4,972 | 7,370 | 25,722 | 59,009 | 110,731 |
| Due from related entities: | | | | | | | |
| Non-derivative balances | 727 | 371 | - | - | - | - | 1,098 |
| Derivative financial instruments: | | | | | | | |
| Held for trading | 80 | - | - | - | - | - | 80 |
| Held for hedging purposes (net settled) | - | 9 | 1 | 24 | 36 | - | 70 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | (25) | (77) | (3,591) | - | (3,693) |
| Cash inflow | - | - | 16 | 55 | 3,669 | - | 3,740 |
| Other assets | - | 50 | - | - | - | - | 50 |
| **Total undiscounted financial assets** | 7,493 | 10,176 | 5,493 | 8,376 | 29,554 | 59,072 | 120,164 |
| **Financial liabilities** | | | | | | | |
| Due to other financial institutions | 7 | 403 | - | - | - | - | 410 |
| Deposits and other borrowings | 28,990 | 5,169 | 10,656 | 12,325 | 1,951 | - | 59,091 |
| Other financial liabilities at fair value through income statement | - | 10 | - | - | - | - | 10 |
| Derivative financial instruments: | | | | | | | |
| Held for hedging purposes (net settled) | - | 3 | 11 | 70 | 74 | 2 | 160 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | 12 | 710 | 1,050 | 4,543 | 1,133 | 7,448 |
| Cash inflow | - | (2) | (549) | (832) | (3,746) | (894) | (6,023) |
| Debt issues | - | 27 | 1,360 | 3,577 | 10,589 | 924 | 16,477 |
| Other liabilities | - | 82 | - | - | - | - | 82 |
| Due to related entities: | | | | | | | |
| Non-derivative balances | 790 | 603 | 247 | 225 | 948 | - | 2,813 |
| Derivative financial instruments: | | | | | | | |
| Held for hedging purposes (net settled) | - | 32 | 53 | 123 | 67 | - | 275 |
| Held for hedging purposes (gross settled): | | | | | | | |
| Cash outflow | - | - | 17 | 53 | 1,673 | 32 | 1,775 |
| Cash inflow | - | - | (15) | (46) | (1,590) | (30) | (1,681) |
| Subordinated notes | - | - | 13 | 40 | 1,317 | - | 1,370 |
| **Total undiscounted financial liabilities** | 29,787 | 6,339 | 12,503 | 16,585 | 15,826 | 1,167 | 82,207 |
| **Total contingent liabilities and commitments** | | | | | | | |
| Letters of credit and guarantees | 764 | - | - | - | - | - | 764 |
| Commitments to extend credit | 24,215 | - | - | - | - | - | 24,215 |
| Other commitments | 25 | - | - | - | - | - | 25 |
| **Total undiscounted contingent liabilities and commitments** | 25,004 | - | - | - | - | - | 25,004 |

## Note 17 Concentration of funding

| $ millions | The Banking Group 31-Mar-17 Unaudited |
|---|---|
| **Funding consists of** | |
| Due to other financial institutions | **410** |
| Deposits and other borrowings | **58,429** |
| Other financial liabilities at fair value through income statement | **10** |
| Debt issues[1] | **15,803** |
| Due to related entities[2] | **2,739** |
| Subordinated notes | **1,138** |
| **Total funding** | **78,529** |
| **Analysis of funding by geographical areas**[1] | |
| New Zealand | **61,113** |
| Australia | **1,006** |
| United Kingdom | **7,091** |
| United States of America | **2,691** |
| Other | **6,628** |
| **Total funding** | **78,529** |
| **Analysis of funding by industry sector** | |
| Accommodation, cafes and restaurants | **323** |
| Agriculture | **1,296** |
| Construction | **1,737** |
| Finance and insurance | **27,363** |
| Forestry and fishing | **434** |
| Government, administration and defence | **3,531** |
| Manufacturing | **1,439** |
| Mining | **69** |
| Property services and business services | **5,400** |
| Services | **3,468** |
| Trade | **1,458** |
| Transport and storage | **734** |
| Utilities | **637** |
| Households | **23,818** |
| Other | **4,083** |
| **Subtotal** | **75,790** |
| Due to related entities[2] | **2,739** |
| **Total funding** | **78,529** |

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 programme does not necessarily represent an appropriate proxy, the debt issues are classified as 'Other'. These instruments may have subsequently been on-sold.

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

Australian and New Zealand Standard Industrial Classification ('**ANZSIC**') has been used as the basis for disclosing industry sectors.

## Note 18 Concentration of credit exposures

| $ millions | The Banking Group 31-Mar-17 Unaudited |
|---|---|
| **On-balance sheet credit exposures consists of** | |
| Cash and balances with central banks | **1,495** |
| Due from other financial institutions | **753** |
| Trading securities and other financial assets designated at fair value | **1,708** |
| Derivative financial instruments | **63** |
| Available-for-sale securities | **3,818** |
| Loans | **76,542** |
| Due from related entities | **1,349** |
| Other assets | **177** |
| **Total on-balance sheet credit exposures** | **85,905** |
| **Analysis of on-balance sheet credit exposures by industry sector** | |
| Accommodation, cafes and restaurants | **395** |
| Agriculture | **7,784** |
| Construction | **622** |
| Finance and insurance | **5,621** |
| Forestry and fishing | **361** |
| Government, administration and defence | **5,325** |
| Manufacturing | **2,097** |
| Mining | **217** |
| Property | **6,284** |
| Property services and business services | **1,180** |
| Services | **1,559** |
| Trade | **2,064** |
| Transport and storage | **1,288** |
| Utilities | **1,939** |
| Retail lending | **48,168** |
| **Subtotal** | **84,904** |
| Provisions for impairment charges on loans | **(398)** |
| Due from related entities | **1,349** |
| Other assets | **50** |
| **Total on-balance sheet credit exposures** | **85,905** |
| **Off-balance sheet credit exposures consists of** | |
| Credit risk-related instruments | **25,004** |
| **Total off-balance sheet credit exposures** | **25,004** |
| **Analysis of off-balance sheet credit exposures by industry sector** | |
| Accommodation, cafes and restaurants | **89** |
| Agriculture | **550** |
| Construction | **385** |
| Finance and insurance | **1,863** |
| Forestry and fishing | **154** |
| Government, administration and defence | **592** |
| Manufacturing | **1,477** |
| Mining | **162** |
| Property | **1,526** |
| Property services and business services | **485** |
| Services | **659** |
| Trade | **1,816** |
| Transport and storage | **959** |
| Utilities | **1,446** |
| Retail lending | **12,841** |
| **Total off-balance sheet credit exposures** | **25,004** |

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

The categorisation between industry sectors has changed from those previously reported to align disclosure with the classifications in the new Reserve Bank requirements.

## Note 18 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 counterparties (which are not members of a group of closely related counterparties), and groups of closely related counterparties of which a bank is the parent, to which the Banking Group has an aggregate credit exposure or peak end-of-day aggregate credit exposure that equals or exceeds 10% of the Banking Group's equity:

- as at 31 March 2017 was nil; and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 31 March 2017 was nil.

The number of individual non-bank counterparties (which are not members of a group of closely related counterparties), and groups of closely related counterparties of which a bank is not the parent, to which the Banking Group has an aggregate credit exposure or peak end-of-day aggregate credit exposure that equals or exceeds 10% of the Banking Group's equity:

| % of Banking Group's equity | The Banking Group<br>31-Mar-17<br>Long-term credit rating<br>A- or A3<br>and above |
|---|---|
| **As at 31 March 2017[1]** | |
| 10-14 | **1** |
| 15-19 | **-** |
| 20 and above | **1** |
| **Peak end-of-day aggregate credit exposure for the three months ended 31 March 2017[1]** | |
| 10-14 | **1** |
| 15-19 | **-** |
| 20 and above | **1** |

[1] There were no individual non-bank counterparties with aggregate credit exposure that equals or exceeds 10% of the Banking Group's equity and with a long-term credit rating of at least BBB- or Baa3, or its equivalent, and at most BBB+ or Baa1, or its equivalent.

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 three month period and then dividing that amount by the Banking Group's equity as at the end of the period.

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

# *Independent Auditor's Review Report*

To the shareholder of Westpac New Zealand Limited

## *Report on the financial statements*

We have reviewed pages 4 to 29 of the half year Disclosure Statement of Westpac New Zealand Limited (the "Bank") and the entities it controlled at 31 March 2017 or from time to time during the period (the "Banking Group"), which consists of the financial statements required by Clause 25 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (the "Order") and the supplementary information required by Schedules 5, 7, 11, 13, 16 and 18 of the Order. The financial statements comprise the balance sheet as at 31 March 2017, the income statement, statement of comprehensive income, statement of changes in equity and statement of cash flows for the six months then ended, and the notes to the financial statements that include a statement of accounting policies and other explanatory information for the Banking Group.

## *Directors' responsibility for the financial statements*

The Directors of Westpac New Zealand Limited (the "Directors") are responsible on behalf of the Bank for the preparation and presentation of the half year Disclosure Statement, which includes financial statements prepared in accordance with Clause 25 of the Order and that present fairly the financial position of the Banking Group as at 31 March 2017, and its financial performance and cash flows for the period ended on that date. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the Directors are responsible for the preparation and fair presentation of supplementary information in the half year Disclosure Statement which complies with Schedules 3, 5, 7, 11, 13, 16 and 18 of the Order.

## *Our responsibility*

Our responsibility is to express a conclusion on the financial statements and the supplementary information, disclosed in accordance with Clause 25 and Schedules 5, 7, 11, 13, 16 and 18 of the Order, presented by the Directors, based on our review.

Our responsibility is to express a conclusion on the financial statements (excluding the supplementary information) whether, in our opinion on the basis of the procedures performed by us, anything has come to our attention that would cause us to believe that the financial statements have not been prepared, in all material respects, in accordance with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting* and *International Accounting Standard 34: Interim Financial Reporting*.

Our responsibility is to express a conclusion on the supplementary information (excluding the supplementary information relating to capital adequacy) whether, in our opinion on the basis of the procedures performed by us, anything has come to our attention that would cause us to believe that the supplementary information does not fairly state the matters to which it relates in accordance with Schedules 5, 7, 13, 16 and 18 of the Order.

## Independent auditor’s review report (continued)

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Our responsibility is to express a conclusion on the supplementary information relating to capital adequacy whether, in our opinion on the basis of the procedures performed by us, anything has come to our attention that would cause us to believe that the supplementary information is not in all material respects:

(a) prepared in accordance with the Bank’s Conditions of Registration;

(b) prepared in accordance with the Bank’s internal models for credit risk and operational risk as accredited by the Reserve Bank of New Zealand; and

(c) disclosed in accordance with Schedule 11 of the Order.

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”). As the auditor of the Bank, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

A review 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 International Standards on Auditing (New Zealand) and International Standards on Auditing. Accordingly we do not express an audit opinion on the financial statements.

We are independent of the Banking Group. Our firm carries out other services for the Banking Group in the areas of other assurance services and agreed procedures. In addition, certain partners and employees of our firm may deal with the Banking Group and Westpac Banking Corporation Group on normal terms within the ordinary course of trading activities of the Banking Group and Westpac Banking Corporation Group. These matters have not impaired our independence as auditor of the Banking Group.

### *Conclusion*

Based on our review, nothing has come to our attention that causes us to believe that:

(a) the financial statements on pages 4 to 29 (excluding the supplementary information) have not been prepared, in all material respects, in accordance with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting* and International Accounting Standard 34: *Interim Financial Reporting*;

(b) the supplementary information prescribed by Schedules 5, 7, 13, 16 and 18 of the Order, does not fairly state the matters to which it relates in accordance with those Schedules; and

(c) the supplementary information relating to capital adequacy prescribed by Schedule 11 of the Order, is not, in all material respects:

(i) prepared in accordance with the Bank’s Conditions of Registration;

(ii) prepared in accordance with the Bank’s internal models for credit risk and operational risk as accredited by the Reserve Bank of New Zealand; and

(iii) disclosed in accordance with Schedule 11 of the Order.

### *Emphasis of matter*

Without modifying our conclusion, we draw attention to the other information on page 2 of the Disclosure Statement and to Note 15 to 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 has been operating versions of certain internal models for credit risk that have not been accredited by the Reserve Bank of New Zealand. However, as disclosed in the other information on page 2 of the Disclosure Statement and in Note 15 to the financial statements, 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 condition of registration 1B on the information relating to capital adequacy disclosed in the financial statements is not considered to be material.

### *Who we report to*

This report is made solely to the Bank's shareholder. Our review work has been undertaken so that we might state to the Bank's shareholder those matters which we are required to state to them in a review 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 review procedures, for this report or for the conclusions we have formed.

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants — Auckland

23 May 2017