Westpac Banking Corporation - New Zealand Banking Group
Disclosure Statement

For the year ended 30 September 2016

Index

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 (Overseas Incorporated Registered Banks) Order 2014 ('**Order**').

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

- Westpac Banking Corporation (otherwise referred to as the '**Overseas Bank**') – refers to the worldwide business of Westpac Banking Corporation excluding its controlled entities;
- Westpac Banking Corporation Group (otherwise referred to as the '**Overseas Banking Group**') – refers to the total worldwide business of Westpac Banking Corporation including its controlled entities;
- Westpac Banking Corporation New Zealand Branch (otherwise referred to as the '**NZ Branch**') – refers to the New Zealand Branch of Westpac Banking Corporation (trading as Westpac);
- Westpac New Zealand Limited (otherwise referred to as '**Westpac New Zealand**') – refers to a locally incorporated subsidiary of the Overseas Bank (carrying on the Overseas Bank's New Zealand consumer, business and institutional banking operations); and
- Westpac Banking Corporation - New Zealand Banking Group (otherwise referred to as the '**NZ Banking Group**') – refers to the New Zealand operations of Westpac Banking Corporation Group including those entities whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business. Controlled entities of the NZ Banking Group as at 30 September 2016 are set out in Note 25 Related entities.

Words and phrases not defined in this Disclosure Statement, but defined by the Order, have the meaning given by the Order when used in this Disclosure Statement. 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 the Overseas Bank that its Extended Licensed Entity ('**ELE**') non-equity exposures to New Zealand banking subsidiaries is to transition to be below a limit of five percent of the Overseas Bank's Level 1 Tier 1 capital.

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

APRA has allowed a period of five years commencing on 1 January 2016 to transition to be less than the 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 Overseas 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.

While the limit and associated conditions do not apply to the ELE's non-equity exposures to the NZ Branch (which is within the ELE), the limit and associated conditions do apply to the NZ Branch's non-equity exposures to the rest of the NZ Banking Group other than Westpac New Zealand Group Limited. As at 30 September 2016, the ELE's non-equity exposures to New Zealand banking subsidiaries affected by the limit was approximately 6.4% of Level 1 Tier 1 capital of the Overseas Bank. Non-equity exposure would need to reduce by approximately $0.6 billion from the 30 September 2016 position to comply with the 5% limit. The Overseas Bank expects to achieve compliance with the 5% limit within the transition period.

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

General matters

Registered Bank

The Overseas Bank is entered on the register maintained under the Reserve Bank Act. The NZ Branch's head office is situated at Westpac on Takutai Square, 16 Takutai Square, Auckland 1010, New Zealand and the address for service of process on the NZ Branch is Westpac on Takutai Square, 53 Galway Street, Auckland, New Zealand.

Overseas Bank

The Overseas Bank was founded in 1817 and was incorporated in 1850 pursuant to the Bank of New South Wales Act 1850. In 1982 the Overseas Bank acquired The Commercial Bank of Australia Limited and the Overseas Bank changed its name to Westpac Banking Corporation. On 23 August 2002, the Overseas Bank registered as a public company limited by shares under the Australian Corporations Act 2001 and as of that date the Bank of New South Wales Act 1850 ceased to apply.

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

Until 1 November 2006, the Overseas Bank operated as a branch in New Zealand. Effective 1 November 2006, the Overseas Bank has operated in New Zealand through both the NZ Branch (a branch of the Overseas Bank carrying on financial markets operations and institutional banking activities until 1 November 2011) and Westpac New Zealand. Westpac New Zealand is a member of the NZ Banking Group.

On 1 November 2011, the NZ Branch transferred additional business activities and associated employees to Westpac New Zealand (For further details refer to Note 2 to the financial statements included in the Disclosure Statement for the year ended 30 September 2013).

As a registered bank, Westpac New Zealand is required to produce its own disclosure statement. Accordingly, further information on Westpac New Zealand is available in Westpac New Zealand's Disclosure Statement for the year ended 30 September 2016.

General matters (continued)

Registered bank: Directorate

Directors

The Directors of the Overseas Bank ('**Board**') at the time this Disclosure Statement was signed were:

Name: Lindsay Philip Maxsted, DipBus (Gordon), FCA, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Chairman of Transurban Holdings Limited, Transurban Infrastructure Management Limited and Transurban International Limited. Managing Director of Align Capital Pty Ltd. Director of BHP Billiton Limited, BHP Billiton plc, Align Investments Pty Ltd, Baker IDI Heart and Diabetes Institute Holdings Limited, Belmont Pty Ltd, Centip Pty Ltd, Continuum Investments Pty Ltd, Jacobite Investments Pty Ltd and 139 Pty Ltd. Member of the Coolmore Australia Advisory Board.
Name: Brian Charles Hartzer, BA, CFA **Non-executive:** No **Country of Residence:** Australia **Primary Occupation:** Managing Director & Chief Executive Officer, Westpac Banking Corporation **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** No	**External Directorships:** Director of Australian Bankers' Association Incorporated and The Financial Markets Foundation for Children.
Name: Elizabeth Blomfield Bryan AM, BA (Econ.), MA (Econ.) **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of Insurance Australia Group Limited and Virgin Australia Holdings Limited. Director of Virgin Australia International Airlines Pty Ltd, Virgin Australia Airlines (SE Asia) Pty Ltd, Virgin Australia Airlines (NZ) Limited, Virgin Australia International Holdings Pty Ltd, Tiger International Number1 Pty Ltd, CGU Insurance Limited, CGU-VACC Insurance Limited, HBF Insurance Pty Ltd, IAG Finance (New Zealand) Limited, IAG RE Australia Limited, Insurance Australia Limited, Insurance Manufacturers of Australia Pty Limited, Mutual Community General Insurance Proprietary Limited, Swann Insurance (Aust) Pty Ltd, WFI Insurance Limited and the E. Bryan Superannuation Fund Pty Ltd. Member of the Takeovers Panel and the Australian Securities and Investments Commission's Director Advisory Panel. President of YWCA NSW.
Name: Ewen Graham Wolseley Crouch AM, BEc (Hons.), LLB, FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Sydney Symphony Orchestra Holdings Pty Limited, Sydney Symphony Limited, BlueScope Steel Limited, Wersley Investments Pty Limited and Wersley Pty Limited. Member of the Law Committee of the Australian Institute of Company Directors, the Corporations Committee of the Law Council of Australia and the Commonwealth Remuneration Tribunal. Board Member of Jawun.
Name: Catriona Alison Deans, BA, MBA, GAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Director of Cochlear Limited, Insurance Australia Group Limited, IAG RE Australia Limited, WFI Insurance Limited, kikki.K Holdings Pty Ltd, Chessholme Pty Ltd and Ascog Pty Ltd. Senior Advisor to McKinsey & Company and Advisor to Beat the Q Holdings Pty Limited (trading as Hey You!).
Name: Craig William Dunn, BCom, FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** No **Independent Director:** Yes	**External Directorships:** Chairman of Stone and Chalk Limited, The Australian Ballet and the Australian Government's Fintech Advisory Group. Director of Telstra Corporation Limited, Amiala Pty Ltd, Carringbush Consulting Services Pty Ltd, Financial Literacy Australia Limited and the Australian Government's Financial Literacy Board. Member of the Australian Securities and Investments Commission's External Advisory Panel, the New South Wales Government's Financial Services Knowledge Hub, and Jobs for New South Wales. Consultant to King & Wood Mallesons.

General matters (continued)

Name: Robert George Elstone, BA (Hons.), MA (Econ.), MCom **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of R & S Elstone Pty Ltd, Elstone Investments Pty Limited and R Elstone Pty Limited. Board Member of the University of Western Australia Business School. Adjunct Professor of the University of Western Australia Business School and University of Sydney School of Business.
Name: Peter John Oswin Hawkins, BCA (Hons.), SF Fin, FAIM, ACA (NZ), FAICD **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes **Independent Director:** Yes	**External Directorships:** Director of Clayton Utz, Mirvac Funds Limited, Mirvac Limited, Joshawk Investments Pty Ltd, Liberty Financial Pty Ltd, Liberty Fiduciary Ltd, Lynter Investments Pty Ltd, LFI Group Pty Ltd, Minerva Financial Group Pty Limited and Petlyn Holdings Pty Ltd.
Name: Peter Ralph Marriott, BEc (Hons.), FCA **Non-executive:** Yes **Country of Residence:** Australia **Primary Occupation:** Director **Secondary Occupations:** None **Board Audit Committee Member:** Yes, Chairman **Independent Director:** Yes	**External Directorships:** Chairman of Austraclear Limited. Director of ASX Limited, ASX Settlement Corporation Limited, ASX Clear (Futures) Pty Limited, ASX Clear Pty Limited, ASX Clearing Corporation Limited, ASX Settlement Pty Limited, P. & E. Marriott Investments Pty Ltd, P. & E. Marriott Holdings Pty Ltd and P. & E. Marriott Pty Ltd. Member of the Review Panel & Policy Council of the Banking & Finance Oath.

Changes to Directorate

Elizabeth Blomfield Bryan will retire as a director of the Overseas Bank on 9 December 2016. There have been no other changes to the composition of the Overseas Bank's Board since 30 September 2015.

Chief Executive Officer, NZ Branch

Name: Karen Lee Ann Silk, B.Com

Country of Residence: New Zealand

Primary Occupation: Chief Executive Officer, NZ Branch

Secondary Occupations: General Manager, Commercial Corporate and Institutional, Westpac New Zealand

External Directorships: Director of Waianiwa Pastoral Limited, Payments NZ Limited (alternate Director)

Responsible person

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

Name: David Alexander McLean, LLB (Hons.)

Country of Residence: New Zealand

Primary Occupation: Chief Executive, Westpac New Zealand

Secondary Occupations: None

Address for communications

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

Conflicts of interest policy

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

(i) give notice to the Board of any direct or indirect interest in any contract, proposed contract or other matter with the Overseas Bank as soon as practicable after the relevant facts have come to that Director's knowledge. Alternatively, a Director may give to the Board a general notice to the effect that the Director is to be regarded as interested in any present or prospective contract or other matter between the Overseas Bank and a person or persons specified in that notice; and

(ii) in relation to any matter that is to be considered at a Directors' meeting in which that Director has a material personal interest, not vote on the matter nor be present while the matter is being considered at the meeting (unless the remaining Directors have previously resolved to the contrary).

General matters (continued)

Interested transactions

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

(a) on terms other than on those that would, in the ordinary course of business of the Overseas Bank or any member of the NZ Banking Group, be given to any other person of like circumstances and means; or

(b) which could be reasonably likely to influence materially the exercise of the Directors', or the Chief Executive Officer, NZ Branch's duties.

Auditors

NZ Banking Group

PricewaterhouseCoopers
PricewaterhouseCoopers Tower
188 Quay Street
Auckland
New Zealand

Credit ratings

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

Rating Agency	Current Credit Rating	Rating Outlook
Fitch Ratings	AA-	Stable
Moody's Investors Service	Aa2	Negative
S&P Global Ratings	AA-	Negative

On 7 July 2016, S&P Global Ratings ('**S&P**') affirmed the Overseas Bank's credit rating at AA-, however, as a result of S&P revising the outlook for the Australian sovereign rating to 'negative' from 'stable', the Overseas Bank's outlook was also revised to 'negative' from 'stable'. On 18 August 2016, Moody's Investors Service ('**Moody's**') affirmed the Overseas Bank's credit rating at Aa2, but revised the outlook to 'negative' from 'stable'. The revision in outlook follows Moody's revision of the Australian Macro Profile to 'Very Strong -' from 'Very Strong'. There have been no changes to the Overseas Bank's credit rating in the two years prior to 30 September 2016.

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

Descriptions of credit rating scales[1]

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

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

General matters (continued)

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

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

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

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

The most recently published financial statements of the Overseas Bank and the Overseas Banking Group are for the year ended 30 September 2016 and can be accessed at the internet address www.westpac.com.au.

Historical summary of financial statements

	NZ Banking Group				
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15	Year Ended 30-Sep-14	Year Ended 30-Sep-13	Year Ended 30-Sep-12
Income statement					
Interest income	**4,172**	4,451	4,037	3,801	3,965
Interest expense	**(2,398)**	(2,670)	(2,447)	(2,223)	(2,440)
Net interest income	**1,774**	1,781	1,590	1,578	1,525
Non-interest income	**588**	590	678	586	583
Net operating income	**2,362**	2,371	2,268	2,164	2,108
Operating expenses	**(953)**	(943)	(868)	(877)	(872)
Impairment charges on loans	**(73)**	(47)	(26)	(105)	(184)
Profit before income tax expense	**1,336**	1,381	1,374	1,182	1,052
Income tax expense	**(373)**	(375)	(355)	(327)	(293)
Profit after income tax expense	**963**	1,006	1,019	855	759
Profit after income tax expense attributable to:					
Head office account and owners of the NZ Banking Group	**963**	1,003	1,016	852	756
Non-controlling interests	**-**	3	3	3	3
	963	1,006	1,019	855	759
Dividends paid on ordinary share capital	**(111)**	(159)	(251)	(327)	(4)
Dividends paid on convertible debentures (net of tax)	**-**	-	-	(66)	(72)
Balance sheet					
Total assets	**93,358**	88,861	81,678	77,554	77,854
Total individually impaired assets	**222**	282	346	573	868
Total liabilities	**86,321**	82,668	76,179	72,757	72,339
Total head office account	**1,913**	1,824	1,750	1,639	1,513
Total equity	**7,037**	6,193	5,499	4,797	5,515

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

Guarantee arrangements

No material obligations of the Overseas Bank that relate to the NZ Branch are guaranteed as at the date this Disclosure Statement was signed.

Ranking of local creditors in liquidation

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

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

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

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

Section 13A(3) of the Australian Banking Act affects all unsecured liabilities of the NZ Branch, which, as at 30 September 2016, amounted to $11,339 million (30 September 2015: $15,415 million).

Section 13A(4) of the Australian Banking Act also provides that it is an offence for an ADI not to hold assets (other than goodwill and any assets or other amount excluded by the prudential standards) in Australia of a value that is equal to or greater than the total amount of its deposit liabilities in Australia, unless APRA has authorised the ADI to hold assets of a lesser value. During the year ended 30 September 2016, the Overseas Bank has at all times held assets (other than goodwill) in Australia of not less than the value of the Overseas Bank's total deposit liabilities in Australia.

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

The requirements of the above provisions have the potential to impact on the management of the liquidity of the NZ Banking Group.

Other material matters

Certain matters relating to the business or affairs of the Overseas Bank and the NZ Banking Group have been disclosed on the New Zealand and/or Australian stock exchanges.

There are no other matters relating to the business or affairs of the Overseas Bank and the NZ Banking Group which are not contained elsewhere in the Disclosure Statement and which would, if disclosed, materially affect the decision of a person to subscribe for debt securities of which the Overseas Bank or any member of the NZ Banking Group is the issuer.

Conditions of registration

The registration of Westpac Banking Corporation (the '**registered bank**') in New Zealand is subject to the following conditions, which applied from 1 November 2015:

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

   In this condition of registration, the meaning of 'material' is based on generally accepted accounting practice.
2. That the Banking Group's insurance business is not greater than 1% of its total consolidated assets.

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

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

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

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

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

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

   For the purposes of this condition of registration:

   - 'insurance business' means the undertaking or assumption of liability as an insurer under a contract of insurance;
   - 'insurer' and 'contract of insurance' have the same meaning as provided in sections 6 and 7 of the Insurance (Prudential Supervision) Act 2010.
3. That the business of the registered bank in New Zealand does not constitute a predominant proportion of the total business of the registered bank.
4. That no appointment to the position of the New Zealand Chief Executive Officer of the registered bank shall be made unless:

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

   (b) the Reserve Bank has advised that it has no objection to that appointment.
5. That Westpac Banking Corporation complies with the requirements imposed on it by the Australian Prudential Regulation Authority.
6. That Westpac Banking Corporation complies with the following minimum capital adequacy requirements, as administered by the Australian Prudential Regulation Authority:

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

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

   (c) Total capital of Westpac Banking Corporation is not less than 8% of risk-weighted exposures.
7. That liabilities of the registered bank in New Zealand, net of amounts due to related parties (including amounts due to a subsidiary or affiliate of the registered bank), do not exceed $15 billion.
8. That the retail deposits of the registered bank in New Zealand do not exceed $200 million. For the purposes of this condition retail deposits are defined as deposits by natural persons, excluding deposits with an outstanding balance which exceeds $250,000.
9. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of APIL with a loan-to-valuation ratio of more than 70%, must not exceed 5% of the total of the qualifying new mortgage lending amount in respect of APIL arising in the loan-to-valuation measurement period.
10. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of ANPIL with a loan-to-valuation ratio of more than 80%, must not exceed 10% of the total of the qualifying new mortgage lending amount in respect of ANPIL arising in the loan-to-valuation measurement period.
11. That, for a loan-to-valuation measurement period, the total of the business of the registered bank in New Zealand's qualifying new mortgage lending amount in respect of non-Auckland loans with a loan-to-valuation ratio of more than 80%, must not exceed 15% of the total of the qualifying new mortgage lending amount in respect of non-Auckland loans arising in the loan-to-valuation measurement period.
12. That the business of the registered bank in New Zealand must not make a residential mortgage loan unless the terms and conditions of the loan contract or the terms and conditions for an associated mortgage require that a borrower obtain the registered bank's agreement before the borrower can grant to another person a charge over the residential property used as security for the loan.

Conditions of registration (continued)

In these conditions of registration:

- 'Banking Group'—

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

- 'business of the registered bank in New Zealand'—

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

- 'generally accepted accounting practice'—

  has the same meaning as in section 8 of the Financial Reporting Act 2013.

- 'liabilities of the registered bank in New Zealand'—

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

- In conditions of registration 9 to 12,—

  "ANPIL", "APIL", "loan-to-valuation ratio", "non-Auckland loan", "qualifying new mortgage lending amount in respect of […]" and "residential mortgage loan" have the same meaning as in the Reserve Bank of New Zealand document entitled "Framework for Restrictions on High-LVR Residential Mortgage Lending" (BS19) dated November 2015, where the version of the Reserve Bank of New Zealand document "Capital Adequacy Framework (Standardised Approach)" (BS2A) referred to in BS19 for the purpose of defining these terms is that dated November 2015; and

  'loan-to-valuation measurement period' means a period of six calendar months ending on the last day of the sixth calendar month, the first of which ends on the last day of April 2016.

Changes to conditions of registration

The conditions of registration were amended on 28 September 2016 with effect from 1 October 2016 to revise the high loan to value ratio ('LVR') restrictions on residential mortgage lending. Property investment residential lending at LVRs of greater than 60% must not exceed 5% of the total qualifying new property investment residential mortgage loans arising during the relevant loan-to-valuation measurement period. Non property-investment residential mortgage lending with an LVR of more than 80% must not exceed 10% of the total qualifying new non property investment residential mortgage loans arising during the relevant loan-to-valuation measurement period.

The Reserve Bank document 'Framework for Restrictions on High-LVR Residential Mortgage lending' (BS19) was also revised.

Westpac New Zealand conditions of registration

Westpac New Zealand has disclosed instances of non-compliance with its conditions of registration in Westpac New Zealand's Disclosure Statement for the year ended 30 September 2016. These instances have no impact on the compliance by the Overseas Bank with its conditions of registration.

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

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

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

(b) is not false or misleading.

Each Director of the Overseas Bank and the Chief Executive Officer, NZ Branch, believe, after due enquiry, that, over the year ended 30 September 2016:

(a) the Overseas Bank has complied with all conditions of registration imposed on it pursuant to section 74 of the Reserve Bank Act; and

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

Refer to Note 36 for further detail regarding the entities which had systems in place to monitor and control the material risks of relevant members of NZ Banking Group.

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

David Alexander McLean

Karen Lee Ann Silk

Dated this 8th day of December 2016

Index to financial statements

Income statement for the years ended 30 September

$ millions	Note	NZ Banking Group Year Ended 30-Sep-16	 Year Ended 30-Sep-15
Interest income	2	**4,172**	4,451
Interest expense	2	**(2,398)**	(2,670)
Net interest income		**1,774**	1,781
Non-interest income	3	**588**	590
Net operating income		**2,362**	2,371
Operating expenses	4	**(953)**	(943)
Impairment charges on loans	6	**(73)**	(47)
Profit before income tax expense		**1,336**	1,381
Income tax expense	7	**(373)**	(375)
Profit after income tax expense		**963**	1,006
Profit after income tax expense attributable to:			
Head office account and owners of the NZ Banking Group		**963**	1,003
Non-controlling interests		**-**	3
		963	1,006

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

Statement of comprehensive income for the years ended 30 September

		NZ Banking Group	
$ millions	Note	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Profit after income tax expense		**963**	1,006
Other comprehensive expense which may be reclassified subsequently to the income statement:			
Available-for-sale securities:			
Net unrealised losses from changes in fair value of available-for-sale securities		**(21)**	(8)
Transferred to the income statement	3	**-**	(19)
Income tax effect		**6**	8
Cash flow hedges:			
Net losses from changes in fair value of cash flow hedges		**(117)**	(217)
Transferred to the income statement		**133**	39
Income tax effect		**(4)**	50
Total other comprehensive expense which may be reclassified subsequently to the income statement		**(3)**	(147)
Other comprehensive expense which will not be reclassified subsequently to the income statement:			
Remeasurement of employee defined benefit obligations		**(7)**	(7)
Income tax effect		**2**	2
Total other comprehensive expense which will not be reclassified subsequently to the income statement		**(5)**	(5)
Total other comprehensive expense, net of tax		**(8)**	(152)
Total comprehensive income		**955**	854
Total comprehensive income attributable to:			
Head office account and owners of the NZ Banking Group		**955**	851
Non-controlling interests		**-**	3
		955	854

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

Balance sheet as at 30 September

$ millions	Note	NZ Banking Group 2016	2015
Assets			
Cash and balances with central banks		**1,472**	939
Due from other financial institutions	9	**844**	168
Trading securities and other financial assets designated at fair value	10	**4,035**	4,215
Derivative financial instruments	26	**4,838**	5,459
Available-for-sale securities	11	**3,790**	3,421
Loans	12,13	**75,582**	69,576
Life insurance assets		**269**	265
Due from related entities	25	**1,218**	3,451
Investment in associate	25	**9**	-
Property and equipment		**161**	164
Deferred tax assets	14	**166**	167
Intangible assets	15	**650**	658
Other assets	16	**324**	378
Total assets		**93,358**	88,861
Liabilities			
Due to other financial institutions	18	**616**	837
Deposits and other borrowings	19	**58,791**	52,986
Other financial liabilities at fair value through income statement	20	**576**	279
Derivative financial instruments	26	**6,236**	6,717
Debt issues	21	**14,727**	14,685
Current tax liabilities		**70**	25
Provisions	22	**99**	92
Other liabilities	23	**590**	775
Total liabilities excluding related entities liabilities		**81,705**	76,396
Due to related entities	25	**3,525**	4,288
Subordinated debentures	24	**1,091**	1,984
Total related entities liabilities		**4,616**	6,272
Total liabilities		**86,321**	82,668
Net assets		**7,037**	6,193
Equity			
Head office account			
Branch capital		**1,300**	1,300
Retained profits		**613**	524
Total head office account		**1,913**	1,824
NZ Banking Group equity			
Ordinary share capital		**143**	143
Retained profits		**5,086**	4,328
Available-for-sale securities reserve		**1**	16
Cash flow hedge reserve		**(106)**	(118)
Total equity attributable to owners of the NZ Banking Group		**5,124**	4,369
Total equity		**7,037**	6,193
Interest earning and discount bearing assets		**86,427**	80,925
Interest and discount bearing liabilities		**73,743**	69,623

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

Signed on behalf of the Board of Directors.

Director
8 December 2016

Director
8 December 2016

Statement of changes in equity for the years ended 30 September

	NZ Banking Group								
	NZ Branch Head Office Account		Other members of the NZ Banking Group						
$ millions	Branch Capital	Retained Profits	Ordinary Share Capital	Retained Profits	Available-for-sale Securities Reserve	Cash Flow Hedge Reserve	Total Before Non-controlling Interests	Non-controlling Interests	Total Equity
As at 1 October 2014	1,300	450	143	3,555	35	10	5,493	6	5,499
Year ended 30 September 2015									
Profit after income tax expense	-	74	-	929	-	-	1,003	3	1,006
Net losses from changes in fair value	-	-	-	-	(8)	(217)	(225)	-	(225)
Income tax effect	-	-	-	-	3	61	64	-	64
Transferred to the income statement	-	-	-	-	(19)	39	20	-	20
Income tax effect	-	-	-	-	5	(11)	(6)	-	(6)
Remeasurement of employee defined benefit obligations	-	-	-	(7)	-	-	(7)	-	(7)
Income tax effect	-	-	-	2	-	-	2	-	2
Total comprehensive income for the year ended 30 September 2015	-	74	-	924	(19)	(128)	851	3	854
Transactions with owners:									
Dividends paid on ordinary shares (refer to Note 25)	-	-	-	(151)	-	-	(151)	(8)	(159)
Derecognition of non-controlling interest	-	-	-	-	-	-	-	(1)	(1)
As at 30 September 2015	1,300	524	143	4,328	16	(118)	6,193	-	6,193
Year ended 30 September 2016									
Profit after income tax expense	**-**	**89**	**-**	**874**	**-**	**-**	**963**	**-**	**963**
Net losses from changes in fair value	**-**	**-**	**-**	**-**	**(21)**	**(117)**	**(138)**	**-**	**(138)**
Income tax effect	**-**	**-**	**-**	**-**	**6**	**33**	**39**	**-**	**39**
Transferred to the income statement	**-**	**-**	**-**	**-**	**-**	**133**	**133**	**-**	**133**
Income tax effect	**-**	**-**	**-**	**-**	**-**	**(37)**	**(37)**	**-**	**(37)**
Remeasurement of employee defined benefit obligations	**-**	**-**	**-**	**(7)**	**-**	**-**	**(7)**	**-**	**(7)**
Income tax effect	**-**	**-**	**-**	**2**	**-**	**-**	**2**	**-**	**2**
Total comprehensive income for the year ended 30 September 2016	**-**	**89**	**-**	**869**	**(15)**	**12**	**955**	**-**	**955**
Transactions with owners:									
Dividends paid on ordinary shares (refer to Note 25)	**-**	**-**	**-**	**(111)**	**-**	**-**	**(111)**	**-**	**(111)**
As at 30 September 2016	**1,300**	**613**	**143**	**5,086**	**1**	**(106)**	**7,037**	**-**	**7,037**

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

Statement of cash flows for the years ended 30 September

		NZ Banking Group	
		Year Ended	Year Ended
$ millions	Note	**30-Sep-16**	30-Sep-15
Cash flows from operating activities			
Interest income received		**4,198**	4,475
Interest expense paid		**(2,403)**	(2,647)
Non-interest income received		**521**	511
Operating expenses paid		**(838)**	(813)
Income tax paid		**(328)**	(369)
Cash flows from operating activities before changes in operating assets and liabilities		**1,150**	1,157
Net (increase)/decrease in:			
Due from other financial institutions		**(716)**	105
Trading securities and other financial assets designated at fair value		**53**	(537)
Loans		**(6,107)**	(4,489)
Due from related entities		**1,897**	(2,250)
Other assets		**3**	-
Net (decrease)/increase in:			
Due to other financial institutions		**(221)**	(304)
Deposits and other borrowings		**5,805**	2,375
Other financial liabilities at fair value through income statement		**297**	(793)
Other liabilities		**(4)**	(9)
Net movement in external and related entity derivative financial instruments		**(1,915)**	2,964
Net cash provided by/(used in) operating activities	40	**242**	(1,781)
Cash flows from investing activities			
Purchase of available-for-sale securities		**(652)**	(930)
Proceeds from maturities/sales of available-for-sale securities		**300**	506
Net movement in life insurance assets		**(4)**	32
Proceeds from disposal of subsidiary	25	**-**	7
Cash receipts from associate	25	**-**	48
Purchase of capitalised computer software		**(56)**	(39)
Proceeds from disposal of software		**-**	2
Purchase of property and equipment		**(25)**	(24)
Net cash used in investing activities		**(437)**	(398)
Cash flows from financing activities			
Proceeds from debt issues		**7,840**	7,775
Repayments of debt issues		**(6,018)**	(7,124)
Net movement in due to related entities		**(261)**	(743)
Settlement of promissory note	25	**-**	(48)
Proceeds from issuance of subordinated debentures	24	**-**	1,172
Redemption of subordinated debentures	24	**(762)**	-
Dividends paid to ordinary shareholders	25	**(111)**	(151)
Dividends paid to minority shareholders		**-**	(8)
Net cash provided by financing activities		**688**	873
Net increase/(decrease) in cash and cash equivalents		**493**	(1,306)
Cash and cash equivalents at beginning of the year		**1,037**	2,343
Cash and cash equivalents at end of the year	40	**1,530**	1,037

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

Notes to the financial statements

Note 1 Basis of preparation

In these financial statements, reference is made to the following reporting groups:

- Westpac Banking Corporation (otherwise referred to as the '**Overseas Bank**') – refers to the worldwide business of Westpac Banking Corporation excluding its controlled entities;
- Westpac Banking Corporation Group (otherwise referred to as the '**Overseas Banking Group**') – refers to the total worldwide business of Westpac Banking Corporation including its controlled entities;
- Westpac Banking Corporation New Zealand Branch (otherwise referred to as the '**NZ Branch'**) – refers to the New Zealand Branch of Westpac Banking Corporation (trading as Westpac);
- Westpac New Zealand Limited (otherwise referred to as '**Westpac New Zealand**') – refers to a locally incorporated subsidiary of the Overseas Bank (carrying on the Overseas Bank's New Zealand consumer, business and institutional banking operations); and
- Westpac Banking Corporation - New Zealand Banking Group (otherwise referred to as the '**NZ Banking Group**') – refers to the New Zealand operations of Westpac Banking Corporation Group including those entities whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business.

These financial statements are consolidated financial statements for the NZ Banking Group.

These financial statements were authorised for issue by the Overseas Bank's Board of Directors (the '**Board**') on 8 December 2016. The Board has the power to amend the financial statements after they are authorised for issue.

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

a. Basis of preparation

(i) Basis of accounting

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

- the requirements of the Financial Markets Conduct Act 2013;
- the Reserve Bank of New Zealand Act 1989 ('**Reserve Bank Act**'); and
- the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 ('**Order**').

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

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

(ii) Accounting conventions

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.

(iii) Comparative revisions

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

(iv) Changes in accounting standards

No new accounting standards or amendments have been adopted for the year ended 30 September 2016.

b. Basis of aggregation

The NZ Banking Group as at 30 September 2016 has been aggregated by combining the sum of the capital and reserves of the NZ Branch, and the consolidated capital and reserves of Westpac New Zealand Group Limited, BT Financial Group (NZ) Limited, Westpac Financial Services Group-NZ-Limited, Westpac Group Investment-NZ-Limited, Capital Finance New Zealand Limited, and their subsidiaries (including structured entities) and Hastings Forestry Investments Limited. For New Zealand entities acquired by the Overseas Banking Group, capital and reserves at acquisition are netted and recognised as capital contributed to the NZ Banking Group.

Subsidiaries (including structured entities) are those entities over which the NZ Banking Group has control. Control exists when it is exposed to, or has rights to, variable returns from its involvement with the entity, and has the ability to affect those returns through its power over the entity. All transactions between entities within the NZ Banking Group are eliminated. Non-controlling interests and equity of non-wholly-owned subsidiaries are shown separately in the consolidated income statement, statement of comprehensive income, balance sheet and statement of changes in equity. Subsidiaries are fully consolidated from the date on which control commences and are de-consolidated from the date that control ceases.

The interest of non-controlling shareholders is stated at their proportion of the net profit after tax and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly by the NZ Banking Group. Losses are attributed to the non-controlling interest even if that results in a deficit balance.

(i) Business combinations

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

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

(ii) Foreign currency translation

Functional and presentational currency

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

Note 1 Basis of preparation (continued)

Transactions and balances

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

(iii) Head office account, share capital, reserves and non-controlling interests

Head office account - Branch capital

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

Ordinary shares

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

Available-for-sale securities reserve

This comprises the changes in the fair value of available-for-sale 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.

Non-controlling interests

Non-controlling interests represent the share in the net assets of subsidiaries attributable to equity interests that are not owned directly or indirectly by the parent entity.

c. Financial assets and financial liabilities

(i) Recognition

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

Financial liabilities are recognised when an obligation arises.

(ii) Classification and measurement

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

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

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

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

The NZ Banking Group's policies for determining the fair value of financial assets and financial liabilities are set out in Note 27.

(iii) Derecognition

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

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

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

d. Critical accounting assumptions and estimates

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

- Note 7 Income tax expense
- Note 13 Credit quality, impaired assets and provisions for impairment charges on loans
- Note 14 Deferred tax assets
- Note 15 Intangible assets
- Note 22 Provisions
- Note 27 Fair value of financial instruments
- Note 31 Superannuation commitments
- Note 34 Insurance business

Note 1 Basis of preparation (continued)

e. Future accounting developments

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

NZ IFRS 9 *Financial Instruments* (September 2014) ('**NZ IFRS 9**') will replace NZ IAS 39 *Financial Instruments: Recognition and Measurement* ('**NZ IAS 39**'). It includes a forward looking 'expected credit loss' impairment model, revised classification and measurement model and modifies the approach to hedge accounting. Unless early adopted, the standard will be effective for the 30 September 2019 financial year. Whilst it is not yet practical to reliably estimate the financial impact on the financial statements, the major changes under the standard are outlined below:

Impairment

NZ IFRS 9 introduces a revised impairment model which requires entities to recognise expected credit losses based on unbiased forward looking information, replacing the existing incurred loss model which only recognises impairment if there is objective evidence that a loss has been incurred. Key elements of the new impairment model are:

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

Classification and measurement

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

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

The accounting for financial liabilities is largely unchanged.

Hedging

NZ IFRS 9 will change hedge accounting by increasing the eligibility of both hedged items and hedging instruments and introducing a more principles-based approach to assessing hedge effectiveness. Adoption of the new hedge accounting model is optional and current hedge accounting under NZ IAS 39 can continue to be applied until the IASB completes its Accounting for Dynamic Risk Management project. The NZ Banking Group is yet to determine whether to apply the new hedge accounting model when NZ IFRS 9 is adopted.

The NZ Banking Group is in the process of assessing the full impact of the application of NZ IFRS 9. The financial impact on the financial statements has not yet been determined.

NZ IFRS 15 *Revenue from Contracts with Customers* ('**NZ IFRS 15**') was issued on 3 July 2014 and will be effective for the 30 September 2019 financial year. The standard provides a single comprehensive model for revenue recognition. It supersedes current recognition and related interpretations. The application of NZ IFRS 15 is not expected to have a material impact on the NZ Banking Group.

NZ IFRS 16 *Leasing* ('**NZ IFRS 16**') was issued on 11 February 2016 and will be effective for the 30 September 2020 financial year. NZ IFRS 16 will replace NZ IAS 17 *Leases* ('**NZ IAS 17**'). The main changes under the standard for lessees are:

- all operating leases of greater than 12 months duration will be required to be presented on balance sheet. The net present value of these leases will be recognised as an asset and a liability; and
- all leases on balance sheet will give rise to a combination of interest expense on the lease liability and depreciation of the leased asset.

For lessors the accounting for leases under NZ IFRS 16 remains substantially the same as under NZ IAS 17. The impact of NZ IFRS 16 will be determined by the level of operating lease commitments greater than 12 months duration at adoption and is not yet practicable to determine.

Disclosure Initiative: Amendments to *NZ IAS 7 Statement of Cash Flows* was issued on 12 May 2016 and will be effective for the 30 September 2018 year end unless early adopted. Comparatives are not required on first application. The standard requires additional disclosures regarding both cash and non–cash changes in liabilities arising from financing activities. The standard is not expected to have a material impact on the NZ Banking Group.

Note 2 Net interest income

Accounting policy

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

Interest relating to impaired loans is recognised using the loan's original effective interest rate based on the net carrying value of the impaired loan or for a variable rate loan, the current effective interest rate.

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

	NZ Banking Group	
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Interest income		
Cash and balances with central banks	**32**	48
Due from other financial institutions	**6**	6
Trading securities and other financial assets designated at fair value	**126**	149
Available-for-sale securities	**151**	141
Loans [1]	**3,850**	4,103
Due from related entities	**7**	4
Total interest income	**4,172**	4,451
Interest expense		
Due to other financial institutions	**11**	15
Deposits and other borrowings	**1,375**	1,772
Other financial liabilities at fair value through income statement	**6**	18
Debt issues	**324**	318
Subordinated debentures	**78**	42
Other [2]	**604**	505
Total interest expense	**2,398**	2,670
Net interest income	**1,774**	1,781

[1] Interest income on loans includes interest income of $15 million (30 September 2015: $20 million) on impaired assets.

[2] Includes interest expense due to related entities (refer to Note 25) and the net impact of treasury balance sheet management activities.

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

	NZ Banking Group	
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Interest income	**4,046**	4,302
Interest expense	**2,340**	2,584

Note 3 Non-interest income

Accounting policy

Fees and commissions income

Fees and commissions income is recognised as follows:

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

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

Trading income

- Realised and unrealised gains or losses arising from changes in the fair value of trading assets and liabilities are recognised in the period in which they arise (except day one profits or losses which are deferred, refer to Note 27). Those relating to foreign exchange related products are recognised in foreign exchange income, the remaining gains and losses are recognised in other trading products.
- Trading income related to Treasury's interest rate and liquidity management activities is included in net interest income rather than non-interest income.

Note 3 Non-interest income (continued)

Net life insurance income and change in policy liabilities

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

Premium income

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

Claims expense

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

	NZ Banking Group	
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Fees and commissions		
Transaction fees and commissions	**189**	194
Lending fees	**64**	65
Other non-risk fee income	**49**	45
Total fees and commissions	**302**	304
Wealth management revenue		
Fees from trust and other fiduciary activities	**42**	38
Net life insurance income and change in policy liabilities	**108**	100
Total wealth management revenue	**150**	138
Trading income		
Foreign exchange trading	**106**	103
Other trading products	**(2)**	14
Total trading income	**104**	117
Net ineffectiveness on qualifying hedges	**4**	(4)
Other non-interest income		
Dividend income	**-**	2
Gain on sale of available-for-sale securities	**-**	19
Gain on disposal of a subsidiary (refer to Note 25)	**-**	4
Share of profit of associate accounted for using the equity method (refer to Note 25)	**11**	-
Other	**17**	10
Total other non-interest income	**28**	35
Total non-interest income	**588**	590

Note 4 Operating expenses

	NZ Banking Group	
$ millions	Year Ended 30-Sep-16	Year Ended 30-Sep-15
Staff expenses		
Employee remuneration, entitlements and on-costs	**420**	420
Superannuation costs:		
Defined contribution scheme	**31**	32
Defined benefit scheme	**2**	1
Share-based payments	**5**	5
Restructuring costs	**-**	2
Other	**7**	8
Total staff expenses	**465**	468
Occupancy expenses		
Operating lease rentals	**64**	67
Depreciation	**45**	38
Equipment repairs and maintenance	**10**	10
Other	**10**	11
Total occupancy expenses	**129**	126
Other expenses		
Outsourcing	**109**	100
Purchased services	**103**	76
Software amortisation costs	**64**	95
Advertising	**22**	11
Postage and freight	**18**	18
Stationery	**11**	13
Related entities - management fees (refer to Note 25)	**6**	8
Litigation and non-lending losses	**3**	2
Other	**23**	26
Total other expenses	**359**	349
Total operating expenses	**953**	943

Note 5 Auditors' remuneration

	NZ Banking Group	
$'000s	Year Ended 30-Sep-16	Year Ended 30-Sep-15
Audit and audit related services		
Audit and review of financial statements [1]	**2,066**	2,050
Other audit related services [2]	**54**	43
Total remuneration for audit and other audit related services	**2,120**	2,093
Other services [3]	**159**	167
Total remuneration for non-audit services	**159**	167
Total remuneration for audit, other audit related services and non-audit services	**2,279**	2,260

1 Fees for the annual audit of the financial statements, the review or other procedures performed on the interim financial statements and Sarbanes-Oxley reporting undertaken in the role of auditor.

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

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

The amounts in the table above are presented exclusive of goods and services tax ('**GST**'). It is the NZ Banking Group's policy to engage the external auditors on assignments additional to their statutory audit duties only if their independence is not either impaired or seen to be impaired, and where their expertise and experience with the NZ Banking Group is important.

The external auditors also provide audit and non-audit services to non-consolidated entities, including non-consolidated trusts of which a member of the NZ Banking Group is manager or responsible entity and non-consolidated superannuation funds or pension funds. During the year ended 30 September 2016, the fees in respect of these services were approximately $582,000 (30 September 2015: $577,000).

Note 6 Impairment charges on loans

Accounting policy

Impaired loans

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

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

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

The impairment charge is recognised in the income statement with a corresponding reduction of the carrying value of the loan through an offsetting provision account (refer to Note 13).

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

Uncollectable loans

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

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

	NZ Banking Group	
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Collectively assessed provisions	**8**	(23)
Individually assessed provisions	**6**	34
Bad debts written off directly to the income statement	**59**	36
Total impairment charges on loans	**73**	47

Refer to Note 13 for further details on Provisions for impairment charges on loans.

Note 7 Income tax expense

Accounting policy

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

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

Goods and services tax

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

Critical accounting assumptions and estimates

The NZ Banking Group operates in multiple tax jurisdictions and significant judgment is required in determining the worldwide current tax liability. There are many transactions with uncertain tax outcomes and provisions are held to reflect these tax uncertainties.

	NZ Banking Group	
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Income tax expense		
Current tax:		
Current year	**377**	367
Prior year adjustments	**(3)**	-
Deferred tax (refer to Note 14):		
Current year	**(5)**	14
Prior year adjustments	**4**	(6)
Total income tax expense	**373**	375
Profit before income tax expense	**1,336**	1,381
Tax calculated at tax rate of 28%	**374**	387
Income not subject to tax	**(4)**	(7)
Expenses not deductible for tax purposes	**2**	2
Prior year adjustments	**1**	(6)
Other items	**-**	(1)
Total income tax expense	**373**	375

The effective tax rate for the year ended 30 September 2016 was 27.9% (30 September 2015: 27.2%).

Note 8 Imputation credit account

	NZ Banking Group	
$ millions	**2016**	2015
Imputation credits available for use in subsequent reporting periods	**1,272**	1,365

Note 9 Due from other financial institutions

Accounting policy

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

	NZ Banking Group	
$ millions	**2016**	2015
Loans and advances to other banks	**844**	168
Total due from other financial institutions	**844**	168
Due from other financial institutions:		
At call	**58**	98
Term	**786**	70
Total due from other financial institutions	**844**	168
Amounts expected to be recovered within 12 months	**844**	168
Amounts expected to be recovered after 12 months	**-**	-
Total due from other financial institutions	**844**	168

Note 10 Trading securities and other financial assets designated at fair value

Accounting policy

Trading securities include actively traded debt (government and other) and those acquired for sale in the near term.

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

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

Securities purchased under agreements to resell are not recognised on the balance sheet as the NZ Banking Group has not obtained the risks and rewards of ownership. The cash consideration paid is recognised as an asset. Reverse repos which are part of a trading portfolio are designated at fair value. Gains and losses on these financial assets are recognised in the income statement. Interest received under these agreements is recognised in net interest income.

	NZ Banking Group	
$ millions	**2016**	2015
Government and semi-government securities	**1,350**	1,813
Other debt securities	**2,374**	2,124
Securities purchased under agreement to resell	**311**	278
Total trading securities and other financial assets designated at fair value	**4,035**	4,215
Amounts expected to be recovered within 12 months	**3,716**	3,821
Amounts expected to be recovered after 12 months	**319**	394
Total trading securities and other financial assets designated at fair value	**4,035**	4,215

Note 11 Available-for-sale securities

Accounting policy

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

- Interest on debt securities; and
- Impairment charges.

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

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

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

	NZ Banking Group	
$ millions	**2016**	2015
Government and semi-government securities	**2,409**	2,193
Other debt securities	**1,381**	1,228
Total available-for-sale securities	**3,790**	3,421
Amounts expected to be recovered within 12 months	**141**	308
Amounts expected to be recovered after 12 months	**3,649**	3,113
Total available-for-sale securities	**3,790**	3,421

Note 12 Loans

Accounting policy

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

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

The following table shows loans disaggregated by type of product.

	NZ Banking Group	
$ millions	**2016**	2015
Overdrafts	**1,313**	1,249
Credit card outstandings	**1,503**	1,537
Money market loans	**1,362**	1,386
Term loans:		
Housing	**45,126**	42,121
Non-housing	**25,425**	22,475
Other	**1,288**	1,223
Total gross loans	**76,017**	69,991
Provisions for impairment charges on loans	**(435)**	(415)
Total net loans	**75,582**	69,576
Amounts expected to be recovered within 12 months	**9,849**	8,218
Amounts expected to be recovered after 12 months	**65,733**	61,358
Total net loans	**75,582**	69,576

As at 30 September 2016, $6,591 million of housing loans were used by the NZ Banking Group to secure the obligations of Westpac Securities NZ Limited ('**WSNZL**') under Westpac New Zealand's Global Covered Bond Programme ('**CB Programme**') (30 September 2015: $4,821 million). These housing loans were not derecognised from the NZ Banking Group's balance sheet in accordance with the accounting policies outlined in Note 1. As at 30 September 2016, the New Zealand dollar equivalent of bonds issued by WSNZL under the CB Programme was $3,480 million (30 September 2015: $4,022 million).

Movements in impaired assets and provisions for impairment charges on loans are outlined in Note 13.

Note 13 Credit quality, impaired assets and provisions for impairment charges on loans

Accounting policy

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

- individually assessed to be impaired; and
- collectively assessed to be impaired.

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

- individually for loans that exceed specified thresholds. Where the loans are assessed as impaired, individually assessed provisions will be recognised; and
- if an individually assessed loan is not impaired, it is then included in a group of loans with similar risk characteristics and, along with those loans below the specified thresholds noted above, collectively assessed for impairment. If there is objective evidence that the group of loans is collectively impaired, collectively assessed provisions will be recognised.

Critical accounting assumptions and estimates

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

Individual component

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

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

Collective component

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

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

Note 13 Credit quality, impaired assets and provisions for impairment charges on loans (continued)

	NZ Banking Group 2016					NZ Banking Group 2015				
$ millions	Residential Mortgages	Other Retail	Corporate	Other	Total	Residential Mortgages	Other Retail	Corporate	Other	Total
Neither past due nor impaired	**44,246**	**3,625**	**26,470**	**250**	**74,591**	41,174	3,518	23,365	388	68,445
Past due but not impaired assets										
Less than 30 days past due	**732**	**132**	**106**	**-**	**970**	762	136	136	1	1,035
At least 30 days but less than 60 days past due	**62**	**18**	**43**	**-**	**123**	67	21	4	-	92
At least 60 days but less than 90 days past due	**30**	**10**	**15**	**-**	**55**	34	10	10	-	54
At least 90 days past due	**31**	**15**	**10**	**-**	**56**	35	19	29	-	83
Total past due assets not impaired	**855**	**175**	**174**	**-**	**1,204**	898	186	179	1	1,264
Individually impaired assets[1]										
Balance at beginning of the year	**49**	**2**	**231**	**-**	**282**	57	4	285	-	346
Additions	**35**	**6**	**104**	**-**	**145**	64	5	119	-	188
Amounts written off	**(7)**	**-**	**(13)**	**-**	**(20)**	(14)	(5)	(43)	-	(62)
Returned to performing or repaid	**(52)**	**(4)**	**(129)**	**-**	**(185)**	(58)	(2)	(130)	-	(190)
Balance at end of the year	**25**	**4**	**193**	**-**	**222**	49	2	231	-	282
Total gross loans[2]	**45,126**	**3,804**	**26,837**	**250**	**76,017**	42,121	3,706	23,775	389	69,991
Individually assessed provisions										
Balance at beginning of the year	**14**	**1**	**103**	**-**	**118**	19	2	123	-	144
Impairment charges on loans:					**-**					
New provisions	**8**	**2**	**13**	**-**	**23**	20	5	30	-	55
Recoveries	**-**	**-**	**-**	**-**	**-**	-	-	-	-	-
Reversal of previously recognised impairment charges on loans	**(8)**	**-**	**(9)**	**-**	**(17)**	(11)	(2)	(8)	-	(21)
Amounts written off	**(7)**	**-**	**(12)**	**-**	**(19)**	(14)	(4)	(44)	-	(62)
Interest adjustments	**-**	**-**	**-**	**-**	**-**	-	-	2	-	2
Balance at end of the year	**7**	**3**	**95**	**-**	**105**	14	1	103	-	118
Collectively assessed provisions										
Balance at beginning of the year	**55**	**93**	**181**	**-**	**329**	66	86	177	-	329
Impairment (reversals)/charges on loans	**(12)**	**(8)**	**28**	**-**	**8**	(14)	(2)	(7)	-	(23)
Interest adjustments	**3**	**10**	**11**	**-**	**24**	3	11	11	-	25
Disposal of a subsidiary	**-**	**-**	**-**	**-**	**-**	-	(2)	-	-	(2)
Balance at end of the year	**46**	**95**	**220**	**-**	**361**	55	93	181	-	329
Total provisions for impairment charges on loans and credit commitments	**53**	**98**	**315**	**-**	**466**	69	94	284	-	447
Provision for credit commitments (refer to Note 22)	**-**	**(4)**	**(27)**	**-**	**(31)**	-	(3)	(29)	-	(32)
Total provisions for impairment charges on loans	**53**	**94**	**288**	**-**	**435**	69	91	255	-	415
Total net loans	**45,073**	**3,710**	**26,549**	**250**	**75,582**	42,052	3,615	23,520	389	69,576

1 The NZ Banking Group had undrawn commitments of $14 million (30 September 2015: $103 million) to counterparties for whom drawn balances are classified as individually impaired assets under corporate loans as at 30 September 2016.

2 The NZ Banking Group does not have other assets under administration as at 30 September 2016.

Note 14 Deferred tax assets

Accounting policy

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

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

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

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

Deferred tax is not recognised for the following temporary differences:

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

As described in Note 7, tax is considered one of the NZ Banking Group's critical accounting assumptions and estimates.

	NZ Banking Group	
$ millions	**2016**	2015
Deferred tax assets are attributable to the following:		
Property and equipment	**9**	7
Provisions for impairment charges on loans	**134**	128
Provision for employee entitlements	**18**	14
Life insurance policy liabilities	**(34)**	(28)
Cash flow hedges	**42**	46
Other temporary differences	**(3)**	-
Balance at end of the year	**166**	167
The deferred tax credit/(charge) in income tax expense comprises the following temporary differences:		
Property and equipment	**2**	5
Provisions for impairment charges on loans	**6**	(4)
Provision for employee entitlements	**2**	-
Life insurance policy liabilities	**(6)**	(5)
Other temporary differences	**(3)**	(4)
Total deferred tax credit/(charge) in income tax expense	**1**	(8)
The deferred tax (charge)/credit in other comprehensive income comprises the following temporary differences:		
Cash flow hedges	**(4)**	50
Provision for employee entitlements	**2**	2
Other temporary differences	**-**	3
Total deferred tax (charge)/credit in other comprehensive income	**(2)**	55

Note 15 Intangible assets

Accounting policy

Indefinite life intangible assets

Goodwill

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

i) the consideration paid; over

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

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

Finite life intangible assets

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

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

Note 15 Intangible assets (continued)

Critical accounting assumptions and estimates

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

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

	NZ Banking Group	
$ millions	**2016**	2015
Goodwill		
Cost	**547**	547
Accumulated impairment	**(22)**	(22)
Net carrying amount of goodwill	**525**	525
Computer software		
Cost	**637**	571
Accumulated amortisation and impairment	**(512)**	(438)
Net carrying amount of computer software	**125**	133
Total goodwill and other intangible assets	**650**	658

Significant assumptions used in the recoverable amount calculations

Goodwill is allocated to and tested at least annually for impairment as part of identified CGUs.

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

- NZ Banking Group's after tax return on equity was 11.0% (2015: 11.0%)
- NZ Banking Group's adjusted pre-tax equity rate was 15.3% (2015: 15.3%)

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

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

A reasonably possible change in these key assumptions would not result in an indication of impairment or cause the CGUs' carrying amount to exceed their recoverable amounts.

Goodwill has been allocated to the following CGUs, which are equivalent to the operating segments of the same names as described in Note 30:

	NZ Banking Group	
$ millions	**2016**	2015
Consumer Banking and Wealth	**512**	512
Investments and Insurance	**13**	13
Net carrying amount of goodwill	**525**	525

Note 16 Other assets

	NZ Banking Group	
$ millions	**2016**	2015
Accrued interest receivable	**134**	160
Securities sold not yet delivered	**59**	108
Trade debtors and prepayments	**70**	49
Other	**61**	61
Total other assets	**324**	378
Amounts expected to be recovered within 12 months	**317**	367
Amounts expected to be recovered after 12 months	**7**	11
Total other assets	**324**	378

Included in accrued interest receivable as at 30 September 2016 were balances that amounted to $13 million (30 September 2015: $11 million) which relate to accrued interest on housing loans sold to a special purpose entity under the CB Programme (refer to Note 33 for details of the CB Programme).

Note 17 Financial assets pledged as collateral

The NZ 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 disclosed in Note 33, the carrying value of these financial assets pledged as collateral is:

	NZ Banking Group	
$ millions	**2016**	2015
Cash	**786**	70
Securities pledged under repurchase agreements		
Available-for-sale securities	**400**	-
Trading securities and other financial assets designated at fair value	**44**	220
Total amount pledged to secure liabilities (excluding CB Programme)	**1,230**	290

Note 18 Due to other financial institutions

Accounting policy

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

	NZ Banking Group	
$ millions	**2016**	2015
Interest bearing interbank deposits	**601**	831
Non-interest bearing, repayable at call	**15**	6
Total due to other financial institutions	**616**	837
Due to other financial institutions:		
At call	**538**	176
Term	**78**	661
Total due to other financial institutions	**616**	837
Amounts expected to be settled within 12 months	**616**	837
Amounts expected to be settled after 12 months	**-**	-
Total due to other financial institutions	**616**	837

Note 19 Deposits and other borrowings

Accounting policy

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

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

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

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

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

	NZ Banking Group	
$ millions	**2016**	2015
Deposits and other borrowings at fair value		
Certificates of deposit	**1,250**	1,070
Total deposits and other borrowings at fair value	**1,250**	1,070
Deposits and other borrowings at amortised cost		
Non-interest bearing, repayable at call	**4,621**	4,032
Other interest bearing:		
At call	**23,741**	23,871
Term	**29,179**	24,013
Total deposits and other borrowings at amortised cost	**57,541**	51,916
Total deposits and other borrowings	**58,791**	52,986
Amounts expected to be settled within 12 months	**57,169**	51,142
Amounts expected to be settled after 12 months	**1,622**	1,844
Total deposits and other borrowings	**58,791**	52,986

The NZ Branch held no retail deposits and other borrowings from individuals as at 30 September 2016 (30 September 2015: nil).

Note 20 Other financial liabilities at fair value through income statement

Accounting policy

Other financial liabilities at fair value through income statement include trading securities sold short and security repurchase agreements which have been designated at fair value at initial recognition.

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

The cash consideration received is recognised as a liability ('security repurchase agreements'). Security repurchase agreements are designated at fair value and recognised as part of other financial liabilities at fair value through income statement where they are managed as part of a trading portfolio; otherwise they are measured on an amortised cost basis and recognised in due to other financial institutions or due to related entities, depending on the counterparty.

Securities sold short reflect the obligation to deliver securities to a buyer for the sale of securities the NZ Banking Group does not own at the time of sale but that are promised to be delivered to the buyer. Securities delivered to the buyer are usually borrowed and/or subsequently repurchased.

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

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

	NZ Banking Group	
$ millions	**2016**	2015
Securities sold short	**132**	60
Security repurchase agreements	**444**	219
Total other financial liabilities at fair value through income statement	**576**	279
Amounts expected to be settled within 12 months	**576**	279
Amounts expected to be settled after 12 months	**-**	-
Total other financial liabilities at fair value through income statement	**576**	279

Note 21 Debt issues

Accounting policy

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

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

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

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

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

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

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

Note 21 Debt issues (continued)

$ millions	NZ Banking Group 2016	2015
Short-term debt		
Commercial paper	**2,410**	2,716
Total short-term debt	**2,410**	2,716
Long-term debt		
Non-domestic medium-term notes	**5,616**	5,024
Covered Bonds	**3,480**	4,022
Domestic medium-term notes	**3,221**	2,923
Total long-term debt	**12,317**	11,969
Total debt issues	**14,727**	14,685
Debt issues at amortised cost	**12,317**	11,969
Debt issues at fair value	**2,410**	2,716
Total debt issues	**14,727**	14,685
Movement in debt issues		
Balance at beginning of the year	**14,685**	12,592
Issuance during the year	**7,840**	7,775
Repayments during the year	**(6,018)**	(7,124)
Effect of foreign exchange movements during the year	**(1,824)**	1,464
Effect of fair value movements and amortisation adjustments during the year	**44**	(22)
Balance at end of the year	**14,727**	14,685
Amounts expected to be settled within 12 months	**5,729**	4,935
Amounts expected to be settled after 12 months	**8,998**	9,750
Total debt issues	**14,727**	14,685

Note 22 Provisions

Accounting policy

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

Employee benefits – annual leave and other employee benefits

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

Provision for impairment on credit commitments

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

Critical accounting assumptions and estimates

Some of the provisions involve significant judgment about the likely outcome of various events and estimated future cash flows.

Payments that are expected to be incurred after more than one year are discounted at a rate which reflects both current interest rates and the risks specific to that provision.

	NZ Banking Group					
$ millions	Annual Leave and Other Employee Benefits	Provisions for Impairment on Credit Commitments	Long Service Leave	Restructuring (refer to Note 25)	Litigation and Non-lending Losses	Total
For the year ended 30 September 2016						
Balance as at 1 October 2015	**42**	**32**	**7**	**5**	**6**	**92**
Additional provisions recognised	**36**	**1**	**5**	**9**	**3**	**54**
Utilised during the year	**(32)**	**(2)**	**-**	**(7)**	**(6)**	**(47)**
Balance as at 30 September 2016	**46**	**31**	**12**	**7**	**3**	**99**
For the year ended 30 September 2015						
Balance as at 1 October 2014	41	31	7	-	8	87
Additional provisions recognised	38	2	2	8	2	52
Utilised during the year	(37)	(1)	(2)	(3)	(4)	(47)
Balance as at 30 September 2015	42	32	7	5	6	92

Provisions expected to be utilised beyond 12 months as at 30 September 2016 are $43 million (30 September 2015: $39 million).

Note 23 Other liabilities

$ millions	NZ Banking Group 2016	2015
Accrued interest payable	**322**	341
Securities purchased but not yet delivered	**44**	226
Claims reserves	**27**	25
Credit card loyalty programme	**32**	35
Retirement benefit obligations (refer to Note 31)	**27**	19
Trade creditors and other accrued expenses	**91**	78
Other	**47**	51
Total other liabilities	**590**	775
Amounts expected to be settled within 12 months	**557**	748
Amounts expected to be settled after 12 months	**33**	27
Total other liabilities	**590**	775

Note 24 Subordinated debentures

Accounting policy

Subordinated debentures issued by the NZ Banking Group are initially recognised as a financial liability and recorded at the fair value of the consideration received, net of transaction costs. They are subsequently measured at amortised cost using the effective interest rate method.

$ millions	NZ Banking Group 2016	2015
Subordinated debentures	**-**	841
Tier Two Notes	**1,091**	1,143
Total subordinated debentures	**1,091**	1,984

Subordinated debentures

On 5 April 2004, the NZ Branch issued US$525 million of junior subordinated convertible debentures to the trustee of the Tavarua Funding Trust IV (‘**Funding Trust IV**’), a member of the Overseas Banking Group. The investment by Funding Trust IV in the subordinated convertible debentures was ultimately funded from the proceeds (net of issue costs) of approximately US$525 million of Trust Preferred Securities issued by the Overseas Banking Group in the United States of America.

On 31 March 2016, the NZ Branch redeemed the junior subordinated convertible debentures in full for cash.

Tier Two Notes

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

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 Westpac New Zealand being solvent at the time of the interest payment and immediately following the interest payment.

Conversion

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

Redemption

Westpac New Zealand 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.

Note 25 Related entities

Related Entities

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions, or one other party controls both. Examples include subsidiaries, associates, joint ventures and superannuation plans as well as key management personnel and their related parties.

NZ Banking Group

The NZ Banking Group consists of the New Zealand operations of the Overseas Banking Group including the NZ Branch and the following controlled entities as at 30 September 2016 whose business is required to be reported in the financial statements of the Overseas Banking Group's New Zealand business:

Name of Entity	Principal Activity	Notes
BT Financial Group (NZ) Limited	Holding company	
BT Funds Management (NZ) Limited	Funds management company	
Capital Finance New Zealand Limited	Finance company	
Sie-Lease (New Zealand) Pty Limited	Leasing company	
Hastings Forestry Investments Limited	Non-active company	
Westpac Financial Services Group-NZ- Limited	Holding company	
Westpac Life-NZ- Limited	Life insurance company	
Westpac Nominees -NZ- Limited	Nominee company	
HLT Custodian Trust	Custodian entity	
MIF Custodian Trust	Custodian entity	
Westpac Superannuation Nominees-NZ-Limited	Nominee company	
Westpac Group Investment-NZ-Limited	Holding company	
Westpac Holdings - NZ - Limited	Holding company	
Westpac Capital-NZ- Limited	Finance company	
Westpac Equity Investments NZ Limited	Non-active company	
Westpac New Zealand Group Limited	Holding company	
Westpac New Zealand Limited	Registered bank	
Westpac NZ Operations Limited	Holding company	
Aotearoa Financial Services Limited	Non-active company	
Number 120 Limited	Finance company	
The Home Mortgage Company Limited	Residential mortgage company	
Westpac (NZ) Investments Limited	Property company	
Westpac Securities NZ Limited	Funding company	
Westpac New Zealand Staff Superannuation Scheme Trustee Limited[1]	Trustee company	Established on 30 June 2016
Westpac NZ Covered Bond Holdings Limited	Holding company	19% owned[2]
Westpac NZ Covered Bond Limited	Guarantor	19% owned[2]
Westpac NZ Securitisation Holdings Limited	Holding company	19% owned[3]
Westpac NZ Securitisation Limited	Funding company	19% owned[3]
Westpac NZ Securitisation No.2 Limited	Non-active company	19% owned[3]
Westpac Cash PIE Fund	Portfolio investment entity	Not owned[4]
Westpac Notice Saver PIE Fund	Portfolio investment entity	Not owned[4]
Westpac Term PIE Fund	Portfolio investment entity	Not owned[4]

1 Westpac New Zealand Staff Superannuation Scheme Trustee Limited ('**WNZSSSTL**'), a wholly owned subsidiary of Westpac NZ Operations Limited ('**WNZO**') was incorporated on 30 June 2016 to provide services as the trustee of the Westpac New Zealand Staff Superannuation Scheme.

2 The NZ Banking Group, through its subsidiaries, WNZO (9.5%) and Westpac Holdings – NZ - Limited (9.5%), has a total qualifying interest of 19% in Westpac NZ Covered Bond Holdings Limited ('**WNZCBHL**') and its wholly-owned subsidiary company, Westpac NZ Covered Bond Limited ('**WNZCBL**'). Westpac New Zealand is considered to control both WNZCBHL and WNZCBL based on contractual arrangements in place, and as such both WNZCBHL and WNZCBL are consolidated within the financial statements of the NZ Banking Group.

3 The NZ Banking Group, through its subsidiaries, WNZO (9.5%) and Westpac Holdings – NZ - Limited (9.5%), has a total qualifying interest of 19% in Westpac NZ Securitisation Holdings Limited ('**WNZSHL**') and its wholly-owned subsidiaries, Westpac NZ Securitisation Limited ('**WNZSL**') and Westpac NZ Securitisation No.2 Limited ('**WNZSL2**'). Westpac New Zealand is considered to control WNZSHL, WNZSL and WNZSL2 based on contractual arrangements in place, and as such WNZSHL, WNZSL and WNZSL2 are consolidated within the financial statements of the NZ Banking Group.

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

Other than disclosed below, there have been no changes in the ownership percentages since 30 September 2015.

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

On 30 September 2015, WNZO sold its 51% share of The Warehouse Financial Services Limited ('**TWFSL**') for a cash consideration of $7 million and the gain on sale amounted to $4 million (refer to Note 3).

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

Transactions and balances with related parties are disclosed separately in these financial statements.

The total liabilities of the NZ Branch, net of amounts due to related entities as at 30 September 2016, amounted to $6,189 million (30 September 2015: $7,384 million).

Note 25 Related entities (continued)

Investment in associate

In March 2016, the NZ Banking Group changed the method of accounting for its investment in Paymark Limited from cost method to equity method. At 30 September 2016, the carrying value of the investment in associate related to Paymark Limited was $9 million. WNZO holds 25% of Paymark Limited's equity. Paymark Limited has a balance date of 31 March. The share of associate profit recognised for the year ended 30 September 2016 is $11 million (refer to Note 3).

The NZ Banking Group had on issue a promissory note to Cards NZ Limited ('**Cards NZ**') in relation to the purchase of Visa Inc. shares. The promissory note was settled in July 2015.

On 30 September 2015, Cards NZ ceased to operate as a business and distributed its remaining net assets to its shareholders. The NZ Banking Group received $48 million from Cards NZ on 30 September 2015. Cards NZ was removed from the Companies Register on 16 August 2016.

Nature of transactions

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

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

Transactions with the Overseas Bank

Management fees are paid by the NZ Banking Group to the Overseas Bank for management and administration services (consisting of salaries, data processing facilities and other head office expenses) provided by the Overseas Bank. The total fees paid to the Overseas Bank by the NZ Banking Group for the year ended 30 September 2016 was $6 million (30 September 2015: $8 million) (refer to Note 4).

The NZ Banking Group enters into derivative transactions with the Overseas Bank. They are accounted for as trading derivatives except for two cross currency swaps which are designated in a hedging relationship and are discussed below.

The NZ Banking Group receives funding from the Overseas Bank.

The NZ Banking Group receives funding from the London Branch on an as needs basis.

During the year ended 30 September 2016, the following transactions occurred:

- NZ Branch repaid $400 million funding owing to the Overseas Bank in November 2015;
- NZ Branch received additional funding from the Overseas Bank of $911 million in June 2016; and
- NZ Branch repaid A$763 million funding owing to the Overseas Bank in June 2016.

In September 2016, a provision relating to restructuring costs of $9 million (30 September 2015: $8 million) was raised, $2 million (30 September 2015: $3 million) of which has been settled during the year (refer to Note 22). The Overseas Bank will ultimately bear the cost of this restructuring provision and therefore the provision does not impact the NZ Banking Group's income statement. Consequently, the NZ Banking Group has recorded a receivable of $7 million (30 September 2015: $8 million) within due from related entities.

During the year ended 30 September 2015, the NZ Branch repaid $871 million funding owing to the Overseas Bank. In addition, Westpac New Zealand Group Limited received funding of A$284 million from the London Branch and Westpac New Zealand issued A$1,040 million of Tier Two Notes to the London Branch (refer to note 24). Derivatives are in place with the Overseas Bank, designated in a cash flow hedge relationship, to hedge the currency risk exposure of this funding.

Transactions with other controlled entities of the Overseas Bank

During the year ended 30 September 2016, Westpac Group Investment-NZ-Limited declared and paid a dividend of $34 million (30 September 2015: $66 million) to Westpac Overseas Holdings Pty Limited and Westpac Custodian Nominees Pty Limited.

During the year ended 30 September 2016, Westpac Financial Services Group-NZ- Limited declared and paid a dividend of $50 million to Westpac Equity Holdings Pty Limited (30 September 2015: $85 million).

During the year ended 30 September 2016, BT Financial Group (NZ) Limited declared and paid a dividend of $27 million to Westpac Equity Holdings Pty Limited (30 September 2015: nil).

During the year ended 30 September 2016, the NZ Banking Group repaid the US$525 million of junior subordinated convertible debentures to the trustee of the Tavarua Funding Trust IV, a member of the Overseas Banking Group. Interest expense paid on the junior subordinated convertible debentures up to the date of repayment on 31 March 2016 amounted to $21 million (30 September 2015: $38 million).

During the year ended 30 September 2016, interest expense paid on the Tier Two Notes issued by the NZ Banking Group and held by related parties amounted to $57 million (30 September 2015: $4 million).

For the year ended 30 September 2016, the NZ Banking Group paid fees of $5 million to Advance Asset Management Limited, a subsidiary of the Overseas Bank, for investment management services (30 September 2015: $5 million).

Note 25 Related entities (continued)

Due from and to related entities

$ millions	NZ Banking Group 2016	2015
Due from related entities		
Overseas Bank	**1,218**	3,451
Total due from related entities	**1,218**	3,451
Due from related entities at amortised cost	**524**	2,421
Due from related entities at fair value	**694**	1,030
Total due from related entities	**1,218**	3,451
Amounts expected to be recovered within 12 months	**1,218**	3,451
Amounts expected to be recovered after 12 months	**-**	-
Total due from related entities	**1,218**	3,451
Due to related entities		
Overseas Bank	**3,521**	4,283
Other members of the Overseas Banking Group	**4**	5
Total due to related entities	**3,525**	4,288
Due to related entities at amortised cost	**2,644**	2,930
Due to related entities at fair value	**881**	1,358
Total due to related entities	**3,525**	4,288
Amounts expected to be settled within 12 months	**3,114**	3,928
Amounts expected to be settled after 12 months	**411**	360
Total due to related entities	**3,525**	4,288
Total liabilities excluding subordinated debentures and due to related entities	**81,705**	76,396

Other group investment

The NZ Banking Group had a significant non-controlling shareholding in the following New Zealand based entity as at 30 September 2016:

Name	Shares held by	Beneficial Interest	Nature of Business
Payments NZ Limited	Westpac New Zealand Limited	23% (2015: 23%)	Payment Rules

The NZ Banking Group does not have significant influence over this entity, and therefore, it is not classified as an associate.

The total carrying amount of the NZ Banking Group's significant non-controlling shareholding in the above investment, and its contribution to the results of the NZ Banking Group, is not material.

Note 26 Derivative financial instruments

Accounting policy

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

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

The NZ Banking Group uses derivative instruments for trading and also as part of its asset and liability risk management activities, which are discussed in Note 36: Risk management. Derivatives used for risk management activities includes designating derivatives into one of two types of hedge accounting relationships: fair value hedge or cash flow hedge, where permitted under NZ IAS 39. These hedge designations and associated accounting treatment are as follows:

Fair value hedges

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

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

Cash flow hedges

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

- For effective hedges, changes in the fair value of derivatives are recognised in the cash flow hedge reserve through other comprehensive income and subsequently recognised in net interest income when the asset or liability that was hedged impacts the income statement.
- For hedges with some ineffectiveness, the changes in the fair value of the derivatives relating to the ineffective portion are immediately recognised in the income statement.

Note 26 Derivative financial instruments (continued)

- If a hedge is discontinued, any cumulative gain or loss remains in other comprehensive income and is subsequently amortised to net interest income over the period which the asset or liability that was hedged also impacts the income statement.
- If a hedge of a forecast transaction is no longer expected to occur, any cumulative gain or loss in other comprehensive income is immediately recognised in the income statement.

Derivatives of the NZ Banking Group are mainly held either in the NZ Branch or Westpac New Zealand.

Trading

As a trader, the NZ Branch's primary objective is to derive income from the sale of derivatives to meet the NZ Banking Group's customers' needs. In addition to the sale of derivatives to customers, the NZ Branch also undertakes market making and risk management activities. Market making involves providing quotes to other dealers, who reciprocate by providing the NZ Branch with their own quotes. This process provides liquidity in the key markets in which the NZ Branch operates.

Fair value hedges

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

	NZ Banking Group	
$ millions	**2016**	2015
Change in fair value of hedging instruments	**15**	(271)
Change in fair value of hedged items attributed to hedged risk	**(15)**	274
Fair value hedge ineffectiveness	**-**	3

Cash flow hedges

The NZ Banking Group hedges a portion of the cash flows from floating-rate customer deposits, term deposits and floating rate loans using interest rate swaps. The NZ Banking Group also hedges exposure to foreign currency principal and interest cash flows from floating-rate medium-term debt, covered bonds and Tier Two Notes through the use of cross currency swaps.

Underlying cash flows from cash flow hedges, as a proportion of total cash flows, are expected to occur in the following periods:

	NZ Banking Group 2016							
%	**Less Than 1 Month**	**1 Month to 3 Months**	**3 Months to 1 Year**	**1 Year to 2 Years**	**2 Years to 3 Years**	**3 Years to 4 Years**	**4 Years to 5 Years**	**Over 5 Years**
Cash inflows (assets)	**-**	**3**	**31**	**12**	**14**	**13**	**18**	**9**
Cash outflows (liabilities)	**-**	**3**	**32**	**13**	**13**	**13**	**18**	**8**

	NZ Banking Group 2015							
%	Less Than 1 Month	1 Month to 3 Months	3 Months to 1 Year	1 Year to 2 Years	2 Years to 3 Years	3 Years to 4 Years	4 Years to 5 Years	Over 5 Years
Cash inflows (assets)	-	1	23	35	14	14	4	9
Cash outflows (liabilities)	-	1	24	36	13	13	4	9

	NZ Banking Group	
$ millions	**2016**	2015
Cash flow hedge ineffectiveness	**4**	(7)

Dual fair value and cash flow hedges

The NZ Banking Group hedges fixed rate foreign currency denominated medium-term debt and covered bonds using cross currency swaps, designated as fair value hedges of foreign interest rates and cash flow hedges of foreign exchange rates.

Note 26 Derivative financial instruments (continued)

Derivatives held with external counterparties

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

	NZ Banking Group 2016								
		Fair Value [1]							
				Hedging					
	Notional	Trading		Fair Value		Cash Flow		Total	
$ millions	Amount	Assets	(Liabilities)	Assets	(Liabilities)	Assets	(Liabilities)	Assets	(Liabilities)
Interest rate contracts									
Futures[2]	**15,273**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Forwards	**1,225**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Swaps	**257,354**	**4,690**	**(4,268)**	**29**	**(394)**	**69**	**(245)**	**4,788**	**(4,907)**
Options	**1,181**	**2**	**-**	**-**	**-**	**-**	**-**	**2**	**-**
Total interest rate contracts	**275,033**	**4,692**	**(4,268)**	**29**	**(394)**	**69**	**(245)**	**4,790**	**(4,907)**
Foreign exchange contracts									
Spot and forwards	**17,295**	**179**	**(255)**	**-**	**-**	**-**	**-**	**179**	**(255)**
Cross currency swaps	**51,204**	**835**	**(1,222)**	**90**	**118**	**11**	**(1,037)**	**936**	**(2,141)**
Total foreign exchange contracts	**68,499**	**1,014**	**(1,477)**	**90**	**118**	**11**	**(1,037)**	**1,115**	**(2,396)**
Total of gross derivatives	**343,532**	**5,706**	**(5,745)**	**119**	**(276)**	**80**	**(1,282)**	**5,905**	**(7,303)**
Impact of netting arrangements[3]	**-**	**(1,067)**	**1,067**	**-**	**-**	**-**	**-**	**(1,067)**	**1,067**
Total of net derivatives	**343,532**	**4,639**	**(4,678)**	**119**	**(276)**	**80**	**(1,282)**	**4,838**	**(6,236)**
Amounts expected to be settled within 12 months								**4,648**	**(5,337)**
Amounts expected to be settled after 12 months								**190**	**(899)**
Total derivatives								**4,838**	**(6,236)**

	NZ Banking Group 2015								
		Fair Value [1]							
				Hedging					
	Notional	Trading		Fair Value		Cash Flow		Total	
$ millions	Amount	Assets	(Liabilities)	Assets	(Liabilities)	Assets	(Liabilities)	Assets	(Liabilities)
Interest rate contracts									
Futures[2]	8,821	-	-	-	-	-	-	-	-
Forwards	112	-	-	-	-	-	-	-	-
Swaps	350,798	5,167	(4,753)	35	(340)	63	(315)	5,265	(5,408)
Options	215	1	-	-	-	-	-	1	-
Total interest rate contracts	359,946	5,168	(4,753)	35	(340)	63	(315)	5,266	(5,408)
Foreign exchange contracts									
Spot and forwards	27,540	709	(391)	-	-	-	-	709	(391)
Cross currency swaps	46,538	621	(2,614)	132	80	502	(155)	1,255	(2,689)
Total foreign exchange contracts	74,078	1,330	(3,005)	132	80	502	(155)	1,964	(3,080)
Total of gross derivatives	434,024	6,498	(7,758)	167	(260)	565	(470)	7,230	(8,488)
Impact of netting arrangements[3]	-	(1,771)	1,771	-	-	-	-	(1,771)	1,771
Total of net derivatives	434,024	4,727	(5,987)	167	(260)	565	(470)	5,459	(6,717)
Amounts expected to be settled within 12 months								4,739	(4,787)
Amounts expected to be settled after 12 months								720	(1,930)
Total derivatives								5,459	(6,717)

1 Excludes derivatives with related entities. Related entity derivatives in a hedging relationship are disclosed in Note 25.

2 The fair value differential of futures contracts are settled daily with the exchange. The notional balance represents open contracts as at 30 September.

3 Amounts offset against derivatives consist of NZ Branch derivative trades settled directly with a central clearing counterparty. The Overseas Bank became a direct clearing member of LCH.Clearnet Limited during the year ended 30 September 2015.

Note 27 Fair value of financial instruments

Accounting policy

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

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

Critical accounting assumptions and estimates

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

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

- Product type;
- Depth of market activity;
- Maturity of market models; and
- Complexity of the transaction.

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

- Industry standards;
- Economic models; and
- Observed transaction prices.

In order to determine a reliable fair value for a financial instrument, management may apply adjustments to the techniques previously described. These adjustments reflect the NZ Banking Group's assessment of factors that market participants would typically consider in setting the fair value. These adjustments incorporate bid/offer spreads, credit valuation adjustments and funding valuation adjustments.

Fair Valuation Control Framework

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

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

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

Fair value hierarchy

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

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

Valuation techniques

The NZ Banking Group applies market accepted valuation techniques in determining the fair valuation of Over the Counter 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 technique
Exchange traded products	Derivative financial instruments	Exchange traded interest rate futures	These instruments are traded in liquid, active markets where prices are readily observable. No modelling or assumptions are used in the valuation.
Non-asset backed debt instruments	Available-for-sale securities and trading securities and other financial assets designated at fair value	New Zealand Government bonds	

Note 27 Fair value of financial instruments (continued)

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.

Instrument	Balance sheet category	Includes:	Valuation technique
Interest rate derivatives	Derivative financial instruments	Interest rate swaps, forwards and options	Industry standard valuation models are used to calculate the expected future value of payments by product, which are discounted back to a present value. The model's interest rate inputs are benchmark interest rates such as Bank Bill Mid-Market Settlement Rate ('**BKBM**') and active broker quoted interest rates in the swaps, bonds and futures markets. Interest rate volatilities are sourced through a consensus data provider.
Foreign exchange products	Derivative financial instruments	Forwards and cross currency swaps	Derived from market observable inputs or consensus pricing providers using industry standard models.
Asset backed debt instruments	Trading securities and other financial assets designated at fair value Available-for-sale securities	Asset backed securities	Valued using an industry approach to value floating rate debt with prepayment features. The main inputs to the model are the trading margin and the weighted average life of the security. These inputs are sourced from a consensus data provider. If consensus prices are not available these are classified as Level 3 instruments.
Non-asset backed debt instruments	Trading securities and other financial assets designated at fair value Available-for-sale securities 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, off-shore securities and corporate bonds 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.
Deposits at fair value	Deposits and other borrowings	Certificates of deposit	Discounted cash flow using market rates offered for deposits of similar remaining maturities.
Debt issues at fair value	Debt issues	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 applicable credit rating of Westpac New Zealand.
Life insurance assets	Life insurance assets	NZ Government bonds, investment grade corporate bonds and units in unlisted unit trusts	Valued using observable market prices or other widely used and accepted valuation techniques utilising observable market input.

Level 3 instruments

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

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

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

Note 27 Fair value of financial instruments (continued)

The following table summarises the attribution of financial instruments to the fair value hierarchy based on the measurement basis after initial recognition:

	NZ Banking Group							
	2016				2015			
$ millions	Level 1	Level 2	Level 3[1]	Total	Level 1	Level 2	Level 3[1]	Total
Financial assets								
Trading securities and other financial assets designated at fair value	**668**	**3,268**	**99**	**4,035**	161	4,010	44	4,215
Derivative financial instruments	**-**	**4,833**	**5**	**4,838**	7	5,448	4	5,459
Available-for-sale securities	**1,608**	**2,182**	**-**	**3,790**	1,619	1,802	-	3,421
Life insurance assets	**-**	**269**	**-**	**269**	21	244	-	265
Due from related entities	**-**	**694**	**-**	**694**	-	1,030	-	1,030
Total financial assets carried at fair value	**2,276**	**11,246**	**104**	**13,626**	1,808	12,534	48	14,390
Financial liabilities								
Deposits at fair value	**-**	**1,250**	**-**	**1,250**	-	1,070	-	1,070
Other financial liabilities at fair value through income statement	**132**	**444**	**-**	**576**	41	238	-	279
Derivative financial instruments	**-**	**6,236**	**-**	**6,236**	4	6,708	5	6,717
Debt issues at fair value	**-**	**2,410**	**-**	**2,410**	-	2,716	-	2,716
Due to related entities	**-**	**881**	**-**	**881**	-	1,358	-	1,358
Total financial liabilities carried at fair value	**132**	**11,221**	**-**	**11,353**	45	12,090	5	12,140

[1] Balances within this category of the fair value hierarchy are not considered material to the total trading securities and other financial assets designated at fair value, derivative financial instruments balances.

Analysis of movements between Fair Value Hierarchy Levels

There were no material amounts of changes in fair value estimated using a valuation technique incorporating significant non-observable inputs that were recognised in the income statement or the statement of comprehensive income of the NZ Banking Group during the year ended 30 September 2016 (30 September 2015: no material changes in fair value).

During the year there were no material transfers between levels of the fair value hierarchy (30 September 2015: nil).

Transfers in and transfers out are reported using the end-of-period fair values.

Financial instruments not measured at fair value

For financial instruments not carried at fair value on a recurring basis on the balance sheet, including amounts due from and due to related entities, fair value has been derived as follows:

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

Note 27 Fair value of financial instruments (continued)

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

	NZ Banking Group 2016				
	Carrying	Fair Value			
$ millions	Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and balances with central banks	1,472	1,472	-	-	1,472
Due from other financial institutions	844	786	58	-	844
Loans	75,582	-	-	75,831	75,831
Due from related entities	524	-	524	-	524
Other assets	254	-	-	254	254
Total financial assets	78,676	2,258	582	76,085	78,925
Financial liabilities					
Due to other financial institutions	616	91	525	-	616
Deposits and other borrowings	57,541	-	57,070	527	57,597
Debt issues	12,317	-	12,473	-	12,473
Other liabilities	465	-	465	-	465
Subordinated debentures	1,091	-	-	1,111	1,111
Due to related entities	2,644	-	2,658	-	2,658
Total financial liabilities	74,674	91	73,191	1,638	74,920

	NZ Banking Group 2015				
	Carrying	Fair Value			
$ millions	Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and balances with central banks	939	939	-	-	939
Due from other financial institutions	168	70	98	-	168
Loans	69,576	-	-	69,757	69,757
Due from related entities	2,421	-	2,421	-	2,421
Other assets	325	-	-	325	325
Total financial assets	73,429	1,009	2,519	70,082	73,610
Financial liabilities					
Due to other financial institutions	837	627	210	-	837
Deposits and other borrowings	51,916	-	51,542	470	52,012
Debt issues	11,969	-	12,038	-	12,038
Other liabilities	647	-	647	-	647
Subordinated debentures	1,984	-	1,977	-	1,977
Due to related entities	2,930	-	2,944	-	2,944
Total financial liabilities	70,283	627	68,706	1,122	70,455

Note 28 Offsetting financial assets and financial liabilities

Accounting policy

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

Some of the NZ Banking Group's offsetting arrangements are not enforceable in all circumstances. The assets and liabilities under such agreements are also disclosed in the table below, to illustrate the net balance sheet amount if these future events should occur. The amounts in the tables below may not tie back to the balance sheet if there are balances which are not subject to offsetting arrangements. The amounts presented in this note do not represent the credit risk exposure of the NZ Banking Group. Refer to Note 36.1 for information on credit risk management. The offsetting and collateral arrangements and other credit risk mitigation strategies used by the NZ Banking Group are further explained in the 'Credit risk' section under Note 36.1.

	NZ Banking Group 2016						
	Effects of Offsetting on Balance Sheet			Amounts Subject to Enforceable Netting Arrangements But Not Offset			
$ millions	Gross Amounts	Amounts Offset[4]	Net Amounts Reported on the Balance Sheet	Other Recognised Financial Instruments	Cash Collateral	Financial Instrument Collateral	Net amount
Assets							
Securities purchased under agreement to resell[1]	**311**	**-**	**311**	**-**	**-**	**(311)**	**-**
Derivative financial instruments	**5,905**	**(1,067)**	**4,838**	**(3,749)**	**(71)**	**-**	**1,018**
Due from related entities - derivative financial instruments[2]	**694**	**-**	**694**	**(694)**	**-**	**-**	**-**
Total assets	**6,910**	**(1,067)**	**5,843**	**(4,443)**	**(71)**	**(311)**	**1,018**
Liabilities							
Security repurchase agreements[3]	**444**	**-**	**444**	**-**	**-**	**(444)**	**-**
Derivative financial instruments	**7,303**	**(1,067)**	**6,236**	**(3,749)**	**(781)**	**-**	**1,706**
Due to related entities - derivative financial instruments[5]	**881**	**-**	**881**	**(694)**	**-**	**-**	**187**
Total liabilities	**8,628**	**(1,067)**	**7,561**	**(4,443)**	**(781)**	**(444)**	**1,893**

	NZ Banking Group 2015						
	Effects of Offsetting on Balance Sheet			Amounts Subject to Enforceable Netting Arrangements But Not Offset			
$ millions	Gross Amounts	Amounts Offset[4]	Net Amounts Reported on the Balance Sheet	Other Recognised Financial Instruments	Cash Collateral	Financial Instrument Collateral	Net amount
Assets							
Securities purchased under agreement to resell[1]	278	-	278	-	-	(278)	-
Derivative financial instruments	7,230	(1,771)	5,459	(2,952)	(601)	-	1,906
Due from related entities - derivative financial instruments[2]	1,030	-	1,030	(1,030)	-	-	-
Total assets	8,538	(1,771)	6,767	(3,982)	(601)	(278)	1,906
Liabilities							
Security repurchase agreements[3]	219	-	219	-	-	(219)	-
Derivative financial instruments	8,488	(1,771)	6,717	(2,952)	(70)	-	3,695
Due to related entities - derivative financial instruments[5]	1,358	-	1,358	(1,030)	-	-	328
Total liabilities	10,065	(1,771)	8,294	(3,982)	(70)	(219)	4,023

1 Forms part of trading securities and other financial assets designated at fair value on the balance sheet (refer to Note 10).

2 Forms part of due from related entities on the balance sheet (refer to Note 25).

3 Forms part of other financial liabilities at fair value through income statement on the balance sheet (refer to Note 20).

4 Amounts offset against derivatives consist of NZ Branch derivative trades settled directly with a central clearing counterparty. The Overseas Bank became a direct clearing member of LCH.Clearnet Limited during the year ended 30 September 2015.

5 Forms part of due to related entities on the balance sheet (refer to Note 25).

Other recognised financial instruments

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

Cash collateral and financial instrument collateral

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

Note 29 Contingent liabilities, contingent assets and credit commitments

	NZ Banking Group	
$ millions	2016	2015
Commitments for capital expenditure		
Due within one year	**3**	5
Lease commitments[1]		
One year or less	**57**	58
Between one and five years	**141**	146
Over five years	**16**	34
Total lease commitments	**214**	238
Undrawn credit commitments		
Letters of credit and guarantees[2]	**1,084**	1,232
Commitments to extend credit[3]	**23,988**	23,834
Other commitments	**263**	220
Total undrawn credit commitments	**25,335**	25,286

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

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

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

Undrawn credit commitments

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

They expose the NZ Banking Group to liquidity risk when called upon and also to credit risk if the customer fails to repay the amounts owed at the due date. The maximum exposure to credit loss is the contractual or notional amount of the instruments disclosed above. Some of the arrangements can be cancelled by the NZ Banking Group at any time and a significant portion is expected to expire without being drawn. The actual required liquidity and credit risk exposure is therefore less than the amounts disclosed. The NZ Banking Group uses the same credit policies when entering into these arrangements as it does for on-balance sheet instruments. Refer to Note 36 for further details of liquidity risk and credit risk management.

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

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

(b) held by WNZCBL (pursuant to the CB Programme) where:

  (i) it is discovered that there has been a material breach of a sale warranty (or any such sale warranty is materially untrue);

  (ii) the loan becomes materially impaired or is enforced prior to the second monthly covered bond payment date falling after the assignment of the loan; or

  (iii) at the cut-off date relating to the loan, there were arrears of interest and that loan subsequently becomes a delinquent loan prior to the second monthly covered bond payment date falling after the assignment of the loan.

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

Guarantees

Westpac New Zealand guarantees the due and punctual payment of all sums payable to the holders of the debt securities issued by its indirect wholly-owned subsidiary, WSNZL, the proceeds of which are immediately on-lent to Westpac New Zealand. The aggregate amount of outstanding principal and interest is already reflected on the balance sheet as part of the amounts due from related entities.

In addition, WNZCBL guarantees covered bonds issued by WSNZL (refer to Note 12 for further details).

Other contingent liabilities

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

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

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 NZ Banking Group.

Westpac (NZ) Investments Limited ('**WNZIL**'), a subsidiary of Westpac New Zealand, leases the majority of the properties occupied by the NZ Banking Group. As is normal practice, the lease agreements contain 'make good' provisions which require WNZIL, upon termination of the lease, to return the premises to the lessor in the original condition. The maximum amount payable by WNZIL upon vacation of all leased premises subject to these provisions as at 30 September 2016 was estimated to be $31 million (30 September 2015: $32 million).

No amount has been recognised for the $31 million in estimated maximum vacation payments as the NZ Banking Group believes it is highly unlikely that WNZIL would incur a material operating loss as a result of such 'make good' provisions in the normal course of its business operations.

Note 30 Segment information

Accounting policy

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

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

The NZ Banking Group operates predominantly in the consumer banking and wealth, commercial, corporate and institutional banking, and investments and insurance sectors within New Zealand. On this basis, no geographical segment 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 NZ Banking Group does not rely on any single major customer for its revenue base.

Comparative information for the year ended 30 September 2015 has been restated following a change to the NZ Banking Group's operating segments in the current reporting period. The change has been made to allocate head office operating expenses and net internal interest expense to the NZ Banking Group's operating segments. Comparative information has been restated to ensure consistent presentation with the current reporting period. The NZ Banking Group's operating segments are defined by the customers they serve and the services they provide. The NZ Banking Group has identified the following main operating segments:

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

Reconciling items primarily represent:

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

	NZ Banking Group				
$ millions	**Consumer Banking and Wealth**	**Commercial, Corporate and Institutional**	**Investments and Insurance**	**Reconciling Items**	**Total**
Year ended 30 September 2016					
Net interest income/(expense)	**1,001**	**749**	**(4)**	**28**	**1,774**
Non-interest income	**194**	**246**	**128**	**20**	**588**
Net operating income	**1,195**	**995**	**124**	**48**	**2,362**
Net operating income from external customers	**1,632**	**1,418**	**129**	**(817)**	**2,362**
Net internal interest expense	**(437)**	**(423)**	**(5)**	**865**	**-**
Net operating income	**1,195**	**995**	**124**	**48**	**2,362**
Operating expenses	**(664)**	**(248)**	**(32)**	**(9)**	**(953)**
Impairment charges on loans	**(33)**	**(29)**	**-**	**(11)**	**(73)**
Profit before income tax expense	**498**	**718**	**92**	**28**	**1,336**
Total gross loans	**41,327**	**34,656**	**-**	**34**	**76,017**
Total deposits	**32,686**	**24,855**	**-**	**1,250**	**58,791**
Year ended 30 September 2015					
Net interest income/(expense)	975	704	(8)	110	1,781
Non-interest income	195	267	120	8	590
Net operating income	1,170	971	112	118	2,371
Net operating income from external customers	1,541	1,413	120	(703)	2,371
Net internal interest expense	(371)	(442)	(8)	821	-
Net operating income	1,170	971	112	118	2,371
Operating Expenses	(627)	(234)	(30)	(52)	(943)
Impairment (charges)/recoveries on loans	(27)	(21)	-	1	(47)
Profit before income tax expense	516	716	82	67	1,381
Total gross loans	38,225	31,746	-	20	69,991
Total deposits	31,153	20,763	-	1,070	52,986

Note 31 Superannuation commitments

Accounting policy

Retirement benefit obligations

The NZ Banking Group recognises an asset or a liability for its defined benefit scheme, being the net of the defined benefit obligations and the fair value of the scheme's assets. The defined benefit obligation is calculated as the present value of the estimated future cash flows, discounted using blended interest rates of government bonds that have terms to maturity approximating to the terms of the related superannuation liability. The calculation is performed annually by an independent actuary using the projected unit credit method. The carrying value of the retirement benefit obligation is disclosed as part of Note 23.

The superannuation expense is recognised in operating expenses and re-measurements are recognised through other comprehensive income.

Critical accounting assumptions and estimates

The actuarial valuation of plan obligations is dependent upon a series of assumptions, principally price inflation, salary growth, mortality, morbidity, discount rate and investment returns. Different assumptions could significantly alter the valuation of the plan assets and obligations and the superannuation cost recognised in the income statement and other comprehensive income.

The NZ Banking Group operates a defined benefit superannuation scheme for staff in New Zealand. The scheme has been closed to new members since 1 April 1990. Contributions, as specified in the rules of the scheme, are made by the NZ Banking Group based on the funding valuation performed annually. The last actuarial assessment of the funding status was undertaken on 30 June 2014. Contributions to the defined benefit scheme are at a rate sufficient to keep the scheme solvent, and contributions are currently being made to the defined benefit scheme at the rate of 12% (before employer's superannuation contribution tax) of members' salaries.

The NZ Banking Group has no material obligations in respect of post-retirement benefits other than pensions.

The table below details the primary actuarial assumptions used in the calculations of the defined benefit scheme obligation.

	NZ Banking Group	
%	**2016**	2015
Primary actuarial assumptions used		
Discount rate	**2.3**	3.3
Rate of increase in salaries	**3.0**	3.0
Rate of increase for pensions	**2.0**	2.2
Asset allocation		
Australasian Equity	**15.0**	15.4
International Equity	**33.2**	27.3
Fixed Income	**31.4**	32.3
Property & Infrastructure	**10.1**	9.8
Other	**1.8**	5.4
Cash	**8.5**	9.8
Total asset allocation	**100.0**	100.0

Note 32 Key management personnel

Key management personnel compensation

Key management personnel are defined as the Directors and senior management of the NZ Banking Group. The information disclosed relating to the key management personnel includes transactions with those individuals, their close family members and their controlled entities.

	NZ Banking Group	
	Year Ended	Year Ended
$'000s	**30-Sep-16**	30-Sep-15
Salaries and other short-term benefits	**9,978**	9,812
Post-employment benefits	**496**	539
Other termination benefits	**-**	758
Share-based payments	**2,582**	2,243
Total key management personnel compensation	**13,056**	13,352
Loans to key management personnel	**17,388**	26,910
Deposits from key management personnel	**1,132**	1,624
Interest income on amounts due from key management personnel	**702**	473
Interest expense on amounts due to key management personnel	**36**	61

Where the Directors of the Overseas Bank have received remuneration from the NZ Banking Group, the amounts are included above. Details of Directors' remuneration are disclosed in the Overseas Banking Group's 30 September 2016 Annual Financial Report.

Loans and deposits with key management personnel

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

As at 30 September 2016, no provisions have been recognised in respect of loans given to key management personnel and their related parties (30 September 2015: nil).

Note 32 Key management personnel (continued)

Other key management personnel transactions

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

Note 33 Structured entities, securitisation, funds management, other fiduciary activities and the marketing and distribution of insurance products

Accounting policy

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

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

The NZ Banking Group may have an interest in or sponsor a structured entity but not consolidate it. The details below provide information on both consolidated and unconsolidated structured entities.

Westpac New Zealand, through its housing loan securitisation programme, sells housing loans (referred to as securitised loans) to a controlled entity and that controlled entity sells residential mortgage-backed securities to investors. Securitised loans that do not qualify for derecognition and the associated funding is included in loans and debt issues respectively.

Consolidated structured entities

Securitisation

In October 2008, WNZSL was set up as part of Westpac New Zealand's internal residential mortgage-backed securitisation programme. Under this programme Westpac New Zealand sold the rights (but not the obligations) of a pool of housing loans to WNZSL. The purchase was funded by WNZSL's issuance of RMBS. These RMBS are currently held by Westpac New Zealand and are included in its due from related entities. The housing loans were not derecognised from Westpac New Zealand's financial statements in accordance with the accounting policies set out in Note 1. Accordingly, an equivalent amount of liabilities associated with the transferred rights of the pool of housing loans is recognised (in the form of a 'deemed loan' from WNZSL). The RMBS and the liability to WNZSL are fully eliminated in the NZ Banking Group's financial statements. Refer to Note 29 for a description of the NZ Banking Group's obligation to repurchase certain housing loans sold to WNZSL.

The NZ Banking Group currently has a $5,000 million (30 September 2015: $5,000 million) internal residential mortgage-backed securitisation programme. The most senior rated securities at 30 September 2016 of $4,750 million (30 September 2015: $4,750 million) qualify as eligible collateral for repurchase agreements with the Reserve Bank. Holding a portion of housing loans in securitised format enables the NZ Banking Group to maintain a readily available source of cash should market conditions become difficult. Westpac New Zealand takes advantage of the Reserve Bank's guidelines for its overnight reverse repo facility and open market operations, which allows banks in New Zealand to offer RMBS as collateral for the Reserve Bank's repurchase agreements.

Covered bonds

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

The cover pool is comprised of housing loans up to a value of $7,500 million as at 30 September 2016 (30 September 2015: $5,500 million). The intercompany loan made by Westpac New Zealand to WNZCBL to fund the initial purchase (and subsequent further purchases which increased the cover pool) is included in Westpac New Zealand's due from related entities. The housing loans purchased by WNZCBL were not derecognised from Westpac New Zealand's financial statements (and therefore, Westpac New Zealand and the NZ Banking Group recognises these housing loans) in accordance with the accounting policies outlined in Note 1. For this reason, Westpac New Zealand recognises a liability owed to WNZCBL (in the form of a 'deemed loan' from WNZCBL) of an amount equivalent to the sum of the value of the housing loans, cash and unpaid accrued interest arising from, and in respect of, the housing loans and the asset performance fee, and is included in Westpac New Zealand's due to related entities. The intercompany loan made by Westpac New Zealand to WNZCBL and the liability representing the deemed loan from WNZCBL to Westpac New Zealand are fully eliminated in the NZ Banking Group's financial statements.

Over time, the composition of the cover pool will include, in addition to housing loans, accrued interest (representing accrued and unpaid interest on the outstanding housing loans) and cash (representing collections of principal and interest from the underlying housing loans). As at 30 September 2016, the assets of WNZCBL were $7,521 million (30 September 2015: $5,520 million), comprising housing loans, accrued interest and cash.

NZ Banking Group managed funds

As disclosed in Note 25 and the 'Funds management and fiduciary activities' section, the PIE Funds are consolidated within the financial statements of the NZ Banking Group.

Non-contractual financial support

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

Unconsolidated structured entities

As at 30 September 2016, the NZ Banking Group had securitised housing loans amounting to $62 million (30 September 2015: $85 million) which had been sold by the NZ Banking Group to external parties being the Westpac Home Loan Trust ('**HLT**') and the Westpac Mortgage Investment Fund ('**MIF**') via HLT.

Note 33 Structured entities, securitisation, funds management, other fiduciary activities and the marketing and distribution of insurance products (continued)

HLT and MIF were established pursuant to trust deeds between BTNZ and The New Zealand Guardian Trust Company Limited ('**NZGT**'), as trustee for HLT and MIF, and were designed to enable investors to obtain investment exposure to housing loans. The purchase of these housing loans has been funded with the proceeds of units subscribed for, and issued to, retail investors in New Zealand. The NZ Banking Group receives fees for various services provided to HLT and MIF on standard commercial terms, including servicing fees. These fees are recognised over the financial periods in which the costs are borne. The securitised assets have been derecognised from the financial statements of the NZ Banking Group as the risks and rewards of the assets have been substantially transferred to external parties. Pursuant to the terms of the servicing agreements for HLT and MIF, any cash collected by Westpac New Zealand in respect of the securitised assets is held on behalf of NZGT, as trustee for HLT and MIF until the relevant monthly payment date when this cash is paid to NZGT. As at 30 September 2016, the amount so held by Westpac New Zealand was $0.5 million (30 September 2015: $1 million). As at 3 October 2016, securitised housing loans which had been sold to external parties HLT and MIF amounting to $62 million were re-purchased by the NZ Banking Group at fair value and will be subsequently recognised in the financial statements of the NZ Banking Group from this date.

In addition to the above, the NZ Banking Group has interests in various unconsolidated structured entities including debt or equity instruments, guarantees, liquidity and other credit support arrangements, lending, loan commitments, certain derivatives and investment management agreements in the normal course of business to facilitate customer transactions, for liquidity management purposes and for specific investment opportunities.

Interests exclude non–complex derivatives (e.g. interest rate or currency swaps), instruments that create, rather than absorb, variability in the entity (e.g. credit protection under a credit default swap), and lending to a structured entity with recourse to a wider operating entity, not just the structured entity.

The main types of interests held by the NZ Banking Group in other unconsolidated structured entities, not disclosed elsewhere in these financial statements, generally comprise the following:

- Trading securities and other financial assets designated at fair value: the NZ Banking Group buys and sells interests in structured entities as part of its normal trading activities and includes RMBS or other asset-backed securities. The carrying amount of RMBS and asset-backed securities on the balance sheet included in trading securities and other financial assets designated at fair value is $99 million (refer to Note 10) (30 September 2015: $44 million). These securities represent the senior tranche of notes issued by the structured entities and are rated investment grade. They are typically held as part of a larger trading portfolio and the NZ Banking Group would normally have no other involvement with the structured entity. The maximum exposure to loss is limited to the carrying value of these instruments at reporting date. The size of the structured entities, which is based on the total value of the notes on issue, is $810 million (30 September 2015: $200 million). The NZ Banking Group derives interest income on these securities, and also recognises realised and unrealised gains or losses arising from a change in fair value through trading income;
- Loans and other credit commitments: The NZ Banking Group provides lending facilities to other unconsolidated structured entities, in the normal course of its lending business to earn income in the form of interest and lending fees. The other unconsolidated structured entities mainly comprise securitisation vehicles originated or sponsored by third parties, where the primary source of debt service, security and repayment is derived from the underlying assets of the entity, and investment funds (including NZ Banking Group managed funds). All loans and credit commitments are subject to the NZ Banking Group's credit approval process with collateral specific to the circumstances of each loan. The carrying amount of loans (net of provisions) recognised on the balance sheet and off-balance sheet commitments relating to interest in other unconsolidated structured entities amounted to $2,228 million and $946 million respectively (30 September 2015: $1,215 million and $854 million respectively). The maximum exposure to loss is the NZ Banking Group's total committed exposure to these entities of $3,174 million as at 30 September 2016 (30 September 2015: $2,069 million). This amount represents the size of the structured entities as the information on the total assets of the entities is not available to the NZ Banking Group; and
- Investment management agreements: As part of its normal funds management activities, the NZ Banking Group establishes and manages a number of funds that provide customers with investment opportunities. The NZ Banking Group also manages superannuation funds established for its employees. As the fund manager, the NZ Banking Group is entitled to receive on-going management and fee income based on the value of the assets under management. As at 30 September 2016, the accrued receivable included in 'Other assets' is $6 million (30 September 2015: $4 million). The NZ Banking Group also retains units in these funds, which are primarily held by its consolidated life insurance entity. The carrying value of these units included in life insurance assets amounts to $160 million (30 September 2015: $157 million), which is also the NZ Banking Group's maximum exposure to loss. The NZ Banking Group derives fund distribution income from these holdings and recognises fair value movements (through non-interest income) where the instruments are held at fair value through the income statement. The size of the entities, represented by the value of assets subject to funds management and other fiduciary activities (excluding the PIE Funds as they are consolidated in NZ Banking Group's balance sheet) is $8,173 million (refer to the 'Funds management and other fiduciary activities' section) (30 September 2015: $7,090 million). The NZ Banking Group (through NZ Branch) also guarantees the repayment of capital in the Capital Protection Plan Funds, except in certain limited circumstances. The amount of guarantees provided by the NZ Branch is included in off-balance sheet commitments above. The size of the Capital Protection Plan Funds is $65 million (30 September 2015: $65 million) which is included in the value of funds under management under 'Retirement plans' (refer to the 'Funds management and other fiduciary activities' section).

Non-contractual financial support

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

Funds management and other fiduciary activities

The NZ Banking Group conducts investment and other fiduciary activities that result in the holding or placing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions. These assets are not the property of the NZ Banking Group and accordingly are not included in these financial statements, with the exception of the PIE Funds which are treated as controlled entities of Westpac New Zealand (refer to Note 25 for further details) and life insurance assets owned by Westpac Life-NZ- Limited ('**Westpac Life**') which are included in wholesale client portfolios. Where controlled entities incur certain liabilities in respect of these activities, a right of indemnity exists against the assets of the applicable trusts. As these assets are sufficient to cover liabilities, and it is not probable that the controlled entities will be required to settle them, the liabilities are not included in the consolidated financial statements.

The PIE Funds are managed by a member of the NZ Banking Group (refer to Note 25 for further details) and invest in deposits with Westpac New Zealand. Westpac New Zealand is considered to control the PIE Funds, and as such they are consolidated within the financial statements of the NZ Banking Group.

Note 33 Structured entities, securitisation, funds management, other fiduciary activities and the marketing and distribution of insurance products (continued)

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

$ millions	2016	2015
Private and priority	**587**	462
Retirement plans	**4,578**	3,750
Retail unit trusts	**2,389**	2,241
Wholesale client portfolios	**619**	637
Term PIE	**1,365**	1,186
Cash PIE	**1,038**	1,056
Notice Saver PIE	**190**	116
Total funds under management	**10,766**	9,448

The value of assets in retail unit trusts described above includes the assets of HLT and MIF.

Marketing and distribution of insurance products

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

Risk management

The NZ Banking Group's risk management strategy (refer to Note 36) will help minimise the possibility that any difficulties arising from the above activities would impact adversely on the NZ Banking Group.

Note 34 Insurance business

Accounting policy

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

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

Assets held by the NZ Banking Group's life insurance company, including investments in funds managed by the NZ Banking Group, are designated at fair value through profit or loss. Changes in fair value are recognised in non-interest income.

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

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

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

Critical accounting assumptions and estimates

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

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

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

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

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

$ millions	2016	2015
Total assets of insurance business	**187**	206
As a percentage of total consolidated assets of the NZ Banking Group	**0.20%**	0.23%

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

Note 35 Capital adequacy

The table below represents the capital adequacy calculation for the Overseas Banking Group and Overseas Bank based on Australian Prudential Regulation Authority's ('**APRA**') application of the Basel III capital adequacy framework as at balance date.

%	2016 Unaudited	2015 Unaudited
Overseas Banking Group (excluding entities specifically excluded by APRA regulations)[1, 2]		
Common equity Tier 1 capital ratio	**9.5**	9.5
Additional Tier 1 capital ratio	**1.7**	1.9
Tier 1 capital ratio	**11.2**	11.4
Tier 2 capital ratio	**1.9**	1.9
Total regulatory capital ratio	**13.1**	13.3
Overseas Bank (Extended Licensed Entity)[1, 3]		
Common equity Tier 1 capital ratio	**9.7**	9.7
Additional Tier 1 capital ratio	**1.9**	2.1
Tier 1 capital ratio	**11.6**	11.8
Tier 2 capital ratio	**2.1**	2.1
Total regulatory capital ratio	**13.7**	13.9

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

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

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

The Overseas Banking 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 New Zealand regulations this methodology is referred to as the Basel III (internal models based) approach. With this accreditation, the Overseas Banking Group is required to disclose additional detailed information on its risk management practices and capital adequacy on a quarterly basis. This information is made available to users via the Overseas Banking Group's website (www.westpac.com.au). The aim is to allow the market to better assess the Overseas Banking Group's risk and reward assessment process and hence increase the scrutiny of this process.

The Overseas Banking Group (excluding entities specifically excluded by APRA regulations), and the Overseas Bank (Extended Licensed Entity as defined by APRA), exceeded the minimum capital adequacy requirements as specified by APRA as at 30 September 2016. APRA specifies a minimum prudential capital ratio for the Overseas Banking Group, which is not made publicly available.

The Overseas Banking Group's approach seeks to balance the fact that capital is an expensive form of funding with the need to be adequately capitalised. The Overseas Banking Group considers the need to balance efficiency, flexibility and adequacy when determining sufficiency of capital and when developing capital management plans.

The Overseas Banking Group evaluates these considerations through an Internal Capital Adequacy Assessment Process, the key features of which include:

- the development of a capital management strategy, including preferred capital range, capital buffers and contingency plans;
- consideration of both economic and regulatory capital requirements;
- a process that challenges the capital measures, coverage and requirements which incorporates amongst other things, the impact of adverse economic scenarios; and
- consideration of the perspectives of external stakeholders including rating agencies and equity and debt investors.

Note 36 Risk management

General

The NZ Banking Group regards the management of risk to be a fundamental management activity performed at all levels. Effective risk management incorporating a sound risk culture is one of the essential elements of sound risk management. Supporting this approach is a risk management strategy that supports a holistic approach to risk management and sets out minimum standards for risk management across all risk types ('**Risk Management Strategy**').

Risk strategy and governance

The Board of the Overseas Bank ('**Group Board**') is responsible for determining the appetite for risk for the Overseas Banking Group. Group Board is supported by the Board Audit Committee ('**Group BAC**') and Board Risk and Compliance Committee ('**Group BRCC**'). The Group BRCC is a Group Board subcommittee that is responsible for setting the Overseas Banking Group's risk appetite and overseeing the Overseas Banking Group's risk profile.

The Group BAC comprises four independent non-executive Directors of the Overseas Bank. The Group BAC assists the Board in fulfilling its responsibilities by having oversight of the: integrity of the financial statements and financial reporting systems of the Overseas Banking Group; external audit engagement; performance of the internal audit function; the integrity of the Overseas Banking Group's corporate reporting; and compliance with the Overseas Banking Group's regulatory and statutory reporting requirements.

The Group BRCC comprises all of the independent non-executive Directors of the Overseas Bank. The Group BRCC has power delegated by the Group Board to set risk appetites and approve frameworks, policies and processes for the management of risk. The Group BRCC recommends the Group Risk Management Strategy to the Group Board for approval.

Note 36 Risk management (continued)

The Group Risk Management Strategy applies to the entities that make up the Overseas Banking Group where it has not been deemed necessary to develop individual risk management strategies to suit local conditions, regulatory or legislative requirements.

The NZ Banking Group manages the risks that affect its business as they influence its performance, reputation and future success. The NZ Banking Group adopts a Three Lines of Defence approach to risk management which reflects its culture of 'risk is everyone's business' and that all employees are responsible for identifying and managing risk and operating within the NZ Banking Group's desired risk profile.

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

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

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

The 2nd Line of Defence is a separate risk and compliance advisory, control and monitoring function which establishes frameworks, policies, limits and processes for the management, monitoring and reporting of risk. The 2nd line of Defence may approve risks outside the authorities granted to the 1st Line and evaluates and opines on the adequacy and effectiveness of 1st Line controls and application of frameworks and policies and, where necessary, requires improvement and monitors the 1st Line's progress toward remediation of identified deficiencies.

The 3rd Line of Defence – independent assurance

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

Further to the Directors' Statement on page 9:

- the Overseas Bank and Westpac New Zealand together had systems in place to monitor and control adequately the material risks of the following relevant members of the NZ Banking Group:
  - BT Funds Management (NZ) Limited;
  - BT Financial Group (NZ) Limited;
  - Westpac Financial Services Group-NZ- Limited;
  - Westpac Life-NZ- Limited;
  - Westpac Nominees-NZ- Limited;
  - Westpac Superannuation Nominees-NZ-Limited;
  - Westpac Group Investment-NZ-Limited;
  - Westpac Holdings - NZ - Limited;
  - Westpac Capital-NZ- Limited; and
  - Westpac New Zealand Group Limited;
- the Overseas Bank, the NZ Branch and Westpac New Zealand together had systems in place to monitor and control adequately the material risks of the NZ Branch;
- the Overseas Bank had systems in place to monitor and control adequately the material risks of Capital Finance New Zealand Limited and Sie-Lease (New Zealand) Pty Limited; and
- the remaining relevant members of the NZ Banking Group are not considered to have material risks.

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

Westpac Life–NZ- Limited and BT Funds Management (NZ) Limited maintain separate Risk Management Frameworks. Both documents are approved by the respective Board of each entity and are closely aligned to the Group Risk Management Strategy whilst reflecting each entity's specific regulatory and operating environment.

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

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

Sound risk management

The essential elements of sound risk management include:

- a sound risk culture of 'risk is everyone's business' and awareness of risk management supported by regular communication;
- observable linkages between strategy and risk appetite;
- clearly defined accountabilities, responsibilities and authorities;
- an appropriate level of resources with the capabilities, training and tools (or infrastructure) required to fulfil their responsibilities and support the strategy;
- clearly defined operating structures, reporting lines and governance structures;
- clear principles, goals, objectives and incentives, including risk-adjusted performance measures to support appropriate behaviour and risk and customer outcomes;
- processes and systems that facilitate:
  - risk identification, analysis, evaluation and quantification, including stress testing;
  - communication, reporting and escalation of material risk issues and incidents;
  - risk reward decisions including appropriate targets and buffers;
  - mitigation and acknowledgement or management of residual risk; and
  - capture and reporting of risk data for both internal and external purposes;
- measured risk taking within risk appetite; proactive management of issues, incidents, concerns and risks outside tolerance levels; and

Note 36 Risk management (continued)

- assurance processes which include testing to demonstrate that risk-related practices and controls are appropriately embedded and comply with internal, regulatory and legislative requirements.

Risk types

The NZ Banking Group is subject to key banking risks and those risks arising from the general business environment of each entity, these risks may include:

- Credit risk: the risk of financial loss when a customer or counterparty fails to meet their financial obligations;
- Compliance risk: the risk of legal or regulatory sanction, financial or reputational loss arising from the NZ Banking Group's failure to abide by the compliance obligations required of the NZ Banking Group;
- Operational risk: the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. The definition is aligned to the regulatory (Basel II) definition, including legal and regulatory risk but excluding strategic and reputation risk;
- Market risk: the risk of an adverse impact on earnings resulting from changes in market factors, such as foreign exchange rates, interest rates, commodity prices and equity prices. This includes interest rate risk in the banking book – the risk to interest income from a mismatch between the duration of assets and liabilities that arises in the normal course of business activities; and
- Liquidity risk: the risk that the NZ Banking Group will be unable to fund assets and meet obligations as they come due.

Additional details surrounding the risk management activities relating to the management of these risks are disclosed below under the relevant headings.

Other risks include:

- Conduct risk: the risk that the provision of services and products by the NZ Banking Group results in unsuitable or unfair outcomes for the NZ Banking Group's customers or undermines market integrity;
- Business risk: the risk associated with the vulnerability of a line of business to changes in the business environment;
- Environmental, social and governance risk: the risk that the NZ Banking Group damages its reputation or financial performance (or opportunity costs) due to failure to recognise or address material existing or emerging environmental, social or governance factors. It is a risk arising from failure to consider the inter-generational sustainability and the NZ Banking Group's responsibility to manage the impact on its stakeholders;
- Insurance risk: the risk of mis-estimation of the expected cost of insured events, volatility in the number or severity of insured events, and mis-estimation of the cost of incurred claims;
- Reputation risk: the risk of the loss of reputation, stakeholder confidence, or public trust and standing; and
- Subsidiary (contagion) risk: the risk that problems arising in other NZ Banking Group members compromise the financial and operational position of the authorised deposit-taking institution in the NZ Banking Group.

Group Audit

Group Audit for the Overseas Banking Group ('**Group Audit**') comprises the Group Audit and Credit Portfolio Review (including Model Risk) functions. Group Audit provides an independent assessment of the adequacy and effectiveness of management's controls over operational, market, liquidity and compliance risks. Credit Portfolio Review provides an independent assessment of the effectiveness of the NZ Banking Group's credit management activities and the adequacy of credit provisioning, as well as an independent assessment over compliance with Group model risk policy. The New Zealand Audit function comprises a New Zealand based Audit team, supported by the Overseas Banking Group's Credit Portfolio Review (including Model Risk) functions. Group Audit reports on a quarterly basis, or more often as deemed appropriate, to the Group BAC, to agree the budget and the annual audit plan and to report its findings. In addition, the Group BAC has private sessions with the General Manager Group Audit. Furthermore, the General Manager Group Audit reports to the Chair of the Group BAC, and for administrative purposes to the Overseas Bank's Chief Financial Officer, a member of the Overseas Bank's Executive Team.

As independent functions, New Zealand Audit and Group Audit have no direct authority over the activities of management. They have unlimited access to all the NZ Banking Group's activities, records, property and employees. The scope of responsibility of New Zealand Audit covers systems of management control across all business activities and support functions at all levels of management within the NZ Banking Group. The level of operational risk determines the scope and frequency of individual audits. New Zealand Audit periodically reviews the adequacy and effectiveness of management's controls over market risk and liquidity risk.

Reviews in respect of risk management systems

New Zealand Audit participates in the six monthly management assurance programme in order to assess the adequacy of the governance framework supporting operational risk management.

Group Audit's Credit Portfolio Review function has a rolling programme of credit and model risk reviews throughout the financial year. New Zealand Audit, with support from the Overseas Bank's Group Audit unit, also periodically reviews the NZ Banking Group's Operational, Compliance, Market, Funding and Liquidity Risk Frameworks. These reviews are not conducted by a party which is external to the NZ Banking Group or the Overseas Bank, though they are independent and have no direct authority over the activities of management.

36.1 Credit risk

Credit risk is the risk of financial loss resulting from the failure of customers or counterparties to fully honour the terms and conditions of a contract with the NZ Banking Group. It arises from the NZ Banking Group's lending, interbank, treasury and international trade activities.

Credit risk management

The Board approves major prudential policies and limits that govern large customer exposures, country risk, industry concentration and dealings with related entities. The Board delegates approval authorities to the Westpac New Zealand Chief Executive and the Group Chief Risk Officer, who in turn appoint independent credit officers in each business area. These credit specialists work with line managers to ensure that approved policies are applied appropriately so as to optimise the balance between risk and reward. The Credit Risk Assurance unit provides independent assessments of the quality of the NZ Banking Group's credit portfolio.

The NZ Banking Group is responsible for implementing and operating within established risk management frameworks and policies and has adapted the Overseas Banking Group's credit risk policy to the NZ Banking Group's customer and product set. Accordingly, the NZ Banking Group has its own credit manuals and delegated approval authorities which are approved by the Overseas Banking Group.

Note 36 Risk management (continued)

The NZ Banking Group monitors its portfolio to guard against the development of risk concentrations. This process allows the NZ Banking Group's credit risk to be well diversified throughout the New Zealand economy. The NZ Banking Group has established separate reporting and prudential limits for borrowings that can be accessed by a single customer group. These limits apply to both borrowing equivalents and settlement risk. Separate limits apply to corporates, governments, financial institutions and banks and are scaled by risk grade. Any excesses of limits are reported quarterly to the Westpac New Zealand Board Risk and Compliance Committee ('**Westpac New Zealand BRCC**'), along with a reason for the excess.

All business units produce regular delinquency reports that detail excesses and delinquency positions. These reports trigger appropriate remedial action consistent with risk management procedures aligned to credit approval authority. Delinquency reporting is used to monitor portfolio performance, origination policies and credit decision-making.

Credit policies with group-wide implications are owned by the Group Risk division of the Overseas Bank ('**Overseas Bank Group Risk**'). Compliance with these policies is administered locally.

Overseas Bank Group Risk establishes and maintains the group-wide credit risk management framework, policies and risk concentration limits which incorporate sound credit risk management practices, reflect approved risk appetite and strategy and meet relevant regulatory and legislative obligations. Within these boundaries the NZ Banking Group has its own credit approval limits approved by the Board of Westpac New Zealand and delegated by the Overseas Bank Group Chief Risk Officer. These establish a hierarchy of credit approval levels, aligned to customer risk grades and consistent with normal customer exposures in the business. Any excesses of the group-wide limits are reported quarterly to the Board and Group BRCC, along with a strategy addressing the ongoing management of the excess.

Credit risk mitigation, collateral and other credit enhancements

The NZ Banking Group uses a variety of techniques to reduce the credit risk arising from its lending activities. Enforceable legal documentation establishes the NZ Banking Group's direct, irrevocable and unconditional recourse to any collateral, security or other credit enhancements provided.

The table below describes the nature of collateral held for financial asset classes.

Financial assets	Nature of collateral
Derivative financial instruments	Netting agreements can be used to enable the effects of derivative assets and derivative liabilities with the same counterparty to be offset when measuring these exposures. Additionally, collateralisation agreements are also typically entered into with major derivatives counterparties to avoid the potential build up of excessive mark-to-market positions. Derivative transactions are increasingly being cleared through central clearers.
Loans	Housing and other loans for consumer purposes may be secured, partially secured or unsecured depending on the product. Security is typically taken by a fixed and/or floating charge over property or other assets. Loans for business purposes may be secured, partially secured or unsecured. Security is typically taken by way of a fixed and/or floating charge over property, business assets, or other assets. Other forms of credit protection may also be sought or taken out if warranted.

Management of risk mitigation

The NZ Banking Group mitigates credit risk through controls covering:

Collateral and valuation management	The Overseas Bank manages collateral under collateralisation agreements centrally for all branches of the Overseas Bank and Westpac New Zealand. The estimated realisable value of collateral held in support of loans is based on a combination of: ▪ formal valuations currently held for such collateral; and ▪ management's assessment of the estimated realisable value of all collateral held. This analysis also takes into consideration any other relevant knowledge available to management at the time. Updated valuations are obtained when appropriate. Collateral related to financial markets positions is revalued on a daily basis and formal processes are in place to promptly call for collateral top-ups, if required. The collaterisation arrangements are documented via the Credit Support Annex of the International Swaps and Derivatives Association dealing agreements.
Other credit enhancements	The NZ Banking Group only recognises unconditional irrevocable guarantees or standby letters of credit issued by, or eligible credit derivative protection bought from, the following entities, provided they are not related to the underlying obligor: ▪ sovereign entities; ▪ public sector entities in Australia and New Zealand; ▪ authorised deposit-taking institutions and overseas banks; and ▪ other entities with a minimum risk grade equivalent of A3/A-.
Netting	Creditworthy customers domiciled in New Zealand may enter into formal agreements with the NZ Banking Group, permitting the NZ Banking Group to set-off gross credit and debit balances in their nominated accounts. Cross-border set-offs are not permitted. Close-out netting is undertaken with counterparties with whom the NZ Banking Group has entered into a legally enforceable master netting agreement for their off balance sheet financial market transactions, in the event of default. Further details of offsetting are provided in Note 28.
Central clearing (ASX/LCH)	The NZ Banking Group increasingly executes derivative transactions through central clearing counterparties. Central clearing counterparties mitigate risk through stringent membership requirements, the collection of margin against all trades placed, the collective collateral pool, and an explicitly defined order of priority of payments in the event of default.

Note 36 Risk management (continued)

Internal credit risk rating system

In applying its Control Principles of Credit, the NZ Banking Group recognises and reflects two approaches to managing credit risk based on the nature of the customer and product:

- **Transaction-managed approach**

  For larger customers the NZ Banking Group evaluates credit requests by undertaking detailed individual customer and transaction risk analysis (the '**transaction-managed**' approach). NZ Banking Group assigns a customer risk grade ('**CRG**') to each customer, corresponding to their Probability of Default ('**PD**'). Each facility is assigned a Loss Given Default ('**LGD**') taking into account the realistic distress value of assets over which the NZ Banking Group holds security and considering the seniority of exposures in the capital and debt structure of the customer. The final assignment of CRGs and LGDs are approved by independent credit officers with appropriate authority. Divisional operational units are responsible for ensuring accurate and timely recording of all changes to customer and facility data.
- **Program-managed approach**

  High-volume customer credit portfolios with homogenous credit risk characteristics are managed on a statistical basis according to predetermined objective criteria (the '**program-managed**' approach). Quantitative scorecards are used to assign application and behavioural scores to enable risk-based decision-making within these portfolios. The scorecard outcomes and decisions are regularly monitored and validated against subsequent customer performance and recalibrated (or rebuilt) when required. For capital estimation, and other purposes, risk-based customer segments are created based on expected PDs, and LGDs are assigned for each segment based on historic experience and management judgment.

The principal objective of the credit risk rating system is to produce a reliable quantitative assessment of the credit risk to which the NZ Banking Group is exposed.

The NZ Banking Group's internal credit risk rating system for transaction-managed customers is based on the Overseas Banking Group's internal credit risk rating system and assigns a CRG to each customer, corresponding to their expected PD, and has 20 risk grades for non-defaulted customers and 10 risk grades for defaulted customers. Non-defaulted CRGs are mapped to Moody's Investors Service ('**Moody's**') and S&P Global Ratings ('**S&P**') external senior ranking unsecured ratings. This mapping is reviewed annually and allows the NZ Banking Group to use the rating agencies' long-run default history to calculate long-run average PDs.

The table below shows the current alignment between the NZ Banking Group's CRGs, the corresponding external rating and the supervisory slotting grade. Note that only high-level CRG groupings are shown.

NZ Banking Group's CRG	S&P rating	Moody's rating	Supervisory slotting grade
A	AAA to AA-	Aaa to Aa3	Strong
B	A+ to A-	A1 to A3	Strong
C	BBB+ to BBB-	Baa1 to Baa3	Strong
D	BB+ to B+	Ba1 to B1	Good/satisfactory
NZ Banking Group rating			
E	Watchlist		Weak
F	Specific mention		Weak
G	Substandard/default		Weak/default
H	Default		Default

The retail (program-managed) portfolio is segmented into pools of similar risk. Segments are created by analysing characteristics that have historically proven predictive in determining if an account is likely to go into default. Customers are then grouped according to these predictive characteristics of default. Each segment is assigned a quantified measure of its PD, LGD and exposure at default ('**EAD**').

The NZ Banking Group's credit risk rating system is reviewed annually to ensure the rating criteria and procedures are applicable to the current portfolio and external conditions. The annual review of the credit risk rating system is approved by the Group BRCC.

To ensure the credit risk rating system is applied consistently across the NZ Banking Group, the Overseas Banking Group's Credit Risk Assurance team independently reviews end-to-end technical and operational aspects of the overall process. Models materially impacting the risk rating process are reviewed annually in accordance with the Overseas Banking Group's model risk policy.

Specific credit risk estimates (including PD, LGD and EAD levels) are overseen and approved by a subcommittee of the Overseas Banking Group Credit Risk Committee.

Use of internal credit risk estimates

In addition to using the credit risk estimates for regulatory capital purposes, they are also used for the following purposes:

Economic capital

The NZ Banking Group allocates economic capital to all exposures. Economic capital includes both credit and non-credit components. Economic credit capital is allocated using a framework that considers estimates of PD, LGD, EAD, Total Committed Exposure and loan tenor as well as measures of portfolio composition not reflected in regulatory capital formulae[1].

Pricing

The NZ Banking Group prices loans so as to produce an acceptable return on the economic capital allocated to the loan, after expected credit losses (and other costs) are incurred. Estimates of economic capital and expected credit losses take into account estimates of PD, LGD and EAD.

[1] The NZ Banking Group uses economic capital as the basis for risk-adjusted decision-making across the NZ Banking Group and allows differences between economic and regulatory capital where such differences drive better medium-term to long-term business decisions.

Note 36 Risk management (continued)

Provisioning

Impairment provisions are reserves held by the NZ Banking Group to cover credit losses that are incurred in the loan portfolio. Individual provisions are calculated on impaired loans taking into account management's best estimate of the present value of future cash flows. Collective provisions are established on a portfolio basis taking into account the level of arrears, collateral, past loss experience and emergence periods. Transaction-managed portfolio provisions use the risk grading framework and suitable PDs, LGDs and EADs are assigned to each customer/facility as the basis for the calculation. Program-managed portfolios use estimated loss rates based on recent past experience as the primary basis of the calculation. These estimates are then adjusted for the specific requirements of NZ IFRS.

Credit approval authorities

For transaction-managed facilities, the approval authorities are allocated based on the CRG with lower limits applicable for customers with a higher PD. Program-managed facilities are approved on the basis of application scorecard outcomes and product-based approval authorities.

Risk-adjusted performance measurement

Business unit performance is measured using an economic profit framework which incorporates charges for economic credit capital as well as capital for other risk types.

Regulatory capital

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

Overview of the internal credit risk ratings process by portfolio

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

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

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

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

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

PD

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

LGD

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

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

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

*EAD and Credit Conversion Factor ('**CCF**')*

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

EAD therefore consists of the initial outstanding balances plus the CCF multiplied by undrawn commitments. For transaction-managed exposures CCF's are all 100%.

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

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

Note 36 Risk management (continued)

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

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

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

PD

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

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

LGD

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

EAD

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

Market and/or credit risk concentrations

All exposures to risk transfer counterparties are separately approved under the NZ Banking Group's usual credit approval process with the amount and tenor of mitigation recorded against the counterparty in the NZ Banking Group's exposure management systems. The credit quality of mitigation providers is reviewed regularly in accordance with the NZ Banking Group's usual periodic review processes.

Market risks arising from credit risk mitigation activities are managed similarly to market risks arising from any other trading activities. These risks are managed under either the market risk banking book or trading book frameworks as appropriate.

The banking book is managed by credit limits to restrict credit exposure. Net interest positions are managed within the banking book market risk framework by Value at Risk ('**VaR**') and structural risk limits. The structural risk limits restrict the size of market risk exposures that can be taken on any part of the yield curve.

In the trading book, market risk flowing from credit risk mitigation deals is combined with the underlying market risk and assessed against structural (and VaR) risk limits. The structural risk limits include volume, basis point, 'greeks' and other limits to avoid undue concentration of market risk. These are set and overseen by the independent market risk management unit. The structural risk limits are set taking into account business strategy, trader experience and market liquidity.

Foreign exchange and derivative credit risk management

Foreign exchange and derivative activities expose the NZ Banking Group to pre-settlement and settlement risk. A real-time global limits system is used to record exposure against limits for these risk types. Pre-settlement risk is the risk that the counterparty to a contract defaults prior to settlement when the value of the contract is positive. Both the current replacement cost and the potential future credit risk are taken into consideration in the assessment of pre-settlement risk. 'Close out' netting is used to reduce gross credit exposures for counterparties where legally enforceable netting agreements are in place. In a close out netting situation, the positive and negative mark-to-market values of all eligible foreign exchange and derivative contracts with the same counterparty are netted in the event of default and regardless of maturity.

The NZ Banking Group increasingly executes derivative transactions through central clearing counterparties. The NZ Banking Group's credit exposure to central clearing counterparties is mitigated through the risk management framework employed by the central clearing counterparties which includes stringent membership requirements, initial margin collected on all trades and the structure of the default waterfall. These membership and margin requirements are managed centrally by the Overseas Bank.

Note 36 Risk management (continued)

Maximum exposure to credit risk

$ millions	NZ Banking Group 2016	2015
Financial assets		
Cash and balances with central banks	**1,472**	939
Due from other financial institutions	**844**	168
Trading securities and other financial assets designated at fair value	**4,035**	4,215
Derivative financial instruments	**4,838**	5,459
Available-for-sale securities	**3,790**	3,421
Loans	**75,582**	69,576
Life insurance assets	**8**	28
Due from related entities	**1,218**	3,451
Other assets	**254**	325
Total financial assets	**92,041**	87,582
Undrawn Credit Commitments		
Letters of credit and guarantees	**1,084**	1,232
Commitments to extend credit	**23,988**	23,834
Other commitments	**263**	220
Total undrawn credit commitments	**25,335**	25,286
Total maximum credit risk exposure	**117,376**	112,868

The NZ Banking Group's residential mortgages by loan-to-value ratio ('LVR') as at 30 September 2016 (unaudited)

In order to calculate origination LVR, the current exposure is that used in the internal ratings based approach for mortgage lending. For loans originated from 1 January 2008, the NZ Banking Group utilises its loan origination system.

For loans originated prior to 1 January 2008, the origination LVR is not separately recorded, and therefore not available for disclosure as required under Clause 1 of Schedule 9 of the Order. For these loans, the NZ Banking Group utilises its dynamic LVR process to calculate an origination LVR. Exposures for which no LVR is available have been included in the 'Exceeds 90%' category in accordance with the requirements of the Order.

	NZ Banking Group 2016			
LVR Range ($ millions)	Does not exceed 80%	Exceeds 80% and not 90%	Exceeds 90%	Total
On-balance sheet exposures	**37,807**	**5,207**	**1,822**	**44,836**
Undrawn commitments and other off-balance sheet exposures	**8,273**	**441**	**150**	**8,864**
Value of exposures	**46,080**	**5,648**	**1,972**	**53,700**

The NZ Banking Group's reconciliation of residential mortgage-related amounts (unaudited)

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

$ millions	NZ Banking Group 2016
Term loans - Housing (as disclosed in Note 12)	**45,126**
Reconciling items:	
Unamortised deferred fees and expenses	**(194)**
Fair value hedge adjustments	**(96)**
Value of undrawn commitments and other off-balance sheet amounts relating to residential mortgages	**8,864**
Residential mortgages by LVR	**53,700**

Credit quality of financial assets

An asset is considered to be past due when any payment under the contractual terms has been missed. The amount included as past due is the entire contractual balance, rather than the overdue portion. The breakdown in the table below does not always align with the underlying basis by which credit risk is managed within the NZ Banking Group. The NZ Banking Group considers loans for business purposes to be delinquent after considering all relevant circumstances surrounding the customer. Residential mortgages and personal loans that are more than five days past due are considered to be delinquent.

All the financial assets of the NZ Banking Group as at 30 September 2016 and 2015, other than loans (as disclosed in Note 13), are neither past due nor impaired.

The credit quality of financial assets of the NZ Banking Group that are neither past due nor impaired have been assessed by reference to the credit risk rating system adopted internally. All the financial assets of the NZ Banking Group that are neither past due nor impaired fall into the 'Strong' category except those disclosed.

Note 36 Risk management (continued)

$ millions	NZ Banking Group 2016 Strong	2016 Good/ Satisfactory	2016 Weak	2016 Total	2015 Strong	2015 Good/ Satisfactory	2015 Weak	2015 Total
Trading securities and other financial assets designated at fair value (refer to Note 10)	**4,027**	**8**	**-**	**4,035**	4,202	13	-	4,215
Derivative financial instruments (refer to Note 26)	**4,585**	**253**	**-**	**4,838**	5,348	102	9	5,459
Loans (refer to Note 13)	**30,835**	**41,460**	**2,296**	**74,591**	21,213	46,132	1,100	68,445
Other finanical assets [1] (refer to Note 16)	**56**	**74**	**4**	**134**	50	108	2	160

[1] Comparative information has been restated to ensure consistent presentation with the current reporting period.

Collateral held

Loans

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

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

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

%	NZ Banking Group 2016	2015
Fully secured	**75**	75
Partially secured	**13**	13
Unsecured	**12**	12
Total net loans	**100**	100

Collateral held against financial assets other than loans

$ millions	NZ Banking Group 2016	2015
Cash	**76**	628
Securities under reverse repurchase agreements	**311**	278
Total other collateral held	**387**	906

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

36.2 Compliance and operational risk

Compliance risk

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

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

The Compliance Management Framework outlines business requirements for managing compliance and mitigating compliance risk with respect to governance, risk identification, controls and documentation, reporting and monitoring, and continual improvement. This Framework is approved by the Overseas Bank's BRCC.

Westpac New Zealand operates its own Compliance Management Framework that is closely aligned with that of the Overseas Bank. The Westpac New Zealand Framework is approved by the Westpac New Zealand BRCC.

Operational risk

Operational risk arises from inadequate or failed internal processes, people and systems or from external events, and includes legal and regulatory risk, but excludes strategic and reputation risk. Operational risk has the potential, as a result of the way business objectives are pursued, to negatively impact the NZ Banking Group's financial performance, customer service and/or reputation in the community or cause other damage to the business.

The Operational Risk Management Framework outlines the business requirements for managing operational risk with respect to governance, risk and control assessments, incident management, and reporting and monitoring. This Framework is approved by the Overseas Bank's BRCC.

Westpac New Zealand has its own Operational Risk Management Framework that is closely aligned with that of the Overseas Bank. The Westpac New Zealand Framework is approved by the Westpac New Zealand BRCC.

Note 36 Risk management (continued)

36.3 Market risk

Market risk is the potential for loss arising from adverse movements in the level and volatility of market factors such as foreign exchange rates, interest rates, commodity prices and equity prices. The NZ Banking Group's exposure to market risk arises out of its Financial Markets ('**FM**') and Treasury activities.

Traded market risk

Approach

The NZ Banking Group's exposure to traded market risk arises out of its FM and Treasury trading activities. These activities are controlled by the Overseas Banking Group's Market Risk Management Framework approved by the Group BRCC. Westpac New Zealand operates its own Market Risk Management Framework that is closely aligned with that of the Group. The Westpac New Zealand Framework is approved by the Westpac New Zealand BRCC. Market risk is managed using VaR and structural risk limits (including volume limits and basis point value limits) in conjunction with scenario analysis and stress testing. Market risk limits are allocated to business management based upon business strategies and experience, in addition to market liquidity and concentration risks. All trades are fair valued daily, using independently sourced or reviewed rates. Rates that have limited independent sources are reviewed at least on a monthly basis.

FM trading book activity represents dealings that encompass book running and distribution activity. The types of market risk arising from FM trading activity include interest rate risk, foreign exchange risk, credit spread risk and volatility risk.

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

VaR limits

The Group BRCC has approved a VaR limit for the combined trading activities of the Overseas Banking Group's FM and Group Treasury units.

Backtesting

Daily backtesting of VaR results is performed to ensure model integrity is maintained. A review of the potential profit and loss outcomes is also undertaken to monitor any skew created by the historical data.

Stress testing

Daily stress testing against pre-determined scenarios is performed to analyse potential losses beyond the 99% confidence level. An escalation framework around selective stress tests is approved by the Overseas Banking Group's Risk Committee ('**RISKCO**').

Profit and loss notification framework

The Group BRCC has approved a profit and loss notification framework. Included in this framework are levels of escalation in accordance with the size of the profit or loss. Triggers are applied to both a 1-day and a rolling 20-day cumulative total.

Structure and organisation

An independent Market Risk Management unit ('**Market Risk Management**') is responsible for the daily measurement and monitoring of market risk exposures. This unit performs daily stress tests on the trading portfolios to quantify the impact of extreme or unexpected movements in market factors. Stress tests include historical market movements, tests defined by one of the market risk committees or management and independent scenarios developed by the Overseas Banking Group's economics department.

Risk reporting

Daily monitoring of current exposure and limit utilisation is conducted independently by Market Risk Management, which monitors market risk exposures against VaR and structural limits. Daily VaR position reports are produced by risk type, by product lines and by geographic region. These are supplemented by structural risk reporting, advice of profit and loss trigger levels and stress test escalation trigger points. Model accreditation has been granted by APRA for the use of the internal model approach for the determination of regulatory capital for the key classes of interest rate (general market), and foreign exchange (including specific risk) risks. Specific risk refers to the variations in individual security prices that cannot be explained by general market movements and event and default risk.

Risk mitigation

Market risk positions are managed by the trading desks consistent with delegated trading and product authorities. Risks are consolidated into portfolios based on product and risk type. Risk management is carried out by suitably qualified personnel with varying levels of seniority commensurate with the nature and scale of market risks under management.

The following controls allow for continuous monitoring of market risks by management:

- trading authorities and responsibilities are clearly delineated at all levels to ensure accountability;
- a structured system of limits and reporting of exposures;
- all new products and significant product variations undergo a rigorous approval process to ensure business risks have been identified prior to launch;
- models that are used to determine risk or profit and loss for the NZ Banking Group's accounts are independently reviewed; and
- duties are segregated to ensure that employees involved in the origination, processing and valuation of transactions operate under separate reporting lines, minimising the opportunity for collusion.

Segregation of duties is a significant feature of the NZ Banking Group's internal controls. Separation of persons executing transactions from those responsible for processing contracts, confirming transactions, settling transactions, approving the accounting methodology or entries and performing revaluations minimises opportunities for fraud or embezzlement.

Non-traded market risk (interest rate risk in the banking book)

Approach

The banking book activities that give rise to market risk include lending activities, balance sheet funding and capital management. Interest rate risk, currency risk and funding and liquidity risk are inherent in these activities. Westpac New Zealand's Treasury is responsible for managing the interest rate risk arising from these activities.

Note 36 Risk management (continued)

Asset and liability management

Westpac New Zealand's Treasury manages the structural interest rate mismatch associated with the transfer priced balance sheet, including the investment of the NZ Banking Group's capital to its agreed benchmark duration. A key risk management objective is to help ensure the reasonable stability of net interest income ('**NII**') over time. These activities are performed under the direction of Group RISKCO with oversight from the NZ Branch's Trading Risk Management unit and conducted within a risk framework and appetite set down by the Group BRCC.

NII sensitivity

NII sensitivity is managed in terms of the net interest income-at-risk ('**NaR**') modelled over a one-year time horizon using a 99% confidence interval for movements in wholesale market interest rates. A simulation model is used to calculate the NZ Banking Group's potential NaR. The NII simulation framework combines the underlying balance sheet data with assumptions about run off and new business, expected repricing behaviour and changes in wholesale market interest rates. Simulations using a range of interest rate scenarios are used to provide a series of potential future NII outcomes. The interest rate scenarios modelled include those projected using historical market interest rate volatility as well as 100 and 200 basis point shifts up and down from current market yield curves. Additional stressed interest rate scenarios are also considered and modelled. A comparison between the NII outcomes from these modelled scenarios indicates the sensitivity to interest rate changes.

Limits

The Group BRCC has approved NaR and VaR limits for banking book risk across the Overseas Banking Group. A NaR sub limit has been assigned to the NZ Banking Group and, in addition, structural limits, expressed as interest rate delta, are also in place for the NZ Banking Group.

Risk reporting

Interest rate risk in the banking book risk measurement systems, and personnel are centralised in Sydney, Australia. These include front office product systems which capture all treasury funding and derivative transactions, the transfer pricing system which captures all retail transactions in Australia and New Zealand, traded and non-traded VaR systems which calculate VaR, and the NII system which calculates NII and NaR for the Australian and New Zealand balance sheets.

Daily monitoring of current exposure and limit utilisation is conducted independently by the Overseas Banking Group's Market Risk Management unit, which monitors market risk exposures against VaR and NaR limits. Oversight of risk specific to the NZ Banking Group is monitored by the NZ Branch's Trading Risk Management unit. Management reports detailing structural positions and VaR are produced and distributed daily for use by dealers and management across all stakeholder groups. Monthly and quarterly reports are produced for the senior management market risk forums of Group RISKCO and Group BRCC, respectively, to ensure transparency of material market risks and issues.

Risk mitigation

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

The NZ Banking Group hedges its exposures to such interest rate risk using derivatives. Derivatives are used by the NZ Banking Group as part of its asset and liability management activities, mainly to hedge its exposures to interest rates and foreign currency risk, including exposures arising from forecast transactions. The NZ Banking Group uses hedge accounting techniques where possible to eliminate the volatility which would otherwise arise due to accounting mismatches. This activity is principally carried out by Treasury within the risk management framework of limits, practices and procedures set and overseen by the NZ Banking Group's Executive Risk Committee. Further details on the NZ Banking Group's hedge accounting are discussed in Note 26.

The same controls as used to monitor traded market risk allow for continuous monitoring by management.

VaR

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

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

VaR seeks to take account of all material market variables that may cause a change in the value of the portfolio, including interest rates, foreign exchange rates, price changes, volatility and the correlations between these variables.

The key parameters of VaR are:

Holding period	1 day
Confidence level	99%
Period of historical data used	1 year
Stressed VaR measures	10 day, 99% confidence level

The following table provides a summary of VaR as at balance date by risk type for the NZ Banking Group's trading and non-trading activities.

Trading

	NZ Banking Group	
$ millions	**2016**	2015
Interest rate risk	**1.4**	0.7
Foreign exchange risk	**0.4**	0.5
Price risk	**-**	-
Volatility risk	**-**	-
Net market risk	**1.5**	0.9

Note 36 Risk management (continued)

Non-trading

	NZ Banking Group	
$ millions	**2016**	2015
Interest rate risk	**1.3**	0.7

Market risk notional capital charges (unaudited)

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

For each category of market risk, the NZ Banking Group's peak end-of-day aggregate capital charge is derived by determining the maximum over the six month period ended 30 September 2016 of the aggregate capital charge for that category of market risk at the close of each business day derived in accordance with the BS2A.

The following table provides a summary of the NZ Banking Group's notional capital charges by risk type as at the reporting date and the peak end-of-day notional capital charges by risk type for the six months ended 30 September 2016.

	NZ Banking Group 2016	
$ millions	**Implied risk-weighted exposure**	**Notional capital charge**
End-of-period		
Interest rate risk	**2,704**	**216**
Foreign currency risk	**8**	**1**
Equity risk	**-**	**-**
Peak end-of-day		
Interest rate risk	**3,973**	**318**
Foreign currency risk	**44**	**4**
Equity risk	**-**	**-**

Interest rate sensitivity

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

The following table presents a breakdown of the earlier of the contractual repricing or maturity dates of the NZ Banking Group's net asset position as at 30 September 2016. The NZ Banking Group uses this contractual repricing information as a base, which is then altered to take account of consumer behaviour, to manage its interest rate risk.

Note 36 Risk management (continued)

	NZ Banking Group 2016						
$ 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	1,219	-	-	-	-	253	1,472
Due from other financial institutions	844	-	-	-	-	-	844
Trading securities and other financial assets designated at fair value	2,097	795	486	51	606	-	4,035
Derivative financial instruments	-	-	-	-	-	4,838	4,838
Available-for-sale securities	-	30	111	532	3,117	-	3,790
Loans	41,540	4,327	10,735	14,058	5,357	(435)	75,582
Life insurance assets	6	2	-	-	-	261	269
Due from related entities	514	-	-	-	-	704	1,218
Other assets	-	-	-	-	-	254	254
Total financial assets	46,220	5,154	11,332	14,641	9,080	5,875	92,302
Non-financial assets							1,056
Total assets							93,358
Financial liabilities							
Due to other financial institutions	601	-	-	-	-	15	616
Deposits and other borrowings	39,940	8,384	4,224	1,060	562	4,621	58,791
Other financial liabilities at fair value through income statement	576	-	-	-	-	-	576
Derivative financial instruments	-	-	-	-	-	6,236	6,236
Debt issues	5,473	1,877	-	1,361	6,016	-	14,727
Other liabilities	-	-	-	-	-	465	465
Due to related entities	2,578	-	-	-	-	947	3,525
Subordinated debentures	1,091	-	-	-	-	-	1,091
Total financial liabilities	50,259	10,261	4,224	2,421	6,578	12,284	86,027
Non-financial liabilities							294
Total liabilities							86,321
On-balance sheet interest rate repricing gap	(4,039)	(5,107)	7,108	12,220	2,502		
Net derivative notional principals							
Net interest rate contracts (notional):							
Receivable/(payable)	15,688	(1,864)	(4,801)	(9,997)	974		
Net interest rate repricing gap	11,649	(6,971)	2,307	2,223	3,476		

Note 36 Risk management (continued)

Foreign currency exposures

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

	NZ Banking Group	
$ millions	2016	2015
Receivable/(payable)		
Australian dollar	**(2)**	-
Euro	-	-
British pound	-	(1)
Japanese yen	**(2)**	1
US dollar	**(2)**	(6)
Others	**1**	5

36.4 Funding and liquidity risk

Liquidity risk is the potential inability to fund assets and meet payment obligations as they come due, without incurring unacceptable losses. Liquidity risk is inherent in the NZ Banking Group's balance sheet due to mismatches in the maturity of assets and liabilities. This risk is managed through the Group BRCC approved liquidity risk management framework.

Overall responsibility for liquidity risk management is delegated to the Overseas Banking Group's Treasury unit ('**Group Treasury**'), under the oversight of the Overseas Banking Group's Asset and Liability Committee ('**Group ALCO**'). Group Treasury manages liquidity on a daily basis and submits monthly reports to Group ALCO and quarterly reports to the Group BRCC. Regular liquidity reports are provided to both the Reserve Bank and APRA. Westpac New Zealand's Chief Financial Officer is responsible for managing Westpac New Zealand's funding and liquidity position under the Westpac New Zealand BRCC approved Liquidity Risk Management Framework.

Key aspects of the NZ Banking Group's liquidity risk management strategy are as follows:

Liquidity risk management framework

The Group BRCC has approved the Liquidity Risk Management Framework which applies to the NZ Banking Group. In addition, the Westpac New Zealand BRCC has approved a Liquidity Risk Management Framework for Westpac New Zealand's balance sheet which is consistent with the Overseas Banking Group framework but also meets New Zealand specific requirements. The frameworks cover all aspects of liquidity risk management including:

- roles and responsibilities;
- referencing contingency planning arrangements (covered in the separate Contingency Management Action Plan);
- principal framework components, policies and reports along with the frequency of review and authority for approval;
- measurement and modelling approaches;
- liquidity risk limits;
- reporting and escalation processes; and
- minimum holdings of liquid assets.

The frameworks are reviewed at least every two years and submitted to the appropriate committee for approval.

Daily liquidity modelling and reporting

Westpac New Zealand is required to comply with the quantitative measures specified in the Reserve Bank of New Zealand document 'Liquidity Policy' ('**BS13**'). Accordingly, the following metrics are calculated and reported daily by Westpac New Zealand in accordance with BS13:

- the level of BS13 liquid assets held;
- the one-week mismatch ratio;
- the one-month mismatch ratio; and
- the one-year core funding ratio.

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

- liquidity coverage ratio; and
- going concern limits.

Reports are circulated daily to senior Treasury, Finance and Risk personnel within both Westpac New Zealand and the Overseas Banking Group. Specific oversight of the NZ Banking Group's liquidity risk profile is provided by the NZ Branch's Trading Risk Management unit.

Note 36 Risk management (continued)

Annual funding plan

Each financial year Group Treasury undertakes a comprehensive review of the Overseas Banking Group's funding strategy. In addition, Westpac New Zealand's Treasury unit undertakes an annual review of Westpac New Zealand's funding strategy. These reviews cover areas such as:

- trends in global debt markets;
- funding alternatives;
- peer analysis;
- estimate of long term issuance plan;
- estimated market capacity;
- funding risk analysis; and
- allocation of funding costs.

The output of the reviews is the annual funding plans for the Overseas Banking Group and Westpac New Zealand. The funding plans are approved by the Group BRCC and the Westpac New Zealand BRCC respectively.

Contingency planning

Group Treasury maintains a Crisis Management Action Plan detailing the broad actions that should be taken in the event of a funding crisis affecting the Overseas Banking Group. Additionally, Westpac New Zealand's Treasury unit maintains a Crisis Management Action Plan specific to Westpac New Zealand. These action plans:

- define a committee of senior executives to manage a crisis;
- allocate responsibility to individuals for key tasks;
- include a media relations strategy;
- provide a contingent funding plan; and
- contain detailed contact lists outlining key regulatory, government, ratings agencies, equity and debt investor contact points.

Sources of liquidity

The principal sources of the NZ Banking Group's liquidity are as follows:

- customer deposits;
- wholesale funding;
- proceeds from the sale of marketable securities;
- repurchase agreements;
- principal repayments on loans;
- interest income; and
- fee income.

Liquid assets

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

	NZ Banking Group	
$ millions	**2016**	2015
Cash and balances with central banks	**1,472**	939
Due from other financial institutions	**58**	98
Supranational securities	**1,305**	1,176
NZ Government securities	**2,030**	2,388
NZ public securities	**1,380**	1,518
NZ corporate securities	**2,258**	1,998
Residential mortgage-backed securities	**3,992**	3,992
Total liquid assets	**12,495**	12,109

Contractual maturity of financial instruments

The following tables present 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 NZ 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 financial year.

Note 36 Risk management (continued)

The balances in the tables 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 tables below:

	NZ Banking Group 2016						
$ millions	On Demand	Up to 1 Month	Over 1 Months 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	1,472	-	-	-	-	-	1,472
Due from other financial institutions	58	786	-	-	-	-	844
Trading securities and other financial assets designated at fair value	-	578	1,338	1,434	638	148	4,136
Derivative financial instruments:							
Held for trading	4,639	-	-	-	-	-	4,639
Held for hedging purposes (net settled)	-	9	3	27	61	-	100
Held for hedging purposes (gross settled):							
Cash outflow	-	-	(14)	(40)	(1,611)	(468)	(2,133)
Cash inflow	-	-	5	12	1,539	362	1,918
Available-for-sale securities	-	7	28	266	3,669	64	4,034
Loans	5,462	7,652	5,891	7,095	25,722	58,140	109,962
Life insurance assets	261	6	-	2	-	-	269
Due from related entities:							
Non-derivative balances	47	477	-	-	-	-	524
Derivative financial instruments:							
Held for trading	694	-	-	-	-	-	694
Other assets	-	118	-	-	1	1	120
Total undiscounted financial assets	12,633	9,633	7,251	8,796	30,019	58,247	126,579
Financial liabilities							
Due to other financial institutions	538	78	-	-	-	-	616
Deposits and other borrowings	28,375	5,239	11,174	12,928	1,735	-	59,451
Other financial liabilities at fair value through income statement	132	444	-	-	-	-	576
Derivative financial instruments:							
Held for trading	4,678	-	-	-	-	-	4,678
Held for hedging purposes (net settled)	-	19	57	250	324	4	654
Held for hedging purposes (gross settled):							
Cash outflow	-	15	276	3,248	4,137	631	8,307
Cash inflow	-	(2)	(180)	(2,693)	(3,392)	(540)	(6,807)
Debt issues	-	302	1,108	4,556	8,377	931	15,274
Other liabilities	-	143	-	-	-	-	143
Due to related entities:							
Non-derivative balances	2,344	-	3	8	338	-	2,693
Derivative financial instruments:							
Held for trading	769	-	-	-	-	-	769
Held for hedging purposes (gross settled):							
Cash outflow	-	-	19	54	1,749	-	1,822
Cash inflow	-	-	(15)	(45)	(1,603)	-	(1,663)
Subordinated debentures	-	-	13	37	1,267	-	1,317
Total undiscounted financial liabilities	36,836	6,238	12,455	18,343	12,932	1,026	87,830
Total contingent liabilities and commitments							
Letters of credit and guarantees	1,084	-	-	-	-	-	1,084
Commitments to extend credit	23,988	-	-	-	-	-	23,988
Other commitments	263	-	-	-	-	-	263
Total undiscounted contingent liabilities and commitments	25,335	-	-	-	-	-	25,335

Note 36 Risk management (continued)

	NZ Banking Group 2015						
$ millions	On Demand	Up to 1 Month	Over 1 Months 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	939	-	-	-	-	-	939
Due from other financial institutions	98	70	-	-	-	-	168
Trading securities and other financial assets designated at fair value	-	778	1,945	693	771	207	4,394
Derivative financial instruments:							
Held for trading	4,727	-	-	-	-	-	4,727
Held for hedging purposes (net settled)	-	(13)	(9)	75	49	-	102
Held for hedging purposes (gross settled):							
Cash outflow	-	(11)	(72)	(2,715)	(4,450)	-	(7,248)
Cash inflow	-	3	30	2,689	4,784	-	7,506
Available-for-sale securities	-	6	30	420	3,020	275	3,751
Loans	5,621	6,421	5,462	6,366	25,163	56,792	105,825
Life insurance assets	237	5	7	16	-	-	265
Due from related entities:							
Non-derivative balances	19	2,402	-	-	-	-	2,421
Derivative financial instruments:							
Held for trading	1,030	-	-	-	-	-	1,030
Other assets	-	165	-	-	-	-	165
Total undiscounted financial assets	12,671	9,826	7,393	7,544	29,337	57,274	124,045
Financial liabilities							
Due to other financial institutions	176	635	-	26	-	-	837
Deposits and other borrowings	28,040	3,848	9,022	10,842	1,992	-	53,744
Other financial liabilities at fair value through income statement	279	-	-	-	-	-	279
Derivative financial instruments:							
Held for trading	5,987	-	-	-	-	-	5,987
Held for hedging purposes (net settled)	-	22	32	273	343	10	680
Held for hedging purposes (gross settled):							
Cash outflow	-	-	26	75	1,632	897	2,630
Cash inflow	-	-	-	(56)	(1,390)	(888)	(2,334)
Debt issues	-	19	1,018	4,181	9,182	888	15,288
Other liabilities	-	308	-	-	-	-	308
Due to related entities:							
Non-derivative balances	2,612	-	4	9	53	320	2,998
Derivative financial instruments:							
Held for trading	1,311	-	-	-	-	-	1,311
Held for hedging purposes (gross settled):							
Cash outflow	-	-	24	61	354	1,542	1,981
Cash inflow	-	-	(20)	(50)	(292)	(1,498)	(1,860)
Subordinated debentures	-	-	17	41	239	2,002	2,299
Total undiscounted financial liabilities	38,405	4,832	10,123	15,402	12,113	3,273	84,148
Total contingent liabilities and commitments							
Letters of credit and guarantees	1,232	-	-	-	-	-	1,232
Commitments to extend credit	23,834	-	-	-	-	-	23,834
Other commitments	220	-	-	-	-	-	220
Total undiscounted contingent liabilities and commitments	25,286	-	-	-	-	-	25,286

Note 37 Concentration of funding

$ millions	NZ Banking Group 2016	2015
Funding consists of		
Due to other financial institutions	**616**	837
Deposits and other borrowings	**58,791**	52,986
Other financial liabilities at fair value through income statement	**576**	279
Debt issues[1]	**14,727**	14,685
Due to related entities[2]	**2,609**	2,907
Subordinated debentures	**1,091**	1,984
Total funding	**78,410**	73,678
Analysis of funding by geographical areas[1]		
New Zealand	**59,167**	53,148
Australia	**3,462**	3,453
United Kingdom	**9,903**	10,244
United States of America	**2,753**	3,907
Other	**3,125**	2,926
Total funding	**78,410**	73,678
Analysis of funding by industry sector		
Accommodation, cafes and restaurants	**328**	265
Agriculture	**1,158**	1,163
Construction	**1,657**	1,482
Finance and insurance	**26,675**	25,949
Forestry and fishing	**419**	173
Government, administration and defence	**2,398**	1,637
Manufacturing	**1,449**	1,454
Mining	**57**	45
Property services and business services	**5,714**	5,079
Services	**4,263**	3,959
Trade	**1,787**	1,381
Transport and storage	**758**	442
Utilities	**720**	461
Households	**23,869**	22,463
Other	**4,549**	4,818
Subtotal	**75,801**	70,771
Due to related entities[2]	**2,609**	2,907
Total funding	**78,410**	73,678

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

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

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

Note 38 Concentration of credit exposures

$ millions	NZ Banking Group 2016	NZ Banking Group 2015
On-balance sheet credit exposures (refer to Note 36.1 Maximum exposure to credit risk)		
Analysis of on-balance sheet credit exposures by geographical areas		
New Zealand	**86,250**	79,448
Australia	**2,063**	4,655
United Kingdom	**2,077**	1,334
United States of America	**138**	282
Others	**1,513**	1,863
Total on-balance sheet credit exposures	**92,041**	87,582
Analysis of on-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**641**	596
Agriculture	**8,488**	7,850
Construction	**1,269**	1,326
Finance and insurance	**11,523**	10,319
Forestry and fishing	**276**	342
Government, administration and defence	**5,861**	5,783
Manufacturing	**3,009**	2,954
Mining	**316**	469
Property	**13,021**	12,318
Property services and business services	**2,291**	2,235
Services	**2,785**	2,619
Trade	**3,781**	3,616
Transport and storage	**1,635**	1,599
Utilities	**2,488**	1,793
Retail lending	**33,812**	30,649
Other	**1**	21
Subtotal	**91,197**	84,489
Provisions for impairment charges on loans	**(435)**	(415)
Due from related entities	**1,218**	3,451
Other assets	**61**	57
Total on-balance sheet credit exposures	**92,041**	87,582
Off-balance sheet credit exposures (refer to Note 36.1 Maximum exposure to credit risk)		
Credit risk-related instruments	**25,335**	25,286
Total off-balance sheet credit exposures	**25,335**	25,286
Analysis of off-balance sheet credit exposures by industry sector		
Accommodation, cafes and restaurants	**125**	115
Agriculture	**756**	710
Construction	**581**	635
Finance and insurance	**1,804**	2,331
Forestry and fishing	**82**	56
Government, administration and defence	**878**	626
Manufacturing	**1,824**	1,745
Mining	**255**	84
Property	**2,455**	1,982
Property services and business services	**855**	755
Services	**1,265**	1,490
Trade	**2,660**	3,227
Transport and storage	**1,146**	1,164
Utilities	**1,495**	1,626
Retail lending	**9,130**	8,740
Other	**24**	-
Total off-balance sheet credit exposures	**25,335**	25,286

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

Note 38 Concentration of credit exposures (continued)

Analysis 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 NZ Banking Group has an aggregate credit exposure or peak end-of-day aggregate credit exposure that equals or exceeds 10% of the Overseas Banking Group's equity:

- as at 30 September 2016 was nil; and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 September 2016 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 NZ Banking Group has an aggregate credit exposure or peak end-of-day aggregate credit exposure that equals or exceeds 10% of the Overseas Banking Group's equity:

- as at 30 September 2016 was nil; and
- in respect of peak end-of-day aggregate credit exposure for the three months ended 30 September 2016 was nil.

The peak end-of-day aggregate credit exposure to each individual counterparty (which are not members of a group of closely related counterparties) or 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 Overseas Banking Group's equity as at 30 September 2016 (refer to Note 39).

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 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 NZ Banking Group (excluding exposures booked outside New Zealand) and were calculated net of individually assessed provisions.

Note 39 Other information on the Overseas Banking Group

Other information on the Overseas Banking Group is from the most recently published financial statements of the Overseas Banking Group for the year ended 30 September 2016.

Profitability	**2016**
Net profit after tax for the year ended 30 September 2016 (A$millions)	**7,460**
Net profit after tax (for the year ended 30 September 2016) as a percentage of average total assets	**0.9%**

Total assets and equity	**2016**
Total assets (A$millions)	**839,202**
Percentage change in total assets over the year ended 30 September 2016	**3.3%**
Total equity (A$millions)	**58,181**

Asset quality	**2016**
Total individually impaired assets[1, 2] (A$millions)	**2,159**
Total individually impaired assets expressed as a percentage of total assets	**0.3%**
Total individual credit impairment allowance[3] (A$millions)	**1,067**
Total individual credit impairment allowance expressed as a percentage of total individually impaired assets	**49.4%**
Total collective credit impairment allowance[3] (A$millions)	**2,733**

1 Total individually impaired assets are before allowances for credit impairment loss and net of interest held in suspense. Total individually impaired assets includes A$551 million of assets which are determined to be impaired, but which are not individually significant, and therefore have been grouped into pools of assets for the purpose of collectively calculating an impairment provision.

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

3 Total individual credit impairment allowance and total collective credit impairment allowance both include A$198 million of credit impairment allowance that has been calculated collectively on groups of assets which have been determined to be impaired, but which are not individually significant.

Note 40 Notes to the statement of cash flows

Accounting policy

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

Netting of cash flows

Certain cash flows have been netted in order to provide more meaningful disclosure, as many of the cash flows are received and disbursed on behalf of customers and reflect the activities of those customers rather than the NZ Banking Group.

Cash and balances with central banks

	NZ Banking Group	
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Cash and cash equivalents comprise:		
Cash on hand	**253**	249
Cash and balances with central banks	**1,219**	690
Due from other financial institutions	**58**	98
Cash and cash equivalents at end of the year	**1,530**	1,037

Reconciliation of net cash provided by/(used in) operating activities to net profit for the year

	NZ Banking Group	
$ millions	**Year Ended 30-Sep-16**	Year Ended 30-Sep-15
Reconciliation of net cash provided by/(used in) operating activities to profit after income tax expense		
Profit after income tax expense	**963**	1,006
Adjustments:		
Impairment charges on loans	**73**	47
Computer software amortisation costs	**64**	95
Depreciation on property and equipment	**45**	38
(Gain)/loss from hedging ineffectiveness	**(4)**	4
Movement in accrued interest receivable	**7**	9
Movement in accrued interest payable	**10**	30
Movement in current and deferred tax	**45**	6
Gain on sale of available-for-sale securities	**-**	(19)
Gain on disposal of a subsidiary	**-**	(4)
Share of profit of associate accounted for using the equity method	**(9)**	-
Share-based payments	**5**	5
Other non-cash items	**(49)**	(60)
Cash flows from operating activities before changes in operating assets and liabilities	**1,150**	1,157
Movement in due from other financial institutions	**(716)**	105
Movement in trading securities and other financial assets designated at fair value	**53**	(537)
Movement in net loans	**(6,107)**	(4,489)
Movement in due from related entities	**1,897**	(2,250)
Movement in other assets	**3**	-
Movement in due to other financial institutions	**(221)**	(304)
Movement in deposits and other borrowings	**5,805**	2,375
Movement in other financial liabilities at fair value through income statement	**297**	(793)
Movement in other liabilities and provisions	**(4)**	(9)
Movement in external and related entity derivative financial instruments	**(1,915)**	2,964
Net cash provided by/(used in) operating activities	**242**	(1,781)

Note 41 Events after the reporting date

There were no material events after the reporting date.

Independent auditor's report

To the Directors of Westpac Banking Corporation

This report is for the NZ Banking Group, comprising the aggregation of the New Zealand operations of Westpac Banking Corporation Group.

This report includes:

- our audit opinion on the financial statements prepared in accordance with Clause 25 of the Registered Bank Disclosure Statements (Overseas Incorporated Registered Banks) Order 2014 (as amended) (the 'Order'), New Zealand International Financial Reporting Standards and International Financial Reporting Standards.

- our audit opinion on the supplementary information (excluding supplementary information relating to credit and market risk exposures and capital adequacy) prepared in accordance with Schedules 4, 7, 10, 11 and 13 of the Order.

- our audit opinion on other legal and regulatory requirements in accordance with Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order.

- our review opinion on the supplementary information relating to credit and market risk exposures and capital adequacy prepared in accordance with Schedule 9 of the Order.

Report on the audit of the financial statements (excluding supplementary information relating to credit and market risk exposures and capital adequacy)

Our audit opinion

In our opinion:

- The aggregated financial statements (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 9, 10,11 and 13 of the Order and included within the balance sheet and Notes 13, 33, 34, 35, 36, 38 and 39):

  (i) comply with generally accepted accounting practice in New Zealand;
  (ii) comply with International Financial Reporting Standards; and
  (iii) give a true and fair view of the financial position of the NZ Banking Group as at 30 September 2016, and its financial performance and cash flows for the year then ended.

- The supplementary information disclosed in accordance with Schedules 4, 7, 10, 11 and 13 of the Order and included within the balance sheet and Notes 13, 33, 34, 36, 38 and 39:

  (i) has been prepared, in all material respects, in accordance with the guidelines issued under section 78(3) of the Reserve Bank of New Zealand Act 1989 or any conditions of registration;
  (ii) is in accordance with the books and records of the NZ Banking Group; and
  (iii) fairly states, in all material respects, the matters to which it relates in accordance with those Schedules.

What we have audited

We have audited the aggregated financial statements required by Clause 25 of the Order and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) required by Schedules 4, 7, 10, 11 and 13 of the Order.

The aggregated financial statements comprise:

- the aggregated balance sheet as at 30 September 2016;
- the aggregated income statement for the year then ended;
- the aggregated statement of comprehensive income for the year then ended;
- the aggregated statement of changes in equity for the year then ended;

Independent auditors' report (continued)

- the aggregated statement of cash flows for the year then ended; and
- the notes to the financial statements, which include significant accounting policies.

Basis for our audit opinion

We conducted our audit in accordance with International Standards on Auditing (New Zealand) (ISAs NZ) and International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the aggregated financial statements* section of our report.

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

Our audit approach

Overview

Overall NZ Banking Group materiality: $66.8 million, which represents 5% of profit before income tax expense.

We chose profit before income tax expense as the benchmark because, in our view, it is the benchmark against which the performance of the NZ Banking Group is most commonly measured by users, and is a generally accepted benchmark. We chose 5% based on our professional judgement, noting that it is also within the range of commonly accepted profit-related thresholds.

The following have been determined as the Key Audit Matters:

- Credit risk and provisions for impairment charges
- Operation of IT systems and controls

Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement.

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

Audit scope

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

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

Key Audit Matters

Key Audit Matters are those matters that, in our professional judgement, were of most significance in our audit of the aggregated financial statements for the current year. We have communicated the Key Audit Matters to the Sub-Committee of the Westpac Banking Corporation Board Audit Committee, but they are not a comprehensive reflection of all matters that were identified by our audit and that were discussed with the Sub-Committee of the Westpac Banking Corporation Board Audit Committee. In the table below we have described the Key Audit Matters and have included a summary of the principal audit procedures we performed to address those matters.

These matters were addressed in the context of our audit of the aggregated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter	How our audit addressed the Key Audit Matter
Credit risk and provisions for impairment charges We focused on this area because of the highly subjective and complex judgements made by management in determining the necessity for, and then estimating the size of, impairment provisions against loans. Provisions for impairment of loans that exceed specific thresholds established by management, are individually assessed by management with reference to the estimated future cash repayments and proceeds from the realisation of collateral held by the NZ Banking Group in respect of those loans. If an individually assessed loan is not impaired, it is then included in a group of loans with similar risk characteristics and, along with those loans below the specific thresholds noted above, is collectively assessed on a portfolio basis using models developed by management. Particularly important elements in the impairment provisioning processes include: • the identification of impaired loans and the cash flow forecasts (including the expected realisable value of any collateral held) supporting the calculation of individually assessed provisions. We consider this to be the most significant inherent audit risk due to the subjectivity involved in assessing how much of the debt will be recovered; • the design of the models used in the collectively assessed provision calculations, and the appropriateness of the key assumptions used in those models, including the emergence periods (EP) for unidentified impairments, the probabilities of default (PD) and the loss given default (LGD) factors; and • the economic overlays added to the model calculations, to reflect emerging trends or particular situations which are not captured by the models used. Given the high level of subjectivity involved in estimating loan impairment provisions, one of our overriding audit objectives is to assess whether the calculations and underlying assumptions are consistent with those applied in the previous year, or that any changes are appropriate in the circumstances. See Notes 6 and 13 to the financial statements which explains the critical accounting estimates and assumptions in determining provisions for impairment charges.	We assessed the design and tested the operating effectiveness of the controls over the loan impairment provisioning processes. The key controls included: • governance oversight, including the continuous re-assessment by management that impairment models are calibrated in a way which is appropriate for the credit risks in the NZ Banking Group's loan portfolios; • controls over identification of the deterioration in credit quality of individual loans; • controls inherent in the IT systems that manage and transfer the data between underlying source systems and the impairment models; and • the review and approval process for the outputs of the impairment models, and the adjustments and economic overlays that are applied to the modelled outputs. We determined that we could rely on controls over the loan impairment provisioning processes for the purposes of our audit. For a sample of individually assessed provisions we: • considered the latest developments in relation to the borrower (as known to the NZ Banking Group) and the basis of measuring the impairment provision; • examined the forecast cash flows from the impaired borrowers, as prepared by management, and in particular challenged the key assumptions in relation to both the amount and timing of recoveries; and • compared the valuation of collateral held to external evidence (where available) and assessed whether any independent expert advice was: (i) up to date; (ii) consistent with the strategy being followed in respect of the particular borrower; (iii) appropriate for the purpose; and (iv) used in the impairment calculations. In relation to the collectively assessed provisions, which were calculated using models, our work included: • critically examining management's model monitoring processes and, on a sample basis, conducting in-depth reviews of models used to calculate the impairment provisions; • using our knowledge of industry practice and the actual past experience of the NZ Banking Group's loan portfolios to challenge the appropriateness of the key assumptions applied in the models, such as the EPs, PDs and LGDs; and • performing sensitivity analyses on key assumptions. For economic overlays to model calculations, we considered the potential for impairment to be affected by events not captured by management's models, and challenged management to provide objective evidence that the economic overlays (for example, in relation to the dairy sector) were appropriate. We found that the NZ Banking Group's approach to calculating loan impairment provisions was consistent with prior periods and that the underlying key assumptions, model outputs and overlays were considered to be reasonable.

Independent auditors' report (continued)

Operation of IT systems and controls

We focused on this area because the NZ Banking Group is heavily dependent on complex IT systems for the processing and recording of significant volumes of transactions.

In considering the complexity of the NZ Banking Group's processes and the design of the internal control environment, there are some areas of the audit where we seek to place reliance on automated controls or reports. The effective operation of these areas is dependent on the NZ Banking Group's IT General Control (ITGC) environment. For example:

- change management internal controls are important because they help ensure that changes to applications and data are authorised and made appropriately;
- IT operations are important as they help ensure errors in processing are resolved in a timely manner; and
- user access controls are important to help ensure staff have appropriate access to IT systems and that access is monitored.

For significant financial statement balances we gained an understanding of the business processes, key controls and IT systems used to generate and support those balances. Where relevant to our planned audit approach, we assessed the design and tested the operating effectiveness of the key controls which support the continued integrity of the in-scope IT systems. This involved considering, and where appropriate, testing the following ITGC domains:

- governance controls used to monitor and enforce internal control consciousness throughout the NZ Banking Group's technology teams and third party suppliers;
- program change management controls used to create, test and authorise changes to the functionality of systems;
- IT operations controls that help ensure any significant IT issues or incidents are escalated and resolved in a timely manner; and
- user access security controls that help make sure that access to IT systems are adequately restricted to appropriate personnel, periodically reviewed and promptly removed when access is no longer required.

Where technology services are provided by a third party, we:

- obtained assurance from the third party's auditors on the design and operating effectiveness of controls; and/or
- tested control design and operating effectiveness ourselves.

We also carried out further direct tests of the operation of key programs to establish the accuracy of calculations, the reliability of reports, and to assess the operation of automated controls and technology-dependent manual controls.

Where we noted either design or operating effectiveness issues, we performed additional compensating control tests and/or substantive audit procedures over key financial balances.

Information other than the financial statements and auditor's report

The Directors of Westpac Banking Corporation (the 'Directors') are responsible for the other information in the Disclosure Statement. The other information comprises the information required to be included in the Disclosure Statement in accordance with Schedule 2 of the Order and is included on pages 1 to 10. Our opinion on the aggregated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

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

Independent auditors' report (continued)

Responsibilities of the Directors for the aggregated financial statements

The Directors are responsible, on behalf of Westpac Banking Corporation, for the preparation of the aggregated financial statements in accordance with Clause 25 of the Order, New Zealand International Financial Reporting Standards and International Financial Reporting Standards and that give a true and fair view of the matters to which they relate. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of aggregated financial statements that are free from material misstatement, whether due to fraud or error. In addition, the Directors are responsible for the preparation and fair presentation of supplementary information in the Disclosure Statement which complies with Schedules 2, 4, 7, 10, 11 and 13 of the Order.

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

Auditor's responsibilities for the audit of the aggregated financial statements

Our objectives are to obtain reasonable assurance about whether the aggregated financial statements and the supplementary information (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) disclosed in accordance with Clause 25 and Schedules 4, 7, 10, 11 and 13 of the Order, are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs NZ and ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these aggregated financial statements.

A further description of our responsibilities for the audit of the financial statements is located at the External Reporting Board's website at: https://xrb.govt.nz/Site/Auditing_Assurance_Standards/Current_Standards/Page1.aspx

This description forms part of our auditor's report.

Report on other legal and regulatory requirements (excluding supplementary information relating to credit and market risk exposures and capital adequacy)

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the financial statements (excluding the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36) for the year ended 30 September 2016:

(i) we have obtained all the information and explanations that we have required; and

(ii) in our opinion, proper accounting records have been kept by the NZ Banking Group as far as appears from an examination of those records.

Report on the review of the supplementary information relating to credit and market risk exposures and capital adequacy

Our review opinion

Based on our review procedures, which are not an audit, nothing has come to our attention that causes us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36, is not in all material respects:

(i) prepared in accordance with Capital Adequacy Framework (Standardised Approach) (BS2A); and

(ii) disclosed in accordance with Schedule 9 of the Order.

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

Independent auditors' report (continued)

What we have reviewed

We have reviewed the supplementary information relating to credit and market risk exposures and capital adequacy required by Schedule 9 of the Order as disclosed in Notes 35 and 36 of the financial statements of the NZ Banking Group for the year ended 30 September 2016.

Basis for our review opinion

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).

Responsibilities of the Directors for the supplementary information relating to credit and market risk exposures and capital adequacy

The Directors are responsible, on behalf of Westpac Banking Corporation, for the preparation of supplementary information relating to credit and market risk exposures and capital adequacy that is prepared in accordance with the Capital Adequacy Framework (Standardised Approach) (BS2A) and is disclosed in accordance with Schedule 9 of the Order. The Directors are also responsible for such internal controls as the Directors determine are necessary to enable the preparation of supplementary information relating to credit and market risk exposures and capital adequacy that is free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the review of the supplementary information relating to credit and market risk exposures and capital adequacy

We are responsible for reviewing the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36, to conclude whether anything has come to our attention that would cause us to believe that the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36, is not, in all material respects:

(i) prepared in accordance with Capital Adequacy Framework (Standardised Approach) (BS2A); and

(ii) disclosed in accordance with Schedule 9 of the Order.

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 ISAs NZ and ISAs. Accordingly we do not express an audit opinion on the supplementary information relating to credit and market risk exposures and capital adequacy disclosed in Notes 35 and 36.

Auditor independence

We are independent of the NZ Banking Group in accordance with Professional and Ethical Standard 1 (Revised) *Code of Ethics for Assurance Practitioners* (PES 1) issued by the New Zealand Auditing and Assurance Standards Board and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants (IESBA Code)*, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Who we report to

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

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

For and on behalf of:

PricewaterhouseCoopers

Chartered Accountants Auckland
8 December 2016

westpac.co.nz