

Bank of New Zealand

Disclosure Statement

For the year ended 30 September 2020

No. 94



Disclosure Statement

For the year ended 30 September 2020

This Disclosure Statement has been issued by Bank of New Zealand for the year ended 30 September 2020 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the “Order”).

In this Disclosure Statement, unless the context otherwise requires:

- a) “Banking Group” means Bank of New Zealand’s financial reporting group, which consists of Bank of New Zealand, all of its wholly owned entities and other entities consolidated for financial reporting purposes; and
- b) Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

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Bank of New Zealand Corporate Information

Address for Service

The name of the Registered Bank is Bank of New Zealand (referred to either by its full name or as the “Bank”). The Bank’s address for service is Level 4, 80 Queen Street, Auckland 1010, New Zealand.

Nature of Business

The Bank is a company domiciled in New Zealand. It was incorporated in New Zealand on 29 July 1861. The Banking Group provides a broad range of banking and financial products and services to retail, business, agribusiness, corporate and institutional clients.

Voting Securities and Power to Appoint Directors

National Australia Group (NZ) Limited (“NAGNZ”), National Australia Bank Limited and National Equities Limited are the only holders of a direct or indirect qualifying interest in the 5,075,997,499 voting securities of the Bank. NAGNZ is the registered and beneficial holder of 5,075,997,499 voting securities and therefore holds 100% of the direct interest in the voting securities. Neither National Australia Bank Limited (the ultimate parent company) nor National Equities Limited (the immediate parent company of NAGNZ) is the registered or the beneficial holder of any of the voting securities of the Bank, but each has a relevant interest in all such securities by virtue of NAGNZ being related to them in terms of section 237(d) and 12(2) of the Financial Markets Conduct Act 2013 (“FMCA”) due to the fact that National Equities Limited owns 100% of the voting securities in NAGNZ and National Australia Bank Limited owns 100% of the voting securities in National Equities Limited.

The ultimate parent company has the power under the Bank’s constitution to appoint any person as Director of the Bank or to remove any person from the office of Director, from time to time, by giving written notice to the Bank. Any appointment of a Director is subject to the Reserve Bank of New Zealand (“RBNZ”) confirming it has no objection to that appointment.

Guarantees

Covered Bond Guarantee

Certain debt securities (“Covered Bonds”) issued by the Bank, or its wholly owned controlled entity, BNZ International Funding Limited, acting through its London Branch (“BNZ-IF”), are guaranteed by CBG Trustee Company Limited, as trustee of the BNZ Covered Bond Trust (the “Covered Bond Guarantor”). The Covered Bond Guarantor has guaranteed the payment of all interest and principal under the Covered Bonds pursuant to a guarantee which is secured over a pool of assets. The Covered Bond Guarantor’s address for service is Level 9, 34 Shortland Street, Auckland 1010, New Zealand.

The Covered Bond Guarantor is not a member of the Banking Group and has no credit ratings applicable to any senior unsecured obligations payable in New Zealand dollars. The Covered Bonds have been assigned a long term credit rating of Aaa and AAA from Moody’s Investors Service Pty Limited and Fitch Australia Pty Limited, respectively.

There are no material conditions applicable to the guarantee other than non-performance. There are no material legislative or regulatory restrictions in New Zealand which subordinate any claims under the guarantee of any creditors of the Bank on the assets of the Covered Bond Guarantor, to other claims on the Covered Bond Guarantor, in a winding up of the Covered Bond Guarantor.

Refer to note 28 for further information.

Other material obligations of the Bank are not guaranteed.

Ultimate Parent Bank

Ultimate Parent Bank and Address for Service

The ultimate parent bank, and ultimate holding company, of Bank of New Zealand is National Australia Bank Limited. National Australia Bank Limited’s address for service is Level 1, 800 Bourke Street, Docklands, Victoria 3008, Australia.

References in this document to “NAB” are references to National Australia Bank Limited’s financial reporting group, which consists of National Australia Bank Limited, all of its wholly owned entities and other entities consolidated for financial reporting purposes.

Legally Enforceable Restrictions that may Materially Inhibit National Australia Bank Limited’s Legal Ability to Provide Material Financial Support to Bank of New Zealand

National Australia Bank Limited does not guarantee the obligations of Bank of New Zealand.

The Australian Prudential Regulation Authority (“APRA”) Prudential Standard APS 222 (“APS 222”) restricts associations between an authorised deposit-taking institution (“ADI”) (such as National Australia Bank Limited) and its related entities (such as the Bank). Any provision of financial support to the Bank by National Australia Bank Limited would need to comply with the following pertinent requirements of APS 222:

1. National Australia Bank Limited should not undertake any third-party dealings with the prime purpose of supporting the business of the Bank. National Australia Bank Limited must avoid giving any impression of its support unless there are formal legal arrangements in place providing for such support.
2. National Australia Bank Limited must not hold unlimited exposures to the Bank.
3. National Australia Bank Limited must not enter into cross-default clauses whereby a default by the Bank on an obligation (whether financial or otherwise) is deemed to trigger a default of National Australia Bank Limited on its obligations.
4. In determining limits on acceptable levels of exposure to the Bank, the Board of Directors of National Australia Bank Limited should have regard to the level of exposures which would be approved for unrelated entities of broadly equivalent credit status, and the impact on National Australia Bank Limited’s stand-alone capital and liquidity positions, as well as its ability to continue operating, in the event of a failure of any related entity to which National Australia Bank Limited is exposed.
5. National Australia Bank Limited’s exposure to individual related entities that are overseas based ADIs, such as the Bank, cannot exceed 50% of National Australia Bank Limited’s total stand-alone capital base, and its aggregate exposure to all related ADIs cannot exceed 150% of that total capital base. Exposures in excess of these limits require the prior approval of APRA. On 20 August 2019, APRA released a revised APS 222 standard which will come into effect from 1 January 2022. Under the new standard, National Australia Bank Limited’s exposure to the Bank cannot exceed 25% of National Australia Bank Limited’s stand-alone Tier 1 capital base, and its aggregate exposure to all related ADIs cannot exceed 75% of that Tier 1 capital base.

Bank of New Zealand Corporate Information

Ultimate Parent Bank *continued*

Legally Enforceable Restrictions that may Materially Inhibit National Australia Bank Limited's Legal Ability to Provide Material Financial Support to Bank of New Zealand *continued*

APRA has confirmed that during ordinary times, National Australia Bank Limited's non-equity exposures to the Bank must be below 5% of National Australia Bank Limited's Level One Tier 1 Capital. Exposures subject to this 5% limit include all committed, non-intraday, non-equity exposures, including derivatives and off-balance sheet exposures. As at 30 September 2020, National Australia Bank Limited's non-equity exposures to the Bank are below 5% of National Australia Bank Limited's Level One Tier 1 Capital.

APRA has also confirmed the terms on which National Australia Bank Limited may provide contingent funding support to a New Zealand banking subsidiary (including the Bank) during times of financial stress. APRA has confirmed that, at this time, only Covered Bonds meet its criteria for contingent funding arrangements. Such contingent funding support is proposed to be captured within an aggregate exposure limit (including debt, equity and any exposures held through a branch) of 50% of National Australia Bank Limited's Level One Tier 1 Capital.

Pending Proceedings or Arbitration

The Bank's Directors are of the opinion that there are no pending proceedings or arbitrations concerning any member of the Banking Group, whether in New Zealand or elsewhere, that may have a material adverse effect on the Registered Bank or the Banking Group.

Other Matters

In New Zealand and globally, measures to control the spread of COVID-19, including restrictions on public gatherings, business closures and travel and trade restrictions have had, and may continue to have a substantial negative impact on economic and business activity. Globally, governments (including the New Zealand Government) have introduced fiscal stimulus packages to counter the negative impacts of the current economic downturn. The unwinding of these stimulatory policies presents downside risk to the global economy in the near-term, with the potential to exacerbate existing negative effects on businesses and households. In the longer term, governments may take measures to address the additional debt burden generated by these policies. The extent to which these packages mitigate and/or defer the economic impact, including any credit losses the Bank may incur, is uncertain.

In New Zealand, a broad range of measures have already been implemented, and further measures may be introduced, to promote financial stability and ensure foreign exchange, debt and money markets continue operating efficiently and at low cost, many of which affect the Banking Group.

Further information on some specific measures is set out below.

The New Zealand Government and the RBNZ have implemented a financial support package for homeowners and businesses affected by the economic impacts of the COVID-19 pandemic, in which the Bank, along with other New Zealand registered banks, has agreed to participate. The package includes a loan repayment deferral scheme for residential mortgages and other consumer lending, as well as lending to small to medium-sized enterprises and the agricultural sector, which facilitates the deferral of repayments for a period up to 31 March 2021, as agreed between the bank and the borrower. The financial support package also included wage subsidy schemes to help employers who were adversely affected by the COVID-19 pandemic to continue to pay their staff but these schemes have now ended.

The New Zealand Government and certain New Zealand registered banks (including the Bank) have also implemented the Business Finance Guarantee Scheme ("BFGS"), to provide loans to help eligible businesses respond to, or recover from, the impacts of COVID-19. A limit of NZ\$5,000,000 per borrower guaranteeing group applies and BFGS loans have a maximum term of five years. The New Zealand Government bears 80% of the credit risk of each BFGS loan and the bank making the loan bears the remaining 20%.

The RBNZ has announced a number of lending facilities intended to provide liquidity to New Zealand registered banks and to support bank lending, as well as a NZ\$100 billion large scale asset purchase programme to provide further support to the New Zealand economy, build confidence, and keep interest rates low.

Amendments have been made to the Companies Act 1993 and other legislation to help businesses facing insolvency due to the COVID-19 pandemic to remain viable, including by introducing a COVID-19 business debt hibernation regime.

The Inland Revenue Department has introduced a range of measures to assist businesses impacted by the COVID-19 pandemic, including a small business cash flow loan scheme that can be applied for up to 31 December 2020 and a loss carry back scheme that allows businesses to offset current year losses against prior year profits.

Directorate and Auditor

Communications addressed to the Directors and responsible persons, or any of them, may be sent to Level 4, 80 Queen Street, Auckland 1010, New Zealand.

Directors

Linley Ann Wood was appointed as an Independent Non-Executive Director of the Bank, effective 14 April 2020.

Prudence Mary Flacks resigned as a Director of the Bank, effective 30 October 2020.

Directors' Details

The name, occupation, technical or professional qualifications, country of residence, and other directorships of each Director of the Bank as at the date of this Disclosure Statement are as follows:

Non-Executive Director, Chairman

Douglas Alexander McKay, ONZM

Primary Occupation: Company Director

B.A. (Auckland), A.M.P. (Harvard Business School)

New Zealand

Other Directorships:

Fletcher Building Industries Limited, Fletcher Building Limited, Genesis Energy Limited, IAG New Zealand Limited, IAG (NZ) Holdings Limited, National Australia Bank Limited, Wymac Consulting Limited.

Bank of New Zealand Corporate Information

Directorate and Auditor *continued*

Executive Director

Angela Mentis

Primary Occupation: Managing Director and Chief Executive Officer

Other Occupation: Company Director

B.Bus., GDip Applied Finance, GAICD

New Zealand

Other Directorships:

Banking Ombudsman Scheme Limited.

Independent Non-Executive Directors

Mai Chen

Primary Occupation: Barrister and Solicitor

Other Occupation: Company Director

LL.B (Hons.) (Otago), LL.M (Harvard), FNZIM

New Zealand

Other Directorships:

Chair of ASIANZ CEO Limited, Chen & Palmer Office Services Limited, Chen Palmer Limited, Chen Palmer New Zealand Public Law Specialists Limited, Chen Palmer NZPLS Limited, Chen Palmer NZ Public Law Specialists Limited, CP New Zealand Public Law Specialists Limited, CPP Limited, New Zealand Public Law Specialists Limited, NZPLS Limited, Public Law Toolbox Limited, Socrates NZ Limited, Chair of Superdiverse Women Limited, Chair of Superdiversity Centre for Law, Policy and Business Limited.

Bruce Ronald Hassall

Primary Occupation: Company Director

B.Com., FCA

New Zealand

Other Directorships:

Chairman of Fletcher Building Industries Limited, Chairman of Fletcher Building Limited, Fonterra Co-operative Group Limited, Marivan Holdings Limited, Chairman of Prolife Foods Limited, Chairman of The Farmers' Trading Company Limited.

Louis Arthur Hawke

Primary Occupation: Company Director

BEC (Hons.), MBA

Australia

Other Directorships:

Chairman of BNZ Insurance Services Limited, Chairman of BNZ Life Insurance Limited, Hawke Business Associates Pty Limited, Hawke Family Pty Limited.

Kevin John Kenrick

Primary Occupation: Chief Executive Officer of Television New Zealand Limited

Other Occupation: Company Director

BMS

New Zealand

Other Directorships:

Freeview Television Limited, NZOOM Limited, TVNZ International Limited, TVNZ Investments Limited.

Linley Ann Wood

Primary Occupation: Company Director

BA., LL.B., MBA

New Zealand

Other Directorships:

Kings School Auckland Limited, McSmith Properties Limited, The Sleeping Giant (Fiji) Limited.

Non-Executive Director

Gary Andrew Lennon

Primary Occupation: NAB Group Chief Financial Officer

BEC (Hons.), Sydney, FCA.

Australia

Other Directorships:

Jmega Pty Limited

Diversity

As at 30 September 2020, the proportions of female Directors on the Board and female members as the Bank's Officers were 44% and 30%, respectively (30 September 2019: 38% and 36%).

For the purpose of this disclosure, the BNZ Executive Team has been treated as Officers.

The Bank has a Diversity & Inclusion Council to lead the BNZ diversity agenda, set strategic priorities and oversee performance related to diversity.

Bank of New Zealand Corporate Information

New Zealand Regional Audit Committee

Members of the New Zealand Regional Audit Committee as at the date of this Disclosure Statement were as follows:

Bruce Ronald Hassall (Chair)	Independent Non-Executive Director
Mai Chen	Independent Non-Executive Director
Louis Arthur Hawke	Independent Non-Executive Director

Responsible Persons

Mr. Douglas Alexander McKay, ONZM, Non-Executive Director, Chairman, and Ms. Angela Mentis, Executive Director, have been authorised in writing to sign this Disclosure Statement in accordance with section 82 of the Reserve Bank of New Zealand Act 1989, on behalf of the other Directors, being:

Mai Chen
Bruce Ronald Hassall
Louis Arthur Hawke
Kevin John Kenrick
Gary Andrew Lennon
Linley Ann Wood

Policy for Avoiding and Dealing with Conflicts of Interests

The policy and current practice of the Board of Directors of the Bank for avoiding or dealing with conflicts of interest which may arise from the personal, professional or business interests of the Directors, or any of them, are that, where a Director's judgement could potentially be impaired because a conflict of interest exists between the Director's business and personal affairs and the business affairs of the Bank, then that Director must declare that the conflict of interest exists and subject to certain exceptions set out in the constitution, will not vote on the matter nor be present while the matter is being considered in the meeting.

The Companies Act 1993 requires each Director to cause to be entered in the interests register and disclose to the Board of the Bank:

- the nature and monetary value of the Director's interest in a transaction or proposed transaction if its monetary value is able to be quantified; or
- the nature and extent of the Director's interest in a transaction or proposed transaction if its monetary value is not able to be quantified.

Directors' Benefits

There is no transaction which any Director or immediate relative or close business associate of any Director has with the Bank or any member of the Banking Group which either has been entered into on terms other than those which would, in the ordinary course of business of the Bank or any member of the Banking Group, be given to any other person of like circumstances or means, or could otherwise be reasonably likely to influence materially the exercise of that Director's duties.

Information pertaining to loans to and other transactions with Directors is disclosed in note 25 of this Disclosure Statement.

Auditor

The auditor whose report is referred to in this Disclosure Statement is Ernst & Young. Ernst & Young's address for service is Level 9, EY Building, 2 Takutai Square, Britomart, Auckland 1010, New Zealand.

Financial Statements

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Historical Summary of Financial Statements

Dollars in Millions	Consolidated				
	30/9/20	30/9/19	30/9/18	30/9/17	30/9/16
Income statement					
Interest income	3,619	4,195	4,055	3,843	3,854
Interest expense	1,537	2,134	2,109	2,049	2,097
Net interest income	2,082	2,061	1,946	1,794	1,757
Gains less losses on financial instruments	88	129	191	118	106
Other operating income	369	466	419	403	406
Total operating income	2,539	2,656	2,556	2,315	2,269
Operating expenses	1,177	1,135	1,045	932	889
Total operating profit before credit impairment charge and income tax expense	1,362	1,521	1,511	1,383	1,380
Credit impairment charge	300	114	82	83	120
Total operating profit before income tax expense	1,062	1,407	1,429	1,300	1,260
Income tax expense on operating profit	300	385	400	363	347
Net profit attributable to the shareholders of Bank of New Zealand	762	1,022	1,029	937	913
Dividends					
Dividends paid on ordinary shares	-	545	620	700	500
Dividends reinvested as ordinary shares	-	600	1,105	-	-
Total dividends paid on ordinary shares	-	1,145	1,725	700	500
Perpetual preference dividend	-	-	-	3	32
Significant balance sheet items					
Total assets	112,310	109,112	99,991	95,315	92,541
Total liabilities	103,653	101,179	92,612	88,374	85,536
Ordinary shareholder's equity	8,657	7,933	7,379	6,941	6,805
Contributed equity - perpetual preference shareholders	-	-	-	-	200
Asset quality					
Individually impaired assets - at amortised cost	558	648	248	222	246
Individually impaired assets - at fair value through profit or loss	42	5	17	28	7
Credit impairment charge charged to income statement - at amortised cost	300	114	82	83	120
Credit risk adjustments on financial assets charged to income statement - at fair value through profit or loss (including derivatives)	30	3	(14)	(18)	7

The information presented in the above table has been extracted from audited financial statements of the Banking Group that have been prepared in accordance with New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS").

Basel III regulatory capital ratios

The table below shows the capital adequacy ratios based on the RBNZ's Capital Adequacy Framework (Internal Models Based Approach) ("BS2B") expressed as a percentage of total risk-weighted exposures.

	Consolidated				
	Unaudited 30/9/20	Unaudited 30/9/19	Unaudited 30/9/18	Unaudited ¹ 30/9/17	Unaudited ¹ 30/9/16
Common Equity Tier 1 capital ratio	11.85%	10.97%	10.56%	10.38%	9.98%
Tier 1 capital ratio	13.17%	12.32%	11.95%	11.83%	10.30%
Total qualifying capital ratio	14.91%	13.93%	13.59%	13.02%	11.77%
Buffer ratio	6.91%	5.93%	5.59%	5.02%	3.77%

¹ Comparative data for the Banking Group's capital ratios was restated due to a data error in the Banking Group's unutilised credit limit.

Income Statement

For the year ended 30 September 2020

Dollars in Millions	Note	Consolidated	
		30/9/20	30/9/19
Interest income	2	3,619	4,195
Interest expense	2	1,537	2,134
Net interest income		2,082	2,061
Gains less losses on financial instruments	3	88	129
Other operating income	4	369	466
Total operating income		2,539	2,656
Operating expenses	5	1,177	1,135
Total operating profit before credit impairment charge and income tax expense		1,362	1,521
Credit impairment charge	12	300	114
Total operating profit before income tax expense		1,062	1,407
Income tax expense on operating profit	7	300	385
Net profit attributable to the shareholder of the Bank		762	1,022

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

NZ IFRS 16 Leases ("NZ IFRS 16") has been adopted from 1 October 2019 and has been applied in the preparation of the income statement. Comparative balances have not been restated. Refer to note 1 for further information.

Statement of Comprehensive Income

For the year ended 30 September 2020

Dollars in Millions	Note	Consolidated	
		30/9/20	30/9/19
Net profit attributable to the shareholder of the Bank		762	1,022
Other comprehensive income/(expense):			
Items that will not be reclassified to profit or loss			
Actuarial gain/(loss) on defined benefit plan		1	2
Credit risk adjustments on financial liabilities designated at fair value through profit or loss	26	(67)	20
Tax on items recognised in equity		19	(6)
		(47)	16
Items that may be reclassified subsequently to profit or loss			
Movement in cash flow hedge reserve	14	23	85
Movement in cost of hedging reserve		(12)	-
Tax on items recognised in equity		(3)	(24)
Revaluation of equity instruments held at fair value through other comprehensive income ("FVOCI")		1	-
		9	61
Total other comprehensive income/(expense)		(38)	77
Total comprehensive income attributable to the shareholder of the Bank		724	1,099

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

NZ IFRS 16 has been adopted from 1 October 2019 and has been applied in the preparation of the statement of comprehensive income. Comparative balances have not been restated. Refer to note 1 for further information.

Statement of Changes in Equity

For the year ended 30 September 2020

Dollars in Millions	Consolidated (30/9/20)						Total Shareholder's Equity
	Ordinary Capital	Retained Profits	Asset Revaluation Reserve	Cash Flow Hedge Reserve	Cost of Hedging Reserve	FVOCI Reserve	
Balance at beginning of year	4,056	3,778	3	96	-	-	7,933
Comprehensive income/(expense)							
Net profit attributable to the shareholder of the Bank	-	762	-	-	-	-	762
Actuarial gain/(loss) on defined benefit plan	-	1	-	-	-	-	1
Credit risk adjustments on financial liabilities designated at fair value through profit or loss	-	(67)	-	-	-	-	(67)
Reserve movement through other comprehensive income	-	-	-	23	(12)	1	12
Tax effect on items directly recognised in equity	-	19	-	(6)	3	-	16
Total comprehensive income/(expense)	-	715	-	17	(9)	1	724
Dividends paid on ordinary shares ¹	-	-	-	-	-	-	-
Balance at end of year	4,056	4,493	3	113	(9)	1	8,657
	Consolidated (30/9/19)						
Balance at beginning of year	3,456	3,885	3	35	-	-	7,379
Comprehensive income/(expense)							
Net profit attributable to the shareholder of the Bank	-	1,022	-	-	-	-	1,022
Actuarial gain/(loss) on defined benefit plan	-	2	-	-	-	-	2
Credit risk adjustments on financial liabilities designated at fair value through profit or loss	-	20	-	-	-	-	20
Reserve movement through other comprehensive income	-	-	-	85	-	-	85
Tax effect on items directly recognised in equity	-	(6)	-	(24)	-	-	(30)
Total comprehensive income/(expense)	-	1,038	-	61	-	-	1,099
Dividends paid on ordinary shares	-	(1,145)	-	-	-	-	(1,145)
Issue of ordinary shares through dividend reinvestment	600	-	-	-	-	-	600
Balance at end of year	4,056	3,778	3	96	-	-	7,933

¹ Refer to Conditions of Registration for changes in the Bank's Conditions of Registration affecting dividend payments.

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

NZ IFRS 16 has been adopted from 1 October 2019 and has been applied in the preparation of the statement of changes in equity. Comparative balances have not been restated. Refer to note 1 for further information.

Balance Sheet

As at 30 September 2020

Dollars in Millions	Note	Consolidated	
		30/9/20	30/9/19
Assets			
Cash and liquid assets	8	3,933	2,740
Due from central banks and other institutions	9	782	1,434
Trading securities	10	10,814	7,267
Derivative financial instruments	14	6,140	7,616
Loans and advances to customers	11	88,149	88,041
Amounts due from related entities	25	1,053	615
Other assets	16	492	732
Deferred tax	15	295	197
Property, plant and equipment		423	177
Goodwill and other intangible assets	17	229	293
Total assets		112,310	109,112
Liabilities			
Due to central banks and other institutions	18	2,820	1,833
Trading liabilities		54	91
Derivative financial instruments	14	4,711	6,106
Deposits and other borrowings	19	71,841	67,968
Bonds and notes	20	19,512	21,121
Current tax liabilities		39	80
Amounts due to related entities	25	1,903	838
Other liabilities	21	824	1,194
Subordinated debt	23	1,949	1,948
Total liabilities		103,653	101,179
Net assets		8,657	7,933
Shareholder's equity			
Contributed equity – ordinary shares		4,056	4,056
Reserves		108	99
Retained profits		4,493	3,778
Total shareholder's equity		8,657	7,933
Interest earning and discount bearing assets		103,063	98,437
Interest and discount bearing liabilities		89,212	87,345

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

NZ IFRS 16 has been adopted from 1 October 2019 and has been applied in the preparation of the balance sheet. Comparative balances have not been restated. Refer to note 1 for further information.

Cash Flow Statement

For the year ended 30 September 2020

Dollars in Millions	Note	Consolidated	
		30/9/20	30/9/19
Cash flows from operating activities			
Cash was provided from:			
Interest income		3,644	4,212
Net trading income		-	96
Other income		381	421
Cash was applied to:			
Interest expense		(1,714)	(2,161)
Personnel expenses		(624)	(515)
Net trading income		(49)	-
Other operating expenses		(314)	(367)
Taxes and subvention payments		(422)	(487)
Net cash flows from operating activities before changes in operating assets and liabilities		902	1,199
Changes in operating assets and liabilities arising from cash flow movements			
Net movement in due from central banks and other institutions		580	(844)
Net movement in loans and advances to customers		(453)	(5,001)
Net movement in other assets		214	(169)
Net movement in trading securities and trading liabilities		(3,567)	(429)
Net movement in deposits and other borrowings		3,881	4,524
Net movement in due to central banks and other institutions		264	360
Net movement in other liabilities		(458)	(19)
Net change in operating assets and liabilities		461	(1,578)
Net cash flows from operating activities	37	1,363	(379)
Cash flows from investing activities			
Cash was provided from:			
Proceeds from disposal of associate		-	48
Cash was applied to:			
Acquisition of intangible assets		(119)	(164)
Purchase of property, plant and equipment		(27)	(49)
Net cash flows from investing activities		(146)	(165)
Cash flows from financing activities			
Net movement in bonds and notes		(1,622)	359
Net movement in derivative financial instruments		102	594
Net movement in related entity funding		2	173
Increase in contributed equity - ordinary shares	24	-	600
Net movement in subordinated debt	23	(1)	-
Payment of lease liabilities		(47)	-
Ordinary dividend		-	(1,145)
Net cash flows from financing activities		(1,566)	581
Net movement in cash and cash equivalents		(349)	37
Cash and cash equivalents at beginning of year		1,946	1,909
Cash and cash equivalents at end of year		1,597	1,946
Cash and cash equivalents at end of year comprised:			
Cash and liquid assets	8	3,933	2,740
Due to central banks and other institutions classified as cash and cash equivalents	18	(1,949)	(1,033)
Amounts due from related entities classified as cash and cash equivalents	25	1,045	604
Amounts due to related entities classified as cash and cash equivalents	25	(1,432)	(365)
Total cash and cash equivalents		1,597	1,946

The accounting policies and other notes form part of, and should be read in conjunction with, these financial statements.

NZ IFRS 16 has been adopted from 1 October 2019 and has been applied in the preparation of the cash flow statement. Comparative balances have not been restated. Refer to note 1 for further information.

Notes to and Forming Part of the Financial Statements

For the year ended 30 September 2020

Note 1 Principal Accounting Policies

In these financial statements Bank of New Zealand is referred to as the “Bank”. The “Banking Group” means Bank of New Zealand, all of its wholly owned entities listed in note 34 and entities consolidated for financial reporting purposes listed in note 32.

The financial statements are general purpose financial reports prepared in accordance with the requirements of the Financial Markets Conduct Act 2013 and the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended).

Basis for preparation

The financial statements have been prepared under the historical cost convention, modified by the application of fair value measurements required or allowed by relevant accounting standards. Accounting policies have been consistently applied to all periods presented, unless otherwise stated, throughout the Banking Group.

Assumptions and estimates

The preparation of the financial statements requires the use of certain critical accounting estimates and assumptions that affect the reported amount of assets, liabilities, revenues and expenses and the disclosed amount of contingent liabilities. It also requires management to exercise judgement in the process of applying accounting policies.

Assumptions made as at each reporting date (e.g. the calculation of the provision for credit impairment and fair value measurements), are based on best estimates at that date. Although the Banking Group has internal control systems in place to ensure reliable estimates, actual amounts may differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the reporting period in which the estimates are revised and in any future periods affected.

The Banking Group has considered the impact of COVID-19 and related market volatility in preparing these financial statements. While the methodologies and assumptions applied in the measurement of various items within the financial statements remain unchanged from those applied in the 2019 Disclosure Statement, the impact of COVID-19 has resulted in the application of further judgement and the incorporation of estimates and assumptions specific to the impact of COVID-19. Principally this has resulted in updates to the Banking Group’s economic assumptions used in determining expected credit losses and the impairment assessment for other non-financial assets.

The Banking Group’s risk and capital management framework continues to be applied and the Banking Group continues to monitor the impact of COVID-19 on the Banking Group’s risk and capital profile. Non-financial risks emerging from global movement restrictions, lockdowns, and remote working by staff, counterparties, clients and suppliers, are being identified, assessed, managed and governed through timely application of the Banking Group’s risk management framework.

Further information on specific judgements and assumptions made and estimates applied, are contained within the notes to the financial statements.

Reclassification of financial information

Certain comparative balances have been reclassified to align with the presentation used in the current financial year. These reclassifications have no impact on the overall financial performance or financial position for the comparative year.

Statement of compliance

The financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (“NZ GAAP”). They comply with New Zealand Equivalents to International Financial Reporting Standards (“NZ IFRS”) as appropriate for profit-oriented entities. The financial statements comply with International Financial Reporting Standards (“IFRS”).

Changes in accounting policies and disclosures

The Banking Group adopted the following new accounting standards, interpretations and policies effective from 1 October 2019:

- NZ IFRS 16 *Leases* (“NZ IFRS 16”);
- *Interest Rate Benchmark Reform* amendments to NZ IFRS 9 *Financial Instruments* (“NZ IFRS 9”), NZ IAS 39 *Financial Instruments: Recognition and Measurement* (“NZ IAS 39”) and NZ IFRS 7 *Financial Instruments: Disclosures* (“NZ IFRS 7”);
- Change in classification and measurement of foreign currency bonds and notes with new issuances measured at amortised cost and subject to hedge accounting; and
- NZ IFRIC 23 *Uncertainty over Income Tax Treatments* (“NZ IFRIC 23”).

The impact of each of the changes is described below.

NZ IFRS 16 Leases

NZ IFRS 16 significantly changes accounting for lessees, requiring recognition of all leases (subject to certain exceptions) on balance sheet in a manner comparable to how finance leases were previously accounted for under NZ IAS 17 *Leases* (“NZ IAS 17”), including related interpretations. Lessor accounting remains largely unchanged compared to NZ IAS 17.

The Banking Group adopted NZ IFRS 16 using the modified retrospective transition option, and as a result, comparative information from prior periods has not been restated.

On transition, NZ IFRS 16 requires the lease liability to be measured based on the future lease payments and permits two options for the measurement of the right-of-use asset. The right-of-use asset may either be measured with reference to the value of the lease liability or retrospectively (independently from the lease liability). The standard allows for the measurement to be applied on a lease-by-lease basis. The Banking Group has opted to measure its right-of-use assets with reference to the value of the lease liability.

Notes to and Forming Part of the Financial Statements

Note 1 Principal Accounting Policies *continued*

NZ IFRS 16 Leases *continued*

The following table reconciles the operating lease commitments disclosed under NZ IAS 17 as at 30 September 2019 to the opening lease liabilities recognised under NZ IFRS 16 as at 1 October 2019.

Dollars in Millions

Operating lease commitments at 30 September 2019	228
Less short-term and low value assets	(4)
Add reassessments under NZ IFRS 16	20
Effect of discounting at a weighted average incremental borrowing rate of 2.2%	(17)
Operating lease commitments at 1 October 2019	227

On transition, the Banking Group, as lessee, applied the following practical expedients as permitted by NZ IFRS 16:

- Relied on previous assessments of contracts that were identified as leases under NZ IAS 17.
- Applied a single discount rate to a portfolio of leases with reasonably similar characteristics.
- Accounted for leases for which the lease term ends within 12 months of 1 October 2019 as short-term leases.
- Excluded initial direct costs from the measurement of right-of-use assets.
- Used hindsight to determine the lease term.

Interest Rate Benchmark Reform

The Banking Group has early adopted the new standard *Interest Rate Benchmark Reform* issued by the New Zealand Accounting Standards Board in November 2019. The standard amends NZ IFRS 7 and NZ IFRS 9, modifying some specific hedge accounting requirements to provide relief from the potential effects of the uncertainty caused by interest rate benchmark reform. The standard did not have a significant impact on the Banking Group on adoption.

The Banking Group's hedging activities expose it to the following significant interest rate benchmarks subject to cessation: USD LIBOR, GBP LIBOR, JPY LIBOR and CHF LIBOR. Some of these hedges are designated as hedge accounting relationships. In addition to interest rate risk, the Banking Group is also exposed to foreign exchange risk and potentially in the future, additional basis risk as market conventions develop and evolve.

Further information on the hedging strategy and hedge accounting relationships is provided in note 14.

Change in classification and measurement of foreign currency bonds and notes

The change in classification and measurement of foreign currency bonds and notes is a voluntary change in the Banking Group's practice for measurement of these instruments in accordance with NZ IFRS 9. Historically all foreign currency bonds and notes were designated as measured at fair value through profit or loss. The Banking Group changed this practice in the current reporting period with new issuances now measured at amortised cost. Further, the Banking Group adopted hedge accounting to foreign currency bonds and notes measured at amortised cost to reflect its hedging strategy to swap foreign currency cash flows to New Zealand dollars using cross-currency interest rate swaps. The Banking Group made the election to exclude currency basis from hedge designation. Changes in fair value of hedging instruments due to currency basis are recognised in other comprehensive income and presented in the cost of hedging reserve in equity.

NZ IFRIC 23 Uncertainty over income tax treatments

NZ IFRIC 23 clarifies the application of the recognition and measurement criteria in NZ IAS 12 *Income Taxes* where there is uncertainty over income tax treatments. The interpretation requires an assessment of each uncertain tax position and consideration of whether it is probable that a taxation authority will accept the entity's position. Where it is not probable that the taxation authority will accept the position, the effect of the uncertainty is reflected in determining the relevant taxable profit or loss, tax bases, unused tax losses and unused tax credits or tax rates.

The Banking Group's existing income tax recognition and measurement accounting policies, and related judgements, were materially aligned with the requirements of the interpretation. Consequently, no transition adjustment to retained profits was required.

Future accounting developments

The following issued, but not yet effective, amendment to accounting standards has not been applied in preparing these financial statements: In September 2020, the New Zealand Accounting Standards Board issued *Amending Standard - Interest Rate Benchmark Reform - Phase 2* to address the financial reporting impacts related to market-wide benchmark interest rate reform. The amendments include a practical expedient for modifications of financial assets and financial liabilities, relief from discontinuing hedge accounting, and allow alternative benchmark rates to be deemed to be separately identifiable risk components for hedge accounting purposes. There are also additional disclosure requirements. The amendments apply to annual periods beginning on or after 1 January 2021. The Banking Group is assessing the impact of these amendments.

Currency of presentation

All amounts are expressed in New Zealand dollars, which is the Bank's functional and presentation currency, unless otherwise stated.

Foreign currency translation

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 the year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when recognised in other comprehensive income as qualifying cash flow hedges. Non-monetary items are translated using the exchange rate at the date of the initial recognition of the asset or liability.

Rounding of amounts

All amounts have been rounded to the nearest million dollars except where indicated.

Notes to and Forming Part of the Financial Statements

Note 1 Principal Accounting Policies *continued*

Principles of consolidation

For the purpose of consolidation, the Bank controls another entity (including a structured entity) if the Bank is exposed, 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. An assessment of control is performed on an ongoing basis. Entities are consolidated from the date on which control is obtained by the Bank. Entities are deconsolidated from the date that control ceases.

Inter-company balances and transactions, including income, expenses and dividends, are eliminated in full.

Fair value measurement

Fair value is defined as 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.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Banking Group recognises the difference between the transaction price and the fair value in profit or loss on initial recognition (i.e. on day one).

Where a financial asset or liability is subsequently measured at fair value, the best evidence of fair value is an independently quoted market price in an active market. Where such prices are unavailable, then depending on the circumstances, alternative evidence may be used, including the price of recent transactions, prices for similar instruments or prices obtained utilising component parts (which when aggregated form the price of the whole instrument).

Where no active market exists for a particular asset or liability, the Banking Group uses standard market valuation techniques to arrive at the estimated fair value, utilising observable market sourced inputs wherever possible. Depending on the circumstances, the same alternative evidence (as described above) may be used in the valuation techniques. The valuation techniques address factors such as interest rates, liquidity and credit risk.

Where a financial instrument is designated as measured at fair value through profit or loss and its fair value is determined using a valuation technique, the movement in fair value attributable to changes in interest rates is calculated based on observable market interest rates. The movement in fair value of a financial asset attributable to changes in credit risk is established through a statistical-based calculation to estimate expected losses attributable to adverse movements in credit risk. The movement in fair value of a financial liability attributable to changes in the Bank's own credit quality is calculated by determining the changes in credit spreads above observable market interest rates.

Fair value asset or liability prices defined above generally represent the present value of all future cash flows including those relating to interest, dividends or other cash flows as appropriate.

Financial assets

Financial assets comprise items such as Cash and liquid assets, Due from central banks and other institutions, Trading securities, Derivative financial instruments, Loans and advances to customers and Amounts due from related entities.

Financial assets are classified as measured at fair value through profit or loss, at amortised cost or, in case of investments in equity instruments, at fair value through other comprehensive income. The classification depends on the Banking Group's business model for managing financial assets and the contractual terms of the financial assets' cash flows.

i) Financial assets measured at fair value through profit or loss

Financial assets at fair value through profit or loss include instruments held for trading, and instruments designated as measured at fair value through profit or loss.

Financial assets held for trading

A financial asset is classified as held for trading if it is acquired principally for the purpose of selling or repurchasing in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). The Banking Group holds certain public and other debt securities as held for trading.

Financial assets designated as measured at fair value through profit or loss

Upon initial recognition, financial assets may be designated as measured at fair value through profit or loss if such designation eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring items on a different basis. This may be the case where derivative financial instruments have been transacted to hedge financial assets which would otherwise be measured at amortised cost.

Financial assets measured at fair value through profit or loss are initially recognised at fair value, with transaction costs recognised in the income statement as incurred. Subsequently, they are measured at fair value with gains and losses recognised in the income statement as they arise.

ii) Financial assets measured at amortised cost

A financial asset is measured at amortised cost only if:

- it is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest.

Financial assets measured at amortised cost are initially recognised at fair value plus directly attributable transaction costs and subsequently measured at amortised cost using the effective interest method.

Notes to and Forming Part of the Financial Statements

Note 1 Principal Accounting Policies *continued*

Financial assets *continued*

iii) Investments in equity instruments measured at fair value through other comprehensive income

An investment in an equity instrument is measured at fair value through other comprehensive income if it is not held for trading and the Banking Group made the election to designate the instrument as measured at fair value through other comprehensive income.

Investments in equity instruments measured at fair value through other comprehensive income are initially recognised at fair value plus directly attributable transaction costs. Subsequently, they are measured at fair value with gains and losses recognised in other comprehensive income, except for dividends which are recognised in the income statement. When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity directly to retained profits.

Refer to note 26 for further detail on classification and measurement of the Banking Group's financial assets.

Financial liabilities

Financial liabilities comprise items such as Due to central banks and other institutions, Deposits and other borrowings, Trading liabilities, Derivative financial instruments, Bonds and notes, Amounts due to related entities and Subordinated debt.

Financial liabilities may be held at fair value through profit or loss or at amortised cost.

i) Financial liabilities held at fair value through profit or loss

Financial liabilities held at fair value through profit or loss comprise instruments held for trading and instruments designated as measured at fair value through profit or loss.

Financial liabilities held for trading

A financial liability is classified as held for trading if it is incurred principally for the purpose of selling in the near term, it forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short term profit taking, or it is a derivative (not in a qualifying hedge relationship). The Banking Group has classified short sales of securities as Trading liabilities.

Financial liabilities designated as measured at fair value through profit or loss

Upon initial recognition, financial liabilities may be designated as measured at fair value through profit or loss if:

- the designation eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring items on a different basis; this may be the case where derivative financial instruments have been transacted to hedge financial liabilities which would otherwise be measured at amortised cost; or
- a group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis in accordance with the documented risk management or investment strategy; or
- they contain one or more embedded derivatives, except if the embedded derivative does not modify significantly the associated cash flows or it is clear with little or no analysis that separation is prohibited.

Financial liabilities held at fair value through profit or loss are initially recognised at fair value with transaction costs recognised immediately in the income statement. Subsequently, they are measured at fair value and any gains and losses are recognised in the income statement as they arise.

Where a financial liability is designated as measured at fair value through profit or loss the movement in fair value attributable to changes in the Banking Group's own credit risk is recognised in other comprehensive income.

The carrying amount disclosed is considered to approximate the contractual amount due on maturity on the financial liabilities designated as measured at fair value through profit or loss with the exception of Bonds and notes.

ii) Financial liabilities held at amortised cost

All Other financial liabilities, Due to central banks and other institutions, Amounts due to related entities, Subordinated debt and certain amounts within Bonds and notes and Deposits and other borrowings are measured at amortised cost.

Financial liabilities held at amortised cost are initially recognised at fair value minus directly attributable transaction costs and subsequently measured at amortised cost using the effective interest method.

Refer to note 26 for further detail on classification and measurement of the Banking Group's financial liabilities.

Derecognition of financial instruments

The Banking Group derecognises a financial asset when the contractual cash flows from the asset expire or it transfers its rights to receive contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership are transferred. Any interest in transferred financial assets that is created or retained by the Banking Group is recognised as a separate asset or liability.

A financial liability is derecognised from the balance sheet when the Banking Group has discharged its obligation or the contract is cancelled or expired.

Goods and services tax

Revenues, expenses and assets are recognised net of the amount of value added tax such as goods and services tax, except where the tax incurred is not recoverable from Inland Revenue Department. In these circumstances, the tax is recognised as part of the expense or the acquisition of the asset.

Receivables and payables are stated at an amount with tax included. The net amount of tax recoverable from, or payable to, Inland Revenue Department is included within either other assets or other liabilities.

Cash flows are included in the cash flow statement on a net basis. The tax component of cash flows for all activities is classified within operating activities.

Notes to and Forming Part of the Financial Statements

Note 1 Principal Accounting Policies *continued*

Reserves

Asset revaluation reserve

The asset revaluation reserve records revaluation adjustments on land and buildings. When an asset is sold or disposed of the related balance in the reserve is transferred directly to retained profits.

Cash flow hedge reserve

The cash flow hedge reserve records the effective portion of fair value changes of derivatives designated as cash flow hedging instruments.

Cost of hedging reserve

The cost of hedging reserve records changes in fair value of hedging instruments due to currency basis where the Banking Group excluded currency basis from the designation of a derivative as hedging instrument.

Fair value through other comprehensive income reserve

The fair value through other comprehensive income reserve records changes in fair value of investments in equity instruments that are measured at fair value through other comprehensive income. The cumulative amount recognised in the reserve is transferred directly to retained profits when the related asset is derecognised.

Notes to and Forming Part of the Financial Statements

Income Statement Notes

Note 2 Interest

Accounting policy

Net interest income is reflected in the income statement using the effective interest method.

The effective interest method is a method of calculating amortisation using the effective interest rate of a financial asset or financial liability. The effective interest rate is the rate that exactly discounts the estimated stream of future cash payments or receipts over the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability.

When calculating the effective interest rate, the cash flows are estimated considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) excluding future credit losses.

The calculation of the effective interest rate includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts. Where it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments) are used.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Interest income		
Cash and liquid assets	27	46
Due from central banks and other institutions	21	48
Trading securities	94	146
Loans and advances to customers	3,449	3,926
Individually impaired assets	7	4
Related entities	21	25
Total interest income	3,619	4,195
Total interest income was derived from financial assets:		
Not at fair value through profit or loss	3,440	3,904
At fair value through profit or loss	179	291
	3,619	4,195
Interest expense		
Due to central banks and other institutions	9	26
Deposits and other borrowings	1,064	1,432
Bonds and notes	348	552
Related entities	6	15
Subordinated debt to related entities	74	79
Subordinated notes to external investors	31	30
Other	5	-
Total interest expense	1,537	2,134
Total interest expense was incurred on financial liabilities:		
Not at fair value through profit or loss	1,125	1,462
At fair value through profit or loss	412	672
	1,537	2,134

Notes to and Forming Part of the Financial Statements

Note 3 Gains Less Losses on Financial Instruments

Accounting policy

Gains less losses on financial instruments recognised in the income statement comprises fair value gains and losses from three distinct activities:

- trading financial instruments;
- instruments designated in hedge accounting relationships; and
- financial instruments designated as measured at fair value through profit or loss.

Trading financial instruments include trading derivatives and trading securities. In general, gains less losses on trading derivatives recognises the full change in fair value of the derivatives inclusive of interest income and expense. However, in cases where the trading derivative is economically hedging an asset or liability designated as measured at fair value through profit or loss, the interest income and expense attributable to the derivative is recognised within net interest income and not part of the fair value movement of the trading derivative. Interest income and expenses on trading securities are reported within interest income.

Gains less losses on assets, liabilities and derivatives designated in hedge accounting relationships recognises fair value movements on both the hedged item and hedging derivative in a fair value hedge accounting relationship, and hedge ineffectiveness for both fair value and cash flow hedge accounting relationships. Interest income and expenses on both hedging instruments and hedged item are recognised in net interest income.

Gains less losses on financial assets and liabilities designated at fair value through profit or loss recognises fair value movements excluding interest, which is reported within net interest income. Changes in the fair value of financial liabilities designated at fair value through profit or loss attributable to the Banking Group's own credit quality are recognised in other comprehensive income.

Gains less losses on financial instruments includes gains and losses on the derecognition of financial instruments held at amortised cost.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Trading gains less losses on financial instruments	185	144
Net gain/(loss) attributable to assets, liabilities and derivatives designated in hedge relationships	(6)	(5)
Net gain/(loss) in the fair value of derivatives used for hedging purposes not designated in hedge relationships	(21)	14
Net gain/(loss) in the fair value of financial assets designated at fair value through profit or loss and related derivatives (refer to table below)	(23)	8
Net gain/(loss) in the fair value of financial liabilities designated at fair value through profit or loss and related derivatives (refer to table below) ¹	(45)	(32)
Other gains less losses on financial instruments	(2)	-
Total gains less losses on financial instruments	88	129

Net gain/(loss) in the fair value of financial assets designated at fair value through profit or loss and related derivatives includes:

Credit risk adjustments on financial assets designated at fair value through profit or loss	(21)	5
Gain/(loss) in the fair value of financial assets designated at fair value through profit or loss	(16)	(8)

Net gain/(loss) in the fair value of financial liabilities designated at fair value through profit or loss and related derivatives includes:

Gain/(loss) attributable to derivatives used for hedging of financial liabilities designated at fair value through profit or loss	49	540
Gain/(loss) in the fair value of financial liabilities designated at fair value through profit or loss	(94)	(572)

¹ All foreign currency gains/(losses) are excluded from this category. Due to the Banking Group's practice of managing all foreign exchange risk centrally, all foreign currency gains/(losses) are included within 'Trading gains less losses on financial instruments' above.

Note 4 Other Operating Income

Accounting policy

Fees and commissions

Unless included in the effective interest rate, fees and commissions are recognised on an accruals basis when the service has been provided or on completion of the underlying transaction. Fees charged for providing ongoing services (for example, maintaining and administering existing facilities) are recognised as income over the period the service is provided.

Funds management and other fiduciary activities

Fees and commissions earned through the marketing of funds management products and other fiduciary activities are included in the income statement as they are earned.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Money transfer fees	88	111
Fees earned on financial assets and liabilities at fair value through profit or loss	36	43
Fees earned on financial assets and liabilities at amortised cost	148	141
Fees earned on trust and other fiduciary activities	10	14
Other income, other fees and commissions income ¹	87	157
Total other operating income	369	466

¹ In 2019, other income included insurance proceeds of \$30 million and a \$36 million gain on sale of the Banking Group's 25% shareholding in Paymark Limited.

Notes to and Forming Part of the Financial Statements

Note 5 Operating Expenses

Accounting policy

Operating expenses are recognised as the underlying service is rendered or over the period in which an asset is consumed or once a liability is incurred.

Employee entitlements

Employee entitlements to long service leave are measured as the present value of expected future payments using an actuarial valuation method based on legal and contractual entitlements and assessments having regard to staff departures, leave utilisation and future salary levels. Expected future payments are discounted using relevant market yields at the reporting date.

Wages and salaries, annual leave and other employee entitlements expected to be paid or settled within 12 months of providing the service are measured at their nominal amounts using remuneration rates that the Banking Group expects to pay when the liabilities are settled.

All other employee entitlements that are not expected to be paid or settled within 12 months of the reporting date are measured at the present value of net future cash flows.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Amortisation and depreciation		
Amortisation of intangible assets ¹	183	210
Depreciation on property, plant and equipment ²	100	44
Total amortisation and depreciation	283	254
Personnel expenses		
Share based payments (refer to note 6)	4	5
Defined contribution pension expense	18	18
Salaries and other staff expenses	552	498
Total personnel expenses	574	521
Other		
Rental expense ²	19	76
Related entity expenses	44	37
Other expenses	257	247
Total other operating expenses	320	360
Total operating expenses	1,177	1,135

¹Current period amortisation includes \$151 million (30 September 2019: \$119 million) accelerated amortisation as a result of change in software capitalisation policy.

²Current period amounts reflect the adoption of NZ IFRS 16 on 1 October 2019 and has been applied in the preparation of this note. Comparative balances have not been restated. Refer to note 1 for further information.

Dollars in Thousands	Consolidated	
	30/9/20	30/9/19
Fees paid to auditors		
Audit and review of financial statements	2,134	1,998
Other assurance and agreed upon procedures ³	274	346

³Fees paid to auditors were for other assurance services provided in relation to funding activities and agreed upon procedures related to funds managed by the Banking Group.

Notes to and Forming Part of the Financial Statements

Note 6 Share Based Payments Expense

Accounting policy

The Banking Group engages in equity settled share-based payment transactions via its ultimate parent, National Australia Bank Limited, in respect of services received from its employees. The value of the services received is measured by reference to the grant date fair value of the shares or performance rights. The cost relating to the shares or performance rights granted is recognised in the income statement over the period in which the services are received, which is the vesting period.

The grant date fair value of each share is determined by the market value of the National Australia Bank Limited shares and is generally a five day weighted average price. Employee share plans and performance rights are linked to service conditions, and/or internal performance and market performance.

The fair value of the performance rights with market performance hurdles is determined using a simulated version of the Black-Scholes model. The key assumptions and inputs used in the valuation model are the exercise price of the performance rights, the expected volatility of the National Australia Bank Limited share price, the risk-free interest rate and the expected dividend yield on the National Australia Bank Limited shares for the life of the performance rights.

Except for those that include terms related to market conditions, vesting conditions included in the terms of the grant are not taken into account in estimating fair value.

Non-market vesting conditions are taken into account by adjusting the number of shares or performance rights included in the measurement of the cost of employee services so that ultimately, the amount recognised in the income statement reflects the number of vested shares or performance rights. Where vesting conditions are related to market conditions, the charges for the services received are recognised regardless of whether or not the market related vesting condition is met, provided that the non-market vesting conditions are met.

Shares and performance rights

Shares and performance rights (subject to restrictions) are granted to employees of the Banking Group by the ultimate parent, National Australia Bank Limited, as part of NAB's employee equity plans. These plans are an integral part of the Banking Group's remuneration strategy in rewarding an employee's current and future contribution to the Banking Group's performance.

The plans described below involve the provision of equity grants to employees of the Banking Group. The Banking Group reimburses National Australia Bank Limited for the cost of these grants.

As at 30 September 2020, share based payments cost of \$8 million in relation to performance rights and shares granted to employees of the Banking Group had not yet been charged by National Australia Bank Limited (30 September 2019: \$11 million). This amount is required to be expensed in future periods under NZ IFRS 2 Share-based Payment.

a) NAB New Zealand Staff Share Allocation Plan

This plan provides for the National Australia Bank Limited Board to invite any employee of the Banking Group based in New Zealand to participate in an offer under this plan. Under this plan, funds are provided (if required) to CPU Share Plans Pty Limited to subscribe for or purchase fully paid ordinary shares in National Australia Bank Limited on behalf of participating employees.

Year-end share offer

This programme is designed to offer up to approximately A\$1,000 of ordinary shares to each employee based on NAB's performance, as measured against a scorecard of objectives for NAB for the financial year. These shares are held in trust for three years, or until the employee ceases his or her employment.

Under the New Zealand programme, each eligible employee was required to pay NZ\$1.00 for the whole parcel of shares offered, or the market price of the parcel, whichever was less. Participating employees receive dividends and may exercise voting rights in respect of the shares, but otherwise cannot transact the shares until the restriction period concludes. If a participating employee leaves the Banking Group prior to the end of the three-year restriction period due to voluntary resignation or dismissal, the trustee will purchase the shares back for the lesser of the market price or the price paid by the employee for the shares. The Banking Group ceased to issue shares under the plan in 2019. No shares under the plan will be granted in respect of 2019 or thereafter.

b) NAB Performance Rights Plan

The performance rights plans provided for the National Australia Bank Limited Board to grant performance rights to selected senior executives of the Banking Group to subscribe for fully paid ordinary shares in National Australia Bank Limited. Each performance right entitles the holder to subscribe for one fully paid ordinary share in National Australia Bank Limited. The performance rights cannot be transferred and are not quoted on the Australian Securities Exchange. No payment is required from executives at the time of the grant. There are no voting or dividend rights attached to the performance rights.

Short Term Incentive deferral

Historically, the Banking Group's senior executives who participated in the Short Term Incentive ("STI") deferral offer received up to half of the value of their STI rewards in the form of National Australia Bank Limited performance rights. Employees became eligible for STI deferral rights based on their individual and business performance. STI deferral rights granted in respect 2017 were granted in either one tranche to be restricted for 12 months or two equal tranches with half restricted for 12 months and the remaining half for 24 months. STI deferral rights lapse during the restriction period if the executive resigns or fails to pass specific compliance expectations in respect of their performance review. The National Australia Bank Limited Board may also, in its discretion, lapse all or part of an executive's performance rights. No performance rights under the plan were granted in respect of 2018 or 2019.

Long Term Variable Reward

National Australia Bank Limited awards Long Term Variable Rewards ("LTVR") including prior year Long Term Incentives ("LTI") primarily targeted at key executive positions to help align management decisions with the long term performance of NAB through the use of internal and/or external performance hurdles, generally measured over a four to five-year performance period. The programme delivers performance rights aligned to National Australia Bank Limited's share price. LTVR awarded in respect of 2018 was in the form of ordinary shares in National Australia Bank Limited.

During the restriction period, all of an executive's LTVR rights will lapse on resignation. Unless the National Australia Bank Limited Board determines otherwise, a pro rata portion will lapse on cessation of employment in other circumstances. LTVR rights will also lapse if conduct requirements or performance hurdles are not met. The National Australia Bank Limited Board has absolute discretion to determine vesting or lapsing outcomes for the LTVR rights.

Notes to and Forming Part of the Financial Statements

Note 6 Share Based Payments Expense *continued*

b) NAB Performance Rights Plan *continued*

Commencement benefits

Commencement benefits are provided to enable the buy-out of equity or other incentives from an employee's previous employment. Performance rights are subject to restrictions and certain lapsing conditions, including lapsing on resignation or if conduct requirements are not met.

Retention or recognition benefits

Retention or recognition benefits are offered to key individuals in roles where retention is critical over the medium term (generally between 2 and 3 years). Performance rights are subject to restrictions and certain lapsing conditions, including lapsing on resignation from NAB or if conduct requirements are not met.

The number and weighted average exercise prices of performance rights were as follows:

	Consolidated	
	30/9/20	30/9/19
Number of Rights		
Performance rights		
Outstanding at beginning of year	420,678	490,624
Add: Granted during the year	52,261	52,100
Add: Transferred in during the year	-	27,954
Deduct: Exercised during the year	85,244	80,365
Deduct: Forfeited during the year	112,787	69,635
Deduct: Transferred out during the year	27,954	-
Outstanding at end of year	246,954	420,678
Exercisable at end of year	-	-

The volume weighted average price of National Australia Bank Limited shares during the year ended 30 September 2020 was A\$19.92 (year ended 30 September 2019: A\$25.80).

Fair value of performance rights

The following table shows the significant assumptions used as inputs into the grant date fair value calculation of performance rights granted during the last two years. In the table, values have been presented as weighted averages, but the specific values for each grant are used for the fair value calculation. The table also shows a 'no hurdle' value for performance rights that do not have any market-based performance hurdles attached. The 'no hurdle' value is calculated as the grant date fair value of the rights, adjusted for expected dividends over the vesting period. For further details on the fair value methodology, refer to page 20.

	Consolidated	
	30/9/20	30/9/19
Weighted average values		
Contractual life (years)	4.0	1.4
Risk-free interest rate (per annum)	0.63%	1.74%
Expected volatility of share price	16.00%	N/A
Closing share price on grant date	A\$26.24	A\$24.81
Dividend yield (per annum)	6.30%	7.00%
Fair value of performance rights	A\$10.07	N/A
'No hurdle' value of performance rights	N/A	A\$22.75
Expected time to vesting (years)	3.81	1.12

c) NAB Staff Share Ownership Plan

Long-term Variable Reward Plan

In 2018, eligible NAB executives received a single reward, replacing the STI deferral and the LTVR award (where applicable) ("Variable Reward"). The reward was provided in the form of ordinary shares in National Australia Bank Limited. Variable Reward shares were granted in one tranche restricted for up to four years. Variable Reward shares are forfeited during the restriction period if the executive resigns or breaches the NAB Code of Conduct or, subject to certain exclusions, if the executive is terminated from NAB. The National Australia Bank Limited Board may in its discretion, subject to compliance with the law, forfeit some or all of the Variable Reward or extend the deferral period if circumstances warrant.

Discretionary Variable Reward Plan

From 2019, eligible BNZ executives received their Discretionary Variable Reward Plan ("DVRP") deferral in the form of ordinary shares in National Australia Bank Limited. Employees became eligible for these DVRP deferral shares based on their individual and business performance. DVRP shares are granted in one tranche restricted for 12 months. DVRP shares are forfeited during the restriction period if the executive resigns or breaches the BNZ Code of Conduct or, subject to certain exclusions, if the executive is terminated from NAB Group. The National Australia Bank Limited Board may in its discretion, subject to compliance with the law, forfeit some or all of the DVRP shares or extend the deferral period if circumstances warrant.

Notes to and Forming Part of the Financial Statements

Note 6 Share Based Payments Expense *continued*

c) NAB Staff Share Ownership Plan *continued*

Commencement benefits

Commencement benefits are provided to enable the buy-out of equity or other incentives from an employee's previous employment. Shares are subject to restrictions and certain forfeiture conditions, including forfeiture on resignation or if conduct requirements are not met.

The number and weighted average grant date fair value of shares issued during the year under the NAB New Zealand Staff Share Allocation Plan and NAB Staff Share Ownership Plan were as follows:

	Consolidated			
	Number of fully paid ordinary shares granted 30/9/20	Weighted average grant date fair value 30/9/20	Number of fully paid ordinary shares granted 30/9/19	Weighted average grant date fair value 30/9/19
Staff Share Allocation Plan	-	-	154,869	A\$24.19
Staff Share Ownership Plan	74,364	A\$20.60	76,513	A\$26.24

Note 7 Income Tax

Accounting policy

Income tax expense is the income tax charge or benefit incurred on the current reporting period's profit or loss and is the aggregate of the movements in deferred tax taken through the income statement and the amount of income tax payable or recoverable in respect of taxable profit or loss for the period at the applicable tax rate.

Income tax relating to items recognised directly in other comprehensive income is recognised in other comprehensive income and not in the income statement.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Income tax on operating profit charged to income statement		
Current tax	401	410
Deferred tax	(101)	(25)
Total income tax on operating profit charged to income statement	300	385
Reconciliation of income tax expense on operating profit shown in the income statement with prima facie tax payable on the pre-tax accounting profit		
Total operating profit before income tax expense	1,062	1,407
Prima facie income tax at 28%	297	394
Add/(deduct): Tax effect of amounts which are non-deductible or non-assessable:		
Non-assessable and tax paid income	-	(11)
Prior year adjustment	-	1
Other accounting movements	3	1
Total income tax expense on operating profit	300	385
Effective tax rate	28.2%	27.4%
Income tax charged to other comprehensive income		
Current tax	(19)	6
Deferred tax	3	24
Total income tax charged to other comprehensive income	(16)	30

Imputation Credit Account

The amount of imputation credits available to the Banking Group as at 30 September 2020 was \$1,943 million (30 September 2019: \$1,531 million).

Notes to and Forming Part of the Financial Statements

Asset Notes

Note 8 Cash and Liquid Assets

Accounting policy

Cash and liquid assets consists of cash, transaction balances with central banks and other institutions and reverse repurchase agreements.

Reverse repurchase agreements

Securities purchased under agreements to resell are recorded as Cash and liquid assets and Amounts due from related entities. The difference between the purchase and the resale prices is treated as interest and accrued over the life of the agreements using the effective interest method.

Where the Banking Group has accepted collateral arising from secured placements and reverse repurchase agreements, the Banking Group is obliged to return equivalent securities. Securities repledged by the Banking Group are strictly for the purposes of providing collateral for the counterparty. These transactions are conducted under terms that are usual for customary standard lending, and securities borrowing and lending activities.

Securities lent to counterparties are also disclosed in the financial statements.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Coins, notes and cash at bank	182	166
Transaction balances with central banks	2,182	1,700
Transaction balances with other institutions	570	277
Securities purchased under agreements to resell with other institutions	999	597
Total cash and liquid assets	3,933	2,740

The Banking Group has accepted collateral with a fair value of \$2,048 million as at 30 September 2020 arising from reverse repurchase agreements included in cash and liquid assets and amounts due from related entities (refer to note 25), which it is permitted to sell or repledge (30 September 2019: \$1,176 million).

Government securities with a fair value of \$324 million were repledged as at 30 September 2020 (30 September 2019: \$71 million). The Bank's obligation to repurchase government securities is classified under due to central banks and other institutions (refer to note 18).

Note 9 Due from Central Banks and Other Institutions

Included in due from central banks and other institutions as at 30 September 2020 was \$628 million of collateral posted with counterparties to meet standard derivative trading obligations (30 September 2019: \$1,207 million).

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Government bonds, notes and securities	6,167	2,498
Semi-government bonds, notes and securities	2,949	2,850
Corporate and other institutions bonds, notes and securities	1,698	1,919
Total trading securities	10,814	7,267

Included in trading securities as at 30 September 2020 were \$1,360 million encumbered through repurchase agreements (30 September 2019: \$76 million). These trading securities have not been derecognised by the Bank as the Bank retains substantially all the risks and rewards of ownership. Counterparties have the right to sell or repledge these encumbered securities. The Bank's obligation to repurchase trading securities is classified under due to central banks and other institutions (refer to note 18) and amounts due to related entities (refer to note 25).

Notes to and Forming Part of the Financial Statements

Note 11 Loans and Advances to Customers

Accounting policy

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Banking Group provides money or services directly to a customer and has no intention of trading the loan.

Loans and advances are either measured at fair value through profit or loss or at amortised cost using the effective interest method, net of any provision for credit impairment. Under the effective interest method, fee income and costs directly related to the origination of the loan are deferred over the expected life of the assets or, where appropriate, a shorter period. When calculating the effective interest rate, the Banking Group estimates cash flows considering all contractual terms of the financial instrument and excluding future credit losses.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Overdrafts	2,136	2,970
Credit card outstandings	900	1,140
Housing loans	45,850	42,883
Other term lending	38,809	40,447
Other lending	1,154	1,050
Total gross loans and advances to customers	88,849	88,490
Deduct:		
Provision for credit impairment and credit risk adjustments on financial assets (refer to note 12)	910	657
Deferred and other unearned future income and expenses	(68)	(59)
Fair value hedge adjustments on housing loans	(142)	(149)
Total deductions	700	449
Total net loans and advances to customers	88,149	88,041

Included in loans and advances to customers as at 30 September 2020 was \$631 million of collateral posted with counterparties to meet standard derivative trading obligations (30 September 2019: \$367 million).

As at 30 September 2020, included within the Banking Group's loans and advances to customers were housing loans with a carrying amount of \$13,547 million that have been transferred to consolidated structured entities but not derecognised in their entirety (30 September 2019: \$11,164 million). Details on transactions with the BNZ RMBS Trust Series 2008-1 (the "RMBS Trust") and the BNZ Covered Bond Trust (the "Covered Bond Trust") are provided in notes 28, 32 and 36.

Notes to and Forming Part of the Financial Statements

Note 12 Provision for Credit Impairment

Accounting policy

The Banking Group applies a three-stage approach to measuring expected credit losses ("ECL") for the following categories of financial assets that are not measured at fair value through profit or loss:

- debt instruments measured at amortised cost
- loan commitments

The Banking Group assesses whether the credit risk on a financial asset has increased significantly on an individual or collective basis. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of shared credit risk characteristics, taking into account instrument type, credit risk ratings, date of initial recognition, remaining term to maturity, industry, geographical location of the borrower and other relevant factors.

ECLs are either measured over 12 months or the expected lifetime of the exposure, depending on credit deterioration since origination, according to the following three stage approach:

- 12 month ECL ("Stage 1"): For exposures where there has not been a significant increase in credit risk ("SICR") since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.
- Lifetime ECL-not credit impaired ("Stage 2"): For exposures where there has been a significant increase in credit risk since initial recognition but that are not credit impaired, a lifetime ECL is recognised reflecting the remaining lifetime of the financial asset.
- Lifetime ECL-credit impaired ("Stage 3"): Financial assets are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. For financial assets that have become credit impaired, a lifetime ECL is recognised and interest revenue is calculated by applying the effective interest rate to the amortised cost (net of provision) rather than the gross carrying amount.
- Consistent with guidance from the RBNZ, a customer support payment deferral as part of COVID-19 support packages by itself will not result in a significant increase in credit risk, and therefore will not trigger an automatic migration from Stage 1 to Stage 2 in the credit impairment for such loans.

If credit risk were to improve in a subsequent period such that the increase in credit risk since origination is no longer considered significant, the exposure returns to Stage 1 classification and a 12-month ECL is applied.

The Banking Group considers reasonable and supportable information that is relevant and available without undue cost or effort, for this purpose. This includes quantitative and qualitative information and also forward-looking analysis.

Measurement of Expected Credit Losses

ECLs are derived from unbiased and probability-weighted estimates of expected loss, and are measured as follows:

- Financial assets that are not credit impaired at the reporting date: as the present value of all cash shortfalls over the expected life of the financial asset discounted by the effective interest rate. The cash shortfall is the difference between the cash flows due to the Banking Group in accordance with the contract and the cash flows that the Banking Group expects to receive.
- Financial assets that are credit impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows discounted by the effective interest rate.
- Undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Banking Group if the commitment is drawn down and the cash flows that the Banking Group expects to receive.

Credit quality of financial assets

The Banking Group has an internally developed credit rating master-scale derived from historical default data drawn from a number of sources to assess the potential risk in lending or through providing other financial services products to counterparties or customers. For loans and advances, the Banking Group has a single common master-scale across all retail and non-retail counterparties for probability of default. The probability of default master-scale can be broadly mapped to external rating agencies and has performing (pre-default) and non-performing (post-default) grades.

Inputs, assumptions and techniques used for estimating impairment

In assessing for the impairment of financial assets under the expected credit loss model, the Banking Group defines default in accordance with its Credit Policy and Procedures, which includes defaulted assets and impaired assets as described below:

Defaulted assets consist of retail loans (excluding unsecured portfolio managed facilities) and non-retail loans which are at least 90 days past due on any material obligation. The offer or uptake of a COVID-19 pandemic related payment deferral does not automatically trigger a default event unless there is other evidence that the customer is unlikely to meet their contractual obligations.

Credit impaired assets under the expected credit loss model consist of:

- Retail loans: excluding unsecured portfolio managed facilities, which are contractually past due 90 days and there is sufficient doubt about the ultimate collectability of principal and interest;
- Non-retail loans: which are contractually past due 90 days, including loans where there is sufficient doubt about the ultimate collectability of principal and interest;
- Impaired off-balance sheet credit exposures where current circumstances indicate that losses may be incurred; and
- Unsecured portfolio managed facilities which are 180 days past due (if not written off).

Assessment of significant increase in credit risk

When determining whether the risk of default has increased significantly since initial recognition, the Banking Group considers both quantitative and qualitative information, including expert credit risk assessment, forward looking information and analysis based on the Banking Group's historical experience.

- For non-retail facilities, internally derived credit ratings, as described above, represent a key determinant of credit risk. The Banking Group assigns each customer a credit rating at initial recognition based on available information. Credit risk is deemed to have increased significantly if the credit rating has significantly deteriorated at the reporting date, relative to the credit rating at the date of initial recognition.
- Retail facilities use the number of days past due or the relative change in probability of default at account level, to determine significant increase in credit risk.
- In addition, the Banking Group considers that significant increase in credit risk occurs when an asset is more than 30 days past due.

Notes to and Forming Part of the Financial Statements

Note 12 Provision for Credit Impairment *continued*

Accounting policy *continued*

Calculation of expected credit losses

ECLs are calculated using three main parameters i.e. a probability of default (“PD”), a loss given default (“LGD”) and an exposure at default (“EAD”). These parameters are generally derived from internally developed statistical models combined with historical, current and forward looking information, including macro-economic data.

For accounting purposes, the 12-months and lifetime PD represent the expected point-in-time probability of a default over the next 12 months and remaining lifetime of the financial instrument, respectively, based on conditions existing at the reporting date and future economic conditions that affect credit risk.

The LGD represents expected loss conditional on default, taking into account the mitigating effect of collateral, its expected value when realised and the time value of money.

The EAD represents the expected exposure at default, taking into account the repayment of principal and interest from the reporting date to the default event together with any expected drawdown of a facility.

The 12-months ECL is equal to the discounted sum over the next 12-months of monthly PD multiplied by LGD and EAD. Lifetime ECL is calculated using the discounted sum of monthly PD over the full remaining life multiplied by LGD and EAD.

Incorporation of forward looking information

- The Banking Group uses internal subject matter experts from Risk, Economics and Business Divisions to consider a range of relevant forward looking data, including macro-economic forecasts and assumptions, for the determination of unbiased general economic adjustments and any idiosyncratic or targeted portfolio / industry adjustments, in order to support the calculation of ECLs.
- Forward looking adjustments for both general macro-economic adjustments and more targeted portfolio / industry adjustments, reflect reasonable and supportable forecasts of potential future conditions that are not captured within the base ECL calculations.
- Macro-economic factors taken into consideration include, but are not limited to, unemployment, interest rates, gross domestic product, inflation, commercial and residential property prices, and require an evaluation of both the current and forecast direction of the macro-economic cycle.
- Incorporating forward looking information, including macro-economic forecasts, increases the degree of judgement required to assess how changes in these data points will affect ECLs. The methodologies and assumptions, including any forecasts of future economic conditions, are reviewed regularly.

Key judgements and estimates

- A collective assessment of impairment takes into account data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.) and concentrations of risk and economic data (including levels of unemployment, real estate price indices, country risk and the performance of different individual groups).
- Judgement is required by management in the estimation of the amount and timing of future cash flows when determining an impairment loss for loans and advances. In estimating these cash flows, the Banking Group makes judgements about the borrower’s financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.
- Forward looking macro-economic information and assumptions relating to COVID-19 have been considered in these scenarios, recognising that uncertainty still exists in relation to the duration of COVID-19 related restrictions and the anticipated impact of government stimulus and regulatory actions.
- When determining whether the risk of default has increased significantly since initial recognition, both quantitative and qualitative information is considered, including expert credit assessment, forward looking information and analysis based on the Banking Group’s historical loss experience.

Dollars in Millions	Consolidated (30/9/20)			Total
	Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	
Loans and advances to customers				
Collective provision for credit impairment measured on a 12-months ECL	5	8	44	57
Provision for credit impairment measured on a lifetime ECL				
Collective provision lifetime ECL not credit impaired	33	48	417	498
Collective provision lifetime ECL credit impaired	53	15	39	107
Specific provision lifetime ECL credit impaired	3	8	204	215
Total provision for credit impairment measured on a lifetime ECL	89	71	660	820
Total provision for credit impairment	94	79	704	877
	Consolidated (30/9/19)			

Loans and advances to customers

Collective provision for credit impairment measured on a 12-months ECL	1	17	53	71
Provision for credit impairment measured on a lifetime ECL				
Collective provision lifetime ECL not credit impaired	53	22	294	369
Collective provision lifetime ECL credit impaired	7	16	26	49
Specific provision lifetime ECL credit impaired	2	5	149	156
Total provision for credit impairment measured on a lifetime ECL	62	43	469	574
Total provision for credit impairment	63	60	522	645

Notes to and Forming Part of the Financial Statements

Note 12 Provision for Credit Impairment *continued*

The following tables provide a reconciliation from the opening balance to the closing balance of provision for credit impairment and show the movement in opening balance where financial assets have transferred between provision stages during the year.

	Consolidated (30/9/20)				Total
	Collective Provision 12-months ECL	Collective Provision Lifetime ECL Not Credit Impaired	Collective Provision Lifetime ECL Credit Impaired	Specific Provision Lifetime ECL Credit Impaired	
Movement in provision for credit impairment					
Residential mortgage lending					
Balance at beginning of year	1	53	7	2	63
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	4	(3)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	-	1	(1)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(1)	1	-	-
Transferred to specific provision lifetime ECL credit impaired	-	-	-	-	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	-	(17)	47	3	33
Amounts written off	-	-	-	(2)	(2)
Recovery of amounts written off	-	-	-	-	-
Balance at end of year - Residential mortgage lending	5	33	53	3	94
Other retail exposures					
Balance at beginning of year	17	22	16	5	60
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	8	(6)	(2)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(2)	3	(1)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(2)	2	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(3)	(8)	11	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	(15)	34	8	17	44
Amounts written off	-	-	-	(36)	(36)
Recovery of amounts written off	-	-	-	10	10
Balance at end of year - Other retail exposures	8	48	15	7	78
Corporate exposures					
Balance at beginning of year	53	294	26	149	522
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	59	(58)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(11)	13	(2)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(7)	7	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(14)	(1)	15	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	(57)	189	10	81	223
Amounts written off	-	-	-	(40)	(40)
Recovery of amounts written off	-	-	-	2	2
Discount unwind ²	-	-	-	(2)	(2)
Balance at end of year - Corporate exposures	44	417	39	205	705
Total					
Balance at beginning of year	71	369	49	156	645
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	71	(67)	(4)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(13)	17	(4)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(10)	10	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(17)	(9)	26	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	(72)	206	65	101	300
Amounts written off	-	-	-	(78)	(78)
Recovery of amounts written off	-	-	-	12	12
Discount unwind ²	-	-	-	(2)	(2)
Total provision for credit impairment balance at end of year	57	498	107	215	877

¹ Classified as credit impairment charge in the income statement.

² The impairment loss on an impaired asset is calculated as the difference between the asset's carrying amount and the estimated future cash flows discounted to its present value using the original effective interest rate for the asset. This discount unwinds through interest income over the period the asset is held.

Notes to and Forming Part of the Financial Statements

Note 12 Provision for Credit Impairment *continued*

	Consolidated (30/9/19)				Total
	Collective Provision 12-months ECL	Collective Provision Lifetime ECL Not Credit Impaired	Collective Provision Lifetime ECL Credit Impaired	Specific Provision Lifetime ECL Credit Impaired	
Movement in provision for credit impairment					
Residential mortgage lending					
Balance at beginning of year	1	50	4	3	58
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	2	(1)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	-	1	(1)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	-	-	-	-
Transferred to specific provision lifetime ECL credit impaired	-	-	-	-	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	(2)	3	5	3	9
Amounts written off	-	-	-	(4)	(4)
Recovery of amounts written off	-	-	-	-	-
Balance at end of year - Residential mortgage lending	1	53	7	2	63
Other retail exposures					
Balance at beginning of year	14	13	12	5	44
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	6	(5)	(1)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(1)	2	(1)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(2)	2	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(2)	(7)	9	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	(2)	16	11	20	45
Amounts written off	-	-	-	(39)	(39)
Recovery of amounts written off	-	-	-	10	10
Balance at end of year - Other retail exposures	17	22	16	5	60
Corporate exposures					
Balance at beginning of year	51	303	35	95	484
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	71	(71)	-	-	-
Transferred to collective provision lifetime ECL not credit impaired	(7)	13	(6)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(2)	2	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(13)	(4)	17	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	(62)	64	(1)	59	60
Amounts written off	-	-	-	(23)	(23)
Recovery of amounts written off	-	-	-	5	5
Discount unwind ²	-	-	-	(4)	(4)
Balance at end of year - Corporate exposures	53	294	26	149	522
Total					
Balance at beginning of year	66	366	51	103	586
Changes to the opening balance due to transfer between ECL stages:					
Transferred to collective provision 12-months ECL	79	(77)	(2)	-	-
Transferred to collective provision lifetime ECL not credit impaired	(8)	16	(8)	-	-
Transferred to collective provision lifetime ECL credit impaired	-	(4)	4	-	-
Transferred to specific provision lifetime ECL credit impaired	-	(15)	(11)	26	-
Charge/(credit) to income statement due to new and increased provisions (net of releases) ¹	(66)	83	15	82	114
Amounts written off	-	-	-	(66)	(66)
Recovery of amounts written off	-	-	-	15	15
Discount unwind ²	-	-	-	(4)	(4)
Total provision for credit impairment balance at end of year	71	369	49	156	645

¹ Classified as credit impairment charge in the income statement.

² The impairment loss on an impaired asset is calculated as the difference between the asset's carrying amount and the estimated future cash flows discounted to its present value using the original effective interest rate for the asset. This discount unwinds through interest income over the period the asset is held.

Notes to and Forming Part of the Financial Statements

Note 12 Provision for Credit Impairment *continued*

Impact of changes in gross carrying amount on ECL

Overall, the net increase in the total provision for credit impairment of \$232 million was mainly driven by a \$179 million increase in forward looking economic adjustment ("Economic Adjustment") raised during the year, due to the future potential deterioration of macro-economic factors, including consideration of the COVID-19 pandemic. Refer Sensitivity Analysis below for further information on the Economic Adjustment.

The following table provides a reconciliation of the movements in the provision for credit impairment.

Dollars in Millions	Consolidated				Total 30/9/20
	Collective Provision 12-months ECL 30/9/20	Collective Provision Lifetime ECL Not Credit Impaired 30/9/20	Collective Provision Lifetime ECL Credit Impaired 30/9/20	Specific Provision Lifetime ECL Credit Impaired 30/9/20	
Movement in provision for credit impairment					
Balance at beginning of period	71	369	49	156	645
Economic Adjustment	(10)	158	31	-	179
Other movements	(4)	(29)	27	59	53
Total provision for credit impairment balance at end of period	57	498	107	215	877

The following explains how changes in the gross carrying amount of financial assets during the period have contributed to the changes in the provision for credit impairment excluding the impact of the \$179 million Economic Adjustment. Provision for credit impairment reflects ECL measured using the three-stage approach under NZ IFRS 9.

- Collective provision 12-months ECL (Stage 1) decreased by \$4 million mainly due to an overall improvement in credit quality on Stage 1 loans and advances. During the period \$24.0 billion of loans and advances were newly originated or transferred from Stage 2 or Stage 3 due to credit improvement. This was partially offset by the \$22.1 billion of loans and advances that were repaid, experienced movements in underlying account balances during the period or transferred to Stage 2 or Stage 3 due to deterioration in credit quality.
- Collective provision lifetime ECL not credit impaired (Stage 2) decreased by \$29 million mainly due to \$10.1 billion of loans and advances that were repaid or transferred to Stage 1 or Stage 3. This was partially offset by \$10 billion of loans and advances transferred from Stage 1 or Stage 3.
- Collective provision lifetime ECL credit impaired (Stage 3) increased by \$27 million mainly due to \$459 million of loans and advances that were transferred from Stage 1 or Stage 2 due to deterioration in credit quality. This was partially offset by \$376 million of loans and advances that were repaid or transferred to Stage 1 or Stage 2 due to improvement in credit quality.
- Specific provision lifetime ECL credit impaired (Stage 3) increased by \$59 million primarily driven by a small number of larger corporate exposures. During the period \$308 million of loans and advances experienced change in the underlying account balances or were transferred from previously being assessed collectively. This was offset by \$398 million of loans and advances that were repaid or written off during the period.

Sensitivity Analysis

The following table shows the reported ECL based on the probability weighting of scenarios, with the sensitivity range reflecting the ECL impacts assuming a 100% weighting is applied to the base case scenario or the severe downside scenario (with all other assumptions held constant).

As at 30 September 2020, the probability weighted ECL is a blended outcome taking into consideration the respective scenarios applied across each of the Banking Group's major loan portfolios. Given the point in the credit cycle and forecast near-term outlook, including anticipated COVID-19 pandemic impacts, a negligible weighting has been applied to the upside scenario.

The base case scenario incorporates a reasonable level of portfolio stress driven by forecast macro-economic factors, including potential impacts of the COVID-19 pandemic, that deteriorate sharply in 2020 before recovering in 2021.

	Base case (%)			Severe downside (%)		
	30/9/20	30/9/21	30/9/22	30/9/20	30/9/21	30/9/22
Macro-economic indicators						
Gross domestic product change year on year	(5.9)	1.0	4.1	(8.8)	0.4	5.8
Unemployment	6.2	8.1	5.6	13.4	10.4	9.4
House price change year on year	7.8	(3.7)	6.6	(14.5)	(18.5)	(5.0)

Dollars in Millions	Collective Provision 30/9/20	Specific Provision 30/9/20	Total 30/9/20
Reported probability weighted ECL	662	215	877
100% base case ECL	345	215	560
100% severe downside ECL	1,187	215	1,402

Notes to and Forming Part of the Financial Statements

Note 12 Provision for Credit Impairment *continued*

Contractual modifications

As set out on page 3, the New Zealand Government and the RBNZ have implemented a financial support package for homeowners and businesses affected by the economic impacts of the COVID-19 pandemic, in which the Bank has been participating. The package includes a loan repayment deferral scheme for residential mortgages and other consumer lending for a period of 3-6 months or until 31 March 2021 as well as lending to small to medium-sized enterprises and the agricultural sector.

The terms and conditions related to the deferrals were considered non-substantial modifications and accounted for as a continuation of the existing loan agreements. In accordance with guidance provided by the RBNZ, in respect of the deferral on loans provided as part of a COVID-19 support package, the Bank has paused the counting of days past due when the repayment deferral is granted. At the end of the deferral period, the counting of days past due resumes from the number of days past due of that loan when it entered the payment deferral, unless that loan has been formally modified to a new repayment schedule (in which case the days past due is reset to zero). Payments have been deferred on loans and advances to customers with a gross carrying amount of \$1.6 billion. There was no material loss to the Banking Group from these modifications as the Banking Group continues to earn interest during the deferral period.

Gross carrying amounts written off during the year still subject to enforcement activity

As at 30 September 2020, the contractual amount outstanding on loans and advances to customers written off during the year and that are still subject to enforcement activity was \$28 million for the Banking Group (30 September 2019: \$11 million).

Credit risk adjustment on financial assets designated at fair value through profit or loss

The changes in value of financial assets designated at fair value through profit or loss that are attributable to changes in credit risk have been calculated using a statistical-based calculation that estimates expected losses attributable to adverse movement in credit risks.

Credit risk adjustments on financial assets designated at fair value through profit or loss are analysed in the following table.

Dollars in Millions	Consolidated (30/9/20)			Total
	Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	
Credit risk adjustment on individual financial assets				
Loans and advances to customers				
Balance at beginning of year	-	-	1	1
Charge/(credit) to income statement	-	-	21	21
Balance at end of year	-	-	22	22
Credit risk adjustment on groups of financial assets				
Loans and advances to customers				
Balance at beginning of year	-	-	11	11
Balance at end of year	-	-	11	11
Total credit risk adjustments on loans and advances designated at fair value through profit or loss	-	-	33	33
Trading derivative financial instruments				
Balance at beginning of year	-	-	19	19
Charge/(credit) to income statement	-	-	9	9
Balance at end of year	-	-	28	28
Total credit risk adjustments on trading derivative financial instruments	-	-	28	28
Consolidated (30/9/19)				
Credit risk adjustment on individual financial assets				
Loans and advances to customers				
Balance at beginning of year	-	-	2	2
Charge/(credit) to income statement	-	-	(1)	(1)
Balance at end of year	-	-	1	1
Credit risk adjustment on groups of financial assets				
Loans and advances to customers				
Balance at beginning of year	-	-	15	15
Charge/(credit) to income statement	-	-	(4)	(4)
Balance at end of year	-	-	11	11
Total credit risk adjustments on loans and advances designated at fair value through profit or loss	-	-	12	12
Trading derivative financial instruments				
Balance at beginning of year	-	-	11	11
Charge/(credit) to income statement	-	-	8	8
Balance at end of year	-	-	19	19
Total credit risk adjustments on trading derivative financial instruments	-	-	19	19

Notes to and Forming Part of the Financial Statements

Note 13 Asset Quality

Accounting policy

The Banking Group has disclosed certain components of its loan portfolio as impaired assets according to the classifications below:

- **Credit impaired assets** are defined in note 12 under credit risk - credit quality of financial assets.
- **Individually impaired assets** means impaired assets where an individually assessed allowance has been recorded.

The following categories are also disclosed but are not considered to be impaired assets:

- **Other assets under administration** are those loans that are not impaired or past due, but where the customer is in receivership, liquidation, bankruptcy, statutory management, a no asset procedure, voluntary administration or any other form of administration in New Zealand, or is in an equivalent form of voluntary or involuntary administration in an overseas jurisdiction.
- **Past due assets not individually impaired** are those loans for which payments of principal or interest are contractually past due but adequate security is held.

The Banking Group provides for credit impairment as disclosed in note 12. Accordingly, when management determines that a loan is not expected to be recovered in full, the principal amount and accrued interest on the obligation are written down to estimated net realisable value.

Dollars in Millions	Note	Consolidated (30/9/20)			Total
		Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	
Movements in pre-allowance balances					
Individually impaired assets - at amortised cost					
Balance at beginning of year		15	7	626	648
Amounts written off		(2)	(36)	(40)	(78)
Additions		18	44	246	308
Deletions		(23)	(7)	(290)	(320)
Balance at end of year		8	8	542	558
Specific provision for credit impairment	12	3	8	204	215
Individually impaired assets - at fair value through profit or loss					
Balance at beginning of year		-	-	5	5
Additions		-	-	42	42
Deletions		-	-	(5)	(5)
Balance at end of year		-	-	42	42
Credit risk adjustments on individual financial assets designated at fair value through profit or loss	12	-	-	22	22
Total impaired assets at end of year		8	8	584	600
Individually impaired assets - undrawn lending commitments					
At amortised cost		-	-	8	8
At fair value through profit or loss		-	-	-	-
Other assets under administration		7	1	4	12
Consolidated (30/9/19)					
Movements in pre-allowance balances					
Individually impaired assets - at amortised cost					
Balance at beginning of year		13	8	227	248
Amounts written off		(4)	(39)	(23)	(66)
Additions		32	47	501	580
Deletions		(26)	(9)	(79)	(114)
Balance at end of year		15	7	626	648
Specific provision for credit impairment	12	2	5	149	156
Individually impaired assets - at fair value through profit or loss					
Balance at beginning of year		-	-	17	17
Deletions		-	-	(12)	(12)
Balance at end of year		-	-	5	5
Credit risk adjustments on individual financial assets designated at fair value through profit or loss	12	-	-	1	1
Total impaired assets at end of year		15	7	631	653
Individually impaired assets - undrawn lending commitments					
At amortised cost		-	-	6	6
At fair value through profit or loss		-	-	-	-
Other assets under administration		4	1	-	5

Notes to and Forming Part of the Financial Statements

Note 13 Asset Quality *continued*

Dollars in Millions	Consolidated (30/9/20)			Total
	Residential Mortgage Lending	Other Retail Exposures	Corporate Exposures	
Past due assets not individually impaired				
Loans and advances to customers				
1 - 7 days past due	76	43	95	214
8 - 29 days past due	40	18	30	88
1 - 29 days past due	116	61	125	302
30 - 59 days past due	38	12	22	72
60 - 89 days past due	21	7	5	33
90+ days past due	61	18	96	175
Total past due assets not individually impaired	236	98	248	582
Consolidated (30/9/19)				
Past due assets not individually impaired				
Loans and advances to customers				
1 - 7 days past due	127	63	334	524
8 - 29 days past due	95	29	41	165
1 - 29 days past due	222	92	375	689
30 - 59 days past due	48	16	45	109
60 - 89 days past due	21	10	39	70
90+ days past due	30	18	98	146
Total past due assets not individually impaired	321	136	557	1,014

Notes to and Forming Part of the Financial Statements

Note 14 Derivative Financial Instruments

Accounting Policy

Derivative financial instruments are contracts whose value is dependent on an underlying price, index or other variable, such as interest rates, foreign exchange rates and commodity prices.

All derivatives are recognised in the balance sheet at fair value on trade date and are classified as trading except where they are designated in a qualifying hedge relationship. The carrying value of a derivative is remeasured at fair value throughout the life of the contract. Derivatives are carried as assets when the fair value is positive, and liabilities when the fair value is negative. The fair value of derivative financial instruments is obtained from quoted market prices, discounted cash flow models or option pricing models as appropriate.

The method of recognising the fair value gain or loss on a derivative depends on whether the derivative is a hedging instrument in a qualifying hedge relationship and, if so, the nature of the risk being hedged.

Derivatives used for risk management purposes which, for various reasons, do not meet the qualifying criteria for hedge accounting, are included in trading derivatives.

The Banking Group applies NZ IFRS 9 to account for designated hedge relationships, other than portfolio fair value hedges. The Banking Group continues to account for designated portfolio fair value hedge relationships under NZ IAS 39 as dynamic portfolio risk management is out of scope under NZ IFRS 9.

The Banking Group utilises the following types of hedge relationship in managing its exposure to risk. At inception of all hedge relationships the Banking Group documents the relationship between the hedging instrument and hedged item, the risk being hedged, the Banking Group's risk management objective and strategy and how effectiveness will be measured throughout the hedge relationship. The Banking Group measures hedge effectiveness on a prospective basis at inception, as well as retrospectively over the term of the hedge relationship.

	Cash flow hedge	Fair value hedge
Objective	To hedge changes to cash flows arising from interest rate and foreign currency risk.	To hedge fair value changes arising from interest rate and foreign currency risk.
Methods for testing hedge ineffectiveness	Principally regression analysis. For portfolio hedges, capacity analysis to ensure interest cash flows arising from the portfolio of hedged items are in excess of the hedging instruments.	Regression analysis and the cumulative dollar offset method.
Potential sources of ineffectiveness	Mainly mismatches in terms of the hedged item and the hedging instrument. For example: frequency and timing of interest rate resets.	Mainly mismatches in terms of the hedged item and the hedging instrument as well as prepayment risk.
Recognition of effective hedge portion	Fair value changes of the hedging instrument associated with the hedged risk are recognised in the cash flow hedge reserve in equity and transferred to the income statement and recognised in net interest income when the hedged item affects profit or loss.	Fair value changes of the hedging instrument and those arising from the hedged risk on the hedged item are recognised in the income statement.
Recognition of ineffective hedge portion	Recognised in the income statement as ineffectiveness arises.	Recognised in the income statement as ineffectiveness arises.
Hedging instrument expires, is sold, or when hedging criteria are no longer met	Transferred to the income statement as/when the hedged item affects the income statement. If the hedged item is no longer expected to occur the effective portion accumulated in equity is transferred to the income statement immediately.	Cumulative hedge adjustment to the hedged item is amortised to the income statement on an effective yield basis. If the hedged item no longer exists (e.g. due to prepayment), the cumulative hedged adjustment is recognised in the income statement immediately.

Derivative financial instruments

Dollars in Millions	Consolidated (30/9/20)		Consolidated (30/9/19)	
	Fair Value Assets	Fair Value Liabilities	Fair Value Assets	Fair Value Liabilities
Trading derivatives (including economic hedges)	6,031	4,701	7,544	6,106
Hedging derivatives	109	10	72	-
Total derivative financial instruments	6,140	4,711	7,616	6,106

Notes to and Forming Part of the Financial Statements

Note 14 Derivative Financial Instruments *continued*

Trading derivatives

The Banking Group maintains trading positions in a variety of derivative financial instruments primarily to satisfy the needs of its customers through foreign exchange, interest rate related services and other market related contracts. In addition, the Banking Group takes positions on its own account within a prescribed limit framework, to manage its exposure to market and credit risks relating to trading activities. It satisfies customer needs and maintains access to market liquidity by quoting bid and offer prices on those instruments and trading with other market makers. All trading derivative positions are revalued on a daily basis to reflect market movements and any revaluation profit or loss is recognised immediately in the income statement.

The fair value of trading derivative assets and liabilities are outlined in the table below.

Dollars in Millions	Consolidated (30/9/20)		Consolidated (30/9/19)	
	Fair Value Assets	Fair Value Liabilities	Fair Value Assets	Fair Value Liabilities
Foreign exchange rate-related contracts				
Spot and forward contracts to purchase foreign exchange	738	913	1,659	1,564
Cross currency swaps	790	889	1,623	1,698
Options	48	48	61	61
	1,576	1,850	3,343	3,323
Interest rate-related contracts				
Swaps	4,433	2,830	4,181	2,764
	4,433	2,830	4,181	2,764
Other market-related contracts				
Commodity derivatives	20	19	17	16
Credit derivatives	2	2	3	3
	22	21	20	19
Total trading derivatives (including economic hedges)	6,031	4,701	7,544	6,106

Hedging derivatives

The Banking Group's hedging strategy is to manage its exposure to interest rate risk on a net variable basis in New Zealand dollars. This requires the Banking Group to enter into interest rate swaps where the exposure is to a fixed interest rate. Alternatively, cash flow hedges of interest rate risk are used to arrive at a net variable rate position. In some instances, foreign currency exposures are swapped to New Zealand dollars using cross-currency interest rate swaps.

Not all exposures are automatically managed under the above strategy. Where a risk is within acceptable limits the Banking Group may decide not to apply hedge accounting to that risk. Instead, the Banking Group will manage its exposure under broader risk management processes.

The notional amount and fair value of hedging instruments are outlined in the table below by the type of hedge relationship in which they are designated. The calculation of the notional amount reflects the gross volume of transactions outstanding at the reporting period end and is not indicative of either the market risk or credit risk. The Banking Group may designate separate derivatives to hedge different risk components of one hedged item. In such scenario the notional amount of hedging derivatives will, in sum, exceed the notional amount of the hedged item. In the case of cross-currency swaps the Banking Group may designate a single instrument to hedge both interest rate risk in a fair value hedge and currency risk in a cash flow hedge.

The Banking Group has changed how it calculates the notional amount of futures, now taking into account the effect of closing out positions though equal but opposite transactions. Comparative information has been restated accordingly.

Dollars in Millions	Hedging instrument	Risk	Consolidated (30/9/20)		Consolidated (30/9/19)	
			Notional Amount	Fair Value Amount	Notional Amount	Fair Value Amount
Derivative assets						
Cash flow hedges	Interest rate swaps	Interest	7,578	69	8,133	72
Cash flow hedges	Cross-currency swaps	Currency	981	10	-	-
Cash flow hedges	Futures	Interest	681	-	787	-
Fair value hedges	Interest rate swaps	Interest	1,138	-	230	-
Fair value and cash flow hedges	Cross-currency swaps	Interest and currency	468	30	-	-
			10,846	109	9,150	72
Derivative liabilities						
Cash flow hedges	Interest rate swaps	Interest	5,362	-	5,515	-
Cash flow hedges	Cross-currency swaps	Currency	678	10	-	-
Cash flow hedges	Futures	Interest	500	-	-	-
Fair value hedges	Interest rate swaps	Interest	15,090	-	14,963	-
			21,630	10	20,478	-

Notes to and Forming Part of the Financial Statements

Note 14 Derivative Financial Instruments *continued*

Hedging derivatives *continued*

The following table shows the maturity profile of hedging instruments based on their notional amounts.

Dollars in Millions	Consolidated (30/9/20)				Consolidated (30/9/19)			
	0 to 12 Months	1 to 5 Years	Over 5 Years	Total	0 to 12 Months	1 to 5 Years	Over 5 Years	Total
Interest rate swaps	11,914	17,131	123	29,168	9,686	19,103	52	28,841
Futures	1,181	-	-	1,181	387	400	-	787
Cross-currency swaps	-	1,258	895	2,153	-	-	-	-
Total notional amount	13,095	18,389	1,018	32,502	10,073	19,503	52	29,628

The balance of the cash flow hedge reserve, amounts recognised in the reserve, and amounts transferred out of the reserve are shown in the following table.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Balance at beginning of year	96	35
Transferred to the income statement	(50)	(38)
Net gains from change in fair value	73	123
Net movement before tax	23	85
Movement in deferred tax	(6)	(24)
Balance at end of year	113	96

There were no transactions for which cash flow hedge accounting had to be ceased as a result of the highly probable cash flows no longer being expected to occur (30 September 2019: nil). There are no balances recognised in the cash flow hedge reserve for which hedge accounting is no longer applied (30 September 2019: nil).

A gain of \$1 million was recognised in gains less losses on financial instruments at fair value in the income statement related to hedge ineffectiveness from cash flow hedge relationships (30 September 2019: \$1 million gain).

Hedged items

The carrying amount of hedged items in fair value hedge relationships and the accumulated amount of fair value hedge adjustments included in the carrying amount are as follows:

Dollars in Millions	Consolidated			
	Carrying Amount 30/9/20	Carrying Amount 30/9/19	Fair value hedge adjustments 30/9/20	Fair value hedge adjustments 30/9/19
Assets				
Loans and advances to customers (housing loans)	15,232	15,342	142	149
Liabilities				
Bonds and Notes (offshore medium terms notes)	1,687	-	64	-

Fair value hedge relationships resulted in the following changes in value used as the basis for recognising hedge ineffectiveness during the period.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Gains/(losses) on hedging instruments	65	(111)
Gains/(losses) on hedged items attributable to the hedged risk	(72)	105
Hedge ineffectiveness recognised in gains less losses on financial instruments in the income statement	(7)	(6)

Impact of IBOR reform on hedge accounting

The Banking Group's hedge accounting relationships is exposed to the USD LIBOR interest rate benchmark, which is subject to cessation. In addition to interest rate risk, the Banking Group is also exposed to foreign exchange risk and potentially in the future, additional basis risk as market conventions develop and evolve. The nominal amount of hedging instruments affected by the interest rate benchmark reform is outlined below.

Where a single hedging instrument references more than one benchmark rate that is subject to cessation (for example in the case of a cross currency swap), the notional amount has been disclosed twice to reflect the absolute notional exposure to the benchmark reform. The transition of these instruments to a new reference rate is not expected to have a material impact.

Dollars in Millions	Consolidated	
	USD Libor 30/9/20	
Hedging instruments (NZD notional)		
Fair value hedges		1,138
Cash flow hedges		1,659
Fair value hedge and cashflow hedge		468

Notes to and Forming Part of the Financial Statements

Note 15 Deferred Tax

Accounting policy

Deferred tax assets are the amounts of income tax recoverable in future periods including unused tax losses and unused tax credits carried forward. Deferred tax liabilities are the amounts of income tax payable in future periods. Deferred tax assets and liabilities arise when there is a temporary difference between the tax bases (amount attributable to the asset or liability for tax purposes) of assets and liabilities and their carrying amounts in the balance sheet. Deferred tax assets and liabilities are determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax liabilities are recognised for all taxable temporary differences, except:

- for a deferred income tax liability arising from the initial recognition of goodwill;
- where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or loss nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in wholly owned entities, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilised:

- except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or loss nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in wholly owned entities, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amounts of deferred income tax assets are reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to offset current tax assets and liabilities and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities are realised simultaneously.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Deferred tax assets		
Balance at beginning of year	197	196
Tax expense recognised in income statement	101	25
Tax credit recognised in other comprehensive income/(expense)	(3)	(24)
Balance at end of year	295	197
Deferred tax assets were attributable to the following items:		
Employee entitlements	9	13
Credit risk adjustments on financial assets designated at fair value through profit or loss	17	6
Provision for credit impairment on credit exposures	246	181
Depreciation and amortisation	43	23
Operating expense provisions	10	15
Prepaid pension assets	(2)	(2)
Cash flow hedge reserve	(43)	(37)
Cost of hedging reserve	3	-
NZ IFRS 16 leases	(5)	-
Other	17	(2)
Total deferred tax assets	295	197

The recognition of the deferred tax assets relies on management's judgements about the probability and sufficiency of future taxable profits and future reversals of existing taxable temporary differences.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Note 16 Other Assets		
Accrued interest receivable	112	137
Prepaid pension assets	8	6
Securities sold – not yet settled	115	265
Other assets ¹	257	324
Total other assets	492	732

¹ Other assets includes receivables relating to prepayments and settlements clearing.

Notes to and Forming Part of the Financial Statements

Note 17 Goodwill and Other Intangible Assets

Accounting policy

Goodwill

Goodwill arises on the acquisition of an entity and represents the excess of the consideration paid over the fair value of the identifiable net assets acquired.

Software costs

External and internal costs that are incurred to acquire or develop software are capitalised and recognised as an intangible asset. Capitalised software costs and other intangible assets are amortised on a systematic basis once deployed, using the straight-line method over their expected useful lives which are between three and seven years. Certain software assets are deployed on a progressive basis, in which case the amortisation is recognised in a manner that is reflective of the expected benefits profile from the asset's use.

Impairment of intangible assets

Assets with an indefinite useful life, including goodwill, are not subject to amortisation and are tested on an annual basis for impairment, and additionally whenever an indication of impairment exists. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of an asset is the higher of its fair value less costs to sell or its value in use. For assets that do not generate largely independent cash flows, the recoverable amount is determined for the cash-generating unit ("CGU") to which that asset belongs. Goodwill impairment is assessed at the group of CGUs that represents the lowest level within the Banking Group at which goodwill is maintained for internal management purposes.

Key judgements and estimates

The determination of appropriate cash flows, growth rates and discount rates for the calculation of value in use is subjective and requires a significant degree of judgement.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Goodwill	15	15
Internally generated software	200	261
Acquired software	14	17
Total goodwill and other intangible assets	229	293
At cost	992	877
Deduct: Accumulated amortisation/impairment losses	(763)	(584)
Total goodwill and other intangible assets	229	293

Liability Notes

Note 18 Due to Central Banks and Other Institutions

Accounting policy

Due to central banks and other institutions consists of transaction balances with central banks and other institutions, deposits from central banks and other institutions and repurchase agreements.

Repurchase agreements

Securities sold under agreements to repurchase are classified in the trading portfolios and accounted for accordingly. The Bank's obligation to repurchase is classified under Due to central banks and other institutions and Amounts due to related entities. The difference between the sale and repurchase prices represents interest expense and is recognised in the income statement over the term of the repurchase agreements.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Transaction balances with other institutions ¹	1,283	892
Deposits from central banks	166	250
Deposits from other institutions ²	664	568
Securities sold under agreements to repurchase from central banks ³	142	-
Securities sold under agreements to repurchase from other institutions ¹	565	123
Total due to central banks and other institutions	2,820	1,833

¹ Classified as cash and cash equivalents in the cash flow statement.

² Included in deposits from other institutions as at 30 September 2020 was \$1 million classified as cash and cash equivalents in the cash flow statement (30 September 2019: \$18 million).

³ Included in securities sold under agreements to repurchase from central banks was \$100 million (30 September 2019: nil) relating to Term Auction Facility classified as cash and cash equivalents in the cash flow statement and \$42 million (30 September 2019: nil) relating to Term Lending Facility.

Included in due to central banks and other institutions as at 30 September 2020 was \$652 million of collateral posted by counterparties to meet standard derivative trading obligations (30 September 2019: \$522 million).

Deposits from central banks and deposits from other institutions are unsecured and rank equally with the Banking Group's other unsecured liabilities. In the unlikely event that the Bank was put into liquidation or ceased to trade, the claims of secured creditors and those creditors set out in Schedule 7 of the Companies Act 1993 would rank ahead of the claims of unsecured creditors.

Notes to and Forming Part of the Financial Statements

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Note 19 Deposits and Other Borrowings		
Deposits not bearing interest	8,703	6,267
On-demand and short term deposits bearing interest	28,957	21,865
Term deposits	29,920	34,933
Total customer deposits	67,580	63,065
Certificates of deposit	924	1,349
Commercial paper	3,337	3,554
Total deposits and other borrowings	71,841	67,968

Included in deposits and other borrowings as at 30 September 2020 was \$2 million of collateral posted by counterparties to meet standard derivative trading obligations (30 September 2019: \$5 million).

Deposits and other borrowings are unsecured and rank equally with the Banking Group's other unsecured liabilities. In the unlikely event that the Bank was put into liquidation or ceased to trade, the claims of secured creditors and those creditors set out in Schedule 7 of the Companies Act 1993 would rank ahead of the claims of unsecured creditors.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Note 20 Bonds and Notes		
Domestic Covered Bonds	314	328
Offshore Covered Bonds	4,119	4,054
Domestic medium term notes	2,236	2,710
Offshore medium term notes	12,843	14,029
Total bonds and notes	19,512	21,121

As at 30 September 2020, the contractual amount to be paid at maturity of the Bonds and notes is \$18,776 million (30 September 2019: \$20,585 million).

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Bonds and notes by currency type:		
US Dollar	7,301	7,648
New Zealand Dollar	2,550	3,090
British Pound	-	394
Australian Dollar	165	153
Hong Kong Dollar	354	372
Euro	7,557	8,383
Japanese Yen	245	253
Swiss Franc	1,340	828
Total bonds and notes by currency type	19,512	21,121

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Note 21 Other Liabilities		
Accrued interest payable	191	340
Payables and accrued expenses	91	181
Securities purchased – not yet settled	44	341
Employee entitlements	66	116
Lease liabilities ¹	248	-
Compliance, remediation and product quality assurance	66	47
Reorganisation and structural changes	17	19
Other liabilities ²	101	150
Total other liabilities	824	1,194

¹ NZ IFRS 16 has been adopted from 1 October 2019 and has been applied in the preparation of this note. Comparative balances have not been restated. Refer to note 1 for further information.

² Other liabilities includes payables relating to settlements clearing.

As at 30 September 2020, \$89 million (30 September 2019: \$158 million) of certain unsecured liabilities as set out in Schedule 7 of the Companies Act 1993 rank in priority to general creditors' claims in a winding up of the Bank.

Notes to and Forming Part of the Financial Statements

Note 22 Leases

Accounting policy

At the inception of a contract, the Banking Group assesses whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. At inception or on reassessment of a contract that contains a lease component, the Banking Group allocates the consideration in the contract to each lease component on the basis of their relative stand-alone selling prices. For the leases of land and buildings where the Banking Group is the lessee, the Banking Group has elected not to separate non-lease components and account for the lease and non-lease components as a single lease component.

The Banking Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset, less any lease incentives received.

The right-of-use asset is subsequently measured under the cost model and depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is reviewed for impairment and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that have not been paid at the commencement date, discounted using an incremental borrowing rate which reflects the rate that the Banking Group would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. The lease liability is subsequently measured at amortised cost using the effective interest method. It is remeasured when there is a lease modification that is not accounted for as a separate lease, there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Banking Group's estimate of the amount expected to be payable under a residual value guarantee, or if the Banking Group changes its assessment of whether it will exercise a purchase, extension or termination option. The Banking Group does not include extension options in the measurement of its lease liability until such time that it is reasonably certain that the options will be exercised.

The Banking Group has elected not to recognise right-of-use assets and lease liabilities for short-term leases and leases of low-value assets. The Banking Group recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

When the Banking Group acts as a lessor, it determines at lease inception whether each lease is a finance lease or an operating lease. To classify each lease, the Banking Group makes an overall assessment of whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset. Where this is the case, the lease is a finance lease. All other leases are classified as operating leases.

	Consolidated
Dollars in Millions	30/9/20
Effect of leases on the Balance Sheet	
Right-of-use assets	
Property, plant and equipment	
Buildings	261
Technology and other	4
Total right-of-use assets	265
Additions to right-of-use assets during the period	68
Lease Liabilities	
Other liabilities	248
Total lease liabilities	248

Current period amounts reflect the adoption of NZ IFRS 16 on 1 October 2019. Refer to note 1 for further information.

	Consolidated
Dollars in Millions	30/9/20
Effect of leases on the Income Statement	
Depreciation	
Buildings	52
Technology and other	3
Total depreciation on right-of-use assets	55
Interest	5
Total interest expense on lease liability	5
Short-term lease expense	5
Total short-term lease expense	5

Current period amounts reflect the adoption of NZ IFRS 16 on 1 October 2019. Refer to note 1 for further information.

Notes to and Forming Part of the Financial Statements

Note 22 Leases *continued*

Future cash flow effect of leases

The table below is a maturity analysis of future lease payments in respect of existing lease arrangements on an undiscounted basis.

Dollars in Millions	Consolidate
	30/9/20
Due within one year	49
Due after one year but no later than five years	152
Due after five years	79
Total non-cancellable lease commitments	280

Current period amounts reflect the adoption of NZ IFRS 16 on 1 October 2019. Refer to note 1 for further information.

The Banking Group has committed to a number of future lease contracts in relation to new buildings across New Zealand. As these new leases become effective the Banking Group will recognise additional right-of-use assets and lease liabilities of approximately \$204 million over the next five years.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Note 23 Subordinated Debt		
Subordinated notes due to related entity		
National Australia Bank Limited	500	500
Total subordinated notes due to related entity	500	500
Perpetual notes due to related entity		
National Australia Bank Limited	900	900
Total perpetual notes due to related entity	900	900
Subordinated notes due to external investors		
Subordinated notes due to external investors	549	548
Total subordinated notes due to external investors	549	548
Total subordinated debt	1,949	1,948

Subordinated Notes due to related entity - treated as Tier 2 capital

On 8 May 2018, the Bank issued \$500 million of subordinated unsecured notes ("Subordinated Notes") to National Australia Bank Limited. The Subordinated Notes are treated as Tier 2 capital under the Bank's regulatory capital requirements. The Subordinated Notes will mature on 8 May 2028. The Subordinated Notes do not confer any right to vote in general meetings of the Bank or National Australia Bank Limited.

Redemption

Subject to certain conditions, including the approval of the RBNZ, the Bank has the option to redeem all or some of the Subordinated Notes for their face value together with accrued interest (if any) on any interest payment date on or after 8 May 2023. In addition, subject to certain conditions, including the approval of the RBNZ, the Bank may redeem at any time all (but not some only) of the Subordinated Notes if a regulatory or tax event occurs.

Interest

The interest rate for the Subordinated Notes is reset every six months based on the prevailing six month bank bill rate plus a margin of 1.95% per annum for the term of the Subordinated Notes. Interest is payable semi-annually in arrear subject to the Bank being solvent (by satisfying the solvency test in section 4 of the Companies Act 1993) on the relevant payment date and remaining solvent immediately after making the payment. If the Bank does not pay an amount on the Subordinated Notes because it has not satisfied the solvency test, the Bank must pay that amount on the first date on which it is able to make the payment and satisfy the solvency test.

Interest will accrue daily (at the interest rate then applicable to the Subordinated Notes) on any interest that is not paid when scheduled as a result of the Bank not satisfying the solvency test on the relevant payment date. If some or all of the Subordinated Notes are converted or written off, any rights to receive interest on those Subordinated Notes (including any accrued but unpaid interest) are also terminated and written off.

Conversion

If a non-viability trigger event ("NVTE") occurs, some or all of the Subordinated Notes will automatically and immediately be converted into ordinary shares in the Bank ("BNZ Shares") or written off.

Under the terms and conditions of the Subordinated Notes, an NVTE will occur if: (i) the RBNZ gives the Bank a direction under the RBNZ Act requiring the Bank to exercise its right of conversion or write off of its Tier 2 capital instruments; (ii) the Bank is made, subject to statutory management under the RBNZ Act and the New Zealand statutory manager announces his or her decision, to convert or write off the Bank's Tier 2 capital instruments.

Ranking of Subordinated Notes

In a liquidation of the Bank (if the Subordinated Notes have not been converted or written off), the claims of holders of Subordinated Notes will rank: (1) ahead of claims of holders of BNZ Shares and other subordinated securities that rank below the Subordinated Notes (such as the Perpetual Notes due to related entity); (2) equally with claims of other holders of Subordinated Notes, the holders of the Listed Subordinated Notes and holders of other subordinated securities that rank equally with the Subordinated Notes; and (3) behind all other claims (such as those of the Bank's secured creditors, depositors and holders of unsecured unsubordinated bonds issued by the Bank from time to time). If the Subordinated Notes are converted into BNZ Shares, holders will rank equally with existing shareholders of the Bank.

Notes to and Forming Part of the Financial Statements

Note 23 Subordinated Debt *continued*

Perpetual Notes due to related entity - treated as Additional Tier 1 capital

On 20 October 2016, the Bank issued \$900 million of mandatorily convertible subordinated perpetual unsecured notes ("Perpetual Notes") to National Australia Bank Limited. The Perpetual Notes are treated as Additional Tier 1 capital under the Bank's regulatory capital requirements. The Perpetual Notes have no fixed maturity date and will remain on issue indefinitely if not repaid, converted or written off. The Perpetual Notes do not confer any right to vote in general meetings of the Bank or National Australia Bank Limited.

Interest

The interest rate for the Perpetual Notes is fixed at 6.7539% per annum until 20 October 2021 ("Optional Exchange Date") and, thereafter, will change to a floating interest rate equal to the three month bank bill rate plus a margin of 4.410% per annum. Interest payments are non-cumulative and payable annually in arrear until the Optional Exchange Date.

Following the Optional Exchange Date, the interest payments are payable quarterly in arrear. Interest payments are subject to the Bank's discretion and certain conditions being satisfied (including RBNZ requirements). If interest is not paid, the Bank may not (except in limited circumstances) pay any dividends on BNZ Shares or undertake a share buy-back or other capital reduction until interest is next paid. Unpaid interest is cancelled and does not accumulate.

Conversion

On 20 October 2023, subject to certain mandatory conversion conditions, all of the Perpetual Notes will be converted into BNZ Shares. If the mandatory conversion conditions are not met, the mandatory conversion will be deferred for a specific period (provided that conversion is not required to take place as a result of a common equity trigger event ("CETE") or a NVTE).

The number of BNZ Shares issued on a conversion is determined by reference to the net assets of the Bank in the Bank's most recently published Disclosure Statement and such other information as the Bank considers appropriate.

On the Optional Exchange Date, or on any date if a regulatory or tax event occurs, the Bank may convert or redeem some or all of the Perpetual Notes. Any such conversion or redemption is subject to certain conditions, including in the case of redemption the approval of the RBNZ.

If a CETE or an NVTE occurs, the Bank must convert some or all of the Perpetual Notes into BNZ Shares. Under the terms and conditions of the Perpetual Notes, a CETE will occur if the Banking Group's Common Equity Tier 1 capital ratio is equal to or less than 5.125% and an NVTE will occur if the RBNZ directs the Bank to convert or write off the Perpetual Notes or the Bank is made subject to statutory management and the statutory manager decides the Bank must convert or write off the Perpetual Notes.

Ranking of Perpetual Notes

In a liquidation of the Bank (if the Perpetual Notes have not been converted or written off), the claims of holders of Perpetual Notes will rank: (1) ahead of claims of holders of BNZ Shares and other subordinated securities that rank below the Perpetual Notes; (2) equally with claims of other holders of Perpetual Notes and holders of other subordinated securities that rank equally with the Perpetual Notes; and (3) behind all other claims on the Bank (such as those of the Bank's secured creditors, depositors and holders of the Subordinated Notes and Listed Subordinated Notes, and other unsecured unsubordinated bonds issued by the Bank from time to time). If the Perpetual Notes are converted into BNZ Shares, holders will rank equally with existing shareholders of the Bank.

Subordinated Notes due to external investors - treated as Tier 2 capital

On 17 December 2015, the Bank issued \$550 million of subordinated unsecured notes ("Listed Subordinated Notes"). The Listed Subordinated Notes are treated as Tier 2 capital under the Bank's and National Australia Bank Limited's regulatory capital requirements. The Listed Subordinated Notes will mature on 17 December 2025. The Listed Subordinated Notes do not confer any right to vote in general meetings of the Bank or National Australia Bank Limited.

Redemption

Subject to certain conditions, including the approval of the RBNZ, the Bank has the option to redeem all or some of the Listed Subordinated Notes for their face value together with accrued interest (if any) on 17 December 2020 ("Optional Redemption Date") or on any scheduled interest payment date thereafter. In addition, subject to certain conditions, including the approval of the RBNZ, the Bank may redeem at any time all (but not some only) of the Listed Subordinated Notes if a regulatory or tax event occurs.

Interest

The interest rate for the Listed Subordinated Notes is fixed at 5.314% per annum for five years, and will be reset on the Optional Redemption Date. The interest rate from the Optional Redemption Date onwards will be fixed at the five year swap rate plus a margin of 2.250% per annum. Interest is payable quarterly in arrear subject to the Bank being solvent (by satisfying the solvency test in section 4 of the Companies Act 1993) on the relevant payment date and remaining solvent immediately after making the payment. If the Bank does not pay an amount on the Listed Subordinated Notes because it has not satisfied the solvency test, the Bank must pay that amount on the first date on which it is able to make the payment and satisfy the solvency test.

Interest will accrue daily (at the interest rate then applicable to the Listed Subordinated Notes) on any interest that is not paid when scheduled as a result of the Bank not satisfying the solvency test on the relevant payment date. If some or all of the Listed Subordinated Notes are converted or written off, any rights to receive interest on those Listed Subordinated Notes (including any accrued but unpaid interest) are also terminated and written off.

Conversion

If an NVTE occurs, some or all of the Listed Subordinated Notes will automatically and immediately be converted into National Australia Bank Limited ordinary shares ("NAB Shares") or written off.

Under the terms and conditions of the Listed Subordinated Notes, an NVTE will occur if: (i) the RBNZ gives the Bank a direction under the RBNZ Act requiring the Bank to exercise its right of conversion or write off of its Tier 2 capital instruments; (ii) the Bank is made subject to statutory management under the RBNZ Act and the New Zealand statutory manager announces his or her decision to convert or write off the Bank's Tier 2 capital instruments; or (iii) APRA has provided a written determination to National Australia Bank Limited that without the conversion or write off of a class of capital instruments of National Australia Bank Limited which includes the Listed Subordinated Notes, or a public sector injection of capital into, or equivalent capital support with respect to, National Australia Bank Limited, APRA considers that National Australia Bank Limited would become non-viable.

Notes to and Forming Part of the Financial Statements

Note 23 Subordinated Debt *continued*

Subordinated Notes due to external investors - treated as Tier 2 capital *continued*

Conversion *continued*

In connection with the Listed Subordinated Notes, a Coordination Agreement dated 11 November 2015 between the Bank, National Australia Group (NZ) Limited ("NAGNZ"), National Equities Limited and National Australia Bank Limited sets out intragroup transactions that are intended to occur on conversion of the Listed Subordinated Notes. Under this agreement, the Bank is required to issue a variable number of BNZ Shares to NAGNZ for an amount equivalent to the Listed Subordinated Notes converted into NAB Shares.

Ranking of Listed Subordinated Notes

In a liquidation of the Bank (if the Listed Subordinated Notes have not been converted or written off), the claims of holders of Listed Subordinated Notes will rank: (1) ahead of claims of holders of BNZ Shares and other subordinated securities that rank below the Listed Subordinated Notes (such as the Perpetual Notes); (2) equally with claims of other holders of Listed Subordinated Notes, the holders of the Subordinated Notes and holders of other subordinated securities that rank equally with the Listed Subordinated Notes; and (3) behind all other claims (such as those of the Bank's secured creditors, depositors and holders of unsecured unsubordinated bonds issued by the Bank from time to time). If the Listed Subordinated Notes are converted into NAB Shares, holders will rank equally with existing shareholders of National Australia Bank Limited.

Recent Development

In response to the impacts of the COVID-19 pandemic, the RBNZ has stated that New Zealand-incorporated registered banks should not redeem non-Common Equity Tier 1 capital instruments (other than on a stated final maturity date), until 31 March 2021, or later if required, to support the stability of the New Zealand financial system. Accordingly, on 12 November 2020, the Bank announced that it will not be redeeming any of the Listed Subordinated Notes on the Optional Redemption Date.

Shareholder's Equity Note

	Consolidated	
Number of shares in Millions	30/9/20	30/9/19

Note 24 Contributed Equity

Issued and fully paid ordinary shares

Balance at beginning of year	5,076	4,476
Issued during the year	-	600
Balance at end of year	5,076	5,076

The issued and fully paid ordinary share capital is included in Tier 1 capital of the Banking Group and the Registered Bank (refer to note 35).

Ordinary shares

The ordinary shares do not have a par value. All ordinary shares have equal voting rights and share equally in dividends and any distribution of the surplus assets of the Bank in the event of liquidation.

There were no dividends on ordinary shares for the year ended 30 September 2020 (year ended 30 September 2019: a weighted average of 23.07 cents per share).

Notes to and Forming Part of the Financial Statements

Other Notes

Note 25 Related Entity Transactions

The Bank is a wholly owned controlled entity of NAGNZ. The ultimate parent bank of Bank of New Zealand is National Australia Bank Limited. During the year ended 30 September 2020, there were dealings between the Bank and its related entities (including NAB) as well as other related parties (including key management personnel, their close family members and their controlled entities). Details of these transactions are outlined below.

Dealings with NAB included on-balance sheet activities such as funding and accepting deposits and other activities such as foreign exchange transactions.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Total balances with related entities		
Amounts due from ultimate parent	1,037	578
Amounts due from controlled entities of ultimate parent	16	37
Total amounts due from related entities ¹	1,053	615
Derivative financial assets with related entities	2,296	2,756
Amounts due to ultimate parent	1,497	520
Amounts due to controlled entities of ultimate parent	406	318
Total amounts due to related entities ²	1,903	838
Derivative financial liabilities with related entities	1,989	2,359
Subordinated debt due to related entities (refer to note 23)	1,400	1,400

¹ Included in amounts due from related entities as at 30 September 2020 was \$1,045 million classified as cash and cash equivalent in the cash flow statement (30 September 2019: \$604 million).

² Included in amounts due to related entities as at 30 September 2020 was \$1,432 million classified as cash and cash equivalent in the cash flow statement (30 September 2019: \$365 million).

No provisions have been recognised in respect of loans provided to related entities (year ended 30 September 2019: nil). There were no debts with any of the above parties written off or forgiven during the year ended 30 September 2020 (year ended 30 September 2019: nil).

Included within the amounts due from and due to related entities were the following balances:

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Amounts due from related entities		
Securities purchased under agreements to resell to ultimate parent	1,030	574
Amounts due to related entities		
Deposit from controlled entity of ultimate parent	342	240
Collateral deposit posted by ultimate parent to meet standard derivative trading obligations	381	383
Securities sold under agreements to repurchase from ultimate parent	999	24

Transactions with related entities

The Banking Group provides banking and other administrative services to members of NAB operating in New Zealand at arm's length and on normal terms and conditions.

During the financial year, there have been dealings between the Bank and its controlled entities, and the Banking Group and its related entities. The Bank provides a range of services to related entities including the provision of banking facilities. These transactions are normally subject to normal commercial terms and conditions. The Bank provides some accounting administration and banking services to controlled entities for which fees may not be charged.

Dividends paid to the shareholder are disclosed in the Statement of Changes in Equity and in note 24.

For the year ended 30 September 2020, no dividends were paid by National Wealth Management New Zealand Holdings Limited, a controlled entity of the Bank's ultimate parent, therefore no imputation credits were utilised from the group imputation credit account (year ended 30 September 2019: \$12 million).

BNZ Investment Services Limited ("BNZISL"), a wholly owned controlled entity of the Bank, is the manager and issuer of the BNZ KiwiSaver Scheme ("KiwiSaver"), the Private Wealth Series ("PWS"), the YouWealth Scheme ("YWS"), the BNZ Wholesale Funds ("BWF") and the BNZ Term PIE (collectively the "Investment Schemes"). The banking arrangements for these Investment Schemes are provided by the Bank. Investments by the Investment Schemes currently include, among other things, bank deposits with the Bank. As at 30 September 2020, KiwiSaver, PWS, YWS and BWF collectively held \$39 million in transactional bank accounts with the Bank (30 September 2019: \$41 million). Refer to note 32 for further information.

The RMBS Trust provides an internal residential mortgage-backed securities programme to issue securities as collateral for borrowing from the RBNZ. The Covered Bond Trust holds certain Bank of New Zealand housing loans and its trustee guarantees covered bonds issued by the Bank and BNZ-IF. Refer to note 28 for further information.

The Bank guarantees the obligations of BNZ-IF in respect of securities issued by BNZ-IF to investors.

Notes to and Forming Part of the Financial Statements

Note 25 Related Entity Transactions *continued*

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Interest income on amounts due from related entities		
Ultimate parent	21	25
Total interest income on amounts due from related entities	21	25
Interest expense on amounts due to related entities		
Ultimate parent	77	87
Controlled entities of ultimate parent	3	7
Total interest expense on amounts due to related entities	80	94
Other operating income		
Net unrealised gain/(loss) on derivative contracts with ultimate parent	(90)	111
Commissions received from controlled entities of ultimate parent for sale of insurance	21	22
Operating expenses		
Intercompany recharges paid to ultimate parent	32	27
Other service charges paid to ultimate parent	12	10
Other transactions		
Payment/(reimbursement) for the use of tax losses to controlled entities of ultimate parent	8	9

Key management personnel

Key management personnel are defined as being Directors and the executive team of the Bank. The information relating to key management personnel disclosed below includes transactions with those individuals, their close family members and their controlled entities.

Loans and deposits with non-executive key management personnel of the Bank are made in the ordinary course of business on commercial terms and conditions. Loans and deposits with executive key management personnel of the Bank are made either:

- on commercial terms and conditions; or
- on terms and conditions which apply to other employees of the Bank.

All other transactions with key management personnel, their related entities and other related parties are conducted in the ordinary course of business on commercial terms and conditions.

All loans made to key management personnel have been made in accordance with the Bank's lending policies. No provisions have been recognised in respect of loans provided to key management personnel. There were no debts written off or forgiven during the year ended 30 September 2020 (year ended 30 September 2019: nil).

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Transactions with key management personnel		
Short term employee benefits	12	13
Termination benefits	-	1
Equity compensation benefits	1	2
Total key management personnel benefits	13	16
Loans to key management personnel	5	9
Deposits from key management personnel	12	10
Interest income on amounts due from key management personnel ¹	-	-
Interest expense on amounts due to key management personnel ¹	-	-

¹ Interest income and expense amounts are shown as nil in the table above as a result of rounding to the nearest million.

Notes to and Forming Part of the Financial Statements

Note 26 Classification of Financial Instruments and Fair Value Measurement

Categories of financial assets and financial liabilities

Fair value 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 under current market conditions. For the purposes of this note, carrying amount refers to amounts reflected in the balance sheet.

Dollars in Millions	Consolidated (30/9/20)			Consolidated (30/9/19)		
	Fair Value Through Profit or Loss	At Amortised Cost	Total Carrying Amount	Fair Value Through Profit or Loss	At Amortised Cost	Total Carrying Amount
Financial assets						
Cash and liquid assets	-	3,933	3,933	-	2,740	2,740
Due from central banks and other institutions	-	782	782	132	1,302	1,434
Trading securities	10,814	-	10,814	7,267	-	7,267
Derivative financial instruments	6,140	-	6,140	7,616	-	7,616
Loans and advances to customers	1,412	86,737	88,149	2,042	85,999	88,041
Amounts due from related entities	-	1,053	1,053	-	615	615
Other financial assets	-	255	255	-	429	429
Total financial assets	18,366	92,760	111,126	17,057	91,085	108,142
Financial liabilities						
Due to central banks and other institutions	-	2,820	2,820	215	1,618	1,833
Trading liabilities	54	-	54	91	-	91
Derivative financial instruments	4,711	-	4,711	6,106	-	6,106
Deposits and other borrowings	4,868	66,973	71,841	5,247	62,721	67,968
Bonds and notes	17,825	1,687	19,512	21,121	-	21,121
Amounts due to related entities	-	1,903	1,903	-	838	838
Other financial liabilities ¹	-	543	543	-	826	826
Subordinated debt	-	1,949	1,949	-	1,948	1,948
Total financial liabilities	27,458	75,875	103,333	32,780	67,951	100,731

¹ NZ IFRS 16 has been adopted from 1 October 2019 and has been applied in the preparation of this note. Comparative balances have not been restated. Refer to note 1 for further information.

Movements in fair value of financial liabilities designated at fair value through profit or loss on initial recognition attributable to changes in credit risk

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Bonds and notes		
Balance at beginning of year	38	58
Movement during the year	67	(20)
Balance at end of year	105	38

The movement in fair value attributable to changes in the credit risk of financial liabilities designated at fair value through profit or loss is determined as the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk.

Hierarchy for fair value measurements

The tables on page 46 present a three-level fair value hierarchy of the Banking Group's financial assets and financial liabilities which are measured at fair value or amortised cost.

The three levels in the hierarchy are based on the valuation methods and assumptions used in determining the fair values of financial assets and financial liabilities. The levels are as follows:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs). The Banking Group did not have any financial assets or financial liabilities measured at fair value that met the criteria of Level 3 classification.

Management uses its judgement in selecting an appropriate valuation technique for financial instruments which are not quoted in an active market.

The Banking Group considers transfers between levels of the fair value hierarchy, if any, to have occurred at the beginning of the respective reporting period. There were no transfers between any of the levels for the year ended 30 September 2020 (year ended 30 September 2019: nil).

Notes to and Forming Part of the Financial Statements

Note 26 Classification of Financial Instruments and Fair Value Measurement *continued*

Hierarchy for fair value measurements *continued*

Financial assets and liabilities at fair value

Dollars in Millions	Fair Value Total	Consolidated (30/9/20)		Fair Value Level 3
		Fair Value Level 1	Fair Value Level 2	
Financial assets				
Trading securities	10,814	6,167	4,647	-
Derivative financial instruments	6,140	-	6,140	-
Loans and advances to customers	1,412	-	1,412	-
Financial liabilities				
Trading liabilities	54	31	23	-
Derivative financial instruments	4,711	-	4,711	-
Deposits and other borrowings	4,868	-	4,868	-
Bonds and notes	17,825	-	17,825	-

Consolidated (30/9/19)

Financial assets				
Due from central banks and other institutions	132	-	132	-
Trading securities	7,267	2,492	4,775	-
Derivative financial instruments	7,616	-	7,616	-
Loans and advances to customers	2,042	-	2,042	-
Financial liabilities				
Due to central banks and other institutions	215	-	215	-
Trading liabilities	91	21	70	-
Derivative financial instruments	6,106	-	6,106	-
Deposits and other borrowings	5,247	-	5,247	-
Bonds and notes	21,121	-	21,121	-

Financial assets and liabilities at amortised cost¹

Dollars in Millions	Carrying Value	Consolidated (30/9/20)			Fair Value Level 3
		Fair Value Total	Fair Value Level 1	Fair Value Level 2	
Financial assets					
Loans and advances to customers	86,737	86,808	-	2,136	84,672
Financial liabilities					
Deposits and other borrowings	66,973	67,051	-	67,051	-
Bonds and notes	1,687	1,689	-	1,689	-
Subordinated debt	1,949	1,995	555	1,440	-

Consolidated (30/9/19)

Financial assets					
Loans and advances to customers	85,999	86,083	-	2,970	83,113
Financial liabilities					
Deposits and other borrowings	62,721	62,816	-	62,816	-
Subordinated debt	1,948	2,038	570	1,468	-

¹ Fair values for financial assets and liabilities at amortised cost, where the carrying amount is not considered a close approximation of fair value.

Notes to and Forming Part of the Financial Statements

Note 26 Classification of Financial Instruments and Fair Value Measurement *continued*

The fair value estimates are based on the following methodologies and assumptions:

Due from central banks and other institutions and Due to central banks and other institutions

These assets and liabilities are primarily short term in nature or are receivable or payable on demand. In such cases the carrying amounts approximate their fair value or have been determined using discounted cash flow models based on observable market prices as appropriate.

Trading securities and Trading liabilities

Trading securities include treasury bills, bank bills and bonds, promissory notes, and government and other securities. Trading liabilities include short sales of securities. Where quoted market prices are not available, the Banking Group obtains the fair value by means of discounted cash flows and other valuation techniques based on observable market prices. These techniques have accounted for factors such as interest rates, credit risk and liquidity.

Derivative financial instruments

The fair values of trading and hedging derivatives, including foreign exchange contracts, interest rate swaps, interest rate and currency option contracts, and currency swaps, are obtained from observable market prices as at the reporting date, discounted cash flow models or option pricing models as appropriate.

Loans and advances to customers

The carrying value of loans and advances is net of provision for credit impairment, credit risk adjustments, unearned and deferred income. Floating rate loans to customers generally reprice within six months, therefore, their fair value is assumed to equate to their carrying value. For fixed rate loans, the fair value is estimated by discounting the expected future cash flows based on the maturity of the loans and advances, using current market interest rates. The fair value of loans and advances reflects the movement in observable market interest rates since origination but does not include any adjustments for deferred income.

Deposits and other borrowings

With respect to customer deposits, the fair value of non-interest-bearing, call and variable rate deposits and fixed rate deposits repricing within six months is approximated as the carrying value as at the reporting date. For other fixed rate term deposits, the fair value is estimated by discounting the cash flows based on the maturity of the deposit, using current market interest rates.

With respect to certificates of deposit and commercial paper, these liabilities are primarily short term in nature. The carrying amounts have been determined using discounted cash flow models based on observable market prices.

Bonds and notes

The fair value of bonds and notes is calculated based on a discounted cash flow model using a yield curve appropriate to the remaining maturity of the instruments. This is based on observable market prices as at the reporting date where available, otherwise alternative observable market source data is used. The fair value includes a calculation of the Banking Group's own credit risk based on observable market data.

Subordinated debt

For Subordinated Notes and Perpetual Notes, the fair value is estimated by discounting the expected future cash flows based on the maturity of the notes, using current market interest rates of similar types of notes. The fair value of Listed Subordinated Notes is based on quoted closing market prices as at the reporting date.

Other financial assets/liabilities

These include securities sold/purchased but not yet settled and accrued interest. Securities sold/purchased but not yet settled and the fair value of accrued interest is approximately equal to the carrying amounts on the balance sheet due to their short term nature.

Notes to and Forming Part of the Financial Statements

Note 27 Offsetting Financial Assets and Financial Liabilities

Accounting policy

Under NZ IAS 32 Financial Instruments: Presentation, financial assets and financial liabilities shall be offset in the balance sheet only when two requirements are met: there is a legally enforceable right to offset the recognised amounts and an intention to either settle on a net basis or realise the asset and settle the liability simultaneously.

The table below illustrates the amounts of financial instruments that have been offset on the balance sheet and also those amounts that are subject to enforceable master netting arrangements or similar agreements (i.e. offsetting agreements and any related financial collateral). The table excludes financial instruments not subject to offset and that are only subject to collateral arrangements (e.g. Loans and Advances).

The 'Net amounts' presented in the table are not intended to represent the Banking Group's actual exposure to credit risk, as the Banking Group utilises a wide range of strategies to mitigate credit risk in addition to netting and collateral arrangements. The 'Carrying amount' is comprised of the sum of the 'Net amounts reported in balance sheet' and 'Amounts not subject to enforceable netting arrangements' included in the table below.

Dollars in Millions	Consolidated (30/9/20)								
	Amounts Subject to Enforceable Netting Arrangements			Related Amounts not Offset			Amounts not Subject to Enforceable Netting Arrangements		
	Effect of Offsetting on Balance Sheet	Net Amounts Reported in Balance Sheet	Financial Instruments	Non-Cash Collateral ²	Cash Collateral ²	Net Amount	Carrying Amount		
	Gross Amounts	Amount Offset ¹							
Financial assets									
Derivative financial assets	16,999	11,570	5,429	3,221	-	790	1,418	711	6,140
Collateral paid ³	2,126	867	1,259	-	-	772	487	-	1,259
Reverse repurchase agreements ⁴	2,029	-	2,029	-	2,029	-	-	-	2,029
Financial liabilities									
Derivative financial liabilities	16,428	11,950	4,478	3,221	-	772	485	233	4,711
Collateral received ⁵	1,522	487	1,035	-	-	790	245	-	1,035
Repurchase agreements ⁶	1,706	-	1,706	-	1,706	-	-	-	1,706
	Consolidated (30/9/19)								
Financial assets									
Derivative financial assets	16,151	9,464	6,687	4,246	-	803	1,638	929	7,616
Collateral paid ³	2,369	795	1,574	-	-	1,181	393	-	1,574
Reverse repurchase agreements ⁴	1,171	-	1,171	-	1,171	-	-	-	1,171
Financial liabilities									
Derivative financial liabilities	15,800	9,965	5,835	4,246	-	1,181	408	271	6,106
Collateral received ⁵	1,204	294	910	-	-	803	107	-	910
Repurchase agreements ⁶	147	-	147	-	147	-	-	-	147

¹ Amount offset comprises of certain centrally cleared derivatives and their associated collateral amounts which are deemed to satisfy NZ IAS 32 requirements.

² Collateral amounts (cash and non-cash financial collateral) included are reflected at their fair value; however, this amount is limited to the net balance sheet exposure in order to not include any overcollateralisation.

³ Collateral paid to meet standard derivative trading obligations is reported in the balance sheet within Due from central banks and other institutions of \$628 million (30 September 2019: \$1,207 million) and Loans and advances to customers of \$631 million (30 September 2019: \$367 million) respectively, refer to notes 9 and 11 for further information.

⁴ Reverse repurchase agreements are reported in the balance sheet within Cash and liquid assets of \$999 million (30 September 2019: \$597 million) and Amounts due from related entities of \$1,030 million (30 September 2019: \$574 million) respectively, refer to notes 8 and 25 for further information.

⁵ Collateral received to meet standard derivative trading obligations is reported in the balance sheet within Due to central banks and other institutions of \$652 million (30 September 2019: \$522 million), Deposits and other borrowings of \$2 million (30 September 2019: \$5 million) and Related entity transactions of \$381 million (30 September 2019: \$383 million) respectively, refer to notes 18, 19 and 25 for further information.

⁶ Repurchase agreements are reported in the balance sheet within Due to central banks and other institutions of \$707 million (30 September 2019: \$123 million) and Amounts due to related entities of \$999 million (30 September 2019: \$24 million) respectively, refer to notes 18 and 25 for further information.

Derivative assets and liabilities

Derivative financial instrument contracts are typically subject to International Swaps and Derivatives Association ("ISDA") master netting agreements, as well as relevant Credit Support Annexes ("CSA") around collateral arrangements attached to those ISDA agreements, or derivative exchange or clearing counterparty agreements if contracts are settled via an exchange or clearing house.

Derivative amounts will only be offset on the balance sheet where the Banking Group has a legally enforceable right of offset 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.

Financial instruments refer to amounts that are subject to relevant close out netting arrangements under a relevant ISDA agreement. Cash collateral and Non-cash collateral include amounts of cash and non-cash collateral respectively, which are either obtained or pledged, to cover the net exposure between the counterparty in the event of default or insolvency.

Notes to and Forming Part of the Financial Statements

Note 27 Offsetting Financial Assets and Financial Liabilities *continued*

Reverse repurchase and repurchase agreements

Reverse repurchase and repurchase agreements will typically be subject to Global Master Repurchase Agreements (“GMRAs”) or similar agreements whereby all outstanding transactions with the same counterparty can be offset and closed out upon a default or insolvency event.

When, under the relevant agreement, the Banking Group has a legal right to offset both for payments and default netting, the Banking Group will offset amounts with that counterparty in the balance sheet.

Where the Banking Group has a right of offset on default or insolvency only, the related financial instrument amounts represents highly liquid securities either obtained or pledged, which can be realised in the event of a default or insolvency by one of the counterparties. The value of such securities obtained or pledged must at least equate to the value of the exposure to the counterparty, therefore, the net exposure is considered to be nil.

Note 28 Transfers of Financial Assets

A financial asset is considered to be transferred when the Bank transfers the contractual rights to receive the cash flows of the asset, or retains the contractual rights to receive the cash flows with a contractual obligation to pay the cash flows to another party.

Transfers of financial assets that have not been derecognised in their entirety

The RMBS Trust provides an internal residential mortgage-backed securities (“RMBS”) programme. Securities issued by the RMBS Trust are initially held by the Bank and are eligible to be sold to the RBNZ under agreements to repurchase for liquidity purposes. The Bank has transferred housing loans to the RMBS Trust which secure these securities. These housing loans have not been derecognised by the Bank for financial reporting purposes as the Bank retains substantially all of the risks and rewards of ownership. As these housing loans have been legally transferred, the Bank does not retain the legal rights of ownership, but retains a security interest in these assets. These housing loans, collections receivable and cash of the RMBS Trust secure these securities issued to the Bank as detailed in the Liquidity portfolio management section in note 36.

The BNZ Covered Bond Trust holds certain Bank of New Zealand housing loans and its trustee guarantees the payment of all interest and principal under the Covered Bonds issued by the Bank and BNZ-IF. The assets of the Covered Bond Trust are not available to the Bank unless and until all prior ranking creditors of the Covered Bond Trust have been satisfied. The housing loans held by the Covered Bond Trust have not been derecognised by the Bank for financial reporting purposes as the Bank retains substantially all of the risks and rewards of ownership. As these housing loans have been legally transferred, the Bank does not retain the legal rights of ownership, but retains a security interest in these assets which is secondary to the guarantee provided by the trustee.

Government bonds and securities transferred under the agreements to repurchase have not been derecognised from the balance sheet as the Bank retains substantially all the risks and rewards of ownership. The fair value of these agreements is approximately equal to the carrying amount on the balance sheet due to their short term nature.

The Bank’s obligation under agreements to repurchase are classified under Due to central banks and other institutions. Further detail on securities sold under agreements to repurchase are provided in notes 8, 10 and 18.

The table below presents the carrying value of the transferred assets and the associated liabilities.

Dollars in Millions	Consolidated			
	Carrying Amount of Assets 30/9/20	Carrying Amount of Assets 30/9/19	Carrying Amount of Associated Liabilities 30/9/20	Carrying Amount of Associated Liabilities 30/9/19
Housing loans held by RMBS Trust	8,964	6,478	42	-
Housing loans held by Covered Bond Trust	4,583	4,686	4,433	4,382
Government bonds and securities	1,360	76	1,348	76
	14,907	11,240	5,823	4,458

The Banking Group had issued debt securities with a face value of \$4,292 million that were guaranteed by the Covered Bond Trust as at 30 September 2020 (30 September 2019: \$4,226 million). The underlying collateral that supports the guarantee provided by the Covered Bond Trust comprised housing loans, collections receivable and cash with a carrying amount of \$4,734 million as at 30 September 2020 (30 September 2019: \$4,728 million).

Further details on the transactions with the RMBS Trust and the Covered Bond Trust are provided in notes 32 and 36.

Notes to and Forming Part of the Financial Statements

Note 29 Segment Analysis

Operating segments

An operating segment is a component of an entity engaging in business activities and whose operating results are regularly reviewed by the entity's chief operating decision maker. For each operating segment identified by the Banking Group, financial information is regularly reported to the Bank's Executive Team for the purposes of performance evaluation and resource allocation.

The Banking Group's business is organised into two major reportable and operating segments: Partnership Banking; and Corporate and Institutional Banking. Partnership Banking provides financial products and services to retail, business, corporate and private customers. Corporate and Institutional Banking provides financial products and services to corporate agribusiness and institutional customers.

Revenues and expenses directly associated with each operating segment are included in determining their result. Transactions between operating segments are based on agreed recharges between segments. Segment revenue represents revenue directly attributable to a segment and a portion of the Banking Group's revenue that can be allocated to a segment on a reasonable basis. Segment revenue includes Net interest income and Other operating income, and includes transfer pricing adjustments to reflect inter-segment funding arrangements.

Segment profit represents operating profit before unrealised fair value gains or losses on financial instruments, fair value credit risk adjustment and income or expenses which are one-off in nature and are not part of the Banking Group's core business operations.

Included within the 'Other' category in the following table are business activities that are not separately reportable segments; other balances excluded for management reporting purposes, but included in the consolidated financial statements of the Banking Group for statutory financial reporting purposes; elimination entries on consolidation of the results and of the Banking Group's controlled entities in the preparation of the consolidated financial statements of the Banking Group; and results of an entity included for management reporting purposes, but excluded from the consolidated financial statements of the Banking Group for statutory financial reporting purposes.

The Banking Group primarily conducts business in New Zealand and has limited exposure to risks associated with different economic environments or political conditions in other countries. On this basis, no geographical segment information is provided.

Dollars in Millions	Consolidated (30/9/20)				Total Banking Group
	Partnership Banking ³	Corporate and Institutional Banking ³	Total Reportable Segments	Other ^{3,4}	
Net interest income	1,806	168	1,974	108	2,082
Other income ¹	274	195	469	(12)	457
Total operating income ²	2,080	363	2,443	96	2,539
Operating expenses	856	86	942	235	1,177
Operating profit before credit impairment charge and income tax expense	1,224	277	1,501	(139)	1,362
Credit impairment charge	129	19	148	152	300
Operating profit before income tax expense	1,095	258	1,353	(291)	1,062
Total income tax expense	306	73	379	(79)	300
Net profit attributable to the shareholder of Bank of New Zealand	789	185	974	(212)	762
Lending assets	76,384	10,939	87,323	826	88,149
Deposit liabilities	56,806	7,236	64,042	3,538	67,580
	Consolidated (30/9/19) ³				
Net interest income	1,798	159	1,957	104	2,061
Other income ¹	322	206	528	67	595
Total operating income ²	2,120	365	2,485	171	2,656
Operating expenses	869	90	959	176	1,135
Operating profit before credit impairment charge and income tax expense	1,251	275	1,526	(5)	1,521
Credit impairment charge	80	30	110	4	114
Operating profit before income tax expense	1,171	245	1,416	(9)	1,407
Total income tax expense	327	69	396	(11)	385
Net profit attributable to the shareholder of Bank of New Zealand	844	176	1,020	2	1,022
Lending assets	75,547	10,890	86,437	1,604	88,041
Deposit liabilities	51,864	8,068	59,932	3,133	63,065

¹ Other income includes Gains less losses on financial instruments (refer to note 3) and Other operating income (refer to note 4).

² For the year ended 30 September 2020, there were no revenues deriving from transactions with a single external customer that amounted to 10% or more of the Banking Group's revenues (30 September 2019: nil).

³ For the year ended 30 September 2020, there has been a structural realignment of the business units in the Banking Group. As a result, the three segments have changed from 'Partnership Banking', 'Private, Wealth and Insurance' and 'Corporate and Institutional Banking' to two segments 'Partnership Banking' and 'Corporate and Institutional Banking'. Comparative balances have been reclassified.

⁴ As at 30 September 2020, 'Other' category includes Economic Adjustment increase (refer to note 12) and accelerated amortisation charge as a result of a further change to the software capitalisation policy (refer to note 5).

Notes to and Forming Part of the Financial Statements

Note 30 Contingent Liabilities and Other Commitments

Accounting policy

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefits is not probable or cannot be reliably measured. Where some loss is probable and can be reliably measured, provisions have been made. Contingent liabilities are not recognised in the balance sheet, but are disclosed unless the likelihood of payment is remote.

The Banking Group provides guarantees in its normal course of business on behalf of its customers. Guarantees written are conditional commitments issued by the Banking Group to guarantee the performance or financial obligations of a customer to a third party.

In accordance with IFRS 9 Financial Instruments, the financial guarantee contract is initially recorded at fair value which is equal to the premium received, unless there is evidence to the contrary.

Subsequently, the Banking Group records and measures the financial guarantee contract at the higher of:

- the amount initially recognised less, when appropriate, amortisation of the fee that is recognised over the life of the guarantee; and
- where it is likely the Banking Group will incur a loss as a result of issuing the contract, a liability is recognised for the estimated amount of the loss payable.

Contingent liabilities and credit related commitments at face value arising in respect of the Banking Group's operations were:

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Contingent liabilities		
Bank guarantees	74	66
Standby letters of credit	254	259
Documentary letters of credit ¹	166	159
Performance related contingencies ¹	1,022	1,044
Total contingent liabilities	1,516	1,528
Credit related commitments		
Revocable commitments to extend credit	9,164	9,363
Irrevocable commitments to extend credit	12,599	11,732
Total credit related commitments	21,763	21,095
Total contingent liabilities and credit related commitments	23,279	22,623

¹Comparative information has been restated due to a data capture error.

Contingent liabilities

The Banking Group's maximum exposure to credit risk for contingent exposures is the notional amount which represents the amount that the Banking Group would have to pay if the contingent liability is called upon. The full notional amount of contingent liabilities and credit related commitments have been disclosed as "on-demand" as they could be payable on demand. The Banking Group expects that not all of the contingent liabilities or commitments will be drawn before their contractual expiry.

The Banking Group uses the same credit policies and assessment criteria in making commitments and conditional obligations for off-balance sheet risk as it does for on-balance sheet loan assets.

The Bank has recourse arrangements with customers and others in respect of almost all of the contingent liabilities.

Guarantees

The Banking Group has four principal types of guarantees:

- Bank guarantees - a guarantee that is an agreement by which the Bank agrees to pay an amount of money on demand on behalf of a customer to a third party during the life of the guarantee;
- Standby letters of credit - an obligation of the Bank on behalf of a customer to make payment to a third party in the event that the customer fails to meet an outstanding financial obligation;
- Documentary letters of credit - a guarantee that is established to indemnify exporters and importers in their trade transactions where the Bank agrees to make certain trade payments on behalf of a specified customer under specific conditions; and
- Performance related contingencies - a guarantee given by the Bank that undertakes to pay a sum of money to a third party where the customer fails to carry out certain terms and conditions of a contract.

The credit risk involved in issuing letters of credit and financial guarantees is essentially the same as that involved in extending loan facilities to customers. Apart from the normal documentation for a facility of this type, the customer must also provide the Banking Group with a written indemnity, undertaking that, in the event the Banking Group is called upon to pay, the Banking Group will be fully reimbursed by the customer.

Fees in relation to guarantees are collected over the life of the contract.

Clearing and settlement obligations

The Banking Group is a member of various central clearing houses, most notably the London Clearing House ("LCH") SwapClear platform, which enables the Banking Group to centrally clear derivative instruments. As a member of LCH, the Banking Group is required to make a default fund contribution. In the event of a default of another clearing member, the Banking Group could be required to commit additional funds to the default fund contribution.

Notes to and Forming Part of the Financial Statements

Note 30 Contingent Liabilities and Other Commitments *continued*

Other contingent liabilities

From time to time, the Banking Group is exposed to contingent risks and liabilities arising from conduct of its business, including:

- actual and potential disputes, claims and legal proceedings;
- investigations into past conduct, including actual and potential regulatory breaches, carried out by regulatory authorities;
- internal investigations and reviews into past conduct, including actual and potential regulatory breaches, carried out by the Banking Group (sometimes with the assistance of external parties); and
- contracts that involve giving contingent commitments such as warranties, indemnities or guarantees.

Overall, the number and scale of investigations, reviews and litigation involving banking institutions has increased significantly in recent years. The Banking Group has received information requests from its regulators as part of both industry and bank-specific reviews being undertaken, and the Banking Group has also initiated contact with its regulators on compliance-related matters. The scope of reviews, inquiries and investigations can be wide-ranging and can result in customer remediation programmes.

There are contingent liabilities in respect of all such matters. Such matters are often highly complex and uncertain. Where appropriate, provisions have been made. The aggregate potential liability of the Banking Group in relation to these matters cannot be accurately assessed.

Further information on some specific contingent liabilities that may impact the Banking Group is set out below.

The Banking Group has been working to strengthen its Anti-Money Laundering (“AML”) and Countering Financing of Terrorism (“CFT”) programme. The work involves significant investment in systems and personnel to ensure an effective control environment and an uplift in compliance capability. In addition to a general uplift in capability, the programme of work aims to remediate specific compliance issues and weaknesses. When significant AML or CFT compliance issues are identified, they are notified to the RBNZ. The Banking Group continues to keep the RBNZ informed of its progress in resolving these issues, and will continue to cooperate with, and respond to queries from, the RBNZ. As this work progresses, further compliance issues may be identified and reported to the RBNZ or equivalent foreign regulators, and additional strengthening may be required. The potential outcome and total costs associated with specific issues identified to date, and for any issues identified in the future, remain uncertain.

The Labour Inspectorate of Ministry of Business, Innovation and Employment (“MBIE”) has undertaken a programme of compliance audits of a number of New Zealand organisations, including BNZ, in respect of the Holidays Act 2003 (the “Holidays Act”). Since 2017, BNZ has worked with MBIE to review its compliance with the Holidays Act, including in respect of annual and public holiday payments to certain employees, and is completing remediation, as agreed with MBIE. In addition, the legislative interpretation of the definition of “discretionary payments” under the Holidays Act is not yet certain and, once it has been definitively determined, any potential implications for BNZ will need to be considered.

Credit related commitments

For commitments to extend credit, the maximum credit exposure to the Banking Group is the full amount of the commitment. Irrevocable commitments to extend credit are agreements to lend to a customer which can be drawn down at any time before the commitments expire as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiry dates or other termination clauses and may require payment of a fee by the customer. Since many of the commitments are expected to expire without being drawn down, the total commitment amounts do not necessarily represent future cash requirements.

Revocable commitments to extend credit represent those facilities which can be cancelled at any time at the Bank's discretion without the risk of incurring significant penalty or expense. These facilities are generally on-demand.

For information on the Banking Group's risk management policies, refer to note 36.

Guarantees to wholly owned controlled entities

The Bank guarantees the obligations of BNZ-IF in respect of securities issued by BNZ-IF to investors.

Notes to and Forming Part of the Financial Statements

Note 31 Credit Exposures to Connected Persons and Non-bank Connected Persons

Credit exposures to connected persons have been derived in accordance with the Bank's Conditions of Registration and RBNZ's Connected Exposures Policy ("BS8"). The amounts are net of specific provision for credit impairment and exclude advances of a capital nature.

The RBNZ defines Connected Persons to be other members of NAB and Directors of the Bank. Controlled entities of the Bank are not connected persons.

Credit exposures to connected persons have been calculated on a partial bilateral net basis. The gross amount and amount netted off under a bilateral netting agreement are included in the table below. There is a limit of 125% of the Banking Group's Tier 1 capital in respect of the gross amount of aggregate credit exposure to connected persons that can be netted off in determining the net exposure.

	Consolidated	
	Dollars in Millions 30/9/20	% of Tier One Capital As At 30/9/20
As at end of year		
Credit exposure to connected persons (on gross basis, before netting)	5,631	62.7%
Credit exposure to connected persons (amount netted)	1,989	22.1%
Credit exposure to connected persons (on partial bilateral net basis)	3,642	40.5%
Credit exposure to non-bank connected persons	-	-
Peak for the year ended		
Credit exposure to connected persons (on gross basis, before netting)	9,442	105.1%
Credit exposure to connected persons (amount netted)	4,566	50.8%
Credit exposure to connected persons (on partial bilateral net basis)	4,876	54.3%
Credit exposure to non-bank connected persons	-	-

As at 30 September 2020, the Banking Group's rating-contingent limit to connected person was 60% of the Banking Group's Tier 1 capital. This limit has not changed during the year. Within the overall rating-contingent limit, there is a sublimit of 15% of Tier 1 capital that applies to aggregate credit exposures to non-bank connected persons.

The rating-contingent limit on credit exposures to connected persons as set out in the Bank's Conditions of Registration has been complied with at all times during the year ended 30 September 2020. The peak for the year ended credit exposure to connected persons and non-bank connected persons are calculated by determining the maximum end-of-day aggregated amount of actual credit exposure over Banking Group's Tier 1 Capital as at 30 September 2020.

Where a bank is funding a large loan it is common practice to share the risk of a customer default with other connected banks. These arrangements are called risk lay-off arrangements. As at 30 September 2020, the Banking Group had no contingent credit exposures arising from risk lay-off arrangements with connected persons. There were no credit exposures to connected persons that were credit-impaired, and no provision for credit impairment on individual financial assets for connected person credit exposures as at 30 September 2020.

Notes to and Forming Part of the Financial Statements

Note 32 Structured Entities, Securitisation, Funds Management, Fiduciary Activities and Insurance

Funds management

The Bank markets and distributes funds management products to a range of customers which are managed and issued by its wholly owned subsidiary BNZISL. Refer to note 25 for further information. The Bank provides banking services for funds management products administered by BNZISL. All arrangements are conducted on arms' length commercial terms. The Bank also provides services to a number of customers, including advice on, administration of, and management of investment portfolios.

The outstanding value of assets related to fund management activities is set out in the table below.

Dollars in Millions	30/9/20	30/9/19
Portfolios managed on behalf of customers	5,987	6,195
BNZ Cash PIE ¹	-	13
BNZ Term PIE	1,372	1,577

¹ BNZ Cash PIE has been wound up during the year ended 30 September 2020.

The assets for portfolios managed on behalf of customers do not represent deposits or other liabilities of the Bank or any other member of NAB, are not owned by the Banking Group and are therefore not included as part of the Banking Group's assets on the balance sheet. Investments made in the Investment Schemes are subject to investment risk, including possible delays in repayment and loss of income and principal invested. None of the Bank, or any other member of NAB, the Supervisor (The New Zealand Guardian Trust Company Limited), any Director of any of them, the New Zealand Government or any other person guarantees (either fully or in part) the performance or returns of the Investment Schemes or the repayment of capital. BNZ Term PIE, a controlled entity of the Bank, invests solely in debt securities issued by the Banking Group and on consolidation its assets are eliminated against liabilities recorded by the Bank. Unitholders' interests are included as part of the Banking Group's liabilities.

During the year ended 30 September 2020, the Bank held deposits on behalf of customers of JBWere (NZ) Pty Limited and JBWere (NZ) Nominees Limited. JBWere (NZ) Pty Limited and JBWere (NZ) Nominees Limited, as controlled entities of the ultimate parent, are related parties of the Banking Group, but are not a part of the Banking Group.

Insurance business

The Banking Group does not conduct any Insurance Business, as defined by condition 3 of the Bank's Conditions of Registration set out on page 88.

Marketing and distribution of insurance products

The Banking Group is involved in marketing insurance products for the following entities: BNZ Life Insurance Limited, Union Medical Benefits Society Limited, AMP Services (NZ) Limited, IAG New Zealand Limited, Cigna Life Insurance New Zealand Limited, Partners Life Limited, Asteron Life Limited and QBE Insurance (Australia) Limited. In addition, the Banking Group refers some commercial non life insurance product queries to AON New Zealand and some trade credit queries are referred to National Credit Insurance (Brokers) Pty Limited.

All of these entities are unrelated to the Banking Group, with the exception of BNZ Life Insurance Limited, a controlled entity of National Australia Bank Limited. BNZ Life Insurance Limited is an Affiliated Insurance Entity as defined in BS2B.

Structured entities

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Structured entities generally have restricted activities and a narrow and well defined objective which are both created through contractual arrangements.

Depending on the Banking Group's power over the relevant activities of the structured entity and its exposure to and ability to influence its own returns, it may or may not consolidate the entity.

The Banking Group's involvement in structured entities is subject to internal credit, compliance and legal approval processes to ensure that any difficulties arising from the structured entities do not impact adversely on the Banking Group, beyond that which is normal for arm's length commercial relationships.

Consolidated structured entities

The Banking Group has interests in the following structured entities which are consolidated for financial reporting purposes:

Name	Country of Domicile	Principal Activities
BNZ RMBS Trust Series 2008-1	New Zealand	Securitisation entity
BNZ Covered Bond Trust	New Zealand	Securitisation entity
BNZ Term PIE	New Zealand	Portfolio investment entity

RMBS Trust and Covered Bond Trust

The RMBS Trust provides an internal residential mortgage-backed securities programme to issue securities as collateral for borrowing from the RBNZ. The Covered Bond Trust holds certain Bank of New Zealand housing loans and its trustee guarantees the payment of all interest and principal under the covered bonds issued by the Bank and BNZ-IF.

Further details on the transactions with the RMBS Trust and the Covered Bond Trust are provided in note 28.

Term PIE Investment Entity

The Banking Group has interests in consolidated investment entities. The Banking Group's interests are noted in the funds management section of this note.

Notes to and Forming Part of the Financial Statements

Note 32 Structured Entities, Securitisation, Funds Management, Fiduciary Activities and Insurance *continued*

Unconsolidated structured entities

Unconsolidated structured entities refer to all structured entities that are not controlled by the Banking Group. The Banking Group enters into transactions with unconsolidated structured entities in the normal course of business to facilitate customer transactions and for specific investment opportunities.

The Banking Group engages with third party (client) securitisations by providing funding, liquidity support and derivatives.

Interests in unconsolidated structured entities include, but are not limited to, debt investments, guarantees, liquidity arrangements, and commitments that expose the Banking Group to the risks of the unconsolidated structured entity. Interests do not include plain vanilla derivatives (e.g. interest rate swaps and currency swaps).

The table below shows the carrying value and maximum exposure to loss and credit quality of the Banking Group's interests in unconsolidated securitisation entities as at 30 September 2020.

Dollars in Millions	Consolidated (30/9/20)				Consolidated (30/9/19)			
	Senior Investment Grade	Investment Grade	Sub-Investment Grade	Total	Senior Investment Grade	Investment Grade	Sub-Investment Grade	Total
Carrying value of loans and advances	1,039	9	1	1,049	731	11	3	745
Commitments and guarantees	762	11	5	778	462	3	1	466
Total maximum exposure to credit loss	1,801	20	6	1,827	1,193	14	4	1,211

The total assets of unconsolidated structured entities are not considered meaningful for the purpose of understanding the Banking Group's financial risks associated with these entities and so have not been presented. Unless specified otherwise, the Banking Group's maximum exposure to loss is the total of its on-balance sheet positions and its off-balance sheet arrangements, being loan commitments, financial guarantees, and liquidity support. Exposure to loss is managed as part of the Banking Group-wide risk management framework. Refer to note 36 for further information.

Income earned from interests in unconsolidated structured entities primarily resulted from interest income, fees and commission income.

Risk management

The Banking Group has in place policies and procedures to ensure that the activities identified above are conducted in an appropriate manner. Should adverse investment or liquidity conditions arise it is considered that the Banking Group's policies and procedures, combined with those of BNZ Life Insurance Limited and BNZ Insurance Services Limited, will minimise the possibility that those conditions will adversely impact the Banking Group. The policies and procedures referred to include comprehensive and prominent disclosure of information regarding products, formal and regular review of operations and policies by internal auditors and management, appropriate contractual agreements and compliance with contractual obligations and regulatory requirements.

The Banking Group's risk review and risk management systems are equally applicable to the marketing and distribution of products issued by the third party entities identified in the marketing and distribution of insurance products and funds management sections of this note.

In addition, the following measures are also taken to manage any risk to the Banking Group of marketing and distributing insurance products:

- disclaimers on policies, application forms and other collateral relating to insurance products expressly state that the policy is not an obligation of the Bank and that the Bank does not guarantee the obligations of the insurer;
- the risks under policies issued by BNZ Life Insurance Limited are reinsured appropriately; and
- the introduction of new policies and changes to existing policies marketed or distributed by the Banking Group are subject to the Banking Group's standard risk management policies and procedures.

The Bank does not guarantee the capital, income or return of any of the products referred to above.

Transactions with Banking Group entities

Financial services provided by any member of the Banking Group to entities which are involved in trust, custodial, funds management and other fiduciary activities and securitisation arrangements, and to affiliated insurance entities which conduct marketing and distribution of insurance products, or on whose behalf the marketing and distribution of insurance products are conducted, have been provided on arm's length terms and conditions and at fair value. Assets purchased from any such entities by any member of the Banking Group have been purchased on arm's length terms and conditions and at fair value.

Peak aggregate funding provided to entities

The Bank does not provide any funding to individual unit trusts which the Banking Group distributes on behalf of third parties.

During the year ended 30 September 2020, the Banking Group did not provide any funding to individual affiliated insurance entities and entities involved in securitisation activities, where the Banking Group is involved in the origination of securitised assets and the marketing of securitisation schemes.

Notes to and Forming Part of the Financial Statements

Note 33 Concentrations of Credit Exposures to Individual Counterparties and Groups of Closely Related Counterparties

The Banking Group's disclosure of concentrations of credit exposures to individual counterparties and groups of closely related counterparties is based on actual credit exposures and excludes credit exposures to connected persons, the central government or central bank of any country with a long term credit rating of A- or A3 or above, or its equivalent, and excludes supranationals or quasi-sovereign agencies with a long term credit rating of A- or A3 or above, or its equivalent. Peak credit exposures to individual counterparties are calculated using the Banking Group's end of period Common Equity Tier 1 capital.

	Consolidated (30/9/20)	
	Credit Exposures to Individual Counterparties and Groups of Closely Related Counterparties Long Term Credit Rating	
	Peak End-of-Day A-or A3 or above or its equivalent	Balance Sheet Date A-or A3 or above or its equivalent
Number of bank counterparties		
Percentage of Common Equity Tier 1 capital		
10-14%	4	1
15 -19%	2	-
20 -24%	-	-
Number of non-bank counterparties		
Percentage of Common Equity Tier 1 capital		
10-14%	2	-
15 -19%	1	2
20 -24%	1	-

Where the Banking Group is funding large loans, it is common practice to share the risk of a customer default with other connected banks or enter into other risk lay-off arrangements. The above table has been compiled using gross exposures before risk lay-offs. No account is taken of collateral, security and/or netting agreements that do not qualify for offset in accordance with NZ IAS 32 Financial Instruments: Presentation which the Banking Group may hold in respect of the various counterparty exposures.

The Banking Group had no bank counterparties, supranationals or quasi-sovereign agencies with a long term credit rating below A- or A3, to whom their aggregate credit exposure, as at 30 September 2020, and peak end-of-day aggregate credit exposure, for the six months ended 30 September 2020, equalled or exceeded 10% of the Banking Group's Common Equity Tier 1 capital.

The Banking Group had no non-bank counterparties with a long term credit rating below A- or A3, to whom their aggregate credit exposure, as at 30 September 2020, and peak end-of-day aggregate credit exposure, for the six months ended 30 September 2020, equalled or exceeded 10% of the Banking Group's Common Equity Tier 1 Capital.

Note 34 Investments in Wholly Owned Entities

Wholly owned entities of the Bank as at 30 September 2020 were:

Name	Country of Incorporation	Principal Activities
BNZ Equity Investments No.2 Limited	New Zealand	Investment company
BNZ Facilities Management Limited	New Zealand	Facilities management
BNZ International Funding Limited	New Zealand	Funding company
BNZ Investments Limited	New Zealand	Investment company
BNZ Property Investments Limited	New Zealand	Property company
BNZ Branch Properties Limited	New Zealand	Property company
BNZ Investment Services Limited	New Zealand	Investment administration and management

All wholly owned entities listed above have the same reporting date as the Bank.

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy

The RBNZ minimum regulatory capital requirements for banks have been established under RBNZ Capital Adequacy Framework (Internal Models Based Approach) ("BS2B") and Capital Adequacy Framework (Standardised Approach) ("BS2A") based on the international framework developed by the Bank for International Settlements, Committee on Banking Supervision, commonly known as Basel III. These requirements outline how minimum regulatory capital is to be calculated and provide methods for measuring risks incurred by the banks in New Zealand.

The Basel III framework's objective is to develop capital adequacy guidelines that are more accurately aligned with the individual risk profile of banks. Basel III consists of three pillars – Pillar One covers the capital requirements for banks for credit, operational, and market risks. Pillar Two covers all other material risks that are not already included in Pillar One. Pillar Three relates to market disclosure.

RBNZ Capital Adequacy Framework (Internal Models Based Approach)

The Banking Group has calculated its implied Risk-Weighted Exposure and minimum regulatory capital requirements based on BS2B for operational risk and the majority of credit risk portfolios. For further details on operational risk refer to note 36 under subheading Operational risk.

Under BS2B, accredited banks use their own models for estimating risk and minimum capital requirements. Under the Internal Ratings Based Approach for credit risk, the level of risk associated with customers' exposures is determined by way of the primary components of Probability of Default, Loss Given Default and Exposure at Default. These components and associated processes are subject to regular review. For exposures in the Specialised Lending asset category (including Project Finance, Object Finance, Commodity Finance and Income Producing Real Estate) the Banking Group uses supervisory slotting estimates provided by the RBNZ.

The exceptions to the Internal Ratings Based Approach for credit risk are portfolios of relatively low materiality which are subject to the standardised treatment as set out in BS2A.

Capital for market risk has been calculated in accordance with the approach specified in BS2B.

Capital management policies

The Banking Group's primary objectives in relation to the management of capital adequacy are to comply with the requirements set out by the RBNZ, the Banking Group's primary prudential supervisor, to provide a sufficient capital base to cover risks faced by the Bank and to maintain a credit rating to support future business development.

Total regulatory capital is defined as the sum of Common Equity Tier 1 capital, Additional Tier 1 capital and Tier 2 capital. Tier 1 capital is defined as the sum of Common Equity Tier 1 capital and Additional Tier 1 capital. The Banking Group's Common Equity Tier 1 capital includes paid up ordinary shares and retained profits less certain deductions, Additional Tier 1 capital includes perpetual notes and Tier 2 capital includes revaluation reserves and subordinated debt.

The Banking Group is required under its Conditions of Registration to maintain a minimum ratio of total eligible or qualifying capital to total risk-weighted assets of 8%, of which a minimum of 4.5% must be held in Common Equity Tier 1 capital and a minimum of 6% must be held in Tier 1 capital. The Banking Group must maintain a minimum Common Equity Tier 1 buffer ratio of 2.5% above these minimum ratios or it will face restrictions on the distribution of earnings and be required to prepare a capital plan that restores the Banking Group's buffer ratio and have that capital plan approved by the RBNZ.

The RBNZ has announced significant changes to the capital adequacy framework for New Zealand registered banks, which will result in a significant increase in the level of capital that the Banking Group is required to hold, as well as changes to what types of instruments constitute eligible regulatory capital. The new regime is currently expected to be implemented in stages from 1 July 2021, with a transition period of seven years before banks are required to fully comply with the new rules.

The Banking Group has an Internal Capital Adequacy Assessment Process ("ICAAP") in place which complies with the requirements set out in the RBNZ's "Guidelines on a Bank's Internal Capital Adequacy Assessment Process" ("BS12") as specified under the Bank's Conditions of Registration. The Banking Group's ICAAP outlines the approach to maintaining capital adequacy, risk appetite and stress testing. The ICAAP considers all material risks consistent with the Banking Group's risk appetite and outlines the capital requirements.

Capital requirements, as detailed in the Banking Group's ICAAP document, are managed by the Bank's Risk Return Management Committee ("RRMC") and Asset, Liability and Capital Committee under delegated authority from the Board of Directors.

For more information on the capital structure of the Banking Group, refer to page 65.

The tables on the following pages detail the capital calculation, capital ratios and capital requirements as at 30 September 2020. During the reporting period the Banking Group complied with all RBNZ's capital requirements as set out in the Bank's Conditions of Registration.

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Regulatory capital

The following table shows the qualifying capital for the Banking Group.

Dollars in Millions	Consolidated Unaudited 30/9/20
Qualifying capital	
Common Equity Tier 1 capital	
Contributed equity - ordinary shares	4,056
Retained profits	4,493
Accumulated other comprehensive income and other disclosed reserves	105
Deductions from Common Equity Tier 1 capital:	
Goodwill and other intangible assets	229
Cash flow hedge reserve	113
Credit value adjustment on liabilities designated at fair value through profit or loss	(76)
Prepaid pension assets (net of deferred tax)	6
Deferred tax asset	295
Total expected loss less total eligible allowances for impairment	-
Credit enhancements	2
Total Common Equity Tier 1 capital	8,085
Additional Tier 1 capital	
Perpetual Notes	900
Total Additional Tier 1 capital	900
Total Tier 1 capital	8,985
Tier 2 capital	
Revaluation reserves	3
Subordinated Notes	500
Listed Subordinated Notes	550
Total eligible impairment allowance in excess of expected loss	132
Total Tier 2 capital	1,185
Total Tier 1 and Tier 2 qualifying capital	10,170

Banking Group Basel III regulatory capital ratios

The table below shows the capital adequacy ratios for the Banking Group based on BS2B, expressed as a percentage of total risk-weighted exposures.

	Consolidated		
	Regulatory Minima	Unaudited 30/9/20	Unaudited 30/9/19
Common Equity Tier 1 capital ratio	4.50%	11.85%	10.97%
Tier 1 capital ratio	6.00%	13.17%	12.32%
Total qualifying capital ratio	8.00%	14.91%	13.93%
Buffer ratio	2.50%	6.91%	5.93%

Registered Bank Basel III regulatory capital ratios

The table below shows the capital adequacy ratios for the Registered Bank based on BS2B, expressed as a percentage of total risk-weighted exposures.

	The Registered Bank	
	Unaudited 30/9/20	Unaudited 30/9/19
Common Equity Tier 1 capital ratio	11.80%	10.92%
Tier 1 capital ratio	13.12%	12.27%
Total qualifying capital ratio	14.86%	13.88%

For the purpose of calculating capital adequacy ratios for the Registered Bank under BS2B, subsidiaries which are both funded exclusively and wholly owned by the Registered Bank are consolidated within the Registered Bank.

The Banking Group is currently remediating a data quality issue associated with the linking of certain securities and underlying lending. Once remediated, this may result in a minor adjustment to reported capital ratios for the period ended 30 September 2020.

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Total regulatory capital requirements

	Consolidated		Total Capital Require- ment¹ Unaudited
	Total Exposure at Default Unaudited	Risk- Weighted Exposure or Implied Risk- Weighted Exposure Unaudited	
Dollars in Millions	30/9/20	30/9/20	30/9/20
Credit risk			
Exposures subject to the internal ratings based approach ¹	119,272	45,214	3,617
Specialised lending subject to the slotting approach ¹	8,123	7,589	607
Exposures subject to the standardised approach ¹	2,425	1,014	81
Equity exposures ¹	1	6	-
Credit Value Adjustment subject to BS2B ("CVA")	N/A	2,007	161
Agribusiness supervisory adjustment ²	N/A	1,438	115
Total credit risk	129,821	57,268	4,581
Operational risk	N/A	8,225	658
Market risk	N/A	2,725	218
Total	129,821	68,218	5,457

¹In calculating the total capital requirement, a scalar of 1.06 has been applied to the risk-weighted assets, as required by the RBNZ in accordance with the Bank's Conditions of Registration.

²The agribusiness supervisory adjustment increases the risk weight of the Banking Group's rural lending portfolio to a minimum specified by the RBNZ.

Advanced Internal Ratings Based approach to credit risk management

The Banking Group's quantitative credit risk measurement is based on the Internal Ratings Based ("IRB") approach (IRB for Retail Credit portfolios and Advanced IRB for Non-retail Credit portfolios) and uses a series of models to calculate loss estimates for the credit portfolio. This includes consideration of:

- probability of default ("PD") which estimates the probability that a customer will default over the next 12 months;
- exposure at time of default ("EAD") which estimates the amount of outstanding principal, fees and interest owed at the time of default; and
- loss given default ("LGD") which estimates the expected loss in the event of default. It is the percentage of exposure which will be lost after all recovery efforts, including legal expenses, time value of money and recovery expenses.

The above three elements (PD, EAD, and LGD) are important inputs in determining the risk-weighted exposure calculations for both on and off-balance sheet exposures, including undrawn portions of credit facilities, committed and contingent exposures. These ratings are also an important input into the credit approval, risk management, internal capital allocation and corporate governance functions of the Banking Group.

Methodologies used to calculate credit risk estimates (PD, EAD and LGD) are in accordance with BS2B and the Bank's Conditions of Registration. For credit risk estimates on some portfolios, the RBNZ has set prescribed risk estimates required to be used when calculating risk-weighted assets and capital under BS2B. The RBNZ prescribed risk estimates will continue to be used until the Banking Group develops its own internal models for these portfolios.

Controls surrounding credit risk rating systems

The credit risk rating systems cover all methods, processes, controls, data collection and technology that support the assessment of credit risk, the assignment of internal credit risk ratings and the quantification of associated default and loss estimates.

The credit risk rating systems and risk estimate processes are governed by the Banking Group's RRMC and are an integral part of reporting to senior management. Management and staff of the credit risk function regularly assess the performance of the rating systems, monitor progress on changes being made to systems and identify any areas for improvement. These systems are subject to rigorous internal review and approval and regular independent review. The annual validation of models is undertaken by specialists who are responsible for overseeing the design, implementation and performance of all rating models across the Banking Group.

The risk-weighted asset amounts presented in the following tables include a scalar of 1.06 as required by the RBNZ in accordance with the Bank's Conditions of Registration, which is not in the risk weights shown.

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Credit risk subject to the Internal Ratings Based ("IRB") approach

The following tables analyse credit risk exposures by asset class split into PD bandings. The lower the PD banding the less the probability of default over the next 12 months.

Dollars in Millions	Consolidated					
	Weighted Average PD (%) Unaudited 30/9/20	Exposure at Default Unaudited 30/9/20	Exposure-Weighted LGD used for the Capital Calculation (%) Unaudited 30/9/20	Exposure-Weighted Risk Weight (%) Unaudited 30/9/20	Risk-Weighted Assets Unaudited 30/9/20	Minimum Capital Requirement Unaudited 30/9/20
Corporate						
Exposure-weighted PD grade >0 ≤ 0.1%	0.05	7,390	31	12	915	73
Exposure-weighted PD grade >0.1 ≤ 0.5%	0.32	17,701	34	39	7,242	579
Exposure-weighted PD grade >0.5 ≤ 1.5%	0.92	14,555	33	59	9,151	732
Exposure-weighted PD grade >1.5 ≤ 5.0%	2.46	7,827	35	82	6,830	546
Exposure-weighted PD grade >5.0 ≤ 99.99%	11.30	1,387	39	154	2,263	181
Default PD grade = 100%	100.00	829	45	220	1,932	155
Total corporate exposures	2.76	49,689	34	54	28,333	2,266
Sovereign						
Exposure-weighted PD grade >0 ≤ 0.1%	0.03	10,554	5	1	133	11
Exposure-weighted PD grade >0.1 ≤ 0.5%	0.36	11	45	55	6	1
Exposure-weighted PD grade >0.5 ≤ 1.5%	0.64	5	45	72	4	-
Exposure-weighted PD grade >1.5 ≤ 5.0%	1.93	-	45	97	-	-
Exposure-weighted PD grade >5.0 ≤ 99.99%	5.72	-	45	139	1	-
Default PD grade = 100%	-	-	-	-	-	-
Total sovereign exposures	0.03	10,570	5	1	144	12
Bank						
Exposure-weighted PD grade >0 ≤ 0.1%	0.04	5,659	15	5	318	26
Exposure-weighted PD grade >0.1 ≤ 0.5%	0.20	638	42	37	252	20
Exposure-weighted PD grade >0.5 ≤ 1.5%	0.67	20	60	82	18	1
Exposure-weighted PD grade >1.5 ≤ 5.0%	1.92	-	57	117	-	-
Exposure-weighted PD grade >5.0 ≤ 99.99%	8.11	3	60	213	7	1
Default PD grade = 100%	-	-	-	-	-	-
Total bank exposures	0.06	6,320	18	9	595	48
Residential mortgage						
Exposure-weighted PD grade >0 ≤ 0.1%	0.03	-	38	5	-	-
Exposure-weighted PD grade >0.1 ≤ 0.5%	0.40	1,783	18	13	253	20
Exposure-weighted PD grade >0.5 ≤ 1.5%	0.89	44,777	21	26	12,349	988
Exposure-weighted PD grade >1.5 ≤ 5.0%	4.92	2,057	19	67	1,465	117
Exposure-weighted PD grade >5.0 ≤ 99.99%	-	-	-	-	-	-
Default PD grade = 100%	100.00	229	21	199	482	39
Total residential mortgage exposures	1.51	48,846	20	28	14,549	1,164
Other retail¹						
Exposure-weighted PD grade >0 ≤ 0.1%	0.05	769	86	12	99	8
Exposure-weighted PD grade >0.1 ≤ 0.5%	0.25	532	85	38	215	17
Exposure-weighted PD grade >0.5 ≤ 1.5%	0.93	309	84	81	266	21
Exposure-weighted PD grade >1.5 ≤ 5.0%	2.70	198	82	111	233	18
Exposure-weighted PD grade >5.0 ≤ 99.99%	11.82	110	80	140	163	13
Default PD grade = 100%	100.00	11	80	266	32	3
Total other retail exposures	1.77	1,929	85	49	1,008	80

¹ Other retail includes credit cards, current accounts and personal overdrafts.

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Credit risk subject to the Internal Ratings Based ("IRB") approach *continued*

Dollars in Millions	Consolidated					
	Weighted Average PD (%)	Exposure at Default	Exposure-Weighted LGD used for the Capital Calculation (%)	Exposure-Weighted Risk Weight (%)	Risk-Weighted Assets	Minimum Capital Requirement
	Unaudited 30/9/20	Unaudited 30/9/20	Unaudited 30/9/20	Unaudited 30/9/20	Unaudited 30/9/20	Unaudited 30/9/20
Retail small to medium enterprises						
Exposure-weighted PD grade >0 ≤ 0.1%	0.07	179	38	7	14	1
Exposure-weighted PD grade >0.1 ≤ 0.5%	0.30	820	32	17	144	12
Exposure-weighted PD grade >0.5 ≤ 1.5%	0.90	482	33	32	161	13
Exposure-weighted PD grade >1.5 ≤ 5.0%	2.58	366	34	46	178	14
Exposure-weighted PD grade >5.0 ≤ 99.99%	10.73	41	44	75	33	3
Default PD grade = 100%	100.00	30	47	172	55	4
Total retail SME exposures	2.65	1,918	34	29	585	47
Total¹						
Exposure-weighted PD grade >0 ≤ 0.1%	0.04	24,551	18	6	1,479	119
Exposure-weighted PD grade >0.1 ≤ 0.5%	0.32	21,485	34	36	8,112	649
Exposure-weighted PD grade >0.5 ≤ 1.5%	0.90	60,148	24	34	21,949	1,755
Exposure-weighted PD grade >1.5 ≤ 5.0%	2.96	10,448	33	79	8,706	695
Exposure-weighted PD grade >5.0 ≤ 99.99%	11.32	1,541	42	151	2,467	198
Default PD grade = 100%	100.00	1,099	40	215	2,501	201
Total exposures	1.84	119,272	26	36	45,214	3,617

¹ The CVA and the Agribusiness supervisory adjustment have not been included in the above exposures.

The following table analyses the value and exposure at default of on-balance sheet exposures, off-balance sheet exposures and market related contracts under the IRB approach by asset class.

Dollars in Millions	Consolidated			
	Total Exposure	Exposure at Default	Risk-Weighted Assets	Minimum Capital Requirement
	Unaudited 30/9/20	Unaudited 30/9/20	Unaudited 30/9/20	Unaudited 30/9/20
On-balance sheet exposures				
Corporate	35,597	35,597	21,042	1,683
Sovereign	10,117	10,117	114	9
Bank	3,445	3,445	281	23
Residential mortgage	45,851	45,851	13,764	1,101
Other retail	1,039	1,039	716	57
Retail small to medium enterprises	1,441	1,441	470	38
Total on-balance sheet exposures	97,490	97,490	36,387	2,911
Off-balance sheet exposures				
Corporate	13,208	12,057	6,303	504
Sovereign	206	209	21	2
Bank	697	677	37	3
Residential mortgage	3,498	2,995	785	63
Other retail	2,759	890	292	23
Retail small to medium enterprises	530	477	115	9
Total off-balance sheet exposures	20,898	17,305	7,553	604
Market related contracts				
Corporate	148,515	2,035	988	79
Sovereign	23,890	244	9	1
Bank	65,990	2,198	277	22
Total market related contracts	238,395	4,477	1,274	102

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Credit risk subject to the Internal Ratings Based ("IRB") approach *continued*

Dollars in Millions	Consolidated			
	Total Exposure Unaudited 30/9/20	Exposure at Default Unaudited 30/9/20	Risk-Weighted Assets Unaudited 30/9/20	Minimum Capital Requirement Unaudited 30/9/20
Summary¹				
Corporate	197,320	49,689	28,333	2,266
Sovereign	34,213	10,570	144	12
Bank	70,132	6,320	595	48
Residential mortgage	49,349	48,846	14,549	1,164
Other retail	3,798	1,929	1,008	80
Retail small to medium enterprises	1,971	1,918	585	47
Total credit risk exposures subject to the IRB approach	356,783	119,272	45,214	3,617

¹ The CVA and the Agribusiness supervisory adjustment have not been included in the above exposures.

Specialised lending subject to the slotting approach

The tables below show specialised lending exposures for which the supervisory slotting approach has been used and includes Project Finance, Object Finance, Commodity Finance and Income Producing Real Estate exposures.

Dollars in Millions	Consolidated			
	Total Exposure at Default after Credit Risk Mitigation Unaudited 30/9/20	Risk Weight (%) Unaudited 30/9/20	Risk-Weighted Assets Unaudited 30/9/20	Minimum Pillar One Capital Requirement Unaudited 30/9/20
On-balance sheet exposures subject to the slotting approach				
Strong	1,913	70	1,419	114
Good	4,091	90	3,896	312
Satisfactory	1,115	115	1,356	108
Weak	27	250	72	6
Default	44	-	-	-
Total on-balance sheet exposures subject to the slotting approach	7,190	88	6,743	540

The categories of specialised lending above are associated with the risk weight shown. These categories broadly correspond to external credit assessments from S&P Global Ratings Australia Pty Limited rating scale: BBB- or better (Strong); BB+ or BB (Good); BB- or B+ (Satisfactory); B to C- (Weak).

Dollars in Millions	Consolidated				
	Total Exposure Unaudited 30/9/20	Exposure at Default Unaudited 30/9/20	Average Risk Weight (%) Unaudited 30/9/20	Risk-Weighted Assets Unaudited 30/9/20	Minimum Pillar One Capital Requirement Unaudited 30/9/20
Off-balance sheet exposures subject to the slotting approach					
Off-balance sheet exposures	35	18	81	16	1
Undrawn commitments	1,673	843	87	772	61
Market related contracts	1,153	72	76	58	5
Total off-balance sheet exposures subject to the slotting approach	2,861	933	86	846	67
Total exposures subject to the slotting approach		8,123	88	7,589	607

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Credit risk exposures subject to the standardised approach

The tables below show credit risk exposures in respect of the Banking Group, for which the standardised approach has been used

Dollars in Millions	Consolidated			
	Total Exposure at Default after Credit Risk Mitigation Unaudited	Average Risk Weight (%) Unaudited	Risk-Weighted Assets Unaudited	Minimum Pillar One Capital Requirement Unaudited
	30/9/20	30/9/20	30/9/20	30/9/20
On-balance sheet exposures subject to the standardised approach				
Corporate	97	99	100	8
Residential mortgage	39	83	34	3
Past due assets	1	150	2	-
Other assets ¹	1,472	51	792	63
Total on-balance sheet exposures subject to the standardised approach	1,609	55	928	74

¹ Other assets relate to all other assets (including interest receivables, account receivables, intangibles and cash accounts) that are not included in the other categories in the table.

Dollars in Millions	Consolidated					
	Total Exposure or Principal Amount Unaudited	Average Credit Conversion Factor (%) Unaudited	Credit Equivalent Amount Unaudited	Average Risk Weight (%) Unaudited	Risk-Weighted Assets Unaudited	Minimum Pillar One Capital Requirement Unaudited
	30/9/20	30/9/20	30/9/20	30/9/20	30/9/20	30/9/20
Off-balance sheet exposures subject to the standardised approach						
Total off-balance sheet exposures subject to the standardised approach	101	22	22	99	23	2
Market related contracts subject to the standardised approach						
Foreign exchange contracts	13	N/A	-	100	-	-
Interest rate contracts ²	921,802	N/A	794	7	63	5
Other	1	N/A	-	-	-	-
Total market related contracts subject to the standardised approach	921,816	N/A	794	7	63	5
Total exposures subject to the standardised approach		N/A	2,425	40	1,014	81

² The total exposure or principal amount reflects the gross notional value of contracts transacted through a qualifying central counterparty.

Equity exposures

The table below shows the capital required to be held as a result of equities held.

Dollars in Millions	Consolidated			
	Exposure at Default Unaudited	Risk Weight (%) Unaudited	Risk-Weighted Exposures Unaudited	Minimum Pillar One Capital Requirement Unaudited
	30/9/20	30/9/20	30/9/20	30/9/20
Equity holdings (not deducted from capital) that are publicly traded	-	300	-	-
All other equity holdings (not deducted from capital)	1	400	6	-
Total equity exposures	1	424	6	-

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Credit risk mitigation

The Banking Group assesses the integrity and ability of counterparties to meet their contractual financial obligations for repayment. Collateral security in the form of property or a security interest in personal property is generally taken for business credit except for major government, bank and corporate counterparties of strong financial standing. Longer term consumer finance (e.g. housing loans) is generally secured against real estate while short term revolving consumer credit is generally unsecured.

The table below shows the total value of exposures covered by eligible financial collateral for portfolios subject to the standardised approach and total value of exposures covered by credit derivatives and guarantees for all portfolios.

	Consolidated Corporate (Including Specialised Lending) Unaudited 30/9/20
Dollars in Millions	
For portfolios subject to the standardised approach:	
Total value of exposures covered by eligible financial collateral	1
For all portfolios:	
Total value of exposures covered by credit derivatives or guarantees	-

Residential mortgages by loan-to-valuation ratio

The table below sets out residential mortgages (including loans to businesses) wholly or partly secured by mortgages over residential properties as used to calculate the Banking Group's Pillar One capital requirement by the loan-to-valuation ratio ("LVR").

The LVRs are calculated as the greater of the customer's current loan limit or balance, divided by the Banking Group's valuation of the security at the last credit event for the customer. Where no LVR is available, the exposure is included in the over 90% category.

	Consolidated		
	On-balance Sheet Exposures at Default Unaudited 30/9/20	Off-balance Sheet Exposures at Default ¹ Unaudited 30/9/20	Total Exposures at Default Unaudited 30/9/20
Dollars in Millions			
LVR Range			
0-59%	18,553	1,176	19,729
60-69%	9,906	539	10,445
70-79%	13,732	932	14,664
80-89%	2,306	33	2,339
Over 90%	1,354	315	1,669
Total exposures at default secured by residential mortgages	45,851	2,995	48,846

¹ Off-balance sheet items include unutilised limits and loans approved, but not yet drawn.

Reconciliation of exposures secured by residential mortgages to housing loans in note 11 Loans and advances to customers

	Consolidated On-balance Sheet Exposures at Default Unaudited 30/9/20
Dollars in Millions	
Loans and advances to customers - housing loans	45,850
Add: Partial write offs excluded under the IRB approach	1
Total housing loan exposures secured by residential mortgages	45,851

Operational risk

	Consolidated	
	Implied Risk- Weighted Exposure Unaudited 30/9/20	Total Operational Risk Capital Requirement Unaudited 30/9/20
Dollars in Millions		
Operational risk	8,225	658

The Banking Group calculated operational risk capital using the Advanced Measurement Approach ("AMA") as required by BS2B as well as the standardised approach set out in BS2A, taking the higher of the two.

Notes to and Forming Part of the Financial Statements

Note 35 Capital Adequacy *continued*

Market risk

The table below shows market risk end of period and peak end-of-day capital charges.

Dollars in Millions	Consolidated Unaudited (30/9/20)			
	Implied Risk- Weighted Exposure Peak		Aggregate Capital Charge Peak	
	End of Period	End-of-Day	End of Period	End-of-Day
Interest rate risk	2,705	4,199	216	336
Foreign exchange risk	19	81	2	6
Equity risk	1	1	-	-
Total market risk	2,725	4,281	218	342

The aggregate market risk exposure above is derived in accordance with BS2B and the Bank's Conditions of Registration.

For each category of market risk, the Banking Group's end of period aggregate capital charge is the charge as at the end of period reported. The peak end-of-day aggregate capital charge is the maximum over the half year accounting period at the close of each business day.

Equity risk subject to a market risk capital charge as shown above relates to equities owned by the Bank.

Capital for other material risks

The Banking Group actively manages and measures all material risks affecting its operations. These risks go beyond the traditional banking risks of credit, operational and market risk. The measurement and management of all material risks is determined under the Banking Group's ICAAP and includes consideration of all other material risks, additional to those included in determining the minimum regulatory capital requirements under BS2B. Other material risks assessed by the Banking Group include balance sheet and liquidity risk, regulatory risk, conduct risk, compliance risk and strategic risk.

As at 30 September 2020, the Banking Group had an internal capital allocation for strategic risk of \$109 million (30 September 2019: \$109 million).

Capital structure

Contributed equity - Ordinary shares

These shares do not have a par value; each share entitles the shareholder to one vote at any meeting of shareholders. All shares rank equally in dividends and proceeds available to ordinary shareholders in a winding up.

Subordinated debt

Refer to note 23 for further information.

Reserves

Accumulated other comprehensive income and other disclosed reserves in Tier 1 Capital includes the cost of hedging reserve of \$(9) million which captures changes in fair value of hedging instruments due to currency basis and the FVOCI reserve of \$1 million which captures changes in the fair value of investments in equity instruments that are measured at fair value through other comprehensive income.

The asset revaluation reserve of \$3 million included in Tier 2 Capital relates to increments and any subsequent decrements arising from the revaluation of property, plant and equipment.

National Australia Bank Limited capital adequacy

The table below shows the capital adequacy ratios based on APRA capital adequacy standards, expressed as a percentage of total risk-weighted assets.

	Ultimate Parent Banking Group		Ultimate Parent Bank	
	Unaudited 30/9/20	Unaudited 30/9/19	Unaudited 30/9/20	Unaudited 30/9/19
	Common Equity Tier 1 Capital ratio	11.47%	10.38%	11.50%
Tier 1 Capital ratio	13.20%	12.36%	13.38%	12.67%
Total Capital ratio	16.62%	14.68%	17.01%	15.14%

The ultimate parent banking group data is the Level 2 capital ratio (as published in the National Australia Bank Limited Pillar 3 report) and represents the consolidation of NAB and all its subsidiary entities, other than the non-consolidated subsidiaries as outlined in the Pillar 3 report.

The ultimate parent bank of the Banking Group is National Australia Bank Limited which reports under the Advanced approach for credit risk (other than for several regulatory prescribed portfolios and some other small portfolios where the standardised approach to credit risk is applied), and the AMA for operational risk. The ultimate parent bank capital ratios are effectively represented by the Level 1 capital ratios, which comprises National Australia Bank Limited and its subsidiary entities approved by APRA as part of the Extended Licensed Entity.

Under prudential regulations, NAB is required to hold capital above the prudential capital ratio ("PCR") and capital conservation buffer as determined by APRA for both the Level 1 and Level 2 Groups. The PCR is prescribed on a bilateral basis, and is not publicly disclosed. National Australia Bank Limited met the minimum capital adequacy requirements set by APRA as at 30 September 2020.

National Australia Bank Limited is required to publicly disclose risk management and capital adequacy information as at the reporting date, as specified in APRA's Prudential Standard APS 330: Public Disclosure ("APS 330"). Updates are provided on a quarterly basis in accordance with the APS 330 reporting requirements.

National Australia Bank Limited's Annual Financial Report and Pillar 3 report, incorporating the requirements of APS 330, can be accessed at www.nab.com.au.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management

Risk Management

Risk exists in all aspects of the Banking Group and the environment in which it operates. Risk is managed through the Banking Group's risk management framework. Forming part of the Banking Group's risk management strategy, this starts with the BNZ Board approved Strategy, Risk Appetite and Financial Plans. Risk appetite is translated and cascaded to the businesses qualitatively (through risk policies, standards and operating procedures) and quantitatively (through the Banking Group's risk limits, settings and decision authorities).

Compliance with the risk management framework is non-negotiable. Risk management accountabilities are allocated for risk ownership and functionally independent oversight and assurance using the Three Lines of Accountability Model as follows:

- first line: Management (who own and manage the risks and controls within their business in line with risk appetite);
- second line: Risk (who establish frameworks and provide insight, oversight and set appetite); and
- third line: Internal Audit (who provide independent assurance).

Bank of New Zealand is primarily regulated by the RBNZ and the Banking Group is subject to the prudential reporting requirements of APRA as part of the NAB Group.

The key risks faced by the Banking Group include:

- credit risk;
- operational risk;
- compliance risk;
- conduct risk;
- regulatory risk;
- strategic risk;
- market risk - trading;
- market risk - non-trading/banking positions; and
- liquidity risk.

Further details regarding the nature and extent of key risks faced by the Banking Group, and how these risks are managed, are outlined as part of this note. Regulatory and strategic risks are managed and overseen as part of the Banking Group's broader corporate governance structure and risk management framework as follows:

Board governance

The Banking Group's corporate governance structure provides guidance for effective decision making in all areas of the Banking Group through:

- strategic and operational planning;
- risk management and compliance;
- financial management and external reporting; and
- succession planning and culture.

The BNZ Board determines the most appropriate corporate governance practices for the Banking Group and is supported by a number of committees. The Board Risk Committee ("BRC") supports the framework for risk management across the Banking Group.

Executive governance

At an executive level, risk is overseen by the Chief Executive Officer ("CEO") through the Risk Return Management Committee ("RRMC"), which leads management in respect of risk matters relating to culture, integrated governance processes, risk strategy and performance.

Internal audit function

The internal audit function is the responsibility of the General Manager Internal Audit who reports to the New Zealand Regional Audit Committee ("NZRAC"), the Managing Director and CEO of BNZ, the Chief Financial Officer of BNZ and to the Executive General Manager, NAB Group Audit. Audits are conducted using a risk-based approach to assess key business risks and internal control systems.

NZRAC assists the BNZ Board to fulfil its statutory and fiduciary responsibilities relating to accounting and financial controls, reporting systems and processes of the Banking Group and to oversee the internal audit function.

External auditor and credit rating agencies

As part of their work in issuing an auditor's independent review report on the Banking Group's six month Disclosure Statement or an auditor's independent audit report on the Banking Group's year end Disclosure Statement, the Banking Group's external auditor, Ernst & Young, may review parts of the Banking Group's risk management framework that impact significant aspects of the financial systems, to the extent necessary to form their independent review or audit opinion.

Credit rating agencies also conduct periodic reviews of the Banking Group's risk management approach and risk profile.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Credit risk

Credit risk is the risk that a customer will fail to meet its obligations to the Banking Group in accordance with agreed terms. Credit risk arises from both the Banking Group's lending activities and markets and trading activities.

Bank lending activities account for most of the Banking Group's credit risk, however other sources of credit risk also exist throughout the Banking Group. These activities include the banking book, the trading book, and other financial instruments and loans, as well as in the extension of commitments and guarantees and the settlement of transactions.

The Banking Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to existing or potential counterparties or customers, groups of related counterparties or groups of related customers, and to geographical and industry segments. Such risks are monitored on an ongoing basis and are subject to an annual or more frequent review.

Administration of the Banking Group's credit policies and procedures is the responsibility of the Risk division of the Banking Group. All loans are subject to a customer rating which estimates the probability of default derived from historical default data. There are monitoring procedures and systems in place to control exposures to individual customers, geographical and industry segments to ensure diversification and asset quality are maintained. Exposure to any one customer is further restricted by sub-limits covering on and off-balance sheet exposures, and daily settlement risk limits in relation to trading items such as forward foreign exchange contracts. Actual exposures against limits are monitored on a daily basis. Individual lending authorities are allocated according to demonstrated skills, accreditation and experience. Consequences are in place for any breaches of these authorities.

Exposure to credit risk is managed through regular analysis of the ability of existing or potential counterparties, customers, groups of related counterparties or groups of related customers to meet interest and capital repayment obligations and by changing limits where appropriate. Exposure to credit risk is also managed in part by obtaining collateral and corporate and personal guarantees.

The Banking Group continuously monitors its credit risk to counterparties through the examination of key risk indicators such as irregular or delinquent accounts and early warning signals. In addition, the Strategic Business Services unit has specific responsibility for the management of accounts classified as categorised assets. These processes enable credit impairments to be identified at the earliest possible time. Credit impairment provisions are raised based on an expected credit loss model in line with the requirements of NZ IFRS 9. Recoverable amounts for impaired assets take into account the current market value of collateral held and the realisability of securities.

Certain borrowers are currently unable to meet their contractual payment obligations because of the effects of the COVID-19 pandemic and the Banking Group currently expects that an increased number and amount of the Banking Group's loans will experience ratings downgrades, credit deterioration and defaults in many industries.

In general, the Group does not take possession of collateral it holds as security or call on other credit enhancements that would result in recognition of an asset on the balance sheet. The following section discloses the Bank's policies and procedures for collateral taken to mitigate credit risk.

Cash and liquid assets

Cash and liquid assets consists of cash, transaction balances with central banks and other institutions and reverse repurchase agreements. Reverse repurchase agreements are collateralised with highly liquid securities which are permitted to be sold or re-pledged. The fair values of this collateral is disclosed in note 8.

Due from central banks and other institutions

The balance of due from central banks and other institutions comprises primarily of collateral to meet standard derivative trading obligations. Balances held with central supervisory banks and other interest bearing assets that are due from other banks are managed based on the counterparty's creditworthiness. The Banking Group will utilise master netting arrangements where possible to reduce its exposure to credit risk.

Trading securities

The Banking Group may utilise credit derivatives, guarantees provided by central banks or other forms of credit enhancements or collateral in order to minimise the Banking Group's exposure to credit risk.

Derivative financial instruments

The Banking Group uses documentation including ISDA Master Agreements to document derivative activities. Under the ISDA Master Agreements, if a counterparty defaults, all contracts with that counterparty are terminated. They are then settled on a net basis at market rates current at the time of settlement. The Banking Group also executes Credit Support Annexures in conjunction with ISDA Master Agreements.

Credit risk from over-the-counter derivatives is mitigated where possible through netting arrangements whereby derivative assets and liabilities with the same counterparty can be offset in certain circumstances. Derivatives that are cleared through a central clearing counterparty or an exchange have less credit risk than over-the-counter derivatives and are subject to relevant netting and collateral agreements.

Gross loans and advances to customers

The majority of Gross loans and advances to customers comprise general lending and line of credit products. The distinction in classification is reflective of the type of lending product. These lending and line of credit products will generally have a significant level of collateralisation depending on the nature of the product.

Credit card outstandings are mostly unsecured. However, where the borrower has provided collateral for other lending, the collateral can also be available to secure any credit card debt.

Housing loans are secured by mortgages over residential properties. LVR thresholds range up to, or exceed 100% in limited circumstances, including remediation of damaged properties that are held by the Banking Group as security. Further details on LVR are provided in note 35.

Overdrafts and Other term lending to non-retail customers are mostly secured by acceptable collateral (highly rated investment grade institutional clients may borrow on an unsecured basis). Collateral generally comprises commercial or agricultural properties, business assets, inventories, and in some cases personal assets of the borrower (e.g. residential properties). The Banking Group manages its exposure to these products by completing a credit evaluation to assess the customer's character, industry, business model and capacity to meet their commitments. Collateral provides a secondary source of repayment in the event that a customer cannot meet its contractual repayment obligations.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Credit risk *continued*

Amounts due from related entities

Depending on the nature of the transaction entered into, collateral may be taken to secure such exposures.

Concentrations of credit exposure

The table below presents the maximum exposure to credit risk of financial assets before taking into account any collateral held or other credit enhancements. Except for derivative financial instruments, the majority of the overseas credit exposures are raised for New Zealand based assets funded in New Zealand dollars for offshore customers.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Maximum exposure to credit risk		
Cash and liquid assets	3,751	2,574
Due from central banks and other institutions	782	1,434
Trading securities	10,814	7,267
Derivative financial instruments	6,140	7,616
Gross loans and advances to customers	88,849	88,490
Amounts due from related entities	1,053	615
Total on-balance sheet credit exposures	111,389	107,996
Off-balance sheet credit exposures	14,115	13,260
Total maximum exposure to credit risk	125,504	121,256

The Banking Group's concentrations of credit exposure are reported by industry sector and geographical location in the table below. The concentrations of credit exposure by industry sector is based on Australian and New Zealand Standard Industrial Classification ("ANZSIC") codes. The concentrations of credit exposure by geographical location are based on the geographical location of the counterparty's tax residency.

Dollars in Millions	Consolidated			Consolidated		
	On-balance sheet 30/9/20	Off-balance sheet ¹ 30/9/20	Total exposure 30/9/20	On-balance sheet 30/9/19	Off-balance sheet ^{1,3} 30/9/19	Total exposure 30/9/19
Concentration by industry						
Agriculture	14,056	906	14,962	15,046	910	15,956
Forestry and fishing	980	233	1,213	1,069	250	1,319
Mining	403	213	616	498	160	658
Manufacturing	3,315	1,840	5,155	3,752	1,814	5,566
Electricity, gas and water	1,221	669	1,890	1,076	655	1,731
Construction	1,056	741	1,797	1,302	611	1,913
Wholesale and retail trade	3,242	1,437	4,679	3,731	1,168	4,899
Accommodation, restaurants, culture and recreation	1,516	424	1,940	1,465	414	1,879
Transport and storage	2,077	947	3,024	2,286	870	3,156
Communications	397	299	696	383	230	613
Financial, investment and insurance	10,450	1,522	11,972	11,085	1,283	12,368
Property, business and personal services	10,763	1,765	12,528	11,414	1,942	13,356
Government, education, health and community services	11,650	1,196	12,846	7,250	1,160	8,410
Real estate - mortgage	45,850	1,900	47,750	42,883	1,770	44,653
Personal lending	1,064	23	1,087	1,385	23	1,408
Related entities ²	3,349	-	3,349	3,371	-	3,371
Total credit exposures by industry	111,389	14,115	125,504	107,996	13,260	121,256
Concentration by geography						
New Zealand	104,328	13,850	118,178	100,126	12,948	113,074
Overseas	7,061	265	7,326	7,870	312	8,182
Total credit exposures by geography	111,389	14,115	125,504	107,996	13,260	121,256

¹ Off-balance sheet credit exposures include contingent liabilities and irrevocable commitments to extend credit.

² Related entities include amounts due from related entities and derivative financial assets with related entities.

³ Comparative information has been restated due to a data capture error.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Credit risk exposures by risk grade

The table below shows significant exposures to credit risk to which the expected credit loss model is applied, for recognised and unrecognised financial assets at amortised cost, based on the following risk grades:

- Senior investment grade: broadly corresponds with Standard & Poor's ratings of AAA to A- (internal rating 1 to 5);
- Investment grade: broadly corresponds with Standard & Poor's ratings of BBB+ to BBB- (internal rating 6 to 11);
- Sub-investment grade: broadly corresponds with Standard & Poor's ratings of BB+ (internal rating 12 to 23); and
- Default: broadly corresponds with Standard & Poor's rating of D (internal rating 98 to 99).

Dollars in Millions	Consolidated (30/9/20)			Total
	Loans and advances and loan commitments for which the loss allowance is measured at:			
	12-months ECL	Lifetime ECL Not Credit Impaired	Lifetime ECL Credit Impaired	
Credit risk exposure by risk grade				
Senior investment grade	33,048	58	-	33,106
Investment grade	31,275	4,165	-	35,440
Sub-investment grade	21,129	19,849	-	40,978
Default	-	-	1,159	1,159
Total credit risk exposure by risk grade	85,452	24,072	1,159	110,683
				Consolidated (30/9/19)
Credit risk exposure by risk grade¹				
Senior investment grade	28,879	52	-	28,931
Investment grade	31,595	3,045	-	34,640
Sub-investment grade	25,033	19,340	-	44,373
Default	-	-	1,114	1,114
Total credit risk exposure by risk grade	85,507	22,437	1,114	109,058

¹ Comparative information has been restated due to a data capture error.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Derivatives

The Banking Group maintains appropriate control limits on net open derivative positions (the difference between purchase and sale contracts), by both amount and term. At any one time, the amount subject to risk is limited to the current fair value of instruments that are favourable to the Banking Group (assets where their fair value is positive), which in relation to derivatives is only a small fraction of the contract, or notional values used to express the volume of instruments outstanding. This credit risk exposure is managed as part of the overall lending limits with customers, together with potential exposures from market movements. The requirement for collateral or other security for these instruments is assessed based on the creditworthiness of the counterparty.

Undrawn credit commitments

Undrawn credit commitments represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. The Banking Group is potentially exposed to credit risk for undrawn credit commitments for an amount equal to the total amount undrawn. However, the level of credit risk is mitigated through most commitments to extend credit being contingent upon customers maintaining specific credit standards. The Banking Group monitors the term to maturity of all credit commitments, drawn and undrawn, because longer term commitments generally have a greater degree of credit risk than shorter term commitments.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or external events. This includes legal risk, but excludes strategic risk.

There are reputational implications inherent in the Banking Group's operations due to the range of customers, products and services that the Banking Group provides and the multiple markets and channels these products and services are delivered through.

Operational risk can arise from external events such as biological hazards, climate change, natural disasters or acts of terrorism.

The Banking Group has adopted the NAB Group's Operational Risk Management Framework, which sets out the principles for managing operational risks across the Banking Group. The Banking Group takes a proactive risk-based approach to the identification, assessment, management, reporting, assurance, review and challenge of risks and controls reflecting the Banking Group's risk appetite, strategic objectives and values. This ensures that end-to-end risks and obligations are understood and managed, and that the control environment is fit for purpose. Timely and accurate information on risks, issues and events is provided to enable prompt reporting and sustainable remedial action.

Effective operational risk management within the Banking Group is based upon a three lines of accountability model. The Banking Group's business units are the first line of accountability and are accountable for management of their risks. Review and challenge is provided by the Banking Group's Risk division (second line of accountability) who report to the Banking Group's Chief Risk Officer. Assurance is provided by the internal audit function (third line of accountability).

The primary roles of the Banking Group's Risk division in relation to operational risk are policy making; advisory and support, including monitoring, review and challenge. The team also provides subject matter expertise and additional assistance to business units and identifies systemic trends across the business.

For the year ended 30 September 2020, the Banking Group calculated operational risk capital using the AMA as required by BS2B as well as the standardised approach set out in BS2A, taking the higher of the two.

The operational risk calculations are performed on an aggregate Bank-wide basis, and the resultant capital is allocated across major business lines.

Compliance risk

Compliance risk is the risk of failing to understand and comply with relevant laws, regulations, licence conditions, supervisory requirements, self-regulatory industry codes of conduct and voluntary initiatives.

Compliance risk may also arise from a failure to understand and comply with internal policies, procedures, frameworks and standards that support sustainability and provide protections to the Banking Group's customers. The Banking Group has adopted the NAB Group's Compliance Framework (Compliance Obligation Management Policy) (as appropriate for the Banking Group) which sets out the principles for managing compliance risk across the Banking Group.

The Banking Group has a fundamental duty to obey the law when delivering banking and financial services, and is committed to the fair treatment of customers, and maintaining open, constructive and transparent relationships with the Banking Group's regulators. The Banking Group therefore strives to maintain effective practices for compliance risk management to ensure compliance obligations are met. Timely identification, investigation, escalation, reporting and remediation of any instances of non-compliance is emphasised by the Banking Group.

Conduct risk

Conduct risk is the risk of negative outcomes arising as a result of behaviour or actions of the Banking Group, or those acting on behalf of the Banking Group, that lead to unfair customer, employee, community or other stakeholder outcomes.

Conduct risk is inherent in the Banking Group's business activities and arises from inappropriate, unlawful or unethical judgements, behaviours or actions made during the execution of the Banking Group's business activities.

Conduct Risk is managed by leveraging policies, frameworks, processes and tools used for other material risk types, such as operational risk, compliance risk and regulatory risk, and through the Banking Group's conduct strategy. Governance and oversight of conduct risk and the conduct strategy resides with the Conduct Council, a sub-committee of the Banking Group's RRM. For capital adequacy purposes, conduct risk is part of the calculation of operational risk capital.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Strategy in using financial instruments

By their nature, the Banking Group's activities involve the use of financial instruments. The core activity of the Banking Group is to accept deposits from customers at both fixed and floating rates for various periods, and seek to earn interest margins by investing these funds. The Banking Group also deals in a range of other financial products including derivatives and foreign exchange contracts where the Bank has deemed it has the expertise in the relevant market and infrastructure to support management processes.

Executing this strategy may result in market risk for the Banking Group, which is the risk of financial loss from unfavourable movements in market variables such as interest or foreign exchange rates. The Banking Group may use financial instruments to mitigate this market risk or selectively position for favourable movements in these market variables. The Board places limits on the level of market risk exposure that can be taken from these activities while a comprehensive governance structure is in place to ensure compliance with the Banking Group's risk appetite. This includes independent risk oversight teams which provide oversight over the Banking Group's market risk exposures and escalate any limit breaches.

The Banking Group's activities are divided into traded market risk and non-traded market risk. The differences between the two, including the measures used to control the level of market risk exposure, are documented further in this note.

Market risk - traded

Traded market risk is the risk of loss to the trading book from unfavourable movements in market variables such as interest rates or foreign exchange rates. Financial instruments designated as traded market risk include those which:

- are held for short term resale;
- are taken on by the Banking Group with the intention of benefitting in the short term from actual and/or expected differences between their buying and selling prices, or from other price or interest rate variations;
- arose from broking, market making and providing traded product solutions to clients; and
- are hedging a derivative valuation adjustment.

The trading activities of the Banking Group are carried out by BNZ Markets.

The types of market risk arising from these activities include interest rate, foreign exchange, commodity, credit spread and volatility risk.

Independent oversight of the Banking Group's traded market risk, including compliance with limits, is undertaken by the Market risk team, which reports through to the Chief Risk Officer. Governance is provided by the Banking Group's Market Risk Committee, which is a subcommittee of the Banking Group's RRMCM.

All trading activities are subject to the disciplines prescribed in the NAB Group Traded Market Risk Policy which is approved by the NAB Board, and approved by the BNZ Board for adoption by the Banking Group (as appropriate).

Objectives and limitations of the Value at Risk ("VaR") methodology

VaR is an estimate of potential loss resulting from shifts in market variables such as interest rates, foreign exchange rates, traded credit spreads, option volatility and commodity prices. The estimate is calculated on an entire trading portfolio basis, which includes all financial instruments and derivatives.

VaR is calculated using the historical simulation method. This method involves multiple revaluations of the trading books using two years of historical pricing shifts. The pricing data is updated daily so as to have the most recent two-year history of prices. The results are ranked and the loss at the 99th percentile confidence level identified. The calculation and rate shifts used assume a one day holding period for all positions. This means the model estimates there is a 99% chance that the loss will not exceed the VaR estimate on any given day.

The use of a VaR methodology has limitations, which include:

- the historical data used to calculate VaR is not always an appropriate proxy for current market conditions. If market volatility or correlation conditions change significantly, losses may occur more frequently and to a greater magnitude than the VaR measure suggests;
- the VaR methodology assumes that positions are held for one day and may underestimate losses on positions that cannot be hedged or reversed inside that timeframe;
- VaR is calculated on positions at the close of each trading day, and does not measure risk on positions taken and closed before the end of each trading session; and
- VaR does not describe the directional bias or size of the positions generating the risk.

VaR estimates are checked against profit/loss via backtesting for reasonableness and to assess the continued relevance of the model assumptions.

The following table shows the Banking Group VaR for the trading portfolio, including both physical and derivative positions:

Dollars in Millions	Consolidated							
	As At		Average Value During Year		Minimum Value During Year		Maximum Value During Year	
	30/9/20	30/9/19	30/9/20	30/9/19	30/9/20	30/9/19	30/9/20	30/9/19
VaR at a 99% confidence level								
Foreign exchange risk	1.85	1.46	1.25	0.72	0.02	0.06	3.31	2.55
Interest rate risk	4.06	1.13	2.33	1.52	0.70	0.51	6.37	2.49
Volatility risk	-	0.01	0.01	0.01	-	-	0.03	0.02
Credit spread risk	0.47	0.32	0.37	0.24	0.18	0.15	0.77	0.33
Diversification benefit	(1.67)	(1.31)	(1.15)	(0.85)	N/A	N/A	N/A	N/A
Total VaR for physical and derivative positions	4.71	1.61	2.81	1.64	1.12	0.79	6.22	2.66

VaR is measured individually for foreign exchange risk, interest rate risk, volatility, commodities and credit spread risk.

Due to the limitations of the measure, VaR is supplemented with stress testing which is reported daily and also by other measures such as foreign exchange limits, basis point sensitivity limits, stop loss limits, and profit/loss referral levels.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Foreign exchange risk

Foreign exchange and translation risk arise from the impact of currency movements on the value of the Banking Group's cash flows, profits and losses and assets and liabilities due to participation in global financial markets and international operations.

Foreign exchange limits are in place to control the level of foreign currency exposure run by the Banking Group. This exposure is measured by calculating the net present value position of the products the Banking Group deals in which are denominated in a non-New Zealand dollar currency. This includes foreign currency loans and deposits, foreign currency cash balances and the trading of foreign currency denominated products, such as spot and forward contracts, currency options, foreign currency interest rate derivatives and foreign currency securities.

An analysis of the net open position by currency is shown in the following table. The net open position in each currency represents the net of the non-derivative assets and liabilities in that currency aggregated with the net expected cash flows from derivative financial instrument purchases and sales from foreign exchange transactions in that currency including foreign currency options and futures and the principal on currency swaps. The amounts are stated in New Zealand dollar equivalents translated using the spot exchange rates as at the reporting date.

Net open position

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
US dollar	(3)	6
Australian dollar	(9)	(14)
Japanese yen	6	2
Pound sterling	1	1
Euro	(1)	(5)
Swiss franc	-	1
Hong Kong dollar	(3)	(4)
Other	3	3

Market risk - non-traded/banking positions

Non-traded market risk includes all market risks which are not designated as traded market risk. Non-traded market risk largely consists of structural interest rate risk in the balance sheet arising from loans and deposits.

Non-traded market risk also includes funding and liquidity risk.

Non-traded market risk policies are approved by the National Australia Bank Limited Board of Directors ("NAB Board"), with the NAB Group Liquidity Policy and the NAB Group Capital Policy approved by the BNZ Board for adoption by the Banking Group (as appropriate).

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Interest rate risk

Interest rate risk is the risk of the Banking Group's market operations and trading activities being exposed to changes in the value of securities and derivatives as a result of changes in interest rates.

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the fair value of a financial instrument will fluctuate because of changes in market interest rates.

Interest rate risks primarily result from exposures to changes in the level, slope and curvature of the yield curve, the volatility of interest rates, mortgage prepayment speeds and credit spreads. The Banking Group has exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Exposure to interest rate risk arises in respect of the following activities: borrowing from and lending to customers; borrowing to fund the Banking Group in both domestic and international wholesale debt markets; transacting in money market instruments such as government stock, bank bills, and commercial paper; foreign exchange instruments such as foreign exchange contracts; and derivative financial instruments such as swaps, options and futures.

Interest rate risk for non-traded market risk is measured, managed and monitored using VaR and Earnings at Risk ("EaR") limits, complemented by cash flow analysis, basis point sensitivity and stress testing limits.

Similar to the methodology applied for traded market risk, VaR is calculated using the historic simulation method. Due to the generally longer holding period for non-traded products, the parameters applied differ. The key parameters for measuring non-traded market risk are as follows:

- 99% confidence level;
- three-month holding period;
- six years of historical data;
- rate changes are absolute rather than proportional;
- investment term for capital is two years; and
- investment term for core "Non-Interest Bearing" liabilities (the sum of low and non-interest rate bearing liabilities) is five years.

EaR is the potential accrual income loss over the next 12 months (the forecast period). VaR exposures are measured and reported weekly while EaR exposures are measured and reported monthly.

The table below shows the aggregate VaR figures for non-traded market risk:

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
VaR for physical and derivative positions at a 99% confidence level		
New Zealand		
As at end of year	52	23
Average value during year ended	33	16
Minimum value during year ended	22	7
Maximum value during year ended	52	27

The table below shows the aggregate EaR figures for non-traded market risk:

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
EaR for physical and derivative positions at a 99% confidence level		
New Zealand		
As at end of year	14	8
Average value during year ended	9	6
Minimum value during year ended	4	3
Maximum value during year ended	14	9

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Interest rate repricing schedule

The following tables represent a breakdown of the balance sheet by repricing dates or contractual maturity, whichever is the earlier. As interest rates and yield curves change over time, the Banking Group may be exposed to a loss in earnings due to the characteristics of the assets and their corresponding liability funding. These mismatches are actively managed as part of the overall interest rate risk management process. In managing the structural interest rate risk, the primary objectives are to limit the extent to which net interest income could be impacted from an adverse movement in interest rates and to maximise shareholder's earnings.

Dollars in Millions	Consolidated (30/9/20)						
	Total	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
Assets							
Cash and liquid assets	3,933	3,587	-	-	-	-	346
Due from central banks and other institutions	782	769	13	-	-	-	-
Trading securities	10,814	2,826	1,059	839	954	5,136	-
Derivative financial instruments	6,140	-	-	-	-	-	6,140
Gross loans and advances to customers	88,849	48,662	4,970	15,572	14,111	3,527	2,007
Deductions from loans and advances to customers	(700)	-	-	-	-	-	(700)
Amounts due from related entities	1,053	1,038	-	-	-	-	15
All other assets	1,439	-	-	-	-	-	1,439
Total assets	112,310	56,882	6,042	16,411	15,065	8,663	9,247
Liabilities							
Due to central banks and other institutions	2,820	2,703	9	25	26	57	-
Trading liabilities	54	-	-	-	-	54	-
Derivative financial instruments	4,711	-	-	-	-	-	4,711
Deposits and other borrowings	71,841	44,168	9,666	5,839	2,498	967	8,703
Bonds and notes	19,512	928	1,488	2,300	2,505	12,291	-
Amounts due to related entities	1,903	1,739	-	-	-	-	164
Subordinated debt	1,949	1,049	-	-	900	-	-
All other liabilities	863	-	-	-	-	-	863
Total liabilities	103,653	50,587	11,163	8,164	5,929	13,369	14,441
Shareholder's equity							
Total shareholder's equity	8,657	-	-	-	-	-	8,657
Total liabilities and shareholder's equity	112,310	50,587	11,163	8,164	5,929	13,369	23,098
On-balance sheet sensitivity gap	-	6,295	(5,121)	8,247	9,136	(4,706)	(13,851)
Derivative financial instruments							
Net hedging derivative notionals	-	(7,699)	6,642	(4,438)	(3,839)	9,334	-
Interest sensitivity gap - net	-	(1,404)	1,521	3,809	5,297	4,628	(13,851)

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Interest rate repricing schedule *continued*

Dollars in Millions	Total	Consolidated (30/9/19)					Over 2 Years	Non- Interest Bearing
		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		
Assets								
Cash and liquid assets	2,740	2,483	-	-	-	-	-	257
Due from central banks and other institutions	1,434	1,422	12	-	-	-	-	-
Trading securities	7,267	2,330	689	636	379	3,233	-	-
Derivative financial instruments	7,616	-	-	-	-	-	-	7,616
Gross loans and advances to customers	88,490	49,925	5,609	10,793	13,482	6,843	-	1,838
Deductions from loans and advances to customers	(449)	-	-	-	-	-	-	(449)
Amounts due from related entities	615	601	-	-	-	-	-	14
All other assets	1,399	-	-	-	-	-	-	1,399
Total assets	109,112	56,761	6,310	11,429	13,861	10,076	-	10,675
Liabilities								
Due to central banks and other institutions	1,833	1,691	11	89	10	24	-	8
Trading liabilities	91	-	-	23	-	68	-	-
Derivative financial instruments	6,106	-	-	-	-	-	-	6,106
Deposits and other borrowings	67,968	40,072	13,479	5,807	1,175	1,167	-	6,268
Bonds and notes	21,121	3,279	802	650	3,847	12,543	-	-
Amounts due to related entities	838	660	-	-	-	-	-	178
Subordinated debt	1,948	500	-	-	548	900	-	-
All other liabilities	1,274	-	-	-	-	-	-	1,274
Total liabilities	101,179	46,202	14,292	6,569	5,580	14,702	-	13,834
Shareholder's equity								
Total shareholder's equity	7,933	-	-	-	-	-	-	7,933
Total liabilities and shareholder's equity	109,112	46,202	14,292	6,569	5,580	14,702	-	21,767
On-balance sheet sensitivity gap	-	10,559	(7,982)	4,860	8,281	(4,626)	-	(11,092)
Derivative financial instruments								
Net hedging derivative notionals	-	(10,685)	8,294	(2,614)	(3,336)	8,341	-	-
Interest sensitivity gap - net	-	(126)	312	2,246	4,945	3,715	-	(11,092)

Equity risk

Equity risk results from exposures to changes in the price of individual equities, equity baskets and equity indices. Management reviews the Banking Group's exposure to any equity risk on a monthly basis.

Liquidity risk

Liquidity risk is the risk that the Banking Group is unable to meet its financial obligations as they fall due. These obligations include the repayment of deposits on demand or at their contractual maturity, the repayment of wholesale borrowings and loan capital as they mature, the payment of interest on borrowings and the payment of operational expenses and taxes. The liquidity associated with financial markets can be reduced substantially as a result of external economic or market events, market size or the actions of individual participants.

Maintaining adequate liquidity to meet current and future payment obligations at a reasonable cost is a core objective of the Banking Group. The Banking Group must also comply with APRA prudential and regulatory liquidity obligations as part of the NAB Group.

The following are types of liquidity risks:

- Intra-Day: Ability of the Banking Group to meet its intra-day collateral requirements in relation to its clearing and settlement obligations;
- Operational: Ability of the Banking Group to meet its refinancing requirements for a predefined period, e.g. up to 30 days; and
- Structural: Liquidity risk profile of the balance sheet to accommodate the Banking Group's strategic plan and risk appetite.

The Banking Group manages liquidity risk through a combination of positive cash flow management, the maintenance of portfolios containing high quality liquid assets and maintenance of a prudent funding strategy. The Banking Group undertakes a conservative approach by imposing internal limits that are in addition to regulatory requirements.

Independent oversight of the Banking Group's non-traded market risk, including compliance with limits, is undertaken by the Balance Sheet and Liquidity risk team, which reports through to the Chief Risk Officer. Governance is provided by the Banking Group's Asset, Liability and Capital Committee ("ALCCO"), which is a subcommittee of the Banking Group's RRMC.

The BNZ Board has the ultimate responsibility to monitor and review the adequacy of the Banking Group's liquidity compliance and management framework, with the guidance of the Banking Group's BRC. To aid in the fulfilment of its guidance responsibilities, the BRC receives recommendations from the RRMC and regular reports on the Banking Group's liquidity management activity, risk limits and sensitivity metrics. ALCCO is responsible for approval and providing overview of the execution of the liquidity strategy and escalation of issues to RRMC.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Liquidity risk *continued*

The Banking Group is subject to RBNZ's liquidity requirements (as set out in the RBNZ's Liquidity Policy (BS13/BS13A) ("BS13")). Consistent with the requirements of BS13, liquidity risk is measured and managed in the Banking Group on a cash flow mismatch and also core funding basis to ensure that the Banking Group exceeds RBNZ's specified minimum standards for these metrics. The Banking Group is required to monitor both 'one week' and 'one month' mismatches. Cash flow mismatch limits have been established to limit the Banking Group's exposure in these time buckets. The Banking Group maintains an Internal Liquidity Adequacy Assessment framework that meets the requirements set out in BS13.

The Banking Group also complies with APRA's prudential liquidity standard APS 210 "Liquidity" ("APS 210") as a member of NAB. In accordance with the requirements of APS 210, the Banking Group also measures and manages its funding and liquidity risk based on the Liquidity Coverage Ratio ("LCR"), and Net Stable Funding ratio ("NSFR") methodologies.

LCR is a Basel III requirement, which requires a bank to hold sufficient high quality liquid assets to cover its total net cash outflows over a 30 day period. NSFR was introduced on 1 January 2018 and requires a bank to maintain a stable funding position to support the composition of its assets and off-balance sheet activities.

The ability to realise assets quickly is an important source of liquidity for the Banking Group. The Banking Group holds sizeable balances of high quality assets such as cash and securities that are acceptable under repurchase agreements with the RBNZ to meet these needs.

A three-level contingency funding plan has been established for the management of an escalated liquidity event where the Banking Group experiences either restricted access to wholesale funding, or a large increase in the withdrawal of funds. The plan identifies triggers at each level, details the actions required, allocates the key tasks to individuals, provides timeframes and defines a management committee to oversee the action plan.

Maturity profile

The tables on pages 76 and 77 present the Banking Group's cash flows by remaining contractual maturities as at the reporting date.

The gross cash flows disclosed hereafter are the contractual undiscounted cash flows and include both principal and associated future interest payments and therefore will not agree to the carrying values on the balance sheet. Actual cash flows can differ significantly from contractual cash flows as a result of future actions of the Banking Group and its counterparties. Off-balance sheet exposures are excluded from the tables below as contractual cash flows, if any, are contingent in nature. Irrevocable commitments to extend credit can be drawn down at any time before the commitments expire. Details of off-balance sheet exposures are included in note 30. Other assets and other liabilities only include balances which have contractual future cash flows.

Dollars in Millions	Consolidated (30/9/20)					Total Inflow/ (Outflow)
	On Demand	3 Months or less	3 to 12 Months	1 to 5 Years	Over 5 Years	
Assets						
Cash and liquid assets	2,934	999	-	-	-	3,933
Due from central banks and other institutions	-	770	13	-	-	783
Trading securities	-	2,627	2,085	4,456	1,698	10,866
Loans and advances to customers	5,318	18,585	12,778	27,166	48,872	112,719
Amounts due from related entities	15	1,038	-	-	-	1,053
Other assets	-	402	-	-	-	402
Total	8,267	24,421	14,876	31,622	50,570	129,756
Liabilities						
Due to central banks and other institutions	(1,284)	(1,420)	(34)	(85)	-	(2,823)
Trading liabilities	-	-	(1)	(8)	(51)	(60)
Deposits and other borrowings	(37,528)	(15,392)	(15,715)	(3,575)	-	(72,210)
Bonds and notes	-	(274)	(4,445)	(14,244)	(659)	(19,622)
Amounts due to related entities	(433)	(1,471)	-	-	-	(1,904)
Other liabilities	-	(195)	(36)	(152)	(79)	(462)
Subordinated debt	-	(9)	(35)	(1,238)	(1,090)	(2,372)
Total	(39,245)	(18,761)	(20,266)	(19,302)	(1,879)	(99,453)
Derivative financial liabilities¹						
Derivative financial liabilities inflow	-	33,014	13,598	23,226	4,947	74,785
Derivative financial liabilities (outflow)	-	(35,004)	(17,037)	(32,463)	(7,034)	(91,538)

¹ Derivative financial liabilities include hedging and trading derivative cash flows.

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Maturity profile *continued*

Dollars in Millions	Consolidated (30/9/19)					Total Inflow/ (Outflow)
	On Demand	3 Months or less	3 to 12 Months	1 to 5 Years	Over 5 Years	
Assets						
Cash and liquid assets	2,144	597	-	-	-	2,741
Due from central banks and other institutions	-	1,421	13	-	-	1,434
Trading securities	-	2,032	1,424	2,634	1,414	7,504
Loans and advances to customers	6,895	18,317	12,456	28,643	49,401	115,712
Amounts due from related entities	30	585	-	-	-	615
Other assets	-	595	-	-	-	595
Total	9,069	23,547	13,893	31,277	50,815	128,601
Liabilities						
Due to central banks and other institutions	(910)	(788)	(102)	(37)	-	(1,837)
Trading liabilities	-	(1)	(24)	(8)	(75)	(108)
Deposits and other borrowings	(27,695)	(16,053)	(22,335)	(2,490)	-	(68,573)
Bonds and notes	-	(1,282)	(3,048)	(15,524)	(1,809)	(21,663)
Amounts due to related entities	(342)	(497)	-	-	-	(839)
Other liabilities ¹	-	(632)	-	-	-	(632)
Subordinated debt	-	(12)	(41)	(2,246)	-	(2,299)
Total	(28,947)	(19,265)	(25,550)	(20,305)	(1,884)	(95,951)
Derivative financial liabilities²						
Derivative financial liabilities inflow	-	41,073	14,920	20,299	5,641	81,933
Derivative financial liabilities (outflow)	-	(43,810)	(18,179)	(29,273)	(8,053)	(99,315)

¹ Comparative balances have been restated due to an overstatement of accrued interest in Other liabilities.

² Derivative financial liabilities include hedging and trading derivative cash flows.

Liquidity portfolio management

The table below shows financial assets held by the Banking Group for the purpose of managing liquidity risk.

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Cash and balances immediately convertible to cash ¹	2,944	2,238
Net securities purchased under agreements to resell	269	935
Government bonds, notes and securities	6,167	2,498
Semi-government bonds, notes and securities	2,949	2,850
Corporate and other institution bonds, notes and securities	1,698	1,919
Total liquidity portfolio	14,027	10,440

¹ Included within Cash and balances immediately convertible to cash is \$10 million due from other institutions (30 September 2019: \$96 million)

As at 30 September 2020, the Banking Group also held RMBS of \$9,000 million (30 September 2019: \$6,500 million) of which \$8,400 million (30 September 2019: \$6,240 million) is eligible to be sold to the RBNZ under agreements to repurchase for liquidity purposes. The amount of \$8,400 million is subject to a 19% reduction in value and a 4% limit on the Banking Group's total assets giving a net balance of \$4,650 million (30 September 2019: \$4,269 million). These RMBS are secured by housing loans and other assets. Refer to note 28 for further information. The Banking Group has entered into repurchase agreements with the RBNZ with a value of \$42 million as at 30 September 2020 (30 September 2019: nil), to support lending under the BFGS announced by the New Zealand Government as part of the COVID-19 support measures. The underlying collateral accepted by the RBNZ are RMBS to the value of \$50 million as at 30 September 2020 (30 September 2019: nil).

Additional RBNZ facilities

As part of the COVID-19 support measures, on 20 March 2020 the RBNZ announced that it would provide term funding through a Term Auction Facility to give banks the ability to access term funding using repurchase agreements with qualifying collateral for a term of up to twelve months. On 11 November 2020, the RBNZ also announced details of its Funding for Lending Programme ("FLP") aimed at lowering the cost of borrowing for New Zealand businesses and households. The FLP will allow eligible participants to access three-year floating interest rate funding at the prevailing Official Cash Rate within 18 months for an initial allocation of 4% of eligible loans, with a further six months for an additional allocation of 2% of eligible loans, using qualifying collateral. The RBNZ expects to implement the FLP in early December 2020.

Regulatory liquidity ratios

The table below shows the three-month average of the respective daily ratio values in accordance with the RBNZ's Liquidity Policy (BS13/BS13A) ("BS13") and the Bank's Conditions of Registration relating to liquidity-risk management.

The one-week mismatch ratio is a measure of the Bank's one-week mismatch amount over its total funding, where the one-week mismatch amount represents the Bank's portfolio of primary liquid assets plus expected cash inflows minus expected cash outflows during a one-week period of stress. The Bank is required to maintain this ratio above a minimum level of zero percent on a daily basis. The one-week mismatch ratio = 100 x (one-week mismatch dollar amount / total funding).

Notes to and Forming Part of the Financial Statements

Note 36 Risk Management *continued*

Regulatory liquidity ratios *continued*

The one-month mismatch ratio is a measure of the Bank's one-month mismatch amount over its total funding, where the one-month mismatch amount represents the Bank's stock of primary and secondary liquid assets plus expected cash inflows minus expected cash outflows during a one-month period of stress. The Bank must maintain this ratio above a minimum level of zero percent on a daily basis. The one-month mismatch ratio = 100 x (one-month mismatch dollar amount / total funding).

The one-year core funding ratio measures the extent to which loans and advances are funded by funding that is considered stable. The one-year core funding ratio = 100 x (one-year core funding dollar amount / BS13 total loans and advances) and must currently remain above 75 percent on a daily basis. On 2 April 2020, the RBNZ reduced the one-year core funding ratio requirement from not less than 75% to not less than 50%.

	Consolidated	
	Unaudited For the 3 months ended 30/9/20	Unaudited For the 3 months ended 30/6/20
One-week mismatch ratio	5.1%	7.2%
One-month mismatch ratio	6.3%	7.6%
One-year core funding ratio	89.2%	88.8%

Concentrations of funding

The Banking Group's concentrations of funding is reported by industry sector and geographical location in the following table. The concentrations of funding by industry sector is based on ANZSIC codes. The concentrations of funding by geographical location is based on the principal market location of the funding programmes.

Dollars in Millions	Note	Consolidated	
		30/9/20	30/9/19
Concentration by industry			
Customer deposits			
Agriculture, forestry and fishing		2,964	2,857
Mining		224	244
Manufacturing		2,086	1,584
Electricity, gas and water		86	61
Construction		1,303	1,080
Wholesale and retail trade		2,532	1,983
Accommodation, restaurants, culture and recreation		1,432	1,168
Transport and storage		1,013	1,062
Communications		324	360
Financial, investment and insurance		7,623	8,021
Property, business and personal services		12,055	11,024
Government, education, health and community services		3,003	3,021
Personal deposits		32,935	30,600
Total customer deposits by industry		67,580	63,065
Concentration by geography			
Wholesale funding			
New Zealand		10,147	9,006
Overseas ¹		20,298	21,637
Total wholesale funding by geography		30,445	30,643
Total funding		98,025	93,708
Total funding comprised:			
Customer deposits	19	67,580	63,065
Wholesale funding			
Due to central banks and other institutions		2,820	1,833
Other borrowings	19	4,261	4,903
Bonds and notes		19,512	21,121
Amounts due to related entities		1,903	838
Subordinated debt		1,949	1,948
Total wholesale funding		30,445	30,643
Total funding		98,025	93,708

¹This represents the wholesale active funding programmes of BNZ-IF and the Bank from offshore markets.

Notes to and Forming Part of the Financial Statements

Dollars in Millions	Consolidated	
	30/9/20	30/9/19
Note 37 Notes to the Cash Flow Statement		
Reconciliation of net profit attributable to the shareholder of Bank of New Zealand to net cash flows from operating activities		
Net profit attributable to the shareholder of Bank of New Zealand	762	1,022
Decrease/(increase) in accrued interest receivable	25	17
Depreciation and amortisation expense	283	254
Credit impairment charge	300	114
Impairment losses and write offs on non-financial assets	-	13
(Decrease)/increase in provision for tax	(122)	(102)
Unrealised gains less losses on financial instruments	(136)	(33)
(Decrease)/increase in accrued interest payable	(176)	(27)
Decrease/(increase) in other assets	-	(30)
(Decrease)/increase in other liabilities	(83)	7
Gain on equity investments	2	-
Deduct items classified as investing activities included in net profit:		
Gain on sale from disposal of associate	-	(36)
Add back items classified as financing activities included in net profit:		
Payment of lease liabilities	47	-
Deduct operating cash flows not included in net profit:		
Net change in operating assets and liabilities	461	(1,578)
Net cash flows from operating activities	1,363	(379)

Dollars in Millions	Consolidated (30/9/20)				
	Bonds and Notes	Subordinated Debt	Amounts due to Related Entities ¹	Amounts due from Related Entities ¹	Total
Reconciliation of net debt					
Balance at beginning of year	21,121	1,948	473	(11)	23,531
Net cash flows	(1,622)	(1)	(1)	3	(1,621)
Non-cash changes					
Foreign exchange adjustments	(187)	-	-	-	(187)
Fair value adjustments	145	-	-	-	145
Hedge adjustments	64	-	-	-	64
Other non-cash movements	(9)	2	(1)	-	(8)
Balance at end of year	19,512	1,949	471	(8)	21,924
Consolidated (30/9/19)					
Balance at beginning of year	19,760	1,946	303	(14)	21,995
Net cash flows	359	-	170	3	532
Non-cash changes					
Foreign exchange adjustments	458	-	-	-	458
Fair value adjustments	544	-	-	-	544
Hedge adjustments	-	-	-	-	-
Other non-cash movements	-	2	-	-	2
Balance at end of year	21,121	1,948	473	(11)	23,531

¹ Balances at beginning and end of year exclude amounts classified as cash and cash equivalents in the cash flow statement.



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Independent auditor's report to the Shareholder of Bank of New Zealand

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

Opinion

We have audited the consolidated financial statements required by Clause 24 of the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order 2014 (as amended) (the "Order") and the supplementary information required by Schedules 4, 7, 13 to 15 and 17 of the Order of Bank of New Zealand (the "Bank") and the entities it controlled at 30 September 2020 or from time to time during the year (collectively the "Banking Group") as included on pages 8 to 79 of the Disclosure Statement. The consolidated financial statements and supplementary information comprise:

- ▶ the balance sheet of the Banking Group as at 30 September 2020;
- ▶ the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended of the Banking Group;
- ▶ the notes to the consolidated financial statements of the Banking Group including a summary of significant accounting policies; and
- ▶ the supplementary information required by Schedules 4, 7, 13 to 15 and 17 of the Order.

In our opinion, the consolidated financial statements on pages 8 to 79 (excluding the supplementary information disclosed in accordance with Schedules 4, 7, 13 to 15 and 17 of the Order and included within notes 13, 31, 32, 33 and 36) give a true and fair view of the consolidated financial position of the Banking Group as at 30 September 2020 and its consolidated financial performance and cash flows for the year then ended in accordance with New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards.

In our opinion, the supplementary information disclosed in accordance with Schedules 4, 7, 13 to 15 and 17 of the Order and included within notes 13, 31, 32, 33 and 36 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 and any conditions of registration, are in accordance with the books and records of the Banking Group, and fairly states, in all material respects, the matters to which it relates in accordance with those schedules.

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

Basis for opinion

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

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

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

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Ernst & Young provides interim review, other assurance and agreed upon procedure services to the Banking Group. Partners and employees of our firm may deal with the Banking Group on normal terms within the ordinary course of trading activities of the business of the Banking Group. We have no other relationship with, or interest in, the Banking Group.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current year. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements)* section of the audit report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Provision for Credit Impairment

Why significant

As described in Notes 12 *Provision for credit impairment* and 36 *Risk management*, the provision for credit impairment is determined in accordance with New Zealand Equivalent to International Financial Reporting Standard 9 *Financial Instruments* (NZ IFRS 9).

This was a key audit matter due to:

- ▶ the value and timing of the recognition of the provision;
- ▶ the significant impact of COVID-19 and related industry and government responses (for example, deferral programmes and government stimulus packages) on expected credit losses; and
- ▶ the degree of judgment and estimation uncertainty associated with the calculations.

Key areas of judgment included:

- ▶ the application of the impairment requirements under NZ IFRS 9 within the Banking Group's expected credit loss methodology;
- ▶ the identification of exposures with a significant deterioration in credit quality;
- ▶ assumptions used in the expected credit loss model (for exposures assessed on an individual or collective basis); and
- ▶ forward-looking macroeconomic factors, including developing and incorporating macroeconomic scenarios, given the wide range of potential economic outcomes and impacts from COVID-19 that may impact future expected credit losses.

How our audit addressed the key audit matter

We assessed the alignment of the Banking Group's expected credit loss model and its underlying methodology with the requirements of NZ IFRS 9, with consideration of COVID-19 impacts and related industry and government responses.

We assessed the following for exposures evaluated on a collective basis and overlays:

- ▶ significant modelling and macroeconomic assumptions, including the reasonableness of forward-looking information and scenarios;
- ▶ the basis for and data used to determine overlays; and
- ▶ sensitivity of the collective provisions to changes in modelling assumptions.

We involved our actuarial specialists to test the mathematical accuracy of the model and to consider key assumptions.

We examined a sample of exposures assessed on an individual basis by:

- ▶ assessing the reasonableness and timeliness of internal credit quality assessments based on the borrowers' particular circumstances; and
- ▶ evaluating the associated provisions by assessing the reasonableness of key inputs into the calculation, with particular focus on the impact of COVID-19 on high-risk industries, work out strategies, collateral values, and the value and timing of recoveries.



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In conjunction with our IT specialists, we assessed the effectiveness of relevant controls relating to the:

- ▶ capture of data, including loan origination and transactional data, ongoing internal credit quality assessments, storage of data in data warehouses, and interfaces with the models; and
- ▶ expected credit loss models, including functionality, model governance and validation and ongoing monitoring.

We considered the adequacy and appropriateness of the disclosures related to credit impairment within the consolidated financial statements.

Information Technology (IT) systems and controls over financial reporting

Why significant

A significant part of the Banking Group's financial reporting process is primarily reliant on IT systems with automated processes and controls relating to the capture, storage and extraction of information.

A fundamental component of these IT controls is ensuring that risks relating to inappropriate user access management, unauthorised program changes and IT operating protocols are appropriately addressed.

How our audit addressed the key audit matter

We focused on those IT systems and controls that are significant to the Banking Group's financial reporting process.

We involved our IT specialists, as audit procedures over IT systems and controls require specific expertise.

We assessed the design and tested the operating effectiveness of the Banking Group's IT controls, including those related to user access management, program change management and data integrity.

Where we identified design and/or operating deficiencies in the IT control environment, our procedures included the following:

- ▶ extending our testing to validate the integrity and reliability of the associated systems, data and reporting as it relates to financial reporting.
- ▶ where automated procedures were supported by systems with identified deficiencies, extending our procedures to test alternative controls and performing additional testing of the resulting data and financial statement balances.



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

The directors of the Bank are responsible for the Disclosure Statement, which includes information other than the consolidated financial statements, the supplementary information required by Schedules 4, 7, 13 to 15 and 17 of the Order and our auditor's report.

Our opinion on the consolidated financial statements and supplementary information does not cover the other information and we do not express any form of assurance conclusion thereon except as otherwise stated.

In connection with our audit of the consolidated financial statements and supplementary information, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or supplementary information or our knowledge obtained during the audit, or otherwise appears to be materially misstated.

If, based upon the work we have performed, 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.

Directors' responsibilities for the consolidated financial statements and supplementary information (excluding supplementary information relating to capital adequacy and regulatory liquidity requirements)

The directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the consolidated financial statements in accordance with Clause 24 of the Order, New Zealand equivalents to International Financial Reporting Standards and International Financial Reporting Standards, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In addition, the directors are responsible, on behalf of the Bank, for the preparation and fair presentation of the supplementary information in the Disclosure Statement which complies with Clause 24 and Schedules 2, 4, 7, 13 to 15 and 17 of the Order.

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

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

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole and the supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 35 and 36) disclosed in accordance with Clause 24 and Schedules 4, 7, 13 to 15 and 17 of the Order are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (New Zealand) 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 consolidated financial statements.

A further description of the auditor's responsibilities for the audit of the financial statements is located at the External Reporting Board's website: <https://www.xrb.govt.nz/standards-for-assurance-practitioners/auditors-responsibilities/audit-report-1/>. This description forms part of our auditor's report.

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

We also report in accordance with the requirements of Clauses 2(1)(d) and 2(1)(e) of Schedule 1 of the Order. In relation to our audit of the consolidated financial statements and supplementary information (excluding the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 35 and 36) for the year ended 30 September 2020:

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

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

We have reviewed the supplementary information relating to capital adequacy and regulatory liquidity requirements required by Schedule 11 of the Order as disclosed in notes 35 and 36 of the consolidated financial statements of the Banking Group for the year ended 30 September 2020.

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

Conclusion

Based on our review nothing has come to our attention that causes us to believe that the supplementary information relating to capital adequacy (disclosed in note 35) and regulatory liquidity requirements (being the regulatory liquidity ratios disclosed in note 36) is not, in all material respects, disclosed in accordance with Schedule 11 of the Order.

Basis for conclusion

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

A review of the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 35 and 36 in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly we do not express an audit opinion on the supplementary information relating to capital adequacy and regulatory liquidity requirements disclosed in notes 35 and 36.



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Directors' responsibility for the supplementary information relating to capital adequacy and regulatory liquidity requirements

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

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

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

Our responsibility in relation to supplementary information relating to capital adequacy disclosed in note 35 and regulatory liquidity requirements (being the regulatory liquidity ratios disclosed in note 36) that is required to be disclosed under Schedule 11 of the Order is to express a conclusion as to whether, on the basis of the procedures performed by us, anything has come to our attention that would cause us to believe that the supplementary information is not, in all material respects, disclosed in accordance with Schedule 11 of the Order.

The engagement partner on the engagement resulting in this independent auditor's report is Brent Penrose.

A handwritten signature in black ink that reads 'Ernst & Young' in a cursive script.

Chartered Accountants
Auckland
19 November 2020

Credit Ratings

As at the date on which this Disclosure Statement is signed, the Bank has the following credit ratings applicable to its long term senior unsecured obligations payable in New Zealand, in New Zealand dollars.

Rating Agency	Current Credit Rating	Qualification
S&P Global Ratings Australia Pty Limited	AA-	Outlook Negative
Moody's Investors Service Pty Limited	A1	Outlook Stable
Fitch Australia Pty Limited	A+	Outlook Negative

During the two-year period ended immediately before the signing date:

- there was no change to the Bank's Moody's Investors Service Pty Limited ("Moody's Investors Service") issuer credit rating;
- on 21 February 2019, Fitch Australia Pty Limited ("Fitch Ratings") revised the Bank's credit rating outlook from "outlook stable" to "outlook negative". On 7 April 2020, Fitch Ratings revised the Bank's credit rating from "AA-" to "A+"; and
- on 9 July 2019, Standard & Poor's revised the Bank's credit rating outlook from "outlook negative" to "outlook stable". On 8 April 2020, Standard & Poor's revised the Bank's credit rating outlook from "outlook stable" to "outlook negative".

The following is a summary of the descriptions of the major rating categories for rating agencies for the rating of long term obligations.

Standard & Poor's	Moody's Investors Service	Fitch Ratings	Description of Grade
AAA	Aaa	AAA	Ability to repay principal and interest is extremely strong. This is the highest investment category.
AA	Aa	AA	Very strong ability to repay principal and interest.
A	A	A	Strong ability to repay principal and interest although somewhat susceptible to adverse changes in financial conditions.
BBB	Baa	BBB	Adequate ability to repay principal and interest. More vulnerable to adverse changes.
BB	Ba	BB	Significant uncertainties exist which could affect the payment of principal and interest on a timely basis.
B	B	B	Greater vulnerability and therefore greater likelihood of default.
CCC	Caa	CCC	Likelihood of default considered high. Timely repayment of principal and interest is dependent on favourable financial conditions.
CC to C	Ca to C	CC to C	Highest risk of default.
D	-	RD & D	Obligations currently in default.

Credit ratings by Standard & Poor's and Fitch Ratings may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories. Moody's Investors Service apply numeric modifiers 1, 2 and 3 to show relative standing within the major rating categories with 1 indicating the higher end of that category and 3 indicating the lower end.

Conditions of Registration

The conditions of registration imposed on Bank of New Zealand by the Reserve Bank of New Zealand pursuant to section 74 of the Reserve Bank of New Zealand Act 1989 which were applicable as at the balance date of this Disclosure Statement are as follows:

Conditions of registration that apply on and after 1 May 2020 - Bank of New Zealand

The registration of Bank of New Zealand (the “bank”) as a registered bank is subject to the following conditions:

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

For the purposes of this condition of registration,—

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

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

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

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

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

- 1A. That—
 - (a) the bank has an internal capital adequacy assessment process (“ICAAP”) that accords with the requirements set out in the document “Guidelines on a bank’s internal capital adequacy assessment process (‘ICAAP’)” (BS12) dated December 2007;
 - (b) under its ICAAP the bank identifies and measures its “other material risks” defined as all material risks of the banking group that are not explicitly captured in the calculation of the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio and the Total capital ratio under the requirements set out in the document “Capital Adequacy Framework (Internal Models Based Approach)” (BS2B) dated November 2015; and
 - (c) the bank determines an internal capital allocation for each identified and measured “other material risk”.
- 1B. That the bank complies with the minimum requirements set out in the following sections of the Reserve Bank of New Zealand document “Capital Adequacy Framework (Internal Models Based Approach)” (BS2B) dated November 2015:
 - (a) the model approval requirements in section 1.3A;
 - (b) the compendium requirements in section 1.3B;
 - (c) the minimum requirements for the IRB approach in sections 4.217 to 4.324 (that is, Subpart 4C of BS2B); and
 - (d) the minimum requirements for using the AMA approach for operational risk set out in sections 8.4 to 8.34.
- 1C. That, if the buffer ratio of the banking group is 2.5% or less, the bank must:
 - (a) according to the following table, limit any distributions of the bank’s earnings payable to holders of Additional Tier 1 capital instruments to the percentage limit on distributions that corresponds to the banking group’s buffer ratio:

Banking group's buffer ratio	Percentage limit to distributions of the bank's earnings
0% - 0.625%	0%
>0.625 - 1.25%	20%
>1.25 - 1.875%	40%
>1.875 - 2.5%	60%

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

For the purposes of this condition of registration,—

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

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

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

Conditions of Registration

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

For the purposes of this condition of registration, –

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

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

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

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

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

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

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

- 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
- 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 –

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

For the purposes of this condition of registration, –

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

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

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

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

¹ This table uses the rating scales of Standard & Poor's, Fitch Ratings and Moody's Investors Service. (Fitch Ratings' scale is identical to Standard & Poor's.)

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

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

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

Conditions of Registration

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

7. That no appointment of any director, chief executive officer, or executive who reports or is accountable directly to the chief executive officer, is made in respect of the bank unless:
 - (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - (b) the Reserve Bank has advised that it has no objection to that appointment.
8. That a person must not be appointed as chairperson of the board of the bank unless:
 - (a) the Reserve Bank has been supplied with a copy of the curriculum vitae of the proposed appointee; and
 - (b) the Reserve Bank has advised that it has no objection to that appointment.
9. That the bank has a board audit committee, or other separate board committee covering audit matters, that meets the following requirements:
 - (a) the mandate of the committee must include: ensuring the integrity of the bank’s financial controls, reporting systems and internal audit standards;
 - (b) the committee must have at least three members;
 - (c) every member of the committee must be a non-executive director of the bank;
 - (d) the majority of the members of the committee must be independent; and
 - (e) the chairperson of the committee must be independent and must not be the chairperson of the bank.

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

10. That a substantial proportion of the bank’s business is conducted in and from New Zealand.
11. That the bank will not, without first obtaining the written approval of the Reserve Bank, revoke the constitution of BNZ International Funding Limited or alter the constitution of BNZ International Funding Limited if such alteration would delete or amend or negate the effect of clause 2.2 of the constitution.
12. That:
 - (a) the business and affairs of the bank are managed by, or under the direction or supervision of, the board of the bank;
 - (b) the employment contract of the chief executive officer of the bank or person in an equivalent position (together “CEO”) is with the bank, and the terms and conditions of the CEO’s employment agreement are determined by, and any decisions relating to the employment or termination of employment of the CEO are made by, the board of the bank; and
 - (c) all staff employed by the bank shall have their remuneration determined by (or under the delegated authority of) the board or the CEO of the bank and be accountable (directly or indirectly) to the CEO of the bank.
13. That the bank has legal and practical ability to control and execute any business, and any functions relating to any business, of the bank that are carried on by a person other than the bank, sufficient to achieve, under normal business conditions and in the event of stress or failure of the bank or of a service provider to the bank, the following outcomes:
 - (a) that the bank’s clearing and settlement obligations due on a day can be met on that day;
 - (b) that the bank’s financial risk positions on a day can be identified on that day;
 - (c) that the bank’s financial risk positions can be monitored and managed on the day following any failure and on subsequent days; and
 - (d) that the bank’s existing customers can be given access to payments facilities on the day following any failure and on subsequent days.

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

For the purposes of this condition of registration:

- (a) the term “legal and practical ability to control and execute” is explained in the Reserve Bank of New Zealand document entitled “Outsourcing Policy” (BS11) dated January 2006; and
 - (b) the term “existing outsourcing arrangement” is defined in the Reserve Bank of New Zealand document entitled “Outsourcing Policy” (BS11) dated April 2020.
14. That the banking group complies with the following quantitative requirements for liquidity-risk management:
 - (a) the one-week mismatch ratio of the banking group is not less than zero per cent at the end of each business day;
 - (b) the one-month mismatch ratio of the banking group is not less than zero per cent at the end of each business day; and
 - (c) the one-year core funding ratio of the banking group is not less than 50 per cent at the end of each business day.

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

15. That the bank has an internal framework for liquidity risk management that is adequate in the bank’s view for managing the bank’s liquidity risk at a prudent level, and that, in particular:
 - (a) is clearly documented and communicated to all those in the organisation with responsibility for managing liquidity and liquidity risk;
 - (b) identifies responsibility for approval, oversight and implementation of the framework and policies for liquidity risk management;
 - (c) identifies the principal methods that the bank will use for measuring, monitoring and controlling liquidity risk; and
 - (d) considers the material sources of stress that the bank might face, and prepares the bank to manage stress through a contingency funding plan.
16. That no more than 10% of total assets may be beneficially owned by a SPV.

Conditions of Registration

For the purposes of this condition,—

“total assets” means all assets of the banking group plus any assets held by any SPV that are not included in the banking group’s assets:

“SPV” means a person—

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

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

17. That—

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

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

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

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

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

19. That the bank has an Implementation Plan that—

- (a) is up-to-date; and
- (b) demonstrates that the bank’s prepositioning for Open Bank Resolution meets the requirements set out in the Reserve Bank document: “Open Bank Resolution Pre-positioning Requirements Policy” (BS17) dated September 2013.

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

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

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

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

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

Conditions of Registration

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

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

In these conditions of registration, –

“banking group” means Bank of New Zealand (as reporting entity) and all other entities included in the group as defined in section 6(1) of the Financial Markets Conduct Act 2013 for the purposes of Part 7 of that Act.

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

Changes in Conditions of Registration

On 2 April 2020, a new Condition of Registration came into effect, reflecting the RBNZ’s response to the COVID-19 pandemic. The changes prohibit the payment of distributions (including dividends on ordinary shares), other than discretionary payments payable to holders of Additional Tier 1 capital instruments. Changes were also introduced to reduce the one-year core funding ratio requirement from not less than 75% to not less than 50%, and to extend the transition period of the RBNZ’s Outsourcing Policy (Banking Standard 11) (“BS 11”) from five to six years.

On 1 May 2020, the RBNZ removed three Conditions of Registration that imposed restrictions on new residential mortgage lending at high loan-to-value ratios. The RBNZ has indicated that it will consider the re-imposition of these conditions around 1 May 2021.

Non-compliance with Conditions of Registration

In the Bank’s Disclosure Statement for the year ended 30 September 2018, the Bank signalled that it was undertaking a comprehensive review of the data and systems used to calculate its regulatory capital. As a result of capital reporting errors subsequently identified, the RBNZ increased the Bank’s operational risk capital floor by \$250 million, to \$600 million in November 2019, as a temporary and precautionary measure pending the successful conclusion of the review. As a result of the detailed investigation activities undertaken as part of the review, the Bank identified instances of non-compliance with Condition of Registration 1B (as contemplated through the increase in operational risk capital), including the use of unapproved models, incorrectly categorised credit risk exposures, incorrect risk parameter/exposure modelling approach, the incorrect application of prescribed risk weighted asset and risk parameter estimate calculations. The investigation phase is complete and the Bank is continuing with remediation activities with the RBNZ being provided regular updates on progress.

The Bank identified instances of technical non-compliance with Condition of Registration 22 relating to outsourcing during the period, including minor errors in its BS11 compendium of contracts, a contract entered into as part of the Bank’s response to the COVID-19 pandemic one day prior to the related RBNZ whitelist exemption coming into effect and, following the Bank’s review of installed third party software signalled in the Bank’s Disclosure Statement for the six months ended 31 March 2020, software applications (mainly minor “click and accept” tools) from 92 suppliers that were not acquired in accordance with the Bank’s BS11 process.

Directors' Statement

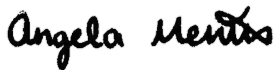
The Directors of Bank of New Zealand state that each Director of the Bank believes, after due enquiry, that:

1. as at the date on which this Disclosure Statement is signed:
 - (a) the Disclosure Statement contains all the information that is required by the Order; and
 - (b) the Disclosure Statement is not false or misleading; and
2. during the year ended 30 September 2020:
 - (a) the Bank has complied with its Conditions of Registration applicable during that period, except as disclosed on page 91 of this Disclosure Statement;
 - (b) credit exposures to connected persons were not contrary to the interests of the Banking Group; and
 - (c) the Bank had systems in place to monitor and control adequately the Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

This Disclosure Statement is dated 19th November 2020 and signed by Mr. McKay and Ms. Mentis as Directors and as responsible persons on behalf of all the other Directors.



D A McKay
Chairman



A Mentis
Managing Director and Chief Executive Officer

